

## Cash-strapped states can't handle consumer protection role (July 24, 2009)

Obama regulatory reform proposal would make state governments the "first line of defense" over nonbank financial providers who stray. State banker association execs ask how cash-strapped states could do that

By Steve Cocheo, executive editor, scocheo@sbpub.com

The Obama Administration's controversial proposal for a "Consumer Financial Protection Agency," as envisioned, takes the federal power to oversee consumer protection in banks and other chartered depository institutions, and strips much of it away from traditional bank regulatory agencies that currently have that duty. At the same time, it would be set up to oversee and enforce federal consumer protection laws and rules over the many types of providers making up the so-called "shadow banking" system of largely unregulated firms.

But there's a double catch to that part of the proposal. In the words of the plan itself, issued by the Treasury Department:

"The CFPA should ... have supervisory and enforcement authority over nonbanking institutions, although the states should be the first line of defense. [Emphasis added.] In its discretion, the CFPA should exercise the full range of supervisory authorities over nonbanking institutions with its jurisdiction, including supervision, information collection, and on-site examination." Indeed, while the proposal gives the states that "first line" bow, it also envisions that CFPA could jump into any situation it chose.

Matters don't end there, in the states' involvement in the CFPA plan. The Obama plan says that "CFPA's strong rules would serve as a floor, not a ceiling. The states should have the ability to adopt and enforce stricter laws for institutions of all types, regardless of charter, and to enforce federal law concurrently with respect to institutions of all types, also regardless of charter." While the first part isn't new—it's a typical feature included when federal laws override state laws—the latter part would be a significant change.

Further, the Obama proposal would subject federally chartered institutions to state consumer protection and civil rights laws, and empower the states to enforce them in regard to federally chartered institutions. This does away with federal preemption of state consumer protection laws for federally chartered institutions. The crack started by the recent Cuomo decision at the U.S. Supreme Court would be pried wide open.

What drives all this? A key paragraph from the Obama regulatory reform plan:

"Insufficient resources were devoted to enforcement during the mortgage boom. Periods of rapid market growth are precisely the time when government needs to be more vigilant. Resources have been increased significantly to address the inevitable fraudulent activities that are associated with the fallout of the mortgage crisis. When financial

services markets begin to grow again, it is critical that funding at the federal and state levels be adequate to meet the challenge.”

But when ABA Banking Journal interviewed selected state bankers association officials attending the ABA Leadership Meeting about this, they regarded an expanded state role in any such enforcement as unrealistic. Funding isn’t there, and the outlook doesn’t see it coming anytime soon. This jibes with ABA’s position from the national level.

#### Focus on less-regulated providers

ABA has attacked the Obama proposal in part because it would subject national banks to potentially 50 different states’ laws.

But the association has also pointed out that “the biggest failures of the current regulatory system, including consumer protection failures, have not been in the regulated banking system, but in the unregulated or weakly regulated sectors.

The association believes that, “the focus of the enhanced consumer protection should be on the less-regulated state-chartered financial services providers that are not now carefully examined and supervised like banks.”

In testimony before the Senate Banking Committee on July 14, ABA President and CEO Edward Yingling criticized the concept of making state governments the first line of defense for the supervision and examination of nonbanks. He said the states lack the resources for meaningful enforcement.

“This is where the failure of non-bank regulation was most severe under the current system,” testified Yingling. “Once again there would be perverse incentives for financial products to flow out of the closely examined banking sector to those who will skirt the meaning, and even the language, of regulations.”

#### State execs weigh in on partnership

Indeed, the federal proposal appears to be hinged on resources that simply aren’t there, and may not be for years, the state executives indicated.

Tanya Wheelless, president and CEO of the Arizona Bankers Association, noted that her state, where there are about 80 deposit-taking banks of all charter types, is looking at being “left with potentially two bank examiners for the entire state.” The Arizona Department of Financial Institutions gathers fees from examined entities, but these go into the state’s general fund. In return, the department receives back an appropriation to cover its costs. This has been successively chopped in recent years, said Wheelless, to the point where the examiner force has dwindled.

And that's not all. The state enacted a loan officer licensing program that is consistent with the federal SAFE Act, said Wheelless. Fees will be assessed and taken into the general fund. But no appropriation has been made for the new state program. [SAFE Act stands for "Secure and Fair Enforcement for Mortgage Licensing Act of 2008.]

There's more.

"We have about 3,000 escrow agents who haven't been examined in five years," said Wheelless. "It's really unconscionable and I think we are setting up for bad things to happen."

"You want to have a strong regulator and you want to have strong oversight," added Wheelless. "But we are going in the exact opposite direction."

Wheelless sees no role at all in any partnership with CFPA for Arizona's DFI.

"Rather than seeing meaningful participation from the state, I think you would see more political action by Arizona's attorney general," said Wheelless. "In our state, the position of attorney general is a jumping-off point to governor or something else. So what we've seen is their looking for high-profile cases, things that are pro-consumer."

Georgia Bankers Association President and CEO Joe Brannen said that his state's government faced a large budget shortfall recently, and state agencies had to cut back. "Those cuts went to the banking department just like they went to every other agency," said Brannen. As it turned out, given difficulties among Georgia banks, the state decided to subject the state regulator to only half the cut other agencies faced.

"But to think that this state agency, funded by fees generated from the industry, would all of the sudden take on a new responsibility mandated by Congress is just laughable," said Brannen. "In an environment like we have today, they're stressed just to examine the banks."

Mike Smith, president and CEO of the New York Bankers Association, noted that state banking regulators still suffer from the huge exodus of banking assets from the state banking system over recent years. He pointed out that the New York Banking Department lost 40% of its budget when a couple of large state banks converted to national charters.

"Their force is not sufficient to examine the very entities that gave rise to many of the problems we're dealing with," said Smith.

Kansas Bankers Association President Chuck Stones says his state's banking regulator already maintains a

division that examines other entities that provide consumer and mortgage loans.

&ldquo;But this CFP&Aacute; is a whole additional layer that&rsquo;s going to be placed on top of them,&rdquo; said Stones, &ldquo;and they can&rsquo;t support it.&rdquo;

The article you have just read was based on a roundtable discussion conducted by ABA Banking Journal with the state bankers association executives quoted. A major article based on the other sections of the roundtable, which dealt with other issues beyond this article, is scheduled to appear in the September ABA Banking Journal print and digital magazines.

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