Testimony

of

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Before the

United States Senate

Committee

On

Banking, Housing, and Urban Affairs

On

September 18, 2014

Chairman Johnson, members of the Committee, it is an honor to be here today. My name is Oliver Ireland. I am a partner in the Financial Services practice at Morrison & Foerster here in Washington D. C. I have over forty years of experience working as a lawyer on financial services issues. I spent twenty-six years with the Federal Reserve System, including fifteen years as an Associate General Counsel at the Board in Washington where I worked on issues ranging from writing rules to protect consumers, to establishing policies and writing rules to reduce systemic risk in the financial system. I have fourteen years' experience as a private sector attorney helping providers of financial products and services to navigate the financial regulatory system.

I understand that this may be Chairman Johnson's last hearing on consumer issues as Chairman of this Committee and as Senator from South Dakota. On behalf of the financial services community I want to start by thanking Chairman Johnson for his work as a member of this Committee and as its Chairman. Financial services issues are complex and usually controversial. At the same time they are critical to American households. Chairman Johnson, we all owe you a debt of gratitude.

I am here today to address the state of the market for consumer financial products and services in the wake of a severe financial crisis where consumer household mortgages played a key role, and in the wake of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") which was designed to address many of the problems related to the financial crisis. A key component of the Dodd-Frank Act was the creation of the Consumer Financial Protection Bureau ("CFPB"), but the Dodd-Frank Act also specifically addressed standards for mortgages in a separate Title. In addition, the Credit CARD Act of 2009, enacted shortly after the peak of the financial crisis, has also played an

important role in shaping the current market for consumer financial products and services.

There is no denying that problems in the market for consumer financial products and services led to the enactment of the Credit Card Act, the mortgage provisions of the Dodd-Frank Act and the creation of the CFPB; however, both statistical and anecdotal information suggest that these initiatives, coupled with actions of the Federal Banking agencies, are having a chilling effect on the markets for consumer financial products and services.

At the outset, it is important to remember that we regulate providers of consumer financial products and services because of the importance of these products and services to American households and to the economy as a whole. Our goal should be to ensure that the markets for these products and services are fair and efficient and that consumers have access to these markets. In establishing the CFPB, the Dodd-Frank Act stated that the purpose of the CFPB is to "seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent and competitive."

This purpose statement sets a lofty goal that can be approached but may be very difficult to achieve. Congress recognized the difficulty in achieving this goal by including the word "seek" in the purpose statement. A key factor in seeking this goal is the recognition that that there are two sides to every consumer financial product and service—the consumer and the provider. Pursuit of fairness for the consumer can make products or services uneconomical for providers and have an adverse effect on access to those products or services for some, or all, consumers.

Zeal in enforcing consumer laws, particularly those that do not have well defined standards such as the unfair, deceptive and, with the passage of the Dodd-

Frank Act, abusive standards that originated in the Federal Trade Commission Act and are incorporated into the Dodd-Frank Act, can also adversely affect access to consumer services as providers become more reluctant to continue existing products and services and to introduce new ones. To illustrate the concerns, I will focus on three areas: the effect of the Credit CARD Act on access to consumer credit for everyday needs, the potential effect of the mortgage provisions of the Dodd-Frank Act on access to mortgage credit, and the chilling effect of uncertainty on access to consumer financial products and services generally.

CREDIT CARD ACT

The Credit CARD Act was enacted in response to a number of practices in the credit card market. For example, in seeking to provide access to credit to more consumers, credit card issuers had developed a practice of granting credit to cardholders with uncertain credit characteristics and, where the card holder later exhibited higher risk characteristics, increasing the rate on the cardholders account to address that risk. Cardholders who thought that they were going to be able to enjoy credit at a lower initial rate viewed this practice as unfair; however, many cardholders continued to enjoy the rates that they had originally anticipated. The Credit CARD Act generally prohibited credit card issuers from raising rates on existing balances, except in very limited circumstances.

In connection with Federal Reserve Board rule makings on this issue that preceded the Credit CARD Act, industry analysis indicated that restricting the ability to raise rates on existing balances would reduce credit card issuer revenue by billions of dollars and that in an effort to adapt to this loss of revenue credit card issuers would either raise interest rates on credit card accounts generally or remove risk from their portfolios by limiting access to credit by consumers that appeared to be higher risk.

Although data on the credit card market subsequent to the implementation of the Credit CARD Act has been affected by the financial crisis and the ensuing high levels of unemployment, data developed by the American Bankers Association, in conjunction with Argus Information and Advisory Services and Keybridge Research, shows marked changes in the credit card market since the implementation of the Credit CARD Act including a significant reduction in the availability of credit card accounts and, where such accounts are available credit card lines, to consumers with higher credit risk scores. These data also show that credit cards, where available, are increasingly being used as payment instruments rather than as means of obtaining household credit. For example, the proportion of credit card accounts that pay off their balance each month has increased even while monthly use of credit cards has increased. At the same time, the effective finance charge yield on credit card portfolios, the amount actually paid for credit, has declined.

These data might be attributed to household deleveraging in the wake of the financial crisis, and indeed mortgage credit has also declined sharply; however, mortgager credit relative to disposable income had shown a marked bubble that appears to coincide with the bubble in housing prices during the first decade of this century, but credit card credit did not experience a similar bubble. Further, other forms of household credit, including automobile loans and student loans, appear to have increased as credit card credit has decreased.

A detailed analysis of these data is beyond the scope of this testimony and is best conducted by economists with a strong understanding of consumer financial transactions and the consumer financial markets, however, these data strongly suggest that significant changes in the regulatory environment for consumer financial products and services, such as the Credit CARD Act, can lead to a reduction in use or the availability of those services. These data also suggest that

in order to achieve the goal of assuring that consumers have access to markets for financial products and services in regulating these markets, it is important to understand the consumer demand that these services meet. If new regulations result in unmet consumer demand because of a redirection in consumer access to financial products and services, that unmet consumer demand is highly likely to lead consumers to try to meet their needs from other, substitute sources. These substitute services may be more expensive or otherwise on less advantageous terms than the products or services that are no longer available. For example, in the case of the Credit CARD Act it is possible that consumers with higher credit risk scores who are no longer able to obtain credit cards to meet their needs for short term credit may find themselves turning to other higher cost credit to meet their needs or to increasing their secured borrowing collateralized by their automobiles or their homes to provide a liquidity cushion to deal with unforeseen events.

At this point in time it is not clear how higher risk score consumers have met any needs for credit that they would have met through the use of credit cards before the Credit CARD Act was implemented. In formulating regulatory policy to meet the goals that the Dodd-Frank Act established for the CFPB, it is important to consider the effect of that policy on consumers' access to retail financial product and services and how consumers may meet their needs if access to the financial products or services that are the focus of new regulation requirements is curtailed.

MORTGAGES

In some cases the stakes are higher. In the case of home mortgages, the financial crisis demonstrated that that the failure of a sufficient volume of retail consumer transactions can have destabilizing effects on the economy as a whole. This potential is significant in the area of home mortgages where mortgage credit outstanding represents almost half of nominal gross domestic product ("GDP"),

and at the time of the financial crisis represented more than sixty percent of nominal GDP. The Dodd-Frank Act sought to protect consumers and improve the market for home mortgages, and potentially the market for residential real estate more broadly, by improving mortgage underwriting standards. It has taken some time for these changes to be put into place and not all of them have been fully implemented even now. Accordingly, it is difficult to assess the overall impact of these reforms on consumers' access to mortgage credit in developing regulatory policy for the home mortgage market. Nevertheless, early indications are that these reforms are materially reducing mortgage originations.

Given the significance of mortgage credit, and housing more broadly, in the economy, the potential effects of an undue reduction in mortgage originations on economic growth and employment have to be considered, as well as individual consumer's access to home mortgage credit.

UNCERTAINTY

Looking beyond the markets for credit cards and home mortgages credit, the markets for other consumer financial products and services are characterized by a higher level of uncertainty on the part of the providers of those products and services than I have observed before. This uncertainty appears to arise from the level of reliance by the CFPB and the federal bank regulatory agencies on generalized guidance and enforcement actions to shape these markets and to address perceived harms to consumers. While financial institutions have long criticized regulatory initiatives as overly prescriptive, the absence of clarity can be as constraining as detailed rules, and in some cases more so. Broadly drawn "guidance", whether issued by the CFPB or the Federal bank regulatory agencies, can, and has, caused financial institutions to abandon products even though those products were well received by their customers.

More difficult to measure is the extent to which new product initiatives are abandoned before they see the light of day out of fear that they will run afoul of hazily defined regulatory concerns. In particular the Federal banking agencies broad reliance on reputational risk is difficult to predict and or anticipate until it appears. Although banking institutions in particular rely on their reputations in the market to maintain their ability to raise deposits and fund themselves in the wholesale markets, in some cases reputational risk has been used in cases where the link to bank safety and soundness is not apparent.

Similarly, the labeling of practices as unfair, deceptive, or abusive in enforcement actions is difficult for financial institutions to interpret. This difficulty arises both from the vagueness of these standards themselves and from the generality of the language included in public enforcement actions. It is simply not possible to read public enforcement actions and to understand the specific practices that were led to the enforcement action. Given the complexity of financial products and services, an enforcement action directed at a specific term of a product or service, or to specific marketing language, but that is described in the public action as unfair or deceptive in connection with the product or service simply does not enable other providers of similar products or services to understand the specific regulatory concerns. This uncertainty makes it difficult to determine how to proceed with current products and services and to determine whether or how to offer new products or services.

This uncertainty could be reduced if regulators relied more often on a rule writing process where existing regulations are revised to address new issues or, if necessary, where new rules are created. The process of developing specific regulatory text, receiving comments on that text, and responding to the comments in final rules imposes a discipline on the regulatory process that increases the likelihood that the desired goals can be achieved and unintended consequences

avoided. This process also gives providers of consumer products and services a better understanding of the agency's goals than vaguely worded enforcement actions and broadly worded guidance provide. This regulatory process also gives providers lead time to implement new requirements. This process is far more conducive to the fair, transparent and competitive markets envisioned by the Dodd-Frank Act than the apprehensive markets for consumer financial products and services that the current process is creating.

As the agency with the primary responsibility for writing rules with respect to consumer financial products and services, the CFPB is still developing its expertise with the regulatory process. As it gains experience with this process it should be able to streamline its information collection process so that providers of consumer financial products or services are not required to produce unnecessary information, and so that the CFPB itself can avoid focusing on collateral issues that do not directly promote the goals that it is seeking to achieve. The CFPB should also be able to sharpen its focus on key issues and potential solutions in order to reduce repetitive clarifications of rules that it does issue.

Thank you for the opportunity to be here today, I would be happy to respond to any questions.