The Wrong Approach to Stronger Consumer Protection

Background: A major part of the Administration’s proposal to restructure the regulatory system for financial institutions is the creation of a new Consumer Financial Protection Agency (CFPA). This proposed new agency would have vast and unprecedented authority to regulate in detail all bank consumer products and services. On March 22, 2010, Senate Banking Committee Chairman Christopher Dodd introduced a slightly modified version of the proposal in his new legislation on regulatory reform. Chairman Dodd’s proposal creates a consumer bureau within the Federal Reserve with extremely broad authority to write rules for banks of all sizes.

Why a new Consumer Protection Bureau Is the Wrong Approach

A consumer bureau, within the Federal Reserve, will not close existing gaps in regulation; it will only add another bureaucratic layer. The biggest failures of the current regulatory system, including consumer protection failures, have not been in the regulated banking system, but in the unregulated or weakly regulated financial sectors. The focus of enhanced consumer protection should be on the less-regulated state-chartered financial services providers that are not now carefully examined and supervised like banks.

Consumer regulation should not be separated from safety and soundness regulation. Although the legislation would exempt banks and savings associations with $10 billion or less in assets from the examination and enforcement of the consumer financial protection bureau, the proposed new bureau would have significant oversight and rulemaking authority over institutions of all sizes, with the potential for conflicts with safety and soundness regulation. Almost every bank consumer product or service has both consumer issues and safety and soundness issues that need to be balanced and resolved. Neither one can be separated from the other without negative consequences, nor should they be separated.

Consumer bureau would have unprecedented authority to control the products and services offered by banks of all sizes. The proposal would give the bureau the authority to regulate sales practices and even regulate compensation for all institutions, regardless of size.

Consumer agency would disrupt interstate commerce in financial products and services. With changes in technology and the incredible mobility of our society, the free flow of financial services is more pronounced today than ever before. This proposed legislation empowers states to exercise new legislative and enforcement authority over national banks, raising serious questions about the functioning of a national market in financial products. For example, how will nationwide ATM networks function if individual states enact new restrictions?

There are better alternatives to enhance consumer protection. Clearly, there have been critical failures in consumer protection. The subprime mortgage crisis was primarily caused by non-banks, demonstrating the need for greater focus on non-banks, which are weakly regulated, if at all. Consumer focus can be increased, and the current authority to regulate unfair and deceptive practices can be given to all banking agencies in a coordinated fashion. A central location for consumer complaints can be created. These and other ideas are vastly superior to creating a new consumer bureau that has unprecedented powers and that will conflict with safety and soundness regulators.