REGULATORY PERSPECTIVES ON THE OBAMA ADMINISTRATION'S FINANCIAL REGULATORY REFORM PROPOSALS, PART II

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REGULATORY PERSPECTIVES ON THE OBAMA ADMINISTRATION'S FINANCIAL REGULATORY REFORM PROPOSALS, PART II

Friday, July 24, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Gutierrez, Watt, Sherman, Meeks, Moore of Kansas, Hinojosa, Miller of North Carolina, Scott, Green, Cleaver, Bean, Ellison, Klein, Wilson, Foster, Carson, Speier, Minnick, Adler, Driehaus, Kosmas, Himes; Bachus, Castle, Royce, Manzullo, Biggert, Miller of California, Capito, Hensarling, Garrett, Neugebauer, Price, McHenry, Campbell, Putnam, Bachmann, Marchant, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will come to order. The photographers will disperse. This is another in a series of hearings we are having on the question of restructuring our financial regulatory apparatus. We will be doing hearings today, and some next week. We will be returning in September with some action.

I think it is very clear the first thing we will be doing will be marking up the consumer financial protection entity. And we will then be proceeding to marking up other aspects of this. Our expectation is that they will go to the Floor as one bill because that has been the Senate's preference.

But I am committed to a structure which will give us time to debate them sort of title by title on the Floor, which is clearly much more than a 1-day Floor event. And I will be working hard to make sure we have adequate time to debate on the Floor the various aspects. We have 8 minutes for—

Mr. BACHUS. Mr. Chairman?

The CHAIRMAN. Yes.

Mr. BACHUS. Are you saying that next week, we will be addressing—is it executive compensation?

The CHAIRMAN. Yes.

Mr. BACHUS. Not the consumer.

The CHAIRMAN. I said September.

Mr. BACHUS. Okay. Thank you.

The CHAIRMAN. The executive compensation on Tuesday, probably on the Floor on Friday.

And with that, we will have our opening statements.

The gentleman from Pennsylvania is recognized for 2 minutes and 40 seconds.

Mr. KANJORSKI. For more than 70 years, Mr. Chairman, the regulatory reforms of the 1930's brought about, and then enacted because of the unbridled excess of dangerous speculation of an earlierera, safely steered our financial markets through the always rocky seas of capitalism.

But all good things must come to an end. Created for the economy of the last century, those antiquated rules failed to respond to today's realities in which financial engineering and innovation surpassed effective oversight.

For our economy to flourish once again, we must fix this problem. The Administration's diligent efforts to reform our outmoded and flawed regulatory system have resulted in a White Paper and subsequently specific legislative proposals.

In particular, I am pleased that the Administration calls for establishing the Office of National Insurance, an idea I first originated and for which I have strongly advocated for some time. Also I commend efforts to regulate the advisors of hedge funds and other private pools of capital. Similarly derivatives and swaps markets will finally face a suitable level of scrutiny under the Administration's plan. These reforms are long overdue.

While the Administration's proposals for credit rating agencies represent a good start, we must do more, much more, in this field. By sprinkling their magic dust on toxic assets, rating agencies turned horse manure into fool's gold. We therefore should no longer pursue only modest modifications in regulating this problematic industry.

Instead, we must consider radical reforms aimed at improving accountability, reliability, transparency, and independence. We could, for example, promote better ratings quality by establishing a fee on securities transactions to pay for ratings, forcing a government quality assessment of rating agency methodologies, changing liability standards for rating agencies and altering business structures.

Additionally, I must reiterate my deep and profound concerns about the selections of the Federal Reserve as the primary entity in charge of systemic risk. I believe that we need someone with real political accountability in this role like the Treasury Secretary.

On the whole, however, the Administration has produced a very thoughtful approach to financial services regulatory reform. I applaud the Administration for its hard work.

Congress has now begun its hard work using the Administration's promising foundation as our guide for enacting new laws that put in place a regulatory system that will last a very long time and help to ensure American prosperity for many years to come.

I yield back my time.

The CHAIRMAN. The gentleman from Texas for 3 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

When you have the wrong diagnosis, you will in turn offer the wrong remedy, and that is exactly the case with the Administration's proposal before us.

Our economic turmoil has not arisen from deregulation, but more so from dumb regulation. That, and regulators who did not lack adequate regulatory authority but may have lacked adequate judgment.

Although I have a number of concerns about the plan, I am simply taken aback by the lack of reform of Fannie Mae and Freddie Mac, the epicenter of the financial crisis, not to mention the suggested creation of an agency to abridge consumer rights.

Rather than taking on the current status quo for these GSEs, the Administration's plan institutionalizes the problem. When President Obama referenced sweeping reform, I didn't know he meant sweeping Fannie and Freddie under the rug.

Worse yet, his plan actually gives the Federal Reserve power to create more systemic risk by establishing tier one financial holding companies which can simply create more Fannies and Freddies, and signals to the market that the biggest institutions among us will always have a taxpayer safety net. In other words, the proposal enshrines us as a perpetual bailout nation.

One of the more troubling components of the proposed plan is the creation of a new consumer financial product approval agency ruled by five unelected bureaucrats. Based upon their subjective determination of "fairness," they will be empowered to decide which credit cards we can receive, which home mortgages we are permitted to possess, and even whether we can access an ATM machine. The proposal represents one of the greatest assaults on consumer rights I have ever witnessed.

The legislation will stifle innovation, perhaps the next online banking service or the next frequent flyer mile offering, and worse yet will contract credit to our small businesses at a time of historic unemployment.

There is a better way. The Republican plan under Ranking Member Bachus' leadership creates a new chapter of the Bankruptcy Code to enhance the resolution of large nonbank financial institutions. It puts an end to taxpayer-funded bailouts and too-big-to-fail. A market stability and capital adequacy board will be established and tasked with monitoring the interactions of all sectors of the financial system and identifying risk that can endanger the stability and soundness of the system.

The Republican plan focuses the Federal Reserve on its core mission of conducting monetary policy. And although we preserve its 13(3) exigent powers, we do not leave them unlimited. Once the housing market is stabilized, we would phase out taxpayer subsidies of Fannie Mae and Freddie Mac and end the current model of privatized profits and socialized losses.

Furthermore, our proposal creates an Office of Consumer Protection to empower consumers with effective disclosure and enhance the penalties for fraud.

There are choices between more bailouts and no bailouts; market discipline or government control; consumer empowerment or the laws of consumer rights. Let's hope this committee and this Congress chooses wisely.

I yield back the balance of my time.

The CHAIRMAN. I will now recognize myself for 2 minutes and 40 seconds.

I want to address a startling misconception that somehow we are ignoring Fannie Mae and Freddie Mac. The charge that Fannie Mae and Freddie Mac were being ignored was accurate up until 2007. That is, before 2007, while there were some efforts to legislate, one which came from this committee under the chairmanship of Mr. Oxley, but was opposed by President Bush, nothing happened.

In 2007, we did pass in March of that year the bill to reform Fannie Mae and Freddie Mac and include every power requested by the Bush Administration. It passed the House that summer. It did not, unfortunately, pass the Senate until the following year because the Senate was narrowly divided, but the fact is that the proposal of the Bush Administration, and particularly Secretary Paulson, for increased powers over Fannie Mae and Freddie Mac did become law; it is now under conservatorship. So the notion that there is an unbridled Fannie Mae and Freddie Mac out there is mythic.

Now, it is true that, going forward, we will need to change the model, but it is not the case that they are now the way they were. They are under conservatorship. They are in fact serving as not what they used to be, but as almost a public utility in terms of trying to deal with the mortgage crisis. And their main role now is to try to help us deal with the foreclosure crisis and with refinancing. So they have, in fact, been—the first step was taken again at the request of the Bush Administration, and everything that was done regarding Fannie and Freddie in 2008 was done at their request.

We do have on the agenda going forward a look at what their future role should be, but they were not what they were.

We will be proceeding finally with other aspects of this. And I do want to say with regard to the Consumer Protection Agency—no, it is not called the consumer product approval agency. It will not be called that except by people trying to caricature it, and it will not have that function. The notion that we should leave exactly as we have consumer protection when it he has been so badly done, frankly that is a debate I am glad to have before the American people.

The notion that the existing institutional structure protects consumers adequately, I think is a mistake. Yes, I was very pleased, for instance, when the National Federation of Independent Business supported our credit card bill, because as credit card users, small businesses wanted that kind of protection. That is what we will be doing going forward.

The gentleman from Texas, Mr. Neugebauer, for 1 minute.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Based on the principles of ending taxpayer bailouts, getting the government out of the business of picking winners and losers, and restoring market discipline, our Republican plan calls for a simplification for consumers not duplication.

Adding new regulations and new bureaucracy does not create a regulatory reform. Designating some firms as too-big-to-fail and creating a permanent bailout authority doesn't reform the system and does not protect the taxpayers. Adding more regulations when original ones weren't getting—regulators, when the original ones weren't getting the job done doesn't fix the problems.

If there are regulatory holes, we should fill them. If we can streamline the number of agencies and reduce the overlap, we should do so. We need reform that tightens the regulatory structure and protects the taxpayers. Rather than more bailouts and more bureaucracy, we need to make more market discipline and more taxpayer protection available.

I yield back.

The CHAIRMAN. The gentleman from North Carolina for 2 minutes and 40 seconds.

Mr. WATT. Thank you, Mr. Chairman.

I want to welcome Secretary Geithner.

And I want to particularly welcome my good friend Joe Smith, the commissioner of banks from my home State, the State of North Carolina, who will be testifying on the second panel.

In the 22 years that I practiced law before I came to this institution, I came to realize that most often the definition of a good compromise is one that leaves everybody unsatisfied. And measured against that criteria, the Administration's proposal for restructuring is a resounding success, because I haven't heard anybody who is completely satisfied with what has been proposed.

That probably suggests that we have hit the right balance if we do what the Administration has proposed with some minor modifications which we have to get involved in.

The area in which I think we have received the most pushback has been the Consumer Products Agency. And I understand the natural resistance to change, but I would just say to my friends and the industry with whom I have worked over the 18 years that I have been in this body now that if we reach the end of this process, having given to the regulators and to the industry, both of whom succeeded in really allowing a meltdown to take place in this country, the same kind of structure and authorities without a focus on the consumer, the public will be outraged, and they should be outraged.

So I want to welcome, encourage my friends and the industry to come to the table and sit down and talk about how we structure this new Consumer Protection Agency in a way that does robustly what we intend for it to do, protection of consumers, and does not have the disadvantages that have been spelled out and in my opinion grossly overstated. I think some of the concerns that have been raised are legitimate. We can address those, but we need to roll up our sleeves and work together to do so. I yield back.

The CHAIRMAN. The gentleman from California, Mr. Royce, for 1 minute.

Mr. ROYCE. Thank you.

I think getting to the bottom of what caused the housing bubble should be our primary objective here.

And in point of fact, it was the Fed that came to us, came to this committee, and came to the Senate committee, and said that because of the size of the portfolios of Fannie and Freddie and because of the leverage ratios of 100 to 1, 100 to 1 in leverage, because of the direction for them to have purchased a trillion in subprime mortgages for their political, for their affordable housing goals and so forth, that they had to be regulated for systemic risk.

In 2003, I put in a bill to do that working with the Fed. In 2005, we in fact had my amendment on the Floor to try to give the regulators the ability to regulate for systemic risk. Fannie and Freddie opposed it. Franklin Raines opposed it. It was opposed by most of the Members of this House.

But in 2006, in the Senate, they actually got it out of committee. But again, the Democratic Members on the Senate side opposed that regulation to give the regulators the ability to handle Fannie and Freddie for systemic risk. That is the history of this. We need to address it.

The CHAIRMAN. The gentlewoman from Illinois for 1 minute.

Mrs. BIGGERT. Mr. Chairman, the Administration's plan endorses the too-big-to-fail mantra putting taxpayers on the hook for future bailouts caused by the behavior of a few dysfunctional Federal regulations and enforcement.

It also allows the Federal Government to continue to pick winners and losers in the marketplace. That is not fair to taxpayers, and it is not fair to the little guys in my district.

Speaking of picking winners and losers, TARP has left many community banks hanging out to dry. Those local banks are denied access to CPP and CAP assistance. By the time any aid is extended, it may be too late.

Illinois banks have private equity at the door, but waiting for a Federal match that is not available. Some have estimated that, with a $250 million capital infusion in total, around 200 community banks could be saved.

I want to hear from today's witnesses, at a fraction of the cost of letting them fold, and for less than 3 percent of the $700 billion authorized, why can't you help our community banks?

The CHAIRMAN. The gentleman from California, Mr. Miller, for 1 minute.

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman.

After listening to the regulators over the last 2 weeks in these hearings, I am very concerned about the lack of communication between financial regulators overseeing our economy and recovery. The Financial Accounting Standard Board may change the fair-value accounting only after serious market turmoil and oversight from financial policymakers.

When asked in a recent hearing, the SEC Chairman was unaware of how the banking regulators were applying the new accounting rules. While it is not the job of the SEC to oversee recovery efforts and regulate banks, financial policymakers should be collaborating on major issues that impact on our economy. The SEC, after all, conducted a 259-page study on fair value accounting standards and specs on financial institutions and banks.

I am glad you are here, the Treasury, along with banking regulators are here to discuss regulatory reform. But I strongly believe that we need to have a hearing on both with regulators and accounting policymakers. In fact, major changes will be enacted in the credit market will be retroactive accounting changes known as SAS, FAS 166 and 67. I hope we can be proactive in examining the changes instead of responding reactively like we did with fair value.

I thank you and I yield back.

The CHAIRMAN. The gentleman from New Jersey, Mr. Garrett, for 1 minute. Let me just say, after this, I believe we will have time for the Secretary's opening statement. Then we will break and come back.

Mr. Garrett for 1 minute.

Mr. GARRETT. Thank you.

Mr. Secretary, you know, Chairman Frank has been critical of the banking industry for opposing the Administration's plan for the CFPA. I don't think anybody believes that we don't need some reform, but the industry is not going to be the only one who expresses concerns.

We are going to have a whole panel later on of all the regulators out there. And I think just about every one of them have expressed some doubts or some concerns with the CFPA proposal. As a matter of fact, Mr. Bernanke was here the other day, and he has expressed his concerns with the proposal as well.

I know that some on the other side are going to say, they create a whole new Federal bureaucracy; that is a good political winner. I will disagree. And some may well say that it is a good thing to go forward. But I am glad that we are going to postpone this debate a little bit longer. As a matter of fact, the chairman has just said that this is an area that is worthy of an actual debate.

I completely agree, because the more we debate, the more we hear about it, the more problems we see, the more we realize it is a bad idea; that it is going to limit consumer choice, limit credit availability. It is going to increase cost, and the most important thing, the most ironic thing, is it potentially decreases safety and soundness for our banking system.

Thank you, Mr. Secretary.

The CHAIRMAN. We will have the Secretary's statement. We probably have about 15 minutes, so the Secretary can give his statement, and we will then break and come back.

Mr. Secretary.

STATEMENT OF THE HONORABLE TIMOTHY F. GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Chairman Frank, Ranking Member Bachus, and members of the committee, thanks for giving me the chance to come before you today.

Let me first begin by commending you for the important work you have already undertaken to help build consensus on financial reform. We have an opportunity to bring about fundamental change to our financial system, to provide greater protection for consumers and for businesses. We share a responsibility to get this right and to get this done.

On June 17th, the President outlined a proposal for comprehensive change of the basic rules of the road for the financial system. These proposals were designed to lay the foundation for a safer, more stable financial system, one less vulnerable to booms and busts, less vulnerable to fraud and manipulation. The President decided we need to move quickly while the memory of the searing damage caused by this crisis was still fresh and before the impetus to reform faded.

These proposals have led to an important debate about how best to reform this system, how to achieve a better balance between innovation and stability. We welcome this debate, and we will work closely with the Congress to help shape a comprehensive and strong package of legislative changes.

My written testimony reviews the full outlines of these proposals. I just want to focus my opening remarks on two central areas for reform.

The first is our proposal for a Consumer Financial Protection Agency. We can all agree, I believe, that in the years leading up to the current crisis, our consumer protection regime fundamentally failed. It failed because our system allowed a range of institutions to escape effective supervision. It failed because our system was fragmented, fragmenting responsibility for consumer protection over numerous regulators, creating opportunities for evasion. And it failed because all of the Federal financial services regulators have higher priorities than consumer protection.

The result left millions of Americans at risk, and I believe for the first time in the modern history of financial crises in our country, we face an acute crisis, a crisis which brought the financial system to the edge of collapse in significant part because of failures in consumer protection. The system allowed—this system allowed the extreme excesses of the subprime mortgage lending boom, loans without proof of income, employment or financial assets that it reset to unaffordable rates that consumers could not understand and that have contributed to millions of Americans losing their homes.

Those practices built up over a long period of time. They peaked in 2006. But it took Federal banking agencies until June of 2007 after the peak to reach consensus on supervisory guidance that would impose even general standards on the sale and underwriting of subprime mortgages. And it took another year for these agencies to settle on a simple model disclosure for subprime mortgages.

These actions came too late to help consumers and homeowners. The basic standards of protection were too weak. They were not effectively enforced, and accountability was diffused. We believe that the only viable solution is to provide a single entity in the government with a clear mandate for consumer protection and financial products and services with clear authority to write rules and to enforce those rules.

We proposed to give this new agency jurisdiction over the entire marketplace. This will provide a level playing field where the reach of Federal oversight is extended for the first time to all financial firms. This means the agency would send examiners into nonbanks as well as to banks reviewing loan files and interviewing sales people.

Consumers will be less vulnerable to the type of race-to-the-bottom standard that was produced by allowing institutions without effective supervision to compete alongside banks. We believe that effective protection requires consolidated authority to both write and enforce rules. Rules written by those not responsible for enforcing them are likely to be poorly designed with insufficient feel for the needs of consumers and for the realities of the market. Rulewriting authority without enforcement authority would risk creating an agency that is too weak dominated by those with enforcement authority. And leaving enforcement authority divided as it is today among this complicated mix of supervisors and other authorities would risk continued opportunities for evasion and uneven protections.

Our proposals are designed to preserve the incentives and opportunities for innovation. Many of the practices of consumer lending that led to this crisis gave innovation a bad name. What they claim was innovation was often just predation. But we want to make it possible for future innovations and financial products to come with less risk of damage. We need to create an agency that restores the confidence of consumers and the confidence of financial investors with authority to prevent abusive and unfair practices while at the same time promoting innovation and consumer access to financial products.

The second critical imperative to reform is to create a more stable system. In the years leading up to this crisis, our regime, our regulatory framework, permitted an excess buildup of leverage both outside the banking system and within the banking system. The shock absorbers that are critical to preserving the stability to the system, these are shock absorbers in the form of capital requirements, margin, liquidity requirements, were inadequate to withstand the force of the global recession. They left the system too weak to withstand the failure of a major financial institution.

Addressing this challenge will require very substantial changes. It will require putting in place stronger constraints on risk taking with stronger limits on leverage and more conservative standards for funding and liquidity management. These standards need to be enforced more broadly across the financial system overall, covering not just all banks but institutions that present potential risk to the stability of the financial system.

This will require bringing the markets that are critical to the provision of credit and capital, the derivatives markets, the securitization markets and the credit rating agencies, within a broad framework or oversight. This will require reform to compensation practices to reduce incentives for excessive risk taking in the future.

This will require much stronger cushions or shock absorbers in the critical centralized financial infrastructure, so that the system as a whole is less vulnerable to contagion and is better able to withstand the pressures that come with financial shocks and the risk of failure of large institutions.

And this will require stronger authority to manage the failure of these institutions. Resolution authority is essential to any credible plan to make it possible to limit moral hazard risk in the future and to limit the need for future bailouts.

Alongside these changes, we need to put in place some important changes to the broader oversight framework. Our patchwork, antiquated balkanized segmented structure of oversight responsibility created large gaps in coverage, allowed institutions to shop for the weakest regulator, and left authorities without the capacity to understand and stay abreast of the changing danger of risk in our financial system. To address this, we proposed establishing a council responsible for looking at the financial system as a whole. No single entity can fully discharge this responsibility.

Our proposed Financial Services Oversight Council would bring together the heads of all the major Federal financial regulatory agencies, including the Federal Reserve, the SEC, etc. This council would be accountable to the Congress for making sure that we have in place strong protections for the stability of the financial system; that policy is closely coordinated across responsible agencies; that we adapt the safeguards and protections as the system changes in the future and new sources of risk emerge; and that we are effectively cooperating with countries around the world in enforcing strong standards.

This council would have the power to gather information from any firm or market to help identify emerging risks, and it would have the responsibility to recommend changes in laws and regulation to reduce future opportunities for arbitrage, to help ensure we put in place and maintain over time strong safeguards against the risk of future crises.

The Federal Reserve will have an important role in this framework. It will be responsible for the consolidated supervision of all large interconnected firms whose failure could threaten the stability of this system, regardless of whether they own a depository institution. The Fed, in our judgment, is the only regulatory body with the experience, the institutional knowledge, and the capacity to do this. This is a role the Fed largely already plays today.

And while our plan does clarify this basic responsibility and gives clear accountability to the Fed for this responsibility, it also takes away substantial authority. We propose to take away from the Fed today responsibility for writing rules for consumer protection, and for enforcing those rules, and we propose to require the Fed to receive written approval from the Secretary of the Treasury before exercising its emergency lending authority.

Now, we look forward to refining these recommendations through the legislative process. To help advance this process, we have already provided detailed draft legislative language to the Hill on every piece of the President's reform package.

The CHAIRMAN. Mr. Secretary, if you can wind it up, and then we can come back. Thank you.

Secretary GEITHNER. Just 30 seconds. We welcome your committee and your counterparts in the Senate to pass reform this year.

Despite this crisis, the United States remains in many ways the most productive, the most innovative, and the most resilient economy in the world. To preserve this, though, we need a more stable, more resilient system and this requires fundamental reform.

Thank you. We look forward to working with you.

[The prepared statement of Secretary Geithner can be found on page 140 of the appendix.]

The CHAIRMAN. We will return to begin the questioning.

[recess]

The CHAIRMAN. The hearing will reconvene.

And, Mr. Secretary, I will get to a question, but I did want to use my 5 minutes, as it is up to us, to continue the history.

I think the distortion of history that we see, particularly with regard to Fannie Mae and Freddie Mac, needs to be addressed.

The gentleman from California, Mr. Royce, mentioned that in 2005, when this committee voted on a bill, he offered an amendment that he said would have resolved the problem, and he obviously strongly believed that. He mentioned that it was opposed. He then went on to say that, in the Senate, there was a version that was better, but the Democrats opposed it. He did not characterize the party positions in the House, so I thought I would check and see if my memory in this one case held up. It did. The vote on the amendment offered by the gentleman from California: 153 Republicans voted no; 70 voted yes. The current ranking member of the committee, Mr. Bachus, voted no, along with me and Mr. Oxley, the chairman of the committee, the gentleman from Texas, Mr. Neugebauer, and the gentleman from California, Mr. Miller; we all voted no.

So it is true that the amendment was offered, but it was defeated overwhelmingly and by more than two-thirds of the Republican Members. So if the history is relevant, it seems to me that is a relevant part of it. The gentleman from Texas did vote yes and spoke for it. And again, I would reiterate that, in 2005, the Republican-controlled House, the Republican-controlled committee brought a bill out. It passed the House. Some Members thought it was too weak. The President thought it was too weak. The Republican Senate passed a different version. The Republican Senate didn't take the bill up, and nothing happened.

The Secretary of the Treasury at the time, Mr. Snow, said he thought the bill that was brought forward by Mr. Oxley was a good bill. He was overruled by the Administration. The gentleman from Ohio was troubled by what the Administration did. I joined him in writing a letter. I had actually voted against the vote on the Floor because of some unrelated issues, not Fannie and Freddie issues, but housing issues. But I did join him in writing to the Senate saying, "Let's try and work this out." The Senate never took up the bill.

The Senate Chair, the Republican Chair, apparently felt that it wasn't at this point worth trying, probably because he had some Republican opposition within. But then, in 2007, as it was clear that there was a crisis, as I did believe by 2005, the House did take it up when the committee organized after the election of 2006, and I was the chairman. The first major piece of legislation we dealt with was to reform Fannie and Freddie, and in this point worked completely with the Administration, including the powers of receivership, etc. The bill passed. It didn't pass the Senate because of that same partisan division; 51–49 Senators are hard to make function. Whether it is 51 Ds or Rs, it doesn't seem to make much difference.

But I did want to say, that was the history. And as I said, the bill did pass in 2008. So we are not dealing with a Fannie Mae and Freddie Mac of the past. Clearly we have to do something before they can resume their role, but they are now playing a very different role than they had played before.

And now, Mr. Secretary, I was struck to note that there has been a lot of debate about whether or not to have a Consumer Protection

Agency and who should be the systemic risk regulator. And it was interesting to me to note that your critics on this seem to be aligned with the socialist government in London, while the conservative government in London is on the other side. I did note that the conservative party line that just came out for a consumer regulator and for the Bank of England being the single systemic risk regulator, which does appear to be close to your position; whereas the socialist government, the labor government, still nominally socialist, has taken the opposite side.

So apparently when things cross the Atlantic, they get reversed. I had not realized that was the ideological effect of a transoceanic voyage. I think the point is this, that what we are talking about here are important issues that people of good will can differ about, and that ideology really shouldn't be driving this and, in many cases, doesn't drive it. These are practical and pragmatic decisions to be made.

The only thing I would add again is that while I strongly support the rationale of the Consumer Protection Agency, one of the members on the other side noted that all the regulators are against it. Now, those regulators should be happy they are getting support from some corners that they don't ordinarily get, so maybe they should cherish it when they get it.

I am always skeptical when people who are often in disagreement with somebody suddenly find great wisdom in that individual when they happen to agree. Stopped clocks come to mind. But the fact is that what we are talking about are agencies that are going to lose powers, and they object to losing their powers. And I think they have the right to make the argument that is sometimes made in an old joke; they can argue that taking the powers away from them may not make sense because the powers that will be taken away from them are in very good shape because they have rarely been used. Yes, it is true that they are pristine powers. They have sat largely undrawn upon for a while. But I think it is time to put them into the hands of someone who will use them.

The gentleman from Texas—I am sorry, the gentleman from Alabama.

Mr. BACHUS. Thank you.

I accept your apology, Mr. Chairman.

Secretary Geithner, before we move on regulatory reform, I hope you will at least avail yourself to coming back one more time so we can talk about that issue because it is of extreme importance, including what the gentleman just said about the new agency which will design and determine appropriateness of all financial products.

Secretary GEITHNER. Come back and talk about that or about GSEs?

Mr. BACHUS. That, GSEs, the whole—I think it would be extremely helpful.

My first question, the chairman reminded me about Fannie Mae, which also you know one of the big things on the table is, how much money is the government or the taxpayers ultimately going to lose from everything that happened over the last year? And you see some figures of $20 trillion, which, you know, that would just take—I mean, I don't even use that figure. I just say, you know, we have seen $3 trillion is the amount outstanding.

But I have looked at those, and I think there are three big areas of loss. And I want to see if you sort of go and follow, how much does it look like we are ultimately going to lose? The biggest loss of all, the $85 billion that we extended to Freddie and Fannie, I see no prospect of getting that money back and would like your views on that.

Now, the second biggest one looks to be the car companies. You know, we extended $80 billion, and it looks like we have gotten $2 billion back. And we do have an equity share, you know, which is going to be very problematic. I see those as the biggest losses.

Normally, people say AIG is the biggest loss. But I know the property you took on board has diminished in value by about $15 billion, so I do see maybe right now a $15 billion or $20 billion loss. But by far, Fannie is the big one. The car companies and Chrysler Finance, and maybe the next one—I know that Bank of America and Citi, there is a lot of money there. And of course, Bear Stearns and CIT, we probably lost $5 billion there.

But would you go over that? Are there others? In fact, I see some of the programs are making money. But I see those two big ones are Fannie being the biggest, about $85 billion, and maybe all those $70 billion.

Secretary GEITHNER. Congressman, I think what you did is very helpful, because I think that some of these broad numbers don't actually capture exposure, and they don't represent any reasonable estimate of risk of loss to the taxpayer. And you are doing it the right way, which is to look at the areas of our system which were most damaged, most at risk, and try to build up from that.

But I don't believe we are in the position today really to give you, even this month or maybe even this year, a realistic estimate yet of those losses. That is the important thing for us to do. One of the strengths of our system is that when we make these commitments, under our budget rules, we are required to sort of set aside an estimate that is done independently of the Administration of the potential risk of loss to the taxpayer.

Let me just take the positive side of this for just a minute. As you said, some of these programs are making money. I will just give you two examples. You know, we have had I think in the range of $80 billion in capital come back to the Treasury in just over the last 2 months.

Mr. BACHUS. You have a Capital Purchase Plan making money—

Secretary GEITHNER. Right.

Mr. BACHUS. That is on the lending program.

Secretary GEITHNER. And if you look at the value of the investment the government made in Goldman Sachs after the warrants, the government did realize a 23 percent annual return on investment. And that is a measure of the effectiveness of the policies that Congress helped put in place to try to bring more stability to our financial system. With the effect of those actions, the ultimate cost of this crisis could prove to be very modest relevant to the scale of the risk we confronted, but we won't know that until—

Mr. BACHUS. And let me ask another question, but I think you have Fannie and the car companies are our biggest loss, looking to me, maybe AIG.

You know, you are talking about the Capital Purchase Plan. The idea there was we put the money in the banks. They will lend it. You get a multiplier effect, and then it will pass through the economy, and I think a velocity is the economic term there. Of course they are holding on to it, but that is because of the capital requirements. They are restocking their capital. Some of them are lending it. But tell me why we didn't really see that multiplier effect?

Secretary GEITHNER. Well, I think you did.

Mr. BACHUS. Did we?

Secretary GEITHNER. Remember, a dollar of capital is equivalent to between $8 and $12 of lending capacity. So if you are short a dollar of capital, you are going to have to reduce lending by $8 to $12. So on the scale of our financial system, just think of this, so without that initial $250 billion of capital the previous Administration put into the financial system, you would have seen overall lending capacity decline by well over $1 trillion, $1 trillion to $2 trillion. So you did see the benefits of that.

The CHAIRMAN. The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Again, welcome. We are sort of wearing that seat out, Mr. Secretary, with your presence, but we do appreciate it.

In my opening remarks, I referred to the rating agencies. And we paid some particular attention to the White Paper and the suggestions of Treasury. I am not necessarily overwhelmed with the strong position—

Secretary GEITHNER. I had that sense.

Mr. KANJORSKI. —that you have taken. Run through some of the alternatives we have. Could you give me arguments pro or con, issuer pay, whether or not if we take issuer pay away that will have a positive effect for straightening out some of the problem, and if we do, where could we allocate that pay?

Secretary GEITHNER. I think you are right that many people say that the fundamental problem is in the issuer pay model. But having looked at that question over a long period of time and having listened to the experts on it, I don't see a practical viable alternative. There have been some models that don't have that structure tested. They didn't seem to work that well. But I agree with you; this is an important area of reform. And of course, we don't have the monopoly of wisdom in these areas, and we are happy to look at any idea, including the ones you listed in your opening statements.

Mr. KANJORSKI. How soon do you think we should try and get the package of the items we are talking about and the White Paper referred to, how soon should they be finished? Would you feel comfortable that we have responded to the—

Secretary GEITHNER. Meaning when do we want to have these reforms in place?

Mr. KANJORSKI. Yes.

Secretary GEITHNER. Well, I think they need to be done as a package. You have made that point yourself many times. You know, you can't fix this by just looking at capital over here and looking at some action over here. And in the systemic stuff, including on the rating agencies, you have to look at the comprehensive set of reforms together as a package. And as I said in my opening remarks, I think it is very important we move this year, just because, as you have already heard, given the scale of interest affected by these reforms, given the amount of authority we are proposing to take away from people who have it today, there is a lot of resistance and opposition. And if we wait or we try to do it piecemeal, it is going to be much harder, I think, for this committee to find consensus on something sufficiently strong.

Mr. KANJORSKI. Now, we are working on something on insurance, and I know Treasury is setting something up. If we don't get a national jurisdiction over the insurance industry of some element, how will this systemic risk regulator work? Won't that leave it very deficient and over a very large portion of our financial industry?

Secretary GEITHNER. I agree that, as you saw in the model line insurance companies and in AIG, one of the things at the center of this crisis was you had entities that were not only insurance companies with no Federal oversight of any meaningful level writing dramatically large commitments for credit protection with no meaningful levels of capital against that, and that is something we can't afford to allow to happen in the future.

So I think the framework that we proposed, which largely models on something you proposed, to begin the process of putting in place a Federal level oversight entity, it will be very important. But, of course, our job is not just to deal with the last war, but to make sure that we are putting in place something that is going to capture those weaknesses and vulnerabilities more quickly in the future. But I think you are hiding one particular example of the weakness of our current framework.

Mr. KANJORSKI. Well, I appreciate that and I look forward to working with you.

And we should not be any more than one telephone call away, Mr. Secretary.

I yield back my time Mr. Chairman.

The CHAIRMAN. The gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. It is always good to see you. If I had more than 5 minutes, we would actually talk about a few of the things that we agree on. But given the limited time, I must admit—

Secretary GEITHNER. I could use my time to describe those.

Mr. HENSARLING. On your time, yes; on my time, no.

Let's continue on with our GSE history lesson if we can. Beginning in 1990, Fannie and Freddie's investment portfolios grew tenfold. In 1995, HUD first authorized Fannie and Freddie to purchase the subprime securities, including loans to low-income borrowers. In 2004 alone, Fannie and Freddie purchased $175 billion in subprime mortgages, accounting for 44 percent of the market. From 2005 to 2007, Fannie and Freddie purchased approximately $1 trillion, a number that is all too common in this Congress, $1 trillion in subprime and Alt-A loans, and the list goes on. That is the history.

Where do we find ours today? We know that Fannie and Freddie's share of the origination market has now increased from roughly half to 75 percent. At last look, the taxpayers have paid out, I believe, $85 billion that none of us expect to get back. They are on the hook for an additional $315 billion, principally for helping securitize loans to people who couldn't afford to pay them back in the first place.

Now, Mr. Secretary, you have said in, I believe in rolling out the White Paper before the Senate Banking Committee on June 18th, "we wanted to make sure we were focusing on central issues of this crisis." I know you are concerned about Fannie and Freddie, but as a logical conclusion, since there is not a proposal beyond a study of the GSEs in the Administration's proposal, that the Administration has concluded that Fannie and Freddie were not a central cause of the crisis.

Secretary GEITHNER. No, I would say that Congress in its wisdom passed legislative authority that provided for, for the first time, a modern oversight capacity over these institutions. That was done in the summer of 2008.

Mr. HENSARLING. So if I could, Mr. Secretary—

Secretary GEITHNER. But I think they did play a fragile role.

Mr. HENSARLING. I do have limited time. So it is a central cause, but do you believe to a great extent it has already been remedied?

Secretary GEITHNER. No. Could I just finish this one thing?

And I agree with you on this. As a government, we are going to have to figure out their future. What they are today is not going to be their future. It is not in their future.

Mr. HENSARLING. But why not include it in the legislative proposal if it is a central cause and needs to be addressed?

Secretary GEITHNER. Because we are rarely accused of insufficient ambition. We are taking on a lot of things. We are trying to solve a lot of problems in this area. And we think we want to do that one, don't need to do that right now, cannot credibly begin to think about that reasonably right now because they are now the entire mortgage market in the country because of the deep failures we saw across the banking system. But that in time will come, and I think it will come relatively quickly.

Mr. HENSARLING. I understand your answer, Mr. Secretary. I have limited time.

Let's think about another ambition then of the Administration. Again, I am not going to adhere to your terminology or the chairman's terminology. What I see is a new government agency being proposed to approve consumer financial products, the CFPA.

Apart from subprime mortgages, can you point to any other consumer financial product that you believe was a but-for cause of this credit crisis?

Secretary GEITHNER. I want to just agree with one thing you said in your opening statement first, which is to say there is a lot of dumb regulation in our country. And part of our challenge is smarter regulation, not just more regulation.

But I think if you look at credit products marketed to consumers, not just subprime, a broader array of mortgage products, and in the credit card area, beyond credit cards, too, there were a lot of examples of practices that we should not have tolerated in this country.

Mr. HENSARLING. I agree with you, Mr. Secretary.

But the question is, besides subprime mortgages, was it viewed as a central cause, since you know the Fed has already issued their final home mortgage disclosure rules under Regulation Z. And so either, one, it is inadequate—I guess I am asking this question—why come up with an agency that has the power to ban or modify mortgages, ban or modify credit cards, ban or modify remittances? And I respectfully disagree with the chairman. I have read the language of his bill. I guess we can have two different lawyers look at it and decide what it means to have the ability to render unlawful unfair acts and practices that are subjectively decided on by this five-person unelected board.

I mean, if credit cards and remittances were not a part of the central cause, why are they included in this legislation, and Fannie and Freddie aren't?

Secretary GEITHNER. This is not an agency we are proposing to give excessively broad scope. We are proposing to focus on the credit area in particular, where the principal failures were. It is a commission. It is a set of five commissioners appointed by the President, confirmed by the Senate, not unelected bureaucrats, and with authority that now exists in a bunch of other agencies. We want to put it in one place.

The CHAIRMAN. The gentlewoman from New York is recognized for 5 minutes.

Mrs. MALONEY. Welcome Mr. Secretary.

And thank you for your service. A ticking time bomb is the commercial mortgage loans. Roughly $1 trillion will become due in the next couple of years, and the credit markets are totally frozen. I am told they can't get refinancing anywhere. So we will be looking at bankruptcies and defaults that will have a terrible effect on the regional banks that have invested heavily in commercial mortgage loans, and community banks, not to mention the loss of jobs and commercial activity.

I would like to know if you are putting some of your creative attention to this problem. I know that Treasury came forward with the proposed guidance on residential-backed securities, mortgage-backed securities, that allowed them to restructure. As you know, under current law, the parties have to wait until a default is imminent before borrowers would put up new capital.

And there has been some indication that Treasury is looking at issuing administrative guidance that would temporarily ease these rules so that borrowers can proactively discuss possible loan modifications with those who service their loans in order to deal with these issues while there is still time to deal with them. And my question is, are you looking at this? Are you intending to put forward guidance? When can we expect this guidance, and what other steps are you taking to prevent this ticking time bomb to our economy?

Secretary GEITHNER. We have not made a judgment on whether guidance in that particular area is necessary or appropriate or possible, but that is something we would be happy to talk to you and your staff about in more detail.

Stepping back a second, you are right to say this is still a significant challenge for the U.S. financial system. We do have in place today, though, relatively creative, carefully designed programs to help mitigate the effects. The first is the program that allows us to give capital to community banks, a program we expanded and extended 2 or 3 months ago. And that is a very important thing to do.

The second is a program we designed with the Fed to provide financing to the markets that are central and important to commercial real estate financing. Now those are important programs. We think they can be helpful in this. But I think you are right to say this is still going to be a challenge for our economy and our financial system to work through.

Mrs. MALONEY. What is the problem with giving the same treatment to commercial-backed securities that you gave to residential mortgage-backed facilities? If this will help them refinance—and we are not talking about forcing them to modify or extend loans, but simply allowing them to begin the dialogue to see if they can work this out.

Secretary GEITHNER. I understand why you are drawing attention to this issue, and I commend you for doing it. But this is an enormously complicated set of issues, and it is something we have to work through very carefully. As I said, we would be happy to talk to you and your staff about this in more detail.

Mrs. MALONEY. Then, secondly, when we talk about the Consumer Protection Agency, which I totally and completely support, but I also support letting the agencies maintain these protections for consumers in these agencies. A great deal of how well an agency performs is who is in charge, who is appointed. And oftentimes, there is a political agenda. We have seen very ineffective chairmen or commissions or whatever and others that really protected consumers. So I believe consumer protection is so important that we should have a check and balance.

And to give the example of the Federal Reserve that was so helpful to this Congress in the passage of the Credit Cardholders' Bill of Rights, I truly believe momentum did not come to this effort until they came forward with a very well-thought-out rule that helped move the process forward.

So it seems to me that it would be counteractive and put in jeopardy consumer protections to take away the right for other agencies that have the in-depth understanding that it would take years for a new agency to learn, to take that away from them and to also counter a situation where you may have an agency head who is not performing the way they should or carries a political agenda. We have certainly seen that at the FDA time and time again.

Secretary GEITHNER. I understand that concern. We thought about that a lot carefully, but let me just make the other case. If you give this agency only rule-writing authority and no enforcement authority, it will be too weak, and the rules won't be well designed, as I said in my opening statements. Because they are not responsible for enforcing, they won't have the incentive to design the rules carefully to meet the needs of both consumers and the basic realities the way these businesses work.

So that is one reason. The second reason is that right now what you have been proposing is you are leaving in place with a bunch of different people now enforcement authority that frankly was not well used or deployed. It is in a bunch of different places now, and I think it is very hard to look at that system and say that it did anything close to an adequate job of what it was designed to do.

So I think it is a hard case to make that enforcement as effective as it needs to be in the future if you leave it where it has been.

Mrs. MALONEY. I would move the enforcement to the protection agency but allow the others to continue with their rulemaking and their input into protecting consumers.

Secretary GEITHNER. So you would move enforcement and leave rule-writing authority where it is?

Mrs. MALONEY. As a backup.

Secretary GEITHNER. Again, as I said, we want to have a strong agency with the right balance between innovation and protection, and we would be happy to work with you and your colleagues on how best to achieve that.

Mr. KANJORSKI. [presiding] The gentlelady's time has expired. The Chair now recognizes Mr. Neugebauer for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Mr. Secretary, thank you for coming today. Earlier in the week, Chairman Bernanke was here, and we entered into a dialogue, and he at the end stated that when it comes to separating the financial products regulator from the primary regulator he was opposed to that because he thought it bifurcated the regulatory process. I guess the first question is—and I am not trying to pit you two against each other—why is he wrong and why are you right?

Secretary GEITHNER. As the Chairman said, I think it is perfectly reasonable and understandable that the institutions that have this authority and have teams of dedicated, motivated, experienced people with that responsibility today, they are not enthusiastic about giving up that authority. And I, with great respect to the Chairman and the other supervisors who are reluctant to do this, they are doing what they should. They would just defend the traditional prerogatives of their agencies. And I think, frankly, all arguments need to be viewed through that basic prism. And I understand that obligation they feel.

On the substance, though, these are very different types of responsibilities. Prudential supervision is different from consumer protection. And I don't think—again we have had a running national experiment as a country living with them being done together in their existing basic framework and that did not turn out so well for us.

So I think the basic point is that I don't think there is a plausible defense of maintaining that current system in place today, although I understand why people who still preside over those authorities are trying to make the case to preserve them.

Mr. NEUGEBAUER. I think the question, then, if you are going to have two different agencies, then what is the size of an agency that has to basically audit or oversee every financial institution in this country for their compliance? And what does that cost and who is going to pay for that?

Secretary GEITHNER. That is an important question. But let us just step back right now. As you said at the beginning, there are existing teams of examiners spread across bank supervisory agencies and to some extent the FTC today, with responsibility for consumer protection. So we would like to take that expertise and put it in a single place, less diffused, take advantage of that accumulated experience and have that entity be responsible for this important function. Since I think overall supervision was inadequate, particularly over the nonbank sector. It is not—I am not sure I can tell today what you are going to need in term of the overall resource envelope. But we can take advantage of the fact that there are substantial existing resources today. They are just spread out in a place where they have not been optimally deployed.

Mr. NEUGEBAUER. Does it concern you, though, when I read your legislation, I see the charge of that and you spend a lot of time talking about this particular area in your recommendation. Other areas are pretty short, but this area—and I think what begins to look like to me is that these—products that could be approved that are going to be "the optimum product begins to look like government trying to limit the choices of the American people." In other words, this is kind of the optimum credit card, this is the optimum mortgage, this is the optimum car loan, and to me, I don't see that as a role of the Federal Government.

So I think there is a difference between consumer protection, and I think all of us are for that. And then there is the other piece of it, which is product, the government determining what products the American people get to look at. I am going to be on the "no" category of the government telling us what kind of financial products we should have.

Secretary GEITHNER. Generally, I agree with you on that. And if we were proposing that, I would agree with your criticism and I would share it. But we are not proposing that. So let me just be clear about this.

We are suggesting that as part of a broad range of reforms to fix these vulnerable business systems, there should be a set of standardized, simple to understand, clear disclosure set of products that are available to consumers, that they can choose to avail themselves of or choose not to. We make it very clear and explicit that we want banks and others institutions to have the ability still to market other products to consumers. But even as your colleague said, there needs to be stronger protections in place against fraud and predation in those types of products.

So we have a relatively pro-choice proposal here, and by suggesting that firms should be marketing standardized, more simple, with clear disclosure products, we are not materially limiting choice.

Mr. NEUGEBAUER. I think we all agree with the disclosure piece that there is a lot of difference between good disclosure and the government picking the products, and I think that to be very careful if this becomes an endorsement of the Federal Government of certain products.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman.

Mr. Geithner, we certainly appreciate your presence here today, and I would like to congratulate you on the strong leadership that you are already providing for the Consumer Financial Protection Agency. I think it is very important. I am absolutely dedicated to the proposition that we can do something for consumers. We held a very important press conference led by our chairman just yesterday, I am releasing an editorial today. When we are on recess, my first town hall meeting will be on this issue, and I will plug it into stops that I will be making for speaking engagements in New Jersey, Tennessee, Georgia, and some other places. So I believe that this is very important and again I appreciate the work that you are doing.

Many of our members are very appreciative of that and will be joining you in your efforts. So I won't talk about that anymore in my limited period of time. I have to focus on what I can do for job creation. I don't have to tell you that the unemployment rates in minority communities and poor communities are double digit, have been for a long time, and when we see 14 and 15 percent like in New York, you are really talking in some census strike areas 35, 40 percent around this country. And so I am very interested in doing everything that I can do to help create jobs.

To that end, you know, I have been a real advocate in pushing for a minority participation with the Treasury on a number of your programs that have been developed under the TARP, the PPIP, minority and women owned programs—well, the PPIP program in particular is your latest effort. Let me thank you for paying attention and including some minority firms in cooperation with some of the majority firms. I am very pleased that we have at least one firm that will be a main participant in the effort, and I am very pleased that we have identified and you have helped to select through your work minority firms that can participate with majority firms.

But in examining what the minority firms are doing, I am finding that they are getting more fee-based work rather than—flat-fee work, rather than percentages. We want to beef up the participation with our minority firms to make sure that they are earning credible amounts of money because this money goes back into these minority communities.

If you would take a look at Magic Johnson, for example, and what he has been able to do showing people that you can go into the minority community, you can do business, you can make a profit, and you can create jobs. So we need a lot more of that, and I would like to commend to you our database which we have been, I think, trying to share with you so that you will have access to those firms that are very, very capable of providing mainstream services and not having to rely on small amounts that are allocated by some of these firms that they have joined up with.

Having said that, have you given more consideration to how you can involve women and minority-owned firms in this really, really once of a lifetime opportunity that has been afforded through all of the work that is going on with TARP?

Secretary GEITHNER. We are giving more consideration to it. We haven't made a judgement yet whether we are going to allocate, appoint additional managers under this program, but we will be reflecting on that as the program gets underway, and I understand how important this is to you. And thank you for highlighting the things we have already done.

Ms. WATERS. As I understand it, you will be involved very soon in another aspect of this work. Are you putting something out within the next few weeks relative to the PPIP program still?

Secretary GEITHNER. We are not fully operational yet. So I think the next stage in particular is as these firms we have appointed go out and try to raise capital for the program—but anyway, I would be happy to come up and spend time with you and talk to you and your staff about the details and what is ahead. As I said, we are committed to trying to find ways to increase participation of small, women-, and minority-owned businesses in these programs. We have already done some important things in that areas, and we will look for ways to do more.

Ms. WATERS. I think we are referring to valuation agents, my staff just said. That is something that I think is available now. And I don't know what has been done in making sure that you do the kind of acceptable outreach to include these firms. They are very capable, they are very competent. This sector of the minority community is more prepared, more developed than a lot of our other sectors. That is why it is so important for them to participate so that they can help create these jobs in needed communities.

I thank you, and I yield back the balance of my time.

The CHAIRMAN. The gentleman from South Carolina, Mr. Barrett. Is Mr. Barrett here?

Then next Mrs. Capito, the gentlewoman from West Virginia.

Mrs. CAPITO. Thank you, Mr. Chairman. Thank you, Mr. Secretary, for being here and for your service to our Nation.

I am from a small State and we have a lot of community bankers. A lot of the commerce and residential business is conducted by the community bankers in a very personal way. In a hearing last week, we had a community banker who talked about a woman who had run into a bit of bad luck because her husband was very ill and she was able to go to her community banker and reshape temporarily her mortgage so that it could meet her needs. Naturally, with the prospect of this Consumer Financial Products Commission and other regulations, the community bankers and those of us living in States who are served principally by community bankers are very concerned that the flexibility that this bank was able to show this individual would not be there for them, not only the flexibility, but the timeliness of this.

What is your response to this kind of situation?

Secretary GEITHNER. I think you are right. What you described is one of the great strengths of our system and it is very important that we preserve that. I don't think there is any credible risk, but this is in the hands of this committee and Congress. But I don't think there is any credible risk that in putting in place strong protections for consumers like we have proposed, we would be limiting credit to viable businesses and families or materially interfering with the capacity of banks to work out those kinds of things. But—and that is something we can achieve together. There is no risk as this takes shape that we reduce that kind of flexibility.

Mrs. CAPITO. But if we are going to talk about—and I would like to get an explanation of this and I would appreciate your answer on this vanilla loan concept where everything has to have a plain vanilla sort of look to it. You know, mortgage products are one of the things that was talked about. It seems to me that we could be limiting some flexibility here for our community bankers, and then you get into things like car loans where they are 5 or 6 percent, or zero percent down or $1,500 incentives.

Is this Product Safety Commission going to be able to move fast enough to oversee this and is this the kind of thing we are going to be overseeing?

Secretary GEITHNER. I am very glad you raised this again, because it is very important. Again, what we are proposing is that banks be required to offer the standardized, simple, easily understood, clear disclosure product. But they can also offer a range of other existing products that can be tailored to meet specific needs of families and businesses and—

Mrs. CAPITO. But the regulation of those products, excuse me, does fall within that consumer product?

Secretary GEITHNER. We are again—we are pretty clear in the language we put out in our draft proposal. And again we are happy to—obviously we are happy to look for ways to make that clear and better. But we are largely going to rely on disclosure and penalties against fraud to provide the protections against the risks that future innovation in these areas imperils the system. But I think that in this area we very much share your objective in trying to make sure we are preserving the capacity for competition of products and for innovation in products. That is very important to us. This is one of the great strengths of our system. We just let it get a little too far away from any basic sense of gravity and we need to bring that balance back a little bit. But I very much share the objective of preserving competition and product innovation but within a better framework of protection against fraud and predation.

Mrs. CAPITO. Well, I think naturally—and you mentioned this in your opening statement or one of the responses to the question, that a lot of the problems was really not in the bank sector, it was in the nonbank sector. And the community bankers and other bankers of this ilk are getting the broad brush painted against them not only in negative publicity associated with what has happened, but also as we come in to regulate, as we are known to do in Congress and Administrations, overregulate and make it a one-size-fits-all sort of policy that it ends up gutting, I think, a lot of what goes on in the day-to-day life of a community banker and other small bankers?

Secretary GEITHNER. I think you are absolutely right. And let me just say for the record we have a system which has 8,000 small community banks as a core part of our system. It is a great strength of our system. Many of those institutions were dramatically more prudent than their larger competitors, and that is a good thing about our system. And you are also right to point out that one of the challenges they faced was we had a system that allowed nonbanks to compete with them without the same basic standards, regulatory framework. That was not so good for them. It required many of them, if they wanted to compete, to lower their standards.

That is something we have to prevent. That is why we need a level playing field. That is why we need a single point of accountability around these basic standards, more evenly enforced. I think the thrust of this will be very helpful for banks, reducing the risk in the future. They are going to be faced with that kind of competitive pressure solely produced by the ability to evade the kind of protections Congress legislates.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. Secretary Geithner, in my opening statement I unequivocally made it clear to everybody that I am a strong supporter of the Consumer Protection Agency, one with equally robust mission and authority as the safety and soundness and prudential regulation authority that other agencies have, and no less subject to being second guessed or having their actions vetoed.

So I am starting from that proposition. I am not debating that philosophical thing anymore. But I am not closing my mind to concerns that are raised, and I want to say that to my committee members and to the industry and to the other regulators—three things I want to ask you about, which I think have some merit that have been raised, and ask you and others if they care to, to work with me on.

One of those you addressed in your opening statement, which was the examination authority. And the question I want to ask is, will you work with me and us and whomever else wants to work on it to make sure that the consumer protection examinations are coordinated with the prudential examinations so that we don't end up with duplicative examiners in their different times and overburden the regulated institutions, the ones that are already regulated? If you can tell me that yes or no, that would be helpful.

Secretary GEITHNER. Absolutely. And I think we can do better than that. We are proposing to put the prudential supervisor on the board of—

Mr. WATT. That is the—actually the second part of it here. The resolution of potential conflicts when—although I have asked multiple people to tell me what those conflicts are and I have yet to find any real credible ones that don't either fall clearly into consumer protection or clearly into safety and soundness, in which case a clear articulation of the authorities would suffice, but my question is, will you work with me to make sure that when there is some kind of conflict, there is an appeal or review mechanism? I thought it was going to be in the financial services oversight council, but I have reviewed what you all sent over in the last few days and I don't see it particularly addressed there, and I want to make sure that we get that clearly articulated somewhere, that everybody gets coordinated or reviewed if there is a real conflict, not a contrived one.

Will you work with me on that?

Secretary GEITHNER. Absolutely. What we propose to do at two levels, someone at the level of the board of this new agency where we have representatives of the supervisors there on the board, that would help, but also at the level of the broader financial services oversight council.

Mr. WATT. The third question that I think is a legitimate question, although I think it is a red herring and I think we ought to completely eliminate it as an issue is, will you work with me to make sure that there is no presumption of liability for products that are issued that are not the so-called plain vanilla products?

The argument I have heard, which I keep hearing over and over again, is that we—if you have a plain vanilla product and we issue something else, somebody is going to sue us because we issued something—will you work with me to make sure that there is no presumption against non-vanilla—plain vanilla products that would create any kind of legal liability just because you created—offered some other product? That is, I think, the same question that Mrs. Capito raised in a different form.

Secretary GEITHNER. Yes.

Mr. WATT. Okay. All right. Now, that I have those three things—

Secretary GEITHNER. I was going to qualify it a little bit, but I understand your objective.

Mr. WATT. —those three things clarified, I am sure there are multiple others, but those at least seem to me to have some degree of validity and I think we can do all of those three things without in any way compromising the authority or subjugating this new agency to somebody else.

I yield back and thank the chairman for the time.

The CHAIRMAN. I will just say the gentleman speaks for me and I think the great majority on our side for that. The gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you. I was just going to go back to an issue where the chairman said he was going to correct the record. I don't think there was anything in the record there to correct. The chairman said that the majority of the members had voted against my legislation that the Fed, the Federal Reserve, wanted and indeed that is true. Most of the members, that is what I said, most of the members had voted against that in the House. The chairman said the bill did not go out of the Senate. That is true. In a straight party line vote in the Senate, it did go out of committee, but it couldn't get off of the Floor on a 55/45 split in the Senate, although I do remember at the time the speeches given by Chuck Hagel, who was the author on the Senate side of the Fed's bill, and the speech given by John McCain in support and the speech on the floor given by Chris Dodd in opposition to it.

So I just want to again confirm that, yes, indeed, the Federal Reserve, and the Treasury as a matter of fact, supported that legislation. And the reason it is important is because we are back to debating that again. If we go back to where OFHEO and HUD were in terms of their positions, we basically have a situation where the safety and soundness regulator is being trumped, is being prevented just as with the case of Fannie and Freddie. HUD had in its mission these affordable housing goals and as a result HUD came out with the idea of zero down payment loans. That would be anathema to safety and soundness, but no skin in the game, zero down payment loans. HUD came out with the idea of allowing them to arbitrage. Go ahead and leverage 100 to 1. Now, this was absolutely anathema to the regulators for safety and soundness, but nevertheless it was allowed to happen. And the amendment to try to do something about it and allow the regulator to step in and regulate for systemic risk was blocked. When it came to the idea of meeting those affordable housing goals by doing $1 trillion in subprime, that was encouraged. Not by the safety and soundness regulators. For them, they saw in 2004, 2005, 2006, as they came up here and advised us against this, they saw where this was headed, and so did the Treasury.

And so now we are in the process of trying to look at the problems that are in the past, but not repeating those problems in the future. And that is why I think it is important at the end of the day that the regulator for safety and soundness be able to trump these other missions. Fannie and Freddie became the most powerful influence or lobby up here. And as you know, I have supported a Federal insurance charter for sometime.

I would like to talk about another issue here. I was concerned about the AIG problem and not being able to get our hands around the information, and I think you were, too. We have talked about that. As you have laid out your regulatory reform proposal, there are several problems with the current balkanized State-based regulatory system. It is inefficient. It is costly for consumers. It hampers U.S. competitiveness. It lacks a centralized regulator, which is a key concern for me, with an ability to look at the entire U.S. market. As we are looking to streamline and consolidate regulatory authority in the insurance portion of our financial system, it appears we may be taking a step back in the banking sector, especially with respect to the Consumer Financial Protection Agency. Within your CFPA proposal, you call for creating a floor for consumer protection which would allow State consumer laws to go over the top of the national standard.

Bearing in mind what has happened in our insurance market, where we have 50 different sets of rules, 50 different regulatory approaches, are you concerned that the negative consequences that have arisen in the insurance market could be replicated in the banking sector with this approach, and would it not make sense to set a ceiling as well as a floor so there is some consistency nationwide?

Secretary GEITHNER. I understand the concern you are raising, and it is difficult to get the balance perfect. We thought about it a lot. What we laid out was our best judgment. Again, how to make sure you have stronger, more uniform protections at the national level without depriving States of the ability to go beyond that. But I understand the concern again. We thought we got the balance right, but this is a very complicated issue. This committee spent a lot of time on these issues in the past in the preemption area. And again, we are happy to work with you and try to think through how best to get a better balance.

Mr. ROYCE. I appreciate it. And one last point before my time expires. Would you concur on the thought about Fannie and Freddie, some of the points that I made in terms of the systemic risk that they pose to the system?

Secretary GEITHNER. There is no doubt that we as a country let Fannie and Freddie get to a point where they posed enormous risk to the financial system. No doubt about it. It would have been good if we had figured out a way to avoid that earlier, and that mistake should underpin much of what we do in thinking about how to create a more stable system.

Mr. ROYCE. Thank you.

The CHAIRMAN. The gentleman's time has expired. We have a couple more. Mr. Secretary, we will start at 1:00 with the next panel. What I plan to do with regard to the questioning is to pick up where we have left off with the second panel. So members who have already asked of the Secretary—we will go to members who haven't asked.

Plus—and I talked to the ranking member—we did have a time for the Secretary and we would have more time, but 56 procedural votes preempted him. They weren't all procedural, but they were all silly. But what we will do is in September when we come back, one of the first things we will have is a full session of several hours with the Secretary. So we will get back to that.

Mr. BACHUS. Thank you, Mr. Chairman.

The CHAIRMAN. And I will now recognize for 5 minutes the gentleman from North Carolina, Mr. Miller, if he would like to take the time. The gentleman from Texas?

Let me just take the gentleman from Texas, if he would yield me his first 30 seconds. The gentleman from California is right. But again, let us be clear, we are not at the old OFHEO/HUD situation. In 2007, this committee passed a bill that included some of the things that had not been in the previous bill, approved by Secretary Paulson, President Bush, and Mr. Lockhart from OFHEO. So we are not now in a situation where the old rules apply. The new rules do apply. There will still have to be further changes, but we are not in the old situation as a result of legislation in 2008.

The gentleman from Texas.

Mr. GREEN. Thank you, Mr. Chairman. Thank you for the clarification as well.

Mr. Secretary, welcome again. It is always a treat to hear you. I was very impressed with your opening statement. I have been visited by many community bankers, as has been the case with many colleagues, and one of the concerns expressed is a desire not to pay for the sins of others. They sincerely say this in a literal sense, they don't want their premiums to escalate because of those who engaged in 3/27s, 2/28s, prepayment penalties that coincided with teaser rates, and many other products that they were not purveying. Can you give us your word, please, that they will be comforted in knowing that they won't pay for the sins of others?

Secretary GEITHNER. I have said this in public before, and I will be happy to say it again. But I think they have a point. And I think, as Commissioner Bair has already laid out and we are very supportive of this, I think we need to move to a point where the basic cost of the failures in the system in the future are shared a bit more fairly. And I think that is an important thing. But, yes, I share that commitment.

Mr. GREEN. Well, I would dearly like to work with you in making sure that they have the level of comfort that I think they richly deserve given that they were not a part of the concerns that we are trying to address today.

Next point. You indicated that penalties against fraud would be one of the means by which going forward hopefully we would deter some of the products or the behavior that we saw. If you would, give a better bit of clarity to that phrase, penalties against fraud. Will there be civil as well as penal actions or are we talking civil only?

Secretary GEITHNER. I probably can't do that justice today, but again, I am happy to spend some time working through those issues. Again, I think the basic principle—it is not enough to have standards, it is not enough to have rules, it is not enough to state protections. They have to be enforced. And fraud, violations of those protections, there has to be consequences. We need to make sure that the framework work in place today provides enough deterrents against those kind of practices reemerging. That is the objective we are working towards, lots of ways to do that. I am happy to spend time talking about how best to do that.

Mr. GREEN. Thank you. And I would just like to share a thought with you as I complete my moment. I understand that we have two classes of consumers. We have those who actually consume or deal with the products that are being purveyed and then you have another class, the folks who work for minimum wage which just went up today to, I think, $7.25 an hour, but who suffer because others make unwise choices. They end up losing jobs, we have seen how connected the economy is, how interconnected the world is. And by virtue of this, I care about those consumers who make $7.25 an hour. I care about not only Fannie Mae and Freddie Mac that we have discussed today, but also Aunt Fannie and Uncle Freddie, people who have real lives that are being impacted by those who made bad choices.

So I am here to let you know that I want to work with you, but my Fannie Mae and Freddie Mac includes at least two classes of Fannies and Freddies.

Thank you. And I will yield back, Mr. Chairman. Mr. Chairman, I did an unusual thing, I yielded back time.

The CHAIRMAN. I appreciate that, and I now recognize the gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman. Thank you, Mr. Secretary. Before I begin, will you work with Mr. Watt on all those issues?

Secretary GEITHNER. I am just—

Mr. GARRETT. I was being funny about it. It was an attempt at humor. Thank you. Following those lines—

The CHAIRMAN. Never mind. Go ahead.

Mr. GARRETT. Yes, thanks.

Randy asked a question with regard to who do we trust, who do we believe with regard to the Feds last week and your position here as far as—

Secretary GEITHNER. You can believe him and believe me. We have a difference, it doesn't mean—

Mr. GARRETT. Right. One of your comments was sort of intriguing. You said you understood what they were saying, you understood what they were doing. And one of your comments was that what they were doing is the right thing, they are defending the prerogatives of the agency basically. And you are nodding your head and she can't write that down, but that is a yes, right? Yes.

Secretary GEITHNER. They are defending the people who have worked on these issues over time.

Mr. GARRETT. Right.

Secretary GEITHNER. And speaking in favor of preserving the traditional prerogatives of their agency. That is an understandable thing to do. It happens all the time.

Mr. GARRETT. I guess my concern there of course is it then really puts us in a hard situation when agencies come before us if that is the understanding of the agencies that are going to come from aspects from defending the prerogatives of their agencies, whether it is the Fed or one of the regulators or whether it is the Treasury, if they come to us doing it not for the good necessarily of the overall economy or the country or what have you, but defending their prerogatives, you can understand why that raised a red flag when I heard that.

Secretary GEITHNER. No. I think that inherent in your job is to think about how to make those choices.

Mr. GARRETT. And to consider the source?

Secretary GEITHNER. There is no doubt about it. Absolutely.

Mr. GARRETT. Going to Mr. Watt's question, though. You said you would work with him with regard to one of the three issues. One of the issues was his example of someone coming in for a vanilla product and then getting a more complicated product. And his concern is that if the more complicated product isn't right for me, do I have the right to sue the bank that gave me this more complicated product? And you just said that you hoped that you would work with him to make sure that you can't sue the banks just because you are into this new product. Did I understood his question right?

Secretary GEITHNER. I would probably say it differently that that. In trying to make sure again we have better protections against fraud and predation and in trying to make sure it is possible that people can be able to see, for example, a 30-year fixed-rate mortgage alongside a suite of other mortgage products, you also want to make sure that they have the ability to choose a 5-year adjustable rate mortgage too without presumption, as he said it, that they would be vulnerable to challenge for offering products other than the vanilla product. That I agree with.

Mr. GARRETT. What about the flip side of that, though? What if an individual comes into the bank and the bank does have these more esoteric products and they don't offer it to the client or the individual and all they offer to the customer is the vanilla product. Does that client have a right to go back to the bank and say that this bank is profiling me and saying that I am not eligible for this type of more sophisticated product?

Secretary GEITHNER. That doesn't worry me that much. In our system—because we will have a lot of banks competing for this business—that consumer will be able to go to another institution and say, I like the range of choice that institution offers.

Mr. GARRETT. That certainly should trouble you because we have heard a lot of discussion on this panel with regard to something called predatory lending, and so many times they said that there should be other products that individuals should be entitled to but they are just not offered those, and all they are offered are these much higher rate products or just really ones that put them in a bad situation.

Secretary GEITHNER. It is very unlikely, I think, that would come with an institution that chose on its own only to offer 30-year fixed-rate mortgages. It is possible, but I think it is unlikely.

Mr. GARRETT. In my time remaining, on the wind-down authority I have heard different stories, and let me go to the source. On the winding down authority—first of all, the chairman made a comment I agree with completely. He said that if we identify who the Tier 1 companies are—what did he say the other day? And then we shouldn't have a pre-existing list because if you do, then he said you will only exacerbate the problem of too-big-to-fail. I agree with that. But under the proposal that has come out right now, it seems as though you are beginning to identify them by certain parameters and what have you. So, A, wouldn't that cause some problem here because you are basically telling us who they are and, B, the second question—maybe you can get back to me on this—is I have heard different stories of where the assessments will be, will the assessments only be on the Tier 1 companies? And if the answer to that is yes—and you can give the answer off line too—will that be potentially harmful to those companies, the remaining companies, if the assessment is too large because you only have a small group?

Respond to the question if you can.

Secretary GEITHNER. Let me do the first part of your question, and the second part and the third part I will be happy to do separately. On the first part, here is our basic challenge. We believe—I think there is a very strong case for this—that the largest institutions that present these unique risks to the stability of our system, they need to have more conservative constraints on capital and leverage. They need to be holding more resources against the risk of loss so that we are less vulnerable in the future to the mistakes they made and the system as a whole is better able to withstand the effects of their failure. To do that, you have to be able to apply differentially higher charges. That requires identifying at least a mix of institutions that meet that risk. But we of course deeply understand the moral hazard risks that we live with today and that come various variants in this stuff. Again, we will work—

The CHAIRMAN. The gentleman's time has expired. I am going to do two more. The gentleman from Georgia.

Mr. SCOTT. Thank you, Mr. Chairman. Mr. Geithner, welcome again. I want to ask you specifically in terms of would you not commit to at least having someone on your staff who is dedicated to increasing the participation of African-American-owned firms, management asset firm, other firms, so that they can get business in the financial sector as we move in this area?

Secretary GEITHNER. I think I can do better than that in the sense that I would be happy to designate to you the principal Senate confirmed official in the Treasury with broad responsibility over the design and management of these programs, part of whose responsibility will be to continue to make sure we are looking for opportunities to increase participation of again small, women-owned, and minority-owned businesses in these programs.

Again we have been pretty careful and pretty effective in expanding those opportunities, and we are happy to work with you on ways we can do better.

Mr. SCOTT. Because there are many, many well-qualified minority-owned firms who, if we don't make a special effort to make sure they have the opportunity to compete, and if it doesn't come from the top, it just doesn't get done. So I would appreciate it, and I know this committee would appreciate your work on that area.

Now another area that I am vitally concerned about, and that is many, or shall we say some in the banking industry, it seems to me, are reverting back to some of the very practices that got us into this mess. I am sure you are familiar with the reports that have come out of now the huge, multimillion dollar, billion dollar compensation packages, bonuses that really got us into some of this. And they are going right back to it. What can you do about that?

Secretary GEITHNER. Congressman, I just want to make it clear, we do not believe we can go back to the set of practices of compensation that prevailed over the last decade and helped contribute to this crisis, and that is why we proposed well designed but very important reforms in the compensation area, and that is why it is very important you are moving question quickly as a committee to consider those reforms just next week, I believe.

But it is important that we do this in the context of broader regulatory reform because it is not going to be enough just to bring about better incentives for compensation. We are also going to have to put other constraints on risk taking through capital requirements; for example, more conservative safeguards, require firms to hold greater cushions against loss. But you need to look at comprehensive reform again to reduce the risks that we start to recreate some of the same problems that got us here.

Mr. SCOTT. We continue to get complaints from some in the banking industry with certain practices. We have the Consumer Protection Agency which we are pushing, which unfortunately some are fighting very hard. And yet they are not doing the basic things that need to be done. They are not lending. What can you do to increase pressure on our banks to lend?

Secretary GEITHNER. Let me just say two things in response to that. One is, there are basically two core substantive strategies that you can do that would be helpful in that area. One is again to make sure that banks who need capital have access to capital. That is critical. Without that, you will have further reduction in lending capacity. Banks will have to pull back further.

The second is to make sure that our broader credit markets that compete alongside banks are working better. We have done a lot of things in both of those areas, but I think those are the most important effective things we can do. I do think it is important, given the cumulative effect of what a bunch of judgements by banks across the country did to our economy. I think it is very important that they work very hard to earn back the confidence of the American people that they are going to be a source of capital and credit for growing businesses and for families going forward. I think it is very important to them they work hard to earn back that basic trust and confidence.

Mr. SCOTT. There is another growing practice that is happening in our financial sector and some banks, not all, but we have gotten reports where, in our rush to allow banks to do a multiplicity of services and products in which they have encouraged individuals to open up their savings account at this bank, open up their checking account at this bank and if they need a loan or home equity loan or any loan that they would take at the bank. What happens is that oftentimes and particularly now when there is pressure on consumers out there to—and they are on the margins, where these banks would go in and if they are a week or 2 late on their payment for a loan, they would go in and take that individual's savings without their knowledge and—or their checking and apply it to the loan.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Delaware, for the last question.

Mr. CASTLE. It has been stated perhaps by you, but I know by others, that various financial entities in this country seem to be relatively free or flexible in selecting their regulators, if you will. It is a little beyond the purview of this hearing. That just interested me. I mean, you are talking about everything from State regulators to the Fed, the OCC, the FDIC, the OTS or whatever. And I would think that the regulator would be dictated by how they are structured. So what are they doing that allows them to be able to so-called select their regulator and how great a problem is that in terms of some of the enforcement mechanisms we are concerned about?

Secretary GEITHNER. Let me just give you some of the most compelling examples of that. Countrywide and WAMU were banks, found the strictures of being banks inconvenient, shifted their charter to a thrift charter, and were able to take advantage of what in retrospect can only be judged as lower standards of enforcement, and they grew dramatically or a more rapid pace after they made that basic switch. That is one example. But there were others in our system, too.

Mr. CASTLE. Should we be looking at legislation to change that?

Secretary GEITHNER. We should. We have proposed as the centerpiece of our legislation that we eliminate the thrift charter and combine Federal responsibility for these bank-like entities into one place, to eliminate—

Mr. CASTLE. Do you think that will solve a lot of the—not all of the problems, but a lot of the problems?

Secretary GEITHNER. Not all. But in the banking area, that difference between the thrift and the bank charter as it was enforced—now, there are hundreds of well-run thrifts across the country. But there were unfortunately a few very big examples that caused a lot of damage where effectively people would go from one system that was stronger to a weaker system, grow market share, took themselves to the edge of the abyss because of that, and that is something we have to prevent.

Mr. CASTLE. Changing subjects, on the Consumer Financial Protection Agency—and this may be in some of your writings. You are submitting a lot of writings. Sometimes, I think in your spare time, you wrote the health care bill and the energy bill and a few other things. And I haven't had a chance to read it all. Maybe this is spelled out in there.

The CHAIRMAN. I would have to rule out attacks on the witness' character.

Secretary GEITHNER. I am innocent of that particular charge. That is right.

Mr. CASTLE. How do you view this would be structured? How big would it be? How expensive would it be? Would there be offsets and reductions in employment in the other various agencies that are now regulating if it were to occur? How do you foresee that? Maybe that is not thought out carefully yet.

Secretary GEITHNER. There is a whole range of complicated design questions we have to work through. But again, the simple thing you said well, which is again there is a substantial body of existing examiners who now do consumer protection spread across our multitude of bank regulators, and what we ideally do is take advantage of that expertise in shaping the workforce of this new agency. That would be the ideal thing. It would not be sensible not to do that. And I think that as a result, the amount of employment in what will be bank supervisor with a narrow set of responsibilities for safety and soundness would be reduced.

Mr. CASTLE. Is it your view that every new product that the bank would issue, a change in a credit card or whatever it may be, would have to go through an approval process with this Consumer Protection Agency?

Secretary GEITHNER. Absolutely not.

Mr. CASTLE. How would they determine whether they go through it or not? In your view, what is going to be the methodology for determining what needs to be submitted and what doesn't?

Secretary GEITHNER. We don't envision that process. I don't think that would be necessary or desirable. Again, the core of our proposal is to say we have put out broad standards and principles that should govern products and practices in this area. There is a lot of good stuff that has happened somewhat late, but good stuff that has happened in the last 2 years both in the credit card and mortgage area. You heard some in the paper today. We build on that basic model. But what we really want to do is just to make sure that consumers have the ability to take advantage of a more standardized plain vanilla, easier to understand product even as they contemplate a range of other different sets of choices. That is the basic thrust of our proposal.

Mr. CASTLE. As you know, some of the existing regulators are not totally happy with this change, shall we say. In my judgment, they are starting to do a lot better than they did before. I will be the first to agree with you that there were serious problems, but the credit card business and the Fed is an example of starting to do a much better job. What is your response to them? There is a great deal of expertise at the Fed, for example, with some of this.

Secretary GEITHNER. There is.

Mr. CASTLE. I am worried about giving that up.

Secretary GEITHNER. There is a lot of respect. We have to take advantage of that. But again, I think we had a long period of testing of the efficacy of that system, and it didn't serve us well enough.

Mr. CASTLE. Thank you.

The CHAIRMAN. Thank you, Mr. Secretary. As the song goes, see you in September. And this part of the hearing is ended and the second panel—we will take about 5 minutes for the second panel to get in place.

Let me apologize in advance for the fact that we are having some votes. We will begin the opening statements and some questions. At some point, there will be votes. As a practical matter, we probably cannot continue. But we have had a great deal to do here, and I apologize to everybody for the inconvenience. The only thing worse I think would have been not to have tried, and we will proceed.

And we will start with the Chairman of the Federal Reserve, Mr. Bernanke, whom I caught unawares and I apologize.

STATEMENT OF THE HONORABLE BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you, Mr. Chairman. Chairman Frank, Ranking Member Bachus, and other members of the committee, I appreciate the opportunity to discuss ways that the U.S. financial regulatory system can be enhanced to better protect against systemic risks.

The financial crisis of the past 2 years has had diverse causes, including both private sector and regulatory failures to identify and manage risks, but also gaps and weaknesses in the regulatory structure itself.

This experience clearly demonstrates that the United States needs a comprehensive and multifaceted strategy, both to help prevent financial crises and to mitigate the effects of crises that may occur. That strategy must include sustained efforts by all our financial regulatory agencies to make more effective use of existing authorities.

It also invites action by the Congress to fill existing gaps in regulation, remove impediments to consolidated oversight of complex institutions, and provide the instruments necessary to cope with serious financial problems that do arise.

In keeping with the committee's interest today in the systemic risk agenda, I would like to identify the key elements that I believe should be part of that agenda.

First, all systemically important financial institutions should be subject to effective consolidated supervision and to tougher standards for capital liquidity and risk management consistent with the risks that the failures such a firm may pose to the broader financial system.

Second, supervision and regulation of systemically critical firms and of financial institutions more generally should incorporate a more macro prudential perspective, that is, one that takes into account the safety and soundness of the financial system as a whole. Such an approach, which considers interlinkages and interdependencies among firms and markets that could threaten the financial system in a crisis, complements the traditional micro prudential orientation of supervision and regulation which is focused primarily on the safety and soundness of individual institutions.

Third, better and more formal mechanisms should be established to help identify, monitor, and address potential or emerging systemic risks across the financial system as a whole, including gaps in regulatory or supervisory coverage that could present systemic risks. The Federal Reserve Board sees substantial merit in the establishment of a council to conduct macro prudential analysis and coordinate oversight of the financial system. The expertise and information of the members of such a council, each with different primary responsibilities, could be of great value in developing a systemwide perspective.

Fourth, to help address the too-big-to-fail problem and mitigate moral hazard, a new resolution process for systemically important nonbank financial firms is needed. Such a process would allow the government to wind down a troubled systemically important firm in an orderly manner that avoids major disruptions to the broader financial system and the economy. Importantly, this process should allow the government to impose haircuts on creditors and shareholders of the firm when consistent with the overarching goal of protecting the financial system and the broader economy.

And fifth, ensuring that the financial infrastructure supporting key markets can withstand and not contribute to periods of financial stress also is critical to addressing both the too-big-to-fail problem and systemic risks. For this reason, reform should ensure that all systemically important payment clearing and settlement arrangements are subject to consistent and robust oversight and prudential standards.

Comprehensive reform of financial regulations should address other important issues as well, including the needs for enhanced protections for consumers and investors in their financial dealings and for improved international coordination in the development of regulations and in the supervision of internationally active firms.

Let me end by noting that there are many possible ways to organize or to reorganize the financial regulatory structure. None would be perfect and each will have advantages and disadvantages. However, one criterion I would suggest as you consider various institutional alternatives is the basic principle of accountability. Collective bodies of regulators can serve many useful purposes, such as identifying emerging risks, coordinating responses to new problems, recommending actions to plug regulatory gaps, and scrutinizing proposals for significant regulatory initiatives from all participating agencies. But when it comes to specific regulatory actions or supervisory judgments, collective decisionmaking can mean that nobody owns the decision and that the lines of responsibility and accountability are blurred. Achieving an effective mix of collective process and agency responsibility, with an eye toward relevant institutional incentives, is critical to a successful reform.

Thank you again for the opportunity to testify in these important matters. The Federal Reserve looks forward to working with the Congress and the Administration to achieve meaningful regulatory reform that will strengthen our financial system and reduce both the probability and the severity of future crisis.

Thank you, Mr. Chairman.

[The prepared statement of Chairman Bernanke can be found on page 72 of the appendix.]

The CHAIRMAN. Ms. Bair.

STATEMENT OF THE HONORABLE SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Ms. BAIR. Chairman Frank, Ranking Member Bachus, and members of the committee, thank you for holding this hearing and for the opportunity to give our views on reforming financial regulation.

The issues before the committee are as challenging as any that we face since the days of the Great Depression. We are emerging from a credit crisis that has greatly harmed the American economy. Homes have been lost, jobs have been lost, retirement and investment accounts have plummeted in value.

The proposals by the Administration to fix the problems that caused this crisis are both thoughtful and comprehensive. Regulatory gaps within the financial system were a major cause of the crisis. Differences in regulating capital, leverage, and complex financial instruments as well as in protecting consumers allowed rampant regulatory arbitrage. Reforms are urgently needed to close these gaps.

At the same time, we must recognize that many of the problems involve financial firms that were already subject to extensive regulation. Therefore, we need robust and credible mechanisms to ensure that all market players actively monitor and control risk taking. We must find ways to impose greater market discipline on systemically important institutions. In a properly functioning market and economy, there will always be winners and losers. And when firms, through their own mismanagement and excessive risk taking, are no longer viable, they should fail.

Efforts to prevent them from failing ultimately distort market mechanisms, including the incentive to compete and to allocate resources to the most efficient players. Unfortunately, the actions taken during the past year have reinforced the idea that some financial organizations are simply too-big-to-fail. To end too-big-to-fail, we need a practical, effective, and highly credible mechanism for the orderly resolution of large and complex institutions that is similar to the process for FDIC insured banks.

When the FDIC closes a bank, shareholders and creditors take the first loss. We are talking about a process where the failed bank is closed, where the shareholders and creditors typically suffer severe loss, where management is replaced, and where the assets of the failed institution are sold off. The process is harsh, as it should be. It is not a bailout. It quickly reallocates assets back into the private sector and into the hands of better management. It also sends a strong message to the market that investors and creditors face losses when an institution fails, as they should.

We also believe potentially systemic institutions should be subject to assessments that provide disincentives for complexity and high risk behavior and reduce taxpayer exposure. I am very pleased that President Obama, earlier this week, said he supports the idea of assessments. Funds raised through an assessment should be kept in reserve to provide working capital for the resolution of large financial organizations to further insulate taxpayers from losses.

In addition to a credible resolution process, we need a better structure for supervising systemically important institutions, and we need a framework that proactively identifies risks to the financial system. The new structure, featuring a strong oversight council, should address such issues as excessive leverage, inadequate capital, and overreliance on short-term funding. A regulatory council would give the necessary perspective and expertise to look at our financial system holistically.

Finally, the FDIC strongly supports creating a new Consumer Financial Protection Agency. This would help eliminate regulatory gaps between bank and nonbank providers of financial products and services by setting strong, consistent, across-the-board standards. Since most of the consumer products and practices that gave rise to the current crisis originated outside of traditional banking, focusing on nonbank examination and enforcement is essential for dealing with the most abusive lending practices that consumers face.

The Administration's proposal would be even more effective if it included tougher oversight for all financial services providers and assured strict consumer compliance oversight for banks. As both the bank regulator and deposit insurer, I am very concerned about taking examination and enforcement responsibility away from bank regulators. It would disrupt consumer protection oversight of banks and would fail to adequately address the current lack of nonbank supervision.

Consumer protection and risk supervision are actually two sides of the same coin. Splitting the two would impair access to critical information and staff expertise and likely create unintended consequences.

Combining the unequivocal prospect of an orderly closing, a stronger supervisory structure, and tougher consumer protections will go a very long way to fixing the problems of the last several years and to assuring that any future problems can be handled without cost to the taxpayer.

Thank you very much.

[The prepared statement of Chairman Bair can be found on page 56 of the appendix.]

Mr. KANJORSKI. [presiding] Thank you very much, Ms. Bair.

Our next presenter will be the Honorable John C. Dugan, Comptroller, Office of the Comptroller of the Currency.

STATEMENT OF THE HONORABLE JOHN C. DUGAN, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. DUGAN. Thank you, Mr. Kanjorski, Ranking Member Bachus, and members of the committee. I appreciate this opportunity to discuss the Administration's comprehensive proposal for reforming the regulation of financial services.

The OCC supports many elements of the proposal, including the establishment of a Council of Financial Regulators to identify and monitor systemic risk. We believe that having a centralized and formalized mechanism for gathering and sharing systemically significant information and making recommendations to individual regulators makes good sense. We also support enhanced authority to resolve systemically significant financial firms.

The FDIC currently has broad authority to resolve systemically significant banks in an orderly manner, but no comparable resolution authority exists for systemically significant holding companies of either banks or non-banks. The proposal would appropriately extend resolution authority like the FDIC's to such companies.

We also believe it would be appropriate to designate the Federal Reserve Board as the consolidated supervisor of all systemically significant financial firms. The Board already plays this role with respect to the largest bank holding companies. In the financial crisis of the last 2 years, the absence of a comparable authority with respect to large securities and insurance firms proved to be an enormous problem. The proposal would fill this gap by extending the Federal Reserve's holding company regulation to such firms.

However, one aspect of this part of the proposal goes much too far, which is to grant broad new authority to the Federal Reserve to override the banking supervisor on standards, examination, and enforcement applicable to the bank. Such override power would undermine the authority and the accountability of the banking supervisor.

We also support the imposition of more stringent capital and liquidity standards on systemically significant firms. This would help address the heightened risk to the system and mitigate the competitive advantage they could realize from being designated as systemically significant.

And we support the proposal to effectively merge the OTS into the OCC with a phaseout of the Federal thrift charter. However, it is critical that the resulting agency be independent from the Treasury Department and the Administration to the same extent that the OCC and the OTS are currently independent.

Finally, we support enhanced consumer protection standards for financial services providers and believe that an independent agency like the proposed CFPA could achieve that goal. However, we do have significant concerns with some elements of the proposed CFPA stemming from its consolidation of all financial consumer protection, rule writing, examination, and enforcement in one agency, which would completely and inappropriately divorce all these functions from the comparable safety and soundness functions at the Federal banking agencies.

I believe it makes sense to consolidate all consumer protection rule writing in a single agency with the rules applying to all financial providers of a product, both bank and non-bank, but we believe the rules must be uniform and that banking supervisors must have meaningful input into formulating these rules. Unfortunately, the proposed CFPA falls short on both counts.

First, the rules would not be uniform, because the proposal would expressly authorize States to adopt different rules for all financial firms, including national banks, by repealing the Federal preemption that has always allowed national banks to operate under uniform Federal standards. This repeal of the uniform Federal standards option is a radical change that will make it far more difficult and costly for national banks to provide financial services to consumers in different States having different rules, and these costs will ultimately be borne by the consumer. The change will also undermine the national banking charter and the dual banking system that has served us very well for nearly 150 years in which national banks operate under uniform Federal Rules and States are free to experiment with different rules for the banks they charter.

Second, the rules do not afford meaningful input from banking supervisors, even on real safety and soundness issues, because in the event of any disputes, the proposed CFPA would always win. That should be changed by allowing more banking supervisors on the board of the CFPA and by providing a formal mechanism for banking supervisor input into CFPA rulemaking.

Finally, the CFPA should not take examination and enforcement responsibilities away from the banking agencies. The current banking regime works well, where the integration of consumer compliance and safety and soundness supervision provides real benefits for both functions. Real life examples attached to my testimony demonstrate how this works.

To the extent the banking agencies have been criticized for consumer protection supervision, the fundamental problem has been with the lack of timely and strong rules, which the CFPA would address, and not the enforcement of those rules. Moreover, moving these bank supervisory functions to the CFPA would only distract it from its most important and daunting implementation challenge, establishing an effective examination and enforcement regime for the shadow banking system of the tens of thousands of non-bank providers that are currently unregulated or lightly regulated, like the non-bank mortgage brokers and originators that were at the heart of the subprime mortgage problem. CFPA's resources should be focused on this fundamental regulatory gap, rather than on already-regulated depository institutions.

Thank you very much.

[The prepared statement of Comptroller Dugan can be found on page 106 of the appendix.]

Mr. KANJORSKI. Thank you very much.

Our next presenter will be Mr. John E. Bowman, Acting Director, Office of Thrift Supervision.

STATEMENT OF JOHN E. BOWMAN, ACTING DIRECTOR, OFFICE OF THRIFT SUPERVISION (OTS)

Mr. BOWMAN. Good afternoon, Mr. Kanjorski, Ranking Member Bachus, and members of the committee.

Thank you for the opportunity to testify today on the Administration's proposal for financial regulatory reform and H.R. 3126, the Consumer Financial Protection Agency Act of 2009. It is my pleasure to address the committee for the first time in my role as Acting Director of the Office of Thrift Supervision.

The OTS supports the fundamental objectives at the heart of the Administration's proposal, agrees that the time to act is now, and agrees that the status quo must change. As you consider legislation to meet those objectives, I encourage you to ensure that each proposed change addresses a real problem that contributed to the financial crisis or otherwise weakens this Nation's financial system.

In my view, the solutions to these real problems fall into three categories:

Number one, protect consumers. One Federal agency whose central mission is the regulation of financial products should establish the rules and standards for all consumer financial products. This structure would replace the current myriad of agencies with fragmented authority and a lack of singular accountability. For entities engaged in consumer lending that are not insured depository institutions, the Consumer Protection Agency should not only have rulemaking authority, but also examination and enforcement authority.

Number two, establish uniform regulation by closing gaps. These gaps became enormous points of vulnerability in the system and were exploited with serious consequences. All entities that offer financial products and services to consumers must be subject to the same consumer protection rules and regulations and vigorous examination and enforcement so that under-regulated entities cannot gain a competitive advantage over their more regulated counterparts.

Number three, create the ability to supervise and resolve systemically important firms. No provider of financial production should be too-big-to-fail, achieving through size and complexity an implicit Federal Government backing to prevent its collapse and thereby gaining an unfair advantage over its more vulnerable competitors. The U.S. economy operates on the principles of healthy competition. Enterprises that are strong, industrious, well-managed, and efficient succeed and prosper. Those that fall short of the mark struggle or fail and other stronger enterprises take their places. Enterprises that become treated as too-big-to-fail subvert the system. When the government is forced to prop up failing systemically important companies, it is in essence supporting poor performance and creating a moral hazard.

If the legislative effort accomplishes these three objectives, it will have accomplished a great deal, and in my view, the reform effort will be a ringing success.

Thank you for the opportunity to be here today. We look forward to continuing to work with the members of this committee and others to create a system of financial services regulation that promotes greater economic stability for the Nation, and I would be happy to answer your questions.

[The prepared statement of Mr. Bowman can be found on page 89 of the appendix.]

Mr. KANJORSKI. Thank you very much.

Now, we will hear our final presenter, Mr. Joseph A. Smith, Jr., North Carolina Commissioner of Banks, on behalf of the Conference of State Bank Supervisors.

STATEMENT OF JOSEPH A. SMITH, JR., NORTH CAROLINA COMMISSIONER OF BANKS, ON BEHALF OF THE CONFERENCE OF STATE BANK SUPERVISORS (CSBS)

Mr. SMITH. Thank you, sir.

Representative Kanjorski, Representative Bachus, members of the committee, good afternoon. My name is Joseph A. Smith, Jr., and I am North Carolina Commissioner of Banks and Chairman of the Conference of State Bank Supervisors.

Thank you for inviting CSBS to testify today on the Administration's plan for financial regulatory reform. CSBS applauds this committee and the Administration for the time and energy put into a challenging undertaking. We look forward to working with Congress and the Administration toward a reform plan that makes meaningful and sustainable improvements in the way our financial system serves the public and strengthens local communities and the Nation's economy.

My statement today reflects the perspectives of commissioners and deputy commissioners from around the country, and I would like to thank them for their efforts in helping to put this together.

Our major concern is that the legacy of this crisis could be a highly concentrated and consolidated industry that is too close to the government and too distant from consumers and the needs of its communities. That need not be the result. To avoid that outcome, Congress needs to realign the regulatory incentives around consumer protection and end too-big-to-fail.

We believe that many provisions of the Administration's plan would advance these goals. These include the continuation of the current supervisory structure for State-chartered banks, a comprehensive approach to consumer protection, and the recognition of the importance of State law and State law enforcement in accomplishing consumer protection.

However, we also have some concerns. In our view, the Administration's plan inadequately addresses the systemic risk posed by large, complex financial institutions. My testimony today will present our perspective on these issues.

We support the creation of the Consumer Financial Protection Agency in concept and we support its goals. Restoring public confidence in our financial system is a necessary objective. Consumer protection standards for all financial service or product providers, such as those to be promulgated by the agency, are an important step in that direction.

Any proposal to create a Federal Consumer Financial Protection Agency must preserve for the States the ability to set higher, stronger consumer protection standards. We are pleased to see that the Administration's proposal, as well as H.R. 3126, does just that, explicitly providing that Federal consumer protection standards constitute a floor for State action.

We believe that the new agency's activities would be most effective if focused on standard setting and rulemaking. As part of this, we support the agency having broad data and information gathering authority. We believe the agency's visitorial authority should be a backup function aimed at filling in regulatory gaps. We also believe the agency's enforcement authority should be a backstop to the primary enforcement authority of State and Federal prudential regulators and law enforcement. As part of this, timely coordination and information sharing among Federal and State authorities will be absolutely critical.

We do not believe that systemically significant institutions should be too-big-to-fail. There should be a clearly defined resolution regime for these institutions that actually allows them to fail.

Every type of institution must have a clear path to resolution. We believe the FDIC is the best choice as receiver or conservator for any type of financial institution. It is an independent agency with demonstrated resolution competence.

For systemically significant institutions, the regulatory regime should be severe, meaning tougher capital leverage and prompt corrective action standards, and it must protect taxpayers from potentially unlimited liability.

We applaud the Administration for its prompt and comprehensive response to the obvious need for improvement in our system of financial regulation. We now look forward to the members of this committee bringing your specialized knowledge and legislative experience to this proposal in order to ensure that it accomplishes its stated objective, a safer, sounder financial system that provides fair and stable access to credit for all sectors of the economy.

We look forward to working with you on this legislation to reduce systemic risk, assure fairness for consumers, preserve the unique diversity of our financial system, and enhance Federal-State coordination to create a seamless network of supervision for all industry participants.

Thank you again for the opportunity to share our views today. I look forward to any questions you may have. Thank you.

[The prepared statement of Mr. Smith can be found on page 149 of the appendix.]

Mr. KANJORSKI. Now we will hear from Mr. Sherman of California for 5 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman.

First as to the CFPA, the consumer agency, I hope that would not interfere with the traditional relationship between attorneys and CPAs and the clients that they advise. This relationship has traditionally been regulated by the States. When attorneys and CPAs act within the scope of their profession, it would seem unnecessary to have yet another consumer agency, since they are already bound by professional ethics, fiduciary duties, State licensure, and centuries of ethical traditions. But my comments don't apply when those professionals decide to become investment brokers or step outside of their traditional roles.

Also as to the consumer agency, and the chairman and I have had a colloquy on this, we should be creating a regulatory agency that enforces the law, not a law-writing agency, and I hope we are able to craft the language to make that clear. Otherwise, we would be taking this committee out of the consumer protection business and punting that to the unelected.

Mr. Kanjorski focused on credit rating agencies. I focus a little different than the chairman in that it is, to me, not who pays the credit rating agency, but who selects the credit rating agency. Imagine a baseball league where the umpire is selected by the home team. Even if the league paid the umpire's fee, if the umpire is selected by the home team, you are going to influence the outcome. I will be introducing legislation to have credit rating agencies selected at random from a qualified panel.

As to derivatives, we are told that even over-the-counter derivatives play this important role in our economy, but most derivatives are just naked casino bets without anybody hedging any risk they have in their actual business. So one wonders why we need over-the-counter derivatives allowed, except in those circumstances when one of the parties is hedging a legitimate business risk. When there is no societal purpose served by an over-the-counter derivative, why expose our economy to the systemic risk?

Chairman Bernanke, I hope you will respond for the record as to whether there would be any harm if the President appointed all your regional boards of governors. After all, I don't know why banks are appointing those who serve on the Fed and indirectly the FOMC, when the pharmaceutical companies don't get to actually name the people who serve on the FDA, the bar association doesn't pick the lawyers. We have a system of democracy where you elect a President and he appoints governmental officers.

Mr. Bowman, you seem to suggest, and I hope you will respond for the record, that perhaps we should break up those institutions that are too systemically important to fail or too-big-to-fail rather than sit around and see if they go under and then break them up. I don't know if that was your suggestion. If so, it is remarkable to have somebody in the Executive Branch be so bold.

Chairman Bernanke, I want to focus on bailout authority. You have powers under 13(3) that are unlimited in terms of dollar amounts. I remember once I asked whether you would accept a $14 trillion limit. It was a facetious question to which I got an interesting answer. But you have limited 13(3) to close to zero risk transactions, and I applaud you for that modest interpretation of your authority.

In one area of his presentation on an issue where you agree with the Secretary of the Treasury, he talks about resolution authority, and he says any cost to the taxpayer from the use of this resolution authority will be recovered through ex post facto assessments on large financial firms.

So his vision of resolution authority is that there will be cost to the taxpayer. And the question is, if we continue to have 13(3) as authority for the Fed, would it be unduly burdensome on those of you in the bailout business or the systemic business, or whatever, to put a half trillion dollar limit on any additional permanent TARP authority that we create in this statute?

Mr. BERNANKE. Thank you. On the presidents question, the regional presidents, we do not support Presidential appointment of the Reserve Bank presidents. We are in a situation now where we need to increase our consistency of enforcement and oversight, where we need to coordinate across the system, and I think creating 12 new Presidential appointees, 19 Presidential appointees around the FMOC table, is going to create a more diffuse and decentralized system. So, I wouldn't be in favor of that.

On 13(3), my answer to your facetious question was also facetious. We recognize the need to be very careful in the use of this authority. And, in particular, if this Congress puts together a resolution authority that can address the problem of failing firms, then I would certainly be open, in fact quite eager, to subordinate the 13(3) authority to the request or the requirement of the resolver.

Mr. SHERMAN. Having your authority limited by another part of the executive branch—if you could just address the question. Do you want unlimited new TARP authority?

Mr. BERNANKE. We are currently, as you know, winding down our 13(3) program. So, I don't anticipate we will be approaching the previous peaks. I can't anticipate what kinds of situations might arise in the future.

Mr. SHERMAN. So you might need unlimited authority to deal with them. Thank you.

Mr. KANJORSKI. The gentleman's time has expired.

We will hear now from the gentlelady, Mrs. Bachmann.

Mrs. BACHMANN. Thank you, Mr. Chairman. I found Mr. Sherman's question very interesting on unlimited authority for the Fed as they go forward, and I appreciate also the Chairman's response, being able to anticipate what the need would be for authority going forward.

I would just ask the Chairman briefly, do you believe it would be beneficial for the GAO to do an audit of the Federal Reserve?

Mr. BERNANKE. Well, I have addressed this question some this week. The GAO already has authority over most of our activities, all supervisory and operational activities, the single firm loans, like AIG and Bear Stearns. It also has authority over our TALF program. So we would be happy to work with Congress to address any remaining aspects of our operations that involve the use of taxpayer funds or financial management. We are more than happy to work with the GAO to allow their audits and oversight.

The concern that I have with the bill that has been proposed is that it does not exempt monetary policy and related operations, and my concern is that GAO audits are not really audits. They are really policy reviews. And I am concerned that the ability of Congress to essentially ask the GAO to audit any monetary policy decision would be a major reduction in the independence of the Federal Reserve to make monetary policy, which would have, I think, very negative consequences for the economy.

Mrs. BACHMANN. So I think to summarize, the answer would be no?

Mr. BERNANKE. Very broad authority is fine, but I would like to retain the exemption for monetary policy and related operations.

Mrs. BACHMANN. I appreciate the nuance. I do. Thank you so much for that.

My concern really goes back also to the concerns in the opening statement that was given by Mr. Hensarling early and also by others. I share those concerns. I am very concerned that the President's proposal that came before this committee is silent on any true, meaningful GSE reform, because nowhere in the President's White Paper that I could surmise does he propose any substantive ideas to fix the fatal flaws that I think many of us would agree are inherent in the GSEs, the too-big-to-fail philosophy that drove Bailout Nation. These are flaws that significantly contributed in many of our estimations to the financial crisis the country experienced.

So my question would be for members of the panel, how can the only plan be, and I am quoting from the White Paper, how can the only plan be to engage in a wide-ranging initiative to develop recommendations on the future of Fannie Mae and Freddie Mac and the Federal Home Loan Bank system which will be punted until the President's release of his 2011 budget? It just seems to me that real reform could have been, had Congress included placing Freddie and Fannie in receivership rather than in conservatorship, and how can we ever expect to fix the problems with our financial system without making changes at the root cause? If we have effectively nationalized these GSEs, what is our way out? I mean literally, will Starbucks be too-big-to-fail? Will these be considered financial Tier 1 organizations?

I think, at this point, we need to ask those questions.

We saw that the government backed away from CIT, which I think many of us were happy to see. But I would ask again, do you believe that we should be acting sooner to reform the GSEs?

And that is for anyone on the panel.

Ms. BAIR. I think the hesitancy to address the GSE issue is that it transcends financial policy and perhaps extends to housing policy, and this is really not an area where any of us have direct responsibilities at this point. But certainly, as the GSEs are functioning now and have functioned before, I believe they are quite profoundly systemic. They were sources of systemic risk that had built up over the years, as we know now.

So I think if they do continue to exist, clearly this is something that an oversight council should have some input and responsibility for. But as you say, the long-term future of those entities seems somewhat unclear right now, and it is really not within our purview as banking regulators to influence that policy decision.

Mrs. BACHMANN. I appreciate that. It is also rhetorical in the sense of just laying that on the table again that there are concerns from this side of the bench to say that this is an area that we do have concern.

Also regarding the resolution authority, my colleague Mr. Sherman had just referenced, and I think rightly so, Secretary Geithner's testimony indicates that because the government can collect the ex post facto assessments to cover the costs of a resolution, that moral hazard will be reduced. So it seems like everyone from the taxpayers to the innocent banks will have the potential to lose big, except the creditors and the counterparties of the failed firms. So how will that improve the status quo, in your estimation?

Mr. BERNANKE. Well, Chairman Bair has also spoken on this topic, but I think we would all agree that an effective resolution regime would take value from shareholders and impose costs and losses on creditors. So, I think that would be an important part of it.

An alternative, a close alternative, would be to require firms to have securities like contingent capital or convertible debt that, in the event of one of these resolution events, would be converted into a less valuable, more junior liability, and therefore indirectly impose costs on the lenders to the company. But I think we all agree that imposing costs on the shareholders and the creditors is an important part of this idea.

Mrs. BACHMANN. Just to change subjects, do you think there is going to be an influx of lawsuits that would be challenging products? This is now on the—apparently my time is up.

Thank you, Mr. Kanjorski. Thank you again to the panel, too. I appreciate it.

Mr. KANJORSKI. The gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

It is good to see all of you again. My first question would be to Chairman Bernanke. It seems that every time you look at reports, we seem to be getting some early signs that if not recovering, at least the recession is bottoming out. But most of the data that we looked at is based on domestic economic trends and housing, employment, etc. But we have also seen that our economy has become increasingly dependent on a broader global economy, and in particular developing countries, which have accounted for some 75 percent of global economic growth this decade and over 60 percent of growth in U.S. exports.

So my question is, how do you see trends and risk in the recovery in developing countries impacting our own recovery here at home, going back and forth?

Mr. BERNANKE. Well, emerging market economies took a very big hit because there was a lot of capital flowing out of those countries, and many of them are very dependent on exports and trade fell a lot. So, those economies did have very serious declines late last year and early this year. But the news I think is generally good. Most emerging market economies in Asia, Latin America, and other parts of the world have generally bounced back to some extent, and I think that is very positive. It won't have a major impact on the United States because we don't export a great deal to those countries, but it will contribute to a broader and more stable global economy and financial system. So, I think it is very positive, both for us and for them.

Mr. MEEKS. I will ask Chairman Bair, and anyone can answer this question, I am always concerned about what took place with Lehman Brothers, especially currently with the bankruptcy that still has a lot of U.S. investors' money tied up in London.

I was wondering how would we prevent something—you know, if we had with the new regulatory reform program coming in, how would we handle the same situation that we had with Lehman Brothers? How would it be different? How could we make sure we don't fall into the same situation that we are currently in in regards to an international holding company like Lehman?

Ms. BAIR. With a resolution authority that is patterned off of what the FDIC has now, you could have, in a situation like that, put the systemic functions into a bridge facility and required that derivative counterparties continue to perform on those contracts.

In a bankruptcy situation, counterparties have an immediate right to close out netting, and that is in point of fact what happened. They exercised those rights, pulled collateral out of the institution, netted out their positions, and went out to re-hedge. That caused a lot of disruption in the system.

With the resolution authority along the lines of what we have now, you could have wiped out shareholders and unsecured creditors under our claims priority. But, you could have required secured creditors, such as counterparties, to continue performing on their contracts and had an orderly wind-down of the institution. But with the rights of immediate closeout netting that are triggered with bankruptcy, you had a very disruptive situation.

Any resolution is going to be a difficult thing, but I do think that with the kinds of tools that we have, you can also do advanced planning with our resolution process, particularly for a bank. We work with the primary regulator. When we see trouble coming, we start planning in advance. So, you can control the timing as well. In bankruptcy, there is no control over the timing.

There are a lot of advantages that we have that I think provide in appropriate circumstances a more orderly process, while at the same time imposing significant losses on shareholders and creditors.

Mr. MEEKS. Let me ask my last question to Comptroller Dugan. This is based upon news reports yesterday that FASB is considering a new accounting standard that would require that all banks' assets be mark-to-market, including those currently held at book value.

Now, given that many people argue that the primary hurdle to getting the banks to move toxic assets off their balance sheets and getting them to participate in the government programs to facilitate this has been the unwillingness of the banks to mark down the value of their held-to-maturity loans.

So do you see this as a positive accounting standard, or do you think it would promote greater urgency for banks to actively move toxic assetts off of their balance sheets?

Mr. DUGAN. Congressman, I believe that FASB announced they will be putting such a proposal out later in the year. I haven't read the exposure draft, but as explained to me, it would move more of the loans on balance sheet to a mark-to-market or fair value status, although it would have different treatment for how the ups and downs in that would be run through the income statement or the balance sheet.

I must say, I do have a very significant concern about moving more assets and liabilities into the mark-to-market arena. I thought, given all of the issues that we have had this year about the volatility that introduces into income statements and balance sheets, that we wouldn't have continued marching down that path. So this concerns me. It also concerns me what it will do to the process of having more ability to have loan loss reserves in good times to prepare for losses in bad times.

So we will want to study this.

The CHAIRMAN. The time has expired.

The gentleman from California.

Mr. CAMPBELL. Thank you, Mr. Chairman.

The CHAIRMAN. This will be the last questioner. I apologize to all concerned, but we have about an hour of votes, and we will end the hearing at this point. It isn't fair to the witnesses to have them sit around while we vote for an hour and have the only two people in Washington who aren't making planes come back and look at them.

Mr. CAMPBELL. I guess I am the clean-up batter.

The first question to Chairman Bernanke, we are talking about firms that are systemically significant, too-big-to-fail, too-interconnected-to-fail. Not an exact number, but in order of magnitude today, how many firms is that? Five, 50, 500?

Mr. BERNANKE. Order of magnitude, I would guess—

The CHAIRMAN. Could members as they are leaving please do it in a quiet way so we don't disrupt the hearing any more than it has been disrupted.

Thank you. Please continue.

Mr. BERNANKE. A very rough guess would be about 25. But I would like to point out that virtually all of those firms are organized as bank holding companies or financial holding companies, which means the Federal Reserve already has umbrella supervision. So, I would not envision the Fed's oversight extending to any significant number of additional firms.

Mr. CAMPBELL. Okay. So it is basically, like you say, additional oversight for about 25 firms over which you already have some oversight?

Mr. BERNANKE. In fact we already have umbrella supervision authority, yes.

Mr. CAMPBELL. Okay. And those firms, if a firm was determined to be systemically significant and they didn't like or want the additional supervision they were going to get, they could always spin off divisions or do whatever they needed to do to not become systemically significant, correct?

Mr. BERNANKE. Absolutely.

Mr. CAMPBELL. The second question for the whole panel is, unless I heard incorrectly, with the exception perhaps of Mr. Bowman, I think all of you believe that some of the powers or authority or whatever in the CFPA should be somewhere else than the CFPA as the Treasury has proposed it.

I think that question was very inartfully worded, but hopefully you understand that the powers and everything that Treasury gave to the CFPA, with the possible exception, Mr. Bowman—or maybe you agree, but all of you believe that some of those powers and authorities should be somewhere else, is that correct?

Everybody is nodding.

The CHAIRMAN. The reporter cannot pick up nods.

Mr. BERNANKE. Yes.

Ms. BAIR. Yes.

Mr. DUGAN. Yes.

Mr. BOWMAN. Yes.

Mr. SMITH. Yes.

Mr. CAMPBELL. All of you believe that.

Okay, then, one final question for me, and then I can yield the balance of my time to Mr. Posey.

The Treasury proposal does not have Federal preemption, which in theory perhaps means 51 regulators instead of one. Do any of you not support Federal preemption?

Ms. BAIR. There are a lot of State-chartered banks that operate in multiple jurisdictions, and they comply with State consumer protection laws, and it is really not that much of a problem. So we do disagree on this issue. We think that it is appropriate, even for federally-chartered institutions, to comply with State consumer protection laws.

Also, with a good strong standards setter and some strong, valid, common-sense standards, the need for the States to go above the Federal standard will probably be greatly reduced, if not eliminated. But, there are lots of State-chartered banks that operate in multiple jurisdictions that comply with these State consumer protection laws now.

Mr. CAMPBELL. I am from California now. No matter what regulations are set up, my State will make them more onerous.

Mr. Smith.

Mr. SMITH. I agree with every single thing that Chairman Bair has said. There are a number of situations where the Federal standards were proper where States did not adopt additional standards. In fact some States actually cut back to the Federal standard. The States have acted when there has been no Federal standard or inadequate enforcement.

Mr. CAMPBELL. So a 3–2 vote on that.

I will be happy to yield the balance of my time to Mr. Posey.

The CHAIRMAN. We will give Mr. Posey 2½ minutes. We will give him an extra minute.

Mr. POSEY. I don't have any questions.

The CHAIRMAN. The hearing will be then be adjourned.

Mr. Bowman, you wanted to add something?

Mr. BOWMAN. Mr. Chairman, if I could, Mr. Sherman asked me a question which I didn't have sufficient opportunity to respond to. With your permission, I would like to supplement the record.

The CHAIRMAN. The record will be open for all witnesses, members, and others to submit statements.

Let me just say there are a number of witnesses here who have appeared before the committee on several occasions. I welcome you here in your guise as born-again consumer protectors.

Mr. BACHUS. Mr. Chairman, I think it is so important that this panel come back, maybe not Mr. Bernanke. Chairman Bernanke has been here so many times. I am kind of reminded of the story of the mother who told her son—

The CHAIRMAN. Let's do it quickly here.

Mr. BACHUS. I would like them to come back in September.

The CHAIRMAN. We are I think sufficiently entangled, all of us, so that, yes, we will see them again as well as we deal with this in September.

The hearing is adjourned.

[Whereupon, at 1:45 p.m., the hearing was adjourned.]

A P P E N D I X

July 24, 2009

Statement by Rep. Michele Bachmann
House Financial Services Committee
Hearing on the Administration's
Regulatory Restructuring Proposal

July 24, 2009

Thank you, Mr. Chairman. And, thank you, Secretary Geithner, for being here today.

The President's financial regulatory reform proposal is disappointing, at best, and clearly demonstrates to the American people that the Administration is not serious about ending the bailout mania, of which the American people have grown more than weary. To the contrary, it includes a government commitment to an everlasting cycle of taxpayer bailouts; an expansion of complex government bureaucracies which haven't worked in the past; a new government-run financial products commission which will no doubt stifle market innovation; and a permanent taxpayer bailout agency tasked with picking winners and losers and responsible for fixing private sector mistakes.

The moral hazard this proposal spreads is astonishing. It virtually takes a megaphone and announces, not just to Wall Street or even just to America, but to the world, that in our country, companies can grow "too big to fail" without risk and without loss, all compliments of the American taxpayer.

And, the utter silence on meaningful GSE (government-sponsored enterprise) reform is deafening. Secretary Geithner, no where in this document do you propose any substantive ideas to fix the fatal flaws inherent in the GSEs – flaws which are at the root of the financial crisis our country has experienced.

How can your only plan be to, and I quote, "engage in a wide-ranging initiative to develop recommendations on the future of Fannie Mae and Freddie Mac, and the Federal Home Loan Bank system," all of which you punt until the President's release of his 2011 budget? How can we ever expect to fix the problems in our financial system without making changes at the root cause?

We are better than this. Our constituents deserve better than this.

My Republican colleagues and I have introduced a plan which would reform our financial system responsibly, preserve important market-based forces and specifically prohibit government bailouts.

We build upon the existing bankruptcy code to ensure the orderly resolution of non-bank corporations and financial institutions – no matter how large or small. There are laws on the books and precedents set which impartial bankruptcy judges should follow to unwind distressed companies without putting their losses on the shoulders of taxpayers.

Our bill also creates a Market Stability and Capital Adequacy Board that would be tasked with monitoring all sectors of the financial system, how they are interconnected and whether their size and scope could jeopardize the safety and soundness of our system.

And unlike the President's proposal, it addresses the Fannie and Freddie mess by ending their taxpayer subsidies and privatizing them within a set time frame.

Our message is loud and clear: no more uncertainty, no more guessing games, and no more bailouts. This is what our country desperately needs.

I look forward to today's discussion and thank the panelists for being here today.

Thank you, Mr. Chairman, and I yield back the balance of my time.

OPENING STATEMENT OF REP. MELVIN WATT

Financial Services Committee Hearing Entitled, "Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals-Part Two"

Friday, July 24, 2009

Good morning. We are here today to hear from the Administration and the federal banking regulators on the merits of the Obama Administration's proposal for financial regulatory reform. First, let me offer a warm welcome to Joseph A. Smith, the Commissioner of Banks for my home state, the great State of North Carolina. We look forward to your testimony on behalf of the Conference of State Bank Supervisors.

Some people have short memories. Let us not forget that less than a year ago – in September 2008 – we experienced a severe financial shock that almost resulted in the complete meltdown of the U. S. economy and other economies around the world. Many agree that unfair and deceptive financial products coupled with weak regulation – or no regulation at all – contributed heavily to the financial collapse. The status quo is simply unacceptable.

The Administration has come forward with a comprehensive proposal for financial regulatory reform that goes too far for some people, and not far enough for others. The part of the Administration proposal that has received the most public comment, at least so far, is the creation of an independent Consumer Financial Protection Agency (CFPA) whose sole mission would be to protect consumers. Some have reflexively opposed the idea of a consumer agency, but the public is demanding protection against predatory, unfair and deceptive consumer financial products that have helped to wipe out billions in consumer wealth. The public also demands accountability for financial companies, particularly ones that have received taxpayer bailouts.

We are at a critical crossroads in the nation's history. In the wake of the Great Depression, Congress drafted rules that served us well for 75 years. We are facing another once-in-a-generation opportunity to fashion rules that should serve us well for the next 75 years and beyond. Today's hearing is one more step in the process to receive information from experts that will allow us to develop clear rules of the road, protect consumers, eliminate gaps in regulation and create a level playing field for all financial services providers. This will ultimately help the safety and soundness of the banking system and create an environment of economic prosperity for all Americans.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

REGULATORY PERSPECTIVES ON
FINANCIAL REGULATORY REFORM PROPOSALS

before the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

July 24, 2009

2128 Rayburn House Office Building

Chairman Frank, Ranking Member Bachus and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on the importance of reforming our financial regulatory system. The issues under discussion today rival in importance those before the Congress in the wake of the Great Depression.

The proposals put forth by the Administration regarding the structure of the financial system, the supervision of financial entities, the protection of consumers, and the resolution of organizations that pose a systemic risk to the economy provide a useful framework for discussion of areas in vital need of reform. However, these are complex issues that can be addressed in a number of different ways. We all agree that we must get this right and enact regulatory reforms that address the fundamental causes of the current crisis within a carefully constructed framework that guards against future crises.

It is clear that one of these causes was the presence of significant regulatory gaps within the financial system. Differences in the regulation of capital, leverage, complex financial instruments, and consumer protection provided an environment in which regulatory arbitrage became rampant. Reforms are urgently needed to close these regulatory gaps.

At the same time, we must recognize that much of the risk in recent years was built up, within and around, financial firms that were already subject to extensive regulation and prudential supervision. One of the lessons of the past several years is that regulation and prudential supervision alone are not sufficient to control risk-taking within a dynamic and complex financial system. Robust and credible mechanisms to ensure that market participants will actively monitor and control risk-taking must be in place.

We must find ways to impose greater market discipline on systemically important institutions. In a properly functioning market economy there will be winners and losers, and when firms -- through their own mismanagement and excessive risk taking – are no longer viable, they should fail. Actions that prevent firms from failing ultimately distort market mechanisms, including the market's incentive to monitor the actions of similarly situated firms. Unfortunately, the actions taken during the past year have reinforced the idea that some financial organizations are too big to fail. The solution must involve a practical, effective and highly credible mechanism for the orderly resolution of these institutions similar to that which exists for FDIC-insured banks. In short, we need an end to too big to fail.

The notion of too big to fail creates a vicious circle that needs to be broken. Large firms are able to raise huge amounts of debt and equity and are given access to the credit markets at favorable terms without consideration of the firms' risk profile. Investors and creditors believe their exposure is minimal since they also believe the government will not allow these firms to fail. The large firms leverage these funds and become even larger, which makes investors and creditors more complacent and more likely to extend credit and funds without fear of losses. In some respects, investors, creditors, and the firms themselves are making a bet that they are immune from the risks of failure and loss because they have become too big, believing that regulators will avoid taking action for fear of the repercussions on the broader market and economy.

If anything is to be learned from this financial crisis, it is that market discipline must be more than a philosophy to ward off appropriate regulation during good times. It must be enforced during difficult times. Given this, we need to develop a resolution regime that provides for the orderly wind-down of large, systemically important financial firms, without imposing large costs to the taxpayers. In contrast to the current situation, this new regime would not focus on propping up the current firm and its management. Instead, under the proposed authority, the resolution would concentrate on maintaining the liquidity and key activities of the organization so that the entity can be resolved in an orderly fashion without disrupting the functioning of the financial system. Losses would be borne by the stockholders and bondholders of the holding company, and senior management would be replaced. Without a new comprehensive resolution regime, we will be forced to repeat the costly, ad hoc responses of the last year.

My testimony discusses ways to address and improve the supervision of systemically important institutions and the identification of issues that pose risks to the financial system. The new structure should address such issues as the industry's excessive leverage, inadequate capital and over-reliance on short-term funding. In addition, the regulatory structure should ensure real corporate separateness and the separation of the bank's management, employees and systems from those affiliates. Risky activities, such as proprietary and hedge fund trading, should be kept outside of insured banks and subject to enhanced capital requirements.

Although regulatory gaps clearly need to be addressed, supervisory changes alone are not enough to address these problems. Accordingly, policymakers should focus on the elements necessary to create a credible resolution regime that can effectively address the resolution of financial institutions regardless of their size or complexity and assure that shareholders and creditors absorb losses before the government. This mechanism is at the heart of our proposals -- a bank and bank holding company resolution facility that will impose losses on shareholders and unsecured debt investors, while maintaining financial market stability and minimizing systemic consequences for the national and international economy. The credibility of this resolution mechanism would be further enhanced by the requirement that each bank holding company with subsidiaries engaged in non-banking financial activities would be required to have, under rules established by the FDIC, a resolution plan that would be annually updated and published for the benefit of market participants and other customers.

The combined enhanced supervision and unequivocal prospect of an orderly resolution will go a long way to assuring that the problems of the last several years are not repeated and that any problems that do arise can be handled without cost to the taxpayer.

Finally, I will discuss our support for the establishment of a new consumer protection agency for financial products. I also will recommend changes to assure appropriate recognition of the relationship between the safety and soundness of insured banks and their consumer practices in both the structure of the new agency, as well as its role in examination and enforcement.

Improving Supervision and Regulation

The widespread economic damage that has occurred over the past two years has called into question the fundamental assumptions regarding financial institutions and their supervision that have directed our regulatory efforts for decades. The unprecedented size and complexity of many of today's financial institutions raise serious issues regarding whether they can be properly managed and effectively supervised through existing mechanisms and techniques. Our current system clearly failed in many instances to manage risk properly and to provide stability. Many of the systemically significant entities that have needed federal assistance were already subject to extensive federal supervision. For various reasons, these powers were not used effectively and, as a consequence, supervision was not sufficiently proactive.

Insufficient attention was paid to the adequacy of complex institutions' risk management capabilities. Too much reliance was placed on mathematical models to drive risk management decisions. Notwithstanding the lessons from Enron, off-balance sheet-vehicles were permitted beyond the reach of prudential regulation, including holding company capital requirements. The failure to ensure that financial products were appropriate and sustainable for consumers caused significant problems not only for those consumers but for the safety and soundness of financial institutions. Lax lending standards employed by lightly regulated non-bank mortgage originators initiated a downward competitive spiral which led to pervasive issuance of unsustainable mortgages. Ratings agencies freely assigned AAA credit ratings to the senior tranches of mortgage securitizations without doing fundamental analysis of underlying loan quality. Trillions of dollars in complex derivative instruments were written to hedge risks associated with mortgage backed securities and other exposures. This market was, by and large, excluded from federal regulation by statute.

A strong case can be made for creating incentives that reduce the size and complexity of financial institutions. A financial system characterized by a handful of giant institutions with global reach and a single regulator is making a huge bet on the performance of those banks and that regulator.

Financial firms that pose systemic risks should be subject to regulatory and economic incentives that require these institutions to hold larger capital and liquidity buffers to mirror the heightened risk they pose to the financial system. In addition, restrictions on leverage and the imposition of risk-based premiums on institutions and their activities would act as disincentives to growth and complexity that raise systemic concerns. In contrast to the standards implied in the Basel II Accord, systemically important firms should face additional capital charges based on both their size and complexity. To address pro-cyclicality, the capital standards should provide for higher capital buffers that increase during expansions and are available to be drawn down during contractions. In addition, these firms should be subject to higher Prompt Corrective Action standards under U.S. laws and holding company capital requirements that are no less stringent than those applicable to insured banks. Regulators also should take into account off-balance-sheet assets and conduits as if these risks were on-balance-sheet.

The Need for a Financial Services Oversight Council

The significant size and growth of unsupervised financial activities outside the traditional banking system -- in what is termed the shadow financial system -- has made it all the more difficult for regulators or market participants to understand the real dynamics of either bank credit markets or public capital markets. The existence of one regulatory framework for insured institutions and a much less effective regulatory scheme for non-bank entities created the conditions for arbitrage that permitted the development of risky and harmful products and services outside regulated entities.

A distinction should be drawn between the direct supervision of systemically-significant financial firms and the macro-prudential oversight and regulation of developing risks that may pose systemic risks to the U.S. financial system. The former appropriately calls for the identification of a prudential supervisor for any potential systemically significant entity. Entities that are already subject to a prudential supervisor, such as insured depository institutions and financial holding companies, should retain those supervisory relationships.

The macro-prudential oversight of system-wide risks requires the integration of insights from a number of different regulatory perspectives -- banks, securities firms, holding companies, and perhaps others. Only through these differing perspectives can there be a holistic view of developing risks to our system. As a result, for this latter role, the FDIC supports the creation of a Council to oversee systemic risk issues, develop needed prudential policies and mitigate developing systemic risks. In addition, for systemic entities not already subject to a federal prudential supervisor, this Council should be empowered to require that they submit to such oversight, presumably as a financial holding company under the Federal Reserve -- without subjecting them to the activities restrictions applicable to these companies.

Supervisors across the financial system failed to identify the systemic nature of the risks before they were realized as widespread industry losses. The performance of the regulatory system in the current crisis underscores the weakness of monitoring systemic risk through the lens of individual financial institutions and argues for the need to assess emerging risks using a system-wide perspective. The Administration's proposal addresses the need for broader-based identification of systemic risks across the economy and improved interagency cooperation through the establishment of a new Financial Services Oversight Council. The Oversight Council described in the Administration's proposal currently lacks sufficient authority to effectively address systemic risks.

In designing the role of the Council, it will be important to preserve the longstanding principle that bank regulation and supervision are best conducted by independent agencies. Careful attention should be given to the establishment of appropriate safeguards to preserve the independence of financial regulation from political influence. The Administration's plan gives the role of Chairman of the Financial Services Oversight Council to the Secretary of the Treasury. To ensure the independence and authority of the Council, consideration should be given to a configuration that would establish the Chairman of the Council as a Presidential appointee, subject to Senate confirmation. This would provide additional independence for the Chairman and enable the Chairman to focus full time on attending to the affairs of the Council and supervising Council staff. Other members on the Council could include, among others, the federal financial institution, securities and commodities regulators. In addition, we would suggest that the Council include an odd number of members in order to avoid deadlocks.

The Council should complement existing regulatory authorities by bringing a macro-prudential perspective to regulation and being able to set or harmonize prudential standards to address systemic risk. Drawing on the expertise of the federal regulators, the Oversight Council should have broad authority and responsibility for identifying institutions, products, practices, services and markets that create potential systemic risks, implementing actions to address those risks, ensuring effective information flow, and completing analyses and making recommendations. In order to do its job, the Council needs the authority to obtain any information requested from systemically important entities.

The crisis has clearly revealed that regulatory gaps, or significant differences in regulation across financial services firms, can encourage regulatory arbitrage. Accordingly, a primary responsibility of the Council should be to harmonize prudential regulatory standards for financial institutions, products and practices to assure that market participants cannot arbitrage regulatory standards in ways that pose systemic risk. The Council should evaluate differing capital standards which apply to commercial banks, investment banks, and investment funds to determine the extent to which differing standards circumvent regulatory efforts to contain excess leverage in the system. The Council could also undertake the harmonization of capital and margin requirements applicable to all OTC derivatives activities -- and facilitate interagency efforts to encourage greater standardization and transparency of derivatives activities and the migration of these activities onto exchanges or Central Counterparties.

The Council also could consider requiring financial companies to issue contingent debt instruments -- for example, long-term debt that, while not counting towards the satisfaction of regulatory capital requirements, automatically converts to equity under specific conditions. Conditions triggering conversion could include the financial companies' capital falling below prompt corrective action mandated capital levels or regulators declaring a systemic emergency. Financial companies also could be required to issue a portion of their short-term debt in the form of debt instruments that similarly automatically convert to long-term debt under specific conditions, perhaps tied to liquidity. Conversion of long-term debt to equity would immediately recapitalize banks in capital difficulty. Conversion of short-term debt to long-term debt would ameliorate liquidity problems.

Also, the Council should be able to harmonize rules regarding systemic risks to serve as a floor that could be met or exceeded, as appropriate, by the primary prudential regulator. Primary regulators would be charged with enforcing the requirements set by the Council. However, if the primary regulators fail to act, the Council should have the authority to do so. The standards set by the Council should be designed to provide incentives to reduce or eliminate potential systemic risks created by the size or complexity of individual entities, concentrations of risk or market practices, and other interconnections between entities and markets. Any standards set by the Council should be construed as a minimum floor for regulation that can be exceeded, as appropriate, by the primary prudential regulator.

The Council should have the authority to consult with systemic and financial regulators from other countries in developing reporting requirements and in identifying potential systemic risk in the global financial market. The Council also should report to Congress annually about its efforts, identify emerging systemic risk issues and recommend any legislative authority needed to mitigate systemic risk.

Some have suggested that a council approach would be less effective than having this authority vested in a single agency because of the perception that a deliberative council such as this would need additional time to address emergency situations that might arise from time to time. Certainly, some additional thought and effort will be needed to address any dissenting views in council deliberations. However, a Council with regulatory agency participation will provide for an appropriate system of checks and balances to ensure that decisions reflect the various interests of public and private stakeholders. In this regard, it should be noted that the board structure at the FDIC, with the participation of the Comptroller of the Currency and the Director of the Office of Thrift Supervision, is not very different from the way the Council would operate. In the case of the FDIC, quick decisions have been made with respect to systemic issues and emergency bank resolutions on many occasions. Based on our experience with a board structure, we believe that decisions could be made quickly by a deliberative council.

Resolution Authority

Even if risk-management practices improve dramatically and we introduce effective macro-prudential supervision, the odds are that a large systemically significant firm will become troubled or fail at some time in the future. The current crisis has clearly demonstrated the need for a single resolution mechanism for financial firms that will preserve stability while imposing the losses on shareholders and creditors and replacing senior management to encourage market discipline. A timely, orderly resolution process that could be applied to both banks and non-bank financial institutions, and their holding companies, would prevent instability and contagion and promote fairness. It would enable the financial markets to continue to function smoothly, while providing for an orderly transfer or unwinding of the firm's operations. The resolution process would ensure that there is the necessary liquidity to complete transactions that are in process at the time of failure, thus addressing the potential for systemic risk without creating the expectation of a bailout.

Under the new resolution regime, Congress should raise the bar higher than existing law and eliminate the possibility of open assistance for individual failing entities. The new resolution powers should result in the shareholders and unsecured creditors taking losses prior to the government, and consideration also should be given to imposing some haircut on secured creditors to promote market discipline and limit costs potentially borne by the government.

Limitations of the current resolution authority

The FDIC's resolution powers are very effective for most failed bank situations (see Appendix). However, systemic financial organizations present additional issues that may complicate the FDIC's process of conducting an efficient and economical resolution. As noted above, many financial activities today take place in financial firms that are outside the insured depository institution where the FDIC's existing authority does not reach. These financial firms must be resolved through the bankruptcy process, as the FDIC's resolution powers only apply to insured depository institutions. Resolving large complex financial firms through the bankruptcy process can be destabilizing to regional, national and international economies since the timing is uncertain and the process can be complex and protracted and may vary by jurisdiction.

By contrast, the powers that are available to the FDIC under its statutory resolution authorities can resolve financial entities much more rapidly than under bankruptcy. The FDIC bears the unique responsibility for resolving failed depository institutions and is therefore able to plan for an orderly resolution process. Through this process, the FDIC works with the primary supervisor to gather information on a troubled bank before it fails and plans for the transfer or orderly wind-down of the bank's assets and businesses. In doing so, the FDIC is able to maintain public confidence and perform its public policy mandate of ensuring financial stability.

Resolution authority for systemically important financial firms

To ensure an orderly and comprehensive resolution mechanism for systemically important financial firms, Congress should adopt a resolution process that adheres to the following principles:

- The resolution scheme and processes should be transparent, including the imposition of losses according to an established claims priority where stockholders and creditors, not the government, are in the first loss position.

- The resolution process should seek to minimize costs and maximize recoveries. The resolution should be conducted to achieve the least cost to the government as a whole with the FDIC allocating the losses among the various affiliates and subsidiaries proportionate to their responsibilities for the cost of the failure.

- There should be a unified resolution process housed in a single entity.

- The resolution entity should have the responsibility and the authority to set assessments to fund systemic resolutions to cover working capital and unanticipated losses.

- The resolution process should allow the continuation of any systemically significant operations, but only as a means to achieve a final resolution of the entity. A bridge mechanism, applicable to the parent company and all affiliated entities, allows the government to preserve systemically significant functions. It enables losses to be imposed on market players who should appropriately bear the risk. It also creates the possibility of multiple bidders for the financial organization and its assets, which can reduce losses to the receivership.

- The resolution entity must effectively manage its financial and operational risk exposure on an on-going basis. The receivership function necessarily entails certain activities such as the establishment of bridge entities, implementing purchase and assumption agreements, claims processing, asset liquidation or disposition and franchise marketing. The resolving entity must establish, maintain and implement these functions for a covered parent company and all affiliated entities.

Financial firms often operate on a day-to-day basis without regard to the legal structure of the firm. That is, employees of the holding company may provide vital services to a subsidiary bank because the same function exists in both the bank and the holding company. However, this intertwining of functions can present significant issues when trying to wind down the firm. For this reason, there should be requirements that mandate greater functional autonomy of holding company affiliates.

In addition, to facilitate the resolution process, the holding companies should have an acceptable resolution plan that could facilitate and guide the resolution in the event of a failure. Through a carefully considered rulemaking, each financial holding company should be required to make conforming changes to their organization to ensure that the resolution plans could be effectively implemented. The plans should be updated annually and made publicly available.

Congress also should alter the current process that establishes a procedure for open bank assistance that benefits shareholders and eliminates the requirement that the resolution option be the least costly to the Deposit Insurance Fund (DIF). As stated above, shareholders and creditors should be required to absorb losses from the institution's failure before the government.

Current law allows for an exception to the standard claims priority where the failure of one or more institutions presents "systemic risk." In other words, once a systemic risk determination is made, the law permits the government to provide assistance irrespective of the least cost requirement, including "open bank" assistance which inures to the benefit of shareholders. The systemic risk exception is an extraordinary procedure, requiring the approval of super majorities of the FDIC Board, the Federal Reserve Board, and the Secretary of the Treasury in consultation with the President.

We believe that the systemic risk exception should be narrowed so that it is available only where there is a finding that support for open institutions is necessary to address problems which pervade the system, as opposed to problems which are particular to an individual institution. Whatever support is provided should be broadly available and justified in that it will result in least cost to the government as a whole. If the government suffers a loss as a result an institution's performance under this exception, the institution should be required to be resolved in accordance with the standard claims priority.

Had this narrower systemic risk exception been in place during the past year, open institution assistance would not have been permitted for individual institutions. An individual institution would likely have been put into a bridge entity, with shareholders and unsecured creditors taking losses before the government. Broader programs that benefit the entire system, such as the Temporary Liquidity Guarantee Program and the Federal Reserve's liquidity facilities, would have been permitted. However if any individual institution participating in these programs had caused a loss, the normal resolution process would be triggered.

The initiation of this type of systemic assistance should require the same concurrence of the supermajority of the FDIC Board, the Federal Reserve Board and the Treasury Department (in consultation with the President) as under current law. No single government entity should be able to unilaterally trigger a resolution strategy outside the defined parameters of the established resolution process. Further, to ensure transparency, these determinations should be made in consultation with Congress, documented and reviewed by the Government Accountability Office.

Other improvements to the resolution process

Consideration should be given to allowing the resolution authority to impose limits on financial institutions' abilities to use collateral to mitigate credit risk ahead of the government for some types of activities. The ability to fully collateralize credit risks removes an institution's incentive to underwrite exposures by assessing a counterparty's ability to perform from revenues from continuing operations. In addition, the recent crisis has demonstrated that collateral calls generate liquidity pressures that can magnify systemic risks. For example, up to 20 percent of the secured claim for companies with derivatives claims against the failed firm could be haircut if the government is expected to suffer losses. This would ensure that market participants always have an interest in monitoring the financial health of their counterparties. It also would limit the sudden demand for more collateral because the protection could be capped and also help to protect the government from losses. Other approaches could include increasing regulatory and supervisory disincentives for excessive reliance on secured borrowing.

As emphasized at the beginning of this statement, a regulatory and resolution structure should, among other things, ensure real corporate separateness and the separation of the bank's management, employees, and systems from those of its affiliates. Risky activities, such as proprietary trading, should be kept outside the bank. Consideration also should be given to enhancing restrictions against transactions with affiliates, including the elimination of 23A waivers. In addition, the resolution process could be greatly enhanced if companies were required to have an acceptable resolution plan that and guides the liquidation in the event of a failure. Requiring that the plans be updated annually and made publicly available would provide additional transparency that would improve market discipline.

Funding Systemic Resolutions

To be credible, a resolution process for systemically significant institutions must have the funds necessary to accomplish the resolution. It is important that funding for this resolution process be provided by the set of potentially systemically significant financial firms, rather than by the taxpayer. To that end, Congress should establish a Financial Company Resolution Fund (FCRF) to provide working capital and cover unanticipated losses for the resolution.

One option for funding the FCRF is to pre-fund it through a levy on larger financial firms -- those with assets above a certain large threshold. The advantage of pre-funding the FCRF is the ability to impose risk-based assessments on large or complex institutions that recognize their potential risks to the financial system. This system also could provide an economic incentive for an institution not to grow too large. In addition, building the fund over time through consistent levies would avoid large procyclical charges during times of systemic stress.

Alternatively, the FCRF could be funded after a systemic failure through an assessment on other large, complex institutions. The advantage to this approach is that it does not take capital out of institutions until there is an actual systemic failure. The disadvantages of this approach are that it is not risk sensitive, it is initially dependent on the ability to borrow from the Treasury, it assess institutions when they can least afford it and the institution causing the loss is the only one that never pays an assessment.

The systemic resolution entity should have the authorities needed to manage this resolution fund, as the FDIC does for the DIF. The entity should also be authorized to borrow from the Treasury if necessary, but those borrowings should be repaid by the financial firms that contribute to the FCRF.

International issues

Some significant challenges exist for international banking resolution actions since existing bank crisis management and resolution arrangements are not designed to deal specifically with cross-border banking problems. However, providing resolution authority to a specific entity in the U.S. would enhance the ability to enter into definitive memoranda of understanding with other countries. Many of these same countries have recognized the benefits of improving their resolution regimes and are considering improvements. This provides a unique opportunity for the U.S. to be the leader in this area and provide a model for the effective resolution of failed entities.

Dealing with cross-border banking problems is difficult. For example, provisions to allow the transfer of assets and liabilities to a bridge bank or other institution may have limited effectiveness in a cross-border context because these actions will not necessarily be recognized or promptly implemented in other jurisdictions. In the absence of other arrangements, it is presumed that ring fencing will occur. Ring fencing may secure the interests of creditors or individuals in foreign jurisdictions to the detriment of the resolution as a whole.

In the United States, the Foreign Bank Supervision Enhancement Act of 1991 requires foreign banks that wish to do a retail deposit-taking business to establish a separately chartered subsidiary bank. This structural arrangement ensures that assets and capital will be available to U.S. depositors or the FDIC should the foreign parent bank and its U.S. subsidiary experience difficulties. In this sense, it is equivalent to "pre-packaged" ring fencing. An idea to consider would be to have U.S. banks operating abroad to do so through bank subsidiaries. This could streamline the FDIC's resolution process for a U.S. bank with foreign operations. U.S. operations would be resolved by the FDIC and the foreign operations by the appropriate foreign regulator. However, this would be a major change and could affect the ability of U.S. banks to attract foreign deposits overseas.

Resolution Authority for Depository Institution Holding Companies

To have a process that not only maintains liquidity in the financial system but also terminates stockholders' rights, it is important that the FDIC have the authority to resolve both systemically important and non-systemically important depository institution holding companies, affiliates and majority-owned subsidiaries in the case of failed or failing insured depository institutions. When a failing bank is part of a large, complex holding company, many of the services essential for the bank's operation may reside in other portions of the holding company, beyond the FDIC's authority. The loss of essential services can make it difficult to preserve the value of a failed institution's assets, operate the bank or resolve it efficiently. The business operations of large, systemic financial organizations are intertwined with business lines that may span several legal entities. When one entity is in the FDIC's control while the other is not, it significantly complicates resolution efforts. Unifying the holding company and the failed institution under the same resolution authority can preserve value, reduce costs and provide stability through an effective resolution. Congress should enhance the authority of the FDIC to resolve the entire organization in order to achieve a more orderly and comprehensive resolution consistent with the least cost to the DIF.

When the holding company structure is less complex, the FDIC may be able to effect a least cost resolution without taking over the holding company. In cases where the holding company is not critical to the operations of the bank or thrift, the FDIC should be able to opt out -- that is, allow the holding company to be resolved through the bankruptcy process. The decision on whether to employ enhanced resolution powers or allow the bank holding company to declare bankruptcy would depend on which strategy would result in the least cost to the DIF. Enhanced authorities that allow the FDIC to efficiently resolve failed depository institutions that are part of a complex holding company structure when it achieves the least costly resolution will provide immediate efficiencies in bank resolutions.

Consumer Protection

Many of the current problems affecting the safety and soundness of the financial system were caused by a lack of strong, comprehensive rules against abusive lending practices applying to both banks and non-banks, and lack of a meaningful examination and enforcement presence in the non-bank sector. Products and practices that strip individual and family wealth undermine the foundation of the economy. As the current crisis demonstrates, increasingly complex financial products combined with frequently opaque marketing and disclosure practices result in problems, not just for consumers, but for institutions and investors as well. As the ultimate insurer of over $6 trillion in deposits, the FDIC has both the responsibility and vital need to ensure that consumer compliance and safety and soundness are appropriately integrated.

To protect consumers from potentially harmful financial products, the Administration has proposed to establish a single primary federal consumer-products regulator, the Consumer Financial Protection Agency (CFPA). The CFPA would regulate providers of consumer credit, savings, payment and other financial products and services. Under the proposal, the agency would be the sole rule-making authority for consumer financial protection statutes and would have supervisory and enforcement authority over all providers of consumer credit. It would set a floor on consumer regulation and supervision and would guarantee the ability of states to adopt and enforce stricter laws for institutions of all types, regardless of charter.

The proposal would eliminate regulatory gaps between insured depository institutions and non-bank providers of financial products and services by establishing strong, consistent consumer protection standards across the board. It also would address another gap by giving the CFPA authority to examine non-bank financial service providers that are not currently examined by the federal banking agencies. In addition, the Administration's proposal would eliminate the potential for regulatory arbitrage that exists because of federal preemption of certain State laws. By creating a floor for consumer protection and by allowing more protective State consumer laws to apply to all providers of financial products and services operating within a State, the CFPA should significantly improve consumer protection.

The Administration's proposal could be made even more effective with a few targeted, but critical changes, which would strengthen oversight for all financial service providers, as well as assure no disruption in consumer compliance oversight of banks. As the banking regulators' experience over the past few years has graphically illustrated, consumer protection issues and the safety and soundness of insured institutions go hand-in-hand. There is a direct correlation between effective consumer compliance programs and safe and sound institutions. Examination and supervision for safety and soundness and consumer protection need to be closely coordinated and reflect a comprehensive understanding of institutions' management, operations, policies, and practices, and the bank supervisory process as a whole. Consumer protection and risk supervision both benefit from the synergies created by this holistic approach and the ready and timely access to expertise and critical information. Separating consumer protection examination and supervision from those other supervisory efforts could undermine the effectiveness of both, with the unintended consequence of weakening bank oversight.

Also, since most of the problem products and practices that contributed to the current crisis began outside the banking industry, focusing examination and enforcement on the non-bank sector is key to addressing most of the abusive lending practices faced by consumers. For example, a recent Treasury Department report indicated that 94 percent of high cost mortgages were made outside the traditional banking sector.[1] However, the Administration proposal does not address the means by which the CFPA will be able to garner the resources or and infrastructure to supervise products and services offered by non-banks. Simply moving the examination and supervision functions from the financial institution regulators to the FCPA will not address the lack of supervision of non-bank entities because the financial institution examiners are already fully engaged with their banking sector institutions. Further, spreading the available resources over both non-banking and banking institutions would only serve to diminish the CFPA's effectiveness overall.

The CFPA should have sole rule-writing authority over consumer financial products and services and the federal banking regulators should be required to examine for and enforce those standards. If the bank regulators are not performing this role properly, the CFPA should retain backup examination and enforcement authority to address any situation where it determines that a banking agency is providing insufficient

[1] Financial Regulatory Reform: A New Foundation, U.S. Department of the Treasury (June 17, 2009), at 69.

supervision. By freeing the CFPA from direct supervision and enforcement of depository institutions, the CFPA would be able to focus its examination and enforcement resources on the non-bank financial providers that provide financial products and services that have not previously been subject to federal examination and clear supervisory standards.

Accordingly, the federal banking agencies should retain the authority to examine and supervise insured institutions for both consumer protection compliance and safety and soundness. The CFPA should be given the authority to examine and supervise non-bank consumer product and service providers and back-up enforcement authority over insured depository institutions. Giving the CFPA authority to write rules for all consumer product and service providers would ensure strong and uniform consumer protection standards for all consumer product and service providers.

In addition, as the only federal regulator with exposure to all insured financial institutions, the FDIC should be represented on the CFPA Board. The FDIC is the primary federal supervisor for the largest number of banks (including many larger ones), and maintains an active examination staff on-site in the largest major banks as back up supervisor. The FDIC's direct supervision of the majority of the nation's community banks provides it with a unique perspective and a "Main Street" orientation that resulted in it being an early proponent of affordable and sustainable mortgage loan modifications, improved economic inclusion, and the prevention of abusive lending practices. Moreover, the FDIC's deposit insurance function involves a significant consumer protection role with regard to consumer deposits that affects all institutions, but is unique to the FDIC.

Some have questioned why prudential supervisors should have a position on the CFPA board when the views of the CFPA would not necessarily be reflected in the activities of the prudential supervisor. To address this criticism, the FDIC would support the addition of the CFPA Chairman as a member of our board of directors. The Administration's proposal to merge the two national chartering agencies will create a vacancy on the FDIC Board that could be filled by the CFPA Chairman. This would increase the visibility of consumer protection as a core mission of the FDIC. In addition, this type of reciprocal arrangement could provide benefits for both safety and soundness and consumer protection regulation and supervision.

Conclusion

The current financial crisis demonstrates the need for changes in the supervision and resolution of financial institutions, especially those that are systemically important to the financial system. The FDIC stands ready to work with Congress to ensure that the appropriate steps are taken to strengthen our supervision and regulation of all financial institutions -- especially those that pose a systemic risk to the financial system.

I would be pleased to answer any questions from the Committee.

APPENDIX A

The FDIC's resolution authority

The FDIC has standard procedures that go into effect when an FDIC-insured bank or thrift is in danger of failing. When the FDIC is notified that an insured institution is in danger of failing, we begin assembling an information package for bidders that specifies the structure and terms of the transaction. FDIC staff review the bank's books, contact prospective bidders, and begin the process of auctioning the bank -- usually prior to its failure -- to achieve the best return to the bank's creditors and the Deposit Insurance Fund (DIF).

When the appropriate federal or state banking authority closes an insured depository institution, it appoints the FDIC as conservator or receiver. On the day of closure by the chartering entity, the FDIC takes control of the bank and in most cases removes the failed bank's management. Shareholder control rights are terminated, although shareholders maintain a claim on any residual value remaining after depositors' and other creditors' claims are satisfied.

Most bank failures are resolved by the sale of some or all of the bank's business to an acquiring bank. FDIC staff work with the acquiring bank, and make the transfer as unobtrusive, seamless and efficient as possible. Generally, all the deposits that are transferred to the acquiring bank are made immediately available on-line or through ATMs. The bank usually reopens the next business day with a new name and under the control of the acquiring institution. Those assets of the failed bank that are not taken by the acquiring institution are then liquidated by the FDIC.

Sometimes banks must be closed quickly because of an inability to meet their funding obligations. These "liquidity failures" may require that the FDIC set up a bridge bank. The bridge bank structure allows the FDIC to provide liquidity to continue the bank's operations until the FDIC has time to market and sell the failed bank. The creation of a bridge also terminates stockholders rights as described earlier.

Perhaps the greatest benefit of the FDIC's process is the quick reallocation of resources. It is a process that can be painful to shareholders, creditors and bank employees, but history has shown that early recognition of losses with closure and sale of non-viable institutions is the fastest path back to economic health.

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Statement of

Ben S. Bernanke

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

July 24, 2009

Chairman Frank, Ranking Member Bachus, and other members of the Committee, I appreciate the opportunity to discuss how to improve the U.S. financial regulatory system so as to contain systemic risk and to address the related problem of too-big-to-fail financial institutions. Experience over the past two years clearly demonstrates that the United States needs a comprehensive strategy to help prevent financial crises and to mitigate the effects of crises that may occur.

The roots of this crisis lie in part in the fact that regulatory powers and capacities lagged the increasingly tight integration of conventional lending activities with the issuance, trading, and financing of securities. This crisis did not begin with depositor runs on banks, but with investor runs on firms that financed their holdings of securities in the wholesale money markets. An effective agenda for containing systemic risk thus requires adjustments by all our financial regulatory agencies under existing authorities. It also invites action by the Congress to fill existing gaps in regulation, remove impediments to consolidated oversight of complex institutions, and provide the instruments necessary to cope with serious financial problems that do arise.

In keeping with the Committee's interest today in a systemic risk agenda, I will identify some of the key administrative and legislative elements that should be a part of that agenda. Ensuring that all systemically important financial institutions are subject to effective consolidated supervision is a critical first step. Second, a more macroprudential outlook--that is, one that takes into account the safety and soundness of the financial system as a whole, as well as individual institutions--needs to be incorporated into the supervision and regulation of these firms and financial institutions more generally. Third, better and more formal mechanisms should be established to help identify, monitor, and address potential or emerging systemic risks across the financial system as a whole, including gaps in regulatory or supervisory coverage that could present systemic risks. A council with broad representation across agencies and departments concerned with financial supervision and regulation is one approach to this goal. Fourth, a new resolution process for systemically important nonbank financial firms should be created that would allow the government to wind down a troubled systemically important firm in an orderly manner. Fifth, all systemically important payment, clearing, and settlement arrangements should be subject to consistent and robust oversight and prudential standards.

The role of the Federal Reserve in a reoriented financial regulatory system derives, in our view, directly from its position as the nation's central bank. Financial stability is integral to the achievement of maximum employment and price stability, the dual mandate that Congress has conferred on the Federal Reserve as its objectives in the conduct of monetary policy. Indeed, there are some important synergies between systemic risk regulation and monetary policy, as insights garnered from each of those functions informs the performance of the other. Close familiarity with private credit relationships, particularly among the largest financial institutions and through critical payment and settlement systems, makes monetary policy makers better able to anticipate how their actions will affect the economy. Conversely, the substantial economic analysis that accompanies monetary policy decisions can reveal potential vulnerabilities of financial institutions.

While the improvements in the financial regulatory framework outlined above would involve some expansion of Federal Reserve responsibilities, that expansion would be an incremental and natural extension of the Federal Reserve's existing supervisory and regulatory responsibilities, reflecting the important relationship between financial stability and the roles of a central bank. An effective and comprehensive agenda for addressing systemic risk will also require new responsibilities for other federal agencies and departments, including the Treasury, Securities and Exchange Commission (SEC), Commodity Futures Trading Commission (CFTC), and Federal Deposit Insurance Corporation (FDIC).

Consolidated Supervision of Systemically Important Financial Institutions

The current financial crisis has clearly demonstrated that risks to the financial system can arise not only in the banking sector, but also from the activities of other financial firms--such as investment banks or insurance organizations--that traditionally have not been subject, either by law or in practice, to the type of regulation and consolidated supervision applicable to bank holding companies. While effective consolidated supervision of potentially systemic firms is not, by itself, sufficient to foster financial stability, it certainly is a necessary condition. The Administration's recent proposal for strengthening the financial system would subject *all* systemically important financial institutions to the same framework for prudential supervision on the same consolidated or group-wide basis that currently applies to bank holding companies. In doing so, it would also prevent systemically important firms that have become bank holding companies during the crisis from reversing this change and escaping prudential supervision in calmer financial times. While this proposal is an important piece of an agenda to contain systemic risk and the too-big-to-fail problem, it would not actually entail a significant expansion of the Federal Reserve's mandate.

The proposal would entail two tasks--first identifying, and then effectively supervising, these systemically important institutions. As to supervision, the Bank Holding Company Act of 1956 (BHCA) designates the Federal Reserve as the consolidated supervisor of all bank holding companies. That act provides the Federal Reserve a range of tools to understand, monitor and, when appropriate, restrain the risks associated with an organization's consolidated or group-wide activities. Under this framework, the Federal Reserve has the authority to establish consolidated capital requirements for bank holding companies. In addition, subject to certain limits I will discuss later, the act permits the Federal Reserve to obtain reports from and conduct examinations of a bank holding company and any of its subsidiaries. It also grants authority to require the organization or its subsidiaries to alter their risk-management practices or take other actions to address risks that threaten the safety and soundness of the organization.

Under the BHCA, the Federal Reserve already supervises some of the largest and most complex financial institutions in the world. In the course of the financial crisis, several large financial firms that previously were not subject to mandatory consolidated supervision--including Goldman Sachs, Morgan Stanley, and American Express--became bank holding companies, in part to assure market participants that they were subject to robust prudential supervision on a consolidated basis. While the number of additional financial institutions that would be subject to supervision under the Administration's approach would of course depend on standards or guidelines adopted by the Congress, the criteria offered by the Administration suggest to us that the initial number of newly regulated firms would probably be relatively limited. One important feature of this approach is that it provides ongoing authority to identify and supervise other firms that may become systemically important in the future, whether through organic growth or the migration of activities from regulated entities.

Determining precisely which firms would meet these criteria will require considerable analysis of the linkages between firms and markets, drawing as much or more on economic and financial analysis as on bank supervisory expertise. Financial institutions are systemically important if the failure of the firm to meet its obligations to creditors and customers would have significant adverse consequences for the financial system and the broader economy. At any point in time, the systemic importance of an individual firm depends on a wide range of factors. Obviously, the consequences of a firm's failure are more likely to be severe if the firm is large, taking account of both its on- and off-balance sheet activities. But size is far from the only relevant consideration. The impact of a firm's financial distress depends also on the degree to which it is interconnected, either receiving funding from, or providing funding to, other potentially systemically important firms, as well as on whether it performs crucial services that cannot easily or quickly be executed by other financial institutions. In addition, the impact varies over time: the more fragile the overall financial backdrop and the condition of other financial institutions, the more likely a given firm is to be judged systemically important. If the ability of the financial system to absorb adverse shocks is low, the threshold for systemic importance will more easily be reached. Judging whether a financial firm is systemically important is thus not a straightforward task, especially because a determination must be based on an assessment of whether the firm's failure would likely have systemic effects during a *future* stress event, the precise parameters of which cannot be fully known.

For supervision of firms identified as systemically important to be effective, we will need to build on lessons learned from the current crisis and on changes we are already undertaking in light of the broader range of financial firms that have come under our supervision in the last year. In October, we issued new consolidated supervision guidance for bank holding companies that provides for supervisory objectives and actions to be calibrated more directly to the systemic significance of individual institutions and bolsters supervisory expectations with respect to the corporate governance, risk management, and internal controls of the largest, most complex organizations.[1] We are also adapting our internal organization of supervisory activities to take

[1] See Supervision and Regulation Letter 08-9, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations," and the associated interagency guidance.

better advantage of the information and insight that the economic and financial analytic capacities of the Federal Reserve can bring to bear in financial regulation.

The recently completed Supervisory Capital Assessment Process (SCAP) reflects some of these changes in the Federal Reserve's system for prudential supervision of the largest banking organizations. This unprecedented process specifically incorporated forward-looking, cross-firm, and aggregate analyses of the 19 largest bank holding companies, which together control a majority of the assets and loans within the financial system. Importantly, supervisors in the SCAP defined a uniform set of parameters to apply to each firm being evaluated, which allowed us to evaluate on a consistent basis the expected performance of the firms, drawing on individual firm information and independently estimated outcomes using supervisory models. Drawing on this experience, we will conduct horizontal examinations on a periodic basis to assess key operations, risks, and risk-management activities of large institutions.

We also plan to create a quantitative surveillance program for large, complex financial organizations that will use supervisory information, firm-specific data analysis, and market-based indicators to identify developing strains and imbalances that may affect multiple institutions, as well as emerging risks to specific firms. Periodic scenario analyses across large firms will enhance our understanding of the potential impact of adverse changes in the operating environment on individual firms and on the system as a whole. This work will be performed by a multi-disciplinary group composed of our economic and market researchers, supervisors, market operations specialists, and accounting and legal experts. This program will be distinct from the activities of on-site examination teams so as to provide an independent supervisory perspective, as well as to complement the work of those teams.

To be fully effective, consolidated supervisors must have clear authority to monitor and address safety and soundness concerns and systemic risks in all parts of an organization, working in coordination with other supervisors wherever possible. As the crisis has demonstrated, the assessment of nonbank activities is essential to understanding the linkages between depository and nondepository subsidiaries and the risk-profile of the organization as a whole. The Administration's proposal would make useful modifications to the provisions added to the law in 1999 that limit the ability of the Federal Reserve to monitor and address risks within an organization and its subsidiaries on a group-wide basis.[2]

A Macroprudential Approach to Supervision and Regulation

The existing framework for the regulation and supervision of banking organizations is focused primarily on the safety and soundness of individual organizations, particularly their insured depository institutions. As the Administration's proposal recognizes, the resiliency of the financial system could be improved by incorporating a more explicit macroprudential approach to supervision and regulation. A macroprudential outlook, which considers interlinkages and interdependencies among firms and markets that could threaten the financial system in a crisis, complements the current microprudential orientation of bank supervision and regulation.

Indeed, a more macroprudential focus is essential in light of the potential for explicit regulatory identification of systemically important firms to exacerbate the "too big to fail" problem. Unless countervailing steps are taken, the belief by market participants that a particular firm is too big to fail, and that shareholders and creditors of the firm may be partially or fully

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[2] The Administration's proposal also would close the loophole in current law that allowed certain investment banks, as well as other financial and nonfinancial firms, to acquire control of a federally insured industrial loan company (ILC) while avoiding the prudential framework that Congress established for the corporate owners of other full-service insured banks. The Board has for many years supported such a change.

protected from the consequences of a failure, has many undesirable effects. It materially weakens the incentive of shareholders and creditors of the firm to restrain the firm's risk-taking, provides incentives for financial firms to become very large in order to be perceived as too big to fail, and creates an unlevel competitive playing field with smaller firms that may not be regarded as having implicit government support.

Creation of a mechanism for the orderly resolution of systemically important nonbank financial firms, which I will discuss later, should help remediate this problem. In addition, capital, liquidity, and risk-management requirements for systemically important firms will need to be strengthened to help counteract moral hazard effects, as well as the greater potential risks these institutions pose to the financial system and to the economy. We believe that the agency responsible for supervision of these institutions should have the authority to adopt and apply such requirements, and thus have clear accountability for their efficacy. Optimally, these requirements should be calibrated based on the relative systemic importance of the institution, a different measure than a firm's direct credit and other risk exposures as calculated in traditional capital or liquidity regulation.

It may also be beneficial for supervisors to require that systemically important firms maintain specific forms of capital so as to increase their ability to absorb losses outside of a bankruptcy or formal resolution procedure. Such capital could be in contingent form, converting to common equity only when necessary to mitigate systemic risk. A macroprudential approach also should be reflected in regulatory capital standards more generally, so that banks are required to increase their capital levels in good times in order to create a buffer that can be drawn down as economic and financial conditions deteriorate.

The development and implementation of capital standards for systemically important firms is but one of many elements of an effective macroprudential approach to financial regulation. Direct and indirect exposures among systemically important firms are an obvious source of interdependency and potential systemic risk. Direct credit exposures may arise from lending, loan commitments, guarantees, or derivative counterparty relationships among institutions. Indirect exposures may arise through exposures to a common risk factor, such as the real estate market, that could stress the system by causing losses to many firms at the same time, through common dependence on potentially unstable sources of short-term funding, or through common participation in payment, clearing, or settlement systems.

While large, correlated exposures have always been an important source of risk and an area of focus for supervisors, macroprudential supervision requires special attention to the interdependencies among systemically important firms that arise from common exposures. Similarly, there must be monitoring of exposures that could grow significantly in times of system-wide financial stress, such as those arising from OTC derivatives or the sponsorship of off-balance-sheet financing conduits funded by short-term liabilities that are susceptible to runs. One tool that would be useful in identifying such exposures would be the cross-firm horizontal reviews that I discussed earlier, enhanced to focus on the collective effects of market stresses.

The Federal Reserve also would expect to carefully monitor and address, either individually or in conjunction with other supervisors and regulators, the potential for additional spillover effects. Spillovers may occur not only due to exposures currently on a firm's books, but also as a result of reactions to stress elsewhere in the system, including at other systemically important firms or in key markets. For example, the failure of one firm may lead to deposit or liability runs at other firms that are seen by investors as similarly situated or that have exposures to such firms. In the recent financial crisis, exactly this sort of spillover resulted from the failure of Lehman Brothers, which led to heightened pressures on other investment banks. One tool that could be helpful in evaluating spillover risks would be multiple-firm or system-level stress tests focused particularly on such risks. However, this type of test would greatly exceed the SCAP in operational complexity; thus, properly developing and implementing such a test would be a substantial challenge.

Potential Role of a Council

The breadth and heterogeneity of the U.S. financial system have been great economic strengths of our country. However, these same characteristics mean that common exposures or practices across a wide range of financial markets and financial institutions may over time pose risks to financial stability, but may be difficult to identify in their early stages. Moreover, addressing the pervasive problem of pro-cyclicality in the financial system will require efforts across financial sectors. To help address these issues, the Administration has proposed the establishment of a Financial Services Oversight Council composed of the Treasury and all of the federal financial supervisory and regulatory agencies, including the Federal Reserve.

The Board sees substantial merit in the establishment of a council to conduct macroprudential analysis and coordinate oversight of the financial system as a whole. The perspective of, and information from, supervisors on such a council with different primary responsibilities would be helpful in identifying and monitoring emerging systemic risks across the full range of financial institutions and markets. A council could be charged with identifying emerging sources of systemic risk, including: large and rising exposures across firms and markets; emerging trends in leverage or activities that could result in increased systemic fragility; possible misalignments in asset markets; potential sources of spillovers between financial firms or between firms and markets that could propagate, or even magnify, financial shocks; and new markets, practices, products, or institutions that may fall through the gaps in regulatory coverage and become threats to systemic stability. In addition, a council could play a useful role in coordinating responses by member agencies to mitigate emerging systemic risks identified by the council, and by helping coordinate actions to address procylicality in capital regulations, accounting standards (particularly with regard to reserves), deposit insurance premiums, and other supervisory and regulatory practices. In light of these responsibilities and its broad membership, a council also would be a useful forum for identifying financial firms that are at the cusp of being systemically important and, when appropriate, recommending such firms for designation as systemically important. Finally, should Congress choose to create default authority for regulation of activities that do not fall under the jurisdiction of any existing financial regulator, the council would seem the appropriate instrumentality to determine how the expanded jurisdiction should be exercised.

A council could be tasked with gathering and evaluating information from the various supervisory agencies and producing an annual report to the Congress on the state of the financial system, potential threats to financial stability, and the responses of member agencies to identified threats. Such a report could include recommendations for statutory changes where needed to address systemic threats due to, for example, growth or changes in unregulated sectors of the financial system. More generally, a council could promote research and other efforts to enhance understanding, both nationally and internationally, of the underlying causes of financial instability and systemic risk and possible approaches to countering such developments.

To fulfill such responsibilities, a council would need access to a broad range of information from its member financial supervisors regarding the institutions and markets under their purview, as well as from other government agencies. Where the information necessary to monitor emerging risks was not available from a member agency, a council likely would need the authority to collect such information directly from financial institutions and markets.[3]

Improved Resolution Process

A key element to addressing systemic risk is the creation of a new regime that would allow the orderly resolution of systemically important nonbank financial firms. In most cases, the federal bankruptcy laws provide an appropriate framework for the resolution of nonbank financial institutions. However, the bankruptcy code does not sufficiently protect the public's strong interest in ensuring the orderly resolution of a nonbank financial firm whose failure would pose substantial risks to the financial system and to the economy. Indeed, after the Lehman and AIG experiences, there is little doubt that there needs to be a third option between the choices of bankruptcy and bailout.

The Administration's proposal would create such an option by allowing the Treasury to appoint a conservator or receiver for a systemically important nonbank financial institution that has failed or is in danger of failing. The conservator or receiver would have a variety of authorities--similar to those provided the FDIC with respect to failing insured banks--to stabilize and either rehabilitate or wind down the firm in a way that mitigates risks to financial stability and to the economy. For example, the conservator or receiver would have the ability to take control of the management and operations of the failing firm; sell assets, liabilities, and business units of the firm; and repudiate contracts of the firm. These are appropriate tools for a conservator or receiver. However, Congress may wish to consider adding some constraints as

[3] To facilitate information collections and interagency sharing, a council should have the clear authority for protecting confidential information subject, of course, to applicable law, including the Freedom of Information Act.

well--such as requiring that shareholders bear losses and that creditors be entitled to at least the liquidation value of their claims.

Importantly, the proposal would allow the government, through a receivership, to impose "haircuts" on creditors and shareholders of the firm, either directly or by "bridging" the failing institution to a new entity, when consistent with the overarching goal of protecting the financial system and the broader economy. This aspect of the proposal is critical to addressing the too-big-to-fail problem and the resulting moral hazard effects that I discussed earlier.

The Administration's proposal appropriately would establish a high standard for invocation of this new resolution regime and would create checks and balances on its potential use, similar to the provisions governing use of the systemic risk exception to least-cost resolution in the Federal Deposit Insurance Act (FDI Act). The Federal Reserve's participation in this decisionmaking process would be an extension of our long-standing role in protecting financial stability, involvement in the current process for invoking the systemic risk exception under the FDI Act, and status as consolidated supervisor for large banking organizations. The Federal Reserve, however, is not well suited, nor do we seek, to serve as the resolution agency for systemically important institutions under the new framework.

As we have seen during the recent crisis, a substantial commitment of public funds may be needed, at least on a temporary basis, to stabilize and facilitate the orderly resolution of a large, highly interconnected financial firm. The Administration's proposal provides for such funding needs to be addressed by the Treasury, with the ultimate costs of any assistance to be recouped through assessments on financial firms over an extended period of time. We believe the Treasury is the appropriate source of funding for the resolution of systemically important financial institutions, given the unpredictable and inherently fiscal nature of this function. The availability of such funding from Treasury also would eliminate the need for the Federal Reserve to use its emergency lending authority under section 13(3) of the Federal Reserve Act to prevent the failure of specific institutions.

Payment, Clearing, and Settlement Arrangements

The current regulatory and supervisory framework for systemically important payment, clearing, and settlement arrangements is fragmented, with no single agency having the ability to ensure that all systemically important arrangements are held to consistent and strong prudential standards. The Administration's proposal would provide the Federal Reserve certain additional authorities for ensuring that all systemically important payment, clearing, and settlement arrangements are subject to robust standards for safety and soundness.

Payment, settlement, and clearing arrangements are the foundation of the nation's financial infrastructure. These arrangements include centralized market utilities for clearing and settling payments, securities, and derivatives transactions, as well as decentralized activities through which financial institutions clear and settle such transactions bilaterally. While payment, clearing, and settlement arrangements can create significant efficiencies and promote transparency in the financial markets, they also may concentrate substantial credit, liquidity, and operational risks. Many of these arrangements also have direct and indirect financial or operational linkages and, absent strong risk controls, can themselves be a source of contagion in times of stress. Thus, it is critical that systemically important systems and activities be subject to strong and consistent prudential standards designed to ensure the identification and sound management of credit, liquidity, and operational risks.

The proposed authority would build on the considerable experience of the Federal Reserve in overseeing systemically important payment, clearing, and settlement arrangements for prudential purposes. Over the years, the Federal Reserve has worked extensively with domestic and foreign regulators to develop strong and internationally recognized standards for critical systems. Further, the Federal Reserve already has direct supervisory responsibility for some of the largest and most critical systems in the United States, including the Depository Trust Company and CLS Bank and has a role in overseeing several other systemically important systems. Yet, at present, this authority depends to a considerable extent on the specific organizational form of these systems as state member banks. The safe and efficient operation of payment, settlement, and clearing systems is critical to the execution of monetary policy and the flow of liquidity throughout the financial sector, which is why many central banks around the world currently have explicit oversight responsibilities for critical systems.

Importantly, the proposed enhancements to our responsibilities for the safety and soundness of systemically important arrangements would complement--and not displace--the authority of the SEC and CFTC for the systems subject to their supervision under the federal securities and commodities laws. We have an extensive history of working cooperatively with these agencies, as well as international authorities. For example, the Federal Reserve works closely with the SEC in supervising the Depository Trust Company and also works closely with 21 other central banks in supervising the foreign exchange settlements of CLS Bank.

Consumer Protection

A word on the consumer protection piece of the Administration's plan may be appropriate here, insofar as we have seen how problems in consumer protection can in some cases contain the seeds of systemic problems. The Administration proposes to shift responsibility for writing and enforcing regulations to protect consumers from unfair practices in financial transactions from the Federal Reserve to a new Consumer Financial Protection Agency.

Without extensively entering the debate on the relative merits of this proposal, I do think it important to point out some of the benefits that would be lost through this change.

Both the substance of consumer protection rules and their enforcement are complementary to prudential supervision. Poorly designed financial products and misaligned incentives can at once harm consumers and undermine financial institutions. Indeed, as with subprime mortgages and securities backed by these mortgages, these products may at times also be connected to systemic risk. At the same time, a determination of how to regulate financial practices both effectively and efficiently can be facilitated by the understanding of institutions' practices and systems that is gained through safety and soundness regulation and supervision. Similarly, risk assessment and compliance monitoring of consumer and prudential regulations are closely related, and thus entail both informational advantages and resource savings.

In the last three years, the Federal Reserve has adopted strong consumer protection measures in the mortgage and credit card areas. These regulations benefited from the supervisory and research capabilities of the Federal Reserve, including expertise in consumer credit markets, retail payments, banking operations, and economic analysis. Involving all these forms of expertise is important for tailoring rules that prevent abuses while not impeding the availability of sensible extensions of credit.

Conclusion

Thank you again for the opportunity to testify on these important matters. The Federal Reserve looks forward to working with Congress and the Administration to enact meaningful regulatory reform that will strengthen the financial system and reduce both the probability and severity of future crises.

Embargoed until
July 24, 2009, at 12:30 p.m.

Statement of

John E. Bowman
Acting Director, Office of Thrift Supervision

regarding the

Administration's Financial Regulatory Reform Proposal

before the

Committee on Financial Services
United States House of Representatives

July 24, 2009

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W.
Washington, DC 20552
202-906-6288

Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on the Administration's Financial Regulatory Reform Proposal

Before the Committee on Financial Services
United States House of Representatives
July 24, 2009

Statement of John E. Bowman
Acting Director, Office of Thrift Supervision

I. Introduction

Good afternoon, Chairman Frank, Ranking Member Bachus, and Members of the Committee. Thank you for the opportunity to testify today on the Administration's Proposal for Financial Regulatory Reform (Administration's Proposal) and H.R. 3126 – The Consumer Financial Protection Agency Act of 2009. It is my pleasure to address the Committee for the first time in my role as Acting Director of the Office of Thrift Supervision (OTS).

We applaud the dedication and diligence this Committee has devoted to achieving proper protections for consumers of financial products. We appreciate the Committee's efforts to enact legislation quickly in response to the current financial crisis.

II. Goals of Regulatory Restructuring

OTS supports all of the fundamental objectives that are at the heart of the Administration's Proposal. In this testimony, I will discuss OTS's view on how those objectives would best be met. In many ways, we agree with the approach of the Administration's Proposal, but in others, we think an alternative would be more effective and workable. Let me be clear at the outset: the recent turmoil in the financial services industry has exposed major gaps and other significant weaknesses that must be addressed. We fully agree that the time to act is now, that fundamental reform is essential and that no current part of the financial regulatory system should be "off the table" during the reform debate.

The OTS believes there are four key principles essential to accomplishing true and lasting reform:

(1) **Protect Consumers** — One federal agency whose central mission is the regulation of financial products should establish the rules and standards for all consumer financial products rather than the current myriad of agencies with fragmented authority and a lack of singular accountability;

(2) **Establish Uniform Regulation** — All entities that offer financial products to consumers must be subject to the same consumer protection rules and regulations, so under-regulated entities cannot gain a competitive advantage over their more regulated counterparts. Also, complex derivative products, such as credit default swaps, should be regulated.

(3) **Create Ability to Supervise and Resolve Systemically Important Firms** — No provider of financial products should be too big to fail, achieving through size and complexity an implicit federal government backing to prevent its collapse — and thereby gaining an unfair advantage over its more vulnerable competitors.

(4) **Ensure Changes to Financial Regulatory System Address Real Problems** — Proposed changes to financial regulatory agencies should be evaluated based on whether they would address the causes of the economic crisis or other true problems.

We believe that each element of the Administration's Proposal should be evaluated based on whether or not that element addresses one of these principles. By performing such an analysis, we can assess whether any single provision would truly solve the problems at hand.

I will examine these principles one-by-one, examine how HR 3126 and the Administration's Proposal would address it and describe the OTS's perspective.

III. Protect Consumers

The events of recent years have demonstrated that the nation's financial system needs to clarify the boundaries set by the federal government to ensure that consumers are treated fairly. Consumer protection performed consistently and judiciously fosters a thriving banking system that fulfills the financial services needs of the nation.

1. Administration's Proposal

The Proposal, as outlined in H.R. 3126 (the Bill), calls for the establishment of the Consumer Financial Protection Agency (CFPA) to regulate the offering of consumer financial products and services. The CFPA would acquire the consumer protection authority and staff of the current Federal Banking Agencies (FBAs), including rulemaking, examination and enforcement regarding consumer protection issues. CFPA regulations would serve as a floor, not a ceiling, with respect to state laws; states would be empowered to enforce CFPA rules. Finally, CFPA would define standards for "plain vanilla" products (e.g., 30-year fixed rate mortgages) that are simple and have straightforward pricing. All providers and intermediaries would be required to offer these products prominently, alongside other products they may offer.

2. OTS's View

The OTS supports consolidating rulemaking authority over all consumer protection regulation in one federal regulator. This regulator should be responsible for promulgating all consumer protection regulations that would apply uniformly to all entities that offer financial products, whether an insured depository institution, state-licensed mortgage broker or mortgage company.

This regulator would replace consumer-regulation-writing parts of the current system of multiple agencies, such as the Department of Housing and Urban Development, the Federal Trade Commission, the Federal Reserve, the Federal Deposit Insurance Corporation, the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency and the OTS, each having segments of a fragmented framework for regulatory oversight and each possessing its own perspectives and priorities. The current system has led to inconsistent regulation, a lack of accountability and, too often, a lack of timely action to implement regulations for the laws passed by Congress to protect consumers.

Unlike the Bill, the OTS recommends retaining consumer-protection-related examination and supervision authority for insured depository institutions with the FBAs and the NCUA. The OTS believes that the CFPA should have rulemaking authority, as well as regulation, examination and enforcement power over entities engaged in consumer lending that are not insured depository institutions.

Safety and soundness and consumer protection examination and enforcement powers should not be separated for insured depository institutions because safety-and-soundness examinations complement and strengthen consumer protection. By separating safety-and-soundness functions from consumer protection, the CFPA and an FBA could each have gaps in their information concerning an institution. Neither agency would see a complete picture, to the detriment of both consumer protection and safety and soundness. Moreover, in its desire to protect consumers, the CFPA could require actions by a depository institution that would be potentially unsafe or unsound. This could lead to potential conflicts with the FBA. For example, the consumer agency might direct an institution to offer mainly 30-year, fixed rate mortgages that would be friendly to consumers. However, a concentration in these types of mortgages could create safety and soundness concerns by increasing interest rate risk and lowering capital, thereby resulting in fewer loans available for consumers.

Separating consumer regulation from safety and soundness could also result in inefficiencies and possible duplication in supervision. A bank or thrift would be examined by its primary federal regulator and, in addition, could be examined by the consumer protection agency. A state chartered institution may have yet another layer of supervision and examination. Moreover, in the case of very large institutions, the systemic regulator would also apply a layer of supervision under the Administration's Proposal.

The OTS also believes the proposed consumer protection legislation would effectively end the consistent, nationwide system of federal standards. Such a change would require banks and thrifts to comply with potentially inconsistent consumer protection laws in all 50 states, as well as local governments. State attorneys general could interpret and enforce CFPA rules differently. Federal institutions would have to comply with a patchwork of different state regulatory regimes, which would subject them to significant compliance and legal costs and the constant threat of litigation. This could result in additional costs to consumers and might cause a drag on the financial system and the economy during a time when the economic health of the nation is a paramount concern.

Without federal preemption to ensure a consistent set of regulations and policies to protect consumers nationwide, the consumer protection agency would be unable to write simple, understandable disclosures to be applied nationwide. Whatever disclosures the agency might develop to address federal requirements would need to be supplemented with state (and local) disclosures. All of the foregoing could lead ultimately to unintended results, including more complex and lengthier disclosures for consumers, two-to-three sets of disclosures (federal, state and local) with different and perhaps inconsistent information, higher-cost financial services for consumers and perhaps the elimination of some services altogether. OTS believes that where there is strong federal consumer law, preemption should be retained, and where strong nationwide protections are not in place, they should be established.

Finally, although OTS respects the Bill's objectives of establishing rules that could require financial institutions to provide consumers with options among various financial products or services to enable consumers to make informed choices about features, terms and risks that are best for them, we are concerned about the consumer protection agency defining standards for financial products and services that would require institutions to offer certain products (e.g. 30-year fixed rate mortgages). The imposition of such a requirement could result in safety and soundness concerns and stifle credit availability and innovation. Finally, we are concerned about the consumer protection agency defining standards for financial products (e.g. 30-year fixed rate mortgages).

OTS does not believe that federal regulators should dictate the types of products that lenders must offer.

Historically, federal consumer protection policy has been based on the premise that if consumers are provided with enough information, they will be able to choose products and services that meet their needs. Although timely and effective disclosure remains necessary, disclosure alone is not always sufficient to protect consumers against abuses. Some practices that are found to be unfair and deceptive should be banned outright, as the OTS and other regulators demonstrated by approving final rules in late 2008 prohibiting unfair credit card practices. Although we believe strongly that government regulators should prohibit products or practices that are unfair to consumers, the government should not be overly prescriptive in defining lenders' business plans or mandating that certain products be offered to consumers.

Defining standards for financial products would put a government seal of approval on certain favored products and would effectively steer lenders toward these products. It could have the unintended consequence of fewer choices for consumers by stifling innovation and inhibiting the creation of products that could benefit consumers and financial institutions.

To address these concerns, OTS suggests providing the CFPA with the authority to issue rules that would require institutions to present the terms, features and risks associated with financial products and services they offer to a consumer along with a description about how products or services in the same class, or of the same type, might also fit the consumers needs.[1] For example, if the institution offered the consumer an overdraft protection program, they would also present information on an overdraft line of credit, whether the institution offered the latter product or not. Similarly, if the institution offered an adjustable rate mortgage with the potential for significant payment increases, the institution might also provide information about fixed rate mortgages.

The requirement for financial institutions would be to present consumers with a description of a different option(s), not to offer products mandated by the CFPA. OTS believes this approach addresses the concern that has been raised about consumers failing to receive the benefit of information and choices among financial products and services, or being steered to higher cost, more complex forms of credit because they were not presented with choices. However, this approach would prevent the risk of unintentionally inhibiting innovation in financial products and services by mandating product offerings that may raise safety and soundness risks and concerns for institutions.

IV. Establish Uniform Regulation

Establishing uniform regulation would address the gaps in regulatory oversight that led to a shadow banking system that was a significant cause of the current crisis. For

[1] [1] The federal banking agencies adopted a related approach in the development of the "Interagency Illustrations of Consumer Information for Nontraditional Mortgage Products" where the agencies provided model illustrations that financial institutions could use to inform consumers about the terms, features and risks of nontraditional mortgage products such as Interest Only loans and Payment Option ARMs in comparison to convention 30 year fixed rate mortgages. The illustrations were designed to help consumers comparison shop and choose the best mortgage to fit their needs. (http://edocket.access.gpo.gov/2007/pdf/07-2859.pdf).

example, during the height of the real estate boom, in September 2006, the Mortgage Bankers Association estimated that state-licensed mortgage brokers were originating 70 percent of subprime mortgages. Another example is the prevalence of unregulated products — credit default swaps — that generated an enormous stockpile of unexpected risk at one of America's largest companies. It is essential that a nationwide system of regulation apply, so all players and products in the mortgage market and other financial markets compete by the same sets of rules.

1. Administration's Proposal

The consumer protection requirements, regulations and standards developed by the CFPA would apply to all entities that offer lending products and services to consumers and communities, whether a state-licensed mortgage company, a state bank or a federally insured depository institution. For nonbanks, the CFPA would address non-compliance through uniform enforcement.

The Administration's Proposal would also bring markets for all derivatives and asset-backed securities "into a coherent and coordinated regulatory framework that requires transparency and improves market discipline." Specifically, the Proposal would require originators and sponsors to retain an economic interest in a material portion of the credit risk of securitized credit exposures and align compensation of market participants with longer term performance of the underlying loans. It would also increase the transparency and standardization of securitization markets and strengthen the regulation of credit rating agencies.

2. OTS's View

The OTS strongly supports closing gaps in regulation, whether the gaps apply to mortgage originators or derivative products such as credit default swaps. These gaps are points of vulnerability that weaken the entire financial system and threaten its viability.

The OTS is on record supporting regulation of derivative products such as credit default swaps, where tremendous risk exposure has been disguised in opaque and complex ways. We also believe that many of the recent problems associated with derivatives, including credit default swaps, resulted in part from over-reliance on credit rating agencies.

The OTS has also spoken out many times in public about how, under the current regulatory environment, nonbank mortgage originators are not subject to prudential regulation and have very little stake in the performance of a loan after origination. Many of the recent excesses in the mortgage market might have been avoided if all mortgage originators had a significant, vested interest in the performance of loans they originated. The OTS recommends linking compensation for loan originators to responsible underwriting practices to assure that they offer appropriate loans to borrowers who have a reasonable prospect of repaying the loan. Mortgage brokers should receive their commission in separate installments over a predetermined period based on the continued good performance of the mortgage. We believe this requirement would result in more sustainable mortgages.

Mortgage brokers should also meet eligibility requirements that reinforce the importance of their jobs and the level of trust consumers place in them. Although the recently enacted S.A.F.E. Mortgage Licensing Act is a good first step, limitations on who may have a license are also necessary.

The OTS is also concerned that under the Administration's Proposal, the CFPA might not be empowered to adequately protect consumers from abuses by nonbanks, and that banks and thrifts might continue to be more heavily regulated than nonbank firms offering similar products and services. It is not clear under the Administration's Proposal how or how often the consumer protection agency would examine nonbanks. The nonbanking sector contributed significantly to the problems leading to the present financial crisis. Mortgage brokers and nonbank providers of financial services were not always effectively regulated by the states. Nonbank providers of financial services should be required to comply with the same standards and be subject to the same rigor of examination and enforcement as insured depository institutions; if not, the abuses that led to today's economic turmoil could recur.

V. Create Ability to Supervise and Resolve Systemically Important Firms

The U.S. economy operates on the principle of healthy competition. Enterprises that are strong, industrious, well–managed and efficient succeed and prosper. Those that fall short of the mark struggle or fail and other, stronger enterprises take their places. Enterprises that become "too big to fail" subvert the system when the government is forced to prop up failing, systemically important companies — in essence, supporting poor performance and creating a "moral hazard."

1. Administration's Proposal

The Proposal would establish a systemic risk regulator and a new oversight council to address systemic risk and oversee systemically important firms.

2. OTS's View

The OTS agrees that there is a pressing need for a systemic risk regulator with broad authority to monitor and exercise supervision over any company whose actions or failure could pose unacceptable risk to financial stability. The systemic risk regulator should have the ability and the responsibility for monitoring all data about markets and companies, including, but not limited to, companies involved in banking, securities and insurance. For systemically important institutions, the systemic risk regulator should supplement, not supplant, the holding company regulator and the primary federal bank supervisor.

We also support the establishment of a council with all primary federal banking regulators represented to provide valuable insight and experience to the systemic risk regulator.

The systemic risk regulator should have ready access to funding sources that would provide the capability to resolve problems at these institutions, including providing liquidity when needed.

Given the events of recent years, it is also essential that the federal government have the authority and the resources to act as a conservator or receiver and to provide an orderly resolution of systemically important institutions, whether banks, thrifts or nonbanks. A lesson learned from recent events is that the failure or unwinding of systemically important companies has a far reaching impact on the economy, not just on financial services.

The continued ability of banks, thrifts and other entities in the United States to compete in today's global financial services marketplace is critical. The systemic risk regulator should be charged with coordinating the supervision of conglomerates that have international operations. Safety and soundness standards, including capital adequacy and other factors, should be as comparable as possible for entities that have multinational businesses.

VI. Ensure Changes to Financial Regulatory System Address Real Problems

There is little dispute that the ad hoc framework of financial services regulation cobbled together over the last century-and-a-half is not ideal. Different parts of the system were created to respond to the needs of the time. However, the current system has generally served the nation well over time, despite economic downturns such as the current one. We must ensure that in the rush to address what went wrong, we do not try to "fix" non-existent problems.

1. Administration's Proposal

The Proposal would establish a new agency, the National Bank Supervisor (NBS), by merging the Office of the Comptroller of the Currency, which charters and regulates national banks, and the OTS, which charters federal thrifts and regulates thrifts and their holding companies. The Federal Reserve would supervise all bank holding companies and the thrift charter would be abolished. The unrestricted interstate branching currently permitted by thrifts would apply to all banks.

2. OTS's View

The OTS does not believe the case has been made for abolishing the agency. Two rationales have been made to support this proposal: 1) The OTS was the regulator of the largest insured depository institutions that failed during the current economic turmoil, and, 2) Financial institutions "shopping" for the most lenient regulator have flocked to OTS supervision and the thrift charter. Both of those arguments are incorrect.

There are four reasons why the first assertion is untrue:

First, the OTS regulates financial institutions that historically make mortgages for Americans to buy homes. By law, thrift institutions must keep most of their assets in home mortgages or other retail lending activities. The economic crisis grew out of a sharp downturn in the residential real estate market, including significant and sustained home price depreciation, a protracted decline in home sales and a plunge in rates of real estate investment. The crisis hit OTS-regulated institutions particularly hard because their business models focus on the hardest hit segment of the U.S. economy.

Second, the largest failures among OTS-regulated institutions during this crisis have concentrated their mortgage lending in California and Florida, two of the states most damaged by the real estate decline. These states have had significant retraction in the real estate market, including double-digit declines in home prices and record rates of foreclosure.[2] Although the hindsight of today is 20/20, no one predicted during the peak of the boom in 2006 that nationwide home prices would plummet by more than 30 percent.

Third, failures by insured depository institutions have been no more severe among OTS-regulated thrifts than among institutions supervised by other federal banking regulators. OTS-regulated Washington Mutual, which failed in September 2008 at no cost to the deposit insurance fund, was the largest bank failure in U.S. history because anything larger has been deemed "too big to fail." By law, the federal government can

[2] See Office of Thrift Supervision Quarterly Market Monitor, May 7, 2009 (http://files.ots.treas.gov/131020.pdf).

provide "open-bank assistance" only to prevent a failure. Institutions much larger than Washington Mutual, for example, Citigroup and Bank of America, had collapsed, but the federal government prevented their failure by providing open bank assistance. The "too big to fail" institutions are not regulated by the OTS. The OTS did not regulate the largest banks that failed; the OTS regulated the largest banks that were *allowed to fail.*

Fourth, in terms of numbers of bank failures during the crisis, most banks that have failed have been state-chartered institutions, whose primary federal regulator is not the OTS.

The argument about regulator shopping, or arbitrage, seems to stem from the conversion of Countrywide Bank, which left the supervision of the OCC in March 2007 — after the height of the housing and mortgage boom — and came under OTS regulation. Countrywide made most of its high-risk loans before that time.

An often-overlooked fact is that a few months earlier, in October 2006, Citibank converted two thrift charters from OTS supervision to the OCC. Those two Citibank charters totaled more than $232 billion—more than twice the asset size of Countrywide ($93 billion). No one has suggested that Citibank changed its charters to seek more lenient regulation.

In the last 10 years (1999-2008), there were 45 more institutions that converted away from the thrift charter (164) than converted to the thrift charter (119). Of those that converted to the OTS, more than half were state-chartered thrifts (64). In dollar amounts during the same 10-year period, $223 billion in assets converted to the thrift charter from other charter types and $419 billion in assets converted from the thrift charter to other charter types.

If regulatory arbitrage is indeed a major issue, it would be an issue between a federal charter and the charters of the 50 states, as well as among the states. Under the Administration's Proposal, the possibility of such arbitrage would continue.

We disagree with any suggestion that banks converted to the thrift charter because OTS was a more lenient regulator. Instead, institutions chose the charter type that best fit their business model.

The OTS is also concerned that the NBS would, particularly in times of stress, focus most of its attention on the largest institutions, leaving mid-size and small institutions in the back seat.

With regard to holding company regulation, OTS believes that commercial banks, thrifts and other consumer and community lenders that have non-systemic holding companies should have strong, consistent supervision by a single regulator.

OTS agrees with retaining the dual banking system, but with both federal and state charters for banks and thrifts. This system has served the financial markets in the United States well. The states have provided a charter option for banks and thrifts that have not wanted to have a federal charter. A number of innovations have resulted from the kind of focused product development that can occur on a local level. Banks and thrifts would be able to choose whether to operate with a federal charter or a state charter.

Also, each federal regulator would continue to sustain itself financially through assessments. We do not believe the argument that a self-sustaining system makes regulators susceptible to undue influence from regulated institutions. As history shows, funding federal regulatory agencies through appropriations may expose bank supervisory decisions to undue influence from political pressures. An agency that supervises financial institutions must control its funding to make resources available quickly to respond to supervision and enforcement needs. For example, when the economy declines, the safety-and-soundness ratings of institutions generally drop and enforcement actions rise. These changes require additional resources and often an increase in hiring to handle the larger workload. Such additional resources should not be dependent on a Congressional budget cycle.

The OTS also does not support the provision in the Administration's Proposal to eliminate the federal thrift charter and require all federal thrift institutions to change their charter to the National Bank Charter. We believe the business models of federal banks and thrift institutions are fundamentally different enough to warrant two distinct federal banking charters.

Stock and mutual savings associations generally are smaller institutions that have strong ties to their communities. Many thrifts never made subprime or Alt-A mortgages; rather they adhered to traditional, solid underwriting standards. Most thrifts did not participate in the private originate-to-sell model; they prudently underwrote mortgages intending to hold the loans in their own portfolios until the loans matured.

Forcing thrifts to change their business models would not only be costly, disruptive and punitive for thrifts, but would also deprive credit-worthy U.S. consumers from the credit they need to become homeowners and the extension of credit this country needs to stimulate the economy.

Generally, mutual institutions are weathering the current financial crisis better than their stock competitors. The distress in the housing markets has had a much greater impact on the earnings of stock thrifts than on mutual thrifts over the past year. For the first quarter 2009, mutual thrifts reported a return on average assets (ROA) of 0.42 percent, while stock thrifts reported an ROA of 0.04 percent. We see every reason to preserve the mutual institution charter and no compelling rationale to eliminate it.

VII. Conclusion

In conclusion, we support the goals of the Administration to create a system of financial regulation that ensures protections for consumers, while building a strong framework to prevent the type of financial crisis that we have just endured.

Although we disagree with some of the details, we agree that the time is now to reform the framework that governs the financial services industry.

Thank you again, Mr. Chairman, Ranking Member Bachus, and Members of the Committee, for the opportunity to testify on behalf of the OTS on the Administration's Financial Regulatory Reform Proposal.

We look forward to continuing to work with the Members of this Committee and others to create a system of financial services regulation that promotes greater economic stability for our financial providers and the nation.

For Release Upon Delivery

STATEMENT of

JOHN C. DUGAN

COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

July 24, 2009

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent those of the President.

Statement of

John C. Dugan

Comptroller of the Currency

before the

Committee on Financial Services

U.S. House of Representatives

July 24, 2009

Chairman Frank, Ranking Member Bachus, and Members of the Committee, I appreciate this opportunity to discuss the Administration's Proposal for reforming and restructuring the regulation of financial services in the United States.[1] The events of the last two years – including the unprecedented distress and failure of financial firms, the accumulation of toxic subprime assets in our financial system, and the steep rise in foreclosures – have exposed gaps and weaknesses in our regulatory framework. The Proposal put forward by the Treasury Department for strengthening that framework is thoughtful and comprehensive. I support many of its proposed reforms, but I have significant concerns with two parts of it, *i.e.*, (1) the scope of authority of the newly proposed Consumer Financial Protection Agency (CFPA), and its related elimination of uniform national standards for national banks; and (2) the proposed broad authority of the Federal Reserve, as systemic risk regulator, to override authority of the primary banking

[1] *See* U.S. Department of the Treasury, FINANCIAL REGULATORY REFORM – A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (June 2009) (the Proposal), available on the Treasury Department's Financial Stability website at www.financialstability.gov/docs/regs/FinalReport_web.pdf.

supervisor. Both relate to the way in which important new authorities would interact with the essential functions of the dedicated prudential banking supervisor.

My testimony begins with a brief summary of the key parts of the Proposal we generally support, but then focuses more extensively on our two major areas of concern. We will, of course, be happy to provide additional comments as detailed legislative language on other parts of the Proposal becomes available.

I. Key Provisions Supported by the OCC

Set forth below are key parts of the Proposal that we generally support, which are not intended to be an exhaustive list of the Proposal's suggested reforms.

- **Establishment of a Financial Stability Oversight Council.** This council would consist of the Secretary of the Treasury and all of the federal financial regulators, and would be supported by a permanent staff. Its general role would be to identify and monitor systemic risk, and it would have strong authority to gather the information necessary for that mission, including from <u>any</u> entity that might pose systemic risk. We believe that having a centralized and formalized mechanism for gathering and sharing systemically significant information, and making recommendations to individual regulators, makes good sense.
- **Enhanced authority to resolve systemically significant financial firms**. The Federal Deposit Insurance Corporation (FDIC) currently has broad authority to resolve a distressed systemically significant depository institution in an orderly manner. No comparable resolution authority exists for large bank holding companies, or for systemically significant financial companies that are not banks, as we learned painfully with the problems of such large financial companies as

Bear Stearns, Lehman Brothers, and AIG. The Proposal would extend resolution authority like the FDIC's to such nonbanking companies, while preserving the flexibility to use the FDIC or another regulator as the receiver or conservator, depending on the circumstances. This is a sound approach that would help maximize orderly resolutions of systemically significant firms.

- **Designation of the Federal Reserve as the consolidated supervisor of all systemically significant financial firms.** Working with the OCC and the other bank regulators, the Federal Reserve Board already has strong authority as consolidated supervisor to identify and address problems at large, systemically significant bank holding companies. In the financial crisis of the last two years, the absence of a comparable authority with respect to large securities firms, insurance companies, and government-sponsored enterprises that were not affiliated with banks proved to be an enormous problem, as a disproportionate share of the financial stress in the markets was created by these institutions. The lack of a consistent and coherent regulatory regime applicable to them by a single regulator helped mask problems in these nonbanking companies until they were massive. And gaps in the regulatory regime constrained the government's ability to deal with them once they emerged. The Proposal would extend the Federal Reserve's consolidated bank holding company regulation to systemically significant nonbanks in the future, which would appropriately address the regulatory gap. However, as discussed below, one aspect of this part of the proposal goes too far, *i.e.*, the new Federal Reserve authority to "override" the primary banking supervisor, which would undermine the authority – and the accountability – of the banking supervisor for the soundness of banks that anchor systemically significant holding companies.

- **Strengthened regulation of systemically significant firms, including through higher capital requirements and stronger liquidity requirements.** We support the concept of imposing more stringent prudential standards on systemically significant financial firms to address their heightened risk to the system and to mitigate the competitive advantage they could realize from being designated as systemically significant. However, in those instances where the largest asset of the systemically significant firm is a bank – as may often be the case – the primary banking supervisor should have a strong role in helping to craft the new standards.
- **Effective merger of the Office of Thrift Supervision (OTS) into the Office of the Comptroller of the Currency (OCC), with a phase-out of the federal thrift charter.** In proposing to restructure the banking agencies, the Proposal appropriately preserves an agency whose only mission is banking supervision. This new agency would serve as the primary regulator of federally chartered depository institutions, including the national banks that comprise the dominant businesses of many of the largest bank holding companies. To achieve this goal, the Proposal would effectively merge the OTS into the OCC. It would also eliminate the federal thrift charter – but not the state thrift charter – with all federal thrifts required to convert to either a national bank, state bank, or state thrift, over the course of a reasonable transition period. (State thrifts would then be treated as state "banks" under Federal law.) We believe this approach to the

agency merger is preferable to one that would preserve the federal thrift charter, with federal thrift regulation being conducted by a division of the merged agency. With the same deposit insurance fund, same prudential regulator, same holding company regulator, and a narrower charter (a national bank has all the powers of a federal thrift plus many others), there would no longer be a need for a separate federal thrift charter. In addition, the approach in the Proposal avoids the considerable practical complexities and costs of administering two separate statutory and regulatory regimes that are largely redundant in many areas, and needlessly different in others. Indeed, if the federal thrift charter is not preserved, we see no reason for the government to incur the cost of changing the 146-year-old name of the agency as the Office of the Comptroller of the Currency, since the sole mission of the agency would remain the supervision and regulation of national banks. Finally, it is critical that the legislation implementing this aspect of the Proposal be unambiguously clear that the new agency is independent from the Treasury Department and the Administration to the same extent that the OCC and OTS are currently independent.[2]

- **Changes in accounting standards that would allow banks to build larger loan loss reserves in good times to absorb more losses in bad times.** One of the problems that has impaired banks' ability to absorb increased credit losses while continuing to provide appropriate levels of credit is that their levels of loan loss reserves available to absorb such losses were not as high as they should have been

[2] For example, current law provides the OCC with important independence from political interference in decision-making in matters before the Comptroller, including enforcement proceedings; provides for funding independent of political control; enables the OCC to propose and promulgate regulations without approval by the Treasury; and permits the agency to testify before Congress without the need for the Administration's clearance of the agency's statements.

entering the crisis. One reason for this is the currently cramped accounting regime for building loan loss reserves, which is based on the concept that loan loss provisions are permissible only when losses are "incurred." The Proposal calls for accounting standard setters to improve this standard to make it more forward looking so that banks could build bigger loan loss reserves when times are good and losses are low, in recognition of the fact that good times inevitably end, and large loan loss reserves will be needed to absorb increased losses when times turn bad. The OCC strongly supports this part of the Proposal. In fact, I co-chaired an international task force under the auspices of the Financial Stability Board to achieve this very objective on a global basis, which we hope will contribute to stronger reserving policy both here and abroad.

- **Enhanced consumer protection.** The Proposal calls for enhanced consumer protection standards for consumer financial products through new rules that would be written and implemented by the new Consumer Financial Protection Agency. The OCC supports strong, uniform federal consumer protection standards. While we generally do not have rulewriting authority in this area, we have consistently applied and enforced the rules written by the Federal Reserve (and others), and, in the absence of our own rulewriting authority, have taken strong enforcement actions to address unfair and deceptive practices by national banks. We believe that an independent agency like the CFPA could appropriately strengthen consumer protections, but we have serious concerns with the CFPA as proposed. We believe the goal of strong consumer protection can be accomplished better through CFPA rules that reflect meaningful input from the federal banking agencies and are truly uniform. We also believe that these rules should continue to be implemented by the federal banking agencies for banks, under the existing, well established regulatory and enforcement regime, and by the CFPA and the states for nonbank financial providers, which today are subject to different standards and far less actual oversight than federally regulated banks. This is discussed in greater detail below.

- **Stronger regulation of payments systems, hedge funds, and over-the-counter derivatives, such as credit default swaps.** The Proposal calls for significant enhancements in regulation in each of these areas, which we support in concept. We will provide more detailed comments about each, as appropriate, once we have had more time to review the implementing legislative language.

II. Key Concerns

Let me now turn to the two parts of the proposal with which I have the most significant concerns: the CFPA; and the broad proposed authority for the Federal Reserve, as systemic risk regulator, to override the primary banking supervisor in its fundamental supervisory duties.

A. The Proposed Consumer Financial Protection Agency

Today's severe consumer credit problems can be traced to the multi-year policy of easy money and easy credit that led to an asset bubble, with too many people getting loans that could not be paid back when the bubble burst. With respect to these loans – especially mortgages – the core problem was lax underwriting standards. Inadequate consumer protections – such as inadequate and ineffective disclosures – contributed to this problem, because in many cases consumers did not understand the significant risks of complex loans that had seductively low initial monthly payments. Both aspects of the problem – lax underwriting and inadequate consumer protections – were especially acute in loans made by nonbank lenders that were not subject to federal regulation.

Making a loan that cannot be repaid is obviously bad for the borrower, but it is also fundamentally unsound banking. The fact that the underwriting and consumer dimensions of the mortgage problem are so intertwined makes it especially important to be clear about where the problems were – and where they were not – in developing the best solutions.

For example, some have suggested that the Community Reinvestment Act (CRA) caused the subprime lending crisis. That is simply not true. As the Administration's Proposal expressly recognizes, and as I have testified before, far fewer problem mortgages were made by institutions subject to CRA – that is, federally regulated depository institutions – than were made by mortgage brokers and originators that were <u>not</u> depository institutions. The Treasury Proposal specifically notes that CRA-covered depository institutions made only 6 percent of recent higher-priced mortgages provided to lower-income borrowers or in areas that are the focus of CRA evaluations.[3] Moreover, our experience with the limited portion of subprime loans made by national banks is that they are performing better than non-bank subprime loans. This belies any suggestion that the banking system, and national banks in particular, were any sort of haven for abusive lending practices.

I want to acknowledge that H.R. 3126, which incorporates the CFPA portion of the Proposal, addresses one significant concern about the scope of the proposed new agency's authority. The Treasury Proposal would have transferred to the CFPA the

[3] Proposal, *supra* note 1, at 69-70.

responsibility for administering CRA. H.R. 3126, as introduced earlier this month by Chairman Frank, retains that responsibility in the federal banking agencies. I believe that is the right approach. CRA is not a consumer protection law. Instead, it is a law that, at its core, encourages depository institutions – and only depository institutions – to lend in their communities. The terms of the statute strongly link that lending to safety and soundness – which is one reason that the statute has worked well and an important reason why the federal banking agencies should continue the successful work they have done to implement it.

In terms of changes to financial consumer protection regulation, legislation should be targeted to the two types of fundamental gaps that fueled the current mortgage crisis. The first gap relates to consumer protection rules themselves, which were written under a patchwork of authorities scattered among different agencies; were in some cases not sufficiently robust or timely; and importantly, were not applied to all financial services providers, bank or nonbank, uniformly. The second gap relates to implementation of consumer protection rules, where there was no effective mechanism or framework to ensure that nonbank financial institutions complied with rules to the same extent as regulated banks. That is, the so-called "shadow banking system" of nonbank firms, such as finance companies and mortgage brokers, provides products comparable to those provided by banks, but is not subject to comparable oversight. This shadow banking system has been widely recognized as central to the most abusive subprime lending that fueled the mortgage crisis.

A new Consumer Financial Protection Agency could be one mechanism to target both the rulewriting gap and the implementation gap. In terms of the rulewriting gap, all existing consumer financial protection authority could be centralized in the CFPA and strengthened as Congress sees fit, and that authority could be applied to all providers of a particular type of financial product with rules that are uniform. In terms of the implementation gap, the CFPA could be focused on supervision and/or enforcement mechanisms that raise consumer protection compliance for nonbank financial providers to a similar level as exists for banks – but without diminishing the existing regime for bank compliance. And in both cases, the CFPA could be structured to recognize legitimate bank safety and soundness concerns that in some cases are inextricably intertwined with consumer protection – as is the case with underwriting standards.

Unfortunately, the Proposal's CFPA falls short in addressing the two fundamental consumer protection regulatory gaps. In terms of the rulewriting gap, it does provide a mechanism for centralized authority and stronger rules that could be applied to all providers of financial products. But the rules would not be uniform; that is, because the Proposal authorizes states to adopt different rules, there could be fifty different standards that apply to providers of a particular product or service, including national banks. As I will discuss further below, these differences would needlessly raise the cost of compliance, and therefore the cost of consumer products and services.

In terms of the implementation gap, the Proposal does not provide any specific direction for how the CFPA would put in place a supervision and enforcement framework to address fundamental compliance problems in the shadow banking system. Indeed, instead of focusing only on the daunting challenge of actually regulating this largely unsupervised sector, the Proposal would dilute both CFPA and state examination and enforcement resources by extending them to already regulated depository institutions as well. In addition, by transferring all consumer compliance examination and enforcement responsibilities from the depository institution regulators to the CFPA, the Proposal would create a less effective system for consumer protection oversight of those institutions. And in all of this, the Proposal's attempt to completely divorce consumer protection from safety and soundness raises real potential problems.

Let me address each of these issues in greater detail through the prism of the CFPA's key regulatory powers: rulewriting; and the implementation of rules through examination, supervision, and enforcement.

1. Rulewriting

As noted, to address the rulewriting gap, the Proposal's CFPA provides a mechanism for centralizing authority and adopting stronger financial protection rules that would apply to all providers of financial products. Our two fundamental concerns are that the rules actually applied under the CFPA scheme would not be uniform; and that a stronger role for federal banking supervisors is needed in writing the rules in order to provide better protection for consumers when they obtain financial products, while ensuring safe and sound banking practices in providing those products.

a. Lack of Uniform Rules and National Bank Preemption

A core principle of the Proposal is its recognition that consumers benefit from uniform rules.[4] Yet this very principle is expressly undermined by the specific grant of authority to states to adopt different rules; by the repeal of uniform standards for national

[4] *See, e.g.,* Proposal, *supra* note 1, at 69 (discussing the proposed CFPA, observing that "[f]airness, effective competition, and efficient markets require consistent regulatory treatment for similar products," and noting that consistent regulation facilitates consumers' comparison shopping); and at 39 (discussing the history of insurance regulation by the states, which "has led to a lack of uniformity and reduced competition across state and international boundaries, resulting in inefficiency, reduced product innovation, and higher costs to consumers.").

banks; and by the empowerment of individual states, with their very differing points of view, to enforce federal consumer protection rules – under all federal statutes – in ways that might vary from state to state. In effect, the resulting patchwork of federal-plus-differing-state standards would effectively distort and displace the federal agency's rulemaking, even though the CFPA's rule would be the product of an open public comment process and the behavioral research and evaluative functions that the Proposal highlights. In particular, for the first time in the nearly 150-year history of the national banking system, federally chartered banks would be subject to this multiplicity of state operating standards, because the Proposal sweepingly repeals the ability of national banks to conduct any retail banking business under uniform national standards.

This is a profound change and, in my view, the rejection of a national standards option is unwise and unjustified, especially as it relates to national banks. Given the CFPA's enhanced authority and mandate to write stronger consumer protection rules, there should no longer be any issue as to whether sufficiently strong federal consumer protection standards would be in place and applicable to national banks. In this context there is no need to authorize states to adopt different standards for such banks. Likewise, there would be no need to authorize states to enforce federal rules against national banks – which would inevitably result in differing state interpretations of federal rules – because federal regulators already have broad enforcement authority over such institutions and the resources to exercise that authority fully.

More fundamentally, we live in an era where the market for financial products and services is often national in scope. Advances in technology, including the Internet and the increased functionality of mobile phones, enable banks to do business with customers in many states. Our population is increasingly mobile, and many people live in one state and work in another – the case for many of us in the Washington, D.C. metropolitan area.

In this context, regressing to a regulatory regime that fails to recognize the way retail financial services are now provided, and the need for an option for a single set of rules for banks with multi-state operations and multistate customers, would discard many of the benefits consumers reap from our modern financial product delivery system. The Proposal's balkanized approach could give rise to significant uncertainty about which sets of standards apply to institutions conducting a multistate business, generating major legal and compliance costs, and major impediments to interstate product delivery.

This issue is very real. There are a number of areas in which complying with different standards set by individual states would require a bank to determine which state's law governs – the law of the state where a person providing a product or service is located, the law of the home state of the bank employing that person, or the law of the state where the customer is located. It is far from clear how a bank could do this based on objective analysis, and any conflicts could result in penalties and litigation in multiple jurisdictions.

Examples include rules regarding compensation practices for individuals providing a particular financial product, or permissible rates of interest for bank services. Today the maximum permissible interest rate is derived from the bank's home state, but states could claim that it should be the rate of the state in which the customer resides, or the rate of the location where the loan is made. States could have different standards for exerting jurisdiction over interest rates, creating the potential for the laws of two or more states to apply to the same transaction. And even if the bank gets this all figured out for a particular customer, and for all the product relationships it has with the customer, that would all change if the customer moved.

Such uncertainties have the real potential to confuse consumers, subject providers to major new potential liabilities, and significantly increase the costs of doing business in ways that will be passed on to consumers. It could also cause product providers to pull back where increased costs erase an already thin profit margin – for example, with indirect auto lending across state lines – or where they see unacceptable levels of uncertainty and potential risk.

Moreover, a bank with multi-state operations might well decide that the only sensible way to conduct a national business is to operate to the most stringent standard prevailing in its most significant state market. It should not be the case that the decision by a state legislature about how products should be designed, marketed, and sold should effectively replace a national regulatory standard established by the federal government based on thorough research and an open and nationwide public comment process.

Finally, subjecting national banks to state laws and state enforcement of federal laws is a potentially crippling change to the national bank charter and a rejection of core principles that form the bedrock of the dual banking system. For nearly 150 years, national banks have been subject to a uniform set of federal rules enforced by the OCC, and state banks have been subject to their own states' rules. This dual banking system has worked, as it has allowed an individual state to serve as a "laboratory" for new approaches to an issue – without compelling adoption of a particular approach by all states or as a national standard. That is, the dual banking system is built on individual states experimenting with different kinds of laws, including new consumer protection laws, that apply to state banks in a given state, but not to state banks in all states and not to national banks. Some of these individual state laws have proven to be good ideas, while others have not. When Congress has believed that a particular state's experiment is worthwhile, it has enacted that approach to apply throughout the country, not only to all national banks, but to state banks operating in other states that have not yet adopted such laws. As a result of this system, national banks have always operated under an evolving set of federal rules that are at any one time the same, regardless of the state in which they are headquartered, or the number of different states in which they operate. This reliable set of uniform federal rules is a defining characteristic of the national bank charter, helping banks to provide a broader range of financial products and services at lower cost, which in turn can be passed along to the consumer.

The Proposal's CFPA, by needlessly eliminating this defining characteristic, will effectively "de-nationalize" the national charter and undermine the dual banking system. What will be the point of a national charter if all banks must operate in every state as if they were chartered in that state? With many consumer financial products now commoditized and marketed nationally, it is difficult to understand the sense of replacing the option of enhanced and reliable federal standards that are uniform, with a balkanized "system" of differing state standards that may be adopted under processes very different from the public-comment and research-based rulemaking process that the CFPA would employ as a federal agency.

b. Inadequate Input by Banking Supervisors into Rulemaking

The Proposal would vest all consumer protection rulewriting authority in the CFPA, which in turn would not be constrained in any meaningful way by safety and soundness concerns. That presents serious issues because, in critical aspects of bank supervision, such as underwriting standards, consumer protection cannot be separated from safety and soundness. They are both part of comprehensive and effective banking supervision. Mortgage lending provides a good example. There is no doubt that abusive marketing and ineffective disclosure practices contributed to the build-up of harmful subprime loans. However, the core of the subprime crisis was an underwriting failure – loans made based on lax underwriting standards. Transparent disclosure regimes alone cannot solve that problem, just as sound underwriting does not guarantee that consumers will understand financial products and make informed choices. The integration of both perspectives is essential to effective, comprehensive supervision.

Despite this integral relationship, the Proposal as drafted would allow the CFPA, in writing rules, to dismiss legitimate safety and soundness concerns raised by a banking supervisor. That is, if a particular CFPA rule conflicts with a safety and soundness standard, the CFPA's views would always prevail, because the legislation provides no mechanism for striking an appropriate balance between consumer protection and safety and soundness objectives. The premise for this result seems to be that the CFPA (and the states, for that matter) will always opt for consumer protection rules that are more stringent from a safety and soundness perspective than rules that would be adopted by the safety and soundness supervisor. Not only is this premise counterintuitive – it is, after all, the safety and soundness supervisor's job to protect safety and soundness – but it is also not difficult to imagine circumstances in which the CFPA or a state adopts a rule in the name of consumer protection that would increase safety and soundness concerns, especially in the area of underwriting standards. For example, the CFPA could require a lender to offer a standardized mortgage that has simple terms, but also has a low down payment to make it more beneficial to consumers. That type of rule could clearly raise safety and soundness concerns, because lower down payments are correlated with increased defaults on loans – yet a safety and soundness supervisor would have no ability to stop such a rule from being issued.

In short, as applied to depository institutions, the CFPA rules need to have meaningful input from banking supervisors – both for safety and soundness purposes and because bank supervisors are intimately familiar with bank operations and can help ensure that rules are crafted to be practical and workable. A workable mechanism needs to be specifically provided to incorporate legitimate operational and safety and soundness concerns of the banking agencies into any final rule that would be applicable to insured depository institutions. Moreover, I do not believe it is sufficient to have only one banking supervisor on the agency's board, as provided under the Proposal; instead, all the banking agencies should be represented, even if that requires expanding the size of the board.

2. Implementation: Supervision, Examination, and Enforcement

Consumer protection rules are implemented through examination, supervision, and/or enforcement. In this context, the Proposal fails to adequately address the implementation gap I have previously described because it fails to carefully and appropriately target the CFPA's examination, supervision, and enforcement jurisdiction to the literally tens of thousands of non-depository institution financial providers that are either unregulated, or very lightly regulated. These are the firms most in need of enhanced consumer protection regulation, and these are the ones that will present the greatest implementation challenges to the CFPA. Yet rather than focus the CFPA's implementation responsibilities on solely these firms, the Proposal would effectively dilute both the CFPA's and the states' supervisory and enforcement authorities by extending them to already regulated banks. To do this, the Proposal would strip away all consumer compliance examination and supervisory responsibilities – and for all practical purposes enforcement powers as well – from the federal banking agencies and transfer them to the CFPA. And, although the legislation is unclear about the new agency's responsibilities for receiving and responding to consumer complaints, it would either remove or duplicate the process for receiving and responding to complaints by consumers about their banks. The likely results will be that: (1) nonbank financial institutions will not receive the degree of examination, supervision, and enforcement attention required to achieve effective compliance with consumer protection rules; and (2) consumer protection supervision of banks will become less rigorous and less effective.

In relative terms, it will be easy for the CFPA to adopt consumer protection rules that apply to all providers of financial products and services. But it will be far harder to craft a workable supervisory and enforcement regime to achieve effective implementation of those rules. In particular, it will be a daunting challenge to implement rules with respect to the wide variety and huge number of unregulated or lightly regulated providers of financial services over which the new CFPA would have jurisdiction, *i.e.,* mortgage brokers; mortgage originators; payday lenders; money service transmitters; check cashers; real estate appraisers; title, credit, and mortgage insurance companies; credit reporting agencies; stored value providers; financial data processing, transmission, and storage firms; debt collection firms; investment advisors not subject to SEC regulation; financial advisors, and credit counseling and tax preparation services, among other types of firms. Likewise, it will be daunting to respond to complaints from consumers about these types of firms. Last year, the OCC helped almost 100,000 consumers who had questions or complaints only about their banks. The CFPA is guaranteed to receive far more, given the vastly broader scope of its jurisdiction.

Yet, although the Proposal would give the CFPA broad consumer protection authority over these types of financial product and service providers, it contains no framework or detail for examining them or requiring reports from them – or even knowing who they are. No functions are specified for the CFPA to monitor or examine even the largest of these nonbank firms, much less to supervise and examine them as depository institutions are when engaged in the same activities. No provision is made for registration with the CFPA so that the CFPA could at least know the number and size of firms for which it has supervisory, examination, and enforcement responsibilities. Nor is any means specified for the CFPA to learn this information so that it may equitably assess the costs of its operations – and lacking that, there is a very real concern that assessments will be concentrated on already regulated banks, for which size and operational information is already available.

In short, the CFPA has a full-time job ahead to supervise, examine, and take enforcement actions against nonbank firms in order to effect their compliance with CFPA rules. In contrast, achieving effective compliance with such rules by banks is far more straightforward, since an extensive and effective supervisory and enforcement regime is already in place at the federal banking agencies. It therefore makes compelling sense for the new CFPA to target its scarce implementation resources on the part of the industry that requires the most attention to raise its level of compliance – the shadow banking system – rather than also try to undertake supervisory, examination, and enforcement functions with respect to depository institutions.

Similarly, state consumer protection resources, which are subject to the same severe budgetary pressures affecting state governments generally, would be best focused on examining and enforcing consumer protection laws with respect to the nonbank financial firms that are unregulated or lightly regulated – and have been the disproportionate source of financial consumer protection problems. If states targeted their scarce resources in this way, and drew on new examination and enforcement resources of the CFPA that were also targeted in this way, the states could help achieve significantly increased compliance with consumer protection laws by nonbank financial firms. Unfortunately, rather than have this focus, the Proposal's CFPA would stretch the states' enforcement jurisdiction to federally chartered banks, which are already subject to an extensive examination and enforcement regime at the federal level. We believe this dilution of their resources is unnecessary, and it will only make it more difficult to fill the implementation gap that currently exists in achieving effective compliance of nonbank firms with consumer protection rules.

Finally, I firmly believe that, by transferring all consumer protection examination, supervision, and enforcement functions from the Federal banking agencies to the CFPA, the Proposal would create a supervisory system for banks that would be a less effective approach to consumer protection than the integrated approach to banking supervision that exists today. As previously discussed, safety and soundness is not divorced from consumer protection – they are two aspects of comprehensive bank supervision that are complementary. The removal of all supervision and examination authority from the bank regulators would create fundamental fissures in the supervision of banks' retail businesses. Likewise, if it is the intention of the proposal to remove from the banking agencies the responsibility for receiving and responding to consumer complaints, it will remove a window into potential safety and soundness problems. For example, sometimes consumers raise fairness concerns about products that also present serious business risks. Consumers can be an early warning system for consumer protection problems and for safety and soundness problems.

Today, the banking agencies conduct safety and soundness and consumer compliance examinations on a coordinated basis. Information obtained from exams in one area can lead to follow-up supervisory activities in another. Disclosure deficiencies, aggressive marketing practices, or poor new product development can be symptoms of broader risk control failures that can injure both customers and bank soundness. And credit underwriting weaknesses, which are a core safety and soundness issue, can also constitute the real consumer protection issue of whether consumers are systematically provided credit that they cannot afford. Armed with safety and soundness examination information, bank supervisors have exercised real clout under current law to achieve consumer protection compliance through their ongoing examination presence.

Attached to my testimony are summaries of our actual supervisory experience, drawn from supervisory letters and examination conclusion memoranda, which show the real life linkage between safety and soundness and consumer protection supervision. I believe these summaries demonstrate that the results would be worse for consumers and the overall prudential supervision of these banks if bank examiners were not allowed to assess and address both safety and soundness and consumer protection issues as part of their integrated supervision.

Complaints that banking supervisors did not do enough to protect consumers are fundamentally more about whether consumer protection rules were sufficiently robust and timely, and less about whether supervisors adequately enforced the rules that were in place, which they generally did. The appropriate way for the CFPA to address these complaints is through its enhanced rulemaking function, not its examination, supervision, and enforcement functions.

Indeed, we believe that transferring bank examination and supervision authority to the CFPA will not result in more effective supervision because the new agency will never have the same presence or knowledge about the institution. Our experience at the OCC has been that effective, integrated safety and soundness and compliance supervision grows from the detailed, core knowledge that our examiners develop and maintain about each bank's organizational structure, culture, business lines, products, services, customer base, and level of risk; this knowledge and expertise is cultivated through regular on-site examinations and contact with our community banks, and close, day-to-day focus on the activities of larger banks. An agency with a narrower focus, like that envisioned for the CFPA, would be less effective than a supervisor with a comprehensive grasp of the broader banking business.

B. Systemic Regulator's Authority to Override Primary Banking Supervisor

Let me now turn to our other major concern with the Proposal, as we have seen it to date. As previously discussed, the Proposal would establish the Federal Reserve Board as the systemic supervisor by providing it with enhanced, consolidated authority over a "Tier 1" financial holding company – that is, a company that poses significant systemic risk – and all of its subsidiaries. In essence, this structure builds on and expands the current system for supervising bank holding companies, where the Board already has consolidated authority over the company, and the prudential bank supervisor is responsible for direct bank supervision.

In testimony provided earlier this year, I urged strongly that Congress, in reforming financial services regulation, preserve a robust, independent bank supervisor that is solely dedicated to the prudential oversight of depository institutions. I continue to believe that the benefits of dedicated, strong prudential supervision are significant. Dedicated supervision assures there is no confusion about the supervisor's goals and objectives, and no potential conflict with competing objectives. Responsibility is well defined, and so is accountability.

In practice, many of the companies likely to be designated as Tier 1 financial holding companies will have at their heart very large banks, many of which are national banks. Because of their core role as financial intermediaries, large banks have extensive ties to the "federal safety net" of deposit insurance, the discount window, and the payments system. Accordingly, the responsibility of the prudential bank supervisor must be to ensure that the bank remains a strong anchor within the company as a whole. Indeed, this is our existing responsibility at the OCC, which we take very seriously through our continuous on-site supervision by large teams of resident examiners in all of our largest national banks. As a result, the bank is by far the most intensively regulated part of the largest bank holding companies, which has translated into generally lower levels of losses of banks within the holding company versus other companies owned by that holding company – including those large bank holding companies that have sustained the greatest losses.

In the context of regulatory restructuring for systemically significant bank holding companies, preserving a fundamental role for the prudential supervisor of the bank means that its relationship with the systemic supervisor should be complementary; it should not be subsumed or overtaken by the systemic supervisor. Conflating the two roles undermines the bank supervisor's authority, responsibility, and accountability, and would further stretch the role of the Board.

Parts of the Proposal are consistent with this type of complementary relationship between the Board and the prudential bank supervisor. For example, the Board would be required to rely, as far as possible, on the reports of examination prepared by the prudential bank supervisors. This approach reflects the practical relationship that the OCC has with the Board today, a relationship that has worked well, in part because the lines of authority between the two regulators are appropriately defined. And it has allowed the Board to use and rely on our work to perform its role as supervisor for complex banking organizations that are often involved in many businesses other than banking. It is a model well suited for use in a new regulatory framework where the Board assumes substantial new responsibilities, including potential authority over some Tier 1 companies that do not have bank subsidiaries at all.

In one crucial respect, however, the Proposal departs dramatically from that model and is not consistent with its own stated objective of maintaining a robust, responsible, and independent prudential supervisor that will be accountable for its safety and soundness supervision. That is, the Proposal provides the Board with authority to establish, examine, and enforce more stringent standards with respect to the subsidiaries of Tier 1 financial holding companies – including bank subsidiaries – in order to mitigate systemic risk posed by those subsidiaries. This open-ended authorization would allow the Board to impose customized requirements on any aspect of the bank's operations at any time, subject only to a requirement for "consultation" with the Secretary of the Treasury and the bank's primary federal or state supervisor. This approach is entirely unnecessary and unwarranted in the case of banks already subject to extensive regulation. It would fundamentally alter the relationship between the Board and the bank supervisor by superseding the bank supervisor's authority over bank subsidiaries of systemically significant companies, and would be yet another measure that concentrates more authority in, and stretches the role of, the Board.

In addition, while the Proposal centralizes in the Board more authority over Tier 1 financial holding companies, it does not address the current, significant gap in supervision that exists <u>within</u> bank holding companies. In today's regulatory regime, a bank holding company may engage in a particular banking activity, such as mortgage lending, either through a subsidiary that is a bank or through a subsidiary that is not a bank. If engaged in by the banking subsidiary, the activity is subject to <u>required</u> examination and supervision on a regular basis by the primary banking supervisor. However, if it is engaged in by a nonbanking subsidiary, it is potentially subject to examination by the Federal Reserve, but regular supervision and examination is not required. As a policy matter, the Federal Reserve had previously elected not to subject such nonbanking subsidiaries to full bank-like examination and supervision on the theory that such activities would inappropriately extend "the safety net" of federal protections from banks to nonbanks.[5] The result has been the application of uneven standards to bank and nonbank subsidiaries of bank holding companies. For example, in the area of mortgage lending, banks were held to more rigorous underwriting and consumer compliance standards than nonbank affiliates in the same holding company. While the Board has recently indicated its intent to increase examination of nonbank affiliates, it is not clear that such examinations will be required to be as regular or extensive as the examination of the same activities conducted in banks.

I believe that such differential regulation and supervision of the same activity conducted in different subsidiaries of a single bank holding company – whether in terms of safety and soundness or consumer protection – doesn't make sense and is an invitation to regulatory arbitrage. Indeed, leveling the supervision of all subsidiaries of a bank holding company takes on added importance for a "Tier 1" financial holding company because, by definition, the firm as a whole presents systemically significant risk.

One way to address this problem would be to include in legislative language an explicit direction to the Board to actively supervise nonbanking subsidiaries engaged in banking activities in the same way that a banking subsidiary is supervised by the

[5] *See, e.g.,* Chairman Alan Greenspan, "Insurance Companies and Banks Under the New Regulatory Law," Remarks Before the Annual Meeting of the American Council of Life Insurance (November 14, 1999) ("The Gramm-Leach-Bliley Act is designed to limit extensions of the safety net, and thus to eliminate the need to impose bank-like regulation on nonbank subsidiaries and affiliates of organizations that contain a bank."), available on the Federal Reserve Board's website at www.federalreserve.gov/boarddocs/speeches/1999/19991115.htm.

prudential supervisor, with required regular exams. Of course, adding new required responsibilities for the direct supervision of more companies may serve as a distraction both from the Board's other new assignments under the Proposal as well as the continuation of its existing responsibilities.

An alternative approach would be to assign responsibility to the prudential banking supervisor for supervising certain non-bank holding company subsidiaries. In particular, where those subsidiaries are engaged in the same business as is conducted by an affiliated bank – mortgage or other consumer lending, for example –the prudential supervisor already has the resources and expertise needed to examine the activity. Affiliated companies would then be made subject to the same standards and examined with the same frequency as the affiliated bank. This approach also would ensure that the placement of an activity in a holding company structure could not be used to arbitrage between different supervisory regimes or approaches.

Conclusion

The OCC appreciates the opportunity to testify on proposed regulatory reform, and we would be pleased to provide additional information as the Committee continues its consideration of this important Proposal.

Attachment
to the Statement of John C. Dugan

Examples of How Safety and Soundness
and Consumer Protection Supervision are Linked

Although the Administration's Proposal to create the CFPA is intended to implicate only consumer protection and not safety and soundness, and is premised on a neat division of the two disciplines, supervision of the two areas is inextricably linked. In the OCC model, the two disciplines are interwoven, sometimes performed by the same staff, especially in community banks, and sometimes by integrated teams of specialists. In either case, supervision in one area informs the other in important ways.

The following examples are derived from OCC examiners' supervisory letters and examiner conclusion memoranda and actual examination experience.[6] They demonstrate real-life examples of the interrelationship of safety and soundness and consumer protection supervision in the bank supervision process. This integrated and effective supervisory approach would be dismantled under the Consumer Financial Protection Agency proposal.

EXAMPLE 1: ***A safety and soundness examination of mortgage origination practices identified a potentially significant consumer protection issue.***

During a safety-and-soundness examination of the credit scoring models used in mortgage origination at a bank, the OCC's quantitative modeling expert noted that models being developed for future use included variables that raised potential fair lending risks. Because the modeling expert was part of the group within the OCC that provides modeling support for fair lending examinations, the modeling expert was familiar with fair lending law considerations. The OCC expert discussed this issue with the quantitative modelers working for the bank, who articulated technical reasons for the inclusion of the variables, related to building more consistent models. The OCC expert was able to discuss the issues in depth with the bank, helping to identify potential alternatives for use in the scoring model. The bank revised the model under development and potential fair lending issues thus were avoided.

[6] Supervisory letters typically are provided to bank management at the conclusion of an examination to address exam findings, note violations of law or regulations, or matters requiring attention (MRAs), which are issues that do not necessarily involve violations, but that the OCC requires the bank to nonetheless address. Examiner conclusion memoranda are internal documents prepared at the conclusion of an exam to document examination results.

EXAMPLE 2: ***An examination for fair lending compliance risk resulted in an MRA requiring an enterprise-wide consumer protection (fair lending) risk management program.***

During an examination to evaluate the bank's fair lending compliance risk management program and test compliance with fair lending laws and regulations, examiners found that the bank had not designated fair lending as an enterprise-level risk and did not manage fair lending risk cohesively across the company. Although management maintained an enterprise-level fair lending policy statement, a formal enterprise-level risk management program was not in place. Examiners conveyed the expectation that the bank would have a cohesively stated and implemented mission across all business units, with standard monitoring processes and metrics to measure effectiveness. Examiners required management to submit a detailed action plan to address the issues raised.

EXAMPLE 3: ***A joint safety and soundness and consumer compliance examination of nontraditional mortgage products identified violations related to consumer protection.***

During a joint safety and soundness and consumer compliance examination of nontraditional mortgage products where the primary objective of the review was to assess compliance with OCC Bulletin 2006-41- *Guidance on Nontraditional Mortgage Product Risks,* examiners also evaluated whether nontraditional mortgage disclosures matched the illustrations set forth in OCC Bulletin 2007-28 – *Illustrations of Consumer Information.* Additionally, examiners conducted a concurrent review of stated income products and loans with low or no documentation to determine if the risks involved in these products were sufficiently mitigated. While the exam focused on both safety and soundness and consumer protection issues, the sole violation noted during the exam involved a consumer protection issue. The option ARM payment change notice did not comply with 12 CFR 226.20(c) because it did not include the new interest rate, the prior interest rate and all other rates that applied since the last payment change. The notice also did not include the corresponding index values. It did not indicate if the new payment disclosed any forgone rate increases or if it would fully amortize the loan over the remaining term. As a result of issues identified by examiners, a corrected disclosure form was created and reviewed by examiners during the examination.

EXAMPLE 4: ***A joint safety and soundness and consumer compliance examination of credit cards resulted in an MRA related to consumer protection.***

During a joint safety and soundness and compliance review to assess the adequacy of processes relative to underwriting, account management, collections, and compliance with the credit card Account Management Guidance (OCC Bulletin 2003-1), examiners evaluated credit policies and procedures, controls over a vendor relationship, the quality of MIS, and the bank's marketing plan. Concurrently, examiners also conducted a consumer compliance review that focused on assessing the bank's own testing of controls in place to ensure compliance with the various consumer protection regulations applicable to credit card lending. While the exam focused on both safety and soundness and consumer protection issues, the sole MRA noted during the exam involved a consumer protection issue. Examiners noted that although the bank had agreed to an action plan for developing appropriate consumer compliance controls, a thorough consumer compliance vendor management program and file testing process had yet to be implemented. Examiners required that the bank develop a comprehensive consumer compliance vendor management program that included file testing for compliance with all applicable consumer protection regulations.

EXAMPLE 5: ***Review of a consumer credit unit required an integrated team of safety and soundness, information technology (IT), and consumer compliance examiners.***

During a review of a bank's consumer credit unit, the OCC utilized safety and soundness, IT, and compliance examiners to specifically address the quantity and direction of portfolio credit risk; assess underwriting practices, including compliance with the *Subprime Mortgage Lending* guidance outlined in OCC Bulletin 2007-26; and evaluate collateral valuation methodologies. Examiners also evaluated credit quality assurance reviews, exception tracking systems, and control systems. Other areas assessed in this joint review included model risks associated with the collection and origination scorecards; marketing practices and controls; the adequacy of management information systems (MIS); loss forecasting methodologies, with an emphasis on the ACL process; information technology systems within the bank, with a focus on the consumer credit unit.

EXAMPLE 6: ***Review of subprime mortgage products required an integrated team of safety and soundness and consumer compliance examiners.***

During the joint safety and soundness and compliance examination of a bank's subprime mortgage products, the primary objective was to assess the propriety of loan origination and risk management processes. Examiners focused on current underwriting and also reviewed controls established to ensure consumer protection against steering and predatory lending practices. Examiners assessed compliance with banking laws, regulations, and guidance, including recent guidance on subprime products. Examiners tested a sample of subprime loans to assess underwriting and consumer protection processes, reviewed written policies and procedures, and also assessed processes used to measure and monitor subprime mortgage performance.

EXAMPLE 7: ***Consumer complaints received by the agency about a third-party service provider triggered a comprehensive review by safety and soundness and consumer compliance examiners of a bank's relationships with that provider***

During a joint safety and soundness and compliance review of a bank's relationships with a third-party service provider, examiners also reviewed other third-party marketing relationships in existence for the businesses. Examiners reviewed policies and procedures covering due diligence and performance monitoring of third-party marketing relationships. The primary objective was to identify all of the bank's business relationships with this provider and the bank's respective due diligence efforts to monitor and control reputation and compliance/legal risks from these relationships. Products were reviewed to evaluate how they were being marketed, the accuracy and transparency of disclosures to the customer, and whether the products offered value to the consumer. This review was conducted because the third-party provider and its programs were the subject of several recent consumer complaints received by the OCC. It also took into account findings from an earlier credit card UDAP review of marketing, disclosures, and internal controls.

EXAMPLE 8: ***A safety and soundness review of a bank's internal audit function found weaknesses in the compliance audit function.***

During an annual review of a bank's internal audit program, safety and soundness examiners focused on evaluating the scope of audit work performed, the effectiveness of following up and validation activities, and the adequacy of management reporting. Test work was completed using the customary integrated approach of having each functional team complete an assessment of audit work in their areas of expertise. The scope of these reviews focused on work paper samples, call program databases, and corrective action databases.

Examiners identified areas for improvement in compliance audit functions. Examiners noted that an overall "state of compliance" for each significant consumer protection regulation would be beneficial to bank executive management in determining compliance risk areas and spending priorities.

The bank's approach to compliance auditing entailed a highly decentralized line of business approach. Examiners noted that related to the lack of an overall compliance roll-up, the compliance audit process would also benefit from improved scoping of higher risk products/services and deeper analysis of activity and associated risks. Because audit testing occurred almost exclusively as part of the line of business audits, examiners noted that few audit resources were dedicated to review specific compliance risks associated with individual products or services.

EXAMPLE 9: ***A safety and soundness examination of nontraditional mortgages (NTM) and home equity loans resulted in a series of consumer-protection-related recommendations.***

During a safety and soundness review of a bank's consumer finance unit to assess compliance with regulatory guidances including non-traditional, subprime, and home equity mortgages, examiners assessed the adequacy of risk management oversight and control systems. Examiners specifically targeted underwriting of near-prime broker originated, interest only mortgage loans, subprime broker originated mortgage loans, and subprime retail mortgage loans. The examiners reviewed risk management MIS, third party monitoring, and mortgage loss mitigation and workout programs. During the review the safety and soundness examiners noted consumer protection issues.

While the combined disclosures provided adequately addressed the requirements indicated in the Statement on Subprime Guidance (OCC Bulletin 2007-26) and in the Interagency NTM guidance, examiners determined that it was based on the proposed, not final illustrations. Additionally, examiners identified that the system which generated the disclosures at the time of application for certain loans was not updated as intended with the combined disclosure.

Examiners made the following consumer protection related recommendations to bank management.

The bank should revise the nontraditional mortgage disclosure, *Consumer Finance Division Comparison of Sample Mortgage Features*, to fully comply with OCC Bulletin 2007-28, provide better consistency with other ARM disclosures, and address computation errors. Additionally, bank management should verify the accuracy of the numbers disclosed in the comparison table. Examiners identified small computational errors in numbers in the table under the interest only 5/1 ARM example and an error in the balloon loan footnote.

Examiners also recommended that quality assurance expand its interest-only mortgage review checklist to verify that the NTM disclosure was provided. Additionally, examiners recommended that the bank verify that all software systems are updated with the most current version of the disclosures when changes occur.

EXAMPLE 10: ***During a trust examination, a number of consumer protection issues were identified.***

During a fiduciary review of a bank's personal trust area, trust examiners identified consumer protection MRAs.

Examiners noted that bank management needed to ensure that trust accounts were properly compensated for income lost as a result of bank errors. Examiners identified one account in a sample where an errant transaction resulted in the nominal loss of interest income. The bank did not reimburse the account for the lost income, as required by internal policy. In addition, there was not a process in place to identify errant transactions and ensure that proper compensation is made to an account. Examiners required bank management to compensate the account noted in the sample and identify tools to be used to ensure that similar situations be detected and resolved appropriately going forward.

Examiners further noted that bank management needed to compensate customer accounts for the loss of earnings from the untimely posting of mutual fund dividends and capital gains. Examiners also noted that management needed to establish or modify policies and procedures to define the remedial measures to be taken in similar situations going forward. The untimely posting of payments negatively impacted the accounts involved and benefited the bank. Examiners required bank management to properly compensate all accounts impacted by the posting problems and ensure appropriate policies and procedures were in place to govern recurrences.

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Secretary Timothy F. Geithner
Written Testimony
House Financial Services Committee
Hearing on Financial Regulatory Reform
July 24th, 2009

Chairman Frank, Ranking Member Bachus, and members of the Financial Services Committee, thank you for the opportunity to testify before you today about the Administration's plan for financial regulatory reform.

On June 17, President Obama unveiled a sweeping set of regulatory reforms to lay the foundation for a safer, more stable financial system; one that properly delivers the benefits of market-driven financial innovation while safeguarding against the dangers of market-driven excess.

The President's plan focuses on the essential reforms. It addresses the core causes of the current economic crisis. It addresses the areas critical to confronting future vulnerabilities. And, in pursuing what amounts to the most extensive overhaul of our financial regulatory regime in decades, it makes clear to the American people that their government, at an early stage in this new Administration, is intent on fixing the basic regulatory flaws that caused extensive damage to families and businesses.

Over the past five weeks, in Congress and in the press, among legislators and business leaders, academics and advocates, the Administration's proposals have spurred an important and sometimes heated debate about how best to reform the financial regulatory system. That debate is to be expected, and is welcome. While crafting our plan, the Administration sought input from all points of view, considered all options and heard many of the opinions being expressed today.

We understand that on any issue this complex and this important there will be areas where parties genuinely disagree, and we look forward to refining our recommendations through the legislative process.

But there should be no disagreement on the need to act.

Over the past two years, we have faced the most severe financial crisis since the Great Depression. The damage has been indiscriminate and unforgiving. Millions of Americans have lost their jobs; families have lost their homes; small businesses have shut down; students have deferred college educations; and seniors have shelved retirement plans. Some of our largest financial institutions failed; others came under extraordinary pressure; and many of the securities markets that are critical to the flow of credit broke down.

As a country, we now know that our financial system failed in its most basic responsibility to be stable and resilient enough to provide credit while protecting consumers and investors.

We now know that our regulatory regime permitted an excessive build-up of leverage, both outside the banking system and within the banking system; that the shock absorbers critical to

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preserving the stability of the financial system – capital, margin, and liquidity cushions in particular – were inadequate to withstand the force of the global recession; and that they left the system too weak to withstand the failure of major financial institutions.

We now know that millions of Americans were left without adequate protection against financial predation, especially in the mortgage and consumer finance areas; and that many were unable to evaluate the risks associated with borrowing to support the purchase of a home, a car, or an education.

And, we know that the United States entered this crisis without an adequate set of tools to contain the risk of broader damage to the economy and to manage the failure of large, complex financial institutions.

As a result, American families have made essential changes and they expect their government to do the same. There exists today a national mandate, not seen in years, to reform our outdated and ineffective regulatory system.

Still, despite that reality, there are some who suggest we are trying to do too much too soon, and that we should wait until the crisis has definitively receded. Others say we do not need comprehensive change or that it will destroy innovation. And with respect to consumer protection in financial services, there are even those who contend we should leave things as they are.

That is not surprising. Every financial crisis of the last generation has sparked some effort at reform, but past attempts began too late, after the will to act had subsided.

That cannot happen this time.

The reforms proposed by the President are necessary. They would substantially alter the ability of financial institutions to escape regulation, to choose which regulator suits them best, to shape the content of future regulation and to continue the financial practices that were lucrative for parts of the industry for a time, but that ultimately proved so damaging. That is why we have to act, and why we need to deliver real, meaningful change.

The Administration welcomes the commitment of this Committee and your counterparts in the Senate, as well as other key committees and the Congressional leadership, to pass legislation this year. And the Administration is moving aggressively to help advance the overall process.

In the weeks following the President's announcement, we have delivered detailed legislative language to Congress on virtually all of our proposals: on the enhanced regulation of our largest, most interconnected financial firms; on the supervision and regulation of federal depository institutions; on new resolution authority; on payments and settlement systems; on investor protection; on private fund registration; on executive compensation; on securitization and credit rating agencies; and on the proposed new Financial Services Oversight Council and Consumer Financial Protection Agency (CFPA).

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We are also working to put in place reforms that do not require legislation. We have used the President's Working Group on Financial Markets to pull together all government agencies that oversee elements of the financial system to formulate more detailed proposals for implementing the comprehensive reforms outlined by the President.

By now the details of our plan are widely known and so I would like to provide some additional context by explaining our key priorities for reform.

Consumer Protection

Let me begin with a pressing concern for this Committee – building strong protections for consumers, and ensuring they can understand the risks and rewards associated with the products sold to them. I know you will soon be marking up legislation on this issue.

There is broad agreement that consumer protection needs to be stronger. Achieving this objective requires mission focus, market-wide coverage, and consolidated authority, none of which exist in today's system.

That is why we are proposing one agency for one market place with one mission – protecting consumers.

The case for the Consumer Financial Protection Agency is clear.

First, non-banks such as mortgage brokers and large independent mortgage companies, consumer credit companies and pay-day loan operations, currently operate under no federal supervision. No federal agency sends consumer protection examiners into these institutions to review their files or interview their salespeople. No federal regulator collects information from them, except for limited mortgage data.

In the years before the crisis, capital flowed heavily to these unsupervised non-banks in large measure because they enjoyed the advantage of weak consumer oversight. Banks were left with the untenable choice of lowering their standards to compete or giving up market share.

The proposed CFPA would fix this problem and ensure a level playing field by extending the reach of federal oversight to all financial firms, no matter whether they are banks or non-banks.

Second, even where federal oversight exists, standards are weakened by the ability of banks and thrifts to choose the regulator that will have the least restrictive oversight of consumer protection, something we also saw in the years leading up to the current crisis.

The President's proposal would correct this by consolidating responsibility for consumer protection into one agency, meaning financial institutions would no longer be able to shop for the weakest regulator and pursue a race to the regulatory bottom.

Third, the banking agencies responsible for implementing and enforcing consumer protection have higher priorities. The agencies' primary focus is the safety and soundness of the institutions

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they oversee. As a matter of mission and internal organization, they are focused on the effect of a bank's products and practices on the bank itself, rather than the effect on consumers. That is why the CFPA would have as its sole mission examining how a product or practice affects consumers.

Importantly, nothing in the CFPA's mission or authority would conflict with or undermine the safety and soundness of banking institutions. Our proposal ensures cooperation with prudential regulators by placing one of them on the board of directors and requiring examiners to exchange examination reports.

Making banks act fairly and transparently with their customers only enhances their safety and soundness. Market-wide jurisdiction of the CFPA will ensure that banks are not forced to choose between lowering their standards and giving up market share.

Finally, the government agencies that have responsibility for consumer financial protection are limited in their ability to do something about the problems they encounter because they have only one set of authorities available to them, instead of the full range, from rule-writing to supervision to enforcement. This leads to inertia and finger-pointing in place of action. And it makes any action taken less likely to be effective.

For example, when it comes to credit cards, the Federal Reserve has substantial power to write rules but has little authority to enforce them outside of bank holding companies, while the Office of the Comptroller of the Currency has little authority to write rules but wide power to enforce them. As concerns about fairness and transparency emerged, each agency looked to the other to act and, in the end, not enough was done.

Even in cases where agencies have what, in principle, should be the more flexible authority to issue regulatory guidance to institutions, they are hampered by the fact that several agencies have similar authority.

In the case of subprime mortgages, it took the federal banking agencies until June 2007 to reach final consensus on supervisory guidance imposing even general standards on subprime mortgages. By then it was too late.

Our consumer protection proposal would put an end to this problem by giving the CFPA consolidated authority to write rules, supervise compliance and take enforcement action when there are violations.

It is time for a level playing field for financial services competition based on strong rules, not based on exploiting consumer confusion. Our proposal achieves that by ensuring consumer choice, preserving innovation, strengthening depository institutions, reducing regulatory costs, and increasing national regulatory uniformity and accountability.

Financial Stability

Our second priority was creating a more stable financial system by strengthening supervision and regulation of financial firms.

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That necessarily begins with higher capital requirements. The most important thing to lowering risk in the financial system is stronger capital cushions.

The Committee is well aware that in the years leading up to this crisis, as rising asset prices, particularly in housing, concealed a sharp deterioration of some of the underwriting standards for loans, risks built up substantially while capital cushions did not. The nation's largest financial firms, already highly leveraged, became increasingly dependent on unstable sources of short-term funding.

These firms did not plan for the potential demands on their liquidity during a crisis. And when asset prices started to fall and market liquidity froze, they were forced to pull back from lending, limiting credit for households and businesses.

Looking back it is clear that regulators did not require firms to hold sufficient capital to cover risks from their trading assets, high-risk loans, and off-balance sheet commitments.

Under our plan, that will change. Financial firms will be required to follow the example of millions of families across the country that are saving more money as a precaution against bad times. They will be required to keep more capital and liquid assets on hand and, importantly, the biggest, most interconnected firms will be required to keep even bigger cushions.

Now, higher capital requirements are an important step towards longer-term stability, but they are only the first step.

While many of the financial firms at the center of this crisis were under some form of federal supervision and regulation, that oversight did not do enough. A patchwork of supervisory responsibility, loopholes that allowed some institutions to shop for the weakest regulator, and the rise of new financial institutions and instruments that were almost entirely outside the government's supervisory framework left regulators largely blind to emerging dangers and without the tools needed to address them.

That is why we propose evolving the Federal Reserve's authority to create a single point of accountability for the consolidated supervision of all large, interconnected firms whose failure could threaten the stability of the system, regardless of whether they own an insured depository institution. This is a role the Fed plays today, given its supervision and regulation of bank holding companies, including all major U.S. commercial and investment banks.

While our plan gives some new authority – along with necessary accountability – to the Fed, it also takes some away. That includes transferring the Fed's consumer protection responsibility to the CFPA and requiring the Fed to receive written approval from the Secretary of the Treasury before exercising its emergency lending authority.

Alongside the new role played by the Fed, there must also be a mechanism to look at the system as a whole for dangers, given that risk can emerge from almost any quarter.

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That is why we are proposing a Financial Services Oversight Council to bring together the heads of all of the major federal financial regulatory agencies. This Council will improve coordination of policy and resolution of disputes among the agencies. It will have a significant consultative role to play in helping preserve financial stability. And, most importantly, it will have the power to gather information from any firm or market to help identify emerging risks.

Improving the supervision and regulation of financial firms broadly also requires reducing the ability of depository institutions to choose their regulator and regulatory framework. To address this problem, we have proposed eliminating the thrift and thrift holding company charter and removing other loopholes in the Bank Holding Company Act.

Market Oversight

The third priority that guided our decision making was establishing comprehensive regulation of financial markets.

The current financial crisis emerged after a long and remarkable period of growth and innovation. New instruments, such as over-the-counter (OTC) derivatives, allowed risks to be spread quickly and widely, enabling investors to diversify their portfolios in new ways and enabling banks and other companies to shed exposures that had once resided on their balance sheets.

However, the OTC derivatives markets, which were thought to efficiently promote dispersion of risk to those most able to bear it, instead became a major channel of contagion through the financial sector in the crisis. When fear spread that any institution could fail, the markets for risk transfer and liquidity froze – making it difficult for all financial institutions to maintain daily operations.

Two weeks ago, I testified at a joint hearing of this committee and the House Agriculture Committee on our comprehensive regulatory framework for the OTC derivatives markets. I outlined how our plan would provide strong regulation and transparency for all OTC derivatives regardless of whether the derivative is customized or standardized. In addition, I discussed how our plan will provide for strong supervision and regulation of all OTC derivative dealers and all other major participants in the OTC derivative markets.

We intend very soon to send up draft legislation on derivatives to implement our proposal.

Alongside reforms in the derivatives market, we also propose enhanced regulation of the securitization markets.

In the years preceding the crisis, mortgages and other loans were aggregated with similar loans and sold in tranches to a large and diverse pool of new investors with different risk profiles. Securitization, by breaking down the traditional relationship between borrowers and lenders, created various conflicts of interest that market discipline failed to correct.

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Loan originators failed to require sufficient documentation of income and ability to pay. Securitizers failed to set high standards for the loans they were willing to buy, encouraging underwriting standards to sag. Investors were overly reliant on credit rating agencies, whose procedures proved no match for the complexity of the instruments they were rating. In each case, lack of transparency prevented market participants from understanding the full nature of the risks they were taking.

In response, the President's plan requires securitization sponsors to retain five percent of the credit risk of securitized exposures; it requires transparency of loan level data and standardization of data formats to better enable investor due diligence and market discipline; and, with respect to credit rating agencies, it ends the practice of allowing them to provide consulting services to the same companies they rate, requires these agencies differentiate between structure and other products, and requires disclosure of any "ratings shopping" by issuers.

Crisis Resolution

Our fourth priority was addressing the basic vulnerabilities in our capacity to manage future crises.

The United States came into the current crisis without an adequate set of tools to contain the risk of broader damage to the economy and to manage the failure of large, complex financial institutions. That left the government with extremely limited choices when faced with the failure of the largest insurance company in the world and one of the largest U.S. investment banks.

That is why, in addition to addressing the root causes of our current crisis, we must also act preemptively to provide the government better tools to manage future crises. To do that, we have proposed a new resolution authority for financial firms whose disorderly failure would threaten the stability of the financial system.

Our proposal is modeled on the existing FDIC resolution regime for banks. This exception allows the FDIC to depart from the least cost resolution standard only when financial stability is at risk. Similarly, our resolution authority would only be for extraordinary times and would be subject to very strict governance and control procedures.

Any costs to the taxpayer from the use of this authority would be recovered through ex post assessments on large financial firms. As such, it will reduce moral hazard by allowing the government to resolve failing large, interconnected financial institutions in a way that imposes costs on owners, creditors and counterparties, making them more vigilant and prudent.

No one should assume that the government will step in and bail them out if their firm fails.

In addition, we propose that the biggest firms prepare, continuously update, and periodically provide to regulators a credible plan for their rapid resolution in the event of severe financial distress. This would create incentives for firms to better monitor and simplify their organizational structure and would better prepare the government, as well as the firm's investors, creditors, and counterparties, for the possibility of a firm's collapse.

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The key test of these reforms will be whether we make this system strong enough to withstand the stress of future recessions and the failure of large institutions.

Level Playing Field Internationally

The final priority of the Administration was working with our global partners to raise international regulatory standards and improve international cooperation.

As we have witnessed during this crisis, financial stress can spread easily and quickly across national boundaries. Yet, regulation is still set largely in a national context. Without consistent supervision and regulation, financial institutions will tend to move their activities to jurisdictions with looser standards, creating a race to the bottom and intensifying systemic risk for the entire global financial system.

The United States is playing a strong leadership role in efforts to coordinate international financial policy through the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision. Alongside our partners, we are proposing that the international banking regulators responsible for setting capital requirements take forward their work on reforming capital ratios to more effectively constrain leverage in the future. More broadly, we will call on the international banking regulators to develop proposals by the end of this year for countries to have the necessary tools to quickly resolve failures of cross-border financial firms.

Conclusion

Over the past six months, in responding to the current economic crisis, the Obama Administration has taken extraordinary action.

We moved quickly to restore confidence in the banking system. Without first stabilizing and repairing the financial system, broader economic recovery would not be possible. In doing so, we have increased transparency and disclosure, helping to bring billions of dollars of private capital into banks so they could safeguard against a deeper recession, and enabling some banks who took taxpayer funds to start paying back the government.

We worked to ease the housing crisis by helping to bring mortgage rates down to historic lows and establishing new programs to allow responsible homeowners to refinance into affordable mortgages or alter at-risk loans and help homeowners lower their monthly mortgage payments. Estimates indicate that up to 3 to 4 million homeowners will be offered trial loan modifications under the Administration's program.

We worked to offset the dramatic contraction in demand by working with Congress to put in place the most sweeping economic recovery package in our nation's history – a comprehensive program of immediate tax incentives for businesses and households, support for state and local governments, and investments in critical economic priorities, from infrastructure and energy to health care and education. The Recovery Act was designed to provide a sustained boost to

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economic demand, concentrated over a two year period and, as designed, the largest effects on the spending side will come in the next six months.

Through the G-20 and G-8, we are working with the major economies of the world on a coordinated program of macroeconomic stimulus and financial stabilization, alongside regulatory reform. This has amounted to the most aggressive international response to any financial crisis in the last fifty years, implemented with unprecedented speed and breadth.

Because of these steps, in just six months, the Administration has substantially reduced the risk of a much deeper and more prolonged recession. We have begun stabilizing an economy that in January was in a free-fall. And we have seen improvements that have been more substantial and have come more quickly than expected when we were designing our response in December and January. Business and consumer confidence has started to improve, housing markets have begun to stabilize, the cost of credit has fallen significantly and credit markets are starting to open up.

But there is still a long way to go. We have a lot more work to do to lay the foundation for a more sustainable recovery, with the gains more broadly shared among all Americans, and central to that effort is passing comprehensive regulatory reform legislation by the end of the year.

We simply cannot afford inaction on this issue. We cannot afford a situation where we leave in place vulnerabilities that will sow the seeds for future crises, and prevent our financial system from functioning properly.

The United States is the world's most vibrant and flexible economy, in large measure because our financial markets and our institutions create a continuous flow of new products, services and capital. That makes it easier to turn a new idea into the next big company.

America's tradition of innovation has been vital to our prosperity. The reforms proposed in the Administration's plan are designed to strengthen our markets by restoring confidence and accountability, while preserving that tradition of innovation.

In the weeks and months ahead I look forward to working this Committee to help pass regulatory reform legislation and, in turn, build a stronger American economy.

Thank you.

TESTIMONY OF

JOSEPH A. SMITH, JR.

NORTH CAROLINA COMMISSIONER OF BANKS

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

"FINANCIAL REGULATION AND RESTRUCTURING"

Before the

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

July 24, 2009

Room 2128 Rayburn House Office Building

INTRODUCTION

Good morning, Chairman Frank, Ranking Member Bachus, and distinguished members of the Committee. My name is Joseph A. Smith, Jr. I am North Carolina Commissioner of Banks and Chairman of the Conference of State Bank Supervisors (CSBS), the professional association of state officials responsible for chartering, regulating and supervising the nation's approximately 6,000 state-chartered banks. In addition to regulating banks, most state banking departments also supervise the residential mortgage industry as well as many other areas of consumer finance and lending. As the mortgage industry has evolved over the past two decades, CSBS has expanded its mission beyond traditional commercial bank supervision and has been working closely with the American Association of Residential Mortgage Regulators (AARMR) to enhance supervision of the mortgage industry.

Thank you for inviting CSBS to testify today on the Administration's plan for financial regulatory reform. CSBS applauds this Committee and the Administration for the time and energy put into this challenging undertaking. CSBS looks forward to working with Congress and the Administration toward a reform plan that makes meaningful and sustainable improvements in the way our financial system serves the public and strengthens local communities and our nation's economy.

Upon the release of the Administration's regulatory restructuring proposal and Chairman Frank's introduction of H.R. 3126, CSBS and its members began a process of evaluating the various proposals and developing policy positions and recommendations. I would like to thank my colleagues in states across the nation for their thoughtful efforts. My statement today reflects the positions and recommendations that emerged from this process.

The financial crisis and the recent economic downturn have exposed weaknesses in financial oversight, identified gaps in statutes and regulations, uncovered harmful industry practices and products, highlighted imprudent consumer habits, and sparked an important debate among regulators, the industry, consumer groups, the Administration and Congress. From where the members of CSBS sit, with years of financial services supervisory and regulatory experience and with a real-time appreciation for the impact of the current crisis on consumers and communities, it is clear that some form of financial regulatory reform is necessary. The legacy of this crisis could be a highly concentrated and consolidated industry that is too close to the government and too distant from the consumer and the needs of our communities. That need not be the result -- but it is the course we are on. To avoid that outcome, Congress needs to realign the regulatory incentives around consumer protection and directly address and end "too-big-to-fail." To prevail through the next crisis, we need a diverse industry, not a handful of mega-banks.

We believe that effective regulatory restructuring should promote and maintain a financial services industry that is safe, sound, diverse, and competitive and that provides a broad range of borrowers with access to sustainable credit. This industry must serve consumers with a diverse universe of understandable financial services and products that meet a wide range of financial and borrowing needs, and these consumers need to have confidence in a legal and regulatory structure that protects them from abusive products and providers. The regulatory structure must create incentives for innovation and prudent growth, but it also must have robust safeguards to prevent growth driven by excessive risk taking and leverage and to protect taxpayers from potentially unlimited liability.

CSBS believes that many provisions of the Administration's plan would significantly advance these goals. These include the continuation of the current supervisory structure for state-chartered banks, a comprehensive approach to consumer protection in the financial services arena, and the recognition of the importance of state law and state law enforcement in accomplishing consumer protection.

CSBS also believes, however, that some provisions of the Administration's plan would be inconsistent with the objective of a strong, diverse, and competitive financial services industry that provides broad access to affordable credit and more effectively protects consumers and taxpayers. In particular, we are concerned that the Administration's plan inadequately addresses the systemic risks posed by large complex financial institutions. The Administration's plan leaves open the real prospect of creating a bifurcated industry, with one class of systemically significant large institutions that enjoy real and perceived federal preferences and "the rest," those who lack the scale to merit an implicit link to the government and the market advantages such a link confers. This disparate treatment is unsustainable and likely would drive non-systemic institutions out of business or to the margins. Finally, we believe that still other aspects of the Administration's proposal warrant further discussion and detail in order to determine whether and how they will serve our broader goals.

My testimony today will present our perspective on these issues, discussing four main elements: the proposal to create a new Consumer Financial Protection Agency; the proposal to create a new Financial Services Oversight Council; the proposal for a new resolution regime for failing bank holding companies, including Tier 1 financial holding companies; and the structure for consolidated supervision of large, interconnected financial firms. Additionally, my testimony touches briefly on a few other aspects of the Administration's regulatory restructuring proposal.

THE DUAL BANKING SYSTEM CONTINUES TO PROMOTE INDUSTRY DIVERSITY AND BROAD ACCESS TO AFFORDABLE CREDIT

The United States' dual banking system is unique, allowing for the creation of a diverse, dynamic, and durable banking industry that has, in turn, fueled the world's most influential economy for 150 years. Despite industry consolidation, which has increased as federal law has offered more and broader preemptions of state authority, the United States still boasts over 8,000 insured banks and thrifts that vary in size, complexity, the markets they serve, and the products they offer.

If we have learned nothing else from the recent upheaval in our financial sector, we must remember that excessive concentration of financial power and the lack of transparency in the provision of financial services are harmful to the long-term interests of our financial system and its customers. However, it is also important to preserve and strengthen those aspects of our financial system that have kept it relatively resilient and have help keep credit flowing to consumers and businesses across our diverse economy. The dual banking system continues to ensure that citizens across the nation have access to credit, and CSBS is pleased that the Administration's regulatory restructuring proposal preserves the dual banking system. If the financial system were composed of a handful of behemoth, systemic institutions, it is likely that citizens in rural areas and smaller communities would not have sufficient access to credit. As the map attached as

Exhibit A demonstrates, the seven largest institutions tend to concentrate their presence in major urban metropolitan areas, while smaller communities and cities are served by other banks.

A FEDERAL CONSUMER FINANCIAL PROTECTION AGENCY SHOULD BE FOCUSED ON RULEMAKING AND MUST REFLECT THE IMPORTANT ROLE OF THE STATES IN CONSUMER PROTECTION

The Administration's proposed Consumer Financial Protection Agency (CFPA) would be a single primary federal supervisor charged with protecting consumers of credit, savings, payment, and other consumer financial products and services, and with regulating providers of these products and services.

CSBS supports the creation of the CFPA, in concept, and its goals. Public confidence is an essential element of our financial system, and restoring this confidence must be a central goal of this reform effort. Consumer protection standards for all financial service or product providers, such as those to be promulgated by the CFPA, are an important step in restoring and maintaining this public confidence.

Effective consumer protection requires preserving and enhancing the role of the states in setting and enforcing consumer protection standards. Any proposal to create a federal consumer financial protection agency must preserve for states the ability to set higher, stronger consumer protection standards. The Administration's proposal, as well as H.R. 3126, does just that -- explicitly providing that federal consumer protection standards constitute a "floor" for state action.

This creates a system of regulatory checks and balances that will lead to more effective consumer protection and that need not result in the so-called "patchwork quilt." Our experience has been that thoughtful and deliberate federal standards will obviate the need for the states to act and, instead, will enable the states to respond to local development and emerging risks and practices, many of which are occurring outside the depository world. The Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act) is one very recent example of a how this "floor not ceiling" approach has led to strong and uniform standards. The S.A.F.E. Act, passed on July 31, 2008, gave the states one year – until July 31, 2009 -- to pass legislation to meet minimum licensing and registration requirements for loan originators. The states have risen to the challenge and have unified under a Model State Law. I am pleased to inform the Committee that, as of today, 49 states and the District of Columbia have enacted or introduced legislation implementing the S.A.F.E. Act.[1] Special recognition must go to Ranking Member Bachus, who first developed the SAFE Act and its state-federal model for regulation and supervision.

Additionally, any federal consumer protection legislation must ensure that state authorities continue to have the power to enforce applicable state and federal laws for all financial entities operating within their borders, regardless of charter type. The Supreme Court recently affirmed this authority with its decision in *Cuomo v. Clearing House Association*, and CSBS supports the provisions of the Administration's proposal and of H.R. 3126 codifying this decision into federal law.

The strong affirmation in the Administration's proposal and H.R. 3126 of the states' role in consumer protection must be reinforced with a significant emphasis on

[1] A detailed update on state implementation of the S.A.F.E. Act is attached as Exhibit B.

effective and timely coordination and information sharing between federal and state regulators. Any legislation must include explicit mandates and mechanisms for this coordination and information sharing.

CSBS shares the concerns of others about separating consumer compliance regulation from prudential supervision. We see the two as not necessarily in conflict, but rather -- with appropriate checks and balances in place -- mutually supporting and reinforcing. Consumer complaints not only identify trends, practices, or products that harm consumers, but also indicate that an institution may be operating in an unsafe or unsound manner. Similarly, an institution that is well capitalized, well managed, and safe and sound effectively provides consumer protection by ensuring that consumer accounts are secure. Separating the two types of exams could eliminate this benefit.

Establishing another primary federal examining authority also risks creating additional unnecessary regulatory burdens, especially for state-chartered depository institutions that are already subject to both federal and state regulatory oversight. While we agree that more comprehensive and consistent consumer protection oversight across all providers of financial services will benefit the financial system and consumers, we also believe that regulatory reform should not create regulatory burdens that distort the playing field.

To enhance consumer protection while minimizing regulatory and supervisory inefficiencies, CSBS believes that the CFPA should focus first and foremost on rulemaking and data and information gathering and analysis. Additionally, we believe that the CFPA should be vested with sufficient examination and enforcement authority to fill regulatory gaps or shortcomings.[2] Prudential regulators should continue to examine for safety and soundness and consumer protection compliance, with the CFPA retaining back-up examination powers to strengthen the checks and balances in the system and better align regulatory incentives with consumer protection goals. Additionally, we believe that states could apply to the CFPA to exempt state-chartered depository institutions (or classes thereof) from federal consumer protection examinations. Such exemptions would be based on the CFPA's determination of factors such as the state's ongoing regulatory oversight.

Similarly, CSBS believes the CFPA should have back-up enforcement powers; with the prudential federal and state regulatory authorities and state attorneys general sharing primary enforcement authority. This back-up enforcement authority will enable the CFPA to take action when prudential or law enforcement authorities have failed to act, without displacing or duplicating existing cooperative enforcement efforts. For example, state prudential regulators and law enforcement have collaborated to conduct major consumer protection actions, such as the landmark $484 million settlement in 2002 between the states and Household Finance for unfair and deceptive lending practices. The CFPA needs sufficient enforcement resources to prevent regulatory arbitrage or under-enforcement, but it would be unnecessary, and possibly counterproductive, for it to attempt to lead enforcement efforts on a routine basis.

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2 In the event that a federal consumer protection agency is vested with primary consumer protection examination authority – as contemplated by H.R. 3126 and the Administration's proposal -- coordination with state authorities will be an even greater imperative, and the legislation must create a structure for this coordination. Therefore, Congress should direct the CPFA to coordinate its examination activities with the consumer protection work of state regulators, and Congress should also build upon H.R. 3126's information sharing provisions by directing the CFPA to create mechanisms for effective, coordinated information sharing with state regulators.

This suggested structure will allow the CFPA to accomplish its essential consumer protection mission and objectives, but with a smaller, more efficient agency that leverages the existing resources, relationships, and capabilities of prudential and law enforcement authorities at both the state and federal level. The CFPA, as we envision it, would be armed with the necessary data and information to set effective federal minimum consumer protection standards and to collaborate with state and other federal agencies to ensure these standards are being met by all financial market participants. (Attached as Exhibit C is a chart summarizing CSBS's proposal for state and federal consumer protection authorities.)

CSBS believes it crucial that any federal consumer protection proposal include a mechanism for the federal agency to consult with state authorities in developing and implementing these new standards and regulations. While the Administration's proposal and H.R. 3126 clearly recognize the important role of the states in consumer protection, neither makes provision for state input into the CFPA's rulemaking process. Recent history shows that state officials often bring important prudential and compliance perspectives to consumer protection issues that federal agencies may lack; therefore, it is essential that reform legislation include a provision for mandated consultation between the CFPA and state banking regulators. This would also help ensure a balanced regulatory approach across state and federally chartered and licensed institutions.

In addition to a mandated consultative role for state banking regulators in the CFPA's rulemaking, we believe that the CFPA Board should include one member with state bank supervisory experience. This mirrors the structure of the current FDIC Board and would help ensure a diversity of regulatory perspectives and equitable treatment across different business models and classes of institutions.

Finally, we have significant concerns about the funding burdens of creating a new federal agency. Both the Administration's proposal and H.R. 3126 authorize the CFPA to collect fees and assessments. CSBS is concerned that the institutions that we oversee will bear a disproportionate financial burden. To avoid this, any legislation must require the CFPA to develop a means for equitably spreading the financial burden across the industry without depleting already limited state regulatory resources. Our proposal for a CFPA focused primarily on rulemaking, with existing prudential regulators maintaining their examination responsibilities and authorities, alleviates this concern somewhat as it envisions a smaller agency.

THE FINANCIAL SERVICES OVERSIGHT COUNCIL SHOULD INCLUDE REPRESENTATIVES OF STATE FINANCIAL REGULATORS

The Administration's plan proposes the creation of a Financial Services Oversight Council to facilitate information sharing and coordination, identify emerging risks, advise the Federal Reserve Board on the identification of Tier 1 financial holding companies (FHCs), and provide a forum for resolving jurisdictional disputes between regulators. The states agree on a need for a council of multiple regulators charged specifically with the coordination of supervisory efforts to limit the systemic risk posed by certain financial firms. (Please refer to Exhibit D, a May 2009 letter to House and Senate committee leaders from state authorities on this issue.)

We are concerned that the current proposal does not include a provision for state involvement in the Financial Services Oversight Council. The proposed Council would include the Treasury Department, the Federal Reserve Board, the proposed National Bank Supervisor (NBS), the proposed CFPA, the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission (CFTC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Housing Finance Agency (FHFA), but no state financial regulator. Given the Council's broad mission, the exclusion of state financial regulators will seriously curtail the Council's view of the financial system and emerging risks. A lack of state participation will impede the Council's stated goals and is simply unacceptable.

The vast majority of insured financial institutions operating within the United States are currently chartered and regulated by the states. States also have oversight of those financial service providers that are not affiliated with a depository institution, such as mortgage brokers, money services businesses, check cashers, and consumer finance companies. States have primary regulatory and supervisory authority over insurance companies, some of which have proven to pose systemic challenges to other financial institutions. Because of our proximity to and knowledge of the entities we regulate, the local economic conditions, and consumers, states are often the first to identify emerging trends, practices, products, or threats that impact the financial system. An Oversight Council that does not include some mechanism for state involvement will not be informed by this knowledge and proximity and, accordingly will be less likely to fulfill its statutory mission.

The existing Federal Financial Institutions Examination Council coordinates examination policies and procedures among the federal banking agencies, with input from a State Liaison Committee. CSBS recommends that the Financial Services Oversight Council incorporate a similar State Liaison Committee, comprising state regulators of banks, insurance companies, securities firms, and mortgage companies. This State Liaison Committee could include other state regulators as needed, to address the regulatory requirements of related industries, such as payday lenders, prepaid funeral contracts, check cashing, money transmitters, real estate appraisers, or any other state-regulated financial service.

The State Liaison Committee would work with the Financial Services Oversight Council through designated staff, but should also provide voting members to the Council. These members would communicate the State Liaison Committee's deliberations on emerging risks and practices. The state members would also serve as a conduit of information from the Council to the state regulatory agencies. This approach would not only encourage a consistent approach to regulation among all state and federal agencies, but also help to identify gaps in regulation or supervision.

AN EFFECTIVE RESOLUTION REGIME FOR SYSTEMICALLY SIGNIFICANT INSTITUTIONS SHOULD BE FOCUSED ON MANAGING FAILURES IN AN ORDERLY FASHION AND MUST ALLOW FIRMS TO FAIL

The President's plan recommends the creation of a resolution regime based on the FDIC's systemic risk exception; that is, a system that would prevent the disorderly closure of a failing bank holding company, including Tier 1 FHCs, if that closure would have serious adverse effects on the financial system or the economy. CSBS supports this recommendation, but has concerns with the procedure outlined by the Administration's proposal.

Under the current proposal, the resolution regime could be initiated by the Treasury, the Federal Reserve, the FDIC or the SEC. Resolution authority would be invoked after consultation with the President and a 2/3 majority of the Federal Reserve Board and the FDIC Board of Directors, but the Treasury would hold the ultimate authority over whether and how to resolve a failing firm, with broad authority to take any necessary action.

Diversity requires fair competition among institutions. The system cannot reward firms that operate in an unsafe and unsound manner and become insolvent. These institutions *must* be allowed to fail, regardless of their size or complexity. The Administration's proposal leaves open the possibility that an institution might be propped up indefinitely for "systemic" reasons, continuing business as usual and continuing to present a risk to our entire economy.

Under the proposal, the resolution regime would have the ability to establish conservatorship or receivership for a failing firm. In addition, however, the regime could stabilize a failing institution by providing loans to the firm, purchasing assets from the firm, guaranteeing the liabilities of the firm, or making equity investments in the firm. In short, the resolution regime would be allowed to use current subsidization techniques to prop up failing institutions. If this provision is written into law, it will effectively allow all systemic institutions to evade the consequences of their risky business practices or unsafe decisions.

If we hope to avoid future calamities that leave taxpayers on the hook for billions of dollars, Congress must not allow the resolving regime to have the power to bail out failing institutions. Firms that are not able to remain in business on their own accord must fail. The resolution regime's priority should be to manage these failures in an orderly fashion.

Therefore, we recommend that the FDIC be designated conservator or receiver of any institution that comes under this resolution regime. Additionally, an institution receiving either a systemic exemption to prompt corrective action or funding from the Federal Reserve's emergency lending facility should automatically be transferred to FDIC conservatorship. The FDIC is an independent agency that has the expertise and experience with managing and/or resolving troubled and failing institutions.

REGULATORY STRUCTURES AND INCENTIVES MUST NOT ENCOURAGE THE EMERGENCE OF "TOO BIG TO FAIL" INSTITUTIONS

The Administration's plan would grant the Federal Reserve Board authority and accountability for consolidated supervision and regulation of Tier 1 FHCs. The prudential standards for Tier 1 FHCs would be stricter and more conservative than those applicable to other financial firms, in order to account for the greater risks that their potential failure would impose on the financial system.

CSBS agrees in principle that the regulatory system would benefit from a single agency tasked with supervising systemically significant financial institutions. While the Federal Reserve Board's current authority as "umbrella supervisor" under Gramm-Leach-Bliley would make the Federal Reserve Board a logical candidate for the systemic risk regulator, CSBS does have some concerns regarding the Federal Reserve Board's ability to serve in this capacity.

Under current statutes, the Federal Reserve has extensive authority to serve as the umbrella supervisor for the financial services industry. Further, we do not believe that any other single agency is a better candidate for this role. That said, we think that consolidated supervision in a single agency eliminates valuable checks and balances to the system and effectively minimizes resources and expertise that should be applied to this crucial activity. We suggest, therefore, that any agency charged with supervising and regulating these large, interconnected institutions must report, in turn, to the Financial Services Oversight Council. Requiring the systemic risk regulator to consult with and perhaps even seek approval from the Council will maintain the system of checks and balances and will provide the responsible agency with an array of external opinions and experience.

More broadly, however, the Administration's plan appears to concede that some Tier 1 FHCs will always be "too big to fail." We do not agree with this assumption. The current crisis has proven that our regulatory structure was simply not capable of properly supervising the nation's largest firms. When it became evident these firms were insolvent, the federal government felt obligated to prop them up, as their failure would have far-reaching, systemic consequences. This decision was difficult, but necessary.

The government's subsidization of these institutions has cost American taxpayers billions of dollars and left our government and nation facing tremendous residual liabilities.

As long as some financial institutions are considered too big or too important to fail, no regulatory regime will be able to regulate or supervise them effectively. Instead of repeating these actions in the future, CSBS urges Congress to prevent these firms from becoming too big to fail in the first place. While we believe the Administration's proposal to impose more stringent prudential standards upon Tier 1 FHCs will provide some disincentive from becoming "too big to fail," eventually firms will evade these standards, just as they maneuvered around deposit caps.

We believe it is necessary for Congress to outline these higher prudential standards clearly to ensure that they discourage an institution from becoming "too big to fail" and to demonstrate the real market cost of being a systemically significant institution. We recommend that Congress consider the following requirements for all Tier 1 FHCs:

1. Minimum consolidated capital requirements, including a minimum leverage capital ratio, above the minimums required for other bank holding companies. Regular issuance of non-government guaranteed subordinated debt should, in general, be a component of these requirements with exceptions subject to the approval of the consolidated supervisor.
2. Maintenance of a liquidity risk management plan that is approved at least annually by the consolidated supervisor.
3. Higher PCA standards than are required for non-systemic firms.

4. Maintenance of a liquidation plan that is approved at least annually by the consolidated supervisor.
5. Payment of regular assessments into a fund established for the purpose of resolving Tier 1 holding companies. The assessment will be set annually, or more frequently as events warrant, by the Financial Services Oversight Council. The fund will be managed by the FDIC separately from the DIF. The fund can be used to facilitate the resolution of Tier 1 FHCs or supplement the deposit insurance fund in times of broad economic stress.

DE NOVO INTERSTATE BRANCHING

CSBS supports the Administration's proposal to eliminate the remaining restrictions on interstate banking. While Riegle-Neal intended to leave this decision in the hands of the states, inconsistencies in federal law have created contradictory rules about how financial institutions can branch across state lines. The contradictions affect state-chartered banks disproportionately. Federally-chartered savings institutions are not subject to de novo interstate branching restrictions, and creative interpretations from the Comptroller of the Currency have exempted most national banks as well. The Administration's proposal would restore competitive equity by allowing *de novo* interstate branching for all federally-insured deposit institutions.

RETAINED ECONOMIC INTEREST ("SKIN IN THE GAME")

The Administration's proposal includes a requirement that loan originators or sponsors retain an economic interest in a material portion of the credit risk for any such loan that the creditor transfers, sells or conveys to a third party. As we have no experience with such a requirement, we do not know what the impact will be, but it is not unreasonable to imagine such a requirement could reshape the mortgage industry and have a significant impact upon credit availability.

In our experience, corporate risk alone may not alter our outcomes. Both bank and nonbank lenders that seemingly had "skin in the game" made risk decisions that resulted in their failure. And more would have failed if not for government intervention. It is possible that risk retention could have the opposite of the desired effect. It could result in an industry consolidation that creates more banks that are considered too big to fail that pose even greater and seemingly intractable risks to our financial system and economy. Additionally, from our state perspective it is not difficult to imagine an industry so consolidated and systemic that it is seemingly unaccountable to consumers.

If the goal is to encourage sound underwriting and good origination practices there may be better and more holistic ways to revision the current system of originations. One possible idea would be to limit an originator's upfront earnings potential by spreading a future income stream out over the life of the loan. Our belief is that the transparency provided by unique identifiers applicable to the entire industry of originators also provides important incentives and checks on poor lending standards and abusive practices.

CONCLUSION

CSBS applauds this Committee and the Administration for seeking a prompt and comprehensive response to the obvious need for improvement in our system of financial regulation. We now look to the members of this Committee to bring your specialized knowledge and legislative experience to this proposal in order to ensure that it accomplishes its stated objective: a system to ensure a safer, sounder financial system that provides fair, stable access to credit and investment to all sectors of our economy.

We look forward to working with you toward legislation that reduces systemic risk, assures fairness for consumers, preserves the unique diversity of our financial system, and enhances state-federal coordination to create a seamless network of supervision for all industry participants.

Thank you again for the opportunity to share our views this morning. I look forward to any questions you may have.

* * *

Appendix

Exhibit A: Branch Location Map

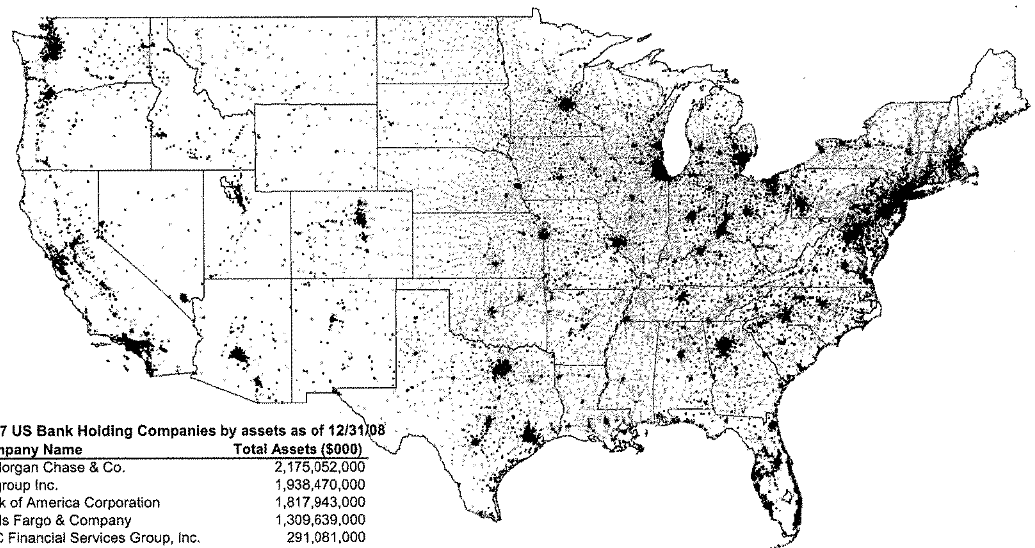
Exhibit B: S.A.F.E. Act Overview and Update

Exhibit C: Proposed State and Federal Consumer Protection Authorities

Exhibit D: May 2009 Letter to Congressional Committee Leaders on Systemic Risk Council

Exhibit A

Branch Locations Of Top 7 (Red) Overlaid On All Others (Green) As Of March 16, 2009



Top 7 US Bank Holding Companies by assets as of 12/31/08

Company Name	Total Assets ($000)
JPMorgan Chase & Co.	2,175,052,000
Citigroup Inc.	1,938,470,000
Bank of America Corporation	1,817,943,000
Wells Fargo & Company	1,309,639,000
PNC Financial Services Group, Inc.	291,081,000
U.S. Bancorp	265,912,000
Bank of New York Mellon Corporation	237,512,000

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Exhibit B

STATES MOVE AGGRESSIVELY TO IMPLEMENT SAFE ACT AND IMPROVE MORTGAGE SUPERVISION

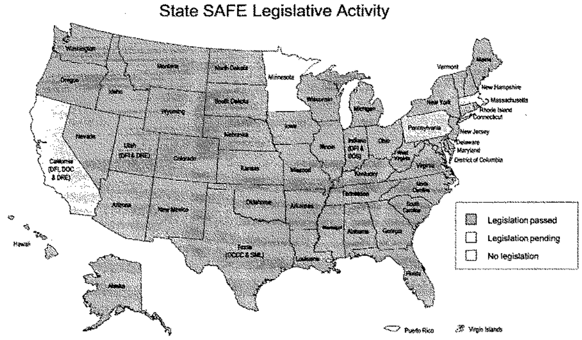
Title V of P.L. 110-289, the *Secure and Fair Enforcement for Mortgage Licensing Act of 2008* ("SAFE Act"), was passed on July 30, 2008. The SAFE Act gave states one year to pass legislation requiring the licensure of mortgage loan originators according to national standards and the participation of state agencies on the Nationwide Mortgage Licensing System and Registry (NMLS).

States have moved in an unprecedented manner in just **ONE YEAR** to accomplish the following:

Legislation

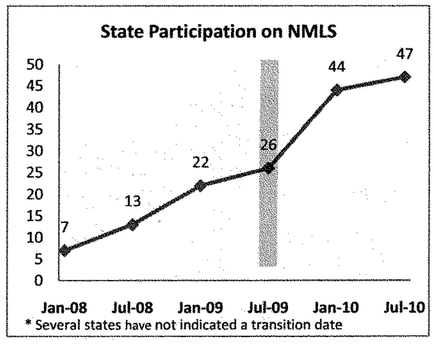
- **49 states** and the District of Columbia have enacted or introduced legislation implementing the SAFE Act.
  - 46 states and the District of Columbia have already *passed* legislation, and
  - 3 states and Puerto Rico and the Virgin Islands have *legislation pending* in legislatures that are still in session.
- **All** legislation enacted to date includes standardized definitions, national pre-licensure and continuing education and testing requirements, and criminal background standards for mortgage loan originators as contained in the SAFE Act.
- **Virtually all of the** legislation enacted to date includes a robust set of prohibited acts and practices to protect consumers as promoted in the CSBS/AARMR Model State Law.
- **Uniformity in mortgage regulation** has been fostered and driven by enactment of the SAFE Act as the 50 existing state licensing laws are revised in a nationally consistent manner to establish standardized licensing applications, processes and practices.

State SAFE Legislative Activity



Participation in NMLS

- **26 states** and territories are already participating on the Nationwide Mortgage Licensing System.
  - 7 more states and territories (for a total of 33) are scheduled to participate in 2009.
  - 13 more states and territories (for a total of 46) are scheduled to participate in January 2010.
- **90% of states** are scheduled to be participating in NMLS by January 2010, just two years after launch of the system.

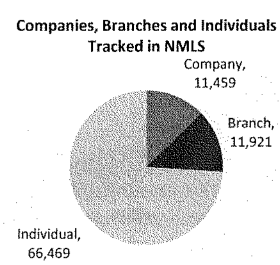


Testing and Education Standards

- NMLS developed the psychometrically valid SAFE Mortgage Loan Originator Test, with the national component of the test available for all state licensed mortgage loan originators on July 30, 2009.
- NMLS developed eleven SAFE state component tests that will be available on July 30, 2009. Remaining state tests will be rolled out on a quarterly basis over the next year.
- NMLS developed policy and procedures for approving course providers to offer pre-licensure and continuing education according to national standards.
- Since accepting applications from providers starting June 22, 2009, NMLS has approved 20 course providers and is processing applications from 30 more.
- By September 1st, NMLS approved courses will be available for MLOs across the country.

Coordinated Licensing of Companies and Mortgage Loan Originators

- **66,469 mortgage loan originators** in 26 states and territories have been issued a NMLS unique identifier and are being tracked in the system.
- **11,459 mortgage broker and lender companies** in 26 states and territories have also received an NMLS unique identifier and are being tracked in the system.



More information about state efforts to implement the SAFE Act and improve supervision can be found on the CSBS website at www.csbs.org.

More information about the Nationwide Mortgage Licensing System and Registry (NMLS) can be found at http://www.stateregulatoryregistry.org/NMLS.

Exhibit C

Consumer Protection – Proposed State-Federal Authorities

	CFPA	Federal Banking Supervisor(s)	Federal Reserve/FDIC	State Regulators	State Attorneys General
Rulemaking Authority	Exclusive federal rulemaking – with required consultation with state regulators -- over: NCD SCD SLND			More protective rules for: NCD SCD SLND	
Examination Authority – Primary	No primary exam authority, but broad information and data gathering[1]	NCD‡	SCD[2]‡	SCD‡ SLND‡	
Enforcement Authority – Primary/ Concurrent		NCD‡	SCD‡	SCD‡ SLND‡	NCD‡ (per Cuomo) SCD‡ SLND‡
Back-up[1] Enforcement and Examination	NCD SCD SLND				

Legend: ‡ -- Denotes existing authority
NCD – Nationally-Chartered Depository Institution
SCD – State-Chartered Depository Institution
SLND – State-Licensed Non-Depository Institution

Notes:
1. Back-up enforcement driven by data and consumer complaints.
2. States can apply for exemption based on state supervision and examinations.

July 24, 2009

Exhibit D

May 18, 2009

The Honorable Christopher J. Dodd
Chairman
Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Richard Shelby
Ranking Member
Senate Committee on Banking,
Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Barney Frank
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairmen Dodd and Frank, and Ranking Members Shelby and Bachus:

The Conference of State Bank Supervisors (CSBS), the National Association of Insurance Commissioners (NAIC) and the North American Securities Administrators Association (NASAA) have each proposed principles for financial services regulatory reform that we believe will help guide the ongoing policy debate over the changes necessary to strengthen the nation's financial services regulatory structure. The unique experiences of state regulators on the front lines of consumer and investor protection provide the basis for our suggestions. Any regulatory reform measure must recognize the importance of ground level detection and policy sensitivity. These are critical characteristics of state regulation and necessary components of an effective financial regulatory structure.

At this time, we want to address one particular issue that has received considerable attention from your Committees in recent months – identifying and managing systemic risk in our financial markets. We encourage you to consider several basic recommendations from state banking, insurance and securities regulators as you reflect upon structural methodologies to address this challenge. After analyzing a number of strategies, we have concluded that the responsibility of identifying and managing systemic risk should not be assigned to a single agency but should be carried out by a council made up of state and federal regulators. We believe this approach holds the greatest promise of success in evaluating and controlling systemic risk in the marketplace because it will formalize regulatory cooperation and communication among state and federal regulators that oversee our financially intertwined markets.

Membership. The systemic risk council should include representatives from all federal and state banking, insurance and securities regulators. This holistic approach is effective and efficient. It creates a body with access to all relevant information regarding the accumulation of risk in our financial system, and it draws upon the existing expertise and proficiency of each functional regulator. It also minimizes the possibility of regulatory capture or philosophical bias that might arise if an existing federal agency were tasked with overseeing systemic risk. As a further measure against undue influence or capture, we believe the council should be headed by an independent chair. This would maintain balance and reduce the likelihood that any one member of the council or any one regulatory perspective exerts undue influence over the council's policies and operations.

Including state regulators on the council is necessary and appropriate. In all financial sectors, state regulators gather and act upon large amounts of information from industry participants and from investors. Consequently, they serve as an early warning system. As a general proposition, state regulators are usually the first to identify risks and related trends that are substantial contributing factors to systemic risk.

Function. The council should be tasked with collecting and evaluating data from all financial sectors to assess existing levels of systemic risk as well as the identification and analysis of new financial products or business practices that may be expected to increase levels of risk. In addition, when the council perceives the need for corrective measures, it should issue recommendations to the regulators with primary authority over the market sector in question. Those recommendations may range from the suggestion that various actions be taken, including emergency market intervention, the promulgation of new regulations, or even enforcement actions. In addition, the council would, where appropriate, recommend the passage of new legislation at the federal or state level.

Authority. The council should have the authority to require industry participants and other agencies to share information relevant to the mission of risk assessment. In other respects, however, its powers should be carefully circumscribed and its primary focus should remain the collection and analysis of data and issuing appropriate recommendations, leaving the authority of existing functional regulators intact.

In conclusion, as the state organizations representing the three major sectors of financial services regulation, we are committed to working with Congress to address the problem of systemic risk in our financial markets. We believe that the systemic risk council model described above is the optimal approach, as it recognizes and incorporates the states' vital role in financial services regulation and consumer protection.

Sincerely,

Timothy J. Karsky	Roger Sevigny	Fred J. Joseph
CSBS Chairman	NAIC President	NASAA President
North Dakota Banking Commissioner	New Hampshire Insurance Commissioner	Colorado Securities Commissioner

cc: Senate Banking, Housing, and Urban Affairs Committee members
House Financial Services Committee members

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF
THE COMMISSIONER

July 28, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Frank:

I write to express my opposition to the current proposal to create a Consumer Financial Protection Agency (CFPA). As a current Commissioner, former Chairman, former General Counsel, and former staff member at the Federal Trade Commission, as well as a legal academic who has studied consumer protection and competition issues, I have followed the proposed legislation with great interest. As you and your committee continue to consider how best to reform consumer financial protection regulation, I write to identify three grave risks inherent in this proposal.

First, the creation of the CFPA will reduce – not enhance – consumer protection by divesting the FTC of all of its consumer protection functions in the financial services arena. Currently, the FTC is one of several agencies responsible for protecting consumers in the financial services sector. While jurisdictional limitations significantly restrict the FTC's authority in this sector, the FTC has been a leader in financial services consumer protection because of its superior enforcement and regulatory experience in a wide variety of consumer protection areas, from privacy to deceptive advertising in wide-ranging sectors of our economy. Unlike other agencies, the FTC's Bureau of Consumer Protection benefits from the research of its independent Bureau of Economics and the insights of its Bureau of Competition – all of which report directly to the Commission and its Chairman.[1] For these reasons, I disagree with the proposal to divest the FTC of all consumer protection functions in the financial services area. To the extent that the legislation provides the FTC with "backstop authority" to bring enforcement actions in the financial services area, I doubt that such authority would be anything more than a mirage. Once core functions and personnel have been transferred to a new entity, the FTC's capability to do effective work in this area likely will disappear. I believe that a more promising

[1] *See generally* Prepared Statement of Stephen Calkins, Testimony Before the Subcommittee on Commerce, Trade, and Consumer Protection, Committee on Energy and Commerce, United States House of Representatives, Jul. 8, 2009, *available at* http://energycommerce.house.gov/Press_111/20090708/testimony_calkins.pdf.

approach could include removing the limits on jurisdiction that currently constrain the FTC's regulatory and enforcement authority in the financial services sector.

Second, as currently drafted, the legislation will jeopardize certain core functions that the FTC would retain after creation of the CFPA. For example, by transferring the FTC's entire consumer protection function concerning consumer financial products and services, the proposed legislation could limit, hinder, or even disable our primary enforcement authority in key areas of consumer protection such as telemarketing fraud involving non-financial products and services.[2] In addition, as the CFPA carries out its primary enforcement authority for unfair, deceptive, or abusive acts or practices under Federal law regarding consumer financial products or services, and as the FTC continues to enforce consumer protection laws as to non-financial products and services, there is no assurance – beyond mandates for interagency coordination – that the CFPA will account properly for the FTC's views about the appropriate content of unfairness and deception jurisprudence. Conflicts in interpretation and in litigation strategies, along with an increase in litigation over jurisdictional questions, will adversely affect every core area of consumer protection for which the FTC will continue to exercise primary responsibility. Furthermore, the present draft legislation could be read to divest the FTC of certain competition authority and resources where the product market at issue involves the issuance of credit.

Third, the wisdom of granting new substantive powers to the CFPA has yet to be established. Indeed, I have concerns about the benefits of certain new responsibilities that have been proposed, such as the requirement that the CFPA prescribe "plain vanilla" products for consumers.

Please feel free to contact me if you wish to discuss these issues at greater length.

Sincerely,

William E. Kovacic

William E. Kovacic

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[2] Even assuming the legislation made it clear that the CFPA's primary enforcement authority did not extend to entities such as payment processors providing services to entities offering non-financial products/services, the FTC would be hindered by the increased costs of coordinating enforcement actions with the CFPA and other agencies in cases involving both financial and non-financial entities.

Statement for the Record
of
Commissioner J. Thomas Rosch
Federal Trade Commission
on
The Proposal to Create A Consumer Financial Protection Agency

Before the Committee on Financial Services
U.S. House of Representatives
July 21, 2009

I appreciate the opportunity to share my personal opposition to the proposal to create a new consumer financial protection agency. I am a Commissioner of the Federal Trade Commission (FTC), sworn in on January 5, 2006, to a term that expires in September 2012.[1] Although I am a Republican appointee, in the three-and-a-half years of my service as a Commissioner, I have not hesitated to exercise my independence when I believed that it was in the best interests of consumers to do so.[2] I also served as the Director of the FTC's Bureau of Consumer Protection from 1973 to 1975, and in 1989 was a member of the American Bar Association's Special Committee to Study the Role of the FTC. I have nothing to gain or lose politically or personally by opposing the proposal to create a new consumer financial protection agency (CFPA).

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[1] By law, the Commission is an independent regulatory agency. The Commission is headed by five Commissioners, nominated by the President and confirmed by the Senate, each serving a seven-year term. The President chooses one Commissioner to act as Chairman. No more than three Commissioners can be of the same political party. 15 U.S.C. § 41.

The Commission is not an Executive Branch agency. It is instead subject to oversight by a number of Congressional committees. *See Humphrey's Executor v. United States*, 295 U.S. 602, 628 (1935).

[2] I have previously described my own independence. *See* J. Thomas Rosch, *The Redemption of a Republican*, FTC Watch, June 1, 2009, at 4, *available at* http://www.ftc.gov/speeches/rosch/090601redemption.pdf. My career predating my term as a Commissioner is described at http://www.ftc.gov/commissioners/rosch/index.shtml.

I. Summary of Position.

The current system for protecting consumers against deception and unfairness in the financial marketplace is broken. Authority and responsibility to define and prevent deceptive and unfair practices are both diffuse and under-utilized. The current consumer protection regime gives authority and jurisdiction to a host of federal agencies without regard to whether those agencies have the expertise or experience (core competency) to best perform the consumer protection functions assigned to them. Because some agencies have little or no core competency to perform those functions and lack adequate resources to do so, they cannot fairly be (and generally are not) held responsible for their failure to protect consumers adequately.

The proposal to create a brand new Executive Branch agency[3] to protect consumers of financial products and services would replace the current flawed system with an even more fundamentally flawed system. The proposed new agency has no track record in protecting consumers from deceptive and unfair practices in the financial marketplace, and the time, money and other resources necessary to implement the new agency promise to be immense. As proposed, the new agency seemingly would have unlimited jurisdiction, yet the extent to which the new agency would be subject to Congressional oversight is completely unclear. The public is simply asked to buy a pig in a poke. The only thing about which the public can be certain is that creation of this new agency would result in considerable delay in protecting consumers, wasteful and inefficient consumer protection law enforcement, and very substantial (if still indeterminate) costs to taxpayers.

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[3] As proposed, the President would appoint all members of the new agency's governing board, but in contrast to the FTC, which limits to three the number of Commissioners from any one political party, all members of the new agency's governing board could come from one political party.

The current broken system should be replaced instead with a system that assigns exclusive authority and responsibility to perform consumer protection functions to specific agencies based on the core competency of the agency to perform those functions. In the case of the FTC, this would mean that it would assume plenary authority and responsibility for, among other things, defining and requiring the necessary and appropriate consumer disclosures respecting financial products and services. It would also mean assigning to the FTC plenary authority and responsibility for protecting consumers against invasions of their privacy, including protecting them from identity theft and securing their other confidential data. These are functions where the FTC has not only taken the lead, but where other federal agencies have looked to the FTC for guidance. Finally, it would mean that the FTC would be provided with the resources and law enforcement tools to enable it to perform those law enforcement functions by itself. Taking these steps would make it fair to hold the agency responsible for performing those functions in a fashion that protects consumers.

In short, replacing the current balkanized system of financial consumer protection with a brand new Executive Branch agency is very poor public policy. The FTC is an independent agency that has the expertise and experience to protect consumers in the realm of financial products and services, and there is no reason to supplant it.

II. The Current System is Broken.

No one can say that the current balkanized paradigm of consumer protection law enforcement regarding financial products and services is desirable. As matters now stand, for example, at least six different federal agencies are responsible for protecting consumers in the financial marketplace,[4] each having jurisdiction over only a specific segment of the marketplace. For example, the FTC's jurisdiction reaches only to non-bank financial companies, including non-bank mortgage companies, mortgage brokers, and finance companies. Banks, thrifts, and federal credit unions are exempt from the Commission's jurisdiction under the FTC Act but are instead subject to the jurisdiction of other agencies.

Similarly, a host of federal statutes – the Gramm-Leach-Bliley Act, the Truth-in-Lending Act, the Fair Credit Reporting Act, the Home Ownership and Equity Protection Act, the Consumer Leasing Act, the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Credit Repair Organizations Act, and the Electronic Funds Transfer Act – distribute to a number of federal agencies various consumer protection responsibilities and obligations respecting only the financial institutions that they regulate.

Thus, the current framework does not accord authority and responsibility based on any agency's core competency to perform that agency's consumer protection function(s). Rather, the current framework gives each federal agency consumer protection authority and responsibility for the specific institutions over which it has jurisdiction in the financial marketplace. As a result, the current framework entrusts some agencies with consumer protection functions even though those agencies have little or no expertise in performing those functions. Other agencies, recognizing their shortcomings, rely on the agency which has demonstrated the highest degree of core competency to perform the functions. For example, a number of agencies in the past have looked to the FTC to determine the disclosures that are necessary and appropriate to protect

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[4] These agencies are the Federal Trade Commission, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration.

consumers in the financial marketplace.[5]

This patchwork quilt of jurisdiction results in wasteful duplication in performing some consumer protection functions. Law enforcement activities in the credit card industry illustrate this inefficiency. In a federal court complaint filed in June 2008, the FTC alleged that CompuCredit Corporation, a company marketing Visa and MasterCard credit cards to consumers in the subprime credit market, engaged in deceptive conduct in connection with the marketing of credit cards.[6] CompuCredit ultimately settled with the FTC and agreed to reverse fees charged to eligible consumers' accounts, estimated to result in more than $114 million in credits.

However, because CompuCredit also acted on behalf of some entities regulated by the Federal Deposit Insurance Corporation (FDIC), in addition to the FTC action, the FDIC also challenged the same practices, and put CompuCredit under order extracting a civil money penalty of $2.4 million.[7] The need to engage in dual prosecutions relating to the same consumer protection issues was inefficient, time-consuming and a wasteful use of agency resources.

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[5] *See, e.g.*, Federal Trade Commission Staff Comment for the Board of Governors of the Federal Reserve Board Regarding Truth in Lending, Proposed Rule (April 2008), *available at* http://www2.ftc.gov/opa/2008/04/frb.shtm; Federal Trade Commission Staff Comment to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve Board System, *Regarding Proposed Illustrations of Consumer Information for Subprime Mortgage Lending* (November 2007), (comment to the OCC, the Federal Reserve Board, the FDIC, the OTS, and the NCUA), *available at* http://www.ftc.gov/opa/2007/11/mortgage.shtm; Federal Trade Commission Comment Before the Board of Governors of the Federal Reserve System, Docket No. OP-1253: *Unfair and Deceptive Practices in the Mortgage Lending Market, Alternative Mortgage Products, and Informed Consumer Choice in the Mortgage Marketplace* (September 2006), *available at* http://www.ftc.gov/opa/2006/09/fyi0661.shtm.

[6] CompuCredit settled with the FTC and agreed to reverse fees charged to eligible consumers' accounts to settle allegations that it violated federal law. It is estimated that the redress program will result in more than $114 million in credits to consumer accounts. *See* Press Release, *available at* http://www.ftc.gov/opa/2008/12/compucredit.shtm.

[7] *Id.*

Beyond that, because no one agency is given plenary authority or jurisdiction or the resources to effectively protect consumers, no single agency fairly can be held ultimately accountable for the protection of consumers.[8] Consequently, the current balkanized system may result not only in the inefficient use of agency resources, but also in under-enforcement of existing consumer protection statutes and inadequate protection of consumers. For example, even though the FTC may detect deceptive and unfair practices in the financial marketplace, it can act only within its limited jurisdiction. Thus, despite the FTC's success in challenging the inadequate disclosures made by CompuCredit, the FTC was otherwise constrained from bringing such a case against any depository institutions – such as banks that issue credit cards.

III. The Proposal to Create a New Agency is Fundamentally Flawed.

The creation of a new Executive Branch consumer protection agency will only make matters worse by compounding, rather than mitigating, the enforcement problems that now exist. First and foremost, there is no evidence that this proposed new agency has any core competency in protecting consumers in the financial marketplace. It is entirely untested and without any experience or expertise.

Second, the creation of a brand new Executive Branch agency will come at a great financial cost to consumers. The resources necessary to implement this proposal will be immense, including space requirements, employees, infrastructure, and overhead. I have yet to see proponents of the proposal offer even an estimate of the cost to American taxpayers for this anticipated project. This proposal seems particularly ill-advised in light of the current economic

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8 *See generally*, Hearing On Improving Consumer Protections In Subprime Lending, Before the Before the Subcommittee On Interstate Commerce, Trade, and Tourism of the Committee On Commerce, Science, and Transportation, United States Senate, April 29, 2008.

situation and the fact that at least one existing federal agency with proven expertise (the FTC) stands ready, willing and able to better perform most of the consumer protection functions that would be given to this new agency. Indeed, it is ironic that a consumer protection proposal should be so anti-consumer; as consumers, we generally demand to know beforehand the costs and benefits of the products we purchase.

Third, it is anticipated that it will take at least eighteen to twenty-four months for this new agency to become operational. This long start-up time will entail considerable burden and delay in protecting consumers in the financial marketplace – consumers that need immediate assistance.

Fourth, the proposal creates an agency with virtually unlimited jurisdiction and entirely uncertain Congressional oversight. The definitions that determine the extent of the new agency's exclusive or primary authority are extremely broad:

- The definition of "financial activity" includes a long list of activities, and then allows the proposed agency to add others to the list by rule.
- Likewise, the definition of "financial product or service" includes any product or service that "directly or indirectly" "results from or is related to" engaging in a financial activity. The payment side of every business of every sort could be so described and thus apparently become the responsibility of the proposed new agency.
- Specifically, because the granting of "credit" is considered a "financial product or service," the proposed new agency would have authority over every transaction that involves payment by means other than cash on the barrel head. That is because "credit" is defined as including, among other things, the right granted by a person to a consumer to "purchase property or services and defer payment therefor."

Fifth, the broad definitions of the new agency's plenary authority would also severely impact the future operations of the FTC. For example, in the proposal, a "covered person" is defined as one who engages "directly or indirectly" in a financial activity in connection with the provision of a consumer financial product or service, or one who provides a material service to or processes a transaction on behalf of such person. That definition would result in the transfer to the new agency all of the consumer protection functions that relate to financial products and services even if tangentially offered by any entity. Such a transfer would not only include a transfer of authority, but a transfer of staff, office space, infrastructure and funding – critical components without which the FTC would be crippled in exercising whatever enforcement authority remains.

Indeed, the exclusive authority of the proposed new agency would extend beyond rulemaking to "guidance, examination, and requiring reports." Such expansive authority would threaten to atrophy the FTC's ability to issue enforcement policy statements, business education materials, consumer education, press releases explaining its cases and other kinds of guidance relating to its retained authority over financial matters.

Similarly, the proposal provides for the collection of financial consumer complaints by the new agency. Yet, for years, the FTC has developed and maintained an extensive database of consumer complaints including complaints about financial products and services, obtained from a myriad of sources and available to all interested law enforcement agencies. That database would inevitably wither.

Finally, and perhaps most strikingly, the proposal does not even appear to authorize the FTC to enforce the new agency's rules (although it does authorize the states to enforce them). To be sure, there is a provision for coordinating enforcement, but it provides that the FTC must refer to the new agency any enforcement matter, then wait up to 120 days for the new agency to bring the case; the FTC can then only bring a case if the new agency declines to do so. At worst, that is a recipe for duplicative and wasteful exercise of the agencies' prosecutorial discretion. At best, it is a recipe for delay. As noted earlier, there is no estimate as to the size or cost of the new agency's staff, but it is likely that it will be created at the expense of the FTC.

This is not just parading horribles. The proposal would of course provide the FTC with "backstop enforcement authority." However, that provision is at best a fig leaf for stripping the agency of its current role as the primary agency responsible for protecting consumers in the financial market.[9]

In sum, the creation of a new Executive Branch consumer protection agency for financial products and services will introduce an even worse situation than now exists. As with the creation of any new federal agency from whole cloth, the proposal guarantees that there will be substantial delay in law enforcement while the new agency is established, in addition to imposing substantial financial costs on the public and sapping the vitality of the FTC as a consumer protection agency.

IV. The Proposal to Create the CFPA Should Be Scrapped in Favor of Entrusting Consumer Protection Authority and Responsibility on the Basis of Core Competency.

Plenary and exclusive authority and responsibility for consumer protection functions in the financial market, as in other markets, should be assigned to that agency which has the highest degree of expertise, experience and core competency to perform those functions.

That agency is not inevitably the FTC. There are certain functions which the FTC is ill-

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[9] *See* Prepared Statement of Stephen Calkins On the Proposed Consumer Financial Protection Agency: Implications for Consumers and the FTC, Testimony Before the Committee on Energy and Commerce Subcommittee on Commerce, Trade, and Consumer Protection, United States House of Representatives, July 8, 2009, at 9-10, *available at* http://energycommerce.house.gov/Press_111/20090708/testimony_calkins.pdf.

equipped to perform. For example, the monitoring of the safety and soundness of financial institutions has never been within the FTC's purview and it is strongly arguable that the FTC might not be effective in performing that function. Likewise, the FTC lacks a comparative advantage in terms of the experience and expertise required to determine whether a particular financial product or service should or should not be offered to the public.

On the other hand, the FTC has traditionally exercised particular expertise and experience with respect to, among other things, the fashioning of disclosures that are necessary and appropriate to protect consumers both from a lack of sufficient information to make an informed choice as well as from information overload. The Commission has a long history of conducting empirical tests of the efficacy of disclosures in a wide variety of commercial contexts.[10] The Commission has made the development and testing of disclosures (especially mortgage disclosures) a key priority in its research relating to financial services. Current statutory and regulatory schemes related to financial services include a host of requirements mandating that information be disclosed to consumers. Most recently, the FTC's Bureau of Economics published a seminal research report concluding that the current mortgage disclosure requirements do not work and that alternative disclosures should be considered and tested.[11]

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[10] For example, the FTC staff released a study showing that broker compensation disclosures that the Department of Housing and Urban Development had proposed confused consumers, leading many of them to choose loans that were more expensive. *See* Federal Trade Commission, Bureau of Economics Staff Report, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment* (February 2004). Another example is seminal empirical research conducted by FTC staff on rent-to-own transactions, including evaluating consumer disclosure requirements. *See* Federal Trade Commission, Bureau of Economics Staff Report, *Survey of Rent-to-Own Customers* (April 2000).

[11] *See* Federal Trade Commission, Bureau of Economics Staff Report, *Improving Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype*

In fact, evidencing that core competency, other agencies (including the Federal Reserve Board) have looked to the FTC for guidance in this respect. Furthermore, the FTC has been the dominant force in spearheading efforts to educate consumers about a wide array of important financial issues.[12]

Another function as to which the FTC has been the lead agency has been data security and protection of consumers from identity theft. Because of its experience and expertise regarding consumer expectations, the FTC has exercised primacy in that area. Specific examples include the Commission's efforts to protect privacy and fight identity theft through its law enforcement actions, its leadership on the President's Identity Theft Task Force, and its extensive consumer and business education and outreach activities.[13] This discussion of the FTC's core competencies is illustrative not exhaustive.

Of course, the FTC cannot adequately perform these functions on a plenary and exclusive basis (as it should do) without adequate resources. Thus, the assignment of these functions to the FTC must be accompanied by an adequate addition of staff to perform them, as well as by

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Disclosure Forms (June 2007), *available at* http://www.ftc.gov/os/2007/06/P025505mortgagedisclosurereport.pdf.

[12] For example, the FTC distributes consumer education materials on mortgage servicing, what consumers should do if they are having trouble making mortgage payments, and how consumers can manage their mortgage if their lender closes or files for bankruptcy. *See* http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea10.shtm; http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea04.shtm; http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea12.shtm.

[13] *See generally* Prepared Statement of the Federal Trade Commission On Protecting Consumer Privacy and Combating Identity Theft, Testimony Before the Subcommittee on Crime, Terrorism, and Homeland Security of the Committee on the Judiciary, United States House of Representatives, Dec. 18, 2007, *available at* http://www.ftc.gov/os/testimony/P065404idtheft.pdf.

safeguards against those resources being indirectly attacked by superior wages at other federal agencies.[14]

There is another compelling reason for entrusting certain functions to the FTC on a plenary and exclusive basis rather than to a new agency. Quite apart from its demonstrated superior core competency in performing these functions, the FTC has long maintained a vibrant competition mission. As former FTC Chairman Muris has pointed out, it is imperative to the competition mission that the consumer protection mission inform the competition mission. Otherwise, there is a danger that competition will be distorted by unwise consumer protection initiatives.[15] This cross-fertilization is all the more important today, when "behavioral economists" suggest that consumers are not always rational in their behavior and that the best competition missions are those which are coupled with an expert and experienced consumer protection mission.[16]

V. Conclusion

In short, trading the current flawed balkanized system of consumer protection for a new federal Executive Branch consumer financial protection agency, with all of its fundamental faults, is no way to make sound public policy.

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[14] For example, the Securities and Exchange Commission and the Federal Reserve Board have higher pay scales than comparable pay scales at the FTC. Of course, reducing those pay scales is not the only way to avoid this problem.

[15] *See* Prepared Statement of Timothy Muris On The Economy and Fraud: Protecting Consumers During Downward Economic Times, Testimony Before the Committee on Commerce, Science, and Transportation, United States Senate, July 14, 2009, at 3-4, *available at* http://commerce.senate.gov/public/_files/MurisJuly14Testimony.pdf.

[16] *See* Economics Roundtable, Global Competition Review (March 2009).

**Response to questions from the Honorable Spencer Bachus
by Sheila C. Bair, Chairman,
Federal Deposit Insurance Corporation**

UDAP Questions

Q1. Under the Federal Trade Commission Act, only the Board of Governors of the Federal Reserve System (Fed) has the authority to issue rules or regulations defining what acts or practices are unfair or deceptive with respect to all banks, including those for which the FDIC or the OCC is the primary federal regulator. Neither the FDIC nor the OCC has authority to adopt such rules or regulations for the banks they regulate. The Fed, FDIC and OCC, however, have taken the position that the FDIC and the OCC may define what acts or practices they think are unfair or deceptive on a case-by-case basis in the context of administrative enforcement proceedings, and the FDIC has done just that, as reflected in a series of Consent Cease and Desist Orders recently issued by the FDIC including those regarding Advanta Bank Corporation; American Express Centurion Bank of Salt Lake City, Utah; and the CompuCredit-related cease and desist orders against Columbus Bank and Trust, Columbus, Georgia, First Bank of Delaware, Wilmington, Delaware, and First Bank & Trust, Brookings, South Dakota.

Q1a. The FTC Act explicitly confers upon the Federal Reserve Board, the Federal Home Loan Bank Board, and the National Credit Union Administration Board the authority to "define with specificity" unfair and deceptive acts and practices. While the FTC Act grants enforcement authority to the FDIC and OCC, the Act does not explicitly grant the FDIC and OCC the authority to define unfair or deceptive acts and practices. In other words, under the express language of the FTC Act, the FDIC and the OCC do not have the statutory authority to decide for the banks they regulate that a particular act or practice is unsafe or unsound, either by adopting a regulation or on a case-by-case basis in enforcement proceedings.

Q1a(i). Have the FDIC and the OCC each analyzed this legal issue and prepared written legal opinions which conclude that they each do have the authority to define unfair or deceptive acts or practices on a case by case basis?

A1a(i)*:* The FDIC General Counsel has not issued a formal legal opinion, but the FDIC has issued two Financial Institution Letters (FILs) addressing this issue, "Guidance on Unfair or Deceptive Acts," FIL-57-2002 (May 30, 2002), and "Unfair or Deceptive Acts or Practices by State-Chartered Banks," FIL-26-2004 (March 11, 2004). Copies of the two FILS are attached.

The FTC Act contains a broad prohibition on the use of unfair or deceptive acts or practices that does not depend on specific regulations. The FTC Act also grants authority to the FTC and to certain financial regulators including the Fed (for banks), the Office of Thrift Supervision (for thrifts), and the National Credit Union Administration (for credit unions) to issue regulations with respect to specific practices. Insured financial institutions must comply with both the general prohibition on the use of unfair or deceptive practices and any regulations issued by the appropriate financial regulator. If an insured financial institution violates the FTC Act or an implementing regulation, the banking agencies can pursue corrective actions including enforcement actions such as cease and desist orders and the imposition of civil money penalties under Section 8 of the Federal Deposit Insurance Act (FDI Act). For example, in the Compucredit cases listed above, the FDIC brought actions against the three banks, and the FDIC and FTC brought parallel actions against Compucredit.

Q1a(ii). Have these opinions been reviewed and approved by the General Counsel of each agency?

A1a(ii). The FDIC General Counsel reviewed the issue and approved the two FILS before their issuance.

Q1a(iii). Has the Fed General Counsel's office reviewed these opinions or performed its own analysis and prepared its own written opinion?

A1a(iii). While the FDIC is not aware of a formal written opinion by the Fed's General Counsel addressing the FDIC and the OCC's authority to cite banks for violations of Section 5 and take appropriate enforcement action, the Fed has publicly stated this position. Then Chairman Greenspan in his May 30, 2002 letter to Honorable John J. LaFalce, Ranking Member, Committee on Financial Services, noted that "the banking agencies also may take formal enforcement actions under the FDI Act to prevent unfair or deceptive practices that violate the FTC Act." Further, the Fed and the FDIC jointly issued FIL-26-2004, "Unfair or Deceptive Acts or Practices by State-Chartered Banks," which explicitly stated the authority to take enforcement actions under Section 8 of the FDI Act against banks that commit unfair or deceptive trade practices, as provided in Section 5. The Fed, along with the OTS and the NCUA, recently reaffirmed the authority to enforce Section 5 on a case-by-case basis in the Preamble to the January 29, 2009, Amendments to Regulation AA, 74 FR 5498.

Q1a(iv). Have any of the opinions that may have been prepared by the FDIC, OCC, and/or the Fed regarding this issue been reviewed by any independent third party, such as the relevant Inspectors General or the Justice Department?

A1a(iv). We are not aware that either FIL has been reviewed by the FDIC Inspector General or the Justice Department. In Roberts v. Fleet Bank (R.I.), 342 F. 3d 260, 269-70 (3rd Cir. 2003), the Court of Appeals recognized that the OCC has the authority under Section 8 to address proscribed conduct under Section 5.

Qb. What, if any procedures have been established to assure that the Fed, OCC, and the FDIC are all in agreement as to what acts or practices are unfair or deceptive?

Ab: When the FDIC first considered whether it would be appropriate to enforce the FTC Act's Section 5 prohibition against unfair and deceptive acts and practices on a case-by-case basis, it consulted with the Fed. The two agencies determined that such enforcement would be appropriate under Section 8 of the FDI Act. As a means to ensure consistency, they also agreed to follow the standards developed by the FTC and tested through the courts. In FIL 26-2004, the FDIC and the Fed jointly explained that they would follow those standards, which were described in the FIL, and that they would "also consider factually similar cases brought by the FTC and other agencies to ensure that these standards are applied consistently."

The FDIC subjects all potential UDAP cases to a thorough internal review, by both examination and legal staff at multiple levels, which considers the unique facts and circumstances of that case. Each case is considered individually, because a change in a single fact can make the difference between finding a UDAP violation or not.

The FDIC staff regularly consults with FTC staff to obtain informal views in particular situations. The FDIC and Fed staffs are in regular contact through mechanisms such as the FFIEC Consumer Compliance Task Force and other less formal means of communication. A Consumer Compliance Task Force working group has been drafting UDAP examination procedures, for example.

Qb(i). How do the regulators ensure that the OCC and/or the FDIC do not adopt a UDAP rule in a case through their respective adjudicatory processes that has not been, or is not, also adopted by the other banking agencies? Do you see a problem with the possibility of inconsistent rulings or positions between or among the federal banking agencies regarding what acts or practices are unfair or deceptive?

Ab(i). When the FDIC brings an enforcement action against a bank for unfair or deceptive practices on a case-by case basis, the agency has not promulgated a UDAP rule under the FTC Act. As the agencies follow the standards established by the FTC and consult with that agency, we do not believe the agencies will enforce Section 5 in an inconsistent manner. In addition, final decisions by the FDIC in enforcement cases are subject to review by United States Courts of Appeal.

Qb(ii). Are you aware of any inconsistent positions that exist as of today, i.e. situations where the FDIC or OCC or Fed has determined in the context of an administrative enforcement proceeding that a particular act or practice is unfair or deceptive, while one or both of the other agencies have not and do not regard the conduct at issue as a violation of the FTC Act? How would you find out if that was the case?

Ab(ii): We are unaware of any inconsistent positions taken by the agencies in administrative enforcement proceedings addressing unfair or deceptive acts or practices. Further before the FDIC brings a significant formal enforcement action against an institution in a UDAP matter, such as to impose a cease and desist order, restitution order, or a civil money penalty, in most instances the action is approved by the FDIC Case Review Committee, which includes OCC and OTS representatives as voting members. Agency staff routinely discusses matters such as these at Consumer Compliance Task Force meetings.

Questions on FAS 166 and FAS 167

Q1. What will be the impact of this "consolidation" on bond investors who are critical to the extension of credit and the future of our securitized credit markets?

A1. The securitization market involves the complex interaction of originators, borrowers, servicers, and investors. While securitization has helped to extend credit and increase funding of housing and other important markets, the recent crisis has exposed some deficiencies that are in the process of being addressed. The impact of the Financial Accounting Standards Board's (FASB) new accounting standards that will require the consolidation of certain off-balance sheet structures along with other recent reform efforts, such as the requirement for securitizers to retain a percentage of the credit risk on any asset that is transferred through a securitization, is difficult to predict. The various initiatives change the incentives, risks, and rewards for the various securitization market participants in different ways that make it difficult to predict the overall market impact.

The FDIC along with the other banking agencies has just issued a Notice of Proposed Rulemaking (NPR) related to the FASB's adoption of FAS 166 and FAS 167. The NPR seeks to better align regulatory capital requirements with the actual risks of certain exposures and seeks comment and supporting data on the impact of the accounting changes on securitization activity, lending, and financial markets generally. It also seeks comment and supporting data on the features and characteristics of transactions that, although consolidated under the new accounting standards, might merit an alternative capital treatment, as well as on the potential impact of the new accounting standards on lending, provisioning, and other activities.

Q2(a) Does the FDIC consult with the other federal banking agencies in an effort to achieve uniformity with respect to the factors that will be evaluated and the standards that will be applied in arriving at such individual capital requirements for institutions?

A2(a): The federal banking agencies work together to achieve uniformity in the development, interpretation, and implementation of the risk-based capital requirements. An interagency capital policy group from the supervision and legal divisions of the respective agencies meets regularly to discuss and reach consensus on capital policy issues involving new interpretations of the agencies capital rules. We note, for example, that the FDIC and the other federal banking agencies have just developed a uniform joint NPR for a regulatory capital rule to address FAS 166 and FAS 167.

Q2(b): Should the federal banking agencies apply the same criteria to determine the capital ratios for a regulated institution?

A2(b): Insured depository institutions are subject to regulatory capital standards that are, with rare and very minor exceptions, identical across the federal banking agencies. Supervisors generally expect banks to hold capital in excess of regulatory minimums commensurate with their risk profiles. It is appropriate for the agencies to look to a common set of factors in determining capital adequacy, including the individual risk profile of the institution, the level and severity of adversely classified assets, and the institution's interest rate risk.

Q2(c): Is there consistency between and among the federal banking agencies regarding the criteria they use to determine whether to establish individual capital requirements?

A2(c): As provided in the response to question 2(b) above, the agencies generally evaluate a common set of factors in determining whether, and to what extent, an institution should be required to hold capital in excess of the regulatory minimums. However, this determination is dictated largely by the circumstances of the individual institution and supervisory judgment by the respective agencies, including under the specific delegations of authority under the capital rules involving the appropriate classification of capital instruments and the proper risk-weighting of assets under the risk-based capital rules.

Q2(d): Does your agency use an economic model to determine the capital ratios a given institution should maintain in light of its particular risk profile in order to be considered adequately capitalized or well-capitalized?

- **ii. If you do use a model, whose model is it?**
    1. **Was it constructed by your agency alone?**
    2. **Did you discuss it with the other banking agencies, or consult with them regarding what, if any, models they use for such purposes?**
    3. **To the extent you know what differences there are between any model that your agency uses and any model used by any other banking agency, how do you go about resolving hose differences, if at all?**

4. **Do you have a set of standards you use in evaluating capital adequacy models that are employed by the institutions you regulate and, if so, what are they and were they developed in consultation with any other agencies?**

A2(d): No, the FDIC does not use an economic model in determining the capital ratios an institution should maintain. In December 2007, the banking agencies promulgated a regulation mandating the use of certain "advanced approaches" from Basel II to calculate regulatory capital for large, complex banks. These approaches draw heavily from banks' own internal risk models. No U.S. bank is currently calculating its capital requirements under these approaches.

The agencies expect the internal capital adequacy assessment of any institution to go beyond the assumptions underlying the minimum risk-based capital requirements. Although the assessment process may vary on an institution-by-institution basis, banks may use economic capital measures for certain elements of risk management, such as limit setting or for evaluating performance and aggregate capital needs. However, notwithstanding the particular metrics or analytical paradigm used for any given process, the fundamental objectives of the internal assessment must remain the same: to identify and measure material risks; set and assess internal capital adequacy objectives that relate directly to risk; and ensure the integrity of internal capital adequacy assessments. The interagency guidance document discusses the agencies' expectations with respect to each of these objectives, with a specific emphasis on the various risk types that should be identified and measured as part of the internal capital adequacy assessment process (i.e., credit, market, operational, interest rate, and liquidity risk).

Financial Institution Letters

GUIDANCE ON UNFAIR OR DECEPTIVE ACTS OR PRACTICES

FIL-57-2002
May 30, 2002

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: *Unfair or Deceptive Acts or Practices: Applicability of the Federal Trade Commission Act*

The Federal Trade Commission Act (FTC Act) declares that unfair or deceptive trade practices are illegal. **See** 15 USC § 45(a) (FTC Act Section 5). This letter confirms that the Federal Deposit Insurance Corporation (FDIC) intends to cite state nonmember banks and their institution-affiliated parties for violations of FTC Act Section 5 and will take appropriate action pursuant to its authority under Section 8 of the Federal Deposit Insurance Act (FDI Act) when unfair or deceptive trade practices are discovered. FDIC enforcement action against entities other than banks will be coordinated with the Federal Trade Commission, which also has authority to take action against nonbank parties that engage in unfair or deceptive trade practices.

In order to determine whether a practice is "unfair," the FDIC will consider whether the practice "causes or is likely to cause substantial injury to consumers which is not reasonably avoided by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." 15 U.S.C. § 45(n). By adhering to this tenet, the FDIC will take action to address conduct that falls well below the high standards of business practice expected of most banks and the parties affiliated with them.

In addition, to correct deceptive trade practices, the FDIC will take action against representations, omissions, or practices that are likely to mislead consumers acting reasonably under the circumstances, and are likely to cause such consumers harm. The FDIC will focus on material misrepresentations, i.e., those that affect choices made by consumers because such misrepresentations are most likely to cause consumers financial harm.

The FDIC recognizes that the institutions that it supervises generally adhere to high standards of conduct. The agency, therefore, anticipates that it will not be required to take action to correct unfair or deceptive practices on a frequent basis. However, to avoid misunderstanding about the applicability of the FTC Act, this letter is intended to clarify that the FTC Act's prohibition against unfair and deceptive trade practices does apply to your institution, and to its subsidiaries and third-party contractors.

While the Federal Trade Commission has adopted policy statements on unfairness (FTC Policy Statement on Unfairness, December 17, 1980) and deception (FTC Policy Statement on Deception, October 14, 1983), most unfair and deceptive trade practices have been defined in fact-specific, case-by-case adjudications. The FDIC anticipates that additional guidance will be provided in similar fashion going forward.

Please contact Division of Compliance and Consumer Affairs (DCA) staff in your regional office for more information. To obtain Federal Trade Commission business guidance on unfair and deceptive practices and other topics, please link to: www.ftc.gov/ftc/business.htm. For assistance from the DCA Washington Office, please call April Breslaw, Senior Policy Analyst, at (202) 942-3061, Louise Kotoshirodo Kramer, Policy Analyst, at (202) 942-3599, or David LaFleur, Policy Analyst, at (202) 942-3466.

Michael J. Zamorski
Director

Distribution: FDIC-Supervised Banks (Commercial and Savings)

NOTE: Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 801 17th Street, NW, Room 100, Washington, DC 20434 (800-276-6003 or (703) 562-2200).

Financial Institution Letters

Unfair or Deceptive Acts or Practices by State-Chartered Banks

FIL-26-2004
March 11, 2004

TO:	CHIEF EXECUTIVE OFFICER (also of interest to Compliance Officer)
SUBJECT:	Unfair or Deceptive Acts or Practices Under Section 5 of the Federal Trade Commission Act
Summary:	*The FDIC and the Board of Governors of the Federal Reserve System are issuing guidance to state-chartered banks to outline the standards that the agencies will consider when applying the prohibitions against unfair or deceptive acts or practices found in section 5 of the Federal Trade Commission Act. The guidance also provides information about managing risks relating to unfair or deceptive acts or practices, including best practices.*

The Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System are jointly issuing the attached guidance to state-chartered banks regarding unfair or deceptive acts or practices prohibited by section 5 of the Federal Trade Commission (FTC) Act.

In FIL-57-2002, issued May 30, 2002, the FDIC informed state nonmember banks that these prohibitions apply to their activities, and that the FDIC would issue guidance about how institutions could avoid engaging in practices that might be viewed as unfair or deceptive. In its corresponding release, the Federal Reserve Board indicated that it would work with the FDIC to prepare additional guidance for state member banks on this subject. The attached guidance fulfills these commitments.

Specifically, the guidance explains:

- the standards used to assess whether an act or practice is unfair or deceptive;
- the interplay between the FTC Act and other consumer protection statutes; and
- guidelines for managing risks related to unfair and deceptive practices.

Although most insured banks adhere to high levels of professional conduct, managers of all banks must remain vigilant against possible unfair or deceptive acts or practices to protect consumers and to minimize their own risk.

For more information about the guidance, please contact April P. Breslaw, Section Chief (202- 898-6609); Deirdre Foley, Senior Policy Analyst (202-898-6612); or Mira N. Marshall, Senior Policy Analyst (202-898-3912), in the Division of Supervision and Consumer Protection.

For your reference, FDIC Financial Institution Letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2004/index.html.

Michael J. Zamorski
Director
Division of Supervision and Consumer Protection

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Attachment: Unfair or Deceptive Acts or Practices by State-Chartered Banks March 11, 2004

Distribution: FDIC-Supervised Banks (Commercial and Savings)

NOTE: Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center , 801 17 th Street, NW , Room 100, Washington , DC 20434 (1-877-275-3342 or (703) 562-2200).

Financial Institution Letters

Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation

Unfair or Deceptive Acts or Practices by State-Chartered Banks
March 11, 2004

Purpose

The Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (the "Board" and the "FDIC," or collectively, the "Agencies") are issuing this statement to outline the standards that will be considered by the Agencies as they carry out their responsibility to enforce the prohibitions against unfair or deceptive trade practices found in section 5 of the Federal Trade Commission Act ("FTC Act") as they apply to acts and practices of state-chartered banks. The Agencies will apply these standards when weighing the need to take supervisory and enforcement actions and when seeking to ensure that unfair or deceptive practices do not recur.

This statement also contains a section on managing risks relating to unfair or deceptive acts or practices, which includes best practices as well as general guidance on measures that state-chartered banks can take to avoid engaging in such acts or practices.

Although the majority of insured banks adhere to a high level of professional conduct, banks must remain vigilant against possible unfair or deceptive acts or practices both to protect consumers and to minimize their own risks.

Coordination of Enforcement Efforts

Section 5(a) of the FTC Act prohibits "unfair or deceptive acts or practices in or affecting commerce," and applies to all persons engaged in commerce, including banks. The Agencies each have affirmed their authority under section 8 of the Federal Deposit Insurance Act to take appropriate action when unfair or deceptive acts or practices are discovered.

A number of agencies have authority to combat unfair or deceptive acts or practices. For example, the FTC has broad authority to enforce the require¬ments of section 5 of the FTC Act against many non-bank entities. In addition, state authorities have primary responsibility for enforcing state statutes against unfair or deceptive acts or practices. The Agencies intend to work with these other regulators as appropriate in investigating and responding to allegations of unfair or deceptive acts or practices that involve state banks and other entities supervised by the Agencies.

Standards for Determining What is Unfair or Deceptive

The FTC Act prohibits unfair or deceptive acts or practices. Congress drafted this provision broadly in order to provide sufficient flexibility in the law to address changes in the market and unfair or deceptive practices that may emerge.

An act or practice may be found to be unfair where it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." A representation, omission, or practice is deceptive if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer's conduct or decision regarding a product or service.

The standards for unfairness and deception are independent of each other. While a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is either unfair or deceptive. Whether an act or practice is unfair or deceptive will in each instance depend upon a careful analysis of the facts and circumstances. In analyzing a particular act or practice, the Agencies will be guided by the body of law and official interpretations for defining unfair or deceptive acts or practices developed by the courts and the FTC. The Agencies will also consider factually similar cases brought by the FTC and other agencies to ensure that these standards are applied consistently.

Unfair Acts or Practices

Assessing whether an act or practice is unfair

An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair. Each of these elements is discussed further below.

- The act or practice must cause or be likely to cause substantial injury to consumers.

To be unfair, an act or practice must cause or be likely to cause substantial injury to consumers. Substantial injury usually involves monetary harm. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. An injury may be substantial if it raises a significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair.

- Consumers must not reasonably be able to avoid the injury.

A practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer has committed to purchase the product or service would be an example of preventing a consumer from making an informed decision. A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

The Agencies will not second-guess the wisdom of particular consumer decisions. Instead, the Agencies will consider whether a bank's behavior unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making.

- The injury must not be outweighed by countervailing benefits to consumers or to competition.

To be unfair, the act or practice must be injurious in its net effects —that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a wider availability of products and services.

Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the bank in taking preventive measures and the costs to society as a whole of any increased burden and similar matters.

- Public policy may be considered.

Public policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

Deceptive Acts and Practices

Assessing whether an act or practice is deceptive

A three-part test is used to determine whether a representation, omission, or practice is "deceptive." First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material. Each of these elements is discussed below in greater detail.

- There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.

An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is likely to mislead consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled.

In determining whether an individual statement, representation, or omission is misleading, the statement, representation, or omission will not be evaluated in isolation. The Agencies will evaluate it in the context of the entire advertisement, transaction, or course of dealing to determine whether it constitutes deception. Acts or practices that have the potential to be deceptive include: making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not in fact available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.

- The act or practice must be considered from the perspective of the reasonable consumer.

In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. The test is whether the consumer's expectations or interpretation are reasonable in light of the claims made. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the standard is based upon the effects of the act or practice on a reasonable member of that group.

If a representation conveys two or more meanings to reasonable consumers and one meaning is misleading, the representation may be deceptive. Moreover, a consumer's interpretation or reaction may indicate that an act or practice is deceptive under the circumstances, even if the consumer's interpretation is not shared by a majority of the consumers in the relevant class, so long as a significant minority of such consumers is misled.

In evaluating whether a representation, omission or practice is deceptive, the Agencies will look at the entire advertisement, transaction, or course of dealing to determine how a reasonable consumer would respond. Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosures is unnecessary. Likewise, oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation.

- The representation, omission, or practice must be material.

A representation, omission, or practice is material if it is likely to affect a consumer's decision regarding a product or service. In general, information about costs, benefits, or restrictions on the use or availability of a product or service is material. When express claims are made with respect to a financial product or service, the claims will be presumed to be material. Similarly, the materiality of an implied claim will be presumed when it is demonstrated that the institution intended that the consumer draw certain conclusions based upon the claim.

Claims made with the knowledge that they are false will also be presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service.

Relationship to Other Laws

Acts or practices that are unfair or deceptive within the meaning of section 5 of the FTC Act may also violate other federal or state statutes. On the other hand, there may be circumstances in which an act or practice violates section 5 of the FTC Act even though the institution is in technical compliance with other applicable laws, such as consumer protection and fair lending laws. Banks should be mindful of both possibilities. The following laws warrant particular attention in this regard:

Truth in Lending and Truth in Savings Acts

Pursuant to the Truth in Lending Act (TILA), creditors must "clearly and conspicuously" disclose the costs and terms of credit. The Truth in Savings Act (TISA) requires depository institutions to provide interest and fee disclosures for deposit accounts so that consumers may compare deposit products. TISA also provides that advertisements shall not be misleading or inaccurate, and cannot misrepresent an institution's deposit contract. An act or practice that does not comply with these provisions of TILA or TISA may also violate the FTC Act. On the other hand, a transaction that is in technical compliance with TILA or TISA may nevertheless violate the FTC Act. For example, consumers could be misled by advertisements of "guaranteed" or "lifetime" interest rates when the creditor or depository institution intends to change the rates, whether or not the disclosures satisfy the technical requirements of TILA or TISA.

Equal Credit Opportunity and Fair Housing Acts

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction against persons on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that an applicant's income derives from any public assistance program, and the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. Similarly, the Fair Housing Act (FHA) prohibits creditors involved in residential real estate transactions from discriminating against any person on the basis of race, color, religion, sex, handicap, familial status, or national origin. Unfair or deceptive practices that target or have a disparate impact on consumers who are members of these protected classes may violate the ECOA or the FHA, as well as the FTC Act.

Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act prohibits unfair, deceptive, and abusive practices related to the collection of consumer debts. Although this statute does not by its terms apply to banks that collect their own debts, failure to adhere to the standards set by this Act may support a claim of unfair or deceptive practices in violation of the FTC Act. Moreover, banks that either affirmatively or through lack of oversight, permit a third-party debt collector acting on their behalf to engage in deception, harassment, or threats in the collection of monies due may be exposed to liability for approving or assisting in an unfair or deceptive act or practice.

Managing Risks Related to Unfair or Deceptive Acts or Practices

Since the release of the FDIC's statement and the Board's letter on unfair and deceptive practices in May 2002, bankers have asked for guidance on strategies for managing risk in this area. This section outlines guidance on best practices to address some areas with the greatest potential for unfair or deceptive acts and practices, including: advertising and solicitation; servicing and collections; and the management and monitoring of employees and third-party service providers. Banks also should monitor compliance with their own policies in these areas, and should have procedures for receiving and addressing consumer complaints and monitoring activities performed by third parties on behalf of the bank.

To avoid engaging in unfair or deceptive activity, the Agencies encourage use of the following practices, which have already been adopted by many institutions:

Review all promotional materials, marketing scripts, and customer agreements and disclosures to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not misrepresent such terms either affirmatively or by omission. Ensure that these materials do not use fine print, separate statements or inconspicuous disclosures to correct potentially misleading headlines, and ensure that there is a reasonable factual basis for all representations made.

Draw the attention of customers to key terms, including limitations and conditions, that are important in enabling the customer to make an informed decision regarding whether the product or service meets the customer's needs.

Clearly disclose all material limitations or conditions on the terms or availability of products or services, such as a limitation that applies a special interest rate only to balance transfers; the expiration date for terms that apply only during an introductory period; material prerequisites for obtaining particular products, services or terms (e.g., minimum transaction amounts, introductory or other fees, or other qualifications); or conditions for canceling a service without charge when the service is offered on a free trial basis.

Inform consumers in a clear and timely manner about any fees, penalties, or other charges (including charges for any force-placed products) that have been imposed, and the reasons for their imposition.

Clearly inform customers of contract provisions that permit a change in the terms and conditions of an agreement.

When using terms such as "pre-approved" or "guaranteed," clearly disclose any limitations, conditions, or restrictions on the offer.

Clearly inform consumers when the account terms approved by the bank for the consumer are less favorable than the advertised terms or terms previously disclosed.

Tailor advertisements, promotional materials, disclosures and scripts to take account of the sophistication and experience of the target audience. Do not make claims, representations or statements that mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.

Avoid advertising that a particular service will be provided in connection with an account if the bank does not intend or is not able to provide the service to accountholders. Clearly disclose when optional products and services — such as insurance, travel services, credit protection, and consumer report update services that are offered simultaneously with credit — are not required to obtain credit or considered in decisions to grant credit.

Ensure that costs and benefits of optional or related products and services are not misrepresented or presented in an incomplete manner.

When making claims about amounts of credit available to consumers, accurately and completely represent the amount of potential, approved, or useable credit that the consumer will receive.

Avoid advertising terms that are not available to most customers and using unrepresentative examples in advertising, marketing, and promotional materials.

Avoid making representations to consumers that they may pay less than the minimum amount due required by the account terms without adequately disclosing any late fees, overlimit fees, or other account fees that will result from the consumer paying such reduced amount.

Clearly disclose a telephone number or mailing address (and, as an addition, an email or website address if available) that consumers may use to contact the bank or its third-party servicers regarding any complaints they may have, and maintain appropriate procedures for resolving complaints. Consumer complaints should also be reviewed by banks to identify practices that have the potential to be misleading to customers.

Implement and maintain effective risk and supervisory controls to select and manage third-party servicers.

Ensure that employees and third parties who market or promote bank products, or service loans, are adequately trained to avoid making statements or taking actions that might be unfair or deceptive.

Review compensation arrangements for bank employees as well as third-party vendors and servicers to ensure that they do not create unintended incentives to engage in unfair or deceptive practices.

Ensure that the institution and its third party servicers have and follow procedures to credit consumer payments in a timely manner. Consumers should be clearly told when and if monthly payments are applied to fees, penalties, or other charges before being applied to regular principal and interest.

The need for clear and accurate disclosures that are sensitive to the sophistication of the target audience is heightened for products and services that have been associated with abusive practices. Accordingly, banks should take particular care in marketing credit and other products and services to the elderly, the financially vulnerable, and customers who are not financially sophisticated. In addition, creditors should pay particular attention to ensure that disclosures are clear and accurate with respect to: the points and other charges that will be financed as part of home-secured loans; the terms and conditions related to insurance offered in connection with loans; loans covered by the Home Ownership and Equity Protection Act; reverse mortgages; credit cards designed to rehabilitate the credit position of the cardholder; and loans with pre-payment penalties, temporary introductory terms, or terms that are not available as advertised to all consumers.

Conclusion

The development and implementation of policies and procedures in these areas and the other steps outlined above will help banks assure that products and services are provided in a manner that is fair, allows informed customer choice, and is consistent with the FTC Act.

Chairman Bernanke subsequently submitted the following in response to written questions received from Congressman Bachus in connection with the July 24, 2009, hearing before the Committee on Financial Services:

UDAP Questions:

1. **Under the Federal Trade Commission Act, only the Board of Governors of the Federal Reserve System ("Fed") has the authority to issue rules or regulations defining what acts or practices are unfair or deceptive with respect to all banks, including those for which the FDIC or the OCC is the primary federal regulator. Neither the FDIC nor the OCC has the authority to adopt such rules or regulations for the banks they regulate. The Fed, FDIC and OCC, however, have taken the position that the FDIC and the OCC may define what acts or practices they think are unfair or deceptive on a case-by-case basis in the context of administrative enforcement proceedings, and the FDIC has done just that, as reflected in a series of Consent Cease and Desist Orders recently issued by the FDIC, including those regarding Advanta Bank Corporation; American Express Centurion Bank of Salt Lake City, Utah; and the CompuCredit-related cease and desist orders against Columbus Bank and Trust, Columbus, Georgia, First Bank of Delaware, Wilmington, Delaware, and First Bank & Trust, Brookings, South Dakota.**

    a. **The FTC Act explicitly confers upon the Federal Reserve Board, the Federal Home Loan Bank Board, and the National Credit Union Administration Board the authority to "define with specificity" unfair and deceptive acts and practices. While the FTC Act grants enforcement authority to the FDIC and OCC, the Act does not explicitly grant the FDIC and OCC the authority to define unfair or deceptive acts and practices. In other words, under the express language of the FTC Act, the FDIC and the OCC do not have the statutory authority to decide for the banks they regulate that a particular act or practice is unsafe or unsound, either by adopting a regulation or on a case-by-case basis in enforcement proceedings.**

        i. **Has you General Counsel's office performed its own analysis and prepared its own written opinion?**

        ii. **Have any of the opinions that may have been prepared by the FDIC, OCC and/or the Fed regarding this issue been reviewed by any independent third party, such as the relevant Inspectors General or the Justice Department?**

    b. **What, if any, procedures have been established to assure that the Fed, OCC and the FDIC are all in agreement as to what acts or practices are unfair or deceptive?**

        i. **How do the regulators ensure that the OCC and/or the FDIC do not adopt a UDAP rule in a case through their respective adjudicatory processing that has been , or is not, also adopted by the other banking agencies? Do you see a problem with the possibility of inconsistent rulings or positions between or**

among the federal banking agencies regarding what acts or practices re unfair or deceptive?

ii. **Are you aware of any inconsistent positions that exist as of today, i.e., situations where the FDIC or OCC or Fed has determined in the context of an administrative enforcement proceeding that a particular act of practice is unfair or deceptive, while one or both of the other agencies have not and do not regard the conduct at issue as a violation of the FTC Act? How would you find out if that were the case?**

As you point out, section 18(f)(1) of the FTC Act provides that the Board (with respect to banks), the OTS (with respect to savings associations), and the NCUA (with respect to federal credit unions) are responsible for prescribing "regulations defining with specificity . . . unfair or deceptive acts or practices, and containing requirements prescribed for the purpose of preventing such acts or practices." 15 U.S.C. § 57a(f)(1). Section 18(f)(2) of the FTC Act authorizes a number of agencies, including agencies not empowered to write rules under the FTC Act, to enforce these rules.

However, these provisions do not define the full extent of the authority of the agencies to address unfair and deceptive acts or practices. The prohibition against unfair acts or practices in section 5(a) of the FTC Act applies to all banks as a matter of law. Each banking agency is authorized to enforce compliance with any law under section 8 of the Federal Deposit Insurance Act (FDI Act) on a case-by case basis against their respective institutions. *See* 12 U.S.C. § 1818. This authority is independent from the banking agencies' authority under section 18(f)(2) to enforce any regulations the Board may promulgate. Thus, the agencies are authorized to identify and address potentially unfair or deceptive practices using information from consumer complaints, the examination process and, ultimately the formal enforcement process.

The expectation that the banking agencies would use this enforcement authority is reflected in section 18(f)(1) of the FTC Act, which provides that "each agency specified in paragraphs (2) or (3) [that is, the Board, OCC, FDIC, and OTS] shall establish a separate division of consumer affairs which shall receive and take appropriate action upon complaints with respect to such acts or practices by banks or savings and loan institutions described in paragraph (3) subject to its jurisdiction." This section contemplates that the agencies would "take appropriate action" with respect to unfair and deceptive acts or practices without reference to whether or not the specific act or practice had been identified by regulation. Indeed, the courts have long recognized that the FTC Act prohibits all unfair or deceptive acts or practices, not only those identified by regulation. *See FTC v. Orkin*, 849 F.2d 1354 (11th Cir. 1988); *FTC v. Cyberspace.com*, 453 F.3d 1196 (9th Cir. 2006).

The Board considered this legal position in connection with the adoption of its policy statement[1] confirming the broad authority of the agencies to enforce the FTC Act. The statement

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[1] FRB and FDIC Policy Statement on Unfair or Deceptive Acts or Practices by State-Chartered Banks (March 11, 2004) (available at http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040311/default.htm). The Board also has consumer compliance examination procedures in place for section 5 of the FTC Act. The OCC also issued an advisory letter in 2002 setting forth the standards the agency uses to determine whether an act or practice is unfair or

describes the standards and principles the agencies will follow in determining on a case-by-case basis whether an act or practice constitutes a violation of section 5 of the FTC Act and also outlines guidance on best practices to address some areas with the greatest potential for unfairness or deception. In enforcing the FTC Act, the Board applies those principles to the specific facts and circumstances of the case before it.

While there is no formal process for conducting interagency discussions about practices that may be under review in a pending examination or administrative enforcement proceeding, staff of the agencies discuss cases involving unfair or deceptive practices on an informal basis. The agencies work towards maintaining uniform examination procedures through the FFIEC consumer compliance task force.

1. **Treasury Secretary Geithner has warned that "no financial recovery plan will be successful unless it helps restart securitization markets...." At the same time, the Financial Accounting Standards Board (FASB) has recently finalized significant and retroactive changes to securitization accounting that will have a tremendous impact on existing assets and future lending. These changes -which become effective January 1, 2010 could seriously complicate efforts to repair financial markets.**

   The Administration has made the securitized credit markets the centerpiece of the Financial Stability Plan (through TALF, PPIP, etc). However, in promulgating FAS 166 and 167, FASB has sought to retroactively eliminate the securitization accounting vehicle known as the "Qualified Special Purpose Entity," which will require some bond investors to "consolidate" an entire pool of loans on their balance sheet, despite only owning 2-3% of the transaction. What will be the impact of this "consolidation" on bond investors who are critical to the extension of credit and the future of our securitized credit markets?

In the process of considering lessons learned from the financial crisis, the President's Working Group on Financial Markets and the Securities and Exchange Commission encouraged the FASB to re-assess its accounting standards for off-balance sheet vehicles. In response and following a period of public comment on the proposal, FASB recently modified GAAP through FAS 166 and 167.

Under the new accounting standards, an enterprise (e.g., company, individual, or group of bond holders) is required to consolidate certain special purpose entities (SPEs) whenever it has a "controlling financial interest" in the SPE, that is, the enterprise has the power to direct the SPE's most significant activities and the right to receive benefits from, or obligation to bear losses of, the SPE. The accounting standards also require disclosure of the enterprise's involvement with such SPEs and any significant changes in risk exposure that result.

Whether an enterprise will be required to consolidate an SPE will depend on the specific facts and circumstances of each transaction. Beginning in 2010, many banking organizations that

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deceptive, and providing general guidance on the activities examiners should scrutinize. Guidance on Unfair or Deceptive Acts or Practices (March 22, 2002) (available at http://www.occ.treas.gov/ftp/advisory/2002-3.txt).

sponsor securitizations will be required to consolidate the associated SPEs. Certain asset-backed commercial paper conduits, revolving securitizations structured as master trusts (such as credit card securitizations), mortgage loan securitizations not guaranteed by the U.S. government or a U.S. government-sponsored agency, and term loan securitizations (such as auto and student loan securitizations), are among the types of securitization SPEs that will likely require consolidation by their sponsoring banking organization. In almost all cases, the SPE consolidation requirements will not apply to investors in the asset-backed securities, because such investors generally do not have power to direct the SPE's most significant activities.

2. The same statutory capital ratios apply to every federally insured depository institution for purposes of determining what their level of capital adequacy is, e.g., well capitalized, adequately capitalized, undercapitalized, etc. However, each of the federal banking agencies also has the authority to require a given institution it regulates to achieve and maintain capital ratios (e.g., for total risk-based capital, core capital, etc.) at specific levels set by the agency, which may be even higher than the statutory ratios used to define a "well-capitalized" institution. In connection with these individual capital requirements:

a. Does your agency consult with the other federal banking agencies in an effort to achieve uniformity with respect to the factors that will be evaluated and the standards that will be applied in arriving at such individual capital requirements for institutions?

b. Should the federal banking agencies apply the same criteria to determine the capital ratios for a regulated institution?

c. Is there consistency between and among the federal banking agencies regarding the criteria they use to determine whether to establish individual capital requirements?

While the federal banking agencies (the Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS)) have substantially consistent minimum regulatory capital rules, depository institutions are generally expected to operate well above these minimums and in all cases hold capital commensurate with the magnitude and nature of risks to which they are exposed.[2] The federal banking agencies apply consistent criteria when evaluating a depository institution's capital adequacy and potential need for additional capital. The agencies assess the capital adequacy of depository institutions using the interagency Uniform Financial Institutions Ratings System (UFIRS), commonly known by the acronym CAMELS (capital adequacy, asset quality, management and administration, earnings, liquidity, and sensitivity to market risk).[3] Under this system, the agencies endeavor to ensure that all financial institutions are evaluated comprehensively and uniformly and that supervisory attention is appropriately focused on the financial institutions exhibiting financial and operational weaknesses or adverse trends.

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[2] See, e.g., 12 CFR parts 208 and 225, Appendix A.

[3] Board SR letter 96-38 (December 27, 1996), available at http://www.federalreserve.gov/boarddocs/srletters/1996/sr9638.htm.

With respect to capital adequacy, the UFIRS states:

> A financial institution is expected to maintain capital commensurate with its risks and the ability of management to identify, measure, monitor, and control these risks. The effect of credit, market, and other risks on the institution's financial condition should be considered when evaluating the adequacy of capital. The types and quantity of risk inherent in an institution's activities will determine the need to maintain capital at levels above required regulatory minimums to properly reflect the potentially adverse consequences of these risks on the institution's capital.
>
> The capital adequacy of an institution is rated based on, but not limited to, an assessment of the following evaluation factors:
>
> - the level and quality of capital and the overall financial condition of the institution
> - the ability of management to address emerging needs for additional capital
> - the nature, trend, and volume of problem assets, and the adequacy of allowances for loan and lease losses and other valuation reserves
> - balance-sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities
> - risk exposure represented by off-balance-sheet activities
> - the quality and strength of earnings, and the reasonableness of dividends
> - prospects and plans for growth, as well as past experience in managing growth
> - access to capital markets and other sources of capital, including support provided by a parent holding company.

The agencies periodically issue joint supplementary guidance regarding risk assessment and capital adequacy as specific issues arise. For example, interagency Expanded Guidance on Subprime Lending and guidance on Concentrations in Commercial Real Estate Lending identify factors that institutions and examiners should consider when evaluating the risks and capital needs of particular portfolios.[4]

[4] See Board SR letter 01-4 (January 31, 2001), available at http://www.federalreserve.gov/boarddocs/srletters/2001/sr0104.htm (Subprime Lending Guidance) and Board SR letter 07-1 (January 4, 2007), available at http://fedweb.frb.gov/fedweb/bsr/srltrs/SR0701.htm (Commercial Real Estate Guidance).

Each depository institution is responsible for assessing the level of capital appropriate for its specific risk profile, and the agencies consider this analysis when making their own assessments of capital adequacy. Some institutions require the use of more sophisticated internal processes to assess capital adequacy because of their size, complexity, and the corresponding limitations of regulatory capital requirements to fully capture their risk profile. Federal Reserve guidance supplements the interagency standards described above by describing how supervisory staff should evaluate a large or complex banking organization's internal capital management processes to judge whether they meaningfully tie the identification, monitoring, and evaluation of risk to the determination of the institution's capital needs.[5] In cases where the appropriate federal banking agency determines that a depository institution's level of capital does not fully support its risk profile, the agency may require that the institution improve its capital position, even if the institution's regulatory capital levels exceed minimum regulatory and statutory requirements.[6]

(d) Does your agency use an economic model to determine the capital ratios a given institution should maintain in light of its particular risk profile in order to be considered adequately capitalized or well-capitalized?

i. If you don't use a model, how do you make that determination?

ii. If you do use a model, whose model is it?

1. Was it constructed by your agency alone?

2. Did you discuss it with the other banking agencies, or consult with them regarding what, if any, models they use for such purposes?

3. To the extent you know what differences there are between any model that your agency uses and any model used by any other banking agency, how do you go about resolving those differences, if at all?

The Board does not use a particular model for determining a depository institution's prompt corrective action category or overall capital adequacy.[7] A banking organization's regulatory capital ratios are the starting point for assessing its capital adequacy. Currently, all banking organizations subject to the Board's capital guidelines must calculate their minimum capital requirements based on the Board's general risk-based capital rules, which generally use a standard risk weighting of assets by asset category to determine minimum regulatory capital requirements for credit risk.[8] The federal banking agencies all have similar general risk-based capital rules.[9]

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[5] See Board SR letter 99-18 (July 1, 1999), available at http://fedweb.frb.gov/fedweb/bsr/srltrs/SR9918.htm.

[6] 12 U.S.C. § 3907(a)(2).

[7] Bank holding companies are not subject to the statutory prompt corrective action framework. See 12 U.S.C. § 1831(*o*). They are, however, required to meet minimum risk-based capital ratios that are used for various supervisory purposes, including the evaluation of applications from such organizations. See 12 CFR part 225, Appendix A, § IV; 12 CFR 225.2(r).

[8] 12 CFR parts 208 and 225, Appendix A.

[9] See 12 CFR part 8, Appendix A (OCC); 12 CFR parts 208 and 225, Appendix A (Board); 12 CFR part 325, Appendix A (FDIC).

With respect to banking organizations that are required to calculate regulatory capital requirements for market risk, the Board, FDIC, and OCC have substantially consistent rules that require a banking organization with substantial exposure to market risk to use its own internal models to determine a value at risk (VaR)-based measure of market risk. This VaR-based measure is incorporated into the organization's risk-based capital ratio. A banking organization's market risk internal models must meet qualitative and quantitative standards, and the banking organization must meet associated risk management and governance requirements.

In addition, large, internationally active U.S. banking organizations are in the process of implementing the advanced approaches of Basel II, which also use organizations' internal models to determine inputs into the risk-based capital ratios. Like the market risk rule, the advanced approaches rule includes quantitative, qualitative, risk management, and governance requirements. The advanced approaches rule is consistent across the federal banking agencies. At this time, however, no banking organization is using the advanced approaches to calculate its risk-based capital ratios.[10]

Under the Board's regulations, a state member bank is "adequately capitalized" for PCA purposes if its regulatory capital ratios meet the regulatory minimums, typically a four percent tier 1 leverage ratio, four percent tier 1 risk-based capital ratio, and eight percent total capital ratio.[11] A state member bank is "well capitalized" if has at least a five percent tier 1 leverage ratio, six percent tier 1 risk-based capital ratio, and ten percent total risk-based capital ratio, unless the institution is subject to any written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.[12] In making the determination whether to issue such corrective measures, as well as whether to informally encourage an institution to strengthen its capital position, the Federal Reserve considers the factors outlined above with respect to the capital adequacy analysis required by UIFRS.

4. **Do you have a set of standards you use in evaluating capital adequacy models that are employed by the institutions you regulate and, if so, what are they and were they developed in consultation with any other agencies?**

Banking organizations are responsible for validating the internal models they use for capital adequacy and other risk management purposes. Review of validation documentation and output is a long-standing component of supervisory activities in the United States. Through the supervisory process, the Federal Reserve has a robust system for reviewing the results of validation activities and following up when validation efforts are inadequate.

Two examples of interagency coordination of model validation standards are the uniform standards described in the market risk rule and the advanced approaches rule.[13] The market risk

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[10] See, e.g., 12 CFR part 208, Appendix F; 12 CFR part 225, Appendix G.

[11] 12 CFR 208.43(b)(2).

[12] 12 CFR 208.43(b)(1).

[13] See, e.g., 12 CFR parts 208 and 225, Appendix E (market risk rule); 12 CFR part 208, Appendix F, section 22(j), and 12 CFR part 225, Appendix G, section 22 (j) (advanced approaches rule).

rule standards include annual independent model review and validation and model stress testing and backtesting. The standards in the advanced approaches are more granular and include review of the appropriateness of the data and theoretical framework upon which a model is based, review of model performance relative to alternative methods of measuring the desired output, and review of actual model performance relative to realized results. In addition, Federal Reserve supervisory letter 99-18 describes the process Federal Reserve supervisors use to review models and other approaches used by institutions in their own internal assessments of capital adequacy, which for many of the largest firms include economic capital and stress testing models.[14]

3. It is my understanding that the Federal Reserve may be considering changing capital requirements for "banks" to address the impact of FASB's consolidation rules. Is it true that the Federal Reserve can only reactively address some of these issues for "banks," while the universe of impacted market participants is much larger and could include bond investors, life insurers, and mutual and pension funds?

The Boards authority to establish minimum capital requirements is limited to certain affiliates of banks, including bank holding companies, and state-chartered banks that are members of the Federal Reserve; it does not extend to other financial market participants, such as insurance companies and mutual and pension funds, unless such entities are bank holding companies.[15]

[14] See Board SR letter 99-18 (July 1, 1999), available at http://fedweb.frb.gov/fedweb/bsr/srltrs/SR9918.htm.

[15] 12 U.S.C. § 1831(*o*); 12 U.S.C. §§ 3907(a)(1), 3909(a)(2).

Chairman Bernanke subsequently submitted the following in response to a written question received from Congresswoman Bean in connection with the July 24, 2009, hearing before the Committee on Financial Services:

Over the last five years, how many enforcement actions has your agency taken on consumer protection violations?

Since 2004, the Federal Reserve has taken a number of formal and informal enforcement actions against the institutions under its supervision to address issues arising from consumer compliance examinations that involve violations of consumer protection laws and regulations. Our actions include:

3	Written Agreements and Cease and Desist Orders;
37	Civil Money Penalties (primarily to address noncompliance with Federal Flood Disaster Protection laws);
91	Memoranda of Understanding and Board of Director Resolutions; and
22	Referrals to the U.S. Department of Justice involving patterns or practices of discrimination under the ECOA and Fair Housing Act.

The Federal Reserve conducts consumer compliance examination of state member banks under an established frequency schedule and has done so for more than 30 years. These examinations are generally separate from safety and soundness examinations and are conducted by specially trained consumer compliance examiners. We have found that most banks voluntarily take prompt action to address weaknesses in compliance risk management programs and to correct instances of noncompliance with laws and regulations. Thus, the use of enforcement tools, informal or formal, is typically not necessary to ensure that problems are rectified. Nonetheless, we will not hesitate to take enforcement action and use our authority when appropriate. The severity of the action taken (formal vs. informal) corresponds to the degree of noncompliance, the breadth of the issues involved, and the level of responsiveness of a bank's management to supervisory concerns.

Chairman Bernanke subsequently submitted the following in response to written questions received from Congresswoman Capito in connection with the July 24, 2009, hearing before the Committee on Financial Services:

Chairman Bernanke, in past economic downturns, rural areas often do not feel the pain as quickly as the rest of the nation and do not recover as quickly. What are you seeing with the current economic conditions in rural areas? Do you believe that there will be a significant lag in these communities recovering as opposed to our more urban areas?

For quite some time, economic conditions in rural areas increasingly have become integrated with the general economy, and to the extent that this has occurred, rural communities have shared in the distress arising from the recent turmoil in financial markets and the decline in overall economic activity. Within the agricultural sector, Department of Agriculture projections suggest that net farm income this year will be $54 billion, down substantially from the $87 billion recorded in 2008, and this is a serious financial blow to farm communities. However, farm entrepreneurs had several years of remarkable profitability earlier in the decade, allowing them to build a substantial financial cushion. The USDA estimates that the value of farm assets totaled around $2 trillion in 2008, and that despite the depth of the recession they project the value will fall only about 3-1/2 percent in 2009. With regard to agricultural banks, the annualized rate of return on their assets (ROA) was 0.8 percent during the first half of 2009, considerably below the ten-year average of about 1.2 percent; by way of comparison, the ROA over the first half of 2009 at nonagricultural small banks was 0.0.

The leadership in Congress has placed a high emphasis on an energy policy that, in my view, punishes use of our carbon based natural resources. If a cap and trade policy were to be implemented, what do you see being the economic affect nationally?

With regard to a cap and trade policy, as you know I have avoided taking a position on explicit fiscal policy issues during my tenure as Chairman of the Federal Reserve Board. I believe that these are fundamental decisions that must be made by the Congress, the Administration, and the American people. Instead, I have attempted to articulate general principles that I believe most economists would agree are important for the long-term performance of the economy and for helping fiscal policy to contribute as much as possible to that performance.

As highlighted in a recent report by the Congressional Budget Office, there are a number of factors that are relevant when considering the economic effects of a cap and trade policy.[1] For instance, the effects on the economy would depend on the specific design of the policy, including: the stringency of the emission reductions required by the policy; the flexibility in the policy for determining the timing, location, and manner in

[1] Congressional Budget Office, *The Economic Effects of Legislation to Reduce Greenhouse-Gas Emissions*, September 2009.

which emissions could be reduced; and how the emission allowances would be allocated. Also, the costs of the policy would be determined by the flexibility of the economy in adapting to shifts in production and employment as energy consumption moved from carbon-based sources toward alternative sources. Moreover, the effects of a cap and trade policy on the U.S. economy would be influenced by whether other countries also imposed similar emission-reduction policies. Furthermore, the economic costs of a cap and trade policy should be weighed against the economic costs of climate change that could occur in the absence of an emission-reduction policy. Of course, this will involve making difficult decisions as there appears to be considerable uncertainty in estimating both the economic effects of global climate change and the economic effects of emission-reduction policies.

Follow up Question Submitted to
John E. Bowman, Acting Director,
Office of Thrift Supervision
From the Hearing Entitled: "Regulatory Perspectives on the Obama Administration's
Financial Regulatory Reform Proposals-Part Two"
July 24, 2009

Question: Over the last five years, how many enforcement actions has your agency taken on consumer protection violations?

Answer: For the period January 2004 through July 9, 2009, the Office of Thrift Supervision has issued 91 formal enforcement actions involving consumer protection issues. To summarize:

In 2009 (thru July 9, 2009), OTS issued 10 formal enforcement actions addressing consumer protection issues: 5 Cease and Desist Orders, 2 Supervisory Agreements, 2 Flood CMPs, and 1 other CMP.

In 2008, OTS issued 15 formal enforcement actions addressing consumer protection issues: 6 Cease and Desist Orders, 3 Supervisory Agreements, 5 Flood CMPs, and 1 other CMP.

In 2007, OTS issued 11 formal enforcement actions addressing consumer protection issues: 4 Cease and Desist Orders, 4 Supervisory Agreements (including AIG), and 3 Flood CMPs.

In 2006, OTS issued 8 formal enforcement actions addressing consumer protection issues: 2 Cease and Desist Orders, 2 Supervisory Agreements, and 4 Flood CMPs.

In 2005, OTS issued 22 formal enforcement actions addressing consumer protection issues: 7 Cease and Desist Orders, 4 Supervisory Agreements, 7 Flood CMPs, and 4 other CMPS.

In 2004, OTS issued 25 formal enforcement actions addressing consumer protection issues: 6 Cease and Desist Orders, 7 Supervisory Agreements, 2 Orders of Prohibition, 7 Flood CMPs, and 3 other CMPs.

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6372

John E. Bowman
Acting Director

August 14, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Thank you for the opportunity to testify before your Committee regarding "Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals-Part Two" on July 24, 2009. During the hearing, Congressman Brad Sherman asked for clarification of the OTS position on the creation of a systemic risk regulator. Unfortunately, time did not permit me to respond to the question. I would like to clarify for the record that the OTS agrees there is a pressing need for a systemic risk regulator. As I stated in my oral testimony (and page twelve of my written testimony), we believe a systemic risk regulator should be equipped with broad authority to resolve in an orderly manner any company whose failure could pose unacceptable risk to financial stability. To be clear, the OTS does not support any type of limitation on the growth of a successful, healthy institution.

The OTS believes the U.S. economy operates on the principal of healthy competition. Enterprises that are strong, industrious, well-managed and efficient succeed and prosper. Those that become "too big to fail" subvert the system when the government is forced to prop up failing, systemically important companies—in essence, supporting poor performance and creating a "moral hazard."

I respectfully request inclusion of this response to Congressman Sherman's question in the hearing record.

Sincerely,

John E. Bowman
Acting Director

Questions Submitted by Rep. Bachus

UDAP Questions

1. Under the Federal Trade Commission Act, only the Board of Governors of the Federal Reserve System ("Fed") has the authority to issue rules or regulations defining what acts or practices are unfair or deceptive with respect to all banks, including those for which the FDIC or the OCC is the primary federal regulator. Neither the FDIC nor the OCC has the authority to adopt such rules or regulations for the banks they regulate. The Fed, FDIC and OCC, however, have taken the position that the FDIC and the OCC may define what acts or practices they think are unfair or deceptive on a case-by-case basis in the context of administrative enforcement proceedings, and the FDIC has done just that, as reflected in a series of Consent Cease and Desist Orders recently issued by the FDIC, including those regarding Advanta Bank Corporation; American Express Centurion Bank of Salt Lake City, Utah; and the CompuCredit-related cease and desist orders against Columbus Bank and Trust, Columbus, Georgia, First Bank of Delaware, Wilmington, Delaware, and First Bank & Trust, Brookings, South Dakota.

a. The FTC Act explicitly confers upon the Federal Reserve Board, the Federal Home Loan Bank Board, and the National Credit Union Administration Board the authority to "define with specificity" unfair and deceptive acts and practices. While the FTC Act grants enforcement authority to the FDIC and OCC, the Act does not explicitly grant the FDIC and OCC the authority to define unfair or deceptive acts and practices. In other words, under the express language of the FTC Act, the FDIC and the OCC do not have the statutory authority to decide for the banks they regulate that a particular act or practice is unsafe or unsound, either by adopting a regulation or on a case-by-case basis in enforcement proceedings.

i. Have the FDIC and the OCC each analyzed this legal issue and prepared written legal opinions which conclude that they each do have the authority to define unfair or deceptive acts or practices on a case-by-case basis?

ii. Have these opinions been reviewed and approved by the General Counsel of each agency?

iii. Has the Fed General Counsel's office reviewed these opinions or performed its own analysis and prepared its own written opinion?

iv. Have any of the opinions that may have been prepared by the FDIC, OCC and/or the Fed regarding this issue been reviewed by any independent third party, such as the relevant Inspectors General or the Justice Department?

This set of questions relates to the authority of the federal banking agencies under the Federal Trade Commission Act (FTC Act) to define particular practices to be unfair or deceptive and to take enforcement actions to address such conduct.

By way of background, unfair or deceptive acts or practices are unlawful under federal and state law.[1] Section 5 of the FTC Act, 15 USC 45(a)(1), provides that "[u]nfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful." This prohibition applies to banks. In addition, section 18 of the FTC Act provides the Federal Reserve Board the exclusive authority to define by regulation specific practices by banks that are unfair or deceptive. Finally, section 8 of the Federal Deposit Insurance Act, 12 USC 1818, authorizes the OCC to take appropriate enforcement actions against national banks for violations of any applicable law or regulation. This would include the prohibition on unfair or deceptive practices in section 5 of the FTC Act, any regulations issued by the Federal Reserve Board under section 18 of the FTC Act, and any applicable state law prohibitions on unfair and deceptive acts and practices.

The OCC has analyzed the question of its authority to enforce section 5 of the FTC Act and concluded that it has the authority under the FDI Act to take action to address conduct that violates section 5 of the FTC Act, whether or not the conduct also violates a Federal Reserve Board rule. This is the longstanding opinion of the Chief Counsel of the OCC.[2]

It also is the opinion of the Federal Reserve Board, the FDIC, and the Office of Thrift Supervision, and is reflected in several documents by those agencies.[3] For example, two different Chairmen of the Federal Reserve Board have stated the Board's determination that the prohibition against unfair and deceptive acts or practices in section 5 of the FTC Act applies to all banks as a matter of law and may be enforced by the banking agencies using their FDI Act authority.

In a letter to Representative Barney Frank in 2006, Chairman Bernanke stated that:

> [t]his authority is independent from the banking agencies' authority under section 18 of the FTC Act to enforce any regulations the Board may promulgate. Thus, the agencies are able to identify and address potentially unfair or deceptive

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[1] *See, e.g.*, Cal. Bus. Prof. Code 17200 *et seq.*

[2] *See* OCC Advisory Letter 2002-3, "Guidance on Unfair or Deceptive Acts or Practices (March 22, 2002).

[3] *See* letter from Alan Greenspan, Chairman, Federal Reserve Board, to Honorable John J. LaFalce (May 30, 2002); letter from Ben S. Bernanke, Chairman, Federal Reserve Board, to Honorable Barney Frank (March 21, 2006) (Bernanke letter); "Unfair or Deceptive Acts or Practices" Applicability of the Federal Trade Commission Act," FIL 57-2002 (May 30, 2002); "Unfair and Deceptive Acts or Practices by State-Chartered Banks," Federal Reserve Board and FDIC, (March 11, 2004); OTS Op. Chief Counsel (October 25, 2004) and OTS Op. Chief Counsel (June 9, 2006). At least one federal court has concluded that the statutory prohibition on unfair and deceptive practices in section 5 of the FTC Act is subject to federal banking agency enforcement authority. *See* Roberts v. Fleet Bank, 342 F. 3d 260 (3d Cir. 2003). In response to your question, the OCC is not aware of any opinion on the issue by the Justice Department.

practices using information from consumer complaints, the examination process and, ultimately the formal enforcement process.[4]

Certain unfair or deceptive practices by banks have already been prohibited by Federal Reserve Board regulation under the FTC Act. In addition, the OCC (and the other federal banking agencies) may identify additional acts or practices on a case-by-case basis and determine them to be unfair or deceptive after a careful analysis of the FTC Act's standards as applied to the particular facts and circumstances, and after the institution has an opportunity to present its views. The OCC may use its enforcement authority as necessary and appropriate to address all such instances of unlawful conduct. As noted above, the OCC does not have authority to adopt rules to define particular acts or practices as unfair or deceptive for the banks we supervise -- the Federal Reserve Board has the exclusive rulemaking authority with respect to banks under the FTC Act.

b. What, if any, procedures have been established to assure that the Fed, OCC and the FDIC are all in agreement as to what acts or practices are unfair or deceptive?

i. How do the regulators ensure that the OCC and/or the FDIC do not adopt a UDAP rule in a case through their respective adjudicatory processes that has not been, or is not, also adopted by the other banking agencies? Do you see a problem with the possibility of inconsistent rulings or positions between or among the federal banking agencies regarding what acts or practices are unfair or deceptive?

ii. Are you aware of any inconsistent positions that exist as of today, i.e., situations where the FDIC or OCC or Fed has determined in the context of an administrative enforcement proceeding that a particular act or practice is unfair or deceptive, while one or both of the other agencies have not and do not regard the conduct at issue as a violation of the FTC Act? How would you find out if that were the case?

Like the FDIC, the OCC also has taken a number of enforcement actions to address conduct that violates the FTC Act prohibition on unfair or deceptive acts or practices, including the first FTC Act enforcement action ever by a federal banking agency (to address deceptive practices in connection with credit cards).[5] The OCC is unaware of instances in which the federal banking agencies have reached different conclusions in an enforcement context about whether identical conduct by different institutions violates FTC Act standards. The agencies generally keep one another informed of developments in these types of enforcement matters and consult on proposed outcomes as appropriate.[6] By doing so, the agencies limit any potential for inconsistent application of the law. Moreover, in all such cases, the agencies follow the guidelines they have published on

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[4] Bernanke letter, *supra*, note 1.

[5] *Providian National Bank, Tilton, NH*, Consent Order 2000-53 (June 28, 2000).

[6] The agencies are in the process of developing a common set of examination procedures for FTC Act compliance.

FTC Act enforcement. The agencies' guidelines are consistent with one another, and with the standards set forth in the FTC Act and the FTC's Policy Statements on Unfairness and Deception.[7]

Questions on FAS 166 and 167

1. Treasury Secretary Geithner has warned that "no financial recovery plan will be successful unless it helps restart securitization markets. . . ." At the same time, the Financial Accounting Standards Board (FASB) has recently finalized significant and retroactive changes to securitization accounting that will have a tremendous impact on existing assets and future lending. These changes – which become effective January 1, 2010 – could seriously complicate efforts to repair financial markets.
The Administration has made the securitized credit markets the centerpiece of the Financial Stability Plan (through TALF, PPIP, etc). However, in promulgating FAS 166 and 167, FASB has sought to retroactively eliminate the securitization accounting vehicle known as the "Qualified Special Purpose Entity," which will require some bond investors to "consolidate" an entire pool of loans on their balance sheet, despite only owning 2-3% of the transaction. What will be the impact of this "consolidation" on bond investors who are critical to the extension of credit and the future of our securitized credit markets?

As you note, recent accounting changes adopted by FASB will require the consolidation of certain assets and liabilities that are currently not included on financial institutions' balance sheets. Under existing generally accepted accounting principles (GAAP), a company must consolidate any entity in which it has a "controlling interest," as determined by a quantitative analysis. FAS 167, Amendments to FASB Interpretation No. 46(R), revises consolidation guidance for variable interest entities (VIEs).[8] Under the new standard, the company must consolidate its VIEs if, after a qualitative analysis, it determines its interest results in the power to direct the most significant activities of the entity and it has the right to receive benefits of the VIE that are potentially significant or the obligation to absorb losses of the VIE that are potentially significant. This new standard requires ongoing reassessments of the VIEs to determine if consolidation is necessary. Most significantly, FAS 166, Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140, removes the concept of a qualifying "special-purpose entity"[9] from U.S. GAAP. Qualifying special-purpose entities (QSPEs) generally are off-balance-sheet entities that are currently exempt from consolidation. FAS 167 eliminates that exemption from consolidation. All QSPEs that currently are held off balance sheet, such as various securitization vehicles, will become *subject to the* revised consolidation guidance in FAS 167. As a result of these new standards, the amount of assets and liabilities reported on bank balance sheets could increase significantly. It is difficult to predict the ultimate effect on investors, originators and

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[7] *See* FTC Policy Statement on Deception (October 14, 1983) and FTC Policy Statement on Unfairness (December 17, 1980).
[8] A VIE is a business structure that allows an investor to hold a controlling interest in the entity without that interest translating into possessing enough voting privileges to result in a majority. VIEs generally are thinly-capitalized entities and include many "special-purpose entities," or "SPEs."
[9] A special purpose entity is a legal entity created to fulfill narrow, specific, or temporary objectives and generally are used by companies to isolate the firm from financial risk.

other market participants involved in these transactions because we do not know how firms might adapt or alter their behavior as a result of the accounting changes. Nevertheless, we provide some observations below.

For investors in securitization transactions, we anticipate the accounting changes to have a relatively minor effect. For example, an institutional investor in a securitization transaction will generally not be affected by the accounting changes because the investor will not likely have the power to direct significant activities of the securitization entity, and therefore would not be subject to the amended consolidation standards adopted by FASB. These investors will presumably continue to evaluate the risk-return tradeoff in the investment based on the underlying economics of the transaction.

The main effect of the accounting changes likely will be on the originators and sponsors of securitization transactions. In many cases, application of the revised consolidation standards may result in a determination that the originator or sponsor retains an interest that conveys the right to receive benefits or the obligation to absorb losses such that the originator or sponsor is deemed to have the power to direct the most significant activities of the securitization entity. As a result, these firms, which are often banks, will have to consolidate exposures that previously would not have been reported on their balance sheets. We believe that the amended consolidation standards provide a more accurate picture of a firm's true financial position than the standards which they replace. For example, during the recent financial turmoil, we have seen originators provide credit support to securitization structures that they were not required to consolidate under GAAP. They have taken these actions even though they were not contractually required to do so, in part, for reputational reasons and to preserve access to cost-efficient funding. In light of this recent experience, the OCC believes that using the broader accounting consolidation requirements included in FAS 167 as a starting point for assessing regulatory capital requirements will result in regulatory capital treatment that more appropriately reflects the risks to which banking organizations are exposed.

The US banking agencies have recently issued a notice of proposed rulemaking relating to the effects of the accounting changes on regulatory capital requirements. By focusing on control, risk of loss, and the potential for gain, we believe that the consolidation requirements under the new accounting standards will result in a regulatory capital treatment that more appropriately reflects the risks to which banking organizations are exposed. We note the Federal banking agencies considered the "on-boarding" of assets under FAS 166 and FAS 167 when they assessed capital adequacy under the Supervisory Capital Assessment Program conducted for the 19 largest banking organizations whose securitization activities make up a significant portion of securitization activities by U.S. banking organizations. However, we also recognize the significant effect that the accounting changes could have on bank regulatory capital requirements. Therefore, the proposal requests public comment on the need for a phase-in period for the resulting regulatory capital impact.

In summary, we expect the accounting changes and the resulting effects on regulatory capital to have an effect on the securitization markets; however, we believe that these changes are important to improve transparency in financial markets and to ensure adequate levels of capital are maintained for risks involved in securitization transactions.

2. The same statutory capital ratios apply to every federally insured depository institution for purposes of determining what their level of capital adequacy is, e.g., well capitalized, adequately capitalized, undercapitalized, etc. However, each of the federal banking agencies also has the authority to require a given institution it regulates to achieve and maintain capital ratios (e.g., for total risk-based capital, core capital, etc.) at specific levels set by the agency, which may be even higher than the statutory ratios used to define a "well-capitalized" institution. In connection with these individual capital requirements:

Does your agency consult with the other federal banking agencies in an effort to achieve uniformity with respect to the factors that will be evaluated and the standards that will be applied in arriving at such individual capital requirements for institutions?

The agencies have consistent regulations that set forth the minimum capital requirements for federally insured depository institutions and that implement the provisions of Prompt Corrective Action, which establishes and defines the terms "well capitalized," "adequately capitalized," etc. The agencies routinely discuss interpretations of their capital regulations to ensure consistent treatment of similarly situated institutions regardless of charter.

As noted in your question, each of the agencies also has the authority to require higher minimum capital ratios for an individual bank in view of its circumstances. Through these authorities and implementing regulations, the agencies set forth consistent factors that examiners consider in making individual capital determinations. The OCC's authority to require higher minimum capital requirements is established in 12 USC 3907(a)(2) and is implemented in 12 CFR 3 Subpart C, "Establishment of Minimum Capital Ratios for an Individual Bank." Section 3.10 of Subpart C provides guidance on when higher capital levels may be appropriate and includes the following factors:

(a) A newly chartered bank;

(b) A bank receiving special supervisory attention;

(c) A bank that has, or is expected to have, losses resulting in capital inadequacy;

(d) A bank with significant exposure due to the risks from concentrations of credit, certain risks arising from nontraditional activities, or management's overall inability to monitor and control financial and operating risks presented by concentrations of credit and nontraditional activities;

(e) A bank with significant exposure to declines in the economic value of its capital due to changes in interest rates;

(f) A bank with significant exposure due to fiduciary or operational risk;

(g) A bank exposed to a high degree of asset depreciation, or a low level of liquid assets in relation to short term liabilities;

(h) A bank exposed to a high volume, or particularly severe, problem loans;

(i) A bank that is growing rapidly, either internally or through acquisitions; or

(j) A bank that may be adversely affected by the activities or condition of its holding company, affiliate(s), or other persons or institutions including chain banking organizations, with which it has significant business relationships.

The other agencies include similar factors in their capital regulations.

The evaluation of an individual bank's capital adequacy and its potential need for higher minimum capital ratios is made through each agency's supervisory activities and examinations. Under the agencies' Uniform Financial Institutions Rating System (UFIRS), every insured depository institution is assigned a composite and component "CAMELS" rating. The "C" component of a bank's CAMELS rating assesses a bank's capital adequacy. The UFIRS includes evaluation factors that examiners are to consider when making this assessment. Capital ratings of three, four or five are not satisfactory and usually compel an institution to raise additional capital or make other balance sheet adjustments that will result in improved capital ratios.

In the case of national banks, any supervisory requirement to hold a specific level of capital above regulatory minimums will be done through some type of formal or informal enforcement action. The decisions to place formal and informal actions in place are made by senior managers in our districts and/or Washington based on discussions with, and recommendations from, the examiner or supervisory official responsible for the supervisory activities and strategies for the bank. The FDIC routinely participates in these discussions at our invitation and, in this fashion, consultation does occur. Likewise, we have discussions with Federal Reserve examiners when a holding company owns the bulk of a national bank's stock as the Reserve Banks often have formal or informal actions against the holding company in place or under consideration when we are placing an action against the subsidiary bank.

Should the federal banking agencies apply the same criteria to determine the capital ratios for a regulated institution?

As noted above, the agencies' capital regulations and the UFIRS provide a common framework for evaluating an insured depository institution's capital adequacy. While these frameworks provide common criteria for examiners to consider, the application of these criteria are, by their nature, very fact and institution specific. As noted in the UFIRS, the types and quantity of risk inherent in an institution's activities will determine the extent to which it may be necessary to maintain capital at levels above required regulatory minimums. These assessments require examiners to consider both the level of risk and the quality of the bank's risk management systems. As a result, we believe that the primary supervisor is in the best position to determine when and how much additional capital an institution may need and that these decisions may vary, based on the specific facts and circumstances. As mentioned above, in the case of national banks, other agencies are often informed of, and consulted about, any such decisions.

Is there consistency between and among the federal banking agencies regarding the criteria they use to determine whether to establish individual capital requirements?

Yes, see above.

Does your agency use an economic model to determine the capital ratios a given institution should maintain in light of its particular risk profile in order to be considered adequately capitalized or well-capitalized?

The terms "adequately" and "well capitalized" generally refer to the capital provisions under Prompt Corrective Action (PCA) and are established in 12 CFR 6.4. Under PCA, a bank is required to file a written capital restoration plan with the OCC if the bank falls below the "adequately capitalized" threshold. More generally, all national banks are expected to maintain sufficient capital levels to support their activities and risk profile and most national banks voluntarily hold capital above the regulatory "well capitalized" minimums. As noted above, under 12 CFR 3, the OCC can direct a national bank to hold higher minimum capital ratios.

While we do have a variety of tools that assist examiners in evaluating a bank's capital adequacy, we do not use a model to determine when or how much additional capital is needed.

If you don't use a model, how do you make that determination?

Determining capital adequacy, like assigning supervisory ratings, is influenced by judgment as well as specific and measured levels of risk within an institution. As stated in 12 CFR 3.11, "[T]he appropriate minimum capital ratios for an individual bank cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. The decision is necessarily based in part on subjective judgment grounded in agency expertise."

Examiners consider a variety of factors in making these determinations, including the following factors outlined in the UFIRS:

- The level and quality of capital and the overall financial condition of the institution.
- The ability of management to address emerging needs for additional capital.
- The nature, trend, and volume of problem assets, and the adequacy of the allowance for loan and lease losses and other valuation reserves.
- Balance sheet composition, including the nature and amount of intangible assets, market risk, concentration risk, and risks associated with nontraditional activities.

- Risk exposure represented by off-balance-sheet activities.
- The quality and strength of earnings, and the reasonableness of dividends.
- Prospects and plans for growth, as well as past experience in managing growth.
- Access to the capital markets and other sources of capital, including support provided by a parent holding company.

Examiners also consider the results of a bank's own internal risk models and capital plans, as well as supervisory tools that can help identify banks that may have excessive risk exposures or adverse trends. These include the OCC's Canary Early Warning System that can assist examiners in identifying community and midsize national banks that may have potentially high credit, interest rate, or liquidity risk exposures, and various performance and financial ratios contained in the interagency Uniform Bank Performance Report. These ratios provide comparative data on peer institutions. While peer analysis should never be the only basis for determining capital adequacy, it is reflective of others' views of the level of capital needed to support a certain level of risk and is a valuable factor that examiners consider in determining whether a particular institution's capital is sufficient to support the risk to which it is exposed.

If you do use a model, whose model is it?
1. Was it constructed by your agency alone? N/A

2. Did you discuss it with the other banking agencies, or consult with them regarding what, if any, models they use for such purposes? N/A

3. To the extent you know what differences there are between any model that your agency uses and any model used by any other banking agency, how do you go about resolving those differences, if at all? N/A

4. Do you have a set of standards you use in evaluating capital adequacy models that are employed by the institutions you regulate and, if so, what are they and were they developed in consultation with any other agencies?

The agencies have developed uniform standards and requirements for banks that are using quantitative models as part of the Basel II advanced approaches rule or under the agencies' market risk capital rules.[10] The OCC has also issued guidance to national banks on model validation that applies more generally to the various types of financial models that banks may use and sets forth the OCC's expectations for model validation.[11]

[10] See: 12 CFR 3 Appendix C: "Capital Adequacy Guidelines for Banks: Internal-Ratings-Based and Advanced Measurement Approaches," Part III – Qualification; and 12 CFR 3 Appendix B: "Risk-Based Capital Guidelines: Market Risk Adjustment," Section 4, Internal Models.
[11] OCC Bulletin 2000-16, "Risk Modeling: Model Validation."

Questions Submitted by Representative Bean

1. In your testimony, you expressed your concerns with removing federal pre-emption of national banks. Can you quantify what the cost to consumers of national banks would be if national banks were forced to comply with 50+ state based rules?

If preemption is repealed for national banks, consumers will bear increased costs for at least two reasons. First, operating under multiple sets of rules will significantly raise the cost of doing business for national banks. Second, national banks' exposure to liability if they fail to successfully sort out applicable governing standards will increase substantially. As is the case for other types of businesses, those higher costs will be reflected in the pricing of banks' consumer products and services. In some cases, higher costs and the greatly expanded potential for liability may cause national banks to restrict the number of products they offer or to decide not to do business in certain jurisdictions. If so, the resulting costs borne by consumers would include a diminution in the choices available to them.

It is virtually impossible to quantify these costs to consumers because they are to a large degree dependent on how states regulate each of the consumer products and services offered by national banks and, for each national bank, how many different states' standards apply. Moreover, costs will change over time as some states modify existing requirements or add new ones. Each bank will continuously have to determine which states' standards apply to the bank's different products and services and will have to maintain and staff the systems necessary to ensure compliance with all of those requirements.

The following are examples of specific areas where the repeal of federal preemption for national banks would have costly consequences.

- Different rules regarding allowable terms and conditions of particular products;
- Different standards for how products may be solicited and sold (including the internal organizational structure of the provider selling the product);
- Different duties and responsibilities for individuals providing a particular financial product;
- Different limitations on how individuals offering particular products and services may be compensated;
- Different standards for counterparty and assignee liability in connection with specified products;
- Different standards for risk retention ("skin in the game") by parties in a chain of origination and sale;
- Different disclosure standards;
- Different requirements, or permissible rates of interest, for bank products; and
- Different licensing and product clearance requirements.

In all these situations, the bank must attempt to sort out which state standard might be applicable. This will be costly, and the potential litigation risk and accompanying liability is real and substantial. One state could impose standards based on the residence of a customer, another could impose requirements based on the location of the institution that initiates the transaction (or the location of the branch of the institution), or on where the product was issued or offered, and another state might impose standards based on the location of the property or asset involved.

Even if a national bank successfully sorts out these requirements, new issues will be raised whenever a customer moves from one state to another or otherwise changes the location or manner of how he or she interacts with a bank (*e.g.*, by going to a different branch in a different state or by conducting internet transactions). These changes are routine in our highly mobile and technologically savvy economy, and the magnitude of the costs to national banks will be staggering, if each such change requires a national bank to apply a different set of standards to the bank's relationship with the customer with respect to each of the different products and services the customer obtains from the bank.

2. *Over the last five years, how many enforcement actions has your agency taken on consumer protections violations?*

The OCC has been active in enforcing consumer protection laws and regulations during this time period. In addition to obtaining voluntary correction of violations through the supervisory process or nonpublic enforcement actions, our enforcement activity since 2000 includes 11 formal actions under the FTC Act and nearly 70 public enforcement actions against national banks and other entities involving issues such as payday lending, violations of Home Mortgage Disclosure Act (HMDA) requirements, the lack of adequate controls to ensure information security, and the lack of adequate controls to ensure compliance with consumer protection laws and regulations.

Consumer Protection Enforcement Actions under the FTC Act

- Providian National Bank, Tilton, New Hampshire (consent order – June 28, 2000). We required the bank to set aside not less than $300 million for restitution to affected consumers and to change its credit card marketing program, policies, and procedures.

- Direct Merchants Credit Card Bank, N.A., Scottsdale, Arizona (consent order – May 3, 2001). We required the bank to provide restitution of approximately $3.2 million and to change its credit card marketing practices.

- First National Bank of Marin, Las Vegas, Nevada (consent order – December 3, 2001). We required the bank to set aside at least $4 million for restitution to affected consumers and to change its marketing practices.

- First National Bank, Ft. Pierre, South Dakota (formal agreement – July 18, 2002). We required the bank to change its marketing practices.

- First National Bank in Brookings, Brookings, South Dakota (consent order – January 17, 2003). We required the bank to set aside at least $6 million for restitution to affected consumers, to obtain prior OCC approval for marketing subprime credit cards to non-customers, to cease engaging in misleading and deceptive advertising, and to take other actions.

- Household Bank (SB), National Association, Las Vegas, Nevada (formal agreement – March 25, 2003). We required the bank to provide restitution in connection with private label credit card lending and to make appropriate improvements in its compliance program.

- First Consumers National Bank, Beaverton, Oregon (formal agreement – July 31, 2003). We required the bank to provide refunds of approximately $1.9 million to affected consumers in connection with credit card practices.

- Clear Lake National Bank, San Antonio, Texas (consent order – November 7, 2003). We required the bank to set aside at least $100,000 to provide restitution for borrowers who received tax lien loans, review a portfolio of mortgage loans to determine if similar violations existed, and take steps to prevent future violations.

- First National Bank of Marin, Las Vegas, Nevada (consent order – May 24, 2004). In a second case involving this bank, we required the bank to set aside at least $10 million for restitution to affected consumers and prohibited the bank from offering secured credit cards in which the security deposit is charged to the consumer's credit card account.

- The Laredo National Bank, Laredo, Texas, and its subsidiary, Homeowners Loan Corporation (formal agreement – November 1, 2005). We required the bank to set aside at least $14 million for restitution to affected customers and to strengthen internal controls to improve compliance with applicable consumer laws and regulations.

- Wachovia Bank, N.A., Charlotte, North Carolina (consent order and formal agreement – April 24, 2008). We required the bank to set aside $125 million for restitution to affected consumers and to develop policies and procedures governing its banking relationships with customers who regularly deposit remotely created checks. We also imposed a civil money penalty of $10 million.

Enforcement Actions Involving Other Consumer Protection Issues

The OCC's enforcement actions also have addressed a broad range of consumer issues in addition to the FTC Act. Since January 2000, the OCC has taken a number of public enforcement actions to address violations of federal consumer protection statutes and regulations and/or the lack of adequate controls to ensure compliance with these provisions. The OCC's actions in this area have included the following formal actions:

- An order issued against ABN AMRO Mortgage Group, Inc., a subsidiary of LaSalle Bank Midwest, N.A. (Dec. 30, 2005), required the bank's subsidiary to provide $6.84

million in restitution and to pay a penalty of $6.25 million for falsely certifying compliance with the underwriting standards of the U.S. Department of Housing and Urban Development.

- An order issued against Eagle National Bank, Upper Darby, Pennsylvania (Dec. 18, 2001), required the bank to cease making payday loans.

- An order issued against ACE Cash Express, Inc. (Oct. 25, 2002), required the company to cease making payday loans through national banks and to pay a civil money penalty of $250,000.

- An order issued against Goleta National Bank, Goleta, California (Oct. 28, 2002), required the bank to cease making payday loans through ACE Cash Express, Inc., to notify consumers of missing loan files, and to pay a civil money penalty of $75,000.

- An order issued against Advance America, Cash Advance Centers, Inc. (Jan. 29, 2003), required the company to cease making payday loans through national banks.

- An order issued against Peoples National Bank, Paris, Texas (Jan. 30, 2003), required the bank to cease making payday loans and to pay a civil money penalty of $175,000.

- An order issued against Chicago Title Insurance Company (Feb. 24, 2005), acting as agent for Frost National Bank, San Antonio, Texas; Southwest Bank of Texas, N.A., Houston, Texas; and Whitney National Bank, New Orleans, Louisiana, required the company to pay a civil money penalty of $5 million and to ensure the accuracy of real estate settlement documents provided to federally insured depository institution lenders and borrowers.

- An order issued against First Horizon Home Loan Corporation, a subsidiary of First Tennessee Bank N.A., Memphis, Tennessee (June 30, 2005), required the bank to pay a civil money penalty of $180,000 for violations of customer information security protections.

- An order issued against an operating subsidiary of First National Bank of Omaha (Aug. 7, 2006) required the company to pay a civil money penalty of $25,000 for violations of HMDA and its implementing regulation.

- An order issued against Guaranty National Bank, Tallahassee, Florida (May 2, 2003), required the bank to send proper adverse action notices to consumers who had been denied credit without receiving an adequate notice and to strengthen its internal controls to improve compliance with applicable consumer laws and regulations.

- A Formal Agreement entered with Merchants Bank of California N.A., Carson, California (March 31, 2009), required the bank to strengthen internal controls to improve its information security program and to improve compliance with applicable consumer laws and regulations.

- An order issued against Crown Bank N.A., Ocean City, New Jersey (Feb. 19, 2008), required the bank to pay a civil money penalty of $7,500 for violations of HMDA and its implementing regulation.

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

ATTN: Terrie Allison

RE: July 24, 2009 Hearing, "Regulatory Perspectives on the Obama Administration's Financial Regulatory Reform Proposals-Part Two"

Dear Ms. Allison:

Thank you for sending for my review the transcript from the July 24th hearing and for sending Representative Bean's questions. I have no corrections to the transcript.

Below, I have provided for the hearing record my responses to Representative Bean's questions:

Question: "In my home state of Illinois, the agency that regulates banks also regulates non-bank lenders, brokers, and other non-financial services related professions. How common is it amongst the states to have similar arrangements?"

Answer: While financial services regulation varies amongst the different states, it is quite common for state banking agencies to regulate non-bank lenders, brokers, and other non-bank financial services providers. This universe of state-regulated entities includes non-bank mortgage providers (except mortgage providers who are part of federally-chartered financial institutions), title lenders, pawnshops, financial services technology providers, check cashers, check sellers, money transmitters, consumer finance companies, payday lenders, appraisers, escrow companies, tax refund anticipation lenders, and credit counselors.

Not all state banking departments regulate all types of non-bank financial service providers. However, a majority of states regulate mortgage providers, check cashers, check sellers, money transmitters, consumer finance companies and payday lenders. In my home state of North Carolina, in addition to banks, the Office of the Commissioner of Banks' jurisdiction includes mortgage providers, reverse mortgage

CONFERENCE OF STATE BANK SUPERVISORS
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lenders, check cashers, money transmitters, consumer finance companies, and refund anticipation lenders.

The Conference of State Bank Supervisors (CSBS) publishes a Profile of State Chartered Banking, which includes a survey of the types of institutions supervised by its 54 member state banking supervisors. While the Profile might not capture every type of business supervised by every state banking department, it provides a useful summary of the range of financial services firms that the various state banking departments supervise. I have included an excerpt of the most recent Profile as part of my response to this question.

Question: "What changes if any are the states making in improving regulation of non-bank lenders?"

Answer: States have taken a variety of actions to improve regulation of non-bank lenders. State regulators and policy makers often have an "on-the-ground" perspective that enables them to quickly identify problems and troubling trends. In the mortgage arena, the states early on identified problematic and abusive lending practices and products. As you know, over the past decade, many states sought to address these problems by enacting state anti-predatory lending laws, only to be thwarted by pre-emption assertions by regulators of federally-chartered institutions.

Additionally, in 2003, the CSBS and the American Association of Mortgage Regulators (AARMR) began an effort to identify and track mortgage entities and originators through a national database of licensing and registration, the Nationwide Mortgage Licensing System (NMLS). CSBS and AARMR launched the NMLS in January 2008. To date, 29 states, the District of Columbia and Puerto Rico are using the NMLS. Congress recognized the consumer and public policy benefits of this system and, in 2009, enacted the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act), which set minimum professional education, licensing and registration requirements for mortgage originators. States were given one year – until July 31, 2009 – to pass legislation meeting these minimum standards. As of today, 48 states and the District of Columbia have enacted S.A.F.E. Act implementing legislation. I have attached for your information a recent detailed S.A.F.E. Act update.

Separate from mortgage lending, regulation of money services businesses (MSBs) has been an area of significant state activity. In particular, state regulation of payday lenders and of money transmitters has evolved relatively quickly into comprehensive

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supervision. In both cases, states enacted statutes that established regulation, licensing, and examination and enforcement programs.

Today over 30 states regulate payday lenders. In addition to required programs of licensing, examination and enforcement, these regulatory regimes also include enhanced consumer protections such as disclosure requirements, advertising restrictions, and limits on fees and the number of outstanding loans per borrower.

Money transmitters have been an area of growing regulatory attention for the past 10 to 15 years. Efforts accelerated after the events of 9-11, which intensified state and federal efforts to address regulatory gaps and improve disclosure and reporting requirements. Laws were passed, staff was hired and licensing and effective examination programs began almost immediately, followed by significant enforcement filings in many states. Today, virtually all states regulate money transmitters, working in close coordination with the Internal Revenue Service and FINCEN, the Treasury Department's Financial Crimes Enforcement Network.

Thank you again for the opportunity to testify before the Committee and to respond to Representative Bean's additional questions.

Sincerely,

Joseph A. Smith, Jr.
North Carolina Commissioner of Banks
Chairman, Conference of State Bank Supervisors

Attachments:
2008 Profile of State Chartered Banking (excerpt)
S.A.F.E. Act One Year Update

Cc: The Honorable Melissa Bean
United State House of Representatives

Institutions Supervised - Part I

	Commercial Banks			Foreign Bank Organizations and Foreign Agencies		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Alabama[1]	Yes	127	$213,477	Yes	0	N/A
Alaska	Yes	3	$2	Yes	0	N/A
Arizona	Yes	34	$5,487	No	N/A	N/A
Arkansas	Yes	106	$39,306	No	N/A	N/A
California	Yes	217	$241,843	Yes	35	$25,465
Colorado	Yes	106	$37,488	No	N/A	N/A
Connecticut	Yes	17	$2,742	Yes	4	$81,317
Delaware	Yes	14	$30,381	Yes	1	Data not collected
District of Columbia	Yes	2	$530	No	N/A	N/A
Florida	Yes	209	$70,994	Yes	38	$15,126
Georgia	Yes	274	$278,472	Yes	6	NR
Guam	Yes	5	NR	Yes	3	NR
Hawaii	Yes	5	$29,197	Yes	1	$4
Idaho	Yes	15	$5,741	Yes	0	NR
Illinois	Yes	443	$167,986	Yes	12	$71,110
Indiana	Yes	92	$37,814	No	N/A	N/A
Iowa	Yes	322	$45,600	No	N/A	N/A
Kansas	Yes	247	$29,249	No	N/A	N/A
Kentucky	Yes	155	$41,856	Yes	1	NR
Louisiana	Yes	122	$33,633	Yes	0	N/A

Institutions Supervised - Part I

	Commercial Banks			Foreign Bank Organizations and Foreign Agencies		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Maine	Yes	5	$2,297	Yes	0	N/A
Maryland	Yes	46	$26,610	No	N/A	N/A
Massachusetts	Yes	19	$192,770	Yes	0	N/A
Michigan	Yes	126	$104,848	Yes	0	N/A
Minnesota	Yes	321	$39,117	No	N/A	N/A
Mississippi	Yes	74	$40,584	Yes	0	N/A
Missouri	Yes	284	$76,037	No	N/A	N/A
Montana	Yes	64	$15,524	No	N/A	N/A
Nebraska	Yes	179	$21,191	No	N/A	N/A
Nevada	Yes	24	$12,724	Yes	0	N/A
New Hampshire	Yes	7	$2,627	No	N/A	N/A
New Jersey	Yes	52	$21,942	Yes	3	NR
New Mexico	Yes	36	$9,402	No	N/A	N/A
New York	Yes	82	$550,054	Yes	101	$1,636,014
North Carolina	Yes	75	$223,363	Yes	0	N/A
North Dakota	Yes	81	$11,437	Yes	0	N/A
Ohio	Yes	94	$87,514	No	N/A	N/A
Oklahoma	Yes	174	$31,352	Yes	0	N/A
Oregon	Yes	35	$22,763	Yes	3	NR
Pennsylvania	Yes	95	$67,912	No	N/A	N/A

Institutions Supervised - Part I

	Commercial Banks				Foreign Bank Organizations and Foreign Agencies			
	Supervise		Number	Assets (Millions)	Supervise		Number	Assets (Millions)
Puerto Rico	Yes		12	$94,247	Yes		37	$63,790
Rhode Island[2]	Yes		7	NR	No		N/A	N/A
South Carolina	Yes		49	$34,757	No		N/A	N/A
South Dakota	Yes		66	$21,378	No		N/A	N/A
Tennessee	Yes		161	$43,092	No		N/A	N/A
Texas DOB	Yes		326	$162,586	Yes		10	$57,484
Texas S&L	N/A		N/A	N/A	N/A		N/A	N/A
Utah	Yes		30	$43,663	Yes		0	N/A
Vermont	Yes		5	$3,141	Yes		0	N/A
Virginia	Yes		81	$37,106	No		N/A	N/A
Washington	Yes		72	$42,730	Yes		2	$584
West Virginia	Yes		52	$20,099	Yes		0	N/A
Wisconsin	Yes		212	$102,042	No		N/A	N/A
Wyoming	Yes		26	$4,006	No		N/A	N/A
	YES	NO	Total	Total	YES	NO	Total	Total
	53	0	5,487	$3,480,710	30	23	257	$1,950,893

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Responses as of December 31, 2006

Institutions Supervised - Part II

	Savings Banks/Savings & Loans			Banker's Banks		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Alabama[1]	Yes	0	N/A	Yes	0	N/A
Alaska	Yes	1	NR	No	N/A	N/A
Arizona	Yes	0	N/A	Yes	0	N/A
Arkansas	No	N/A	N/A	Yes	1	$183
California	Yes	0	N/A	Yes	1	$683
Colorado	No	N/A	N/A	Yes	1	$435
Connecticut	Yes	22	$25,565	Yes	1	$138
Delaware	Yes	1	$633	Yes	0	N/A
District of Columbia	Yes	0	N/A	No	N/A	N/A
Florida	Yes	0	N/A	Yes	1	$447
Georgia	Yes	1	$430	No	N/A	N/A
Guam	Yes	1	NR	No	N/A	N/A
Hawaii	Yes	0	N/A	Yes	0	N/A
Idaho	Yes	0	N/A	Yes	0	N/A
Illinois	No	N/A	N/A	Yes	1	$497
Indiana	Yes	8	$2,208	Yes	0	N/A
Iowa	Yes	0	N/A	Yes	0	N/A
Kansas	Yes	0	N/A	Yes	0	N/A
Kentucky	Yes	0	N/A	Yes	1	$61
Louisiana	Yes	7	$1,503	Yes	0	N/A

Institutions Supervised - Part II

	Savings Banks/Savings & Loans			Banker's Banks		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Maine	Yes	15	$10,152	Yes	0	N/A
Maryland	Yes	2	$168	Yes	1	$68
Massachusetts	Yes	128	$63,344	No	N/A	N/A
Michigan	Yes	3	$3,175	Yes	0	N/A
Minnesota	Yes	0	N/A	Yes	1	$588
Mississippi	Yes	0	N/A	Yes	0	N/A
Missouri	Yes	6	$424	Yes	1	$372
Montana	Yes	0	N/A	No	N/A	N/A
Nebraska	Yes	1	$1	Yes	1	$55
Nevada	Yes	0	N/A	No	N/A	N/A
New Hampshire	Yes	9	$3,675	No	N/A	N/A
New Jersey	Yes	29	$28,466	No	N/A	N/A
New Mexico	Yes	1	$70	No	N/A	N/A
New York	Yes	23	$62,624	No	N/A	N/A
North Carolina	Yes	17	$4,014	Yes	0	N/A
North Dakota	Yes	0	N/A	Yes	1	$3,517
Ohio	Yes	49	$9,686	Yes	1	$70
Oklahoma	Yes	2	$12	Yes	1	$281
Oregon	Yes	0	N/A	No	N/A	N/A
Pennsylvania	Yes	54	$64,914	Yes	1	$581

Institutions Supervised - Part II

	Savings Banks/Savings & Loans			Banker's Banks		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Puerto Rico	No	N/A	N/A	No	N/A	N/A
Rhode Island[2]	Yes	1	NR	No	N/A	N/A
South Carolina	Yes	3	$276	No	N/A	N/A
South Dakota	No	N/A	N/A	No	N/A	N/A
Tennessee	Yes	0	N/A	Yes	0	N/A
Texas DOB	No	N/A	N/A	Yes	1	$2,090
Texas S&L	Yes	28	N/A	N/A	N/A	N/A
Utah	Yes	0	N/A	No	N/A	N/A
Vermont	Yes	1	$136	No	N/A	N/A
Virginia	Yes	1	$10	Yes	1	$139
Washington	Yes	10	$7,903	Yes	0	N/A
West Virginia	No	N/A	N/A	Yes	0	N/A
Wisconsin	Yes	16	$4,627	Yes	1	$42
Wyoming	Yes	0	N/A	No	N/A	N/A
	YES 47, NO 7	Total 440	Total $294,014	YES 34, NO 19	Total 18	Total $10,246

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Responses as of December 31, 2006

Institutions Supervised - Part III

	Non-Depository Trust Companies			Industrial Loan Corporations		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Alabama[1]	Yes	3	$1,788	Yes	0	N/A
Alaska	Yes	2	$31	N/A	N/A	N/A
Arizona	Yes	4	NR	No	N/A	N/A
Arkansas	Yes	2	$460	No	N/A	N/A
California	Yes	7	$95,841	Yes	12	$10,974
Colorado	Yes	6	NR	Yes	2	$1
Connecticut	Yes	2	$15,935	No	N/A	N/A
Delaware	Yes	25	$5,635	Yes	0	N/A
District of Columbia	Yes	0	N/A	No	N/A	N/A
Florida	Yes	12	$69	No	N/A	N/A
Georgia	Yes	1	$268	No	N/A	N/A
Guam	Yes	1	NR	Yes	0	N/A
Hawaii	Yes	0	N/A	Yes	1	$690
Idaho	Yes	2	NR	No	N/A	N/A
Illinois	Yes	18	NR	No	N/A	N/A
Indiana	Yes	9	$4,461	Yes	5	$122
Iowa	Yes	1	$2	No	N/A	N/A
Kansas	Yes	10	$21,832	No	N/A	N/A
Kentucky	Yes	6	$5,985	Yes	49	NR
Louisiana	Yes	2	$397	No	N/A	N/A

Institutions Supervised - Part III

	Non-Depository Trust Companies			Industrial Loan Corporations		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Maine	Yes	9	$13,339	Yes	0	N/A
Maryland	Yes	5	$144,771	No	N/A	N/A
Massachusetts	Yes	0	N/A	No	N/A	N/A
Michigan	No	N/A	N/A	No	N/A	N/A
Minnesota	Yes	4	$91	Yes	1	$27
Mississippi	Yes	1	$153	No	N/A	N/A
Missouri	Yes	7	NR	No	N/A	N/A
Montana	Yes	1	$10	No	N/A	N/A
Nebraska	Yes	4	$2	No	N/A	N/A
Nevada	Yes	27	NR	Yes	5	$10,688
New Hampshire	Yes	20	$166,055	Yes	N/A	$0
New Jersey	Yes	9	$411	No	N/A	N/A
New Mexico	Yes	6	$3	No	N/A	N/A
New York	Yes	12	$4,625	No	N/A	N/A
North Carolina	Yes	7	$16	Yes	0	N/A
North Dakota	Yes	3	$18	No	N/A	N/A
Ohio	Yes	2	$6	No	N/A	N/A
Oklahoma	Yes	9	$3,744	No	N/A	N/A
Oregon	Yes	4	$8,154	No	N/A	N/A
Pennsylvania	Yes	19	$176	No	N/A	N/A

Institutions Supervised - Part III

	Non-Depository Trust Companies			Industrial Loan Corporations		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Puerto Rico	Yes	1	$26	No	N/A	N/A
Rhode Island[2]	Yes	1	NR	No	N/A	N/A
South Carolina	Yes	2	$222	No	N/A	N/A
South Dakota	Yes	33	$35,110	No	N/A	N/A
Tennessee	Yes	8	$9,891	Yes	1,009	$3,480
Texas DOB	Yes	22	$29,404	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A
Utah	Yes	2	$366	Yes	27	$161,537
Vermont	Yes	4	$941	Yes	0	N/A
Virginia	Yes	1	$3,400	Yes	6	$38
Washington	Yes	10	$50,767	No	N/A	N/A
West Virginia	No	N/A	N/A	No	N/A	N/A
Wisconsin	Yes	4	$28	No	N/A	N/A
Wyoming	Yes	2	$348	No	N/A	N/A
	YES 51 / NO 2	Total 352	Total $624,780	YES 17 / NO 35	Total 1,117	Total $187,558

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Responses as of December 31, 2006

Institutions Supervised - Part IV

	One Bank Holding Companies			Multi-Bank Holding Companies			Credit Unions		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Alabama[1]	Yes	N/A[2]	N/A	Yes	N/A[2]	N/A	No	N/A	N/A
Alaska	Yes	3	NR	Yes	0	N/A	Yes	1	$1
Arizona	Yes	11	NR	Yes	7	NR	Yes	26	$6,300
Arkansas	Yes	69		Yes	16		No	N/A	N/A
California	Yes	93	$132,399	Yes	7	NR	Yes	187	$51,983
Colorado	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Connecticut	Yes	10	$11,990	Yes	4	$1,295	Yes	38	$2,653
Delaware	Yes	0	N/A	Yes	0	N/A	No	N/A	N/A
District of Columbia	Yes	0	N/A	Yes	0	N/A	No	N/A	N/A
Florida	No	N/A	N/A	No	N/A	N/A	Yes	81	$18,707
Georgia	Yes	247	NR	Yes	18	NR	Yes	68	$10,703
Guam	Yes	1	NR	No	N/A	N/A	Yes	0	N/A
Hawaii	Yes	2	$16,196	Yes	1	$79,858	Yes	2	$155
Idaho	Yes	9	NR	Yes	0	N/A	Yes	40	$1,995
Illinois	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Indiana	Yes	0	N/A	Yes	0	N/A	Yes	46	$8,323
Iowa	Yes	211	$29,600	Yes	43	$51,800	No	N/A	N/A
Kansas	Yes	170	NR	Yes	41	N/A	No	N/A	N/A
Kentucky	Yes	112	NR	Yes	18	NR	Yes	26	$1,541
Louisiana	Yes	92	$22,170	Yes	5	$7,231	Yes	48	$1,188

Institutions Supervised - Part IV

	One Bank Holding Companies			Multi-Bank Holding Companies			Credit Unions		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Maine	Yes	11	$8,242	No	N/A	N/A	Yes	12	$1,318
Maryland	Yes	33	NR	Yes	2	NR	Yes	9	$3,589
Massachusetts	Yes	47	$210,613	Yes	5	$11,123	Yes	94	$12,699
Michigan	Yes	77	NR	Yes	10	NR	Yes	217	$22,591
Minnesota	No	N/A	N/A	No	N/A	N/A	Yes	94	$4,073
Mississippi	No	N/A	N/A	No	N/A	N/A	Yes	29	$615
Missouri	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Montana	No	N/A	N/A	No	N/A	N/A	Yes	11	$1,840
Nebraska	Yes	0	N/A	Yes	219 [3]	NR	Yes	20	$532
Nevada	Yes	4	NR	Yes	7	NR	Yes	10	$3,456
New Hampshire	Yes	0	N/A	Yes	0	N/A	Yes	19	$3,954
New Jersey	Yes	35	NR	Yes	4	NR	Yes	19	$507
New Mexico	No	N/A	N/A	No	N/A	N/A	Yes	25	$1,388
New York	Yes	30	NR	Yes	7	NR	Yes	21	$4,500
North Carolina	Yes	40	$68,305	Yes	3	$166,212	No	N/A	N/A
North Dakota	No	N/A	N/A	No	N/A	N/A	Yes	31	$1,629
Ohio	Yes	65	NR	Yes	9	NR	Yes	177	$10,340
Oklahoma	Yes	115	$22,082	Yes	8	$2,389	Yes	24	$3,506
Oregon	Yes	20	NR	Yes	0	N/A	Yes	21	$10,229
Pennsylvania	Yes	78		Yes	21		Yes	66	$7,710

Institutions Supervised - Part IV

	One Bank Holding Companies			Multi-Bank Holding Companies			Credit Unions		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Puerto Rico	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Rhode Island[4]	Yes	7	NR	No	N/A	N/A	Yes	11	NR
South Carolina	No	N/A	N/A	No	N/A	N/A	Yes	16	$848
South Dakota	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Tennessee	No	N/A	N/A	No	N/A	N/A	Yes	111	$7,724
Texas DOB	Yes	186	$48,867	Yes	33	$83,490	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Utah	Yes	41	$604,370 [5]	Yes	9	$4,945,267 [6]	Yes	53	$1,823
Vermont	Yes	2	$1,143	No	N/A	N/A	Yes	22	$785
Virginia	Yes	47	$18,706	Yes	2	$162,250	Yes	59	$4,423
Washington	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
West Virginia	Yes	40	$16,795	Yes	2	$1,102	Yes	6	$337
Wisconsin	Yes	178	NR	Yes	15	NR	No	N/A	N/A
Wyoming	Yes	19	NR	No	N/A	N/A	No	N/A	N/A
	YES / NO	Total	Total	YES / NO	Total	Total	YES / NO	Total	Total
	39 / 14	2,105	$1,211,479	34 / 19	516	$5,512,018	37 / 16	1,740	$213,965

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Exam Authority
[3]Includes One and Multi-Bank Holding Companies
[4]Responses as of December 31, 2006
[5]Includes traditional BHCs and the parents of Industrial Loan Corporations, exempt under the BHC Act but BHCs under State statutes.
[6]Includes Industrial Loan Corporation parent companies.

Institutions Supervised - Part V

	Mortgage Providers			Credit Card Banks			Title Lenders		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Alabama[1]	Yes	1,521	NR	Yes	0		Yes	1,012	NR
Alaska	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Arizona	Yes	1,602	NR	No	N/A	N/A	Yes	616	NR
Arkansas	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
California	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Colorado	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Connecticut	Yes	1,513	NR	Yes	0	N/A	Yes	0	N/A
Delaware	Yes	172	NR	Yes	3	$36,491	Yes	18	NR
District of Columbia	Yes	800	$200	Yes	0	N/A	No	N/A	N/A
Florida	No	N/A	N/A	Yes	0	N/A	No	N/A	N/A
Georgia	Yes	2,259	NR	Yes	1	$10	No	N/A	N/A
Guam	Yes	0	N/A	Yes	0	N/A	Yes	0	N/A
Hawaii	No	N/A	N/A	Yes	0	N/A	No	N/A	N/A
Idaho	Yes	4,368	NR	Yes	0	N/A	Yes	104	NR
Illinois	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Indiana	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Iowa	Yes	459[2]		No	N/A	N/A	No	N/A	N/A
Kansas	Yes	419	N/A[3]	Yes	0	N/A	Yes	11	N/A[3]
Kentucky	Yes	332	NR	No	N/A	N/A	No	N/A	N/A
Louisiana	Yes	518	NR	Yes	0	N/A	No	N/A	N/A

Institutions Supervised - Part V

	Mortgage Providers			Credit Card Banks			Title Lenders		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Maine	No	N/A	N/A	Yes	0	N/A	No	N/A	N/A
Maryland	Yes	3,031	NR	No	N/A	N/A	No	N/A	N/A
Massachusetts	Yes	800	NR	No	N/A	N/A	No	N/A	N/A
Michigan	Yes	2,160	NR	Yes	0	N/A	No	N/A	N/A
Minnesota	Yes	1,193	NR	Yes	0	N/A	No	N/A	N/A
Mississippi	Yes	501	NR	Yes	0	N/A	Yes	344	$26
Missouri	No	N/A	N/A	No	N/A	N/A	Yes	244	NR
Montana	Yes	474	N/A	No	N/A	N/A	Yes	43	N/A
Nebraska	Yes	379	NR	Yes	1	$728	No	N/A	N/A
Nevada	No	N/A	N/A	Yes	0	N/A	No	N/A	N/A
New Hampshire	Yes	790	N/A	No	N/A	N/A	No	N/A	N/A
New Jersey	Yes	2,413	NR	No	N/A	N/A	No	N/A	N/A
New Mexico	Yes	1,194		Yes	0	N/A	No	N/A	N/A
New York	Yes	2,308	NR	No	N/A	N/A	No	N/A	N/A
North Carolina	Yes	427	$0 [4]	Yes	0	N/A	No	N/A	N/A
North Dakota	Yes [5]	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Ohio	Yes	859	NR	Yes	0	N/A	No	N/A	N/A
Oklahoma	No	N/A	N/A	Yes	0	N/A	No	N/A	N/A
Oregon	Yes	1,166	NR	Yes	0	N/A	Yes	78	NR
Pennsylvania	Yes	1,489		No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part V

	Mortgage Providers			Credit Card Banks			Title Lenders		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Puerto Rico	Yes	73	$5,286	No	N/A	N/A	No	N/A	N/A
Rhode Island[6]	Yes	671	NR	No	N/A	N/A	No	N/A	N/A
South Carolina	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
South Dakota	Yes	603	NR	Yes	0	N/A	Yes	0	N/A
Tennessee	Yes	1,275	N/A [7]	Yes	0	N/A	Yes	742	$159
Texas DOB	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Texas S&L	Yes	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Utah	No	N/A	N/A	Yes	0	N/A	Yes	261	$51
Vermont	Yes	448	NR	Yes	0	$0	No	N/A	N/A
Virginia	Yes	1,665 [8]	N/R	Yes	1	$27,929	No	N/A	N/A
Washington	Yes	1,507	NR	No	N/A	N/A	No	N/A	N/A
West Virginia	Yes	359	NR	Yes	0	NR	No	N/A	N/A
Wisconsin	Yes	944	NR	No	N/A	N/A	Yes	N/A [9]	N/A
Wyoming	Yes	537	NR	No	N/A	N/A	No	N/A	N/A
	YES / NO	Total	Total	YES / NO	Total	Total	YES / NO	Total	Total
	39 / 15	41,229	$5,486	28 / 25	6	$65,158	15 / 38	3,473	$236

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Includes mortgage bankers and brokers.
[3]Temporarily unavailable due to a database conversion.
[4]Information not submitted to agency until 3/31/2009. Will follow up with figure once it is available.
[5]Included with Licensed lenders below.

Institutions Supervised - Part V

[6]Responses as of December 31, 2006

[7]Mortgage Providers are not required to file annual report information. Mortgage Lenders must maintain a $200,000 bond and Mortgage Brokers must maintain a $90,000 bond.

[8]Mortgage Brokers 1,211; Mortgage Lenders 75; Lender/Broker 379

[9]Included with mortgage providers.

Institutions Supervised - Part VI

	Pawnshops			Insurance Agents & Companies		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Alabama[1]	Yes	1,012	NR	No	N/A	N/A
Alaska	No	N/A	N/A	No	N/A	N/A
Arizona	No	N/A	N/A	No	N/A	N/A
Arkansas	No	N/A	N/A	No	N/A	N/A
California	No	N/A	N/A	No	N/A	N/A
Colorado	No	N/A	N/A	No	N/A	N/A
Connecticut	No	N/A	N/A	No	N/A	N/A
Delaware	No	N/A	N/A	No	N/A	N/A
District of Columbia	No	N/A	N/A	No	N/A	N/A
Florida	No	N/A	N/A	No	N/A	N/A
Georgia	No	N/A	N/A	No	N/A	N/A
Guam	Yes	8	NR	Yes	1,401	NR
Hawaii	No	N/A	N/A	No	N/A	N/A
Idaho	No	N/A	N/A	No	N/A	N/A
Illinois	Yes	212	NR	No	N/A	N/A
Indiana	Yes	58	NR	No	N/A	N/A
Iowa	No	N/A	N/A	No	N/A	N/A
Kansas	No	N/A	N/A	No	N/A	N/A
Kentucky	No	N/A	N/A	No	N/A	N/A
Louisiana	Yes	185	NR	No	N/A	N/A

Institutions Supervised - Part VI

	Pawnshops			Insurance Agents & Companies		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Maine	No	N/A	N/A	No	N/A	N/A
Maryland	No	N/A	N/A	No	N/A	N/A
Massachusetts	No	N/A	N/A	No	N/A	N/A
Michigan	No	N/A	N/A	Yes	201,454 [2]	NR
Minnesota	No	N/A	N/A	No	N/A	N/A
Mississippi	Yes	272	$8	No	N/A	N/A
Missouri	No	N/A	N/A	No	N/A	N/A
Montana	No	N/A	N/A	No	N/A	N/A
Nebraska	No	N/A	N/A	No	N/A	N/A
Nevada	No	N/A	N/A	No	N/A	N/A
New Hampshire	No	N/A	N/A	No	N/A	N/A
New Jersey	Yes	33	NR	Yes	0	N/A
New Mexico	No	N/A	N/A	No	N/A	N/A
New York	No	N/A	N/A	No	N/A	N/A
North Carolina	No	N/A	N/A	No	N/A	N/A
North Dakota	No	N/A	N/A	No	N/A	N/A
Ohio	Yes	165	NR	No	N/A	N/A
Oklahoma	No	N/A	N/A	No	N/A	N/A
Oregon	Yes	66	NR	No	N/A	N/A
Pennsylvania	Yes	56		No	N/A	N/A

Institutions Supervised - Part VI

	Pawnshops			Insurance Agents & Companies		
	Supervise	Number	Assets (Millions)	Supervise	Number	Assets (Millions)
Puerto Rico	Yes	157		No	N/A	N/A
Rhode Island[3]	No	N/A	N/A	No	N/A	N/A
South Carolina	No	N/A	N/A	No	N/A	N/A
South Dakota	No	N/A	N/A	No	N/A	N/A
Tennessee	No	N/A	N/A	No	N/A	N/A
Texas DOB	No	N/A	N/A	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A
Utah	No	N/A	N/A	No	N/A	N/A
Vermont	No	N/A	N/A	No	N/A	N/A
Virginia	No	N/A	N/A	No	N/A	N/A
Washington	No	N/A	N/A	No	N/A	N/A
West Virginia	No	N/A	N/A	No	N/A	N/A
Wisconsin	Yes	17	NR	No	N/A	N/A
Wyoming	Yes	50	NR	No	N/A	N/A
	YES 13 / NO 40	Total 2,291	Total $8	YES 3 / NO 50	Total 202,355	Total $0

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007

[2]1,604 insurance companies; 27 HMOs; Blue Cross/Blue Shield of Michigan; 53,034 Individual Resident agents; 1,632 Solicitors; 118,245 Nonresident agents; 321 Surplus lines agents; 179 Adjusters for the insured; 6,301 Insurance adjusters; 998 Insurance counselors; 986 Non-resident surplus lines.--AGENCY: 8,675 Resident agents; 8,637 Nonresident agents; 137 Surplus lines agents; 387 Third party administrators; 317 Non-resident surplus lines

[3]Responses as of December 31, 2006

Institutions Supervised - Part VII

	Securities Broker/Dealers & Firms			Technology Service Providers	
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number
Alabama[1]	No	N/A	N/A	N/A	
Alaska	No	N/A	N/A	No	N/A
Arizona	No	N/A	N/A	No	N/A
Arkansas	No	N/A	N/A	No	N/A
California	No	N/A	N/A	Yes	NR
Colorado	No	N/A	N/A	Yes	6
Connecticut	Yes	2,537	NR	Yes	4
Delaware	No	N/A	N/A	No	N/A
District of Columbia	No	N/A	N/A	No	N/A
Florida	No	N/A	N/A	No	N/A
Georgia	No	N/A	N/A	Yes	31
Guam	Yes	36	NR	No	N/A
Hawaii	No	N/A	N/A	No	N/A
Idaho	Yes	1,478	NASD net capital	No	N/A
Illinois	No	N/A	N/A	Yes	13
Indiana	No	N/A	N/A	Yes	28
Iowa	No	N/A	N/A	Yes	1
Kansas	No	N/A	N/A	Yes	3
Kentucky	Yes	1,668	$0	Yes	2

Institutions Supervised - Part VII

	Securities Broker/Dealers & Firms			Technology Service Providers	
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number
Louisiana	Yes	84,924	Bond $10,000 or CIPC membership	No	N/A
Maine	No	N/A	N/A	No	N/A
Maryland	No	N/A	N/A	No	N/A
Massachusetts	No	N/A	N/A	Yes	2
Michigan	Yes	2,041	NR	No	N/A
Minnesota	No	N/A	N/A	No	N/A
Mississippi	No	N/A	N/A	No	N/A
Missouri	No	N/A	N/A	No	N/A
Montana	No	N/A	N/A	No	N/A
Nebraska	Yes	67,744	NR	Yes	4
Nevada	No	N/A	N/A	No	N/A
New Hampshire	No	N/A	N/A	No	N/A
New Jersey	Yes	0	N/A	No	N/A
New Mexico	No	N/A	N/A	No	N/A
New York	No	N/A	N/A	No	N/A
North Carolina	No	N/A	N/A	No	N/A
North Dakota	No	N/A	N/A	Yes	1
Ohio	No	N/A	N/A	Yes	11
Oklahoma	No	N/A	N/A	No	N/A

Institutions Supervised - Part VII

	Securities Broker/Dealers & Firms			Technology Service Providers	
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number
Oregon	Yes	1,841	$25	Yes	0
Pennsylvania	No	N/A	N/A	Yes	3
Puerto Rico	Yes	46		No	N/A
Rhode Island[2]	No	N/A	N/A	No	N/A
South Carolina	No	N/A	N/A	No	N/A
South Dakota	No	N/A	N/A	No	N/A
Tennessee	No	N/A	N/A	Yes	3[3]
Texas DOB	No	N/A	N/A	Yes	16
Texas S&L	N/A	N/A	N/A	N/A	N/A
Utah	No	N/A	N/A	Yes	22
Vermont	No	N/A	N/A	No	N/A
Virginia	No	N/A	N/A	No	N/A
Washington	No	N/A	N/A	No	N/A
West Virginia	No	N/A	N/A	Yes	0
Wisconsin	No	N/A	N/A	Yes	11
Wyoming	No	N/A	N/A	No	N/A
	YES 10 / NO 43	Total 162,315		YES 20 / NO 32	Total 161

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Responses as of December 31, 2006
[3]Includes non-bank servicers only.

Institutions Supervised - Part VIII

	Check Cashers			Money Transmitters/Sale of Checks			Consumer Finance Companies		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Alabama[1]	No	N/A	N/A	No	N/A	N/A	Yes	1,480	$25
Alaska	No	N/A	N/A	No	N/A	N/A	Yes	1	$25
Arizona	No	N/A	N/A	Yes	60	$25	Yes	33	N/A
Arkansas	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
California	No	N/A	N/A	Yes	66	$1	No	N/A	N/A
Colorado	No	N/A	N/A	Yes	39	$1 [2]	No	N/A	N/A
Connecticut	Yes	120	$10	Yes	57	$300	Yes	184	N/A
Delaware	Yes	72	$0	Yes	42	$0	Yes	Included in Lic Lenders	$0
District of Columbia	Yes	155	$5	Yes	50	$50	Yes	29	$5
Florida	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Georgia	Yes	907	NR	Yes	103	$100	No	N/A	N/A
Guam	Yes	2	NR	Yes	15	$50	Yes	11	N/A
Hawaii	No	N/A	N/A	Yes	37	$0 [3]	Yes	15	$1 [4]
Idaho	No	N/A	N/A	Yes	42	$0	Yes	419	$0
Illinois	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Indiana	Yes	68	$0	Yes	24	$200	Yes	66	$0
Iowa	No	N/A	N/A	Yes	43	Bond amount of $50,000 plus $10,000 per location capped at $300,000; minimum net worth of $100,000 plus $10,000 per delegate not to exceed $500,000	Yes [5]	154	Bond of $1,000; net worth of $5,000

Institutions Supervised - Part VIII

	Check Cashers			Money Transmitters/Sale of Checks			Consumer Finance Companies		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Kansas	No	N/A	N/A	Yes	39	$200	Yes	49	$100
Kentucky	No	N/A	N/A	Yes	38	$1	Yes	347	$0
Louisiana	Yes	1,176	NR	Yes	55	$25/$100 (NW) [6]	Yes	1,879 [7]	$25,000 cash to start
Maine	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Maryland	Yes	520	N/A	Yes	73	$150,000-$1,000,000	Yes	657	$12
Massachusetts	Yes	148	$25	Yes	2,138	$50	Yes	306	N/A
Michigan	No	N/A	N/A	Yes	36	Min. net worth lesser of $125,000 +$25,000 per location or $1 million; surety bond $500,000 - $1.5 million.	Yes	17	Varies
Minnesota	Yes	82	$10	Yes	68	$25	Yes	132	$20
Mississippi	Yes	1,100	$0	Yes	54	$0	Yes	590	$0
Missouri	No	N/A	N/A	Yes	51	$100	Yes	1,029	$0
Montana	No	N/A	N/A	No	N/A	N/A	Yes	255	N/A
Nebraska	No	N/A	N/A	Yes	40	$100	Yes	26	$50
Nevada	Yes	215	$50	Yes	53	$10	Yes	65	$50
New Hampshire	Yes	0	N/A	Yes	31	$0	Yes	142	$0
New Jersey	Yes	230	$50,000 Bond	Yes	151	$100,000/$100,000	Yes	1,476	N/A
New Mexico	No	N/A	N/A	No	N/A	N/A	Yes	782	$30
New York	Yes	198	$0	Yes	70	$1	Yes	165	$0
North Carolina	Yes	376	$50	Yes	67	$150	Yes	82	$50

Institutions Supervised - Part VIII

	Check Cashers			Money Transmitters/Sale of Checks			Consumer Finance Companies		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
North Dakota	No	N/A	N/A	Yes	20	$150	Yes	27	N/A
Ohio	Yes	258	$25	Yes	52	$300	Yes	238	$50
Oklahoma	No	N/A	N/A	Yes	50	$50	No	N/A	N/A
Oregon	Yes	N/A [8]	N/A	Yes	63	$25	Yes	241	$0
Pennsylvania	Yes	568	N/A	Yes	40	$1	Yes	383	$0
Puerto Rico	Yes	92	N/A	Yes	20	N/A	Yes	7	N/A
Rhode Island[9]	Yes	21	N/A	Yes	46	$50	Yes	9	$10
South Carolina	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
South Dakota	No	N/A	N/A	Yes	30	$100	No	N/A	N/A
Tennessee	Yes	638	$0	Yes	61	$0	No	N/A	N/A
Texas DOB	No	N/A	N/A	Yes	124	$300	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Utah	Yes	207	$0 [10]	Yes	34	$50 [11]	Yes	1,745	$0
Vermont	Yes	2	$0	Yes	16	$100	Yes	101	$0
Virginia	Yes	313	$0	Yes	68	$25,000-$500,000 bond	Yes	17 (232 office)	$25,000 to $50,000 liquid assets

Institutions Supervised - Part VIII

	Check Cashers			Money Transmitters/Sale of Checks			Consumer Finance Companies		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Washington	Yes	192	N/A [12]	Yes	86	N/A [12]	Yes	292	$400
West Virginia	Yes	0	$100	Yes	27	$100	Yes	8	$0
Wisconsin	Yes	187	$0 [13]	Yes	43	$0 [14]	Yes	253	$0 [15]
Wyoming	No	N/A	N/A	Yes	25	$10	Yes	123	NR
	YES / NO	Total		YES / NO	Total		YES / NO	Total	
	28 / 25	7,847		44 / 9	4,347		41 / 12	13,818	

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Can reduce to $250,000
[3]$1k minimum bond, max is $500k. Total Net Worth must be no less than $1k.
[4]$500k net worth requirement
[5]Regulated loan licensees
[6]Minimum Bond = $25,000; Net Worth Minimum = $100,000
[7]Same as Licensed Lenders
[8]We are registering check cashers under a law that became effective 1/1/09.
[9]Responses as of December 31, 2006
[10]Registration Fee
[11]and a $1,000,000 net worth
[12]Varies
[13]$5,000 Bond/$5,000 Net Worth
[14]$10,000 Bond for 1st location, then $5,000 each/$10,000 Net Worth.
[15]$25,000 Bond/$10,000 Net Worth

Institutions Supervised - Part IX

	Licensed Lenders			Payday Lenders			Appraisers		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Alabama[1]	Yes	414	$10	Yes	1,186	$20	No	N/A	N/A
Alaska	No	N/A	N/A	Yes	36	$25	No	N/A	N/A
Arizona	Yes	435	N/A	Yes	85	N/A	No	N/A	N/A
Arkansas	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
California	Yes	113	$1	No	N/A	N/A	No	N/A	N/A
Colorado	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Connecticut	Yes	5,134	N/A [2]	Yes	0	N/A	No	0	N/A
Delaware	Yes	270	$0	Yes	63	$0	No	N/A	N/A
District of Columbia	Yes	11	$50	No	N/A	N/A	No	N/A	N/A
Florida	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Georgia	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Guam	Yes	0	N/A	Yes	0	N/A	Yes	21	NR
Hawaii	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Idaho	Yes	836	$0	Yes	300	$0	No	N/A	N/A
Illinois	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Indiana	Yes	137	$0	Yes	44	$50	No	N/A	N/A
Iowa	Yes [3]	77	$0	Yes	264	Bond of $25,000 per county in which operating; $25,000 in unencumbered assets for each county in which it operates	Yes	1,278	$0
Kansas	Yes	419	$100	Yes	89	$100	No	N/A	N/A
Kentucky	No	N/A	N/A	Yes	767	$0	No	N/A	N/A
Louisiana	Yes	1,879 [4]	$25,000 cash to start	Yes	944 [5]	$25,000 cash to start	No	N/A	N/A

Institutions Supervised - Part IX

	Licensed Lenders			Payday Lenders			Appraisers		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Maine	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Maryland	Yes	362	$12	No	N/A	N/A	No	N/A	N/A
Massachusetts	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Michigan	Yes	22	Min. net worth $100,000	Yes	731	Min. net worth $50,000 per location with max. aggregate required $250,000; $50,000 surety bond.	No	N/A	N/A
Minnesota	No	N/A	N/A	Yes	28	$50	No	N/A	N/A
Mississippi	No	N/A	N/A	Yes	1,100	$0	No	N/A	N/A
Missouri	No	N/A	N/A	Yes	1,272	$0	No	N/A	N/A
Montana	No	N/A	N/A	Yes	107	$10	No	N/A	N/A
Nebraska	Yes	124	N/A	Yes	136	$50	No	N/A	N/A
Nevada	No	N/A	N/A	Yes	215	$50	No	N/A	N/A
New Hampshire	Yes	452	$0	Yes	9	$0	No	0	N/A
New Jersey	Yes	See mortgage providersrs	$151,000 Bond	No	N/A	N/A	No	N/A	N/A
New Mexico	No	N/A	N/A	Yes	137	$30	No	N/A	N/A
New York	Yes	21	$0	No	N/A	N/A	No	N/A	N/A
North Carolina	Yes	512	$150	No	N/A	N/A	No	N/A	N/A
North Dakota	Yes	293	$25	Yes	78	$20	No	N/A	N/A
Ohio	Yes	51	$25	Yes	187	$100	No	N/A	N/A
Oklahoma	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Oregon	No	N/A	N/A	Yes	123	$0	No	N/A	N/A
Pennsylvania	Yes [6]	3,002	N/A	No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part IX

	Licensed Lenders			Payday Lenders			Appraisers		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Puerto Rico	Yes	71	N/A	No	N/A	N/A	No	N/A	N/A
Rhode Island[7]	Yes	257	$50	Yes	0	N/A	No	N/A	N/A
South Carolina	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
South Dakota	Yes	375	$10	No	N/A	N/A	No	N/A	N/A
Tennessee	Yes	N/A	$0 [8]	Yes	1,359	$0	No	N/A	N/A
Texas DOB	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Utah	Yes	0	$0	Yes	348	$0 [9]	No	N/A	N/A
Vermont	Yes	76	$50	Yes	N/A	N/A	No	N/A	N/A
Virginia	No	N/A	N/A	Yes	83 (784 offices)	$10,000 per location not to exceed $50,000	No	N/A	N/A
Washington	Yes	N/A [10]	N/A	Yes	N/A [11]	N/A	No	N/A	N/A
West Virginia	Yes	0	$0	No	N/A	N/A	No	N/A	N/A
Wisconsin	No	254	$0 [12]	Yes	533	$0 [12]	No	N/A	N/A
Wyoming	Yes	336	N/A	Yes	96	N/A	No	N/A	N/A
	YES / NO	Total		YES / NO	Total		YES / NO	Total	
	31 / 22	15,933		32 / 21	10,237		2 / 51	1,299	

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Start-up requirements vary depending on type of lender.
[3]Industrial loan licensees

Institutions Supervised - Part IX

[4]Same as Consumer Finance Companies

[5]Payday Lenders are Licensed Lenders (Consumer Finance Companies) and included in 1,879 licensees.

[6]Licensed Lenders are motor vehicle dealers who are licensed as installment sellers.

[7]Responses as of December 31, 2006

[8]Refer to Title Lenders

[9]Registration Fee

[10]Included in the Consumer Finance Companies

[11]Included in the number of Consumer Finance Companies

[12]$5,000 Bond per location/$50,000 Net Worth

Institutions Supervised - Part X

	Credit Counselors			Financial Advisers			Other Business Supervised		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Alabama[1]	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Alaska	No	N/A	N/A	No	N/A	N/A	Yes	23	$5
Arizona	No	N/A	N/A	No	N/A	N/A	Yes	828	N/A
Arkansas	No	N/A	N/A	No	N/A	N/A	Yes	3	$81
California	No	N/A	N/A	No	N/A	N/A	Yes	1	$2 [2]
Colorado	No	N/A	N/A	No	N/A	N/A	Yes	0	$2 [3]
Connecticut	Yes	34	$40	Yes	445	N/R	Yes	1 [4]	$3
Delaware	No	N/A	N/A	No	N/A	N/A	Yes	92	N/A
District of Columbia	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Florida	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Georgia	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Guam	Yes	0	N/A	Yes	32	N/A	No	N/A	N/A
Hawaii	No	N/A	N/A	No	N/A	N/A	Yes	13	$0 [5]
Idaho	Yes	44	$0	Yes	92	$0	No	N/A	N/A
Illinois	No	N/A	N/A	No	N/A	N/A	Yes	626	N/A
Indiana	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Iowa	Yes	47	$10,000 for bond	No	N/A	N/A	Yes [6]	1,459	N/A
Kansas	Yes	30	$25	No	N/A	N/A	Yes	4,813	N/A
Kentucky	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Louisiana	No	N/A	N/A	Yes	4,960	N/A	Yes	2,065 [7]	Various

Institutions Supervised - Part X

	Credit Counselors			Financial Advisers			Other Business Supervised		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Maine	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Maryland	Yes	36	NR	No	N/A	N/A	Yes	1,465	N/A
Massachusetts	No	N/A	N/A	No	N/A	N/A	Yes	569 [8]	$25
Michigan	No	N/A	N/A	No	N/A	N/A	Yes	125,722 [9]	Varies
Minnesota	Yes	31	$5	No	N/A	N/A	No	N/A	N/A
Mississippi	Yes	68	$0	No	N/A	N/A	Yes	355	Various
Missouri	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Montana	No	N/A	N/A	No	N/A	N/A	Yes	8	$100
Nebraska	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Nevada	Yes	0	N/A	No	N/A	N/A	Yes	534	$35
New Hampshire	Yes	19	$0	No	N/A	N/A	No	N/A	N/A
New Jersey	Yes	25	$50,000 Bond	No	N/A	N/A	Yes	653	Various
New Mexico	No	N/A	N/A	No	N/A	N/A	Yes	4,078	N/A
New York	Yes	52	N/A [10]	No	N/A	N/A	No	N/A	N/A
North Carolina	No	N/A	N/A	No	N/A	N/A	Yes	834	N/A
North Dakota	No	N/A	N/A	No	N/A	N/A	Yes [11]	419	$20
Ohio	No	N/A	N/A	No	N/A	N/A	Yes	46	N/A
Oklahoma	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Oregon	Yes	12	$25	Yes	1,401	$10	No	N/A	N/A
Pennsylvania	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part X

	Credit Counselors			Financial Advisers			Other Business Supervised		
	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements	Supervise	Number	Minimum Bond/Startup Requirements
Puerto Rico	Yes	6	N/A	Yes	22	N/A	Yes	251	N/A
Rhode Island[12]	Yes	12	$50	No	N/A	N/A	Yes	414 [13]	$20
South Carolina	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
South Dakota	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Tennessee	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
Texas DOB	No	N/A	N/A	No	N/A	N/A	Yes	655	$50
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Utah	No	N/A	N/A	No	N/A	N/A	Yes [14]	195	N/A
Vermont	Yes	24	$50	No	N/A	N/A	No	N/A	N/A
Virginia	Yes	41	$25,000-$350,000	No	N/A	N/A	Yes	39	$25,000 to $350,000 bond
Washington	No	N/A	N/A	No	N/A	N/A	No	N/A	N/A
West Virginia	No	N/A	N/A	No	N/A	N/A	Yes	362 [15]	$0
Wisconsin	Yes	94	N/A	No	N/A	N/A	Yes	268	N/A [16]
Wyoming	No	N/A	N/A	No	N/A	N/A	Yes	33	N/A
	YES 18 / NO 35	Total 575		YES 6 / NO 47	Total 6,952		YES 31 / NO 22	Total 146,824	

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Business and Industrial Development Corporations

Institutions Supervised - Part X

[3]Core capital

[4]BIDCO

[5]Escrow Depositories - $50k Net Worth requirement; $100k Escrow Depository Bond requirement

[6]Individual loan originators

[7]Includes 2,014 Notification Filers (Consumer Credit Sellers), 12 Bond for Deed Escrow Agents, and 39 Repossession Agencies and Agents. We also regulate consumer loan brokers, but we don't currently have any licensed.

[8]loan servicers & debt collectors

[9]1,831 Investment advisers; 123,829 securities agents; 36 debt management locations; 26 living care facilities; and 2 BIDCOs

[10]Bond equivalent to the monthly average of client funds held in trust

[11]Collection Agencies

[12]Responses as of December 31, 2006

[13]Loan Brokers

[14]Mortgage Servicers

[15]Licensed Loan Originators

[16]No Bond/$10,000 Net Worth

Institutions Supervised - Part XII

	Private Banks			Non-federally Insured Credit Unions		
	Supervise	Number	Total Assets if applicable	Supervise	Number	Total Assets if applicable
Alabama[1]	No	N/A	N/A	No	N/A	N/A
Alaska	No	N/A	N/A	No	N/A	N/A
Arizona	No	N/A	N/A	No	N/A	N/A
Arkansas	No	N/A	N/A	No	N/A	N/A
California	No	N/A	N/A	Yes	17	$3,010
Colorado	No	N/A	N/A	No	N/A	N/A
Connecticut	No	N/A	N/A	No	N/A	N/A
Delaware	No	N/A	N/A	No	N/A	N/A
District of Columbia	No	N/A	N/A	No	N/A	N/A
Florida	No	N/A	N/A	No	N/A	N/A
Georgia	No	N/A	N/A	No	N/A	N/A
Guam	No	N/A	N/A	Yes	0	N/A
Hawaii	No	N/A	N/A	No	N/A	N/A
Idaho	No	N/A	N/A	Yes	19	$158
Illinois	No	N/A	N/A	Yes	30	$2,416,446
Indiana	No	N/A	N/A	Yes	17	$1,421
Iowa	No	N/A	N/A	No	N/A	N/A
Kansas	No	N/A	N/A	No	N/A	N/A
Kentucky	No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part XII

	Private Banks			Non-federally Insured Credit Unions		
	Supervise	Number	Total Assets If applicable	Supervise	Number	Total Assets If applicable
Louisiana	No	N/A	N/A	No	N/A	N/A
Maine	No	N/A	N/A	No	N/A	N/A
Maryland	No	N/A	N/A	Yes	3	$91
Massachusetts	No	N/A	N/A	No	N/A	N/A
Michigan	No	N/A	N/A	No	N/A	N/A
Minnesota	No	N/A	N/A	No	N/A	N/A
Mississippi	No	N/A	N/A	No	N/A	N/A
Missouri	No	N/A	N/A	No	N/A	N/A
Montana	No	N/A	N/A	No	N/A	N/A
Nebraska	No	N/A	N/A	No	N/A	N/A
Nevada	No	N/A	N/A	Yes	7	$2,582,995
New Hampshire	No	N/A	N/A	Yes	1	$0
New Jersey	No	N/A	N/A	No	N/A	N/A
New Mexico	No	N/A	N/A	No	N/A	N/A
New York	Yes	1	$6,181	No	N/A	N/A
North Carolina	No	N/A	N/A	No	N/A	N/A
North Dakota	No	N/A	N/A	No	N/A	N/A
Ohio	No	N/A	N/A	Yes	63	$1,894
Oklahoma	No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part XII

	Private Banks			Non-federally Insured Credit Unions		
	Supervise	Number	Total Assets if applicable	Supervise	Number	Total Assets if applicable
Oregon	No	N/A	N/A	No	N/A	N/A
Pennsylvania	Yes	1	$525	No	N/A	N/A
Puerto Rico	No	N/A	N/A	No	N/A	N/A
Rhode Island[2]	No	N/A	N/A	No	N/A	N/A
South Carolina	No	N/A	N/A	No	N/A	N/A
South Dakota	No	N/A	N/A	No	N/A	N/A
Tennessee	No	N/A	N/A	No	N/A	N/A
Texas DOB	No	N/A	N/A	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A
Utah	No	N/A	N/A	No	N/A	N/A
Vermont	No	N/A	N/A	No	N/A	N/A
Virginia	No	N/A	N/A	No	N/A	N/A
Washington	No	N/A	N/A	No	N/A	N/A
West Virginia	No	N/A	N/A	No	N/A	N/A
Wisconsin	No	N/A	N/A	No	N/A	N/A
Wyoming	No	N/A	N/A	No	N/A	N/A
	YES 2 / NO 51			YES 9 / NO 44		

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007
[2]Responses as of December 31, 2006

Institutions Supervised - Part XII

	Private Banks			Non-federally Insured Credit Unions		
	Supervise	Number	Total Assets if applicable	Supervise	Number	Total Assets if applicable
Alabama[1]	No	N/A	N/A	No	N/A	N/A
Alaska	No	N/A	N/A	No	N/A	N/A
Arizona	No	N/A	N/A	No	N/A	N/A
Arkansas	No	N/A	N/A	No	N/A	N/A
California	No	N/A	N/A	Yes	17	$3,010
Colorado	No	N/A	N/A	No	N/A	N/A
Connecticut	No	N/A	N/A	No	N/A	N/A
Delaware	No	N/A	N/A	No	N/A	N/A
District of Columbia	No	N/A	N/A	No	N/A	N/A
Florida	No	N/A	N/A	No	N/A	N/A
Georgia	No	N/A	N/A	No	N/A	N/A
Guam	No	N/A	N/A	Yes	0	N/A
Hawaii	No	N/A	N/A	No	N/A	N/A
Idaho	No	N/A	N/A	Yes	19	$158
Illinois	No	N/A	N/A	Yes	30	$2,416,446
Indiana	No	N/A	N/A	Yes	17	$1,421
Iowa	No	N/A	N/A	No	N/A	N/A
Kansas	No	N/A	N/A	No	N/A	N/A
Kentucky	No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part XII

	Private Banks			Non-federally Insured Credit Unions		
	Supervise	Number	Total Assets if applicable	Supervise	Number	Total Assets if applicable
Louisiana	No	N/A	N/A	No	N/A	N/A
Maine	No	N/A	N/A	No	N/A	N/A
Maryland	No	N/A	N/A	Yes	3	$91
Massachusetts	No	N/A	N/A	No	N/A	N/A
Michigan	No	N/A	N/A	No	N/A	N/A
Minnesota	No	N/A	N/A	No	N/A	N/A
Mississippi	No	N/A	N/A	No	N/A	N/A
Missouri	No	N/A	N/A	No	N/A	N/A
Montana	No	N/A	N/A	No	N/A	N/A
Nebraska	No	N/A	N/A	No	N/A	N/A
Nevada	No	N/A	N/A	Yes	7	$2,582,995
New Hampshire	No	N/A	N/A	Yes	1	$0
New Jersey	No	N/A	N/A	No	N/A	N/A
New Mexico	No	N/A	N/A	No	N/A	N/A
New York	Yes	1	$6,181	No	N/A	N/A
North Carolina	No	N/A	N/A	No	N/A	N/A
North Dakota	No	N/A	N/A	No	N/A	N/A
Ohio	No	N/A	N/A	Yes	63	$1,894
Oklahoma	No	N/A	N/A	No	N/A	N/A

Institutions Supervised - Part XII

	Private Banks			Non-federally Insured Credit Unions		
	Supervise	Number	Total Assets if applicable	Supervise	Number	Total Assets if applicable
Oregon	No	N/A	N/A	No	N/A	N/A
Pennsylvania	Yes	1	$525	No	N/A	N/A
Puerto Rico	No	N/A	N/A	No	N/A	N/A
Rhode Island[2]	No	N/A	N/A	No	N/A	N/A
South Carolina	No	N/A	N/A	No	N/A	N/A
South Dakota	No	N/A	N/A	No	N/A	N/A
Tennessee	No	N/A	N/A	No	N/A	N/A
Texas DOB	No	N/A	N/A	No	N/A	N/A
Texas S&L	N/A	N/A	N/A	N/A	N/A	N/A
Utah	No	N/A	N/A	No	N/A	N/A
Vermont	No	N/A	N/A	No	N/A	N/A
Virginia	No	N/A	N/A	No	N/A	N/A
Washington	No	N/A	N/A	No	N/A	N/A
West Virginia	No	N/A	N/A	No	N/A	N/A
Wisconsin	No	N/A	N/A	No	N/A	N/A
Wyoming	No	N/A	N/A	No	N/A	N/A
	YES 2 / NO 51			YES 9 / NO 44		

NR: Not Reported.
N/A: Not Applicable.
The following state banking departments did not participate in this chart: Virgin Islands.

[1]Responses as of December 31, 2007

STATES MOVE AGGRESSIVELY TO IMPLEMENT SAFE ACT AND IMPROVE MORTGAGE SUPERVISION

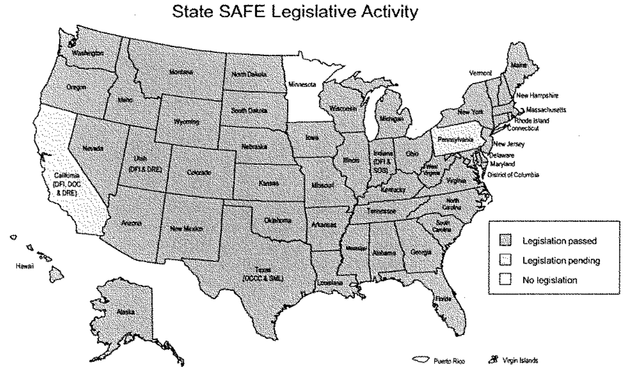
Title V of P.L. 110-289, the *Secure and Fair Enforcement for Mortgage Licensing Act of 2008* ("SAFE Act"), was passed on July 30, 2008. The SAFE Act gave states one year to pass legislation requiring the licensure of mortgage loan originators according to national standards and the participation of state agencies on the Nationwide Mortgage Licensing System and Registry (NMLS).

States have moved in an unprecedented manner in just **ONE YEAR** to accomplish the following:

Legislation

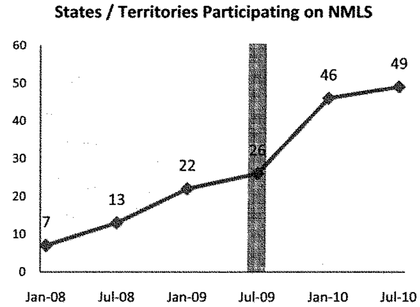
- **49 states** and the District of Columbia have enacted or introduced legislation implementing the SAFE Act.
    - 47 states and the District of Columbia have already *passed* legislation, and
    - 2 states and Puerto Rico and the Virgin Islands have *legislation pending* in legislatures that are still in session.
- **All** legislation enacted to date includes standardized definitions, national pre-licensure and continuing education and testing requirements, and criminal background standards for mortgage loan originators as contained in the SAFE Act.
- **Virtually all of the** legislation enacted to date includes a robust set of prohibited acts and practices to protect consumers as promoted in the CSBS/AARMR Model State Law.
- **Uniformity in mortgage regulation** has been fostered and driven by enactment of the SAFE Act as the 50 existing state licensing laws are revised in a nationally consistent manner to establish standardized licensing applications, processes and practices.

State SAFE Legislative Activity



Participation in NMLS

- **26 states** and territories are already participating on the Nationwide Mortgage Licensing System.
  - 7 more states and territories (for a total of 33) are scheduled to participate in 2009.
  - 13 more states and territories (for a total of 46) are scheduled to participate in January 2010.
- **90% of states** are scheduled to be participating in NMLS by January 2010, just two years after launch of the system.

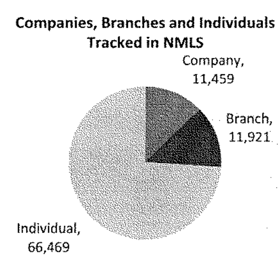


Testing and Education Standards

- NMLS developed the psychometrically valid SAFE Mortgage Loan Originator Test, with the national component of the test available for all state licensed mortgage loan originators on July 30, 2009.
- NMLS developed eleven SAFE state component tests that will be available on July 30, 2009. Remaining state tests will be rolled out on a quarterly basis over the next year.
- NMLS developed policy and procedures for approving course providers to offer pre-licensure and continuing education according to national standards.
- Since accepting applications from providers starting June 22, 2009, NMLS has approved 20 course providers and is processing applications from 30 more.
- By September 1st, NMLS approved courses will be available for MLOs across the country.

Coordinated Licensing of Companies and Mortgage Loan Originators

- **66,469 mortgage loan originators** in 26 states and territories have been issued a NMLS unique identifier and are being tracked in the system.
- **11,459 mortgage broker and lender companies** in 26 states and territories have also received an NMLS unique identifier and are being tracked in the system.



More information about state efforts to implement the SAFE Act and improve supervision can be found on the CSBS website at www.csbs.org.

More information about the Nationwide Mortgage Licensing System and Registry (NMLS) can be found at http://www.stateregulatoryregistry.org/NMLS.

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