



Office of The Attorney General
State of Connecticut

**TESTIMONY OF
ATTORNEY GENERAL RICHARD BLUMENTHAL
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
JULY 14, 2009**

I appreciate the opportunity to strongly support the Administration's proposal to create a federal agency dedicated solely to protecting consumer interests in financial products and markets, and preserve and expand state consumer protection authority.

The new agency -- a consumer financial guardian -- promises to be a powerful watchdog and protector, and a partner of state attorneys general in fighting for our citizens. The proposal marks a giant step toward restoring an historic federal state alliance in combating financial fraud and abuse. This federal-state partnership was riven by excessive resort to federal preemption -- displacing state enforcement and replacing federal-state collegiality and cooperation with relentless conflict.

The new agency is a necessary and appropriate response to exploding complexity, scope, and scale of new financial instruments and markets -- and exponentially increasing impact on ordinary citizens. It fills a deeply felt consumer need. Ever more slick and sophisticated marketing -- often misleading and deceptive -- cannot be battled successfully by states alone, or the existing federal agencies. Creating a new agency to fight consumer cons and abuse in alliance with the states, the federal government can muster more potent and proactive policing and prosecution.

A new consumer guardian -- we need it, and now. New firepower, focus and drive, all are vital. The new agency will be more an enforcer, than a regulator. At the federal level, the new agency would investigate law-breaking and enable and assist Department of Justice prosecutions, both civil and criminal.

Unfortunately, some opponents of this agency have misrepresented its purpose. The Financial Consumer Protection Agency will not "regulate credit." It will not make choices for consumers or deny them access to products and services. Instead, one of its main missions will be to assure that consumers are informed in clear, layman's language of the terms and conditions of credit cards, mortgages and loans. The point is to assure that consumers fully understand the financial realities and consequences of financial obligations, credit cards or loans they are considering before they make commitments.

As even experienced lawyers and consumer protection advocates can attest, anyone attempting to understand their credit card agreements all too frequently faces incomprehensible, consuming small print with huge consequences. This agency's purpose is to assure people have good information so they can make good financial decisions. Once they use that information and make decisions, they will have to live with the consequences.

1. Federal Preemption Doctrine Disaster

For far too long, states have been forced to the sidelines, standing helplessly, while credit card, mortgage and financial rescue companies used federal preemption as a shield to stop state consumer protection agencies from enforcing state laws against unfair and unscrupulous practices. Connecticut consumers have been scammed by fraudulent and unfair marketing schemes and products by companies who create or affiliate with national banks solely to avoid state consumer protection laws.

Worse, federal agencies have been complicit -- aiding and abetting lawbreakers by supporting preemption claims when states sued to stop these unfair practices and recover consumer losses. Federal agencies went AWOL -- not only disavowing their firepower but disarming state enforcers. They forced states from the battlefield and then abandoned it -- in countless areas of consumer protection. They enabled and encouraged use of preemption as an impregnable shield to protect mortgage fraud, credit card abuses, securities scams, banking failure, and many deceptive and misleading snake oil pitches.

The financial meltdown was foreseeable -- and foreseen -- by enforcement authorities who warned of irresponsible and reprehensible retreat and surrender in federal law enforcement. There were warnings -- including mine -- about a regulatory black hole concerning hedge funds, derivatives, credit default swaps, excess leverage devices and other practices. I used this term -- regulatory black hole -- to characterize lack of oversight and scrutiny that enabled self dealing, excessive risk-taking, and other abuses that sabotaged the system.

The national financial meltdown was directly due to massive federal law enforcement failure -- lax or dysfunctional federal oversight and scrutiny of increasingly arcane, complex, opaque, risky practices and products. Federal law placed all enforcement and regulatory authority in an array of federal agencies that were inept, underfunded, complacent or complicit. The result was a void or vacuum unprecedented since the Great Depression.

Robust state investigatory and enforcement authority no doubt would have revealed unfair and illegal activities sooner and helped fill the gap left by federal inaction and inertia. Putting state cops on the consumer protection beat would have sent a message -- educating the public, deterring wrongdoing, punishing lawbreakers.

Connecticut has been at the forefront of state efforts to protect consumers from unfair and fraudulent financial transactions. And two areas illustrate the obstacles that we and other states have faced under the current system.

Tax preparers use the lure of instant cash to entice taxpayers -- mostly low income -- to borrow money at extremely high interest rates, using their tax refund to pay these loans. Recognizing that Connecticut could not regulate such usurious lending by national banks, our state sought to cap at 60% the interest charged on loans made through a tax preparer or other facilitator of the loan. The statute was challenged by lenders who charge more than 300 percent annual interest rate. As a former United States Attorney, I can tell you that organized crime would offer a better deal. The federal Second Circuit Court of Appeals held that Connecticut law could not be applied to national banks or their agents. *Pacific Capital v. Connecticut*, 542 F.3d 341 (2d Cir. 2008). As a result, consumers continue to pay astronomical interest rates for such refund anticipation loans.

Second, even as gift cards have become increasingly popular in Connecticut and the country, consumers often see their cash value erode over time because of hidden inactivity fees or short expiration dates. In response, Connecticut prohibited both inactivity fees and expiration dates. Mall operators and retail chain stores avoided such consumer protection laws by merely contracting with national banks to issue gift cards. The Second Circuit Court of Appeals held that state consumer protection laws are preempted because the state measures affect a national bank rule. It ruled that Visa gift cards had expiration dates so the state could not prohibit them. *SPGGC v. Blumenthal*, 505 F.3d 183 (2d Cir. 2007). The result is pervasive consumer confusion because some gift cards issued by national banks may expire, but others have no such expiration dates.

Other states have faced similar preemption obstacles to protecting consumers. My colleague in Minnesota began investigating Capital One's credit card marketing practices under the state's consumer protection laws. Capital One transferred all its credit card operations into a national bank, successfully halting the investigation, because Minnesota's consumer protection laws were preempted. Similarly, an Illinois investigation into Wells Fargo Financial's steering of minorities into high cost loans was stymied by Wells Fargo's transfer of those assets into a national bank.

2. An Historic New Alliance

I speak for other states in my enthusiastic and energetic support for section 1041 provisions of the Consumer Financial Protection Agency Act of 2009 that establish federal law as a minimum standard for consumer protection, allowing states to enact laws and regulations "if the protection such statute, regulation, order, or interpretation affords consumers is greater than the protection provided under this title, as determined by the [Consumer Financial Protection] agency." In addition, the proposal amends various federal preemption statutes to unshackle the states, allowing enactment of consumer protections at the state level that may become a model for federal, nationwide standards.

This law exemplifies federalism at its best -- state and federal authorities working in common rather than conflict, and making the states laboratories for new, creative measures. Many of our most prominent federal consumer protection laws were first adopted by states.

3. A Federal Consumer Financial Super Cop

I also support the establishment of the Consumer Financial Protection Agency, a federal office dedicated solely to protection of ordinary citizens using the federal savings and payment market.

Currently, consumer credit products are regulated by at least seven different agencies whose primary focus is the proper operation of markets and the safety and soundness of institutions. While consumer protection is within their jurisdiction, it is far from their major focus. Nor does any existing agency dedicate significant or sufficient resources to this responsibility.

They pay scant attention to consumer complaints, often reviewing such problems from an industry perspective rather than the consumer's. Indeed, these agencies face divided loyalties or even conflicts of interest -- when high interest rates and astronomical credit card fees, for example, may be good for the bottom line, but bad for consumers. Given the understandable emphasis on safety and soundness, consumer protection not surprisingly receives short shrift.

The Consumer Financial Protection Agency would have broad authority to promulgate and enforce rules to protect consumers from unfair and deceptive practices and to ensure they understand terms and conditions. These regulations will encourage, not stifle, the development of financial products that well serve consumers. A vibrant, competitive market that is fair and honest is essential to consumers' and the Financial Industry's financial interests. Clear rules and consistent enforcement are vital prerequisites for innovation and wealth creation. To mix metaphors, what's needed is a more level playing field -- essentially rational rules of the roads. When intersections become busy, they need to upgrade from stop signs to traffic lights to avoid car crashes, collisions and pile ups. As the proposal recognizes, joint proactive consumer protection enforcement by both federal and state agencies -- without preemption or exclusive jurisdiction -- best serves consumer interests, especially as financial products and markets grow in complexity and number.

State agencies -- including state attorneys general and other consumer protection agencies -- are often the first line of defense for consumers. Consumers are usually far more comfortable contacting their state officials rather than nameless faraway federal agencies. I have seen firsthand the frustration of consumers when we have had to tell them that my office is legally powerless to help because of federal preemption of state enforcement authority.

Under the proposal, states may enact and enforce consumer protection laws that are consistent with federal law. In addition, state attorneys general may enforce federal rules and regulations in this area provided that the federal Consumer Financial Protection Agency is notified of such enforcement action and has the opportunity to join or assume responsibility.

This notification process seeks federal-state coordination without necessarily allocating primacy to the federal agency. State Attorneys General welcome the federal government as an ally rather than an adversary. Joint efforts can involve far more effective and more efficient use of our resources.

Joint state and federal enforcement efforts are neither new nor novel. States regularly work with each other and the federal government in recovering hundreds of millions of dollars in Medicaid and health care fraud, enforcing our respective antitrust laws against anticompetitive mergers and acquisitions or abuse of market power, and applying consumer protections laws against deceptive or misleading advertisements. I served for several years as chair of the National Association of Attorneys General Antitrust Executive Committee which included regular meetings with the heads of the Department of Justice Antitrust Division and the Federal Trade Commission. Successful collaborations once were common -- against Microsoft for example -- especially when the federal government was an active antitrust enforcer. There are plenty of successful models of joint action involving, for example, the Federal Trade Commission and the United States Department of Justice's Antitrust Division.

Separating regulatory authority from consumer protection authority also has models at the state level. In Connecticut, for example, the Department of Banking regulates the banking industry while the Department of Consumer Protection through the Office of the Attorney General has broad consumer fraud enforcement authority. That authority extends to the banking industry. The Connecticut Supreme Court specifically applied our unfair and deceptive trade practices act to the banking industry. *Mead v. Burns*, 199 Conn. 651 (1986).

I appreciate the industry's concern about two sets of agencies with enforcement authority. The industry justifiably wants predictability of regulation to properly plan product development and promotion. This bill will do so by creating a regulatory floor that applies nationwide. Most valuable would be predictability of vigilant and vigorous enforcement. The message must be that a revived and reinvigorated federal-state alliance will punish any company that profits from illegal anti-consumer devices or unfair and deceptive practices. The predictable outcome is that anyone who cons or scams consumers in financial products will be prosecuted.

Part of the genius of our federal system is that it creates separate distinct sets of authority in federal and state governments. Individual state experiments in solving problems and lawmaking can be models for federal statutes as well as other states. Our United States Constitution assures that states cannot adopt rules inconsistent or conflicting with federal authority.

Finally, I urge the committee to consider authorizing private rights of action against consumer fraud. Most state consumer protection statutes permit such private legal actions enabling victims to bring legal actions and recover damages, sometimes when state authorities may not do so. These initiatives supplement and strengthen state consumer protection enforcement efforts. They could similarly enhance and enlarge federal enforcement efforts.

I appreciate and applaud your and the Administration's dedication to protecting consumers in financial transactions. I commend this committee's support of these efforts and offer my continuing assistance -- along with other state attorneys general.

Thank you.