



The power to make it better.[®]

Written statement
before the

Committee on Financial Services Committee
United States House of Representatives

on

“Improving Federal Consumer Protection in Financial Services”

July 25, 2007

WITNESS: GEORGE GABERLAVAGE
DIRECTOR, POLICY, RESEARCH & DEVELOPMENT
CONSUMER AND STATE AFFAIRS
AARP PUBLIC POLICY INSTITUTE

For further information, contact:
Susanna Montezemolo
Federal Affairs Department, AARP
(202) 434-3800

Chairman Frank, Ranking Member Bachus, and Members of the Committee:

Thank you for the opportunity to appear here today to discuss the current state of consumer protection in financial services regulation and to make recommendations for action in the wake of tremendous changes in the marketplace and consolidation of significant authority in the hands of federal banking regulators.

Older Americans and Financial Services

The traditional aversion to debt among older consumers has given way in recent years to a much more expansive use of credit among today's retirees and near retirees. As baby boomers approach traditional retirement age, the growing number of older persons with mortgage debt and credit card balances is of real concern. At the same time, AARP is concerned about the affordability of basic banking services for seniors. Our research demonstrates that too many moderate- and lower-income older consumers do not use a financial institution because they are afraid of the fees they will incur.

A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets. A key to achieving this goal is helping individuals better manage financial decisions and protecting consumers from financial fraud and abuse that can erode retirement savings and financial assets.

The recent meltdown in the subprime mortgage market, rising levels of home foreclosures and credit card debt, increasing bank fees and questionable practices, and a steady erosion of state authority to protect consumers of financial services has brought us here today to discuss two main issues:

- The adequacy of current federal consumer protection rules and recommendations for improvement; and
- The potential future role of state agencies in protecting financial consumers.

Current Federal Consumer Protection Oversight and Enforcement

The sheer number of hearings in this Congress¹ devoted to exploring the shortcomings in the current federal regulatory system is evidence enough that the system is less than adequate when it comes to protecting consumers of financial services. As Members of this Committee are well aware, there have been more than a dozen hearings in the House and Senate in the first seven months of this Congress that examined issues related to predatory lending, subprime mortgage lending, credit card practices, bank fees, and credit reporting. The testimony presented at these hearings has documented the very real costs to consumers when financial services regulators fail to act in a timely or effective manner against abusive and unfair practices.

The statistics are sobering:

- Projections are that one in every five families who get a subprime mortgage today will lose their home to foreclosure. That translates to 2.2 million borrowers who stand to lose as much as \$164 billion in wealth in the process.²
- In 2006, American consumers paid over \$89 billion in fees, interest payments, added costs on purchases, and other charges associated with their credit cards.³
- Banks and other financial institutions collected over \$17.5 billion in overdraft fees in 2006, up 75 percent from 2004.⁴

Add to this list the cost to consumers of demand drafts used by fraudulent payday lenders and telemarketers to access consumer bank accounts; unequal treatment of debits and credits to checking accounts under “Check 21” provisions; and unauthorized garnishment of Social Security and other federal benefits and it is clear why so many consumers find themselves in financial difficulty.

Over the course of the last several decades, the effectiveness of the regulatory system has eroded, as the substantive state role in credit regulation has been preempted and the federal government

¹ The House Financial Services Committee and Subcommittees have held at least seven hearings this Congress, including hearings the March 27th hearing on Subprime and Predatory Mortgage Lending; April 17th hearing on Possible Responses to Rising Mortgage Foreclosures; April 26th hearing on Credit Card Practices; June 7th hearing on Improving Credit Card Consumer Protections; June 13th hearing on Improving Federal Consumer Protection in Financial Services; June 19th hearing on Consumers’ Ability to Dispute and Change Inaccurate Information; and the July 11th hearing on Overdraft Protection. The Senate Banking Committee has held five hearings, including the January 25th hearing on the Credit Card Industry; February 7th hearing on Predatory Lending and Home Foreclosures; March 22nd hearing on Mortgage Market Turmoil; April 17th hearing on the Subprime Mortgage Market; and the June 25th hearing on Ending Mortgage Abuse. The Senate Permanent Subcommittee on Investigations held a March 7th hearing on Credit Card Practices.

² Center for Responsible Lending, “Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners,” December 2006. <http://www.responsiblelending.org/pdfs/CRL-foreclosure-rprt-1-8.pdf>

³ Elizabeth Warren, “Unsafe At Any Rate,” *Democracy*, Issue #4, Spring 2007. <http://www.democracyjournal.org/article.php?ID=6544>

⁴ Center for Responsible Lending, “Out of Balance,” July 11, 2007. <http://www.responsiblelending.org/pdfs/out-of-balance-report-7-10-final.pdf>

has declined to fill in the gap. Instead, the federal regulators have been overly reliant on disclosures that have proven to be ineffective. The simple fact is that disclosure documents today often are meaningless, with pages and pages of incomprehensible text that works to obfuscate more than illuminate. Often the timing of the disclosure is delivered too late for the consumer to act. And, we have outdated laws that do not take into account the realities of the new credit products in the financial marketplace.

Just as the legal context has changed since the regulatory system was first designed, so too has the economic context. Consumer debt is a more important part of the economy, making it more important than ever to assure a fair marketplace.

The oversight role this Committee and your colleagues in the Senate has performed in terms of casting a spotlight on the regulatory system's ability to adequately protect consumers is critically important to the process of restoring fairness and integrity to the financial marketplace. It is encouraging to see industry participants and regulators alike acknowledge the need for stepped up regulation and enforcement and industry best practices. However, it is equally important that Congress take the steps necessary to institutionalize reform, so that progress continues when the spotlight dims.

The challenge in updating the federal regulatory system is not to be underestimated. Substantial hurdles will have to be overcome to effect meaningful and sustained reform, including:

- **Heavy emphasis on safety and soundness regulation, potentially at the expense of consumer protection.** The primary focus of the federal banking regulators is the financial safety and soundness of the institutions they are charged with overseeing. The Office of the Comptroller of the Currency's (OCC) preemption rules, for example, emphasize the goal of giving national banks wide latitude to conduct their business activities in accordance with "uniform [federal] standards of operation and supervision that" that will reduce compliance costs and maximize profits and stability.⁵ While safety soundness and consumer protection functions sometimes coincide, these goals may be in conflict. Practices that may improve a financial institution's bottom line may not be in the consumer's best interest.
- **Reliance on examinations and case-by-case actions rather than rulemaking and enforcement.** Federal banking regulators generally work to enforce compliance through the supervision and examination process. This process is highly discretionary and lacks transparency. Findings generally are confidential and not available for public review. While this process may assist in resolving safety and soundness concerns at the financial institution level, it is not necessarily effective in correcting abusive practices against individual consumers. The most effective way to ensure fair dealings in the marketplace is to establish clear, firm rules and enforce those rules with clear, firm consequences.

⁵ 69 Fed. Reg. 1904, 1907-08 (2004) (preamble to OCC's activities preemption regulation).

- **Slowness to act in the face of overwhelming evidence of a problem.** It took nearly four years for regulators to act after the first warning signals of problems in the subprime marketplace. In fact, at the same time that the regulators were seeing signs of trouble, they were continuing to encourage the development and use of adjustable rate mortgages that are now defaulting in record rates.⁶ Similarly, just a few months ago, the Federal Reserve Board proposed its first major revision of the credit card disclosure rules in nearly 40 years, despite the enormous changes that have taken place in the industry during that time.
- **Dependence on disclosure rather than substantive regulation to protect consumers.** Certainly, effective disclosure should be an important component of any consumer protection regulatory regime. At the same time, disclosure should not be considered a substitute for substantive regulation, but rather a complement to it. While the federal emphasis on disclosure makes sense in a context where states can undertake the substantive regulation necessary for effective consumer protection, it makes far less sense in an environment where the federal government occupies so much of the financial services regulatory field.

Enhancing Consumer Protection in Financial Services

This Committee has played a key role in spotlighting the abuses that have caused such turmoil in the subprime mortgage market and have plagued consumers of financial services in the credit markets. Congress now has a very real opportunity to put in place meaningful reforms that will minimize abusive practices. While we welcome the recent actions by federal banking regulators recognizing the need to put in place additional consumer protections, there is more that must be done if the hurdles to effective consumer protection are to be overcome.

Among AARP's recommendations for action are the following:

- **Authorize the Federal Trade Commission (FTC) to bring enforcement actions against national banks and thrifts for unfair or deceptive practices. Give the FTC concurrent and independent authority over national banks for all matters covered by the FTC Act.** Currently, the FTC is prohibited from enforcing this statute with respect to national banks. Congress may also want to consider granting similar authority to all federal banking regulators; at a minimum, this authority needs to be granted to the FTC which is the only agency charged with consumer protection.

⁶ See the opening statement of Senate Banking Committee Chairman Christopher Dodd, "Mortgage Market Turmoil: Causes and Consequences," hearing, March 22, 2007: "Regulators tell us that they first noticed credit standards deteriorating late in 2003. By then, Fitch Ratings had already placed one major subprime lender on 'credit watch,' citing concerns over their subprime business. Despite those warning signals, in February 2004 the leadership of the Federal Reserve Board seemed to encourage the development and use of adjustable rate mortgages ..."

- **Allow states to enforce the federal lending laws and federal unfair or deceptive practices provisions of the FTC Act against national banks.** This will help restore the “cop on the beat” consumer protection function traditionally carried out by the states. .
- **Adopt meaningful credit card reforms at the federal level,** including strict prohibitions on two-cycle billing, universal default, and other abusive practices, and required advance notice of material changes in the terms of the credit card agreement.
- **Adopt meaningful rules to ensure that overdraft and other fees** imposed by financial institutions are reasonable and that customers are immediately notified that such charges are being assessed. Consumers should be given a reasonable opportunity to rectify their accounts before any additional charges or similar adverse actions are assessed.
- **Adopt meaningful reform in subprime lending,** including requirements for sensible underwriting policies that examine a borrower’s ability to repay the mortgage over the life of the loan.
- **Adopt meaningful opportunities for consumer redress** by eliminating mandatory arbitration clauses in credit card and mortgage agreements and by allowing individuals to bring private rights of action under the FTC Act.
- **Establish an effective centralized complaint reporting and resolution mechanism.** Consumers cannot be expected to know which of the federal banking regulators has jurisdiction over the financial institution with which they have a dispute or complaint. As such, the concept of a one-stop complaint center makes sense, but only if it does more than simply send the customer back to the bank or discourage the customer from filing a complaint.

The State Role in Consumer Protection

The recent Supreme Court ruling in *Watters vs. Wachovia Bank, N.A.*,⁷ which upheld the federal preemption by the Office of the Comptroller of the Currency of state laws applied to the operating subsidiaries of national banks, is the latest in a string of unfortunate federal regulatory and court actions severely limiting the role of the states in protecting consumers of financial services. AARP is a strong supporter of a robust and energetic state role in consumer protection. We have a longstanding policy in favor of a federal regulatory system that serves as a “floor,” while allowing states and local governments to add their own, stronger protections.⁸

In evaluating the appropriateness of preemption, AARP urges policymakers to consider:

⁷ *Watters v. Wachovia Bank, N.A.*, No. 05-1342 (U.S., April 17, 2007).

⁸ AARP, *The Policy Book*, 2007, Financial Services and Consumer Protection, Federal and State Roles, p. 11-4.

- the extent to which the federal or state authorities have identified and focused on the specified problem and addressed the problem satisfactorily;
- potential benefits resulting from additional federal, state or local laws;
- the possibility of intolerably high compliance burdens resulting from both federal and state regulations;
- unique state or local needs that would be adversely affected;
- the capacity of the states to respond effectively to emerging issues, unusual circumstances or unanticipated consequences; and
- preserving the role of the states as laboratories for policy innovation with our federal system.

It may be cliché now, but the states often are effective consumer protectors because they are the local “cop on the beat.” Consumers generally know who their state and local enforcement officials are and are more likely to complain to them rather than to someone in Washington, D.C. or some other distant place. State officials also are more likely than their federal counterparts to witness first-hand the devastation to communities that can accompany abusive financial services practices, such as predatory lending. As such, the states often can detect problems at the “emergent” stage and before they become a full blown crisis. This “early warning” role can be critical to stopping abusive or unfair practices early.

As the Committee considers the implications of the Watters decision on consumers, we urge you to integrate a state role as fully as is possible under the law. At a minimum, states should be empowered to enforce federal laws against unfair and deceptive practices if national banks engage in such activity.

Conclusion

Mr. Chairman, I want to thank you and the Committee for the opportunity to appear before you today. The issue of adequate consumer protection in the financial services arena is one that is only going to grow in importance over time. We urge Congress to do all that it can to ensure that federal and state regulators and enforcement officials are given all the tools they need to adequately protect consumers from the abuses we are witnessing today ...and those that will emerge in the future.