Hearing on "Consumer Protections in Financial Services: Past Problems, Future Solutions" before the U.S. Senate Committee on Banking, Housing, and Urban Affairs

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10:00 a.m., Tuesday, March 3, 2009 – Dirksen 538

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Chairman Dodd and Members of the Committee: Thank you for inviting me here today to discuss the problem of restructuring the financial regulatory system. I applaud the Committee for exploring bold new approaches to financial regulation on the scale needed to address our nation's economic challenges.

In my remarks today, I propose transferring consumer protection responsibilities in the area of consumer credit from federal banking regulators to a single, dedicated agency whose sole mission is consumer protection. This step is essential for three reasons. First, during the housing bubble, our current system of fragmented regulation drove lenders to shop for the easiest legal regime. Second, the ability of lenders to switch charters put pressure on banking regulators – both state and federal – to relax credit standards. Finally, banking regulators have routinely sacrificed consumer protection for short-term profitability of banks. Creating one, dedicated consumer credit regulator charged with consumer protection would establish uniform standards and enforcement for all lenders and help eliminate another death spiral in lending. Although I examine this issue through the lens of mortgage regulation, my discussion is equally relevant to other forms of consumer credit, such as credit cards and payday lending.

The reasons for the breakdown of the home mortgage market and the private-label market for mortgage-backed securities are well known by now. Today, I wish to focus on lax lending standards for residential mortgages, which were a leading cause of today's credit crisis and recession. Our broken system of mortgage finance and the private actors in that system – ranging from mortgage brokers, lenders, and appraisers to the rating agencies and securitizers – bear direct responsibility for this breakdown in standards.

There is more to the story, however. In 2006, depository institutions and their affiliates, which were regulated by federal banking regulators, originated about 54% of all higher-priced home loans. In 2007, that percentage rose to 79.6%.[1] In some states, mortgages originated by state banks and thrifts and independent nonbank lenders were regulated under state anti-predatory lending laws. In other states, however, mortgages were not subject to meaningful regulation at all. Consequently, the credit crisis resulted from regulatory failure as well as broken private risk management. That regulatory failure was not confined to states, moreover, but pervaded federal banking regulation as well.

Neither of these phenomena – the collapse in lending criteria and the regulatory failure that accompanied it – was an accident. Rather, they occurred because mortgage originators and regulators became locked in a competitive race to the bottom to relax loan underwriting and risk

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[1] Robert B. Avery, Kenneth P. Brevoort & Glenn B. Canner, *The 2007 HMDA Data*, FED. RES. BULL. A107, A124 (Dec. 2008), available at http://www.federalreserve.gov/pubs/bulletin/2008/pdf/hmda07final.pdf.

management. The fragmented U.S. system of financial services regulation exacerbated this race to the bottom by allowing lenders to shop for the easiest regulators and laws.

During the housing bubble, consumers could not police originators because too many loan products had hidden risks. As we now know, these risks were ticking time bombs. Lenders did not take reasonable precautions against default because they able to shift that to investors through securitization. Similarly, regulators failed to clamp down on hazardous loans in a myopic attempt to boost the short-term profitability of banks and thrifts.

I open by examining why reckless lenders were able to take market share away from good lenders and good products. Next, I describe our fragmented financial regulatory system and how it encouraged lenders to shop for lenient regulators. In part three of my remarks, I document regulatory failure by federal banking regulators. Finally, I end with a proposal for a separate consumer credit regulator.

I. Why Reckless Lenders Were Able To Crowd Out the Good

During the housing boom, the residential mortgage market was relatively unconcentrated, with thousands of mortgage originators. Normally, we would expect an unconcentrated market to provide vibrant competition benefiting consumers. To the contrary, however, however, highly risky loan products containing hidden risks -- such as hybrid adjustable-rate mortgages (ARMs), interest-only ARMs, and option payment ARMs – gained market share at the expense of safer products such as standard fixed-rate mortgages and FHA-guaranteed loans.[2]

These nontraditional mortgages and subprime loans inflicted incalculable harm on borrowers, their neighbors, and ultimately the global economy. As of September 30, 2008, almost 10% of U.S. residential mortgages were one month past due or more.[3] By year-end 2008, every sixth borrower owed more than his or her home was worth.[4] The proliferation of toxic loans was the direct result of the ability to confuse borrowers and to shop for the laxest regulatory regime.[5]

A. The Growth in Dangerous Mortgage Products

During the housing boom, hybrid subprime ARMs, interest-only mortgages, and option payment ARMs captured a growing part of the market. We can see this from the growth in nonprime

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2 A hybrid ARM offers a two- or three-year fixed introductory rate followed by a floating rate at the end of the introductory period with substantial increases in the rate and payment (so-called "2-28" and "3-27" mortgages). Federal Reserve System, *Truth in Lending, Part II: Proposed rule; request for public comment*, 73 Fed. Reg. 1672, 1674 (January 9, 2008). An interest-only mortgage allows borrowers to defer principal payments for an initial period. An option payment ARM combines a floating rate feature with a variety of payment options, including the option to pay no principal and less than the interest due every month, for an initial period. Choosing that option results in negative amortization. Department of the Treasury et al., *Interagency Guidance on Nontraditional Mortgage Product Risks*: *Final guidance*, 71 Fed. Reg. 58609, 58613 (Oct. 4, 2006).

3 See Mortgage Bankers Association, *Delinquencies Increase, Foreclosure Starts Flat in Latest MBA National Delinquency Survey* (Dec. 5, 2008), available at www.mbaa.org/NewsandMedia/PressCenter/66626.htm.

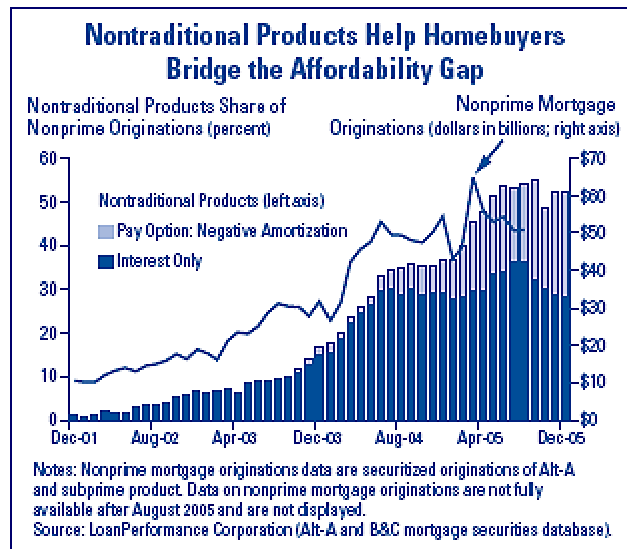
4 Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J., Dec. 31, 2008.

5 The discussion in this section was drawn, in part, from Patricia A. McCoy, Andrey D. Pavlov, & Susan M. Wachter, *Systemic Risk through Securitization: The Result of Deregulation and Regulatory Failure*, ___ CONN. L. REV. ___ (forthcoming 2009) and Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, ___ U. PENN. L. REV. ___ (forthcoming 2009).

mortgages.[6] Between 2003 and 2005, nonprime loans tripled from 11% of all home loans to 33%.[7]

If we unpack these numbers, it turns out that hybrid ARMs, interest-only mortgages, and option payment ARMs accounted for a growing share of nonprime loans over this period. Option payment ARMs and interest-only mortgages went from 3% of all nonprime originations in 2002 to well over 50% by 2005. (*See* Figure 1). Low- and no-documentation loans increased from 25% to slightly over 40% of subprime loans over the same period. By 2004 and continuing through 2006, about three-fourths of the loans in subprime securitizations consisted of hybrid ARMs.[8]

Figure 1. Growth in Nontraditional Mortgages, 2002-2005[9]



As the product mix of nonprime loans became riskier and riskier, two default indicators for nonprime loans also increased substantially. Loan-to-value ratios went up and so did the percentage of loans with combined loan-to-value ratios of over 80%. This occurred even though the credit scores of borrowers with those loans remained relatively unchanged between 2002 and 2006. At the same time, the spreads of rates over the bank cost of capital tightened. To make

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6 I use the term "nonprime" to refer to subprime loans plus other nontraditional mortgages. Subprime mortgages carry higher interest rates and fees and are designed for borrowers with impaired credit. Nontraditional mortgages encompass a variety of risky mortgage products, including option payment ARMs, interest-only mortgages, and reduced documentation loans. Originally, these nontraditional products were offered primarily in the "Alt-A" market to people with near-prime credit scores but intermittent or undocumented income sources. Eventually, interest-only ARMs and reduced documentation loans penetrated the subprime market as well.

7 FDIC Outlook, *Breaking New Ground in U.S. Mortgage Lending* (Summer 2006), available at www.fdic.gov/bank/analytical/regional/ro20062q/na/2006_summer04.html.

8 See generally McCoy, Pavlov & Wachter, *supra* note 5; FDIC Outlook, *Breaking New Ground in U.S. Mortgage Lending* (Summer 2006), available at www.fdic.gov/bank/analytical/regional/ro20062q/na/2006_summer04.html.

9 FDIC Outlook, *Breaking New Ground in U.S. Mortgage Lending* (Summer 2006), available at www.fdic.gov/bank/analytical/regional/ro20062q/na/2006_summer04.html.

matters worse, originators layered risk upon risk, with borrowers who were the most at risk obtaining low equity, no-amortization, reduced documentation loans. (*See* Figure 2).

Figure 2. Underwriting Criteria for Adjustable-Rate Mortgages, 2002-2006

	ARMS										
	Orig Yr	**CLTV**	**CLTV>80**	**Seconds**	**Full Doc**	**IO%**	**DTI**	**FICO<700**	**Investor**	**WAC**	**SpdtoWAC**
Prime	2002	66.4	4.1	1.9	56.0	46	31.0	20.7	0.7	5.5	-
	2003	68.2	10.1	10.9	48.6	53	31.8	21.8	1.6	4.6	-
	2004	73.5	20.7	23.1	51.2	71	33.5	22.0	2.1	4.5	-
	2005	74.1	21.7	26.8	47.3	81	33.6	18.9	1.9	5.4	-
	2006	75.3	26.2	35.3	33.6	91	37.2	19.5	2.3	6.2	-
Alt A	2002	74.3	20.8	2.7	29.3	26	35.4	46.4	9.9	6.3	0.8
	2003	78.0	33.3	23.4	28.1	56	35.3	44.7	12.9	5.6	1.0
	2004	82.6	46.9	39.1	32.6	75	36.2	44.3	15.3	5.5	1.0
	2005	83.5	49.6	46.9	28.3	83	37.0	40.5	16.5	6.0	0.6
	2006	85.0	55.4	55.4	19.0	87	38.3	44.2	13.5	6.8	0.6
Subprime	2002	81.2	46.8	3.7	66.9	1	40.0	93.4	4.7	8.5	3.0
	2003	83.5	55.6	9.9	63.5	5	40.2	91.6	4.9	7.5	2.9
	2004	85.3	61.1	19.1	59.9	20	40.6	90.6	5.3	7.1	2.6
	2005	86.6	64.4	28.1	55.9	32	41.2	89.7	5.4	7.3	1.9
	2006	86.7	64.0	31.0	54.6	20	42.1	91.8	5.7	8.2	2.0

Source: Loan Performance data as of November 2006. UBS, April 16, 2007, Thomas Zimmerman, "How Did We Get Here and What Lies Ahead"

Spreads declined

% Full Doc declined

Not much change in FICO or DTI

Legend:
CLTV: Combined loan-to value ratio
Full Doc: Full documentation loans
IO: Interest-only loans
DTI: Average debt-to-income ratios
FICO: Fair Isaac Company credit score
WAC: Weighted average coupon (measuring spread)

Many of these risky mortgage instruments were made in areas where housing was least affordable, such as California, Florida and Arizona, leading to concentrated areas of unsustainable housing values. (*See* Figures 3 and 4). This concentration of risky loans put the entire local markets at risk, due to the sudden and extreme withdrawal of credit in the aftermath of a bubble.[10]

[10] See Susan M. Wachter, Andrey D. Pavlov & Zoltan Pozsar, *Subprime Lending and Real Estate Markets*, *in* MORTGAGE AND REAL ESTATE FINANCE ___ (Stefania Perrucci, ed., Risk Books 2008).

Figure 3. Geographic Distribution of Interest-Only Loans, 2006.[11]

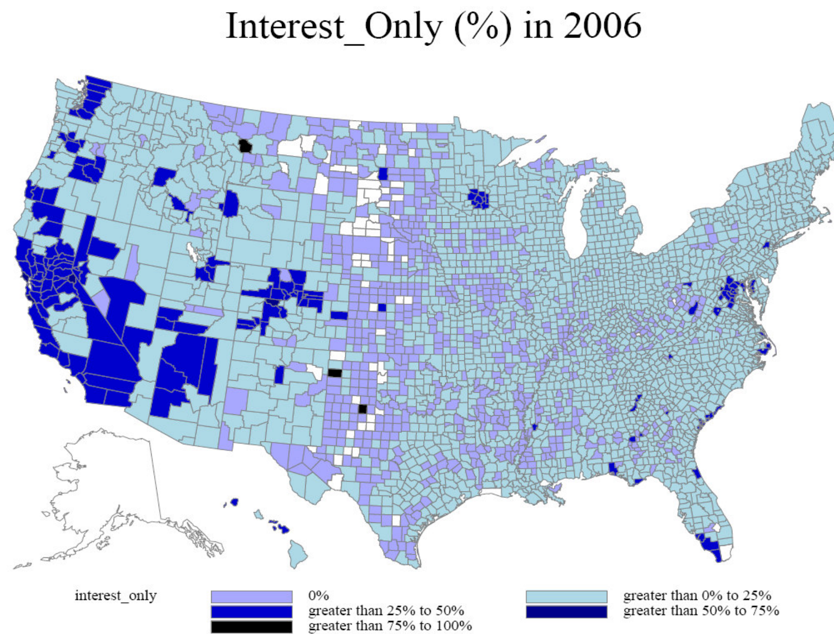
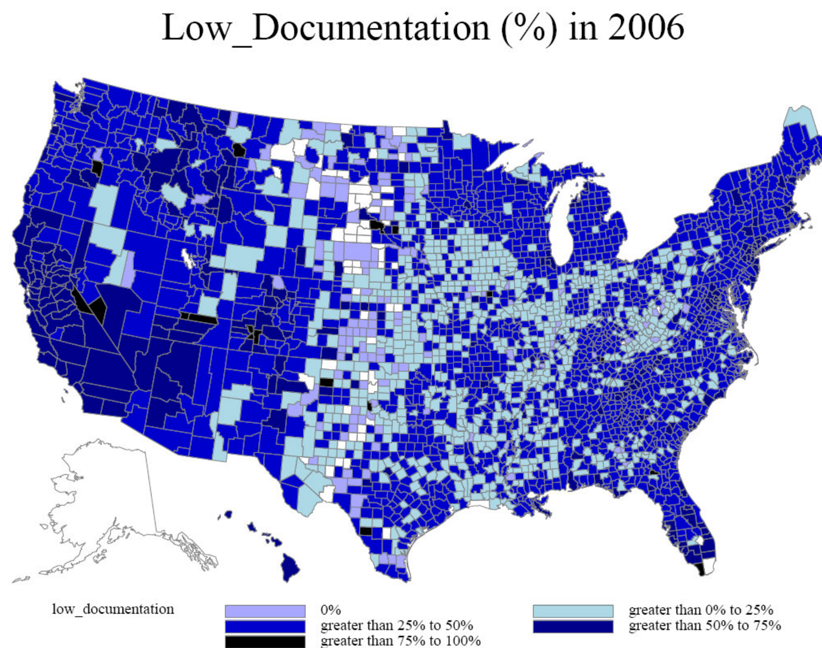


Figure 4. Geographic Distribution of Low-Documentation Loans, 2006[12]



[11] Anthony Pennington-Cross, Mortgage Product Substitution and State Predatory Lending Laws, Presentation at the 2008 Mid-Year Meeting of the American Real Estate and Urban Economics Association, Washington, D.C., May 27, 2008.

[12] *Id.*

The combination of easing credit standards and a growing economy resulted in a sharp increase in homeownership rates through 2004. As the credit quality of loans steadily grew worse over 2005 through 2007,[13] however, the volume of unsustainable loans grew and homeownership rates dropped.[14] (*See* Table 1).

Table 1. U.S. Homeownership Rates, by Year (U.S. Census Bureau)

Period	U.S. Total, %	Non-Hispanic, %				Hispanic%
		White Alone	Black Alone	Other race alone	Two or more races	
1983	64.9	69.1	45.6	53.3	NA	41.2
1984	64.5	69	46	50.9	NA	40.1
1985	64.3	69	44.4	50.7	NA	41.1
1986	63.8	68.4	44.8	49.7	NA	40.6
1987	64	68.7	45.8	48.7	NA	40.6
1988	64	69.1	42.9	49.7	NA	40.6
1989	64	69.3	42.1	50.6	NA	41.6
1990	64.1	69.4	42.6	49.2	NA	41.2
1991	64	69.5	42.7	51.3	NA	39
1992	64.1	69.6	42.6	52.5	NA	39.9
1993	64.1	70.2	42	50.6	NA	39.4
1994	64	70	42.5	50.8	NA	41.2
1995	64.7	70.9	42.9	51.5	NA	42
1996	65.4	71.7	44.5	51.5	NA	42.8
1997	65.7	72	45.4	53.3	NA	43.3
1998	66.3	72.6	46.1	53.7	NA	44.7
1999	66.8	73.2	46.7	54.1	NA	45.5
2000	67.4	73.8	47.6	53.9	NA	46.3
2001	67.8	74.3	48.4	54.7	NA	47.3
2002	67.9	74.7	48.2	55	NA	47
2003	68.3	75.4	48.8	56.7	58	46.7
2004	69	76	49.7	59.6	60.4	48.1
2005	68.9	75.8	48.8	60.4	59.8	49.5
2006	68.8	75.8	48.4	61.1	59.9	49.7
2007	68.1	75.2	47.8	60.3	59	49.7

[13] Subprime mortgage originated in 2005, 2006 and 2007 had successively worse default experiences than vintages in prior years. *See* Freddie Mac, *Freddie Mac Update* 19 (December 2008), available at www.freddiemac.com/investors/pdffiles/investor-presentation.pdf.

[14] *See* Jesse M. Abraham, Andrey Pavlov & Susan Wachter, *Explaining the United States' Uniquely Bad Housing Market*, XII WHARTON REAL ESTATE REV. 24 (2008).

The explosion of nontraditional mortgage lending was timed to maintain securitization deal flows after traditional refinancings weakened in 2003. The major take-off in these products occurred in 2002, which coincided with the winding down of the huge increase in demand for mortgage securities through the refinance process. Coming out of the recession of 2001, interest rates fell and there was a massive securitization boom through refinancing that was fueled by low interest rates. The private-label securitization industry had grown in capacity and profits.

But in 2003, rising interest rates ended the potential for refinancing at ever lower interest rates, leading to an increased need for another source of mortgages to maintain and grow the rate of securitization and the fees it generated. The "solution" was the expansion of the market through nontraditional mortgages, especially interest-only loans and option payment ARMs offering negative amortization. (*See* Figure 1 *supra*). This expansion of credit swept a larger portion of the population into the potential homeowner pool, driving up housing demand and prices, and consumer indebtedness. Indeed, consumer indebtedness grew so rapidly that between 1975 and 2007, total household debt soared from around 43% to nearly 100% of gross domestic product.[15]

The growth in nonprime mortgages was accomplished through market expansion of nontraditional mortgages and by qualifying more borrowing through easing of traditional lending terms. For example, while subprime mortgages were initially made as "hard money" loans with low loan-to-value ratios, by the height of their growth, combined loan-to-value ratios exceeded that of the far less risky prime market. (*See* Figure 3 *supra*). While the demand for riskier mortgages grew fueled by the need for product to securitize, the potential risk due to deteriorating lending standards also grew.

B. Consumer Confusion

If borrowers had been able to distinguish safe loans from highly risky loans, risky loans would not have crowded out the market. But numerous borrowers were not able to do so, for three distinct reasons. First, hybrid subprime ARMs, interest-only mortgages, and option payment ARMs were baffling in their complexity. Second, it was impossible to obtain binding price quotes early enough to permit meaningful comparison shopping in the nonprime market. Finally, borrowers usually did not know that mortgage brokers got higher compensation for steering them into risky loans.

Hidden Risks -- The arcane nature of hybrid ARMs, interest-only loans, and option payment ARMs often made informed consumer choice impossible. These products were highly complex instruments that presented an assortment of hidden risks to borrowers. Chief among those risks was payment shock – in other words, the risk that monthly payments would rise dramatically upon rate reset. These products presented greater potential payment shock than conventional ARMs, which had lower reset rates and manageable lifetime caps. Indeed, with these exotic ARMs, the only way interest rates could go *was* up. Many late vintage subprime hybrid ARMs had initial rate resets of three percentage points, resulting in increased monthly payments of 50% to 100% or more.[16]

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[15] U.S. Federal Reserve Board, Bureau of Economic Analysis.

[16] Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, on Strengthening the Economy: Foreclosure Prevention and Neighborhood Preservation, before the Committee on Banking, Housing and

For a borrower to grasp the potential payment shock on a hybrid, interest-only, or option payment ARM, he or she would need to understand all the moving parts of the mortgage, including the index, rate spread, initial rate cap, and lifetime rate cap. On top of that, the borrower would need to predict future interest rate movements and translate expected rate changes into changes in monthly payments. Interest-only ARMs and option payment ARMs had the added complication of potential deferred or negative amortization, which could cause the principal payments to grow. Finally, these loans were more likely to carry large prepayment penalties. To understand the effect of such a prepayment penalty, the borrower would have to use a formula to compute the penalty's size and then assess the likelihood of moving or refinancing during the penalty period.[17] Truth-in-Lending Act disclosures did not require easy-to-understand disclosures about any of these risks.[18]

Inability to Do Meaningful Comparison Shopping -- The lack of binding rate quotes also hindered informed comparison-shopping in the nonprime market. Nonprime loans had many rates, not one, which varied according to the borrower's risk, the originator's compensation, the documentation level of the loan, and the naïveté of the borrower. Between their complicated price structure and the wide variety of products, subprime loans were not standardized. Furthermore, it was impossible to obtain a binding price quote in the subprime market before submitting a loan application and paying a non-refundable fee. Rate locks were also a rarity in the subprime market. In too many cases, subprime lenders waited until the closing to unveil the true product and price for the loan, a practice that the Truth in Lending Act rules countenanced. These rules, promulgated by the Federal Reserve Board, helped foster rampant "bait-and-switch" schemes in the subprime market.[19]

As a result, deceptive advertising became a stock-in-trade of the nonprime market. Nonprime lenders and brokers did not advertise their prices to permit meaningful comparison-shopping. To the contrary, lenders treated their rate sheets – which listed their price points and pricing criteria – as proprietary secrets that were not to be disclosed to the mass consumer market. Subprime advertisements generally focused on fast approval and low initial monthly payments or interest rates, not on accurate prices.

While the Federal Reserve exhorted people to comparison-shop for nonprime loans,[20] in reality, comparison-shopping was futile. Nonprime lenders did not post prices, did not provide consumers with firm price quotes, and did not offer lock-in commitments as a general rule. Anyone who attempted to comparison-shop had to pay multiple application fees for the privilege

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Urban Affairs, U.S. Senate, 538 Dirksen Senate Office Building, January 31, 2008, www.fdic.gov/news/news/speeches/chairman/spjan3108.html.

17 Federal Reserve System, *Truth in Lending, Part III: Final rule, official staff commentary*, 73 Fed. Reg. 44522, 44524-25 (July 30, 2008); Federal Reserve System, *Truth in Lending, Part II: Proposed rule; request for public comment*, 73 Fed. Reg. 1672, 1674 (January 9, 2008).

18 Patricia A. McCoy, *Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. LEGIS. 123 (2007), available at http://www.law.harvard.edu/students/orgs/jol/vol44_1/mccoy.pdf.

19 *Id.*; Federal Reserve System, Truth in Lending – Proposed rule; request for public comment, 73 Fed. Reg. 1672, 1675 (Jan. 9, 2008).

20 See, e.g., Federal Reserve Board, Looking for the Best Mortgage, www.federalreserve.gov/pubs/mortgage/mortb_1.htm.

and, even then, might not learn the actual price until the closing if the lender engaged in a bait-and-switch.

As early as 1998, the Federal Reserve Board and the Department of Housing and Urban Development were aware that Truth in Lending Act disclosures did not come early enough in the nonprime market to allow meaningful comparison shopping. That year, the two agencies issued a report diagnosing the problem. In the report, HUD recommended changes to the Truth in Lending Act to require mortgage originators to provide binding price quotes before taking loan applications. The Federal Reserve Board dissented from the proposal, however, and it was never adopted.[21] To this day, the Board has still not revamped Truth in Lending disclosures for closed-end mortgages.

Perverse Fee Incentives -- Finally, many consumers were not aware that the compensation structure rewarded mortgage brokers for riskier loan products and higher interest rates. Mortgage brokers only got paid if they closed a loan. Furthermore, they were paid solely through upfront fees at closing, meaning that if a loan went bad, the losses would fall on the lender or investors, not the broker. In the most pernicious practice, lenders paid brokers thousands of dollars per loan in fees known as yield spread premiums (or YSPs) in exchange for loans saddling borrowers with steep prepayment penalties and higher interest rates than the borrowers qualified for, based on their incomes and credit scores.

In sum, these three features – the ability to hide risk, thwart meaningful comparison-shopping, and reward steering – allowed lenders to entice unsuspecting borrowers into needlessly hazardous loans.

C. The Crowd-Out Effect

The ability to bury risky product features in fine print allowed irresponsible lenders to out-compete safe lenders. Low initial monthly payments were the most visible feature of hybrid ARMs, interest-only loans, and option payment ARMs. During the housing boom, lenders commonly touted these products based on low initial monthly payments while obscuring the back-end risks of those loans.[22]

The ability to hide risks made it easy to out-compete lenders offered fixed-rate, fully amortizing loans. Other things being equal, the initial monthly payments on exotic ARMs were lower than on fixed-rate, amortizing loans. Furthermore, some nonprime lenders qualified borrowers solely at the low initial rate alone until the Federal Reserve Board finally banned that practice in July 2008.[23]

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[21] See BD. OF GOVERNORS OF THE FED. RESERVE SYS. & DEP'T OF HOUS. & URBAN DEV., JOINT REPORT TO THE CONGRESS, CONCERNING REFORM TO THE TRUTH IN LENDING ACT AND THE REAL ESTATE SETTLEMENT PROCEDURES ACT, at 28 - 29, 39 - 42 (1998), *available at* www.federalreserve.gov/boarddocs/rptcongress/tila.pdf.

[22] See, e.g., Julie Haviv & Emily Kaiser, *Web lenders woo subprime borrowers despite crisis*, REUTERS (Apr. 22, 2007); E. Scott Reckard, *Refinance pitches in sub-prime tone*, LOS ANGELES TIMES, October 29, 2007.

[23] In fall 2006, federal regulators issued an interagency guidance advising option ARM lenders to qualify borrowers solely at the fully indexed rate. Nevertheless, Washington Mutual (WaMu) apparently continued to qualify applicants for option ARMs at the low, introductory rate alone until mid-2007. It was not until July 30, 2007 that WaMu finally updated its "Bulk Seller Guide" to require its correspondents to underwrite option ARMs and other ARMs at the fully indexed rate.

Of course, many sophisticated customers recognized the dangers of these loans. That did not deter lenders from offering hazardous nontraditional ARMs, however. Instead, the "one-size-fits-one" nature of nonprime loans permitted lenders to discriminate by selling safer products to discerning customers and more lucrative, dangerous products to naïve customers. Sadly, the consumers who were least well equipped in terms of experience and education to grasp arcane loan terms[24] ended up with the most dangerous loans.

In the meantime, lenders who offered safe products – such as fixed-rate prime loans – lost market share to lenders who peddled exotic ARMs with low starting payments. As conventional lenders came to realize that it didn't pay to compete on good products, those lenders expanded into the nonprime market as well.

II. The Regulatory Story: Race to the Bottom

Federal banking regulators added fuel to the crisis by allowing reckless loans to flourish. It is a basic tenet of banking law that banks should not extend credit without proof of ability to repay. Federal banking regulators[25] had ample authority to enforce this tenet through safety and soundness supervision and through federal consumer protection laws. Nevertheless, they refused to exercise their substantial powers of rule-making, formal enforcement, and sanctions to crack down on the proliferation of poorly underwritten loans until it was too late. Their abdication allowed irresponsible loans to multiply. Furthermore, their green light to banks to invest in investment-grade subprime mortgage-backed securities and CDOs left the nation's largest banks struggling with toxic assets. These problems were a direct result of the country's fragmented system of financial regulation, which caused regulators to compete for turf.

A. The Fragmented U.S. System of Mortgage Regulation

In the United States, the home mortgage lending industry operates under a fragmented regulatory structure which varies according to entity.[26] Banks and thrift institutions are regulated under federal banking laws and a subset of those institutions – namely, national banks, federal savings associations, and their subsidiaries – are exempt from state anti-predatory lending and credit laws by virtue of federal preemption. In contrast, mortgage brokers and independent non-depository mortgage lenders escape federal banking regulation but have to comply with all state laws in effect. Only state-chartered banks and thrifts in some states (a dwindling group) are subject to both sets of laws.

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[24] Howard Lax, Michael Manti, Paul Raca & Peter Zorn, *Subprime Lending: An Investigation of Economic Efficiency*, 15 HOUSING POL'Y DEBATE 533, 552-554 (2004), http://www.fanniemaefoundation.org/programs/hpd/pdf/hpd_1503_Lax.pdf.

[25] The four federal banking regulators include the Federal Reserve System, which serves as the central bank and supervises state member banks; the Office of the Comptroller of the Currency, which oversees national banks; the Federal Deposit Insurance Corporation, which operates the Deposit Insurance Fund and regulates state nonmember banks; and the Office of Thrift Supervision, which supervises savings associations.

[26] This discussion is drawn from Patricia A. McCoy & Elizabeth Renuart, *The Legal Infrastructure of Subprime and Nontraditional Mortgage Lending*, *in* BORROWING TO LIVE: CONSUMER AND MORTGAGE CREDIT REVISITED 110 (Nicolas P. Retsinas & Eric S. Belsky eds., Joint Center for Housing Studies of Harvard University & Brookings Institution Press, 2008).

Under this dual system of regulation, depository institutions are subject to a variety of federal examinations, including fair lending, Community Reinvestment Act, and safety and soundness examinations, but independent nondepository lenders are not. Similarly, banks and thrifts must comply with other provisions of the Community Reinvestment Act, including reporting requirements and merger review. Federally insured depository institutions must also meet minimum risk-based capital requirements and reserve requirements, unlike their independent non-depository counterparts.

Some federal laws applied to all mortgage originators. Otherwise, lenders could change their charter and form to shop for the friendliest regulatory scheme.

B. Applicable Law

Despite these differences in regulatory regimes, the Federal Reserve Board did have the power to prohibit reckless mortgages across the entire mortgage industry. The Board had this power by virtue of its authority to administer a federal anti-predatory lending law known as "HOEPA."

1. Federal Law

Following deregulation of home mortgages in the early 1980s, disclosure became the most important type of federal mortgage regulation. The federal Truth in Lending Act (TILA),[27] passed in 1968, mandates uniform disclosures regarding cost for home loans. Its companion law, the federal Real Estate Settlement Procedures Act of 1974 (RESPA),[28] requires similar standardized disclosures for settlement costs. Congress charged the Federal Reserve with administering TILA and the Department of Housing and Urban Development with administering RESPA.

In 1994, Congress augmented TILA and RESPA by enacting the Home Ownership and Equity Protection Act (HOEPA).[29] HOEPA was an early federal anti-predatory lending law and prohibits specific abuses in the subprime mortgage market. HOEPA applies to all residential mortgage lenders and mortgage brokers, regardless of the type of entity.

HOEPA has two important provisions. The first consists of HOEPA's high-cost loan provision,[30] which regulates the high-cost refinance market. This provision seeks to eliminate abuses consisting of "equity stripping." It is hobbled, however, by its extremely limited reach – covering only the most exorbitant subprime mortgages – and its inapplicability to home purchase loans, reverse mortgages, and open-end home equity lines of credit.[31] Lenders learned to evade the high-cost loan provisions rather easily by slightly lowering the interest rates and fees on subprime loans below HOEPA's thresholds and by expanding into subprime purchase loans.

HOEPA also has a second major provision, which gives the Federal Reserve Board the authority to prohibit unfair or deceptive lending practices and refinance loans involving practices that are

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27 15 U.S.C. §§ 1601–1693r (2000).
28 12 U.S.C. §§ 2601–2617 (2000).
29 15 U.S.C. §§ 1601, 1602(aa), 1639(a)–(b).
30 15 U.S.C. § 1602(aa)(1)–(4); 12 C.F.R. § 226.32(a)(1), (b)(1).
31 15 U.S.C. § 1602(i), (w), (bb); 12 C.F.R. § 226.32(a)(2) (1997); EDWARD M. GRAMLICH, SUBPRIME MORTGAGES: AMERICA'S LATEST BOOM AND BUST 28 (Urban Institute Press, 2007).

abusive or against the interest of the borrower.[32] This provision is potentially broader than the high-cost loan provision, because it allows regulation of both the purchase and refinance markets, without regard to interest rates or fees. However, it was not self-activating. Instead, it depended on action by the Federal Reserve Board to implement the provision, which the Board did not take until July 2008.

2. State Law

Before 2008, only the high-cost loan provision of HOEPA was in effect as a practical matter. This provision had a serious Achilles heel, consisting of its narrow coverage. Even though the Federal Reserve Board lowered the high-cost triggers of HOEPA effective in 2002, that provision still only applied to 1% of all subprime home loans.[33]

After 1994, it increasingly became evident that HOEPA was incapable of halting equity stripping and other sorts of subprime abuses. By the late 1990s, some cities and states were contending with rising foreclosures and some jurisdictions were contemplating regulating subprime loans on their own. Many states already had older statutes on the books regulating prepayment penalties and occasionally balloon clauses. These laws were relatively narrow, however, and did not address other types of new abuses that were surfacing in subprime loans.

Consequently, in 1999, North Carolina became the first state to enact a comprehensive anti-predatory lending law.[34] Soon, other states followed suit and passed anti-predatory lending laws of their own. These newer state laws implemented HOEPA's design but frequently expanded coverage or imposed stricter regulation on subprime loans. By year-end 2005, twenty-nine states and the District of Columbia had enacted one of these "mini-HOEPA" laws. Some states also passed stricter disclosure laws or laws regulating mortgage brokers. By the end of 2005, only six states – Arizona, Delaware, Montana, North Dakota, Oregon, and South Dakota – lacked laws regulating prepayment penalties, balloon clauses, or mandatory arbitration clauses, all of which were associated with exploitative subprime loans.[35]

Critics, including some federal banking regulators, have blamed the states for igniting the credit crisis through lax regulation. Certainly, there were states that were largely unregulated and there were states where mortgage regulation was weak. Mortgage brokers were loosely regulated in too many states. Similarly, the states never agreed on an effective, uniform system of mortgage regulation.

Nevertheless, this criticism of the states disregards the hard-fought efforts by a growing number of states – which eventually grew to include the majority of states – to regulate abusive subprime loans within their borders. State attorneys general and state banking commissioners spearheaded some of the most important enforcement actions against deceptive mortgage lenders.[36]

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[32] 15 U.S.C. § 1639(*l*)(2).

[33] Gramlich, *supra* note 31 (2007, p. 28).

[34] N.C. GEN STAT. § 24-1.1E (2000).

[35] *See* Raphael Bostic, Kathleen C. Engel, Patricia A. McCoy, Anthony Pennington-Cross & Susan Wachter, *State and Local Anti-Predatory Lending Laws: The Effect of Legal Enforcement Mechanisms*, 60 J. ECON. & BUS. 47-66 (2008), full working paper version available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1005423.

[36] For instance, in 2002, state authorities in 44 states struck a settlement with Household Finance Corp. for $484 million in consumer restitution and changes in its lending practices following enforcement actions to redress

C. The Ability to Shop For Hospitable Laws and Regulators

State-chartered banks and thrifts and their subsidiaries had to comply with the state anti-predatory lending laws. So did independent nonbank lenders and mortgage brokers.
For the better part of the housing boom, however, national banks, federal savings associations, and their mortgage lending subsidiaries did not have to comply with the state anti-predatory lending laws due to federal preemption rulings by their federal regulators. This became a problem because federal regulators did not replace the preempted state laws with strong federal underwriting rules.

1. Federal Preemption

The states that enacted anti-predatory lending laws did not legislate in a vacuum. In 1996, the federal regulator for thrift institutions – the Office of Thrift Supervision or OTS – promulgated a sweeping preemption rule declaring that henceforth federal savings associations did not have to observe state lending laws.[37] Initially, this rule had little practical effect because any state anti-predatory lending provisions on the books then were fairly narrow.[38]

Following adoption of the OTS preemption rule, federal thrift institutions and their subsidiaries were relieved from having to comply with state consumer protection laws. That was not true, however, for national banks, state banks, state thrifts, and independent nonbank mortgage lenders and brokers.

The stakes rose considerably starting in 1999, when North Carolina passed the first comprehensive state anti-predatory lending law. As state mini-HOEPA laws proliferated, national banks lobbied their regulator – a federal agency known as the Office of the Comptroller of the Currency or OCC – to clothe them with the same federal preemption as federal savings associations. They succeeded and, in 2004, the OCC issued its own preemption rule banning the states from enforcing their laws impinging on real estate lending by national banks and their subsidiaries.[39] In a companion rule, the OCC denied permission to the states to enforce their

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alleged abusive subprime loans. Iowa Attorney General, *States Settle With Household Finance: Up to $484 Million for Consumers* (Oct. 11, 2002), available at www.iowa.gov/government/ag/latest_news/releases/oct_2002/Household_Chicago.html. In 2006, forty-nine states and the District of Columbia reached a $325 million settlement with Ameriquest Mortgage Company over alleged predatory lending practices. *See, e.g.*, Press Release, Iowa Dep't of Justice, Miller: Ameriquest Will Pay $325 Million and Reform its Lending Practices (Jan. 23, 2006), *available at* http://www.state.ia.us/government/ag/latest_news/releases/jan_2006/Ameriquest_Iowa.html.

[37] 12 C.F.R. §§ 559.3(h), 560.2.

[38] Bostic et al., *supra* note 35; Office of Thrift Supervision, *Responsible Alternative Mortgage Lending: Advance notice of proposed rulemaking*, 65 Fed. Reg. 17811, 17814-16 (2000).

[39] Office of the Comptroller of the Currency, *Bank Activities and Operations; Final rule*, 69 FED. REG. 1895 (2004) (codified at 12 C.F.R. § 7.4000); Office of the Comptroller of the Currency, *Bank Activities and Operations; Real Estate Lending and Appraisals; Final rule*, 69 FED. REG. 1904 (2004) (codified at 12 C.F.R. §§ 7.4007-7.4009, 34.4). National City Corporation, the parent of National City Bank, N.A., and a major subprime lender, spearheaded the campaign for OCC preemption. *Predatory lending laws neutered*, ATLANTA JOURNAL-CONSTITUTION, Aug. 6, 2003.

own laws that were *not* federally preempted – state lending discrimination laws are one example – against national banks and their subsidiaries. After a protracted court battle, the controversy ended up in the U.S. Supreme Court, which upheld the OCC preemption rule.[40]

OTS and the OCC had institutional motives to grant federal preemption to the institutions that they regulated. Both agencies depend almost exclusively on fees from their regulated entities for their operating budgets. Both were also eager to persuade state-chartered depository institutions to convert to a federal charter. In addition, the OCC was aware that if national banks wanted federal preemption badly enough, they might defect to the thrift charter to get it. Thus, the OCC had reason to placate national banks to keep them in its fold. Similarly, the OTS was concerned about the steady decline in thrift institutions. Federal preemption provided an inducement to thrift institutions to retain the federal savings association charter.

2. The Ability to Shop for the Most Permissive Laws

As a result of federal preemption, state anti-predatory lending laws applied to state-chartered depository institutions and independent nonbank lenders, but not to national banks, federal savings associations, or their mortgage lending subsidiaries. The only anti-predatory lending provisions that national banks and federally chartered thrifts had to obey were HOEPA and agency pronouncements on subprime and nontraditional mortgage loans.[41] Of these, HOEPA had extremely narrow scope. Meanwhile, agency guidances lacked the binding effect of rules and their content was not as strict as the stronger state laws.

This dual regulatory system allowed mortgage lender to play regulators off one another by threatening to change charters. Mortgage lenders are free to operate with or without depository institution charters. Similarly, depository institutions can choose between a state and federal charter and between a thrift charter and a commercial bank charter. Each of these choices allows a lender to change regulators.

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[40] Watters v. Wachovia Bank, N.A., 550 U.S. 1 (2007); Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System*, 23 ANN. REV. BANKING & FINANCE LAW 225 (2004). The Supreme Court recently granted certiorari to review the legality of the OCC visitorial powers rule. Cuomo v. Clearing House Ass'n, L.L.C., ___ U.S. ___, 129 S. Ct. 987 (2009).

The OCC and the OTS left some areas of state law untouched, namely, state criminal law and state law regulating contracts, torts, homestead rights, debt collection, property, taxation, and zoning. Both agencies, though, reserved the right to declare that any state laws in those areas are preempted in the future. For fuller discussion, see. McCoy & Renuart, *supra* note 26.

[41] Board of Governors of the Federal Reserve System et al., Interagency Guidance on Subprime Lending (March 1, 1999); OCC, Abusive Lending Practices, Advisory Letter 2000-7 (July 25, 2000); OCC et al., Expanded Guidance for Subprime Lending Programs (Jan. 31, 2001); OCC, Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans, Advisory Letter 2003-3 (Feb. 21, 2003); OCC, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, Advisory Letter 2003-2 (Feb. 21, 2003); OCC, OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices, 70 Fed. Reg. 6329 (2005); Department of the Treasury et al., Interagency Guidance on Nontraditional Mortgage Product Risks; Final guidance, 71 Fed. Reg. 58609 (2006); Department of the Treasury et al. Statement on Subprime Mortgage Lending; Final guidance, 72 Fed. Reg. 37569 (2007). Of course, these lenders, like all lenders, are subject to prosecution in cases of fraud. Lenders are also subject to the Federal Trade Commission Act, which prohibits unfair and deceptive acts and practices (UDAPs). However, federal banking regulators were slow to propose rules to define and punish UDAP violations by banking companies in the mortgage lending area.

A lender could escape a strict state law by switching to a federal bank or thrift charter or by shifting its operations to a less regulated state. Similarly, a lender could escape a strict regulator by converting its charter to one with a more accommodating regulator.

Countrywide, the nation's largest mortgage lender and a major subprime presence, took advantage of this system to change its regulator. One of its subsidiaries, Countrywide Home Loans, was supervised by the Federal Reserve. This subsidiary switched and became an OTS-regulated entity as of March 2007. That same month, Countrywide Bank, N.A., converted its charter from a national bank charter under OCC supervision to a federal thrift charter under OTS supervision. Reportedly, OTS promised Countrywide's executives to be a "less antagonistic" regulator if Countrywide switched charters to OTS. Six months later, the regional deputy director of the OTS West Region, where Countrywide was headquartered, was promoted to division director. Some observers considered it a reward.[42]

The result was a system in which lenders could shop for the loosest laws and enforcement. This shopping process, in turn, put pressure on regulators at all levels – state and local – to lower their standards or relax enforcement. What ensued was a regulatory race to the bottom.

III. Regulatory Failure

Federal preemption would not have been such a problem if federal banking regulators had replaced state laws with tough rules and enforcement of their own. Those regulators had ample power to stop the deterioration in mortgage underwriting standards that mushroomed into a full-blown crisis. However, they refused to intervene in disastrous lending practices until it was too late. As a result, federally regulated lenders – as well as all lenders operating in states with weak regulation – were given *carte blanche* to loosen their lending standards free from meaningful regulatory intervention.

A. The Federal Reserve Board

The Federal Reserve Board had the statutory power, starting in 1994, to curb lax lending not only for depository institutions, but for all lenders across-the-board. It declined to exercise that power in any meaningful respect, however, until after the nonprime mortgage market collapsed.

In the mortgage lending area, the Fed's supervisory process has three major parts and breakdowns were apparent in two out of the three. The only part that appeared to work well was the Fed's role as the primary federal regulator for state-chartered banks that are members of the Federal Reserve System.[43]

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42 Richard B. Schmitt, *Regulator takes heat over IndyMac*, LOS ANGELES TIMES, Oct. 6, 2008; see also Binyamin Appelbaum & Ellen Nakashima, *Regulator Played Advocate Over Enforcer*, WASHINGTON POST, November 23, 2008.

43 In general, these are community banks on the small side. In 2007 and 2008, only one failed bank – the tiny First Georgia Community Bank in Jackson, Georgia, with only $237.5 million in assets – was regulated by the Federal Reserve System. It is not clear whether the Fed's performance is explained by the strength of its examination process, the limited role of member banks in risky lending, the fact that state banks had to comply with state anti-predatory lending laws, or all three.

In the following discussion on regulatory failure by the Federal Reserve Board, the OTS, and the OCC, the data regarding failed and near-failed banks and thrifts come from federal bank regulatory and S.E.C. statistics,

As the second part of its supervisory duties, the Fed regulates nonbank mortgage lenders owned by bank holding companies but not owned directly or indirectly by banks or thrifts. During the housing boom, some of the largest subprime and Alt-A lenders were regulated by the Fed, including the top- and third-ranked subprime lenders in 2006, HSBC Finance and Countrywide Financial Corporation, and Wells Fargo Financial, Inc.[44] The Fed's supervisory record with regard to these lenders was mixed. On one notable occasion, in 2004, the Fed levied a $70 million civil money penalty against CitiFinancial Credit Company and its parent holding company, Citigroup Inc., for subprime lending abuses.[45] Apart from that, the Fed did not take public enforcement action against the nonbank lenders that it regulated. That may be because the Federal Reserve did not routinely examine the nonbank mortgage lending subsidiaries under its supervision, which the late Federal Reserve Board Governor Edward Gramlich revealed in 2007. Only then did the Fed kick off a "pilot project" to examine the nonbank lenders under its jurisdiction on a routine basis for loose underwriting and compliance with federal consumer protection laws.[46]

Finally, the Board is responsible for administering most federal consumer credit protection laws, including HOEPA. When former Governor Edward Gramlich served on the Fed, he urged then-Chairman Alan Greenspan to exercise the Fed's power to address unfair and deceptive loans under HOEPA. Greenspan refused, preferring instead to rely on non-binding statements and guidances.[47] This reliance on statements and guidances had two disadvantages: one, major lenders routinely dismissed the guidances as mere "suggestions" and, two, guidances did not apply to independent nonbank mortgage lenders.

The Federal Reserve did not relent until July 2008, when under Chairman Ben Bernanke's leadership, it finally promulgated binding HOEPA regulations banning specific types of lax and

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disclosures, press releases, and orders; rating agency reports; press releases and other web materials by the companies mentioned; statistics compiled by the *American Banker*; and financial press reports.

[44] Data provided by *American Banker*, available at www.americanbanker.com.

[45] Federal Reserve, Citigroup Inc. New York, New York and Citifinancial Credit Company Baltimore, Maryland: Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent, May 27, 2004.

[46] Edward M. Gramlich, Boom and Busts, The Case of Subprime Mortgages, Speech given August 31, 2007, Jackson Hole, Wyo., at symposium titled "Housing, Housing Finance & Monetary Policy," sponsored by the Federal Reserve Bank of Kansas City, pp. 8-9, available at www.kansascityfed.org/publicat/sympos/2007/pdf/2007.09.04.gramlich.pdf; Speech by Governor Randall S. Kroszner At the National Bankers Association 80th Annual convention, Durham, North Carolina, October 11, 2007.

[47] House of Representatives, Committee on Oversight and Government Reform, "The Financial Crisis and the Role of Federal Regulators, Preliminary Transcript" 35, 37-38 (Oct. 23, 2008), available at http://oversight.house.gov/documents/20081024163819.pdf. Greenspan told the House Oversight Committee in 2008:

> Well, let's take the issue of unfair and deceptive practices, which is a fundamental concept to the whole predatory lending issue.
>
> The staff of the Federal Reserve . . . say[] how do they determine as a regulatory group what is unfair and deceptive? And the problem that they were concluding . . . was the issue of maybe 10 percent or so are self-evidently unfair and deceptive, but the vast majority would require a jury trial or other means to deal with it . . .

Id. at 89.

abusive loans. Even then, the regulations were mostly limited to higher-priced mortgages, which the Board confined to first-lien loans of 1.5 percentage points or more above the average prime offer rate for a comparable transaction, and 3.5 percentage points for second-lien loans. Although shoddy nontraditional mortgages below those triggers had also contributed to the credit crisis, the rule left those loans – plus prime loans – mostly untouched.[48]

The rules, while badly needed, were too little and too late. On October 23, 2008, in testimony before the U.S. House of Representatives Oversight Committee, Greenspan admitted that "those of us who have looked to the self-interest of lending institutions to protect shareholder's equity (myself especially) are in a state of shocked disbelief." House Oversight Committee Chairman Henry Waxman asked Greenspan whether "your ideology pushed you to make decisions that you wish you had not made?" Greenspan replied:[49]

> Mr. GREENSPAN. . . . [Y]es, I found a flaw, I don't know how significant or permanent it is, but I have been very distressed by that fact. . . .
>
> Chairman WAXMAN. You found a flaw?
>
> Mr. GREENSPAN. I found a flaw in the model that defines how the world works, so to speak.
>
> Chairman WAXMAN. In other words, you found that your view of the world, your ideology, was not right, it was not working.
>
> Mr. GREENSPAN. Precisely. That's precisely the reason I was shocked, because I had been going for 40 years or more with very considerable evidence that it was working exceptionally well. [50]

B. Regulatory Lapses by the OCC and OTS

Federal preemption might not have devolved into a banking crisis of systemic proportions had OTS and the OCC replaced state regulation for their regulated entities with a comprehensive set of binding rules prohibiting lax underwriting of home mortgages. Generally, in lieu of binding rules, federal banking regulators, including the OCC and OTS, issued a series of "soft law" advisory letters and guidelines against predatory or unfair mortgage lending practices by insured depository institutions.[51] Federal regulators disavowed binding rules during the run-up to the subprime crisis on grounds that the guidelines were more flexible and that the agencies enforced

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48 Federal Reserve System, *Truth in Lending: Final rule; official staff commentary*, 73 FED. REG. 44522, 44536 (July 30, 2008). The Board set those triggers with the intention of covering the subprime market, but not the prime market. *See id*. at 44536-37.

49 House of Representatives, Committee on Oversight and Government Reform, "The Financial Crisis and the Role of Federal Regulators, Preliminary Transcript" 36-37 (Oct. 23, 2008), available at http://oversight.house.gov/documents/20081024163819.pdf.

50 Testimony of Dr. Alan Greenspan before the House of Representatives Committee of Government Oversight and Reform, October 23, 2008, available at http://oversight.house.gov/documents/20081023100438.pdf.

51 See note 41 *supra.*

those guidelines through bank examinations and informal enforcement actions.[52] Informal enforcement actions were usually limited to negotiated, voluntary agreements between regulators and the entities that they supervised, which made it easy for management to drag out negotiations to soften any restrictions and to bid for more time. Furthermore, examinations and informal enforcement are highly confidential, making it easy for a lax regulator to hide its tracks.

1. The Office of Thrift Supervision

Although OTS was the first agency to adopt federal preemption, it managed to fly under the radar during the subprime boom, overshadowed by its larger sister agency, the OCC. After 2003, while commentators were busy berating the OCC preemption rule, OTS allowed the largest federal savings associations to embark on an aggressive campaign of expansion through option payment ARMs, subprime loans, and low-documentation and no-documentation loans.

Autopsies of failed depository institutions in 2007 and 2008 show that five of the seven biggest failures were OTS-regulated thrifts. Two other enormous thrifts during that period – Wachovia Mortgage, FSB and Countrywide Bank, FSB -- were forced to arrange hasty takeovers by large bank holding companies to avoid failing. By December 31, 2008, thrifts totaling $355 billion in assets had failed in the previous sixteen months on OTS' watch.

The reasons for the collapse of these thrifts evidence fundamental regulatory lapses by OTS. Almost all of the thrifts that failed in 2007 and 2008 – and all of the larger ones -- succumbed to massive levels of imprudent home loans. IndyMac Bank, FSB, which became the first major thrift institution to fail during the current crisis in July 2008, manufactured its demise by becoming the nation's top originator of low-documentation and no-documentation loans. These loans, which became known as "liar's loans," infected both the subprime market and credit to borrowers with higher credit scores. By 2006 and 2007, over half of IndyMac's home purchase loans were subprime loans and IndyMac Bank approved up to half of those loans based on low or no documentation.

Washington Mutual Bank, popularly known as "WaMu," was the nation's largest thrift institution in 2008, with over $300 billion in assets. WaMu became the biggest U.S. depository institution in history to fail on September 25, 2008, in the wake of the Lehman Brothers bankruptcy. WaMu was so large that OTS examiners were stationed there permanently onsite. Nevertheless, from 2004 through 2006, despite the daily presence of the resident OTS inspectors, risky option ARMs, second mortgages, and subprime loans constituted over half of WaMu's real estate loans each year. By June 30, 2008, over one fourth of the subprime loans that WaMu originated in 2006 and 2007 were at least thirty days past due. Eventually, it came to light that WaMu's management had pressured its loan underwriters relentlessly to approve more and more exceptions to WaMu's underwriting standards in order to increase its fee revenue from loans.[53]

Downey Savings & Loan became the third largest depository institution to fail in 2008. Like WaMu, Downey had loaded up on option ARMs and subprime loans. When OTS finally had to

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[52] Office of the Comptroller of the Currency, *Bank Activities and Operations; Real Estate Lending and Appraisals; Final rule*, 69 FED. REG. 1904 (2004).

[53] Peter S. Goodman & Gretchen Morgenson, *Saying Yes, WaMu Built Empire on Shaky Loans*, N.Y. TIMES, Dec. 28, 2008.

put it into receivership, over half of Downey's total assets consisted of option ARMs and nonperforming loans accounted for over 15% of the thrift's total assets.

In short, the three largest depository institution failures in 2007 and 2008 resulted from high concentrations of poorly underwritten loans, including low- and no-documentation ARMs (in the case of IndyMac) and option ARMs (in the case of WaMu and Downey) that were often only underwritten to the introductory rate instead of the fully indexed rate. During the housing bubble, OTS issued no binding rules to halt the proliferation by its largest regulated thrifts of option ARMs, subprime loans, and low- and no-documentation mortgages. Instead, OTS relied on oversight through guidances. IndyMac, WaMu, and Downey apparently treated the guidances as solely advisory, however, as evidenced by the fact that all three made substantial numbers of hazardous loans in late 2006 and in 2007 in direct disregard of an interagency guidance on nontraditional mortgages issued in the fall of 2006 and subscribed to by OTS that prescribed underwriting ARMs to the fully indexed rate.[54]

The fact that all three institutions continued to make loans in violation of the guidance suggests that OTS examinations failed to result in enforcement of the guidance. Similarly, OTS fact sheets on the failures of all three institutions show that the agency consistently declined to institute timely formal enforcement proceedings against those thrifts prohibiting the lending practices that resulted in their demise. In sum, OTS supervision of residential mortgage risks was confined to "light touch" regulation in the form of examinations, nonbinding guidances, and occasional informal agreements that ultimately did not work.

2. The Office of the Comptroller of the Currency

The OCC has asserted that national banks made only 10% of subprime loans in 2006. But this assertion fails to mention that national banks moved aggressively into Alt-A low-documentation and no-documentation loans during the housing boom.[55] This mattered a lot, because the biggest national banks are considered "too big to fail" and pose systemic risk on a scale unmatched by independent nonbank lenders. We might not be debating the nationalization of Citibank and Bank of America today had the OCC stopped them from expanding into toxic mortgages, bonds, and SIVs.

Like OTS, "light touch" regulation was apparent at the OCC. Unlike OTS, the OCC did promulgate one rule, in 2004, prohibiting mortgages to borrower who could not afford to repay. However, the rule was vague in design and execution, allowing lax lending to proliferate at national banks and their mortgage lending subsidiaries through 2007.

Despite the 2004 rule, through 2007, large national banks continued to make large quantities of poorly underwritten subprime loans and low- and no-documentation loans. In 2006, for example, fully 62.6% of the first-lien home purchase mortgages made by National City Bank, N.A., and its subsidiary, First Franklin Mortgage, were higher-priced subprime loans. Starting in the third quarter of 2007, National City Corporation reported five straight quarters of net losses,

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[54] Department of the Treasury et al., *Interagency Guidance on Nontraditional Mortgage Product Risks; Final guidance*, 71 FED. REG. 58609 (2006).

[55] Testimony by John C. Dugan, Comptroller, before the Senate Committee on Banking, Housing, and Urban Affairs, March 4, 2008.

largely due to those subprime loans. Just as with WaMu, the Lehman Brothers bankruptcy ignited a silent run by depositors and pushed National City Bank to the brink of collapse. Only a shotgun marriage with PNC Financial Services Group in October 2008 saved the bank from FDIC receivership.

The five largest U.S. banks in 2005 were all national banks and too big to fail. They too made heavy inroads into low- and no-documentation loans. The top-ranked Bank of America, N.A., had a thriving stated-income and no-documentation loan program which it only halted in August 2007, when the market for private-label mortgage-backed securities dried up. Bank of America securitized most of those loans, which may be why the OCC tolerated such lax underwriting practices.

Similarly, in 2006, the OCC overrode public protests about a "substantial volume" of no-documentation loans by JPMorgan Chase Bank, N.A., the second largest bank in 2005, on grounds that the bank had adequate "checks and balances" in place to manage those loans.

Citibank, N.A., was the third largest U.S. bank in 2005. In September 2007, the OCC approved Citibank's purchase of the disreputable subprime lender Argent Mortgage, even though subprime securitizations had slowed to a trickle. Citibank thereupon announced to the press that its new subsidiary – christened "Citi Residential Lending" – would specialize in nonprime loans, including reduced documentation loans. But not long after, by early May 2008 after Bear Stearns narrowly escaped failure, Citibank was forced to admit defeat and dismantle Citi Residential's lending operations.

The fourth largest U.S. bank in 2005, Wachovia Bank, N.A., originated low- and no-documentation loans through its two mortgage subsidiaries. Wachovia Bank originated such large quantities of these loans – termed Alt-A loans – that by the first half of 2007, Wachovia Bank was the twelfth largest Alt-A lender in the country. These loans performed so poorly that between December 31, 2006 and September 30, 2008, the bank's ratio of net write-offs on its closed-end home loans to its total outstanding loans jumped 2400%. Concomitantly, the bank's parent company, Wachovia Corporation, was reported its first quarterly loss in years due to rising defaults on option ARMs made by Wachovia Mortgage, FSB, and its Golden West predecessor. Public concern over Wachovia's loan losses triggered a silent run on Wachovia Bank in late September 2008, following Lehman Brothers' failure. To avoid receivership, the FDIC brokered a hasty sale of Wachovia to Wells Fargo after Wells Fargo outbid Citigroup for the privilege.

Wells Fargo Bank, N.A., was in better financial shape than Wachovia, but it too made large quantities of subprime and reduced documentation loans. In 2006, over 23% of the bank's first-lien refinance mortgages were high-cost subprime loans. Wells Fargo Bank also securitized substantial numbers of low- and no-documentation mortgages in its Alt-A pools. In 2007, a Wells Fargo prospectus for one of those pools stated that Wells Fargo had relaxed its underwriting standards in mid-2005 and did not verify whether the mortgage brokers who had originated the weakest loans in that loan pool complied with its underwriting standards before closing. Not long after, as of July 25, 2008, 22.77% of the loans in that loan pool were past due or in default.

As the Wells Fargo story suggests, the OCC depended on voluntary risk management by national banks, not regulation of loan terms and practices, to contain the risk of improvident loans. A speech by the then-Acting Comptroller, Julie Williams, confirmed as much. In 2005, Comptroller Williams, in a speech to risk managers at banks, coached them on how to "manage" the risks of no-doc loans through debt collection, higher reserves, and prompt loss recognition. Securitization was another risk management device favored by the OCC.

Three years later, in 2008, the Treasury Department's Inspector General issued a report that was critical of the OCC's supervision of risky loans.[56] Among other things, the Inspector General criticized the OCC for not instituting formal enforcement actions while lending problems were still manageable in size. In his written response to the Inspector General, the Comptroller, John Dugan, conceded that "there were shortcomings in our execution of our supervisory process" and ordered OCC examiners to start initiating formal enforcement actions on a timely basis.[57]

The OCC's record of supervision and enforcement during the subprime boom reveals many of the same problems that culminated in regulatory failure by OTS. Like OTS, the OCC usually shunned formal enforcement actions in favor of examinations and informal enforcement. Neither of these supervisory tools obtained compliance with the OCC's 2004 rule prohibiting loans to borrowers who could not repay. Although the OCC supplemented that rule later on with more detailed guidances, some of the largest national banks and their subsidiaries apparently decided that they could ignore the guidances, judging from their lax lending in late 2006 and in 2007. The OCC's emphasis on managing credit risk through securitization, reserves, and loss recognition, instead of through product regulation, likely encouraged that *laissez faire* attitude by national banks.

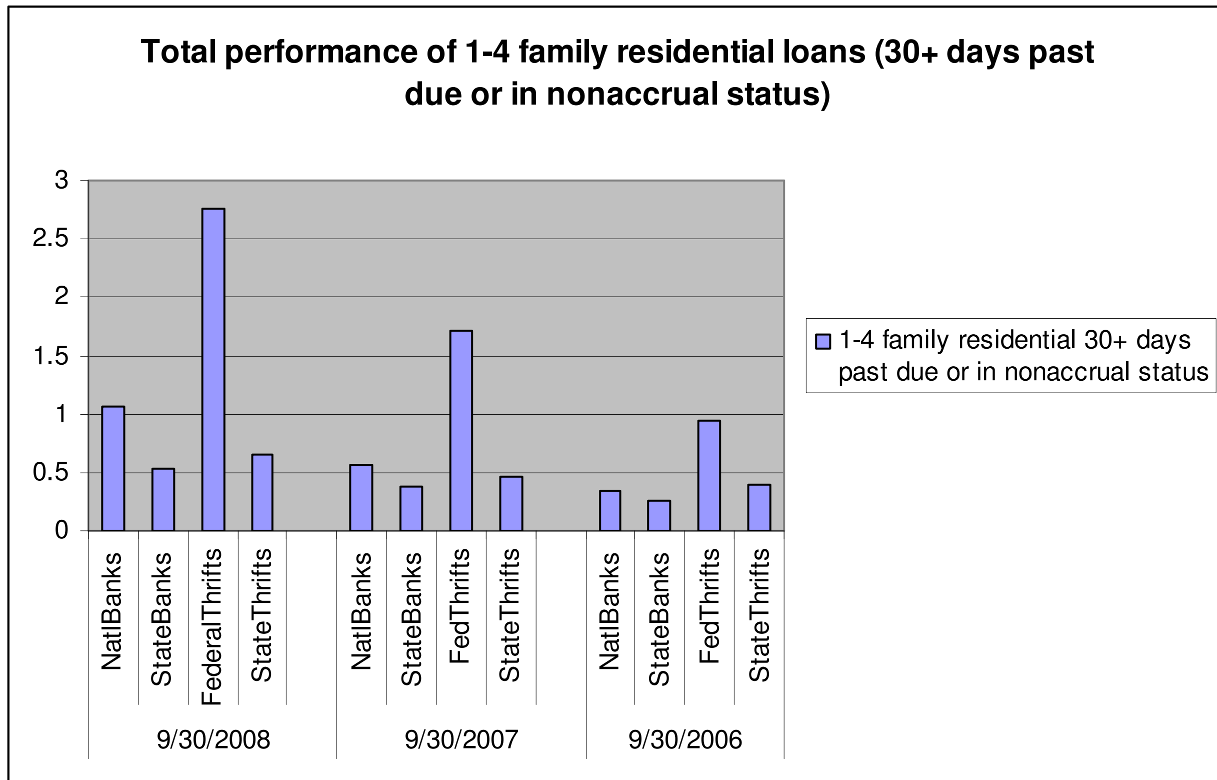
C. Judging by the Results: Loan Performance By Charter

OCC and OTS regulators have argued that their agencies offer "comprehensive" supervision resulting in lower default rates on residential mortgages. The evidence shows otherwise.

Data from the Federal Deposit Insurance Corporation show that among depository institutions, federal thrift institutions had the worst default rate for one-to-four family residential mortgages from 2006 through 2008. (See Figure 5).

[56] Office of Inspector General, Department of the Treasury, "Safety and Soundness: Material Loss Review of ANB Financial, National Association" (OIG-09-013, Nov. 25, 2008).
[57] *Id.*

Figure 5. Total Performance of Residential Mortgages by Depository Institution Lenders



Source: FDIC Statistics on Depository Institutions

The second-worst performance record among depository institution lenders went to national banks. State thrifts had better default rates than either type of federally chartered institution in 2007 and 2008. State banks consistently had the lowest default rates of all.

Among these charter types, the only ones that enjoy federal preemption are national banks regulated by the OCC and federal thrift institutions regulated by the OTS. State banks and state thrift institutions do not. Thus it appears, at least among depository institutions, that federal preemption was associated with *higher* default rates, not lower rates, during 2006 through 2008, when credit standards hit bottom and the mortgage market imploded.

These data do not address whether that independent nonbank lenders have even higher default rates in some states and that may in fact be the case. Nevertheless, the data undercut the assertion that federal preemption reduces default rates among mortgages by depository institution lenders. To the contrary, the lowest default rates were at state banks and thrifts, which are subject both to state and federal regulation.

IV. What to Do

Dual regulation and the resulting crazy quilt of laws encouraged lenders to shop for the lightest rules. In turn, this pressured regulators to weaken their standards and to relax enforcement of safety and soundness and consumer protection laws.

Casting underwriting standards to the wind in a seemingly obscure corner of the consumer credit market ended up triggering a global recession. This crisis shows that the United States ignores consumer protection at its peril. If it was not clear before, we now know that systemic stability and consumer protection are inextricably linked.

To correct the regulatory lapses that I have described, our financial regulatory system needs to adopt three reforms:

- *First*, Congress should adopt uniform minimum safety standards for all providers of consumer credit, regardless of the type of entity or charter.

- *Second,* the authority for administering and enforcing these standards should be housed in one federal agency whose sole mission is consumer protection.

- *Third,* to avoid the risk of agency inaction, Congress should give parallel enforcement authority to the states and allow consumers to bring private causes of action to recover for injuries they sustain.

I expand on these proposals below.

A. Uniform Federal Safety Standards For Consumer Credit

The downward spiral in underwriting standards drove home the need for minimum, uniform consumer credit safety standards. Adopting a uniform federal floor would prevent lenders and brokers from seeking safe havens in legal regimes that do little or nothing to protect consumers.

The purpose of these uniform federal standards is three-fold. First, the standards should ensure proper loan underwriting based on the consumer's ability to repay. Second, the standards should prohibit unfair or deceptive practices in consumer credit products and transactions. Finally, the standards should promote transparency through improved consumer disclosures, product simplification and product standardization. Bottom-line, federal standards should make it possible for consumers to engage in meaningful comparison shopping, with no hidden surprises.

The experience with the high-cost loan provisions of HOEPA reveals that a detailed regulatory statute limited to specific loan terms is not an effective approach. HOEPA has proven too rigid and has failed to address new abuses as they appeared in the mortgage market. Instead, Congress should authorize a broad statutory mandate to give the implementing agency the flexibility to respond promptly to industry innovations (both good and bad) in the consumer credit industry. This broad statutory model would be akin to the open-ended provisions found in Section 5 of the Federal Trade Commission Act and Section 10(b) of the Securities Exchange Act of 1934, instead of the highly detailed prohibitions found in HOEPA. Congress should then delegate

broad authority to the implementing agency to promulgate rules – preferably objective ones – to implement the statute.

The uniform standards should constitute a floor, in which weaker state laws are federally preempted. Under the statute, however, states should remain free to enact stricter consumer protections so long as those protections are consistent with the federal statute.

A minimum federal floor, instead of a ceiling, is critical for three reasons. First, states are closer to local conditions and often more responsive to emerging problems at home. A federal floor would preserve the states' ability to protect their citizens. Second, giving latitude to states to adopt stricter standards would preserve the states' important role as laboratories of experimentation. Finally, a federal floor, not a ceiling, would provide an important safeguard against the possibility that the implementing agency might adopt weak rules or fail to update the rules.

As part of or in addition to creating the uniform federal standards just outlined, Congress should transfer the authority to administer other existing federal consumer credit laws to the implementing agency. At a minimum, oversight for the Truth in Lending Act, HOEPA, the Real Estate Settlement and Procedures Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the fair lending laws, the Fair Credit Billing Act, and the Home Mortgage Disclosure Act should be transferred to this agency.[58] Responsibility for administering Section 5 of the Federal Trade Commission Act as it applies to all providers of consumer credit should also be consolidated in this agency.

B. A Dedicated Federal Agency Whose Sole Mission is Consumer Protection

1. Federal Regulators Cannot Serve Two Masters

The housing bubble and hazardous mortgages by federally regulated depository institutions show that we cannot expect consumer protection to be paramount to federal banking regulators. Recent history has shown that the safety and soundness mandate of federal banking regulators regularly eclipses concern for consumer protection. For this reason, the consumer protection function should be removed from federal banking regulators and housed in its own agency whose sole mission is consumer protection.

The bank regulatory agencies' own mission statements make it clear that consumer protection is a low priority. For example, the Federal Reserve Board divides its duties into four general areas:[59]

[58] This agency should also receive sole responsibility for administering the Consumer Leasing Act, the Right to Financial Privacy Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Women's Business Ownership Act, the Fair Credit and Charge Card Disclosure Act, the Home Equity Loan Consumer Protection Act, the Truth in Savings Act, title V of the Gramm-Leach-Bliley Act, and the Fair and Accurate Credit Transaction Act.

[59] THE FEDERAL RESERVE SYSTEM, PURPOSES & FUNCTIONS 1 (9th ed. 2005).

- “conducting the nation’s monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates
- “supervising and regulating banking institutions to ensure the safety and soundness of the nation’s banking and financial system and to protect the credit rights of consumers
- “maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
- “providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation’s payments system.”

In the Fed’s description, monetary policy comes first, followed by banking supervision. Consumer protection does not even merit its own bullet point.

Similarly, safety and soundness regulation is the paramount mission of the OCC and OTS. The OCC describes its mission as having four objectives, the last of which is consumer protection:[60]

- “To ensure the safety and soundness of the national banking system.
- “To foster competition by allowing banks to offer new products and services.
- “To improve the efficiency and effectiveness of OCC supervision, including reducing regulatory burden.
- “To ensure fair and equal access to financial services for all Americans.”

Like the OCC, OTS describes safety and soundness as its principal job:[61]

> “To supervise savings associations and their holding companies in order to maintain their safety and soundness and compliance with consumer laws, and to encourage a competitive industry that meets America's financial services needs.”

In theory, safety and soundness should serve consumer protection. In practice, it has not, as recent experience shows. During the housing boom, federal banking regulators too often mistook short-term profitability, including profits from excessive fees on consumers,[62] with safety and soundness. In their effort to protect the short-term profitability of banks and thrifts, federal regulators often dismissed consumer protection as conflicting with that mission. When agencies derive most of their operating budgets from assessments on the entities they regulate – as do the OCC and OTS – the pressure to sacrifice consumer protection for profit maximization by those entities can be overwhelming.[63]

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[60] Comptroller of the Currency, *About the OCC* (viewed February 28, 2009), available at http://www.occ.treas.gov/aboutocc.htm.

[61] Office of Thrift Supervision, *Mission and Goals* (viewed February 28, 2009), available at http://www.ots.treas.gov/?p=MissionGoal.

[62] Examples include regulators’ slow response to curtailing large prepayment penalties and their continued indecision on costly overdraft protection.

[63] For instance, the OCC derives 95% of its budget from assessments on national banks. The twenty largest national banks contribute almost 60% of those assessments. See, e.g., Bar-Gill & Warren, supra note 5, at 193-94 (working draft version); Testimony of Arthur E. Wilmarth, Jr., Hearing before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Financial Services (Apr. 26, 2007).

I served on the Federal Reserve Board's Consumer Advisory Council from 2002 through 2004 and saw firsthand how resistant federal banking regulators were to instituting basic consumer protections during the run-up to the current crisis. Repeatedly over that period, I and other members of that Council warned the Federal Reserve's staff and governors about rising foreclosures and other dangers associated with reckless subprime loans. We urged the Board to exercise its powers under HOEPA to strengthen protections for subprime and nontraditional mortgages, but to no avail. During my tenure on the Council, the late Governor Gramlich told me during a break at one of the Council's public meetings that there was not enough support on the Board to expand HOEPA's protections. These experiences confirmed my belief that banking regulators often dismiss the consumer protection piece of their mission.

Some critics argue that removing consumer protection responsibilities from federal banking regulators and housing them in their own dedicated agency would undercut the safety and soundness of banks. As the current crisis shows, however, entrusting consumer protection to the federal banking agencies is no guarantee of bank safety and soundness. Indeed, having a separate federal watchdog for consumer credit would help place healthy, countercyclical constraints on the tendency of federal banking regulators to sacrifice long-term safety for short-term profits at the top of the credit cycle. It would also encourage forward-looking regulation as new problems arise, instead of laggard, backward-looking regulation of the type recently issued by the Federal Reserve.

Congress could institute mechanisms to avoid agency conflicts or to resolve them if they occur. Such mechanisms could include formal or informal consultation with federal banking regulators or judicial dispute resolution.

2. A Separate Federal Consumer Credit Agency Offers Other Strong Advantages

A wide range of experts across the political spectrum, from the Treasury Department under former Secretary Paulson to the Congressional Oversight Panel, have recommended housing consumer credit protection in its own separate agency.[64] A separate federal agency dedicated to consumer protection for all consumer credit would offer several distinct advantages. First, it

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[64] THE DEPARTMENT OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 170-74 (March 2008) (proposing a Conduct of Business Regulatory Agency), available at www.treasury.gov; CONGRESSIONAL OVERSIGHT PANEL, SPECIAL REPORT ON REGULATORY REFORM 30-37 (Jan. 2009), available at http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf. The Committee on Capital Markets Regulation recommended an independent consumer protection agency as one alternative. Committee on Capital Markets Regulation, Recommendations for Reorganizing the U.S. Financial Regulatory Structure 5 (Jan. 14, 2009), available at http://www.capmktsreg.org. While the Government Accountability Office has not taken a position, last month it advised that "[c]onsumer protection should be viewed from the perspective of the consumer rather than through the various and sometimes divergent perspectives of the multitude of federal regulators that currently have responsibilities in this area." GENERAL ACCOUNTABILITY OFFICE, FINANCIAL REGULATION: A FRAMEWORK FOR CRAFTING AND ASSESSING PROPOSALS TO MODERNIZE THE OUTDATED U.S. FINANCIAL REGULATORY SYSTEM 18 (GAO-09-349T Feb. 4, 2009), available at www.gao.gov. See also Heidi Mandanis Schooner, *Consuming Debt: Structuring the Federal Response to Abuses in Consumer Credit*, 18 LOYOLA CONSUMER L. REV. 43, 77-78, 82 (2005) ("while there are benefits to combining prudential regulation and consumer protection, serious doubt remains as to whether it is the best arrangement"; "[t]he most sensible approach to correcting the structural defect in the current regime would be to eliminate entirely the federal banking regulators' role in consumer protection").

would consolidate industry-wide enforcement in one agency, which would mean that all providers of credit would be subject to the same level of enforcement. Under the current regime, even though the Federal Reserve Board administers most federal consumer credit laws, compliance examinations and enforcement are divided among federal banking regulators and sometimes other agencies. Other federal consumer protection laws – such as Section 5 of the Federal Trade Commission Act and the Community Reinvestment Act – are individually implemented by the four federal banking regulators with respect to their regulated entities. Each agency can make its own choice about the extent to which it enforces or does not enforce the law. Ending this fragmentation of enforcement would discourage lenders from switching charters in search of the easiest regulator.

Transferring consumer credit laws to one agency whose sole mission is consumer protection would also provide regulators with a complete overview of the entire consumer credit market, its structure, and emerging issues. Right now, consumer credit regulation suffers from a silo mentality because it is parceled out among so many agencies. Consolidating consumer credit oversight would overcome this silo mentality. In addition, consolidation would have the benefit of concentrating expertise for consumer credit products in one agency.

3. Agency Responsibilities and Oversight

In assigning consumer credit protection to its own separate agency, it is necessary to ask whether the agency should adopt a supervisory model based on routine examinations akin to banking regulation or an enforcement model akin to that used by the Security and Exchange Commission or the Federal Trade Commission.

Banking regulators are supposed to examine all of their regulated entities for consumer compliance on a routine basis. Requiring regular examinations of all credit providers and related entities, from depository institutions and nonbank lenders to mortgage brokers and payday lenders, would be extremely costly and not the best use of tax dollars.

Given the large number of participants in the consumer credit market, it would make more sense to adopt an enforcement model similar to that used by the Securities and Exchange Commission.[65] Under that model, market participants would be required to register with the agency and obtain licenses. Regular reporting would provide the agency with a steady flow of needed information to pinpoint possible violations and identify new problems. Under its broad statutory mandate, the agency would issue binding rules and interpretations to prohibit unfair and deceptive acts and practices. The agency's research arm would conduct empirical tests of the effects of new financial products and proposed regulations. Finally, the agency should have strong enforcement authority, including the power to conduct special examinations and issue subpoenas; the power to take agency enforcement action and levy restitution and sanctions; and criminal and civil enforcement authority.

[65] A consumer complaint model alone, such as that employed by the FTC, would not provide an oversight agency with enough information or authority to keep abreast of the rapid pace of financial innovation.

4. Should Congress Create a New Agency or Transfer All Consumer Credit Oversight to the Federal Trade Commission?

In removing consumer credit oversight from federal banking regulators and transferring it to a dedicated agency, Congress must decide where to house it. There are two obvious choices. One would be to create a new agency for consumer credit oversight. The other would be to transfer this responsibility to the Federal Trade Commission.

Each approach has advantages and disadvantages. Unlike the FTC, a brand new agency would be solely responsible for consumer credit products and would not be distracted by other duties, such as policing antitrust violations or the marketing of home appliances, over-the-counter drugs, dietary supplements, computer software, and other products, that fall under the FTC's purview.

A new agency would also have the benefit of starting on a clean slate. If, as I recommend, the model for consumer protection is based on the SEC's registration and reporting scheme, the FTC would have to transform itself away from its current consumer complaint enforcement model. The FTC, like any other agency, has a bias toward the status quo that could make it hard to implement a new enforcement model and otherwise change the way the agency functions. A new agency would not suffer under this handicap.

On the other hand, creating a new federal agency would be costly and entail substantial start-up time. The FTC already has the institutional expertise and single-minded commitment to consumer protection to regulate consumer credit industry-wide. This is particularly true within the FTC's Division of Financial Practices and the Division of Privacy and Identity Protection, which fall in the FTC's Bureau of Consumer Protection. In 2008, the Division of Financial Practices specifically ramped up its staff and in-house training in anticipation of heightened enforcement activity.

Of course, for the FTC to succeed as *the* consumer protection enforcer, the agency would need dramatic increases in funding. A new agency would also need a substantial commitment of resources to properly do its job. Presumably, some of this cost could be defrayed by transferring resources from the consumer compliance operations of federal banking regulators.

Consolidating oversight in one federal agency – whether that agency is new or the FTC – poses a final concern about agency capture and inaction. The FTC, for example, had a vigorous enforcement record regarding mortgage abuses during the Clinton Administration but a lackluster record during the George W. Bush Administration until recently. Whether consumer credit protection is consolidated in a new agency or the FTC, the best antidote to agency inaction is outside enforcement. Accordingly, Congress should give parallel enforcement authority for federal consumer credit laws to state regulators and private causes of action (including carefully crafted assignee liability) to injured consumers. Congress could also set target consumer protection goals, such as maximum default rates, and require the implementing agency to report to Congress on its performance. Finally, that agency should be funded through congressional appropriations instead of assessments on regulated entities to assure that the agency remains independent.