NATIONAL
CONSUMER LAW
CENTER®

1001 Connecticut Avenue, NW,
Suite 510
Washington, DC 20036
Phone: (202) 452-6252
Fax: (202)463-9462
consumerlaw@nclc.org
http://www.consumerlaw.org

To: Congressional Oversight Panel
From: Lauren Saunders, Managing Attorney, and Margot Saunders, Of Counsel
Date: January 12, 2009
Re: Report on Effectiveness of Regulatory System

On behalf of our low income clients, below is a summary of improvements needed to the regulatory system in order to protect consumers in the credit marketplace. As the current crisis demonstrates, consumer protection is also essential to safety and soundness.

I. WE MUST RETURN TO REGULATION TO PROTECT CONSUMERS AGAINST THE EXCESSES OF AN UNRESTRAINED FREE MARKET.

Deregulation has been an unmitigated disaster. We need to return to substantive protections, restore sound underwriting, and realign the incentives of borrowers and lenders so that both have a common interest in fair, sustainable credit. More regulation will enhance the free market by leveling the playing field between good and bad actors.

A. Mortgage Market

The unaffordable and unsustainable loans that led to the mortgage crisis were legal because of deregulation and profitable because of the fragmentation of the mortgage market. We propose to address these market and regulation failures with these changes:

1) **Originators should be required to offer every applicant a uniform, fixed rate, no-fee, fully amortizing 30-year mortgage**. These products are well understood, perform in a predictable manner, and permit homeowners to comparison shop. Only government fees and taxes would be permitted outside the interest rate, resulting in lenders putting all of the costs into the rate, and limiting the profitability of the origination process (in contrast with profit from the stream of payments following origination). Prepayment penalties also should be banned.

2) Thorough and verified affordability analysis is required. Underwriting must assess the affordability of all payments due under the terms of the loan, after allowing for all permitted principal and interest rate increases. All income must be verified independently, using wage statements, bank account and deposit records, or tax information, as available and appropriate.

3) Originators should be prohibited from making a mortgage loan for more than the home is worth. Originators and investors should be responsible for inflated appraisals. The Bankruptcy Code should be amended to allow mortgage loans on primary residences to be modified to the value of the home.

4) **Tax incentives encouraging the spending of home equity should be eliminated.** The changes to the Tax Code in 1986 that eliminated deductions for personal debt but expanded deductions for home equity debt should be rolled back.

5) Servicers should clearly owe a fiduciary duty to homeowners. In addition, we need improved substantive requirements on servicers to respond to requests for information and correct mistakes in mortgage records.

6) No foreclosures should be permitted without first offering a loan modification. The modification must be subject to specified requirements for both sustainability and appropriate avoidance of loss to investors, as in the FDIC's model.

7) Consumers need meaningful private enforcement against all parties. The secondary market often dictates the characteristics of the loans and must bear some risk for dangerous origination practices. Similarly, holders must also be held liable for violations committed by the servicers acting on their behalf. The relief that consumers need only is meaningful if it is available from the current holder of the note. Wall Street can handle limited assignee liability, capped at the amount of the loan, in its risk assessment of potential and ascertainable losses.

B. Credit Generally.

All credit products should be subjected to:

1) A 36% usury cap that includes all fees and charges.

2) Rules against lending without regard to ability to pay. Risk-based pricing cannot be the excuse to make exorbitantly priced credit available to consumers who cannot afford to repay it.

3) Fees reasonably related to their purpose. Regulators should not permit products and practices that lead creditors to encourage consumer defaults, such as mortgage servicers, credit card issuers and banks who profit from late, over-the-limit or overdraft fees.

4) Protections against unfair practices, in addition to deceptive ones. Disclosure does not protect consumers from unfair practices they cannot reasonably avoid. The new credit card and mortgage rules are a start, but more is needed.

5) Full private and state attorney general enforcement. The individuals who are victimized and the states that are closer to the ground must be able to hold lenders accountable for state and federal legal violations.

6) Updated consumer protection statutes. Critical laws have not been modernized in decades. For example, the Truth in Lending Act's jurisdictional limits and penalties have not been adjusted for inflation since 1968, and TILA no longer covers large auto and student loans.

II. STRUCTURAL REFORMS ARE NEEDED TO THE REGULATORY SYSTEM.

In addition to new substantive laws, changes are also needed to the system itself.

1) The consumer protection function should be housed in a federal agency that is not responsible for safety and soundness. Family devastation was ignored until it rose to levels that disrupted Wall Street. Even now, efforts are aimed at restoring markets, not homes. Consumer protection is inevitably sacrificed when it is performed by the same entity concerned about profitability and fee revenue and involved in a close day-to-day relationship with the regulated entity that emphasizes collegiality. Consumer protection must be the primary focus of the agency charged with that mission, whether it is a new Financial Product Safety Commission or the Federal Trade Commission with an expanded mandate.

2) States must be able to enforce their own laws as well as federal consumer protections. Federal regulators have been more concerned about preempting state law protections than providing federal ones. Yet states are much closer to consumers and see credit market abuses when they first arise, before they become entrenched national problems or become an essential part of an industry's profit model. The preemption regulations must be reversed; only Congress, not federal agencies, should be permitted to preempt state consumer protection laws. States should gain explicit authority to enforce federal laws. If regulatory reform leads to an activity-rather than an entity-based approach that expands the compass of federal agencies, states must retain the authority they currently have over actors primarily regulated at the state level.

3) Consumer protection must take place primarily through transparent and publicized rulemaking and enforcement, not through secretive, unverifiable supervisory actions. Only public actions can have a deterrent effect on the entire market. Federal agencies should never again be allowed to assert, without proof, that they are addressing a problem in private.

4) Charter shopping should be eliminated. One of the chief reasons that so many savings banks have failed, and that OCC issued its preemption regulations, is the ongoing rivalry between the OTS and the OCC for customers.

5) Restore the White House Office of Consumer Affairs. The banking and regulatory agencies are inevitably headed by individuals who come from the financial industry and are familiar with their inner workings. But the President needs to hear the countervailing voice of the consumers who are impacted by the scattered work of multiple agencies. A strong consumer voice in the White House can serve as an early warning system to flag abuses before the endanger entire institutions or the economy.