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WRITTEN TESTIMONY OF NEW YORK CITY DEPARTMENT OF CONSUMER AFFAIRS COMMISSIONER JONATHAN MINTZ AT HOUSE COMMITTEE ON FINANCIAL SERVICES HEARING ON CONSUMER FINANCIAL PRODUCTS REGULATION

Commissioner Mintz Proposes the Creation of a Federal Consumer Financial Products Ratings System

I. Introduction

“Thank you for giving the New York City Department of Consumer Affairs (DCA) the opportunity to submit testimony for the Committee’s hearing on June 24, 2009. We appreciate this opportunity to comment on the regulatory reform effort on behalf of Mayor Michael R. Bloomberg and the City of New York.

“Strong, comprehensive and systemic reforms are imperative for restoring the confidence of American businesses and consumers, and critical to protecting our economy from another financial meltdown. In short, this is important work, and we wish to add New York City’s voice to the chorus commending this Committee and the Obama Administration for the thoughtful and ambitious proposals under consideration here today.

“DCA is the largest and most aggressive municipal consumer protection agency in the country. Our comments focus on the proposed new protections afforded to consumers in the financial services market place. In proposing to create a Consumer Financial Protection Agency, the President has marked the end of second-class status for consumer protection issues. Even more importantly, by advancing such an effort in the midst of economic turmoil, he has reinforced that such protections are in fact the foundation of a sound and profitable financial services industry.

“This testimony sets forth several lessons we’ve learned in New York City in Mayor Bloomberg’s innovative experiment to implement at a local level what now has been proposed federally: that is, inserting robust consumer protection directly into the financial services sector. With the addition of the Department of Consumer Affairs specialized Office of Financial Empowerment (OFE), DCA has paired its core protection functions—including rulemaking, licensing, inspecting, educating, resolving consumer complaints, and bringing targeted litigation—with a successful and large-scale financial empowerment mission that brings financial institutions to the table to offer, and actually sell, jointly developed and specially branded safe consumer financial products. In other words, DCA has on-the-ground experience in the same work that the Consumer Financial Protection Agency would undertake.

In this testimony, we flesh out more examples of this innovative – and doable – integration of consumer protection within the financial services sector. Then we offer several recommendations based on our experience that should inform the debate about the mandate of a federal Consumer Financial Protection Agency. In particular, we highlight a novel approach—an innovative ratings system—that we believe could be a game changer in this debate—for consumers, for financial sector players, and for the

network of regulators seeking to rationalize the many interests at stake.

II. The Need for Consumer Protections: Including Safety and Soundness

“An important lesson learned from the financial crisis is this: our regulatory framework permitted short-term profit objectives to proliferate at the expense of both consumers and the long-term safety and soundness of firms and, as it turns out, the economy. Our current regulatory framework was ill equipped – and generally unwilling – to stem this tide of dangerous financial products. Non-bank lenders were unfettered and reckless, and even regulated institutions had monitors who allowed gains in firm profits to come at the expense of consumers. You will be told by those who have profited from the existing system that we must choose between safety and soundness on the one hand and consumer protection on the other. DCA applauds our President for rejecting that dichotomy as a “false choice” and proposing an agency that would accomplish both objectives.

“More than anything else, consumer protection demands *informed choice*. Imagine where we might be today if banks and other lenders had been held to this expectation. Consumers would have had the opportunity to choose to *accept* products and services rather than having to opt out of often costly features, *and* in plain language, clear and understandable terms. Customer confidence in financial institutions, and their successful, long-term engagement with those products and services, would have created a strong base for our system, offering financial institutions *sustained* profitability.

Consumer protection does not represent a threat to safety and soundness. To the contrary, a Consumer Financial Protection Agency could ensure the sound and stable market that can only come with informed choice.

III. Lessons Learned by the New York City Department of Consumer Affairs

“As the largest local consumer protection agency in the country, New York City’s Department of Consumer Affairs has learned quite a bit about effective approaches to protecting consumers. With DCA’s Office of Financial Empowerment, we’ve also spent more than two years pushing the envelope on scalable efforts to interweave that protection framework into the financial services sector in New York.

“To ensure a fair and vibrant marketplace for the businesses of New York City, its 8.3 million inhabitants, and its 47 million annual visitors, DCA licenses more than 70,000 businesses in 55 different industries; enforces municipal laws including the strongest local unfair and deceptive practices act in the nation through both inspections and targeted litigation; mediates thousands of individual consumer complaints annually; educates consumers and businesses through public hearings and public marketing and outreach campaigns. DCA also works with other city, state and federal law enforcement agencies to protect consumers from deceptive practices and ensure a fair marketplace.

“We’ve learned that often the best way to protect – and educate – consumers is through targeted enforcement initiatives. The Department’s aggressive enforcement of New York City laws regulating income tax preparers complements well our asset building work, as one example. Those of us engaged in financial empowerment know it is critical to get consumers every dollar of their tax refunds, particularly those from the Earned Income Tax Credit. Yet refund anticipation loans, with their high fees and exorbitant interest rates, are classic examples of truly dangerous products. In early 2009, DCA enforcement officers inspected more than 700 income tax preparation

businesses and found 39% in violation of at least one consumer protection regulation. DCA issued more than 1,200 violations, assessing some \$600,000 in fines, primarily against businesses deceptively promoting these loans as though they were simply very fast refunds from the IRS.

“In addition to protecting against unfair and predatory practices, DCA’s OFE spearheads an array of other financial empowerment efforts, each designed with a focus on scale.⁷ Leading the way in the municipal financial empowerment movement, Mayor Bloomberg also created the Cities for Financial Empowerment (CFE) Coalition that identifies innovative cities across the country that partner and coordinate at the national level efforts similar to the work OFE does locally.²

“In addition to our large-scale public education campaigns, we implement innovative asset-building strategies, and coordinate a dynamic network of the City’s many financial education service providers. Mayor Bloomberg recently launched a Citywide network of Financial Empowerment Centers that offer the “gold standard” of financial education: one-on-one financial counseling and coaching. And we offer it for free.

“While offering services such as these, we’ve gained on-the-ground insight to inform our education, enforcement, and policy efforts. Significantly, 64% of those seeking help at our Financial Empowerment Centers come for assistance to reduce untenable debt. The median income of those seeking help is only \$10,000 per year, and yet median debt levels top \$7,000, primarily consisting of revolving debt products like credit cards. One-quarter of clients have debts totaling \$20,000 or more. This street-level data has also been the touchstone for our ability to engage successfully the City’s financial institutions.

IV. DCA’s Active Involvement in the Consumer Financial Products Marketplace

“Last year, DCA conducted extensive research on the availability of financial services and consumer needs in two communities in New York City - Jamaica, Queens and Melrose, in the Bronx. The study went beyond classic supply data by focusing on financial product and service demand. We wanted to understand why residents of these communities do or do not choose bank products and services as compared with products and services provided by other, often fringe, financial service providers. Effective consumer protection efforts must be grounded in market realities.

“DCA’s study uncovered some startling findings. For example, while 69% of residents in those two low-income communities have bank accounts, 75% of residents regularly depend on check cashers to meet their financial needs.³ Why are even mainstream bank customers going elsewhere to meet their needs? Clearly, it’s not for lack of education about maintaining a bank account, as is too often and too easily suggested. Simply put, banks aren’t providing the safe, appropriate products such customers require for their basic financial transactions. Our study revealed that 60% of checking account holders in those communities reported that their landlords would not accept personal checks for rental payments.

“Yet, while banks across New York City typically charge money order fees ranging from \$3 to \$10, most check cashers charge about \$1. Nearly one-third of the unbanked residents in DCA’s study – estimated to represent more than 110,000 people in the two communities - cited excessive fees as the most common reason they avoided mainstream banking, and focus groups reported that unpredictability of fees, was one of the most compelling reasons to avoid banking. Consumers are concerned whether their deposits are safe from the very institutions to which they trust their hard-earned money

The lesson we learned is that educating consumers and investing in financial literacy can only ever be half of the equation. The other half is making sure there are safe and smart products from which to choose.

“DCA set out to see how we could use the power and position of government to change this equation. As one example, we negotiated an agreement that attracted ten financial institutions to develop and sell a specialized “safe” starter account for consumers with low incomes—called our Opportunity NYC account. We also have piloted an innovative tax-linked asset-building savings product, called SaveNYC, which facilitates savings for consumers willing to direct a portion of their tax refund into this special account for a year to qualify for a 50% match.

“Our experience in this area is helping us to influence the debate regarding a statewide program in New York, called the Banking Development District program. We have urged that the benefits of this program be judged by the volume of safe products sold, rather than by good intentions or merely the brick and mortar presence of financial institutions in a low-income neighborhood.

V. Principles for Designing an Effective Consumer Protection Agency

“With these experiences under our belt, DCA offers a set of recommendations that could inform the promise of the Consumer Financial Protection Agency, and we will outline an idea we have for a user friendly product safety ratings system that could serve as both a clear signal to consumers and a reliable tool for regulators for examinations and oversight.

1. **The Consumer Financial Protection Agency should have broad authority to regulate financial products, including banking and savings products as well as credit products.** Banking and savings products must be within the purview of the Consumer Financial Protection Agency for two reasons. First, they necessarily form a big part of any asset-building effort aimed at low- and moderate-income consumers. Second, they often have features that mimic credit products.

A case in point is “courtesy” overdraft protection plans, included automatically in most bank accounts. These plans, wherein banks automatically cover purchases that exceed account balances and charge huge fees for that service, are essentially costly short-term loans, though they are not regulated as such. Customers rarely know they are enrolled in such programs, let alone that they are under an obligation to opt out of them to avoid their automatic triggers.

Surprises are the norm: a bank-authorized debit purchase can trigger the overdraft plans’ fees, which are, on average, higher than the purchase amount itself. In fact, financial institutions generated \$17.5 billion in fee income in return for extending only \$15.8 billion in credit through fee-based overdraft coverage in 2006.⁴ The estimated typical effective APR on fees resulting from ATM and point-of-sale (POS) debit transactions is between 1,173% and 3,540%.⁵ The burden of these exorbitant fees is concentrated on the least financially stable customers, with 16% of overdraft loan users paying 71% of fee-based overdraft loan fees, with repeat users more often low-income, single, non-white renters.⁶ Such predatory practices must be subject to oversight.⁷

Congress should charge the Consumer Financial Protection Agency with regulating not only depository institutions, but also the rapidly expanding non-

bank financial services market. This would include prepaid debit cards or other transactional products, as well as potentially destabilizing and often opaque credit products, such as payday, refund anticipation, debt-consolidation and used-car financing loans.

2. **Default “plain vanilla” products are critical.** The Administration’s proposal discusses the creation of default, “plain vanilla” products. This feature is attainable, though there are a few “lessons learned” from our work in New York City that also should be considered when developing such products.

First, merely requiring that a product be offered is insufficient to ensure the product actually is marketed and sold. We’ve learned much from New York State’s experience with its mandated basic banking account. Requiring state-chartered financial institutions to offer a low-cost account with a nominal opening deposit and one-cent minimum balance requirement was a great step forward for consumers with low incomes. Unfortunately, financial institutions have not been held accountable for marketing, let alone selling, these accounts – and so they are largely absent from the marketplace.

Second, “plain vanilla” products must be able to keep pace with the market. Again, our experience with the New York State basic banking account is instructive. The practice of fee-based overdraft has emerged since the account’s inception, and the basic banking account does not restrict the fees associated with such features.

The Consumer Financial Protection Agency should push beyond the current safe harbors and best-practice disclosure guidance associated with federal Truth In Lending, Truth In Savings and similar statutory compliance. While still encouraging innovation, the Consumer Financial Protection Agency could require certain financial institutions to offer, market and sell products appropriate for a wide range of consumers. And the Consumer Financial Protection Agency could set the standard for plain-language contracts terms in its basic, “plain vanilla” products.

3. **Branding must be both simple and mandatory.** In order for the Consumer Financial Protection Agency’s protections and products to reach their potential, the Consumer Financial Protection Agency must leverage the government’s power and reputation to provide uniform branding that achieves universal recognition. We’ve seen this approach work both at the federal and local level. Take for example, the Department of Energy’s “Energy Star” ratings, now universally recognized and, in today’s green marketplace, sought-after indicators. In New York City, DCA successfully has branded our Opportunity NYC and SaveNYC products. Consumers need to know who and what to trust, and be able to assess “apples-to-apples” comparison points when choosing among products, services, and institutions. With this boost in education and expectations, consumer demand for trusted, rated products will increase their supply.
4. **Consumer complaints must inform policymaking and be shared with diverse regulators at the state and local level.** Consumer complaints can be a valuable source of information to guide policy and practice. DCA’s own experience in our debt collection oversight provides a case in point. Last year, DCA received more than 1,200 complaints against debt collection agencies and secured more than \$2 million in restitution for consumers for debts that weren’t actually owed and harassed in ways outlawed by local license regulations. Our mediation of consumer complaints confirmed that debt

buyers were a growing force—and increasingly involved in improper collection practices. We worked with local legislators to strengthen our statutory authority to regulate this burgeoning industry incarnation that was skirting existing law. By July, we will license debt buyers and have promulgated rules to ensure that they obey critical consumer protections. Similarly, our experience resolving consumer complaints about home improvement contractors revealed that many were engaging in predatory lending practices, using their interactions with consumers to promote bad loans. We wrote regulations and curbed this abusive practice.

Consumers must be able to direct complaints about financial products and services to a central repository. Complaints should be aggregated into a central and broadly accessible clearinghouse to inform policymaking, enforcement, and consumer awareness campaigns at federal, state and local levels.

5. **State and local consumer protection efforts must not be preempted.** The Administration should be commended for recognizing in their proposal that rules promulgated by federal regulators should establish baseline protections and allow state and local authorities, with on-the-ground experience protecting consumers in areas most relevant to their jurisdiction, to establish and enforce stronger protections.
6. **Financial institutions and non-bank financial service providers should be held accountable for new consumer protections.** As noted above, it is important to know not only what products and services are offered but also what is being sold. New ways of holding firms in the financial services marketplace accountable are necessary. Congress should require regular compliance reviews, integration into the Community Reinvestment Act exam process, linkages to safety and soundness exams and impact litigation, among other enforcement mechanisms.

VI. Product Ratings: An Idea

“We are faced with several challenges. Beyond outright bans of certain products and services, how can the Consumer Financial Protection Agency exercise broad authority over product features and disclosures, create product defaults and “plain vanilla” products, and still remain nimble and responsive to the market experience? How can the Consumer Financial Protection Agency confidently steer consumers towards appropriate and safe financial products, yet leave critical latitude for innovation? How can the Consumer Financial Protection Agency ensure that banks and financial institutions won’t just possess safe products, but actually will sell them? And how can the Consumer Financial Protection Agency exercise such broad federal authority while at the same time nurture an environment conducive to state and local collaboration?”

“A federal consumer financial products ratings system, administered by the Consumer Financial Protection Agency, and linked to the CRA exam process, may hold the promise of meeting these fundamental and diverse challenges. Much like the Medicare quality rating system helps those in need of nursing homes identify facilities with the highest quality of care, this ratings system can help consumers make appropriate choices to fit their financial services needs.

“Here’s an outline of how this ratings system could work. The Consumer Financial Protection Agency, with Congressional guidance, would work with diverse stakeholders to establish identifiable safety standards for a broad array of consumer financial products and services. These standards could be translated into a nationally-

recognized ratings system, such as the simple, A through F letter-grade system, or a green, yellow, red "stoplight" system. Highly rated products would correspond to the "plain vanilla" products all financial services providers would offer. Mid-range ratings would warn consumers that some product features may be risky or inappropriate for certain consumers. Poor product ratings would indicate that one or more product features was deemed predatory or dangerous to most consumers, and should be purchased with extreme caution.

"Another possibility is that ratings would be customized for particular consumer profiles or that product data collected through the ratings process would be widely available to consumers through an online database, similar to those currently used in the private sector.

"Finally, the Consumer Financial Protection Agency could hold financial institutions accountable using tools such as the Community Reinvestment Act examination process for their product-rating mix, and the actual number of safe products and services sold in low- and moderate-income communities.

This ratings concept would not preclude outright bans of the most egregious or clearly exploitive products. Rather, it would empower consumers to identify products appropriate for their needs, while encouraging innovation within the boundaries required to attain high product ratings.

"We understand that creating the type of ratings system conceptualized above requires industry expertise, new reporting and considerable resources. In the end, however, a ratings system has the potential to empower consumers to assess their choices on an "apples-to-apples" basis and restore the confidence of consumers in the financial services marketplace. Similarly, ratings would encourage financial institutions to initiate safe, affordable products that lead to long-term profitability based on a mutually beneficial relationship with the customer.

VII. Conclusion

"Thank you for this opportunity to comment on the proposed Consumer Financial Protection Agency. New York City stands ready to offer its local experience, its network of City partners, and its thinking on the power and promise of this Agency at your convenience."

¹ DCA's OFE was the first initiative to be implemented under Mayor Bloomberg's Center for Economic Opportunity (CEO), a comprehensive, research-driven effort to design and implement innovative poverty-reduction strategies.

² Commissioner Jonathan Mintz co-chairs this Coalition with San Francisco Treasurer José Cisneros, promoting CFE member cities as bustling laboratories of large-scale asset building, financial education, and banking initiatives.

³ "Neighborhood Financial Services Study," NYC Department of Consumer Affairs, June 2008.

⁴ Halperin, Eric and Peter Smith, "Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans," Center for Responsible Lending, July 11, 2007.

⁵ FDIC, "Study of Bank Overdraft Programs," November 2008.

⁶ Halperin, Eric, "Overdraft Loans Trap Borrowers in Debt," Center for Responsible Lending, March 18, 2008.

⁷ As noted earlier in this testimony, DCA has negotiated with banks to offer safe, basic banking products. As part of this process, we have successfully moved banks to offer non-overdraft accounts. At the policy level, in March 2009 and July 2008, both DCA's OFE and the CFE Coalition advocated to the Board of Governors of the Federal Reserve System for regulatory changes focused on ensuring full consumer awareness of the fees associated with overdraft to facilitate informed "opt-in" decisions to accept those fees both at the time of account opening and on a transaction by transaction basis at ATMs and point-of-

sale terminals. And we are engaging with rulemakers regarding an analogous "opt in" approach—for credit card over-the-limit fees—recently enacted in credit card legislation.