Financial Reform: Banks say consumer agency proposal aims at the wrong target (July 24, 2009)

Hundreds of bankers gather in Washington at ABA Leadership Meeting to debate Obama regulatory reform plan

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“Can I have a show of hands?” asked the moderator. “How many of you are against consumers?”

No one was, of course.

Multiple bankers and ABA officials made that argument from podiums, panels, audience mikes, and in hallway conversations during ABA’s 2009 Leadership Meeting: Without customers banks don’t have a business.

While the bankers, ABA staff, and state association executives present at the meeting reviewed many important aspects of the Obama regulatory reform program, clearly a major common concern was the Administration’s proposed “Consumer Financial Protection Agency.” This matter, and the issue of preserving institutions’ ability to choose a federal thrift charter, represented the primary message bankers and executives brought to Capitol Hill during a portion of the meeting schedule. Later in the meeting, the bankers had the opportunity make their views known to Neal S. Wolin, Deputy Secretary of the Treasury. Wolin spoke to the bankers first, defending the Obama reform plan in general and in specifics. [Read about Wolin’s speech, and some of the bankers’ reactions and questions.]

“Fundamentally, you did not cause the problem—you are the solution to the problem,” said Edward Yingling, ABA president and chief executive officer.

Bankers’ mindset amid the fray

The Leadership Meeting—traditionally held at a resort location—had been moved to Washington, which permitted bankers to spend that afternoon pressing the industry’s case on Capitol Hill. Overall, the mood of the meeting revealed an industry whose members, especially those who run community banks, fail to understand why their companies are being targeted for a costly, major new regulatory regime when they don’t see themselves as having mistreated consumers.

The greatest irony about the ongoing debate over the Obama Administration’s proposed “Consumer Financial Protection Agency,” bankers noted time and again, is that much of the federal effort that would follow creation of the agency would hit traditional banks and savings banks. While the agency and related elements of the plan are supposed to rope in the so-called “shadow banking” market—largely unregulated players—bankers have their doubts about that. As more than one said, Washington knows where to find traditional banks and bankers. “Shadow banking” companies ranging from mortgage brokers to pawn shops, payday lenders to money services businesses, can be much harder to find—and more expensive to examine and regulate.

Even going solely by the Treasury Department’s own figures, traditional banking wasn’t the cause of today’s crises, especially as it concerns consumers and the troubled mortgage picture. Treasury has stated that 94% of high-cost mortgages were made outside the traditional banking system. (A Treasury white paper accompanying the Obama plan, however, makes this accusation: “…in the run-up to the financial crisis, mortgage companies and other firms outside of the purview of bank regulation exploited that lack of clear accountability by selling mortgages and other products that were overly complicated and unsuited to borrowers’ financial situation. Banks and thrifts followed suit, with disastrous results for consumers and the financial system.”)

Frustration with this state of affairs ran strong. And there was much support for a central tenet of ABA’s objections to the Obama plan—opposition to the separation of safety-and-soundness regulation from consumer protection regulation.

Bankers have long been frustrated when safety-and-soundness examiners and compliance examiners working for the same agency issued contradictory advice or orders. The likelihood of that confusing scenario growing in magnitude with the addition of yet another set of examiners plainly holds horrors for banks.

ABA’s Yingling put this into words for the audience. After seeing off a safety-and-soundness examiner, he said, “the very next day, someone could walk in from this other agency [CFPA] and tell you something different. And then which are you supposed to respond to?”

An apt illustration of the potential results of such opposing viewpoints was the divergent views on loan loss reserves held by the banking regulators and the Securities and Exchange Commission.

Wayne Abernathy, ABA’s executive vice-president for financial institutions policy and regulatory affairs, noted that SEC long opposed over-reserving, in the belief that institutions did so to manipulate reported earnings. The banking regulators, on the other hand, wanted to see reserving on par with the expected risks in bank portfolios. This tension prevented the industry from building reserves that would have helped in the current environment, Abernathy said. Similar disagreements could arise between traditional banking regulators and the CFPA.

Momentum shifts

Dark as the outlook may have seemed when the Leadership Meeting was organized, it had improved by the start of the event. The bankers fanning out throughout the Capitol found the ground friendlier than it would have been only weeks before.

In the wake of the massive Obama financial blueprint’s rollout last month, there was little tangible opposition at first. ABA was among the relative handful of voices registering objections and concerns to elements of the plan early on.

Legislative language detailing the proposed new CFPA came before any other part of the package. This move was clearly calculated to garner early support from consumers, by casting the existing regulatory system in the worst possible light, indicating that it had failed all consumers.

The underlying message of the entire approach was that all providers of consumer financial services had been permitted to run amuck, unregulated and unsupervised.

Clearly, this came as a surprise to the traditional banking industry, which spends millions employing compliance staff and compliance consultants; training employees at many levels in consumer compliance; and working with compliance examiners to keep up their performance with a panoply of regulations that long ago passed by the end of the alphabet and began another go-round.

Indeed, during one of the meeting’s breakout sessions, Wayne Abernathy, said ABA was encouraging member bank’s compliance officers to send special letters to Congress regarding the CFPA proposal. (Link to the special compliance officer ABA comment letter generating utility.)

Since the plan’s introduction, bankers have objected to the potential increase in burden and cost on an industry already much regulated, coupled with the concern that the unsupervised players who caused the problem, while it is proposed that they be regulated and examined, may not really come under comparable controls.

Such objections somewhat played into the hands of those backing the Obama plan who wanted the debate to become a banks versus consumers debate. But the balance has shifted.

The program’s earlier, apparent invulnerability to debate and change began to erode.

A key shift came among the regulatory agencies, especially the Federal Reserve Board, Diane Casey-Landry, ABA Chief Operating Officer and senior executive vice-president, told Leadership Meeting attendees. Casey-Landry said that the banking regulators, delving into the details of the Obama plan, saw significant changes in their roles and abilities coming as the proposed CFPA would absorb consumer regulatory functions from pre-existing agencies. She cited Federal Reserve Governor Betsy Duke’s recent testimony on the matter as strong evidence of the regulators’ “stepping up” to the concerns with the CFPA proposal.

This followed on the heels of a shift made earlier by House Financial Services Committee Chairman Barney Frank (D.-Mass.). The original legislative language sent to the Hill by the Obama Treasury Department would have included special provisions dealing with the Community Reinvestment Act. When Frank introduced his revised approach, H.R. 3126, he had trimmed out those provisions.

Lobbyists in general indicated that where there had been fear to oppose the Administration, that was falling away.

Timing and outlook

During the meeting, ABA staff reviewed the likely timing and handling of the CFPA proposal.

In the days leading up to the meeting, the timeline had lengthened. House Financial Services Chairman Frank had been planning, as recently as mid-July, to markup the CFPA bill by late July, and send it to the House. Frank plans to handle the Obama reform plan section by section, rather than as a single bill.

Now, Frank has postponed markup in his committee on CFPA until September.

In the Senate, although testimony has been heard on CFPA, Chairman Chris Dodd (D.-Conn.) plans to take up the legislation in the September-October period. Dodd hopes to have final legislation through both the House and Senate in time to present a bill to the President by the end of 2009.

This debate is far from over and banking’s point is far from won, however.

A key concern is how this issue will fare not only on its own, but in comparison with other Obama-backed legislation. The Administration has put heavy reputational chips on several key packages, and resistance has now been shown on each front. Concerns are that if the other key Administration goals fail, this will redouble and refocus energies on the financial services business and reforms to its regulation.

In addition to coverage of the Neal Wolin speech and reaction to it, our special coverage also includes an exclusive roundup of state association executives’ preliminary views on the reliance the CFPA proposal would have on state regulatory authorities.

Read the Wolin article.

Read the state association executive article.

[This article was posted on July 24, 2009 on the website of ABA Banking Journal, www.ababj.com, and is copyright 2009 by the American Bankers Association.]