



Nonprofit Publisher
of Consumer Reports

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President Barack Obama
The White House
1600 Pennsylvania Ave NW
Washington, DC 20500

Dear President Obama,

Consumers Union, the non-profit publisher of *Consumer Reports*, strongly supports your recently announced principles for transforming our nation's regulatory system. We respectfully offer the following comments.

Proactive, affirmative consumer protection is essential to the safety and soundness of the financial system. The complex financial instruments that sparked the financial crisis were based on home loans that were poorly underwritten; unsuitable to the borrower; arranged by persons not bound to act in the best interest of the borrower; and contained terms so complex that many individual homeowners had little opportunity to fully understand the nature or magnitude of the risks of these loans. The crisis was magnified by highly leveraged, largely unregulated financial instruments and inadequate risk disclosures. The resulting crisis of confidence led to reduced credibility for the U.S. financial system, gridlocked credit markets, loss of equity for homeowners who accepted subprime mortgages and for their neighbors who did not, empty houses, declining neighborhoods and reduced property tax revenue. All of this started with a failure to protect consumers.

A reformed financial regulatory system must protect consumers, investors and taxpayers. Any future financial regulatory structure must include proactive regulatory oversight, strong consumer protections, steps to make the features and pricing of financial products less complex, credit reform, increased accountability of all who offer financial products, an active role for state consumer protection, a change in regulatory culture, and a federal agency independent of the banks focusing on the safety of consumer financial products.

1. Enforce strict oversight of financial institutions that pose systemic risks. Allow states to actively enforce consumer protection law and create a Financial Product Safety Commission.

As part of addressing systemic risk, every financial regulatory agency should increase the importance of consumer protection, making it as critical a part of the agency's work as safety and soundness. However, no single federal agency can foresee all of the potentially harmful consequences of new practices and products. A strong concurrent role for state law and state agencies will provide needed early enforcement of existing standards and a forum to develop new standards to address emerging practices before they spread, causing widespread consumer harm or systemic risk. State legislatures are in a unique position to spot and stop bad practices before they spread. Harmful financial practices often start in one region or as targeted to one subgroup of consumers, but when those practices go unchallenged, others feel a competitive pressure to adopt similar practices.

Currently, the Home Owners' Loan Act stymies application of state consumer protection laws to federally chartered thrifts. With respect to nationally chartered banks, the Office of the Comptroller of the Currency has severely limited both new state standards and state enforcement of existing federal or state standards with respect to nationally chartered banks, though regulations interpreting vague phrases in the National Bank Act. Consumers Union has more details regarding concerns about the OCC's effort to stymie state consumer protections, which can be viewed at: <http://www.consumersunion.org/pdf/Geithner-Ltr-209.pdf>.

Consumers Union also supports the creation of federal agency independent of the financial services industry with the obligation to impose rules and restrictions on financial products and practices to ensure that they are safe for the public to use.

Finally, the subprime crisis showed us that a non-financial institution, such as a rating agency or a bond insurer, can adopt a practice that has consequences throughout the entire financial system. Toxic mortgage securitizations which initially received solid gold ratings are an example of the widespread consequences of actions by non-financial institutions. A structure addressing systemic risk must also address the role of non-financial institutions.

2. Strengthen markets so they can withstand both system-wide stress and the failure of one or more large institutions.

We strongly agree that markets must be strong enough to withstand external shocks and low-probability events. In addition, recent experiences raise the question about whether some large financial institutions have become "too big to manage" or "too complex to regulate." Finally, a regulator will have little chance of ensuring systemic financial stability if significant risk exposures can be maintained off the balance sheet.

3. Encourage our financial system to be open and transparent, including more transparency in regulatory supervision, and to speak in plain language investors can understand.

We strongly support increased transparency, including all efforts to make financial products easily understood for both consumers and investors. Transparency also can be increased by the use of public enforcement tools such as cease and desist orders and the use of public rulemaking powers to prohibit specific practices or product features deemed to be unfair or deceptive.

4. Supervise financial products based on "actual data on how actual people make financial decisions." Abandon "disclosure only" approaches and change the regulatory culture in federal financial agencies.

While we strongly agree with the principle of using independent, *non-industry data* about how consumers actually perceive, use, and understand financial products, more will be necessary to achieve consumer protection. First, it will be essential to move away from failed "disclosure-only" approaches. Financial products which are too complex for the intended consumer carry special risks that no amount of additional disclosure or information will fix. In subprime mortgages, for example, many homeowners were induced to refinance an existing loan for one that would offer a reduced payment for just the first two years. Others were assured that they

need not worry about a high payment because they could refinance later, yet the loan documents contained an expensive prepayment penalty. Many of the more than 60,000 individuals who filed comments with the Federal Reserve Board about credit card practices clearly had expectations about their credit cards which were inconsistent with the written disclosures they had received. Regulatory reform will be incomplete without an end to practices that make financial products difficult for consumers to understand and evaluate.

Second, financial regulatory reform will be incomplete without a change in federal regulatory culture. An effective financial regulatory culture must value early identification of potential problem areas; early, active, and transparent oversight with respect to new products and practices and their potential harms; strong consumer complaint handling with effective outreach; and an affirmative obligation, desire, and ability to predict and address emerging risks.

5. Hold market players accountable, starting at the top, and including increased accountability for those who earn fees or receive government support.

We strongly agree with the principle of accountability and offer the following suggestions on how it might be achieved. Accountability should include making every entity receiving a fee in connection with a financial instrument responsible for future problems with that instrument. This would help to end the “keep the fee, pass the risk” phenomenon which helped to fuel poor underwriting of subprime mortgages. In addition, suitability requirements and fiduciary duties should be imposed on everyone who offers financial products to individuals.

We also support more accountability for financial institutions who receive public support. Companies that choose to accept taxpayer funds or the benefit of taxpayer-backed programs or guarantees should be required to abandon anti-consumer practices and be held to a high standard of conduct. For example, in connection with the Consumer and Business Lending Initiative, which is to be managed through the Term Asset Backed Securities Facility (TALF), Consumers Union and 26 other groups asked Secretary Geithner on Jan. 29, 2009, to impose eligibility restrictions on program participants to ensure that the TALF would not support the taxpayer financed purchase of credit card debt with unfair terms.
http://www.consumerlaw.org/issues/credit_cards/content/GethnerCreditcardTreas0109.pdf.

6. Overhaul our regulations so they are comprehensive and free of gaps.

Weak regulators and regulatory gaps attract questionable activities. We strongly agree that regulatory gaps must be closed in order to foster the strongest regulation at the federal and state levels. Regulatory gaps create pockets of opportunity for harmful products and practices. Regulatory oversight and strict enforcement at all levels of government can stop harmful products and practices from escaping through the cracks. “All hands on deck” to identify problems, develop effective responses, and enforce existing standards is essential to build a stronger financial system.

7. Recognize that challenges we face are global.

Global forums must serve as places to develop high standards, but they must not pose a barrier to adopting the *highest* standards for the protection of U.S. taxpayers, consumers, and others who invest in our economy.

The challenges are formidable. We look forward to working with you as you develop a comprehensive proposal for regulatory reform that will restore confidence in the integrity of our financial system. If you have any questions, please feel free to contact Gail Hillebrand, Financial Services Campaign Manager, (415) 431-6747 or Pamela Banks, Policy Counsel, (202) 462-6262.

Very truly yours,

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cc: Chairman Lawrence Summers, National Economic Council
Treasury Secretary Timothy Geithner