# CREDIT CRUNCH: IS THE CFPB RESTRICTING CONSUMER ACCESS TO CREDIT?

## HEARING

BEFORE THE

SUBCOMMITTEE ON TARP, FINANCIAL SERVICES AND BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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# CREDIT CRUNCH: IS THE CFPB RESTRICTING CONSUMER ACCESS TO CREDIT?

**Tuesday, July 24, 2012,**

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TARP, FINANCIAL SERVICES, AND BAILOUTS OF PUBLIC AND PRIVATE PROGRAMS,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
*Washington, D.C.*

The subcommittee met, pursuant to call, at 10:03 a.m., in Room 2247, Rayburn House Office Building, Hon. Patrick T. McHenry [chairman of the subcommittee] presiding.

Present: Representatives McHenry, Guinta, Buerkle, Amash, Meehan, Quigley, Maloney, Welch, and Speier.

Also Present: Representative Cummings.

Staff Present: Brian Blase, Majority Professional Staff Member; David Brewer, Majority Counsel; Katelyn E. Christ, Majority Professional Staff Member; John Cuaderes, Majority Deputy Staff Director; Howard A. Denis, Majority Senior Counsel; Linda Good, Majority Chief Clerk; Christopher Hixon, Majority Deputy Chief Counsel, Oversight; Cheyenne Steel, Majority Press Assistant; Noelle Turbitt, Majority Assistant Clerk; Jaron Bourke, Minority Director of Administration; Kevin Corbin, Minority Deputy Clerk; Ashley Etienne, Minority Director of Communications; Jason Powell, Minority Senior Counsel; Dave Rapallo, Minority Staff Director; and Davida Walsh, Minority Counsel.

Mr. MCHENRY. The Committee will come to order. The Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs. Our hearing is entitled Credit Crunch: Is the CFPB Restricting Consumer Access to Credit?

We have two panels today. First, Director Richard Cordray of the Consumer Financial Protection Bureau; and then in the second panel we have four individuals that are both from think tanks and from the private sector.

The tradition of this Subcommittee is to begin with the Oversight and Government Reform Committee's mission statement.

We exist to secure two fundamental principles: first, Americans have a right to know that the money Washington takes from them is well spent and, second, Americans deserve an efficient, effective government that works for them. Our duty on the Oversight and Government Reform Committee is to protect these rights. Our solemn responsibility is to hold government accountable to taxpayers, because taxpayers have a right to know what they get from their government. We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy. This is the mission statement of the Oversight and Government Reform Committee.

I will now recognize myself for the purposes of an opening statement for four minutes.

Today's hearing on this Subcommittee will examine how regulatory actions of the CFPB can restrict access to credit, as well as the metrics and tools the Bureau employs to consider the availability of credit in the course of its supervisory rulemaking and enforcement work.

The American people deserve consumer protection regulations that discourage and discipline financial fraud without compromising access to credit for consumers and small businesses. As our Country continues to exhibit sluggish job growth and the possibility of slipping back into a recession, it has become more important than ever to ensure that our markets encompass adequate liquidity and credit for American businesses and families.

Mr. Cordray's unprecedented appointment earlier this year has already resulted in a lawsuit that, if successful, could invalidate all of the CFPB's actions since his appointment. Such legal wrangling, as well as the regulatory actions of the CFPB itself, creates uncertainty that may restrict credit as financial institutions brace for full implementation of Dodd-Frank.

Mr. Cordray has been a great public servant over his career. We may disagree on policy, but he has a strong reputation. The appointment and the process of appointment does raise a lot of concerns outside of that.

Mr. Cordray's own testimony before this Subcommittee has not helped to alleviate much of the concern about uncertainty, as he and the Bureau have been vague, and continue to be vague in many regards, about the definition of "abusive practice" by market participants.

Since the Subcommittee last met with Mr. Cordray in January, the CFPB has proposed or finalized rulemaking that will increase the regulatory burden for financial institutions and consumers without conducting what I believe is necessary, which is a thorough and robust cost-benefit analysis.

The Bureau's consideration of the Qualified Mortgage rule has been met with dismay from lenders and experts who believe the rule could make consumer borrowing more expensive. That is a great concern. Many experts also believe that the QM rule could make it harder for consumers to compare mortgage options and reduce consumer choice. That is a major concern as well. I would urge Mr. Cordray and the CFPB to consider these consequences as the housing market is finally beginning to see some daylight.

In addition, the finalized rule to regulate international remittance transfers sent from consumers in the United States has already resulted in a reduction of services for consumers. State National Bank of Texas has stopped offering the service and estimates that roughly 3,000 to 4,000 other community banks will exit the remittance transfer business because of the rule.

In light of these negative consequences to certain CFPB regulatory actions, the Bureau should join other independent regulators that have taken steps to improve their cost-benefit analysis. Both the CFTC and the SEC have, of recent, undertaken efforts to implement vigorous cost-benefit analysis of the likely economic consequences of new regulations. With our fragile economic situation, now is not the time for overly aggressive, shortsighted rulemaking by the CFPB.

Today's oversight hearing represents this Subcommittee's commitment to ensuring that government regulators strike the appropriate balance between protecting consumers and ensuring that there is sufficient access to credit. That is the purpose of today's hearing.

I thank Mr. Cordray for returning before this Subcommittee and for his willingness to submit to oversight from Congress. I certainly do appreciate that.

With that, I will now recognize Mr. Quigley of Illinois, the Ranking Member, for four minutes.

Mr. QUIGLEY. Thank you, Mr. Chairman, for holding today's hearing, and thank all of our witnesses for participating this morning.

Congress created the CFPB in the wake of the financial crisis when it became painfully obvious to everyone that credit markets were not working for American consumers. Unscrupulous lenders were able to take advantage of consumers by selling them faulty, fraudulent, and deceptive financial products. This reckless lending poisoned the financial system and directly contributed to the credit crunch and the mortgage meltdown.

We explicitly created the CFPB to protect Americans against these fraudulent and abusive products, and we know too well that the accumulation of faulty products in our financial system is as much a risk to the system as a whole as it is to the borrower and the lender.

I would like to read from the CFPB's mission statement: To make markets for consumers financial products and services work for Americans, whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products.

Markets work best and access is enhanced when regulators reduce the risk of fraud and deception.

Director Cordray, I would like to welcome you back to the Subcommittee and thank you for testifying today. This is the fourth Oversight Committee hearing, by my count, to focus on the CFPB. Director, in January you testified before the Subcommittee that upon your swearing in as Director the CFPB gained "its full authorities to investigate and bring enforcement actions."

Earlier this month the CFPB announced its first public enforcement action, which focused on credit card marketing. Specifically, on July 18th, 2012, the CFPB found that the vendors of Capital One Bank engaged in deceptive marketing tactics to pressure or mislead consumers into paying for add-on products. Capital One was ordered to refund approximately $140 million and pay an additional $25 million in penalties.

The type of action is important, as you stated in January, to ensure that financial providers are held accountable if they violate the law and that the rules of the road governing banks and nonbanks are applied evenhandedly. This is exactly why we created

CFPB, so I am glad to see it actively protecting consumers through enforcement actions.

I am also glad to see CFPB taking action on student loan debt. In March the Federal Reserve of New York reported that the total outstanding student loan balance is $870 billion. That is greater than the total credit card debt and auto loan debt combined. The Federal Reserve also reported that Americans over the age of 60 currently owe $36 billion in student loans, highlighting the unique longevity of student loan debt. The sheer amount of outstanding student loan debt demands attention, especially as we look to finance our children's education.

In July, the CFPB rolled out a tool to help students who have fallen behind on their payments so that they understand their options for going forward. This is a welcome step forward in an area of the economy that has previously received too little attention. I look forward to further CFPB engagement on the student loan debt issue.

Thank you, Mr. Chairman, and I yield back.

Mr. MCHENRY. I thank the Ranking Member.

Members will have seven days to submit opening statements for the record.

We will now recognize our first panel. The Honorable Richard Cordray is the Director of the Consumer Financial Protection Bureau.

It is the policy of this Committee that all witnesses be sworn before they testify. You have testified regularly before Congress and I appreciate that, but if you would please rise and raise your right hand.

Do you solemnly swear or affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

[Witness responds in the affirmative.]

Mr. MCHENRY. Thank you. You may be seated.

Let the record reflect that the witness answered in the affirmative.

We will now begin with five minutes of testimony before this Subcommittee, then we will go to a round of questions, as you well know. You are very aware of the lighting system that we have. You have five minutes to summarize your opening statement. Green means go, yellow means hurry up, and red means stop. So, with that, we would certainly like to give you every opportunity to testify. Mr. Cordray.

## WITNESS STATEMENT

## STATEMENT OF RICHARD CORDRAY

Mr. CORDRAY. Thank you, Chairman McHenry, Ranking Member Quigley, and members of the Subcommittee. Thank you for inviting me back today to talk about the importance of the availability of credit.

At the Consumer Financial Protection Bureau we know that access to credit means access to opportunities. Mortgages allow people to buy a home and spread the payments over years; student loans give people access to further education; and credit cards give people immediate and convenient access to money when they need it. These products can help people achieve their dreams.

Unfortunately, the financial crisis of 2007, 2008 caused investors to flee lending markets. Most of these markets have recently shown some signs of improvement. Credit card originations are growing at a modest pace and we are seeing a more significant growth in auto and student lending. But it concerns us, as it surely concerns you, that many consumers today are shut out of certain credit markets, especially the residential mortgage market.

Lending standards are quite tight and it appears that many creditworthy borrowers are having trouble buying homes. This is making it tough on consumers and it is making it tough on a broader economy.

At the Consumer Bureau, we are working to help change this for the better. The Dodd-Frank Wall Street Reform and Consumer Protection Act directs us to use our authority to achieve two broad purposes: first, we are to ensure that the markets for consumer financial products and services are fair, transparent, and competitive; second, we are to ensure that all consumers have access to these markets. Because credit can create opportunity, we think these two goals work in tandem.

This means we work with the industries we regulate to come up with the best, most common sense solutions to problems. We want to increase opportunities for consumers, not diminish them. This means we are coordinating our rules to reduce unnecessary burdens and we are holding small business review panels to help us gather input from small providers in particular, such as community banks and credit unions.

Indeed, the Dodd-Frank Act specifies that in our rulemakings we must explicitly consider the potential effects of our rules on access to credit. We do that by consulting with industry and with consumer groups, and we work hard to consider all the evidence when analyzing the issues.

Before we propose a rule, a team of attorneys, economists, and market experts evaluates alternatives in terms of their potential consequences for consumers, providers, and the market. This team conducts quantitative and qualitative research wherever possible. They obtain and analyze data and review relevant studies. They consult extensively with industry experts, consumer advocates, and stakeholders from small and large firms, banks and nonbanks.

Industry veterans on our staff help us understand how the market really works and how a rule might affect consumers and providers, both substantively and operationally. For example, our work on the ability-to-pay mortgage rule illustrates how seriously we take our obligation to consider effects on credit availability. Later this year we will finalize rules to implement this new statutory requirement that, before making a mortgage, lenders make a good faith and reasonable determination that borrowers have the ability to repay the loan. Lenders will have to verify and document that point.

In implementing this statute, we want to fulfill its purpose of ensuring that consumers are not sold mortgages they cannot afford, and we want equally to ensure that consumers who can afford to repay loans can find those loans are available to them in the market. We will seek to define these lower risk loans, known as qualified mortgages, carefully so that, as the market stabilizes, every segment of the market is competitive and investors will have an incentive to participate in the lending market. We will strive to craft a sensible rule that works for the market throughout the credit cycle, while being attentive to just how fragile and risk-averse the market seems to be today.

We recently reopened the comment period to be as transparent as we can about the data we are using in this rulemaking and to see if lenders or others have any more pertinent data to share with us. Through these additional efforts, we hope to muster the best available evidence to help us decide how to implement the statute in a manner that will both prevent unaffordable loans and preserve access to credit.

In sum, Mr. Chairman, we are keenly aware that the market is waiting to see the precise shape that our rules take. That is why we are working to put in place our regulations by the deadlines that Congress set, and that is why we are being as transparent as we can in doing so. We want to help provide the mortgage market with the clarity needed to improve performance.

At the Consumer Bureau, our goal is to make consumer financial products and services work better for Americans, for the honest businesses that serve them, and for the broader economy as a whole. An effective marketplace means access to credit, which is essential to providing the opportunity that consumers need all across this Country.

Thank you, and I look forward to your questions.

[Prepared statement of Mr. Cordray follows:]

**Written Testimony of Richard Cordray**

**Director, Consumer Financial Protection Bureau**

**Before the House Oversight and Government Reform Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs**

**July 24, 2012**

Chairman McHenry, Ranking Member Quigley, and Members of the Subcommittee: thank you for inviting me here today to talk about the importance of credit availability. We are always happy to talk with Congress about the work we are doing at the Consumer Financial Protection Bureau. Today is our 23'd appearance testifying before the Congress.

The Bureau understands the importance of the availability of credit to consumers. Credit is the lifeblood of a modern economy. Mortgages allow people to buy a home and spread the payments over many years. Student loans give people with talent and ambition access to a higher education. Credit cards give consumers immediate and convenient access to money when they need it. These products can help people achieve their dreams.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directs the Bureau to use its authority to achieve two broad purposes, among others. First, we are to ensure that all consumers have access to markets for consumer financial products and services. Second, we are to ensure that these markets are fair, transparent, and competitive.

Helping consumers in their financial lives and preserving their access to credit are critical parts of our mission to protect consumers. They are both important goals, and we do not pursue one at the expense of the other.

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Concern for credit availability is foremost in our mind as we undertake the task Congress gave us to develop rules to implement statutory reforms in the residential mortgage market. We are mindful of the fact that many consumers today are shut out of that market.

And let us remember how we got here. Fueled by expanding mortgage lending, consumer credit was growing by more than 10 percent year-over-year on average leading up to 2008.[1]

This growth of credit availability brought an illusion of gain, and a reality of deep losses. The largest financial crisis since the Great Depression cut deeply into Americans' wealth and access to credit. It devastated the private mortgage market and caused investors to flee lending markets more broadly. Without proper safeguards, transparency, and oversight, credit markets caused great damage to the economy and individual Americans.

Consumer credit markets are improving. Most consumer lending markets have recently shown some signs of growth. Credit card originations are growing at a modest pace. We are seeing growth in auto lending and private student lending has stabilized after a rapid decline. But

[1] FRBNY Quarterly Report on Household Debt and Credit, May 2012

mortgage lending standards are still quite tight, and it appears that many creditworthy borrowers cannot buy homes.

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While these challenges arose long before the Bureau was created, it is now our role to put in place common-sense rules of the road to help set the stage for the return of a stable, fair, and transparent private mortgage market.

Over the next six months, we will be proposing and finalizing sound rules, most of them required by Congress, to address each stage of the mortgage process, from application to origination to servicing to termination. Clear rules of the road will support responsible decision-making and rebuild consumer and investor confidence in the system.

Some Americans may fear homeownership because of the devastation they have seen, stemming, in part, from bad lending practices. We believe that consumers will have more confidence after more robust rules are in place. And we are keenly aware that potential investors are waiting to see the precise shape our rules take. That is why we are working to put in place rules by the deadlines that Congress set. We are committed to helping provide the mortgage market with the clarity it is seeking.

We just released our proposal to improve disclosures and help consumers better understand mortgage terms, so that they can make more informed decisions. The disclosures are aimed at helping consumers shop and save. The proposal lays out our preliminary assessment that better disclosure will not impose unnecessary burdens on lenders or undermine credit availability. In fact, maintaining two separate federal mortgage disclosures has added burdens and complexities that have likely raised the cost of credit unnecessarily. We expect that integrating and simplifying these disclosures may reduce the long-term cost of originating mortgages, and these savings may be passed on to consumers, thereby making credit more affordable.

Other rules we will propose soon are intended to ensure basic fairness in mortgage servicing. For example, servicers will have to consider and respond to borrowers' allegations of error, and contact troubled borrowers early with information about their options.

Later this year, we will finalize rules to implement a new statutory requirement that, before providing a mortgage loan, lenders must make a good faith and reasonable determination that borrowers actually have the ability to repay the loan. Lenders will have to verify and document repayment ability.

In implementing this statute, we are seeking to fulfill its purpose of ensuring that consumers are not sold mortgages they cannot afford. And we want equally for consumers who can afford to repay loans to be able to find those loans in the market. We will seek to define those loans known as "qualified mortgages" carefully so that as the market stabilizes, every segment of the market is competitive and has the benefit of sufficient investor appetite to ensure liquidity. And critically, we expect lenders to continue making prudent, profitable loans in non-traditional segments – like loans to self-employed borrowers. We will strive to craft a sensible rule that works for the market throughout the credit cycle, a rule that is attentive to just how fragile and risk-averse the market is right now.

We recognize that implementing an array of mortgage reforms is challenging for industry. We will seek to coordinate these rules to minimize any unnecessary burdens. For example, we will decide effective dates by taking into account the relationships among these rules.

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In each of these rulemakings, we explicitly consider the potential effect of a rule on access to credit. The Dodd-Frank Act specifically requires us to do that.

The rulemakings we are engaged in now are primarily to implement statutory directives. Some of these statutes grant the Bureau discretionary authority within the area Congress directed us to regulate. For example, the statute grants us authority to define the phrase "qualified mortgage." As we consider potential alternative approaches to exercising our discretionary authority, we consider the benefits and costs of these alternatives for consumers and providers, including whether what kinds of effects different alternatives would have on access to consumer financial products and services.

Before we propose a rule, a team of attorneys, economists, and market experts evaluates alternatives in terms of their potential consequences for consumers, providers, and the market. This team conducts quantitative and qualitative research. They obtain and analyze data to the extent data become available to us within statutory deadlines. They also review relevant studies. They consult extensively with industry experts, consumer advocates, other regulators, and stakeholders from small and large firms, banks and non-banks. Industry veterans on our staff help us understand how the market really works and how a rule might affect consumers and providers.

Small-business review panels help us gather input from small providers in particular, such as community banks and credit unions. The Bureau has held three such panels with the Small Business Administration Chief Counsel for Advocacy and the Office of Management and Budget. In each case, the panel spent several hours with small providers discussing potential impacts of a rule and obtained extensive input. These panels are helping the Bureau to identify areas of particular concern to small providers and potential alternatives and mitigation measures that may provide opportunities to achieve statutory objectives with less cost to small providers and their customers.

Staff uses this quantitative and qualitative research to recommend how the Bureau should exercise the constrained discretion that Congress has left to us. Then we make decisions about major contours of the proposed rule, taking into account its potential effects on providers and consumers in light of the input they have provided to us.

The Bureau's proposals explain how we have considered these effects. The proposal contains a preliminary economic analysis of the impact of the rule on providers and consumers. The Bureau also asks the public to identify additional data and provide feedback on our reasoning. The transparency of this process is evident in our recent proposals to reform federal mortgage disclosures and expand protections for high-cost loans. These proposals contain very detailed analyses of benefits and costs.

The Bureau has another opportunity before finalizing the rule to consider ways to achieve statutory objectives at less cost to consumers and providers. To develop a final rule, we consider the comments on the proposed rule and the preliminary economic analysis. Staff also evaluates any additional data they have obtained. Staff reevaluates the proposal in light of new information and recommends any changes to the proposal that are warranted in light of the new information. An economist conducts a final regulatory analysis, taking into account any significant new information that surfaces in the public comments.

Our work on the "ability to pay" mortgage rule illustrates how seriously we take our obligation to consider effects on credit availability. The public comment file reflects many meetings we have been holding with financial institutions, trade associations, consumer groups, and community groups. We plan further consultations with small providers. We have also secured a major data set of mortgage loans, and we are pursuing additional data.

We recently reopened the comment period to be as transparent as we can about the data we are using and to see if there are more data that lenders or others will share with us. With these additional efforts, we hope to muster the best available evidence to help us decide how to implement the statute in a manner that will both prevent unaffordable loans and preserve credit access.

Credit availability is also a consideration in our ongoing efforts to streamline the body of regulations we inherited. We are examining the ability-to-pay rule of the CARD Act to determine whether the rule properly balances repayment ability with credit access for spouses who are not currently employed. We will apply this same consideration to other rules, where relevant, as we proceed with our streamlining efforts.

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Mr. Chairman, thank you for the opportunity to testify on this important topic. I look forward to continuing to work with you and the Committee, and I will be happy to take your questions.

Mr. MCHENRY. Mr. Cordray, thank you so much for your testimony and thank you for your public service and your long career in public service.

I now recognize myself for five minutes.

Mr. Cordray, I know that you are aware of this, but the National Bureau of Economic Research outlined that roughly half the American people couldn't come up with $2,000 within 30 days to meet some unexpected challenge. I think that is proof positive both of the depth of this economic downturn, these tough economic times we are facing, but also the limitation in the credit markets. We have 25 percent of the American people that are either unbanked or underbanked, and as such we see some limitations with credit products available to the American people.

So, in your estimation, how do you resolve this and what obligation does the CFPB have to ensure access to credit products and a greater access to credit products?

Mr. CORDRAY. Thank you, Mr. Chairman, for the question. It is something that we have been focused on in a number of our community field hearings and other events where we get outside of Washington. We have been considering the payday lending industry, the overdraft issue, and prepaid cards, which are various means by which the short-term need for credit is being met in our economy.

I would agree with you that there has been—not only has it been documented by research, but we hear it from people all over the Country as we go out and talk to people face to face, and we hear it from them as they submit stories to us, that they need short-term access to credit.

One of the really great insights that is embodied in the Consumer Financial Protection Bureau is that we both are overseeing large banks, the very largest banks, and also nonbanks, so that we don't have a bank-centric view of this. If people are pushed outside of the banking system and they have to survive on financial products such as payday loans and other types of things, we care a great deal about that because we have to oversee those providers as well.

So for the unbanked and also the underbanked, the many people who have a bank account but still use many alternative financial services to meet their needs, it is very important to us to understand exactly what those needs are, how they can be met better, how they can be met by products that don't further deepen the hole that many Americans find themselves in as they try to meet their needs day-to-day, and it is something that, as I said, is a focus of quite a bit of our efforts, so I appreciate your attention to it as well.

Mr. MCHENRY. So the answer is yes, CFPB does have an obligation to ensure that there is access to credit products for the average American.

Mr. CORDRAY. I think that is part of our mission, absolutely, yes.

Mr. MCHENRY. Okay. And we discussed this before and I have asked you this before, but inherent in regulation is both a cost and a benefit, and it depends your point of view of said regulation on whether or not you think we should focus more on the cost or more on the benefits. But certainly, whether or not your view of regulation is proper and good or improper and destructive, you need to weigh both the costs and the benefits.

As you go through ongoing rulemaking, the cost and the benefits, will they be accounted for, and is that a major concern that you have?

Mr. CORDRAY. So the answer, briefly, is yes, it is a major concern for us, and for a number of reasons. First of all, at a minimum, at a baseline, it is legally required that every time we adopt a rule we have to consider, under our statute, the burdens, the impacts, and the benefits of the rule, and we have to size those up, and, frankly, if the burdens are not outweighed by the benefits, it is not the kind of rule we should be going forward with.

Second, I just think that is common sense and, as you say, if you are doing more harm than good, then you shouldn't be doing what you are doing. But it requires a careful assessment. Sometimes these can involve lengthy analysis. Some of our rules are longer than I would like because, in part, we are engaging in careful cost-benefit analysis. Moreover, the courts require and are increasingly requiring the ability to review very careful analysis on this subject. So for all those reasons I think it makes sense for us to do that. I think it is essential for us to do that, and if we don't do it, it puts our rules in jeopardy.

Mr. MCHENRY. Do you believe there is a linkage between overregulation and a lack of credit availability?

Mr. CORDRAY. I think that if you look at the history of this times, the thing that has most constricted credit to consumers and has most hamstrung lenders has been the credit freeze, the credit crunch, the financial collapse, and the ensuing recession that started in 2007, 2008. That has been what has dried up credit across this economy.

Now, sensible regulations, we think, had they been in place, might have averted that problem. You can say the same thing going back to the 1920s and the 1930s. What caused credit to be tight in the 1930s? It was a financial collapse and an ensuing depression. Did the SEC dry up credit because it got created in 1933? I just don't think anybody would think that historically.

Mr. MCHENRY. Well, to that point, I certainly understand, and that is not exactly answering my question. Friedman and Schwartz and Bernanke determined the finite and eventual causes of the Great Depression; it was both Fed policy and bank failures. I understand that. And we understand the storm that we have just gone through. The concern I have is getting an insight into your world view on regulation. I certainly understand your view that enhanced regulation is better than less regulation, but what I am asking is is there a point by which overregulation does restrict access to credit.

Mr. CORDRAY. So what I would say is better regulation is always better than worse regulation, but, of course, that is somewhat in the eye of the beholder. I think that regulating an entire market rather than part of a market, which is part of what was done before the crisis and before the financial reform law was passed, is not a good recipe for success. But I would agree with what I think is the tenor of your question, which is can the pendulum swing too far in the wake of a crisis like this? Can people overreact and can they potentially compound the problem? I think that is always a possibility, so it is important for us to be thoughtful and careful about what we are doing; not just assume that because it is meeting a problem that existed before, that everything that everybody could think to do is necessary and helpful.

And I think that, again, I find that coming here and having these sessions, where you all have input into what we are doing, is helpful for shaping our perspective, but I do think you can't look at what happened in 2007, 2008 without realizing that we need common sense reforms. And yet I would also agree that if the pendulum swings too far, you could compound the problem. I would agree with that.

Mr. MCHENRY. Thank you. I certainly appreciate the fact that rather than touting the line I have heard over and over again, that the huge fallout of the financial crisis was due to a lack of regulation, it was bad regulation that was the driving force of that, and I certainly appreciate your willingness to be precise when you are discussing that.

With that, I will recognize the Ranking Member, Mr. Quigley of Illinois.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Well, let's talk about that a little more. There was a lack of regulation to a certain extent, wasn't there, Mr. Cordray, on certain aspects that got us into this mess? We can always do regulations better, but there were aspects that just weren't there that helped create this crisis.

Mr. CORDRAY. I actually intended to say it was both lack of regulation and bad regulation in different respects. Let me take an example. If you look at the mortgage market before the financial reform law was passed, only part of the market was regulated. Inevitably, that leads to irrationalities because you have certain players in the market who are held to certain standards and others who are not. That encouraged a race to the bottom, where the irresponsible lenders were crowding out the responsible lenders like community banks and credit unions. That was both—you know, I guess you can define these things various ways. That was due to a lack of regulation in significant parts of the market and, overall, that reflected bad regulation because an incomplete regulatory system is not going to work because it is going to encourage some to do things that other people cannot, the very things you are trying to constrain among the regulated entities. So I think there was a combination of things.

Mr. QUIGLEY. And, Director, you just mentioned community banks. Illinois probably has as many as any State in the Union. I think they are feeling the pinch as much as anyone in that fine line that your agency is trying to walk, but I think you would acknowledge that there isn't necessarily a level playing field in a lot of things that have happened and the rules that are in place for them. Our concern is how you handle that regulation; how you handle that concept tiered regulation notion. This is a different business model; the complexity matters more to them. How do you balance that with community banks?

Mr. CORDRAY. So this is an issue that comes up over and over again for us. When we go around the Country, we always make it a point to have a roundtable with community banks and hear from them, and those are interesting. I find them very helpful sessions. They are pretty candid with us; they talk about some of their anxieties and fears. Some of those fears are misplaced. We do not enforce the law or examine any institutions with less than $10 billion in assets. But when we talk also candidly about their concern about the regulatory regime and how complicated that can be for them. They have fewer employees to spread that burden over, and it is something that I have heard again and again, and I feel sensitive to.

So, as I have said and as we have demonstrated, you know, the first rulemaking we undertook was the remittance rule that we finalized, that we inherited from the Federal Reserve. We immediately issued a supplemental proposal to consider setting a threshold below which institutions would be exempt from complying with that rule if they don't do remittance transactions in the ordinary course of business. And we are going to set a threshold on that and it will exempt some number of institutions from the rule, and I think that is—I know in my case the reason we are doing that, in part, is because we have heard and we are persuaded by the notion that smaller community banks have a model of serving their customers in the community where most of them live and reside; that they are very high-touch with their customers, and they don't necessarily have to be held to all the same requirements and standards that larger institutions that are more remote from the community would be.

And that is something that we will bring to our thinking about all of our rules. It is a case-by-case matter, obviously; it depends on facts and circumstances of what kind of issue we are talking about and how that plays out for them. It is also something we hear quite a bit about in the small business review panels that we have been doing on our rules. That is a special requirement that the Bureau has imposed upon it by Congress. No other banking agency is subject to that additional process. We have found that it has been useful to us. We are getting insight from that process; it is helping us write better rules. So although it is more burdensome for us than for others, we are also finding that it is advantageous, and we have begun to see the wisdom of Congress imposing that requirement.

Mr. QUIGLEY. And, as you said, you are committed to those panels, and there are several that apply directly to the community banks issues, and you are committed to fulfill those requirements.

Mr. CORDRAY. And I also have committed to creating a special advisory board of community banks and a separate one for credit unions. We are in the process of doing that; we are getting close to announcing that, which I think will help give us insight, because we don't have the day-to-day contact with them. We don't examine them, as I said; we don't have any law enforcement authority against them, so it is important for us to find other ways to make sure we have that strong line of communication, and we are trying to do that.

Mr. QUIGLEY. Thank you, Mr. Director.

I yield back.

Mr. McHENRY. We will now recognize the Vice Chairman of the Committee, Mr. Guinta of New Hampshire.

Mr. GUINTA. Thank you, Mr. Chairman.

Thank you, Mr. Cordray, for being here this morning. I just want to follow up on something you just said, and correct me if I am wrong. You said you don't have any legal authority, I think you said, against, you used the word against community banks and credit unions. That, to me, sounds like you are on one side and community banks and small banks and credit unions are on the other side, as if there is a relationship that is more negative, as opposed to one that is more positive. Was that your intent in that remark?

Mr. CORDRAY. Sir, that is not my view. I think what I said, very specifically, was we do not have any enforcement authority against community banks. I think it is kind of hard to characterize enforcement authority as anything other than if you are enforcing the law against someone, you are potentially finding them in violation of the law. We don't have that authority. We don't have the authority to examine community banks, either. We do have the authority to write rules that could affect the community banks, and that is where we are trying to make sure we take plenty of input and are sensitive to the difference in their business model, which I tend to agree is a different traditional positive working business model that did not in any way lead to the financial crisis in this Country; and, therefore, as I spoke earlier about making sure the pendulum doesn't swing too far, I think that that is something we should be very mindful, and we are trying to be mindful of it, and when I come up here I find that you all remind us of it, helpfully. Thank you.

Mr. GUINTA. Well, I come from a small State, New Hampshire, 1.3 million, and we very much are small communities throughout the State rely very much on the positive relationship between the individual, the small business owner, the job creator, with that community bank, and with that credit union. The reason I ask this is, as I have met with that group of people, those small business owners—and when I say small, I am talking about somebody who might employ under 100 people. I know the definition can go up as high as 500, but I am talking about, really, the individual who has maybe 50 employees or less, 100 employees or less, who are telling me now that they don't have access to credit. But they are not saying it for the reasons you are saying it. What they are expressing to me is a concern of an overregulatory burden. So I want to try to figure out how does the CFPB deal with what I am sure you are hearing in field hearings, or at least that is what I hear, maybe you don't. If you hear in a field hearing that a small business owner can't get access to credit because the community bank or the credit union is saying, look, we are small; we have stifling regulatory responsibilities, stifling regulatory burdens that are really stopping us from taking that reasonable risk to lend money to a small business owner so they can expand. How do you deal with the creation of this new entity, the CFPB, the responsibility of new regulation, but also take into account that part of these regulatory burdens could in fact have a negative impact on job growth, on economic growth, and on job creation?

Mr. CORDRAY. So we try to take account of that by getting a lot of input from the entities involved. But I want to go back and——

Mr. GUINTA. But you haven't put together—you said you were going to put together a group of community banks and credit unions——

Mr. CORDRAY. I have committed. It is not required by law, but I thought it would be very helpful for us to have an advisory group of——

Mr. GUINTA. Will you do that before any new regulation is put in place by the CFPB?

Mr. CORDRAY. We are going to be doing that within the next month or so. So we are doing it right away. But let me——

Mr. GUINTA. But would it be before, though—let me get an answer. Would it be before any new rule or regulation is authored by the CFPB?

Mr. CORDRAY. I think between now and then the only rule that we will be finalizing is the exemption threshold on remittance transfers, which is actually a burden-reducing measure for small institutions.

But let me go back. Small businesses were constrained in being able to get loans in the wake of the financial crisis of 2008. That is when the credit dried up. That is when the credit freeze occurred. All through the rest of 2008, all through 2009, all through 2010, the small businesses were dried up from access to credit. Dodd-Frank wasn't even passed at that time. The CFPB was not even created at that time. That is when they started to feel the severe credit crunch. Now it continues as the fallout from that continues. But the CFPB has only finalized one rule at this point, and it relates to international money remittance transfers. So the notion that we have created this immense burden on smaller institutions is absolutely factually incorrect.

Mr. GUINTA. Well, it is the uncertainty that people have, and there is great concern with new rules, on top of existing rules, that I continue to hear from business owners and from community banks and credit unions. I mean, I go and visit every time I am back in New Hampshire, and I consistently hear this. So it is an issue that I have been asked to bring back and ask you about, and suggest to you, if you are going to create that advisory group of credit unions and community banks, that the have real, real input; not just a letter of consideration, but real input on how the new rules and regulations are going to impact their ability to lend; and that is really the point that I wanted to make sure that you were hearing, at least from the people that I represent in New Hampshire.

Mr. CORDRAY. Yes.

Mr. GUINTA. But I see my time has expired. I yield back.

Mr. MCHENRY. The Ranking Member of the full Committee, Mr. Cummings, is recognized for five minutes.

Mr. CUMMINGS. Thank you very much.

Director Cordray, it is good to see you again. A Majority witness on the other panel, Mark Calabria from the Cato Institute, makes a very curious assertion in his written testimony, and he writes, "As an educated guess, I would say that the CFPB has likely increased the cost of consumer credit by at least two full percentage points."

Have you issued any regulations that could have caused the tremendous impact the Cato witness is asserting, and do you anticipate doing that?

Mr. CORDRAY. As I said, the only rule that we have—well, we have finalized two rules at this point. One was the AMTA rule, which merely kept in place the status quo while we assessed that issue, kind of a non-event; and the second was the remittance transfer rule, which was finalized in February, does not actually take effect until next February. No other rules have been finalized, so when you describe this as an educated guess, I guess I would put the emphasis on guess. But I don't think that there is anything tangible that that rests on at this point in time.

Mr. CUMMINGS. Do you see that coming, adding two percentage points, from anything you can see?

Mr. CORDRAY. We actually think that much of what we are contemplating, and, frankly, most of it is required by Congress, not discretionary——

Mr. CUMMINGS. By us.

Mr. CORDRAY. Yes.

Mr. CUMMINGS. Okay.

Mr. CORDRAY.—on the mortgage rules should improve the functioning of the mortgage market, and that is something that we all know the mortgage market performed abysmally in the runup to the financial crisis and helped create the financial crisis. So improvements in the mortgage market should be good for consumers, should be good for lenders. Credit dried up in the mortgage market because of the crash of the economy and because of the crash of the financial system. That is what dried up the credit. And, again, that happened in 2008, it endured through 2009, it endured through 2010, all before Dodd-Frank was enacted, all before the Consumer Bureau was even created, and now we continue to be in the residue of that. So that is the real timing here.

Mr. CUMMINGS. I don't know where Mr. Calabria pulled this number from; I am sure he will let us know.

Now let's turn to an informed industry viewpoint. Last week the House Financial Services Committee held a hearing on the Dodd-Frank Wall Street Reform and Consumer Protection Act. One of the witnesses, Ms. Del Rio, who is the board chairman of a credit union in New York, testified regarding Dodd-Frank and the CFPB's impact on credit availability and this is what she said: The Dodd-Frank Act and other financial reforms have not impeded our credit union's ability to provide low-cost loans and services to our members. In fact, our credit union's lending has increased in recent years.

Director, have you heard similar accounts from other financial service providers and do you think this is an isolated assessment?

Mr. CORDRAY. I think that the data vary by institution. Different institutions are in different places. But I think what actually happened in the financial crisis and the wake of that is there was an awful lot of non-bank, non-credit union shadow lending, shadow industry lending going on, financing of non-bank lending; a lot of it was securitized, a lot of it was you make this loan and then you sell it to someone else. Money was coming essentially from Wall Street. Most of that has dried up. That is a vast amount of funding in the sector.

So there are a lot of people who think that community banks, credit unions haven't been lending. They are still lending. They are pretty much adhering to the same traditional business model that they had before. They found it harder, sometimes, to get financing themselves. They have found that they are subject to capital reserves that can be constraining. But they are still plugging away with the same traditional business model that has worked for decades in this Country. What has happened is that some of the irresponsible money that was in the market has dried up and, therefore, lending as a whole is down, and that has been hard on a lot of people, but it is a fairly natural adjustment coming out of the kind of financial crisis that we had in 2007, 2008.

Mr. CUMMINGS. Ms. Del Rio said something else. She said there are times where we have to update a disclosure to comply with new regulations. We welcome these regulations; we want to be a transparent institution. This is our mission, so for us it is not a cost.

I know everybody wouldn't say that, but she did, and she is a credit union. I am just wondering, the transparency, how do you see that affecting lending?

Mr. CORDRAY. Well, we know with everything that is updated and even simplified there are transitional costs that occur. But then, going forward, with every transaction, the transaction should be more likely to be successful; it should be, in the aggregate, we are helping to stave off the kind of threats to the financial system that we saw crash the system in 2007, 2008. It is better for consumers; it makes the market work better. That feels like it is an appropriate and positive way forward.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

Mr. MCHENRY. We will now recognize Mr. Meehan of Pennsylvania for five minutes.

Mr. MEEHAN. Thank you, Mr. Chairman.

And thank you, Mr. Cordray, for your return again. I appreciate your collaboration with us and looking on this issue. I want to follow some of the issues that have been identified by some of my colleagues, because I too have been spending a significant amount of time back in my community, talking with largely small business owners and small institutions, banks and credit unions, things which you have identified, if I am correct in your testimony, as not really being outside or inside the scope of the problem; that a lot of the outliers, you know, the kind of non-bank kind of lending participated in the creation of the a lot of the problems. What I am concerned about is the regulation that now attempts to deal with the issue, reaching back and really affecting some of these institutions.

Let us take as a point, I think, which would be consistent through most of these institutions. Many in my area, about 100 employees, most of them probably maybe one compliance officer. I talked to one bank president; he is the compliance officer. And the fact of the matter is you talk about the timing of the activities that are coming out, so this small bank already they are dealing with the Basel requirements. There was documentation that went out to these small bankers, 250 pages of documentation which identifies what they must do within their small institutions with regard to retention of capital. Then in the same month of June we had the qualifications that came out for what is a qualified mortgage. This was something small banks have been doing for years. The paperwork that identified what a small—has been put in the Federal Register, it is about 115 pages that, again, all of the fine print, what concerns me is that is 150 pages. With that kind of fine print, it looks to me like a litigator's dream to begin to try to codify all the things the bankers have been doing for years.

But the real concern that I have, in talking with my small community bankers, was took the 10 pages that were part of the Truth in Lending Act and the Real Estate Settlement Procedures Act, and I understand the implications of trying to make it simpler for the buyer, but in the act of creating what it means to take 10 pages now, and we have reduced it to 8 pages so that the borrower can understand what is before them. But for the banker, this, this right here, 1,099 pages of regulations, 1,099 pages that one single compliance officer is going to have to go through to understand what it means to be able to interpret a document which has been in existence, you know, the Real Estate Procedures Act, for years and interpreted many times by the law. It is not the document; it has been the abuse of the document.

How are we going to take into impact trying to draw a distinction so that these small community bankers aren't pulled into the overregulation problem in an effect in which I am concerned we are going to drive the ability of these small banks to continue to service the community?

I asked my question. Let me just give you one other observation. One of the bankers that I talked with was discussing the fact that, when you have 100 people, you are very tight with regard to what you can task each to do. There was enough cash on hand to consider one or two new employees in the coming year. Do they hire lending agents that can go out in the community and negotiate loans, or do they hire compliance people? In both cases it was compliance people. We are spending money on oversight, particularly in institutions that may not need the same degree of oversight as those who were the abusers in the process.

Can you tell me how we are going to approach the ability to try to be fair and effective in the engagement with the small community banks so as not to dry up the very objective of creating credit in the first place?

Mr. CORDRAY. So I appreciate the question, Congressman. I appreciate the chance to address what I think has been much misunderstood about the rule that merges the Truth in Lending Act and Real Estate Settlement Procedures Act forms, which is something, by the way, Congress has been complaining about for 20 years. They wanted those forms integrated; they wanted them simplified. It is actually much more than 10 pages to 8 when you see the other things we are dealing with that go into that. But it is something that is now being accomplished by the Bureau for the first time in 20 years, after 20 years of failure.

But the notion that there is a 1,099-page rule is not a correct statement of fact. Much of what is in that rule involves detailing the efforts the Bureau has made to reach out to smaller institutions, SBREFA panel and so forth. Much of it is detailing the cost-benefit analysis. Much of it is providing what industry tells us they want, which is some detailed guidance. It is not the rule itself, but it is additional guidance on how you can comply with the rule.

So it feels to me that you can't, one and the same time, complain that the Bureau doesn't engage in sufficient extensive cost-benefit analysis and then complain when we devote a lot of pages in our proposal to the cost-benefit analysis that you have told us that you want. It doesn't feel right to complain that the Bureau doesn't do enough outreach to small institutions, and then complain when we do the outreach and it actually results in a lot of summarizing in the proposal that actually we have done that.

Mr. MEEHAN. So is this guidance, then, that is going to be directed to the small community bankers, who is going to have to look at this and interpret the 1,099 pages to be able to determine what the terms of that Real Estate Settlement Procedures Act document mean?

Mr. CORDRAY. Well, they have had extensive input into the forms, which are——

Mr. MEEHAN. What is the purpose of this? What will the small community banker do with this document? Because we know, with 1,099 pages, there is an expectation, or at least litigators will expect there is an expectation that they have read and reviewed and understand the implications of every term within it.

Mr. CORDRAY. Only a small portion of that is the actual rule. Much of it is the kind of explanation, procedure, detail, analysis that Congress has told us they want to require before we can write a rule. So when we go and do all of that detailed analysis and present it, cost-benefit analysis, I don't think that a small bank has to be conversant with our cost-benefit analysis, but it is something required of us to justify the rule. So, again, to complain that the agency needs to be very careful and thorough in its process of developing the proposals for rules—and this is a proposal, it is not the final rule—and then to complain because all of that amounts to a lot of pages, you can't have it both ways.

Also, we are told over and over again by industry that they would prefer specificity. They don't want us to write a small rule. It is kind of counterintuitive for me. They don't want us to write a short rule where there are lots of things that have to be interpreted and end up going into the courts and have to be interpreted how? Through litigation, through hiring lawyers and having them bring cases that obviously puts years——

Mr. MEEHAN. I don't want to step on your explanation, because I appreciate this and I do think it is—and I know my time is up, but as an attorney, my concern is it is just this which will create more litigation, because you know yourself, as a former government attorney, the ability to look at specific cases and then find distinctions and ask why we didn't apply those particular circumstances to the decision that was made creates a litigator's dream.

Mr. CORDRAY. Again, a short rule that is general and vague will leave a lot of things mushy, and there will be a lot of things that will have to be litigated because it is the only way you can get things resolved. Industry tells us they want us to avoid that, they want us to be very specific. Specificity often means greater length. It is a dilemma; it is a challenge. It is something that we are working through, but we are trying to work it through, I want to stress, with a lot of input from the small providers you are talking about, thinking about how these rules affect them, thinking about when we can impose exemptions or thresholds. Ultimately, you are the one—you were a referee, right?

Mr. MEEHAN. Right.

Mr. CORDRAY. Ultimately, we do the best we can. We have to make a call. People are going to criticize us on both sides of it. Were we too thorough and, therefore, too long? Were we not thorough enough and, therefore, subject to challenge on that front? But——

Mr. MCHENRY. The gentleman's time has expired.

Mr. CORDRAY.—we will take this input back and it is something we wrestle with everyday.

Mr. MCHENRY. Thank you. I appreciate your willingness to answer completely, but from this side of the dais, a 1,000-page rulemaking in order to get a 3-page disclosure document seems a little more than on the excessive side.

We will recognize Mr. Welch of Vermont.

Mr. WELCH. Thank you very much, Mr. Chairman.

Mr. Cordray, I remember your first appearance before our full Committee and I asked you about rulemaking and whether you preferred simple and understandable to complex and confusing Any change in heart about that?

Mr. CORDRAY. I still prefer simple and understandable. When you have complex subjects, what industry tells us is sometimes they prefer more specific, nailing everything down so that there is less uncertainty and less to litigate about.

Mr WELCH. Good. I find myself in sympathy with a lot of the concerns that were expressed by Mr. Guinta and Mr. Meehan, but I think in Congress we are mixing up some of the issues here. On this question of the Dodd-Frank regulations there are two issues. One is I think all of us recognize that what makes sense for a regulatory regime for Wall Street and these huge institutions is quite a bit different than our small community banks that really didn't contribute to the problem. So I think all of us would much prefer to not have these regulations be over-broad so the banks that are just doing their local work and didn't cause the problem don't get swept up.

But, second, one of the questions that we duck here is on these big banks, whether in fact they are too big to regulate. Will they find, no matter what we write, no matter what we do, they will find some way to get around it, and I, for one, think that on things like derivatives, where JPMorgan, for instance, had an exposure of $77 trillion, instead of regulating, would it make sense to require them to put more cash into the transaction so that there would just be a very compelling institutional interest to minimize risk, rather than great risk? And I say that for my colleagues because I actually think that is one way to try to deal with these institutions that are too big to regulate.

But the third point is that my understanding of your institution is that it is going to be there to try to protect consumers against some of the practices that have really hurt them, and I have talked to small businesses and heard things that Mr. Guinta heard, but I suspect you have talked to individuals who have also explained to you how confusing it is for them to deal with banks, or parents, how confusing it is to deal with student loan forms. And I just want to go over a couple of things that your organization did do that I think are terrific.

The CFPB created a new student loan assessment tool to help students and their families evaluate the cost to college, and that, I think, is really good. Can you tell us a little bit about that and what its reception has been?

Mr. CORDRAY. Sure. In fact, there have been institutions across the Country, representing over a million students already, who have adopted the Financial Aid Shopping Sheet, which is a simplified version and a uniform and comparable version of what kind of financial aid offer you are getting when you are trying to decide where to go to college and trying to understand, which has been difficult for people to understand, exactly what it is going to cost; what kind of payment schedule you are going to come out of college with, whether you are going to be able to afford that; what kind of rights you may have if you have trouble with repaying the loans and the like. So I think that has been a success. It is the kind of thing that we are trying to do, where I think most people, if they have a young person in their family who has recently been trying to finance a higher education, understand and have dealt with. They need to know very clearly, before they make the decision, what they are getting into so they won't have regrets.

Mr. WELCH. Right. And let me go on to one other. In addition to your settlement with Capital One, where there really was revealed ripoff practices and you were successful in getting return to consumers, over $150, $160 million in addition to the penalty, is your organization working to simplify credit card contracts so folks don't have the blizzard of eye-popping and bone-tearing contract provisions to read, so it is just all simple and understandable?

Mr. CORDRAY. We are trying to do that and we are having some success with that, and I think industry is beginning to see the merits of that as well. We are not proceeding by a compulsory rulemaking there; we have model forms that we are proposing for people, and more and more are moving in that direction. Maybe at some point we would need to regulate, but the idea is to keep it simple for people that can't absorb a 60-, 70-page credit card agreement; they end up getting ambushed and trapped by the fine print.

Mr. WELCH. And one of the things that some of my small bankers who have been the backbone in our community lending program have told me is, Peter, just tell us what the rules are and then we will compete on what those rules are. So simplification works, in their view, for them as well as for consumers. Any comment about that? Then my time will be expired.

Mr. CORDRAY. It is my instinct from my background as a treasurer at the county and State level that if community banks are able to compete on a level playing field with the larger banks, they will do better because they have superior customer service, and that is what people really want from a financial institution. So I think it is important for us to keep that playing field level and also recognize, as was noted earlier, that compliance burdens fall more heavily on a small institution and, therefore, to the extent we can lighten the load or exempt them at times from things, we should look for opportunities where that is appropriate.

Mr. WELCH. Thank you.

Thank you, Mr. Chairman.

Mr. MCHENRY. Mr. Amash of Michigan is recognized.

Mr. AMASH. Thank you, Mr. Chairman.

And thank you, Mr. Cordray, for coming back to Oversight. I am going to yield my time back to the Chairman. Thanks.

Mr. MCHENRY. Certainly appreciate that.

Mr. Cordray, in April of this year, in Bulletin 2012–04, the CFPB outlined their views on fair lending and how to pursue actions related to that. You are familiar with this memo?

Mr. CORDRAY. I am.

Mr. MCHENRY. Okay. And in this memo the CFPB adopted the legal doctrine of disparate impact. Many view this as a controversial legal theory that takes intent out of viewing discriminatory actions and simply uses statistical research to prove out discriminatory actions. Is that right, the CFPB intends to use disparate impact?

Mr. CORDRAY. We adopted the same position that all of the bank regulators have taken for 20 years, but the CFPB, being a new agency, had not yet spoken on that issue, so we wanted to clarify that we do join our fellow regulators in viewing disparate impact as the law of the land that we should follow.

Mr. MCHENRY. And you are familiar with press reports about the City of St. Paul's court case and the Department of Justice perhaps pressuring the City of St. Paul to withdraw that lawsuit?

Mr. CORDRAY. I don't know how familiar I am with all the details of that, that is sort of outside our ambit; it was not a case under one of the statutes that we enforce, but I understand there was a case and ultimately it was resolved through a settlement is my understanding.

Mr. MCHENRY. Okay. Well, you know, this Subcommittee is investigating whether or not the Department of Justice pressured the City of St. Paul to withdraw that lawsuit——

Mr. CORDRAY. I see.

Mr. MCHENRY.—through intermediaries of sorts because of the Department of Justice's concern that the court would have struck down disparate impact as a legal doctrine, a valid legal doctrine for the government to use.

Mr. CORDRAY. I see. That would involve overruling prior decisions, but, of course, that is the court's prerogative.

Mr. MCHENRY. So have you or any of your staff had contact with Assistant Attorney General Perez about disparate impact? Actually, let me start by saying have you had any contact with Assistant Attorney General Perez about disparate impact?

Mr. CORDRAY. I happen to know Assistant Attorney General Perez; he is related by marriage to a woman who worked with me when I was Ohio attorney general, so that is when I first heard his name, and we have had dealings with him as our agency deals with fair lending matters, and I believe he is the head of civil rights, so

I think there probably has been a fair amount of contact there in the normal course of the work that we do, yes.

Mr. MCHENRY. Okay. I would ask you to submit for the record those contacts and whether or not they have entailed discussions of the use of disparate impact in dealing with fair lending practices.

Mr. CORDRAY. I am sure our staff will be happy to work with your staff on that.

Mr. MCHENRY. You know, as it relates to all this, because disparate impact requires showing no intent to discriminate, lenders have no way of knowing whether or not their practices could be subject to future fair lending suits. So do you think that that adds to uncertainty? And is there any way for the CFPB to allay those fears?

Mr. CORDRAY. Does it add to uncertainty? I think it has been the law of the land for more than 20 years, so to the extent it is adding to uncertainty, it hasn't really changed in the last 20 years, maybe 25 years. This is the same test that is used, it is called the effects test, that is used in employment discrimination cases as well; it is the same framework. I think it was adapted into the fair lending context, again, more than 20 years ago, so I think it is established law. I don't know that that is adding to uncertainty. I think uncertainty would be about whether the established law is going to be changed. As you say, it is always within the prerogative of the Supreme Court to change the law if they see fit to do so, but that would be a change in law and that would, I guess, be a subject of uncertainty if that were to occur.

Mr. MCHENRY. Mrs. Maloney of New York is recognized for five minutes.

Mrs. MALONEY. Well, thank you, Mr. Chairman, for calling this hearing.

And welcome, Director Cordray. I was reading the testimony of one of the panelists that is to come, and that is the Cato Institute, Mark Calabria's testimony, and on page 3 he says, "that the spread of rates on credit card loans has remained wide since the end of 2008 in part because of price adjustments made in response to provisions in the CARD Act." But he failed to acknowledge the Federal Reserve's footnote. He was talking about a Federal Reserve report that I have here, in which the Federal Reserve says the widening of these spreads is due to the restrictions the CARD Act placed on issuers' ability to impose certain fees and protecting consumers.

I would like unanimous consent to place in the record the Federal Reserve's full statement on this, highlighting the fact that I just said.

Mr. MCHENRY. Without objection.

Mrs. MALONEY. It also goes on to say that stopping such abuses such as raising rates any reason retroactively on balances, giving the consumer the power to opt-in to higher rates if they so approve, stopping certain tricks and traps of changing the rates of charging on interest that has already been paid and other things that were happening. I would say that the CARD Act has gone a long way towards protecting consumers from abusive, unfair, and anti-competitive actions, and that in some cases the industry has raised rates in order to raise their own revenues.

I would like your comments on that. I would also say the CARD Act has given many consumers many more choices to go to providers that have a lower interest rate. But would you comment from your own experience on how the CARD Act is impacting issuers, consumers, the overall economy? I can say, from my point of view, I don't get complaints from consumers anymore about their credit cards; they seem better able to manage their credit. Apparently there are fewer people walking away from their credit cards and leaving that burden on the issuers, and that it has, overall, been a success.

But your comments, please, Mr. Cordray, on what you are finding in your new position. And congratulations on the transparency that you are bringing to consumers.

Mr. CORDRAY. Thank you, Congresswoman. On the CARD Act in particular, we gathered together credit card issuers and had a transmittal of information for them early in our time to assess how the CARD Act had affected the credit card industry, and we judged, based on the evidence we were able to amass, that it has had a positive effect on the industry, positive effect for consumers. It is not unduly constrained access to credit card credit. Those initiations are growing. Again, tremendous amount of solicitation going on out in the market. I think credit card issuers have adapted to that.

I didn't quite understand, but I guess you are going to submit for the record the notion that the CARD Act would have widened spreads in 2008, given that the CARD Act didn't pass until 2009, so I am not sure how all the dates work together in that. But, in any event, in our view, the CARD Act, from what we have seen so far, has been both successful in reigning in some of the excesses that were hurting consumers, but at the same time the credit card issuers have been able to work with that, have implemented it successfully, and are initiating a tremendous amount of credit card availability of credit for individual consumers in the market place as we speak. And, as you noticed, delinquencies have been down.

Mrs. MALONEY. Delinquencies are down. But still there is over $1 trillion in credit card debt in our Nation, which speaks to many Americans being in debt. Do you believe that over time the Credit CARD Act will bring down that indebtedness, or do you believe it will——

Mr. CORDRAY. It may. I don't want to speculate too much as to cause and effect. I think the crisis has brought down credit card as the savings rate has jumped up again and people have been paying down debt. I also think we should note that credit cards are a tremendous convenience for consumers. The ability to engage in a transaction without having ready cash, because credit cards are the medium and the means of effectuating those transactions. It is very important for people and has created a tremendous amount of convenience for consumers that they appreciate, that they value, that they are willing to pay for. Again, they should pay for it in a clear-eyed way; they should understand the prices and risks of their credit card account. Much of that has been achieved, greater transparency through the CARD Act. We, again, view it as a success. We will continue to monitor its effects. We are, as you know, taking credit card complaints on our website and compiling those and taking a look at those, and I would say that there are many areas that we are not getting many complaints on that I think that, before the CARD Act, we would have received a tremendous number of complaints on.

Mrs. MALONEY. There were 60,000 responses to the Fed's questions on it during the review process. Thank you for your hard work.

Mr. MCHENRY. Ms. Buerkle of New York is recognized.

Ms. BUERKLE. Thank you, Mr. Chairman, and thank you for holding this hearing.

And thank you to Mr. Cordray for being here this morning. My first line of questions has to do with retrospective analysis, and whether or not the CFPB is going to conduct or if it is currently conducting any retrospective review of its regulations just in order to determine the consequences on the consumers, as well as any regulated entities.

Mr. CORDRAY. Retrospective analysis? Yes, this is one of the things that I testified in front of this Committee before, and others, I think was missed by the regulators previously, and it is something we should be attentive to, which is you can keep adopting individual rules, and in each case it is well meaning and in each case there are reasons why it would make sense that that would be protective of people, and you can kind of forget, over time, about the aggregate burden those rules create. And you add more and more; how much does that do for people?

So that is why——

Ms. BUERKLE. I don't mean to be rude. I have never seen five minutes go by so quickly when one is answering questions. So that is a no. You are acknowledging that they should be done, but they are not being done?

Mr. CORDRAY. No, no. One of the things we did—we are not required to do this, but we thought it would made sense, was we launched a streamlining initiative to consider all the rules that we inherited. We didn't write the rules that we inherited from other agencies, so we are not invested in them; and we have asked people to give us their input into what do you think could be streamlined, what could be cut back, what could be eliminated without hurting consumer protection. In what ways could the same protection be delivered at less burden for institutions? We have gotten a lot of good input on that. We are digesting that and we will be looking to streamline rules. I think that is important.

Ms. BUERKLE. My concern is that you are looking at the entities that are affected by this and you are making sure that those—and that is really my concern, not whether it is coordinated in the aggregate, but whether these rules are affecting either the consumer or the affected entity by Dodd-Frank. So is that being done or is it considered, is it going to be considered?

Mr. CORDRAY. So as we go forward with new rules, yes, that is a consideration that we have and are required to undertake. We are conducting small business review panels so that we hear directly from small providers and get their input at a very early stage, when we are still formulating proposals, and that has been useful for us. I would say we weren't sure what to make of that to begin with, it was an additional burden for us, but I think it actually has been positive.

Ms. BUERKLE. So if I could, for the purposes of this hearing this morning, would you commit to adopting formal procedures for a retrospective review of all of the CFPB rules, including a specific review of how the rules are affecting credit access?

Mr. CORDRAY. I see. I should have said this earlier. In our law—and I am glad it is in our law, I think it makes sense—we are required, with any rule we adopt, to review it again after five years to consider whether it is actually having the impact that we intended for it to have; whether there are unintended consequences; whether there are burdens we didn't appreciate at the time. We will be hearing from the institutions. Obviously, we hear from them all the time as we go, but, at a minimum, every five years we have to do that so there won't be just a sort of mindless accumulation of rules over time, without regard to what that does for institutions. I think that is what you are getting at.

Ms. BUERKLE. I am concerned that there is not going to be a look at these new rules that are going into place and have gone into place because of Dodd-Frank; whether the CFPB is willing to and will agree to, today, to make sure that those rules, that you understand and you do a retrospective review—not going forward, not trying to figure out how you should proceed in the future, but actually looking at what has been done, the rules that are in place, and how they are affecting not only the consumer, but also the agencies that are being affected by this law.

Mr. CORDRAY. So again, in terms of our corner of the world, we both are engaged in a streamlining initiative looking retrospectively at rules we inherited and, with every rule that we propose, not only do we get tremendous input as we work through it, but, at a minimum, every five years we will engage in that retrospective analysis of those rules. So I do think it is built into the process for us. But, again, if I am not quite satisfying your line of questioning, I would be happy to have our staff work with your staff to understand further just what you would like to see from us.

Ms. BUERKLE. Yes. I would like to see in the statute the five-year commitment, but also is five years too long a period of time?

Mr. CORDRAY. I think for some it may be; for others it may be even too quick. But I think it is probably a good compromise. It is hard to draw those lines. Congress drew it. I don't have a quarrel with the way they drew it.

Ms. BUERKLE. I see my time has expired and I didn't get to my last two questions. Thank you, Mr. Cordray.

Mr. MCHENRY. Thank you, Mr. Cordray.

We will now recognize Mr. Kelly of Pennsylvania for five minutes.

Mr. KELLY. I thank the Chairman.

Mr. Cordray, nice to have you in front of us again. Mr. Meehan had talked about this and I did, we printed out this Get to Know Your Borrower information that is 1100 pages. You said 1099, so we are not going to make a big deal about one page. But the people that I get a chance to talk to when I go back in the 3rd District of Pennsylvania are small banks. And while it may be easier for big banks to comply with this because they have huge numbers of people onboard that can go through this stuff and sift through it, today's hearing was the Credit Crunch: Is the CFPB Restricting Consumer Access to Credit? Actually, 40 pages of this are actually the cost-benefit analysis, but the rest of it these people have to know. So for the small banks, we may say, listen, they are going to be okay, they are going to get through it; and I have gotten to the point where the too big to fail means you are too small to survive. And for anybody to suggest that there is any way that small banks and small lending institutions can go through this same process and come out the other end, being able to offer the products they have offered before, is ludicrous.

Now, where I come from, we rely on the small banks and the credit unions, and I am looking at this and I am talking to guys who I grew up with, went to school with, our wives know each other, our kids know each other, and yet they have to sit down and get to know who their borrower is and what a qualified borrower is. Does this make any sense to anybody? You talk about these are common sense solutions or reforms that are going to make it easier. It is not making it easier; it is making it more difficult. Access to credit can't be done over a long period of time; people need it now. If you need a transfusion of capital, you need it now. When you go to these small institutions and these small banks, and they say, you know what, I am not sure that I can do this for you. They are opting out of offering products that they have always offered before, and the reason they are doing it is because they are not sure that they can survive what we are putting them through right now.

I am not blaming you for this, but I am saying while the patient is waiting for the people to do the diagnosis, they are dying. Access to capital is critical to small businesses. We are talking about an environment where we are trying to get job creators back online. You know what is keeping them away? Uncertainty. They don't even know if they can borrow money anymore. Heck, I am automobile dealer. I don't know, my covenant changes every quarter. My collateral changes all the time. What used to be acceptable collateral is no longer accepted collateral. The people I used to go to for money right now say, you know what, sorry, we can't help you because we are still trying to sift through the regulations.

So while this may have been well intended to start with, where you are sitting, please tell me is it going to be easier for access to credit or harder? Is this easier or harder?

Mr. CORDRAY. Okay, so, first of all, I think there is some apples and oranges here.

Mr. KELLY. Easier or harder? No, it is not apples and oranges; it is access to credit. Is it easier or harder for small banks to lend money right now?

Mr. CORDRAY. Okay, the reason it has been difficult for small banks to lend——

Mr. KELLY. My question is it easier or harder? I am just asking is it easier or harder, Mr. Cordray. I don't need—I am just asking you what the time is; I don't want you to build me a watch.

Mr. CORDRAY. Okay. Since 2008 it has been harder for small banks to lend money——

Mr. KELLY. It is much harder. It is much harder.

Mr. CORDRAY. Since 2008——

Mr. KELLY. So they are merchants. Banks are merchants. They have money on the shelf to lend to people. That is what they do. So when we make it harder for people like me, small businessmen, to have access to credit, if it is harder to get credit, it is harder to stay alive. And that is my whole point about this. In an environment where we want people to survive, we want people to go ahead and take that jump, go out and borrow the money, they can't go to the traditional lenders because the traditional lenders cannot sift through this.

Mr. CORDRAY. That is not the cause, I don't believe, sir. Since 2008 it has been hard for smaller banks to lend. That is because we had a financial crisis and a crash of the system——

Mr. KELLY. Mr. Cordray, I exist in that world, okay? I know how hard it is to survive in the real world. Only inside this Beltway do we come up with solutions that are so difficult that nobody can pull the trigger anymore. So the purpose of this hearing was are we restricting consumer access to credit, and the answer is yes, we are. We are making it so hard for the small banks and the credit unions to lend money. The rest of this is we are just tap dancing around the outside of this. It is so difficult for these people. They are going out of business.

Mr. CORDRAY. Would you like me to respond or just listen? Which would you prefer?

Mr. KELLY. Well, I would like you to listen, and I would like this Administration to listen, because I will tell you what, they have a deaf ear when it comes to what is really going on in the private sector. I can appreciate where you came from. In my business, we have to survive every day. We go in hand-to-hand combat every day to survive. I do not need 1100 pages from a guy that I have known all my life to tell me whether I am qualified or not. That is the whole purpose of this.

There is no answer to is.

Mr. CORDRAY. Okay——

Mr. KELLY. It is government red tape that is keeping this economy from recovering. And I am out of time, I am out of time, but I am not out of energy. I came here to fight for people who are out in the common world, the private world, and that is what we have to continue to do.

Mr. Chairman, thanks for having this hearing.

Mr. MCHENRY. The gentleman's time has expired.

Mr. Cordray, if you wish to respond, I will give you the time.

Mr. CORDRAY. Sure. We are not asking anybody to give you 1100 pages. This is making forms simpler and clearer so that people can understand the prices and risks of credit. That should be good for the system. We did not do that in 2006, 2007, and 2008. The system crashed and burned. All these form institutions were hurt; a number of them failed. We now need to improve that process. What you are telling me and what I need to hear from you is, as we improve the process, don't make things worse for these institutions; it is already hard enough. We are trying to be mindful of that every day. But people who want us to go through a very, very thorough rulemaking process, it becomes a lengthy process, then want to complain that it is a lengthy process and it is a lot of pages. In the end, the rule part of that is a small part of that pile. The forms are going to be simpler and clearer and more uniform, and that is what we are trying to accomplish, something Congress has been asking for for 20 years. The agencies weren't able to do it; we are now doing it. I hope that is a step forward, but I am interested in your input; I appreciate it and we are happy to hear it any time as we go. We hear from the same institutions you are hearing from and I hear the same things.

Mr. KELLY. Well, while we debate, they are dying.

Mr. MCHENRY. We will now recognize for a second round the Vice Chairman, Mr. Guinta.

Mr. GUINTA. Thank you very much, Mr. Chairman.

Mr. Cordray, I am not sure that Congress, for the last 20 years, has been asking for 1,000 pages of guidance to a rule. I think what maybe Congress has been asking for is a term that was used by Mr. Welch and by you as well: a simpler process. So while the form might have been contracted to one to two pages, the guidance with that form, in many circumstances, appears to be 1,000 pages; and that, I think, is the concern that community banks and credit unions have moving forward, is where will the guidance, along with these forms, be so large that they have a choice between dealing with the regulator as they hire, hire a compliance officer, or hiring someone who can grow and expand their business. So when you say that you want to listen to our input, our input would be if you are trying to make things simpler in terms of the forms, that is a good goal, but the guidance also needs to be simpler, I think is probably what you are hearing from both sides of the aisle.

I want to read from testimony that will be given later by Mr. Fecher, who represents the Credit Union National Association. On page 3 of his testimony he says, "Every dollar a credit union spends complying with these changes is a dollar that is not spent to the benefit of credit union members." And he goes on to say, "Because credit unions are member-owned financial cooperatives, the entire cost of compliance is ultimately borne by credit union members."

So my concern is that additional compliance, overregulation will feed into a credit union or a small community bank's inability to lend in the future. Can you just talk to me again about how you will balance what you view as Congress's mandate to the CFPB in consumer protection and the reality of those consumers needing that direct access to those community banks and those credit unions?

Mr. CORDRAY. So one of the ways in which we are trying to balance that is by getting direct input from the community banks and credit unions to understand their circumstances, and I know from my dealings with them that there are quite a number of credit unions in particular that involve very, very few employees, maybe less than 10; not even less than 100, less than 10. And it is our view that where we can potentially exempt them from burdens, that we should look for the opportunity to do so; that they follow a traditional business model that is very high-touch with their customers that isn't necessarily requiring making it subject to all of the things that we do for the larger, more remote, more volume banks. So that is something that we are trying to keep in mind as we draft regulations and we figure out how they should apply.

But we are also, again, keeping a very open line of communication. I think we hear from the same institutions that you hear from. I invite the community banks to come see us and we go see them as we go around the Country, and we are trying to be mindful of this as we go. But at the same time the cost of a failure of compliance was a financial crisis, a crash of the system that killed a lot of banks and a lot of credit unions that folded up because you can't operate within a system when credit is not flowing anywhere. And, again, that happened in 2007, 2008, long before the CFPB came on the scene——

Mr. GUINTA. But was it the entire system or were they individual actors? Because right now the CFPB seems to be going after the entire system, rather than necessarily individual bad actors.

Mr. CORDRAY. That is a good question, actually, but I think it is a combination. I think there were a lot of bad actors. Many of them were enabled by a system that allowed them to operate fairly freely because we were regulating part, for example, of the mortgage market and not regulating part at all. I think that obviously what you are suggesting is we want vigorous enforcement of the laws to weed out the bad actors. But at the same time the question is what additional regulations are needed? Are they really need——

Mr. GUINTA. Let me clarify what I am saying, then, because that is not necessary. I don't have it in front of me, but I read earlier somewhere that part of the focus of Dodd-Frank—here it is. Congress has directed the Bureau to identify and address outdated, unnecessary, and unduly burdensome regulations in order to reduce unwarranted regulatory burden. That is Section 1021(b)(3).

Mr. CORDRAY. Yes.

Mr. GUINTA. I would love it if you focused on that, because I do continue to hear from those community banks and those credit unions about particularly—and I am talking about the smaller individuals who are helping those people that are our friends, our neighbors who live in our communities. And I am glad that you mentioned the size of credit unions. We have 7200 credit unions. Half of them are 10 or less. You are seeing up to 300 a year merge into larger credit unions. That doesn't help the consumer get greater access and greater flexibility to the market, it constricts it. So the idea here is, going back to that one component of Dodd-Frank that says, look, we have a responsibility to reduce regulation, is where I would like to see the CFPB focus its attention.

I yield back.

Mr. MCHENRY. I thank the Vice Chairman.

I will now recognize Mr. Quigley, the Ranking Member.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Mr. Cordray, just to review let's just—we are all concerned about community banks and their unique roles in our communities, but let's just let you restate. What do you see the exact role your agency has in addressing the issues that you were created for as it relates to community banks and how that is different from the larger banks?

Mr. CORDRAY. So our job is to protect consumers, but in the financial marketplace, which is a difficult marketplace for the average consumer, but we intend and wish to do that in a balanced way. We want to both make it possible for consumers to better understand the decisions they are making, make prices and risks clear, allow them to make more informed decisions, because the consumer will make the best decision if they have the information to do so. Nobody can do that for them.

As for the providers, they have to be able to provide credit, that is important, and they have to be able to do it in an easily understandable way. And the conditions under which smaller banks and credit unions operate are very different, I think it has been my experience, from the largest volume banks, the very large banks that we immediately oversee and enforce the law against, that have $10 billion in assets or more and a multitude of employees.

So what we are trying to do is to balance both a regulatory regime that is taking account of the problems that consumers have had in these different financial markets, but is also trying to understand that if community banks and credit unions are following a traditional business model, a very high-touch, very knowledgeable about their customers, good customer service to their customers, that they may or may not have to be subject to all the same requirements as the larger banks that operate at more of a distance, somewhat more of an anonymous and volume-driven, statistical-driven models of lending. So that is a balance that we need to try to strike, and we are trying to strike in particular with lots of input from the institutions that are affected.

Mr. QUIGLEY. And, so far, what have you put in place as it relates to small banks? Have any other rules passed, have you completed?

Mr. CORDRAY. We have only had two final rules: one was a status quo placeholder while we consider the matter further; the other is the remittance rule, which was finalized in February, does not take effect until February of 2013, so it hasn't even gone into force for any institution yet. All the rest of it is anxiety and concern and hypothetical. Nonetheless, I take that it is very real in a lot of bankers' minds, so we take it seriously; we are trying to understand it. But we have tangible rules that have been put into effect. There has been minimal impact on institutions to date.

Mr. QUIGLEY. Thank you, Mr. Chairman. I yield back.

Mr. MCHENRY. We will now recognize Mr. Meehan of Pennsylvania for five minutes.

Mr. MEEHAN. Thank you, Mr. Chairman.

Mr. Cordray, I do accept the objective of trying to simplify things, but I am just in the brief the few moments that I have been looking at this. It reminds me of trying to build a gas grill. We have all been through that once.

Mr. CORDRAY. I don't like the construction booklets myself, no.

Mr. MEEHAN. Here is H24A, mortgage loan transaction loan estimate. This is the blank form. This is a blank loan estimate that illustrates the application of the content requirements of Section 1026.37, which implies there is about 1,000 other section before that. This form provides two variations of page 1, four variations of page 2, and eight variations of page 3, reflecting the variable content requirements in 1026.37. Then I have to go back to 1026.37.

What I am suggesting to you is the complexity of his is overwhelming. But that is not where I think I want to use a couple of the minutes. Many of the local bankers are concerned about the qualified mortgage definition and whether we are going to get into new kinds of litigation possibilities, and I think you have spent some time and I would like to ask for your help in defining where we think this is going to go on the definition regarding whether there is going to be a safe harbor interpretation or whether or not there is going to be a rebuttable presumption. My reading of what the rebuttable presumption is that in addition to the factual information, there is a series of almost extrinsic evidence that could be introduced about the nature of that transaction. So where do we think this is going to be going with regard to the definition of a qualified mortgage?

Mr. CORDRAY. So the qualified mortgage rule, which is about the consumer's ability to repay the mortgage, which was something that far too little attention was paid to in the lead up to the financial crisis, and it led to many bad mortgages being peddled that failed, that failed in securitizations, that brought down the financial system. The idea here, Congress has required that this rule be adopted. The Federal Reserve put forward an initial proposal that then transferred to us, which we have inherited and we are working on to finalize. The idea is that there will be a realm of qualified mortgages that if they meet certain characteristics, there doesn't have to be any attention to ability to repay because the protective features of those mortgages themselves should accomplish that. And then there will be other mortgages outside of that definition, the non-qualified mortgages, if you will, where they will have to document attention to the consumer's ability to repay.

It has been conveyed to us loudly and clearly by people across the spectrum that if the qualified mortgage realm is drawn too narrowly, that could upset the mortgage market. That would be a notable example of a rule itself potentially restricting access to credit. We are very concerned about making sure that we don't do that, so we have actually backed up our timing on this rule to consider it further. We gained quite a bit of data from FHFA about mortgages. There is a lot of law that if you gain significant new data and you are going to rest a rule on that, you should give people an opportunity to have input and comment on it, which we have been doing over the course of the summer.

Mr. MEEHAN. Do you expect much lending outside of the category what you would call a qualified mortgage?

Mr. CORDRAY. It is hard to know what may happen in the long run with the mortgage market, but what has been conveyed to us and what we are pretty much convinced by is that in the short run, in the next couple, three years, which, of course, we are all living in the short run, there is unlikely to be a lot of lending done outside of the qualified mortgage circle; and, therefore, it is pretty important for us to be more inclusive in terms of what comes within that circle, and that is all input that we are digesting and trying to take into account as we finalize that rule before the end of this year.

Mr. MEEHAN. There is a provision in the bill that talks about a three-day window and terms changing during the course of a transaction requiring a new disclosure. I am concerned and have discussed with bankers that you may get to a point where you are getting towards the end of a transaction, what could be the normal discussion in the course of a negotiation about who may be responsible for fixing a basement or something could change the terms, which would require a whole new period of disclosure that may start the process ticking again, which may impact the availability of credit that is guaranteed on that particular day. Is there a way in which there is going to be some flexibility created to allow there to be some movement within the terms of a transaction without having it be triggering a whole new set of disclosures?

Mr. CORDRAY. So thank you, Congressman. Now you are talking about a different rule, which is the Know Before You Owe Truth in Lending Act-RESPA Form Rule, and part of the proposal there, and it is merely at a proposal stage at this point, we are going to get people's input on it, is that people not be ambushed at the closing table; that they get these disclosures three days before they close so they have time to actually review it. You know how the pressure comes at the closing table; there is all the information there, much of it is required by State law, not by the feds; much of it is required by the lending institutions themselves for protection; and people are being pushed, pushed to sign, sign, sign, not read it, not understand it. The notion here is that if people can have the information, the key information three days before, that gives them a better ability to understand and gage the transaction they are entering into.

We want to try to minimize the impact that that could have on potentially tying up a transaction from occurring on the date, the expected date, so that is something we are trying to take account of and get input on through the proposal stage, which is where we are right now. So your comment, which is similar to comments we have heard from others, are things we are trying to take account of and understand how we can avoid having that effect. Although we do think it is very important for consumers to have some time to look at this; it is the biggest single transaction likely they are ever to engage in, and if they do it in a confused basis or a rushed basis, where they don't quite understand what they are getting into, they can make bad decisions that will harm them the rest of their lives and will lead to a bad transaction.

Mr. MEEHAN. Well, thank you. I hope that you will look for flexibility with regard to that.

Now, just one last issue that I ask that you spend time considering is the implication on small-and medium-sized institutions with regard to requirements for machine readability of documents and the cost that may be associated with whole new kinds of information systems that will have to be obtained in order to do that. I am hearing a lot about that question.

Mr. CORDRAY. Thank you, Congressman. We are too, and we are going to look for how we can try to accommodate those concerns.

Mr. MEEHAN. Thank you.

Mr. GUINTA. [Presiding.] The gentlelady from New York is recognized, Ms. Buerkle.

Ms. BUERKLE. Thank you, Mr. Chairman.

I just have to comment, because as I have been sitting here listening, there are two tones that really concern me, and one is condescension that the American people and the consumers and the small businesses who are trying to consume services from banks just can't do it without the Federal Government, just can't do it without 1,000 pages directing them. And I think, first of all, it is condescension, but, second of all, it is such 180 degrees from what this Country is about. We don't need the Government, we don't need the Government to take care of us. There are consumers and this is the most well-informed consumer world out there, with the Internet, with people doing their legal services online. Yes, there are bad players, and I will just go to my colleague's comment about this regulation and this whole approach looks at all of the institutions as if they are the enemy and they are the cause of this meltdown that we had in 2008, and it is what Government does best, it is one big, fat footprint. We can't pick and choose the ones who were the offenders and the ones who hurt the consumer versus the whole industry itself, and that has always been my argument about government, because it doesn't have the ability; it is 1,000 or 2,000 pages at the whole industry and it impacts everyone.

But the condescension that we can't do it without the Federal Government, we can't do it without Dodd-Frank I find particularly offensive, and I think the American people out there, the American businessmen are far more sophisticated than the Federal Government gives them credit for.

I want to just——

Mr. CORDRAY. May I respond?

Ms. BUERKLE. Sure.

Mr. CORDRAY. With respect, I don't think there is anything condescending about my attitude toward these issues. I have been in these meetings in the community where people have lost their homes, lost their jobs because of the financial meltdown we worked through in 2007, 2008. These are very real human problems for people; they are tragic problems. And that is where the system got us before. We are now trying to clean it up. So the notion that everything is working just fine and just get the Federal Government out of the way I think is not something that can be squared with the facts. But there is nothing condescending about my attitude toward these problems; these are people's lives. People have been harmed and affected by what went on in a financial crisis that was not of their making; they were innocent bystanders. Many people paid faithfully on their mortgages and found their homes under water because there were 10 other foreclosures in their community because of bad lending, and that is the kind of problem we are looking to fix And people need us to do that and they want us to do that, and we are going to work hard to do it. But I will do it with your input and your thoughts and your perspective, and try to keep them very much in mind.

Ms. BUERKLE. Thank you. And I think we can probably debate the rest of the morning what actually caused the meltdown and the fact that Dodd-Frank doesn't handle Fannie and Freddie, and those were a big piece of what happened in 2008, and I think that that should be of concern to everyone.

I just want to harken back to when you were here in January. As we know, the CFPB is empowered to prevent unfair, deceptive, and abusive practices. In January we asked—and as you know, deceptive and unfair have been clearly defined in the statute. But as we get into the term abusive, and I will just read you what you testified to in January: "We have determined that this is going to have to be a fact and circumstance issue. It is not something we are likely to be able to define in the abstract." And that was when we asked you about the definition for abusive practices. Do you recall that statement?

Mr. CORDRAY. I do. And, in fact, Congress defined the term abusive; it is in the Dodd-Frank Act. Congress provided a definition with multiple prongs as to what abusive means. So I don't think the Bureau needs to redefine that; Congress told us what it means. If Congress says something, we accept it; we follow the law. In terms of how that applies in individual circumstances, obviously it has to be done with an eye to what those individual circumstances are.

Ms. BUERKLE. My time is running out. However, the CFPB Examination Manual clearly defines deceptive, clearly defines unfair practices, pages and pages and pages, and yet there is only a paragraph on abusive; and that is what led to the question in January. And my concern with that vagueness, which is what the regulators do, they define and they drill down into the law, my concern is that has a chilling effect. When you can't define what abusive practices are, how are the lenders supposed to know, the credit unions and the banks? How are they supposed to know what constitutes abusive practices? In my mind, and my colleague mentioned it earlier, the uncertainty, the chilling effect that that vagueness will have on the industry.

I see I have run out of time, so I yield back.

Mr. MCHENRY. [Presiding.] We will now recognize Ms. Speier of California.

Ms. SPEIER. Mr. Chairman, thank you.

Mr. Cordray, my applaud out to you for an outstanding job you have done as the Director. You know, for the longest time we have had a Consumer Product Safety Commission that could give us confidence that if we bought a toaster, it wasn't going to blow up in our faces. But we have not had that same confidence when it came to credit card, mortgages, and the like.

The credit reporting agencies have been pretty mystifying to the American people. They are not government entities; they are independent. And yet their numbers and the way they come up with their numbers says a lot to the consumers about whether they are going to get credit or not, and 700 used to be a great credit score and now it is not good enough for most mortgages. The FICO score, which we have known about for a long time, has also become the FACO score of some because, in fact, it is very unclear what scores are being used, and that many of these credit reporting agencies have different scores depending on what product is being anticipated or what you are paying for that score.

So my first question to you, Mr. Cordray, you pointed out in a hearing last Monday in Detroit, "Up to this point, no single Federal Government agency could access all the information necessary to generate a complete picture of what was happening inside these companies." Isn't it true that your supervision of credit reporting agencies has the potential to create a huge positive impact on some individuals' ability to access credit? Could you explain?

Mr. CORDRAY. Thank you, Congresswoman, I appreciate that angle on things. I do think, and we found as we held this field hearing in Detroit, that there are many people who don't fully understand or maybe are even entirely unaware of how much impact on their lives the credit reporting agencies have. They are keeping score, they are keeping a file on you all the time, every bill you pay or don't pay, whether you pay late or pay on time, and that is now being used to determine whether you have access to credit at all; what kind of interest rate you have to pay to get access to credit, which may be very different for you than it is for me or for Mr. Kelly or anyone else; and also can affect things like whether you get hired for a job, as that is part of background checks, now, increasingly, in a lot of workplaces.

So to the extent we can deliver more transparency, more accuracy in credit report files, that should be good for consumers and it should be good for lenders. You know, they pay for this service, they pay for the credit report information. And if it is not accurate, then lenders are harmed by that because they are making loans on terms that aren't the terms they would have used had they had the accurate information. So I think it is a very good point that as we can work with the credit reporting agencies, make sure that their processes are as they should be, that they are accurately pinpointing information and maintaining it, and that they are cleaning up errors that consumers bring to them in their file, that is good for consumers and lenders. It should be a win-win.

Ms. SPEIER. All right, on July 17th, in The Washington Post column highlighting the importance of your work in this area, the column notes "For years, consumer advocates have complained that the information collected often includes errors. Under the Fair Credit Reporting Act, the Bureau and any businesses supplying them with data must correct inaccurate information. However, surveys have shown that getting erroneous information removed from credit files can be an exasperating experience." And let me tell you I have personal experience with this issue, and it takes years. It shouldn't take years to correct an inaccurate credit report. Is this something that you are going to be able to address, now having jurisdiction over the credit reporting agencies?

Mr. CORDRAY. We will. And, frankly, I have had experience with that too, and we had some legislative efforts in Ohio that I was involved in, and people have brought in their huge boxes full of all the information and all the contacts that they had to try to get things corrected on their credit report, in many cases because they were victims of identity theft, so, by definition, through no fault of their own, but it still can take months or even years to get this resolved, and a lot of hours of time sunk into this and lots of frustration.

So I do think that we are going to be working with the credit reporting companies on three areas of concern that we have identified: the kind of information they receive from others, which often can be inaccurate or polluted in various ways; how they actually maintain and assemble that information; and what kind of error resolution procedure is in place for consumers so that they aren't having to go through laborious hoops in order to get problems fixed that they did not create themselves.

Ms. SPEIER. Mr. Chairman, can I ask one follow-up question? I realize my time has expired, but it will be a very short question.

Mr. MCHENRY. Go right ahead.

Ms. SPEIER. Thank you.

In California we actually passed a law that required that if an employer was going to access your credit report as an applicant, that you had to be notified of that. Do we have a federal law that does that?

Mr. CORDRAY. That if someone is accessing your credit report, you have to be notified of it?

Ms. SPEIER. If you are an applicant for a job and an employer is accessing your credit report, that you have to be notified.

Mr. CORDRAY. I don't believe that that is addressed in federal law.

Ms. SPEIER. Thank you.

Mr. CORDRAY. I could be wrong. If so, we will clean it up, but I don't believe so.

Ms. SPEIER. I thank the Chairman.

Mr. MCHENRY. We have a lot of federal statutes, so it is certainly a challenge, but I will now recognize myself for questions.

The head count of the CFPB is roughly, at this point, around 1300 people, is that about right?

Mr. CORDRAY. No, actually, we are not at that level. We plan to grow to at least that level, but I think right now we are at more like 950.

Mr. MCHENRY. Okay, 942 was the 2012 estimate and I wasn't sure if you had moved into the 2013, what you outline is about 1359 in your budget justification. So, with that, I do want to ask a couple questions about economic analysis.

The SEC, the FDIC, the FTC all have a chief economist. Do you have a similar position within the CFPB?

Mr. CORDRAY. So what we have is we have a research division that is composed of various people, including economists. We also have, separately, a markets division, which also engages in a lot of analysis, but maybe with something more of a direct practical eye to the operations of industry and how they work and how different markets for products work. So those are two different sources of information, wisdom, and insight for the rest of the Bureau.

Mr. MCHENRY. But there is no comparable to a chief economist within the CFPB?

Mr. CORDRAY. I don't know that we have something we designate as chief economist. We have economists at different levels, including those who supervise others, and maybe you could characterize someone in that hierarchy as the chief economist. I don't know that we have actually used that title.

Mr. MCHENRY. So who is the final say when you have a cost-benefit analysis?

Mr. CORDRAY. Well, we have an experienced regulations team, many of whom came from the Federal Reserve. We have the research and the markets people. We tend to work on a cross-team basis on the cost-benefit analysis because it is time-consuming, somewhat elaborate, and we want to make sure that we get it right in terms of how all of that then gets processed through the Bureau. Ultimately, that would go up to the Associate Director for the division, which we call RMR, which is Research, Markets, and Regulations. They sort of combine together. Ultimately, I would have sign-off on all of that.

Mr. MCHENRY. Okay, so that is a wholly different process than what we have just gone through with the SEC, trying to make sure that you have a group of economists that actually have the opportunity to affix a cost and a benefit analysis before final rulemaking is issued, so the public has some proper knowledge of that. I certainly understand that you don't have much clarity on what that process is in terms of being two hours in on your testimony.

Mr. CORDRAY. You mean the SEC process?

Mr. MCHENRY. No, no, no, your process that is similar, that would be the counterpart to what the SEC or the FDIC or the FTC does for a cost-benefit analysis.

Mr. CORDRAY. I see. So we developed our process after consulting with those other agencies, because they obviously had years of experience with cost-benefit analysis——

Mr. MCHENRY. And a number of lawsuits.

Mr. CORDRAY. Not all of it, right, exactly. So we tried to learn from them both what they did that they thought worked, what they did that they understood had not worked very well, and we drew up our process accordingly. I don't know that our process mirrors exactly what is done at other agencies, and there is probably some uniqueness in each of the processes, but——

Mr. MCHENRY. Would you provide for me in written response outlining this procedure and practice within the CFPB?

Mr. CORDRAY. Sure. We would be glad to do that.

Mr. MCHENRY. I certainly appreciate that. Now, in terms of behavioral economics, how does the CFPB utilize behavioral economics?

Mr. CORDRAY. Well, we are trying to build behavioral economics into what we do. We are trying to understand, not make judgments in the abstract, in a somewhat academic way, but think about how consumers actually behave and how our rules and other activities should take account of what kind of things consumers actually do.

By the way, industry does this very well. They have been attentive to the new behavioral economics. They think about that as they market products; they think about that as they design products; they think about that on the kind of products that they are looking to deliver. So it feels like we need to keep up with industry, and also we need to be practical about how our rules actually apply. It is one thing to write a rule in the abstract and you can write lots of pretty text and put it in the Federal Register, but if it isn't really coordinated with how consumers actually behave, then it is not very helpful.

One of the ways this has shown up for us is we are doing a lot of consumer testing around, for example, the forms in the combination of the Truth in Lending Act-RESPA forms. There has been a lot of testing with consumers to try to see what they are taking away, what they are understanding, what they are not understanding, what they are stumbling over, what they are getting.

That did lead us, and there has been some disagreement about this, to take the APR, annual percentage rate number, and put it on page 3 of our form, rather than page 1, because we found that consumers typically were confused by that. It was, in practice, not as easy for them to understand that as maybe people thought theoretically would be the case. So we are trying to respond to what consumers actually do, to what they actually know, to what they understand, and we are trying to use that to build our forms.

Mr. MCHENRY. So the concern I would have is your use of behavioral economics is to inform regulators, as a regulator, how consumers make decisions. There is also a tension within that in that there is a substantial part of behavioral economic theory that would tell you that you need to limit choices, limit the choice set and choice architecture of decisions consumers make.

So that tension between a regulator understanding how consumers make decisions versus limiting products is a great concern from my perspective here on the Hill, because it shouldn't be a regulator's policies and procedures that lead to limiting choices for consumers; it should be to inform how consumers make decisions so the regulator understands that, not for the regulator to proscribe that limitation of options for consumers. Do you agree or do you disagree with what I have just said?

Mr. CORDRAY. I think what you just said is a great insight and it is something that we wrestle with. Certainly, much of what we have been doing has been targeted at addressing clearer, simpler, straightforward disclosures so that consumers can know what choices they are making. Are there times where certain acts, and I tend to focus on products, per se, I mean, I think I tend to share some of your skepticism about us banning products. What the statute speaks to is us addressing acts or practices.

So, for example, the enforcement action that just was completed had to do with deceptive marketing of products, which, again, I think interferes with consumers making fair and sensible choices for themselves if they are deceived or misled, but we have really not, I think, been thinking in terms of banning products, per se.

So to the extent that you think that may be some portion of the behavioral economics school of thought—and I would confess that I am not an expert in it, I have been learning about it, been learning many things since I took this position—I don't know that that is a focus of our attention so much as trying to understand consumer behavior, understand some of the things that are not necessarily obvious or rational in consumer behavior, for example, once you have something, there is a greater concern about losing it than there was about obtaining it in the first place. There is some time frame constraints where consumers may tend to downplay things that occur more in the long-term than things that occur right away; various ways that consumers actually think and behave that may not be obvious to people who think that we are all perfectly rational.

But I don't tend to think and I don't think we are approaching this from a standpoint of limiting choices, but I am not sure I fully understand the entire school of behavioral economics. In fact, I know that I don't.

Mr. MCHENRY. Well, I certainly appreciate your humility in that answer, implicit in that answer. I just wanted to understand your frame of reference for this process, obviously. So if I can close by just asking a couple, and if you would just keep it brief, as the time is short.

Again, this question of abusive practices, do you have an intention to lay this out in rulemaking, in a formalized way, clear examples and clarifications on what that definition is and how the Bureau sees it?

Mr. CORDRAY. So, again, I am not close-minded on that subject. I think at the moment we have no present intention to launch a rulemaking on that issue. We are pretty tied up through the remainder of this year with the mortgage rulemakings; we will be hard pressed to meet those deadlines, although I believe that we will. We have been examining institutions around the UDAP procedures. I don't know that we, to date, have identified specific abusive practices, although much of that is in process, so I don't think we have an intention to launch an abusive rulemaking at this time.

Mr. MCHENRY. Okay, so the answer is no.

Mr. CORDRAY. I think that is correct as of this moment.

Mr. MCHENRY. Would you commit to formalizing the process for evaluating, well, let me restate this. Would you commit to formalizing the process for evaluating credit access in rulemaking and examinations?

Mr. CORDRAY. I think that it is part of our process now.

Mr. MCHENRY. But would you commit to formalizing that process?

Mr. CORDRAY. I am not sure what you mean by formalizing.

Mr. MCHENRY. As in outlining it so there are expectations from the private sector.

Mr. CORDRAY. I see. So in our examination process we have an examination manual. Again, it borders on the long side, but it is on our website. Much of it is adapted from procedures that other banking agencies have used. And we have also given more specific guidance about particular products that we are examining around. Those modules are also on our website; they are publicly transparent for institutions and others to assess, so that is a way in which we have formalized that process.

Our rulemaking process is very stylized in terms of the law; we have the SBREFA panels, we have the proposal stage, we have a notice and comment procedure——

Mr. MCHENRY. I understand. Not to cut you off, but to get to the point of this hearing, it is access to credit.

Mr. CORDRAY. Yes.

Mr. MCHENRY. The availability of credit and the access to it. The availability of credit is one thing. The financial crisis proved out, as you outlined, that when institutions lose their rears, so to speak, if I may be overly technical——

Mr. CORDRAY. Appreciate your cleaning that up.

Mr. MCHENRY. When institutions fail or have to be bailed out by the Government for bad decisions they made in loaning people money or investing, that constricts credit for everyday consumers, yes, absolutely. Also, as a part of that, that is the availability of credit becomes constrained. Access to credit can be constrained as a result of less availability of credit, yes.

So that can be a decision made by businesses or banks; it can also be as a result of government regulation. That is our discussion. That is our intention today, is to get to the heart of that. So what I would like you to address, and if I may say it that way, I would encourage you to look at access to credit and to mention this in terms of your rulemaking, the impact that your rules will have on access to credit as you see it, because, as I see it, there is this opportunity to overregulate and thereby constrain access to credit.

Mr. CORDRAY. I see. I see your point.

Mr. MCHENRY. Maybe not explicitly banning products, but having the results of products not being offered. That is my concern I would like to express to you, and I would certainly appreciate it if you would take that into account. I think the American people would appreciate that as well.

Mr. CORDRAY. I understand your point now, and I didn't get it before. We do in fact, that is one of the things we consider in the cost-benefit analysis, is what the potential effect of a proposed rule would be on access to credit. There is only a handful of specific statutory mandates that we have, the objectives laid out by Congress in creating the Bureau. One of them is to give careful consideration to access to credit, and my understanding of how this makes sense is it is great to protect consumers with all the elaborate protections you can think of, but if they can't get a loan, then you are really not helping consumers.

So they have to have access to credit and then the credit needs to be presented in terms that are understandable, clear, so forth. Both of are objective. And I do think we uniformly, as we consider rules, having a discussion of that and a consideration analysis of that, but I appreciate the comment, and we will make sure our process reflects that.

Mr. MCHENRY. Well, Mr. Cordray, thank you for submitting to congressional oversight. I certainly appreciate the responsiveness you have personally presented in your time as Director of the CFPB. As I mentioned and I have expressed to you personally, the means of your appointment I found suspect, but your actions serving in this position have been honorable. Even if at times I disagree with the actions you have taken, you have done so in an honorable fashion, and we can disagree about policies, procedures, and even sometimes results, but I certainly appreciate your willingness to be open about that. That is a very welcomed thing. And thank you for your willingness to be here today.

Mr. CORDRAY. The sentiment is mutual, Mr. Chairman. Thank you.

Mr. MCHENRY. Thank you.

We will now dismiss this panel and we will recess for about a moment or two before we begin our second panel.

[Recess.]

Mr. MCHENRY. The Committee will return to order.

We will now recognize our second panel of witnesses. Thank you for waiting so patiently through the first panel.

Mr. Douglas Fecher is the President of Wright-Patt Credit Union in Fairborn, Ohio; Mr. Steven Zeisel is the Executive Vice President and General Counsel of the Consumer Bankers Association; Mr. Michael Calhoun is the President of Center for Responsible Lending; Mr. Mark Calabria is the Director of Financial Regulation Studies at the Cato Institute.

Thank you so much for being here. It is the policy of this Committee that all witnesses be sworn before they testify. If you will please rise and raise your right hand.

Do you solemnly swear or affirm the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

[Witnesses respond in the affirmative.]

Mr. MCHENRY. Thank you. You may be seated.

Let the record reflect that the witnesses answered in the affirmative.

We will now begin with Mr. Fecher for his testimony. As you have heard, the light system is very simple for opening statements: green means go, yellow means hurry up, and red means stop. You will have five minutes to summarize your opening statement.

Mr. Fecher.

**STATEMENT OF DOUGLAS FECHER**

Mr. FECHER. Thank you, Chairman McHenry, Ranking Member Quigley, members of the Subcommittee. Thank you for the opportunity to testify at today's hearing. My name is Doug Fecher, and I am President and Chief Executive Officer of Wright-Patt Credit Union, a federally-insured, State-chartered credit union serving over 225,000 members with total assets of $2.5 billion, headquartered in Fairborn, Ohio.

Credit unions are not-for-profit financial cooperatives owned by their members, and our job is to help our members improve their financial well being. Today, credit unions face a crisis of creeping complexity with respect to regulatory burden. This burden will ultimately, in my opinion, have a negative impact on credit unions' ability to extend credit to members at reasonable costs.

It is not just one new law or revised regulation that challenges credit unions, but the cumulative effect of all regulatory changes. Every hour and dollar that is diverted to deciphering these new regulations is a resource that cannot be spent working with our members and will have to be paid for out of the interest we earn from consumer loans.

It was the actions of the larger financial institutions that created the need for stronger consumer protections. We understand this. However, it is important that the CFPB recognize that the cost of compliance does not vary much by asset size and is a much greater burden for smaller institutions.

The Dodd-Frank Act required the CFPB to review all the statutes and regulations under its jurisdiction. As part of this process, the CFPB has routinely reached out to the credit union system to seek our perspective and input on their rulemaking process. We appreciate their effort and look forward to continuing to work with them.

However, because of the scope of the review, there could be dozens, if not hundreds, of additional operating changes that credit unions will be required to make. To help give the Committee an idea of what credit unions are facing, in just the past six months the CFPB has issued a 300-page remittance rule, an 1,100-page proposal on RESPA–TILA, a 293-page proposed HOEPA proposal, and we are quite apprehensive about the qualified mortgage regulation and other related rules the CFPB is working on.

The fact of the matter is it is not necessary for credit unions to be subjected to a substantial increase in compliance costs. Congress granted CFPB the authority to exempt credit unions and other parties from a number of the regulations the Bureau is developing. We are very concerned that instead of exempting credit unions, the Bureau seems to be picking and choosing when to use the statutory flexibility Congress provided.

We believe the Bureau has more authority to extend relief to credit unions from certain compliance responsibilities that it has not exercised. If we want credit unions to maintain and expand access to reasonably priced consumer loans, Congress should, at the very least, aggressively urge the CFPB to utilize its exemption authority so that regulations that are intended for abusers and the largest of financial institutions do not have the unintended consequence of overburdening credit unions and other smaller financial institutions.

The RESPA–TILA proposal is massive and reviewing of the document will be a problem for most credit unions. I am personally concerned that things like this proposal, along with all the other changes occurring in the mortgage market, may make many smaller credit unions simply throw up their hands and quit making mortgage loans.

The proposed rule would change many aspects of the current way of doing business. While it is difficult to assign a dollar figure to the cost of compliance for these changes, when a regulation is changed, make no mistake, there are costs to be paid: staff time and credit union resources must be used to comply with the changes; forms and disclosures must be changed; data processing systems must be reprogrammed. It also takes time to discuss these changes with credit union members, and at times members get frustrated because of everything they are being put through.

Regarding the definition of a qualified mortgage, or QM, the Bureau was given broad flexibility to define QMs. We agree with this. The Bureau's broad jurisdiction in this important matter will undoubtedly reshape the mortgage process and determine the cost for borrowers and liability exposure for lenders. The CFPB should consider the broadest possible QM definition that balances the needs of responsible lenders and consumers to ensure maximum access to credit and minimal market disruption.

A common element of all the new rules emanating from the Bureau is a significant increase in cost to credit unions. Faced with increased compliance costs, we will be forced to reduce some other costs that we can control. As an example, one of our most controllable expenses is loan losses. The only way we can lower loan losses is to tighten credit standards, which will impact creditworthy borrowers on the margin. This will be particularly harmful to those Americans hurt most by the recent financial crisis and recession.

Chairman McHenry, credit unions respect the idea of strong consumer protection. Such protection is in our DNA. As a matter of public policy, I believe we should be encouraging responsible community-based lending, rather than discouraging it through costly compliance burdens for groups that were never part of the problem in the first place. We urge the Subcommittee to ensure the Bureau exempts credit unions and other small financial players in their communities to the greatest extent possible.

Thank you for allowing me to testify today. I would be happy to take any questions.

[Prepared statement of Mr. Fecher follows:]

Testimony of
Douglas A. Fecher
President and Chief Executive Officer
Wright-Patt Credit Union
On behalf of the
Credit Union National Association
Before the
Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs
Committee on Oversight and Government Reform
United States House of Representatives
Hearing on
"Credit Crunch: Is the CFPB Restricting Access to Credit?"
July 24, 2012

Chairman McHenry, Ranking Member Quigley, Members of the Subcommittee:

Credit unions greatly appreciate the opportunity to testify before the subcommittee about effects the Consumer Financial Protection Bureau's (the Bureau) regulations could have on the accessibility of credit for credit union members. My name is Doug Fecher, and I am President and Chief Executive Officer of Wright-Patt Credit Union, a federally insured, state chartered credit union serving over 225,000 members, with total assets of $2.5 billion, headquartered in Fairborn, Ohio. I am testifying today on behalf of the Credit Union National Association, the largest credit union advocacy organization in the United States, representing nearly 90% of America's 7,200 state and federally chartered credit unions and their 95 million members.

Credit unions face a crisis of creeping complexity with respect to regulatory burden. It is not just one new law or revised regulation that challenges credit unions, but the cumulative effect of all regulatory changes. The frequency with which new and revised regulations have been promulgated in recent years and the complexity of these requirements is staggering. Since 2008, we estimate that credit unions have been subjected to in excess of 120 regulatory changes from at least 15 different federal agencies. The burden of complying with ever-changing and ever-increasing regulatory requirements is particularly onerous for smaller institutions, including credit unions. This is because most of the costs of compliance do not vary by size, and therefore proportionately are a much greater burden for smaller as opposed to larger institutions. If a smaller credit union offers a service, it has to be concerned about complying with virtually all of the same rules as a larger institution, but can spread those costs over a much smaller volume of business. Further, even though most credit union board members are unpaid volunteers, they face the same legal liabilities regarding compliance as do compensated bank directors.

Today there are nearly 1,000 credit unions operating in the U.S. with one or fewer full-time equivalent employees. Nearly one-half of the nation's 7,200 credit unions operate with just five or fewer full-time equivalent employees. Anecdotally, many of these folks tell us they put in 70- and 80-hours a week trying to keep up with regulations and the constant barrage of regulatory changes. Not surprisingly, smaller credit unions consistently say that their number one concern is regulatory burden. Difficulties in maintaining high levels of member service in the face of increasing regulatory burden are undoubtedly a key reason that roughly 300 small credit unions merge into larger credit unions each year.

Every dollar a credit union spends complying with these changes is a dollar that is not spent to the benefit of credit union members. Because credit unions are member-owned financial cooperatives, the entire cost of compliance is ultimately borne by credit union members. Greater compliance costs reduce net income, which is credit unions' only source of net worth. While increased compliance costs will not drive credit unions into immediate insolvency, it will reduce, on the margin, the protective cushion provided by capital, leaving credit unions less resilient during the next big financial shock.

The Bureau is required by the Dodd-Frank Act to review all the statutes and regulations under its jurisdiction. Because of this review, there may be hundreds of additional changes that credit unions will be required to make. This is why credit unions have a significant amount of anxiety with respect to the potential impact the Bureau will have on their ability to serve and lend to their members. In addition, there is significant amount of frustration within the credit union system with respect to further rules from the Bureau because credit unions did not cause the financial crisis; they did not seek or receive any taxpayer bailout; and they did not engage in the type of activity that prompted the creation of the Bureau. With every regulatory change, many feel as if they are being required to pay for the sins of other financial actors. Credit unions simply want to go about the business of serving their members; but unless the Bureau uses the tools at their disposal to minimize or eliminate the impact of its regulation on them, the adverse impact will be felt by the member-owners of credit unions.

For the purposes of this testimony, I would like to discuss the tools that the Bureau has at its disposal to minimize and eliminate the impact of its regulation on credit unions, as well as the impact of regulatory changes presently under consideration by the Bureau, specifically: the integration of Real Estate Settlement Procedure Act (RESPA) and Truth in Lending Act (TILA) Disclosures; remittance regulation; and the definition of a Qualified Mortgage.

**Exemption Authority**

When considering the impact of the Bureau's rules on credit unions' ability to lend to and serve their members, it is important to keep in mind that the answer to the question should be, "no impact," if the Bureau actively uses the tools that Congress gave it to address regulatory burden. Congress has directed the Bureau to identify and address outdated, unnecessary and unduly burdensome regulations in order to reduce unwarranted regulatory burden. (Section 1021(b)(3)). Further, Congress conveyed to the Bureau the ability to exempt any class of provider from its rulemaking. (Section 1022(b)(3)). The intent here is to ensure that covered entities, such as credit unions, are not under regulation that impedes service to their members or customers, and to ensure that entities that treat consumers well operate in a regulatory environment that allows them to continue to do so.

We believe the Bureau has more authority than it has been exercising to extend relief to credit unions and others from certain compliance responsibilities. We are very concerned that the Bureau seems to be picking and choosing when to use the statutory flexibility Congress provided to the Bureau in the Dodd-Frank Act. It is important that Congress aggressively urge the Bureau to utilize the exemption clause so that the weight of compounding regulations that are intended for abusers and the largest of financial institutions do not overburden credit unions and other smaller financial institutions. The Bureau's failure to use this authority as Congress intended may ultimately drive good actors out of markets, forcing consumers to do business with those entities that remain. We encourage Congress to urge that the Bureau exercise its authority as broadly as possible to protect credit unions from burdensome overregulation, which ultimately impacts consumers. Further, CUNA has urged the Bureau to include an analysis of its exemption authority with every proposal and final rule so that every time the Bureau considers a new regulation, it will also consider whether institutions such as credit unions that are already heavily regulated should be exempted. The default should be exclusion unless demonstrated need.

**Integration of RESPA and TILA Disclosures**

CUNA supports providing consumer disclosures that are meaningful and clear for borrowers to understand the important terms of a financial transaction. When the Dodd-Frank Act was being considered by Congress, CUNA strongly supported combining certain RESPA TILA forms to improve efficiencies in disclosures and minimize disclosure burdens on credit unions as well as on consumers, who are overloaded with financial information that is not practical or useful. During the development of the proposed integrated forms, the Bureau reached out to CUNA on numerous occasions to solicit information on credit unions' views and concerns.

However, we are very concerned about key aspects of the 1,099 page RESPA/TILA proposed regulation that was released on July 9, 2012, and this is a perfect example of the enormous burden that credit unions and other smaller financial institutions face. The proposal is massive, and reviewing of the document will prove to be problematic for some stakeholders who do not have the luxury of large staffs and teams of lawyers they can devote to working through the proposal, while also trying to comply with other Bureau issues that are pending. Due to the various mandates Congress required the Bureau to implement, we are concerned that just being able to respond to all the important issues raised in the proposal will be burdensome, particularly in light of other proposals that are pending or developing from the Bureau to meet statutory requirements.

*Finance Charge*

One aspect of the new RESPA/TILA proposal would be to expand the definition of the finance charge as defined under Regulation Z. As the Bureau has acknowledged, absent further action by the bureau, a more-inclusive finance charge as proposed would have the following effects:

- Cause more closed-end loans to trigger HOEPA protections for high-cost loans;

- Cause more loans to trigger requirements to maintain escrow accounts for first-lien higher-priced mortgage loans;
- Cause more loans to trigger requirements to obtain one or more interior appraisals for "higher-risk" mortgage loans;
- Reduce the number of loans that would otherwise be "qualified mortgages" under the ability-to-repay requirements, given that qualified mortgages cannot have points and fees in excess of 3% of the loan amount.

Comments are due to the Bureau on the finance charge definition by September 7, 2012, and CUNA will be focusing on the substance and impact of the proposed expansion of the finance charge definition. While the current system for determining what is a finance charge and what is not is certainly confusing, we hope to work with the Bureau to address this issue without triggering so many other unintended consequences.

*Effective Dates*

The Bureau is proposing to delay the compliance deadline of certain requirements relating to new disclosures required under the Dodd-Frank Act and is seeking comments on this approach. While Congress is responsible for creating these requirements, it has given the Bureau authority to mitigate compliance burdens and we appreciate the Bureau's willingness to consider how best to use that authority as it relates to these disclosures.

Congress did not specify a specific compliance deadline for this regulation and the Bureau is presently considering a compliance deadline for the RESPA/TILA proposal. We hope the Subcommittee will encourage the Bureau to give credit unions as much time as possible to comply with a final rule.

*Model Forms vs. Standard Forms*

TILA authorizes the Bureau to publish model forms for the TILA disclosures. In contrast, RESPA authorizes the Bureau to require the use of standard forms. Model forms benefit lenders by providing them with safe harbors for complying with disclosure obligations, while preserving flexibility for lenders to vary from the model so long as they adhere to the regulation. Standard forms allow less flexibility for lenders, but provide consistency for both consumers and lenders.

We have urged the Bureau to issue a rule that would require the use of standard forms under RESPA for the Loan Estimate and Settlement Disclosure for mortgage loan transactions that are subject to RESPA, but would allow lenders to use model forms for the TILA disclosures. We believe that such an approach would yield less opportunity for unscrupulous lenders to present "bait and switch" scenarios to consumers, and that this approach would contribute overall to better consumer protection. Again, recognizing that the RESPA/TILA form combination is required by the Dodd-Frank Act, we continue to urge the Bureau to provide consumers with disclosures that are complete yet efficient for both the consumer as well as the lender. Not only is the prospect of too many disclosures daunting to and unwelcomed by most consumers, the cost to generate, deliver and explain the disclosures to consumers has become extremely burdensome to lenders.

*Potential Costs of Compliance*

Assigning a dollar figure to the cost of compliance for these regulatory changes is extremely difficult. When a regulation is changed, there are certain upfront costs that must be incurred: staff time and credit union resources must be applied in determining what is necessary in order to comply with the change; forms and disclosures must be changed; data processing systems must be reprogrammed; and staff must be retrained. It also takes time to discuss these changes with credit union members, and at times, members get frustrated because of the change. The ongoing costs of doing business in a manner that complies with the new regulation, compared to how it was conducted previously, is more challenging to measure.

CUNA encourages the subcommittee to closely monitor the rules that the Bureau has under consideration, including the proposals relating to the RESPA/TILA rulemaking.

*Consider Repeal of Specific Disclosure Requirements*

With respect to disclosures specifically mandated by the Dodd-Frank Act, we recognize that Section 1419 amends TILA to require, in the case of residential mortgage loans, "the disclosure of the total amount of interest that the consumer will pay over the life of the loan as a percentage of the principal of the loan," ("Total Interest Percentage"). The extent to which this disclosure would actually help consumers has not been documented and we encourage Congress to repeal this requirement or make it more meaningful to consumers by clearly distinguishing it from the annual percentage rate. We are concerned that there is tremendous potential for consumer confusion with this disclosure, particularly if it is not distinguished from the APR.

In this same light, Section 1419 also amends TILA to require the disclosure of the "approximate amount of the wholesale rate of funds in connection with the loan." in the case of residential mortgage loans. For those credit unions that intend to sell mortgage originations to the secondary market, this disclosure provides absolutely no benefit or value to the consumer. Secondly, for those credit unions that intend to portfolio their mortgage originations, CUNA believes that a more appropriate measure of the cost of funds in this context would be the credit union's cost of funds as estimated over the life of the loan, rather than solely at the point of origination.

*Settlement Disclosure Delivery Timing*

CUNA is also concerned with a proposal being considered by the Bureau which would require delivery of an integrated Settlement Disclosure three business days before closing in all circumstances. We have urged the Bureau to not proceed with such a requirement. It is difficult, at best, for credit union lenders to coordinate with title companies and others 24 hours in advance of a real estate closing, much less 72 hours. To increase the period to three days prior to closing would be very problematic for credit unions, and likely very frustrating for consumers who usually want to close on their home loan as soon as possible. CUNA encourages the subcommittee to help ensure additional regulatory burden regarding this requirement is not placed on credit unions in any future rulemaking.

**Remittance Rule**

Required by Section 1073 of the Dodd-Frank Act and effective in February 2013, this regulation imposes a series of new requirements on those entities making international remittance transfers. Basically, the regulation requires a "remittance transfer provider" that sends international wire or ACH transfers in the "normal course of business" for consumers to a recipient in a foreign country to comply with very detailed rules. Until now, few credit unions would have ever considered themselves to be "remittance transfer providers," believing this term would cover companies such as Western Union or MoneyGram.

Let me give you some idea of how Wright-Patt will be required to comply. We are a large credit union, but only originate approximately 25 international wire transfers a month. Our core processing system does not support the Remittance Transfer Rule Changes. We would need to implement new software to process international wires allowing for the exchange rate, fees, and receipt requirements. Additionally we would need to put into place the specific error resolution processes required by the regulation and conduct staff training.

Under the final regulation, any credit union that provides this service to members will have to comply. At the same time the Bureau issued the final regulation (which was 116 pages of text and explanation in the Federal Register), it issued a proposal to define a key term, "normal course of business." The agency proposed a definition that would say any credit union that makes 25 or fewer international remittances a year would not be considered a "remittance transfer provider." Credit unions were surprised at the very low number proposed, which would only help a very, very small number of institutions.

If the Bureau adopts this low threshold, many credit unions have said they will simply stop providing this service to their members because of the burden of complying with this new remittance regulation. Surely this is not what Congress intended. CUNA originally urged a 2,400 annual transfer threshold for coverage, which was rejected by the Bureau as inconsistent with the statute. We are now asking that a credit union may make at least 1,000 transfers a year before being subject to this burdensome regulation, which we believe is reasonable.

We believe the rule should treat differently those remittance service providers that are in the business for the sole or primary purpose of providing remittance transfers as opposed to credit unions that provide these services as an accommodation to their members who trust them. A credit union can be very small and serve, for instance, an immigrant population who will want such a service. Time and again, the Bureau and members of Congress have acknowledged that credit unions do a good job providing services to their members, and it is a shame when a regulation imposes such a burden that a credit union has to either raise the fee for providing the service or discontinue the service altogether.

**Qualified Mortgage (QM) definition**

The Bureau has decided to delay until after the November elections the issuance of the Qualified Mortgage rule that will determine proper underwriting standards for borrowers. We wholeheartedly support this delay. CUNA generally supports the proposed definition of "qualified mortgage" and offers the following comments regarding specific provisions of the proposal.

*"Safe Harbor" Alternative*

CUNA strongly supports the proposed "safe harbor" alternative ("Alternative 1") which would treat "qualified mortgages as a legal safe harbor because the safe harbor approach would provide greater legal protection for credit unions than "Alternative 2" (a "presumption of compliance") with respect to the borrower's "defense to foreclosure" under TILA section 130(k), 15 U.S.C. §1640(k), against creditors that do not preform sufficient "ability to repay" analyses.

Additionally, CUNA believes that adoption of the safe harbor approach, by limiting the legal liability and exposure for prudent mortgage lenders such as credit unions, will limit the costs to consumers and provide greater choice in the marketplace for consumers.

Credit unions have historically engaged in safe and sound mortgage underwriting that includes a robust ability to repay analysis. After all, credit unions have historically kept in their own portfolio the vast majority of the mortgage loans they originate. Credit unions are concerned that, without a safe harbor, they could be faced with significant amounts of frivolous foreclosure defense litigation with respect to future foreclosures. A credit union making a qualified mortgage should be entitled to significant legal protections because it will have gone well beyond its statutory obligations under TILA to do an "ability-to-repay" analysis.

For these reasons, CUNA encourages the subcommittee to urge the Bureau to issue a final rule that structures QM as a strong legal safe harbor, not a rebuttable presumption.

*Prepayment Penalties*

CUNA does not support the proposal to include within the definition of "prepayment penalties" waived closing costs that can be recouped in the event of prepayment or certain amortized interest because it would discourage the very member-friendly practice of sometimes waiving some of the costs. In addition, the courts and agencies such as the National Credit Union Administration (NCUA) do not consider these items to be "prepayment penalties".

CUNA opposes including within the prepayment penalty definition fees, such as closing costs, that are waived unless the consumer prepays the loan because NCUA has determined that such arrangements are not "prepayment penalties." Federal credit unions are currently not permitted to charge prepayment penalties pursuant to 12 U.S.C. § 1757(5)(A)(viii). Conflicting regulatory definitions of "prepayment penalty" will lead to increased confusion by credit unions and consumers, and will increase credit union's regulatory burden.

CUNA also opposes the proposed treatment as a "prepayment penalty" of amortized interest occurring after prepayment (such as if a mortgage amortizes monthly on the first of the month and the borrower prepays in full on the 5th of the month, but the creditor continues to charge interest as though the loan were still outstanding until the end of the monthly amortization period). The courts have held that such computation methods are not "prepayment penalties" and requiring credit unions that use this type of periodic amortization calculation to treat this method as a "prepayment penalty" for disclosure purposes would be confusing to consumers and would impose significant regulatory burdens on credit unions while providing limited benefits to consumers.

*Lower Documentation "Qualified Mortgages"*

Some credit unions serve significant numbers of self-employed people and/or immigrant populations who may not have documents such as W-2 forms, pay stubs, and so forth. In order to ensure continued access to mortgage credit for these groups, CUNA has requested the Bureau clarify that "qualified mortgages" can be underwritten based primarily or exclusively on financial institution records so long as those records show ability to repay.

*"Balloon Payment Qualified Mortgages" for Lenders in Rural and Underserved Areas:*

CUNA supports the proposal to allow balloon payment mortgages to be considered "qualified mortgages" if made by lenders under $2 billion in assets that operate predominantly in "underserved" and "rural" areas. This is necessary for maintaining consumer access to mortgage credit in these areas because it allows smaller institutions to control interest rate risk.

CUNA supports the proposed $2 billion asset limitation and believes that no additional limitations regarding the creditor's total annual number of mortgages made or total dollar annual value of mortgage transactions are needed given the asset size limitation and the other proposed limitations in the rule.

CUNA does not support, however, the Board's proposed definitions of "underserved" and "rural" because these proposed definitions are far too narrow to be meaningful in practice. We believe that the proposed definitions of "underserved" (i.e. counties where only one creditor makes five or more mortgages a year) and "rural" (i.e. only counties that are not within or adjacent to a metropolitan statistical area or a micropolitan statistical area) are far too restrictive and should be expanded to include areas determined to be "underserved" or "rural" by other federal agencies such as the National Credit Union Administration (NCUA) Board.

In our view, limiting the definitions of "underserved" and "rural" to only the most underserved and the most rural counties will have the effect of limiting access to mortgage credit in other objectively underserved and rural areas in a manner inconsistent with Congressional intent. Some counties are objectively underserved even when two or more financial institutions each originate 5 or more mortgages a year and many rural areas are in counties adjacent to or included within a micropolitan statistical area or a metropolitan statistical area.

*Delayed Compliance Date*

CUNA has urged the Bureau to set a compliance date that recognizes creditors' need for additional time to implement these requirements. Credit unions and other creditors are faced with myriad new regulatory compliance requirements they are trying to meet that also will affect their compliance efforts with this rule. Additional time will be especially important for credit unions and others that rely on third parties, such as software vendors. These third parties will need time to incorporate the necessary updates, complete the necessary testing, and then include this change into their regularly scheduled releases.

**Conclusion**

This statement reflects just a small portion of the regulatory burden that credit unions are beginning to face because of statutory provisions in the Dodd-Frank Act. As the Bureau continues to review the many rules and regulations that are now under its purview, credit unions are bracing for the almost insurmountable task of deciphering the barrage of information that will be thrust upon them. To help put the burden of compliance into perspective, in order to meet statutory deadlines the Bureau is expected to propose and finalize at least five additional rules and regulations relating to mortgage lending in the next six months that will directly impact credit unions. This is outside of, and in addition to, the two proposed rules issued just a few weeks ago that together amounted to almost 1,400 pages, which includes enumerable proposed operational and disclosure requirements that will significantly alter mortgage lending functions, services and costs for all lenders. Moreover, under the Dodd-Frank Act, the Bureau is required to develop at least six other rules, in addition to the seven mentioned above, just in the area of lending-related issues.

Battered by the volume of regulatory issues and concerns since the beginning of the financial crisis, credit unions are bracing for the next wave of rules that flow from the Dodd-Frank Act. Congressional oversight must begin early in the rulemaking process so that Congress will remain informed of the scope, need and implementation cost of proposed regulations that will affect all financial institutions. Credit unions, like many smaller financial institutions, are disproportionally affected by the burden of compliance compared to their larger counterparts that may operate in a multi-state or national capacity.

We will continue to strongly urge the Bureau to consider using its statutory authority to exempt credit unions so that regulatory burden can be reduced to a more manageable level. The oversight authority of this Committee will prove important in reminding the Bureau of its statutory ability to exempt credit unions.

On behalf of America's credit unions and their 95 million members, thank you very much of the opportunity to testify at today's hearing. I am pleased to answer any questions that you may have.

Mr. MCHENRY. I certainly appreciate the summary of your testimony and certainly appreciate your full written testimony as well.

Mr. Zeisel.

**STATEMENT OF STEVEN I. ZEISEL**

Mr. ZEISEL. Chairman McHenry, Ranking Member Quigley, and members of the Subcommittee, my name is Steve Zeisel, and I am Executive Vice President and General Counsel of the Consumer Bankers Association. We appreciate the opportunity to present our views today.

As the trade association of retail banks of all sizes, we are very focused on the CFPB. We recognize the importance of maintaining an ongoing dialogue with our new regulator. CBA has been pleased with the Bureau's accessibility in that regard and we have met with them on numerous occasions.

Consumers are best served by a health and innovative financial services market. It is critical that, as the Bureau embarks on its mission, it does not act as a brake on the development of creative products, or limit access to credit.

As banks observe the CFPB's development during this transitional period, they may become cautious in developing new products and services. The Bureau must always recognize the potential impact its actions can have on access to credit for consumers, and how over-burdensome regulations will only increase compliance costs and stifle product innovation.

One particular area of industry and consumer concern is the Qualified Mortgage or QM proposal. This may be the most important rule the CFPB issues in its first 18 months, given the significant impact it will have on consumers' ability to access mortgage credit. We have two major concerns.

First, the CFPB needs to define a QM as broadly as possible, using objective standards. If the Bureau is vague or subjective, legal uncertainties will mount, as will costs for consumers. Second, the CFPB also needs to provide a safe harbor which would result in lower risks for lenders, and allow a larger group of consumers to receive safe and affordable mortgages.

Thankfully, the CFPB is taking a deeper look before issuing the final QM rule later this year. If the Bureau misses the mark, consumers could see a significant reduction in the availability of mortgage credit.

The CFPB has also devoted a significant amount of time and resources over the last year combining and simplifying mortgage disclosures. CBA applauds these efforts to simplify disclosures for consumers, since we have long been supporters of more streamlined RESPA and TILA disclosures. But we are concerned the CFPB has proposed other significant changes to the RESPA–TILA rules that are not directly related to the new disclosure forms. We will be reviewing and commenting on the 1,100 page proposal over the next several months.

One of the few rules the CFPB has finalized will have a significant impact on consumers who transfer money abroad. That is the remittance rule. The way it was written, it may cause many banks to exit the business entirely, since they may be unable to comply with the new requirements. This is to the detriment of those consumers whom this rule was meant to help. The CFPB needs to take a second look and study the impact of this rule before it is implemented next year.

The CFPB has also indicated its intention to regulate prepaid cards. This is a product that has seen tremendous innovation and development in recent years and currently serves the needs of roughly 60 million Americans.

These cards, prepaid cards, have proven to be an attractive, safe, and convenient method of conducting financial transactions at retail locations or online, and have opened the door to financial inclusion to many who were previously underserved. It is important that future regulations adopted by the CFPB do not increase costs, decrease availability, or stifle the innovation of this product.

In conclusion, we appreciate the CFPB's mission of protecting consumers; however, we believe the Bureau has the responsibility to ensure that the new rules at issue will not adversely impact the availability of credit. Indeed, the Dodd-Frank Act requires it.

It is important the Bureau continues to keep the dialogue open with all market participants. This will ensure it has the information necessary to understand how theoretical rules and regulations will impact consumers once they are applied in a real world environment. It is also important the Bureau takes the right approach as it moves forward and provides enough time to implement any required changes and to coordinate the timing of such changes with other rules. The more certainty the Bureau can give to the financial services community, the better we can innovate and provide the products and services that consumers need.

We appreciate the opportunity to share our views and I look forward to answering any questions you may have.

[Prepared statement of Mr. Zeisel follows:]

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The Voice of the Retail Banking Industry

Chairman McHenry, Ranking Member Quigley and members of the Subcommittee, thank you for the opportunity to appear before the Subcommittee to discuss the Consumer Financial Protection Bureau ("CFPB" or "Bureau"). My name is Steve Zeisel, and I am Executive Vice President and General Counsel of the Consumer Bankers Association ("CBA")[1].

CBA is the trade association for today's leaders in retail banking – banking services geared towards consumers and small business. Founded in 1919, CBA provides leadership, education and federal representation on retail banking issues on behalf of its member companies. Our corporate members include the nation's largest financial institutions and regional banks, collectively holding two-thirds of the industry's assets.

As the trade association for retail banks of all sizes, we are clearly focused on the CFPB and how it will regulate the retail products and services our members provide to consumers and small businesses. As the CFPB is a powerful new regulator for retail banking, we recognize the importance to our members of developing and maintaining an ongoing dialogue and relationship with the Bureau. CBA has been pleased with the

[1] The Consumer Bankers Association ("CBA") is the only national financial trade group focused exclusively on retail banking and personal financial services — banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation on retail banking issues. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the industry's total assets.

Bureau's accessibility in its first year. We have met with them on numerous occasions, and we have found them to be open to a dialogue on issues of importance to our membership.

On a positive note, the CFPB's first year has been focused on simplifying disclosures for a number of financial products (e.g., mortgages, credit cards, student lending). The agency's "Know Before You Owe" campaign, which was designed to help consumers make informed decisions, is something we can all support. We have always supported the general concept of simplifying the RESPA-TILA disclosures, which has been the subject of interest by both Congress and the regulators for years before the CFPB came into existence.

The Bureau has also begun to supervise nonbank financial institutions. Though the process is still in its very early stages, we believe that a level playing field for regulatory supervision is good for consumers, businesses and the financial services industry.

It is important that, as the Bureau embarks on its mission, the potential for regulation and enforcement action from this new and untested regulatory agency with vast powers not act as a brake on the development of creative products and services that could be beneficial to consumers and businesses. How the agency will behave and what they will expect from regulated institutions are still being assessed, and financial institutions are watching the CFPB's every move. As we observe the CFPB's development during

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this transitional period, banks are appropriately cautious in developing new products and offering new services. It is critical for consumers, small businesses and financial institutions of all sizes, for the CFPB to act in a clear and thoughtful manner. The Bureau must always recognize the potential impact its actions can have on access to credit for consumers, and how over-burdensome regulations will only increase compliance costs and stifle product innovation. The consequences of rushed or ill-prepared rules can produce negative consequences for consumers and small businesses and the financial institutions who are working hard to meet their financial needs.

One particular area of industry and consumer concern is the "ability-to-pay," or Qualified Mortgage ("QM") proposal. This may be the most important rule the CFPB issues in its first 18 months, given the significant impact it will have on consumers' ability to access mortgage credit.

The CFPB needs to address two critical and related issues to ensure this rule will successfully implement the Dodd-Frank requirements. The first is to define a QM loan as broadly as possible with objective standards. Without a broad QM standard, a large portion of borrowers will not qualify for QM loans. They either will not be able to obtain loans or will only be able to obtain them at much higher costs, as lenders will either choose not to make such loans or will impose higher costs as a result of the liability and other risks they will face when making non-QM loans. Vague, subjective standards will

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also add legal uncertainty and costs for lenders. They will limit borrowers' access to credit, as lenders will only make loans well within the QM standard and not loans which may be close to the margins. Providing a broad and objective QM standard will be critical to ensure that the highly anticipated recovery in the housing market will be sustainable for years to come.

For similar reasons, the CFPB needs to provide a "safe harbor" in which any litigation or enforcement challenges would only focus on whether the QM standards are met. This is far preferable to the "rebuttable presumption" alternative that the CFPB is also currently considering. With the latter, compliance could be challenged by facts and circumstances that are beyond and unrelated to the QM requirements. A "safe harbor" standard will result in lower risks for lenders, which will allow them to provide safe and affordable loans to a larger group of qualified borrowers.

Over the past year, the Bureau appeared likely to release its QM rule by late spring 2012. Thankfully the CFPB listened to a broad coalition of industry and consumer groups, as well as a strong bi-partisan voice from Capitol Hill, and is taking a deeper look before issuing the final QM rule. At a hearing in the Financial Institutions Subcommittee of the House Financial Services Committee last week, the CFPB's

Deputy Director Raj Date said "we're going to take the time to get it right"[2] when talking about the QM rule.

CBA is encouraging the CFPB to issue a common-sense regulation which strikes the right balance. If the Bureau misses the mark, consumers could see a significant reduction in the availability of mortgage credit, resulting in a very small window of available products.

The CFPB has devoted a significant amount of time and resources over the last year on its RESPA-TILA initiative to combine certain mortgage disclosures, resulting in the proposal the Bureau issued earlier this month. CBA applauds these efforts to simplify disclosures for consumers, but we are concerned the CFPB has proposed other significant changes to the REPSA-TILA rules that, at best, are not directly related to the new disclosure forms and not specifically required under the Dodd-Frank Act.

Because of the numerous other mortgage rules the CFPB will need to issue to implement the Title 14 provisions of the Dodd-Frank Act, our hope was that this RESPA-TILA proposal would have limited its focus on the new forms and not addressed these other substantive changes at this time. Lenders will already have a huge task

[2] Testimony of CFPB Deputy Director Raj Date on July 19, 2012 before the House Financial Services Subcommittee Financial Institutions and Consumer Credit: http://financialservices.house.gov/UploadedFiles/HHRG-112-BA15-WState-RDate-20120719.pdf

ahead of them as they struggle to comply with all of new rules that have and will be issued under the Dodd-Frank Act. These seemingly unnecessary changes being proposed at this time include a change in the tolerance levels for certain settlement charges, and a change in the definition of "application" which affects the ability of lenders to provide disclosures. We will be carefully reviewing these and all other proposed changes and sharing our comments with the CFPB.

The CFPB's mortgage-related rules and proposals are just one area of concern. The CFPB's final rule on remittances, also known as international funds transfers, will have a significant impact on availability of valuable products and services for consumers. The problem is the implementation of these new restrictions and disclosure requirements for "open networks," commonly employed by banks when transferring funds. Specifically, the final rules require remittance-transfer providers to disclose, prior to the transfer of funds, exchange rates, foreign taxes, and fees charged by non-affiliated entities. Such disclosures are only feasible for remittance transfer providers that use closed networks (e.g. money transmitters such as Western Union) and control the transaction from start to finish. Banks that provide remittance services primarily use open networks for consumer-initiated international funds transfers. While open networks enable consumers to send funds account to account nearly worldwide, they do not enable banks access to the exact exchange rate, third party fees, and foreign taxes required by the CFPB's final rule.

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The final remittance rule will have profound effect on the marketplace that could not have been intended by Congress. Institutions may exit the business entirely, since they will be unable to comply with the new requirements. This is to the detriment of those whom this rule was meant to help, namely consumers who need or want to provide financial help for their relatives in other countries. Although we support improved disclosures for all financial services, we believe these issues need to be addressed and that the upcoming February 2013 effective date of this rule needs to be delayed in order to incorporate the necessary changes. We also urge the CFPB to study the impact of the final rule in order to determine its ultimate effect on consumers.

While the CFPB issuance of new regulations has been minimal in this first year as the agency has been growing, it has sent signals to the marketplace of a number of areas it intends to explore, and is already collecting comments about various products. One particular area is prepaid cards.

We strongly support transparency and consumer protections for consumers who use prepaid cards. This is a product that has seen tremendous innovation and development in recent years. It currently serves the needs of roughly 60 million Americans, including many who would not otherwise have access to mainstream financial products.

Prepaid products are readily accessible at a wide variety of locations and can be easily reloaded by the consumer. They have proved to be an attractive, safe and convenient method of conducting financial transactions at retail locations or on-line, and have opened the door to financial inclusion to many who were previously underbanked. While we support a level playing field to ensure that consumers receive the same protections that are comparable to users of payroll cards, the regulation needs to be tailored to the product and the needs of the consumers who use it. It is important that the regulations adopted by the CFPB not increase cost and decrease availability, without commensurate protections for consumers. For example, periodic statements would be neither beneficial to consumers nor appropriate to the product, as consumers can obtain the information in real time on request, on the Internet or by toll-free number, as they do for payroll cards. The necessity to issue statements would hamper the development of this innovative product, which can provide alternatives to traditional banking services that may be more appropriate and desired by certain consumers. We are providing the CFPB with a detailed comment letter spelling out this and other concerns, to ensure that any regulation of this vibrant product protects consumers with a minimal impact on its availability and cost to consumers.

Student Lending is another area the CFPB has been active, and it recently issued a joint report to Congress with the Department of Education on this market. We were pleased to see the study acknowledge and highlight a number of important and significant changes in the private student loan market since 2008 including improved underwriting, enhanced disclosure for private loans and school certification. Despite some of the positive items in the report, we think it is important to highlight for this subcommittee two concerns we have with the report to Congress.

First, as part of this study of the student loan market, the CFPB and the Department of Education did not examine the approximately 93% of today's student loan market which now consists of loans made by the federal government. In our view, any study that leaves out 93% of any market is far from complete and cannot provide consumers with an accurate picture.

Second, and more troubling, is the report's recommendation for Congress to "determine whether changes are needed to the treatment of private student loans in bankruptcy proceedings." The main reason given is private loans offer "less flexibility compared to federal loans," yet this lack of flexibility is due in major part to regulatory constraints imposed by prudential regulators. The logical recommendation by the CFPB should rather be to find ways to give private lenders the tools necessary to provide additional flexibility which could help borrowers in certain circumstances. The CFPB should focus first on helping struggling consumers find a workable solution short of bankruptcy, since bankruptcy makes it more difficult and expensive to obtain credit in the future, and has other long-lasting negative consequences.

In addition to issuing new rules, the CFPB also has supervision and enforcement authority over banks and nonbanks. CBA is supportive of the introduction of a level playing field through the examinations and supervision of nonbanks. While we have yet to see the impact of these changes, if done correctly, it could prove beneficial for consumers and banks alike. At the same time, the supervision of banks by the CFPB has been difficult in some instances. Banks are dealing with a start-up agency, with a new Supervisory Manual and often inexperienced examiners. They are, in some cases, just learning about the banks they are supervising, while they are trying to establish a heightened level of scrutiny.

It has also been widely reported the CFPB's examiners have been accompanied at times by the Bureau's enforcement attorneys, whose presence can chill the open dialogue necessary for effective supervision. We trust the Bureau will rethink this approach as it streamlines the examination process and its teams gain a better understanding of the banking industry.

Uncertainty can be a major speed bump or roadblock for innovation. The unprecedented authority given to the CFPB by the Dodd-Frank Act is most clearly manifest in the authority to regulate and enforce unfair, deceptive and abusive practices (UDAAP). This principle, particularly the relatively untested concept of "abusive" practices leaves a lot of room for speculation about how, and in what circumstances, the Bureau will use it. As this subcommittee is aware, this issue has garnered a lot of attention by the uncertainty it has created. This in combination with other issues outlined in our testimony cast a shadow on the ability to create new and innovative products and services that are beneficial to consumers.

In closing, a number of questions remain about this new agency. Much of its first year has been focused on hiring staff and tackling a handful of requirements. The coming year will tell us a lot about the Bureau as the rubber meets the road on the ever critical QM rule and several other items which will impact consumers, small businesses and the financial services community for better or worse.

We appreciate the CFPB's mission of protecting consumers as they shop for and use financial products and services. In addition, we believe the Bureau has the responsibility to ensure the cumulative effect of all the new rules it will issue in the coming years will not adversely impact the availability of credit to qualified borrowers, especially at this time as our country struggles to recover from its current economic state. In fact, 1022(b)(2)(A)(i) of the Dodd-Frank Act requires the Bureau to consider "the potential benefits and costs to consumers… including the potential reduction of access by consumers to financial products or services," as it exercises its rulemaking authority.

It is important the Bureau continues to keep the dialogue open with all market participants. This will ensure it has the information necessary to understand how theoretical rules and regulations will impact consumers once applied in a real world environment. It is important the Bureau takes the right approach as it moves forward and provides enough time to implement any required changes and to coordinate the timing of such changes with other rules. The more certainty the Bureau can give to the financial services community, the better it can innovate and provide the products and services consumers need to meet their financial needs and get this country on the road to recovery.

We would like to thank the Committee for its continued oversight of this new agency. We appreciate the opportunity to share our views, and I look forward to answering any questions you may have.

Mr. McHENRY. Well, thank you. Even with the little speed bump we have given you, you handled that very well.

Mr. Calhoun.

**STATEMENT OF MICHAEL D. CALHOUN**

Mr. CALHOUN. Thank you, Chairman McHenry, Ranking Member Quigley, for the opportunity to talk today about the need for both consumer protection and broad access to credit.

At the height of the mortgage boom and resulting crisis, what were previously small niche products came to dominate the market. No-dock loans, loans with deep teaser rates and exploding payments, were marketed without a determination of the sustainability of those loans. As a result, the U.S. had some of the worst quality loans, highest default rates, and worse consequences. In addition, investors who purchased AAA paper, rated AAA experienced losses often exceeding 40 percent on their investments. Understandably, they were scared away.

The CFPB was created to address the failure of other regulators who had the authority to establish safeguards, but did not do so because they were focused on other mission priorities. While some have argued the CFPB has constrained credit, credit constriction followed the mortgage crash and predated the CFPB. Indeed, the CFPB rules we are talking about today, such as the mortgage rules, have not yet been finalized and would not take effect for another year and a half from now.

I would also point out that while there has been widespread litigation in the mortgage market, these have not been borrower claims, which have remained rare, despite widespread abusive lending. Instead, these have been so-called put-back claims, where investors who purchased loans have sued originators based on the terms of those sales contracts that the loans did not meet the represented standards. We have seen not just claims, but tens of billions of dollars of payments on those put-back claims, and that is a major driving force in constraining credit right now.

I will focus my oral testimony here on the mortgage market, because it is so important to families and the overall economy.

One of the most important rules the CFPB will produce, as has been noted, is the Qualified Mortgage rule. There are three interrelated issues regarding that rule. The first is do you have a broad or narrow QM market. We have argued strongly for a broad QM market, and we are heartened by the comments that Director Cordray made today that that seems to be the direction they are headed.

The second is do you have bright line standards or more subjective standards. We initially, in our filed comments with the Federal Reserve, were concerned about bright line standards constricting credit. We have changed that position based on input from lenders, who said that they needed bright line standards so that they felt certain, when they wrote a loan, that they knew that it was a qualified mortgage.

However, one of the consequences of bright line standards is no matter where you set those standards, if you want a broad market, you will allow a significant number of unaffordable loans to meet that standard. So, for example, it is widely proposed that one of the core measures be debt-to-income, and that be set in the mid-40s. That works for a lot of families, but a family on a smaller, fixed income, a loan with a 45 percent so-called debt-to-income ratio we have seen is often unaffordable. We consequently support a rebuttable presumption, and we note that these are very tough claims to make. You have to prove there was no ability to repay the loan at the time it was made, not based on later events. These are individual, not class, actions, and you must prove causation, not just a technical violation.

We have submitted joint comments setting out this structure with lending institutions who originate the majority of the loans in this Country supporting this three-part structure.

Two other quick important points. We support simplification. The QRM, which determines risk requirements, risk retention, should be the same as QM for simplification and to provide broad access and regulatory reduced burden. Lastly, on the HOEPA rule, I would note the statutory reforms did not change the HOEPA interest rate trigger. It changed how it is calculated, but it left it at the same place, which in today's market is over 10 percent interest rate on a first lien mortgage. The points were revised in a way that followed State law such as North Carolina.

Thank you again for the opportunity to testify today, and I look forward to your questions.

[Prepared statement of Mr. Calhoun follows:]

**Testimony of Mike Calhoun**
President, Center for Responsible Lending

Before the House Committee on Oversight and Government Reform
Subcommittee on TARP, Financial Services and
Bailouts of Public and Private Programs

**Hearing: "Credit Crunch: Is the CFPB Restricting Consumer Access to Credit?"**

July 24, 2012

Good Morning Chairman McHenry, Ranking Member Quigley, and Members of the Subcommittee. Thank you for inviting me to testify at today's hearing to discuss the Consumer Financial Protection Bureau (CFPB) and access to credit.

I am President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided over $6 billion of financing to almost 70,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.

- **Lack of regulation led to the foreclosure crisis that has destabilized the housing market and mortgage lending:** Federal regulators could have stepped in to curb abusive lending practices in the years leading up to the foreclosure crisis, but this failed to happen. Instead, the private label securitization system bypassed government oversight by bundling an increasing number of subprime and Alt-A mortgages into mortgage-backed securities, and the widespread failure of these mortgages precipitated the still ongoing foreclosure crisis.

- **Dodd-Frank, and the creation of the CFPB, are important reforms to prevent a future housing crisis:** Creation of a consumer protection agency that consolidates the consumer protection responsibilities of the independent banking regulators, along with reforms to the mortgage market and CFPB supervision of larger nonbank participants, are critical reforms that will help prevent a future housing and foreclosure crisis.

- **Dodd-Frank implementation can level the playing field without restricting access to affordable credit:** The consumer protection reforms included in Dodd-Frank will be good for both consumers and the safety and soundness of our consumer finance system. In particular, the Ability to Repay and Qualified Mortgage provisions in the Dodd-Frank Wall Street Reform and Consumer

Protection Act can ensure broad access to credit, help the vast majority of creditworthy borrowers access safe and affordable mortgages, and prevent the kinds of dangerous lending that led to the current foreclosure crisis.

**1. Lack of regulation led to the foreclosure crisis that has destabilized the housing market and mortgage lending.**

In the years leading up to the still ongoing foreclosure crisis, abusive lending practices went largely unregulated. The private market created a securitization system to package designed-to-fail mortgages into private label mortgage-backed securities, and Federal regulators largely turned a blind eye to these practices. Now, millions of families have lost their homes to foreclosure. Furthermore, the housing market is still struggling to recover, and lenders have responded by restricting access to credit by tightening underwriting standards.

In reviewing the CFPB's role and ongoing mortgage market reforms required by Dodd-Frank, it would be short-sighted to forget that lack of regulatory oversight was an undeniable cause of the housing crisis. Creating a single agency with the mandate of protecting consumer interests and instituting reforms to the mortgage market are common sense responses to this hard-hitting crisis. Reversing course and weakening the CFPB or undoing mortgage lending reforms would be a costly step backward that would pave the road toward another housing-related crisis.

**A. Scope of the crisis**

The value of preventing a future crisis is obvious when considering how harmful the current crisis has been for millions of families. In 2006, which pre-dated the worst of the foreclosure crisis, CRL released a report estimating that abusive and predatory lending would lead to approximately 2.2 million foreclosures among subprime mortgages.[1] At the time, our report was denounced by the mortgage industry as absurdly pessimistic.

As we all now know, the system was loaded with much more risk than CRL originally reported. According to a more recent CRL analysis, from early 2007 through the end of 2011, approximately 10.9 million homes had started the foreclosure process.[2] A separate CRL research report titled *Lost Ground* found that, for mortgages originated during the height of the housing bubble (2004-2008), 2.7 million homeowners had already lost their

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[1] *See* Ellen Schloemer, Wei Li, Keith Ernst, and Kathleen Keest, *Losing Ground: Foreclosures in the Subprime Market and Their Costs to Homeowners*, (December 2006) (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf).

[2] CRL calculation based on MBA National Delinquency Survey from 2007q1 through 2001q4, scaled to reflect market coverage. As per MBA's claims, we assume 85% market coverage for 2007a1-2010q2 and 88% coverage for 2010q3 and after.

homes to foreclosure by February 2011 and another 3.6 million homeowners were delinquent or in the foreclosure process.[3]

The crisis has also pushed housing values low enough where millions of homeowners are now underwater on their mortgages – in other words, they owe more on their mortgage than the home is worth. For the first quarter of 2012, CoreLogic estimates that 11.4 million homeowners were underwater on their mortgage.[4] All told, homeowners have lost $7 trillion in home equity as a result of the housing crisis.[5]

Communities across the country have faced hardship from abusive lending and foreclosures, but this crisis has harmed African-American and Latino households at a staggeringly disproportionate rate. For example, the Pew Research Center found that from 2005-2009 the median wealth of Hispanic households dropped by 66% and that of African-American households fell by 53%, while that of white households went down by 16%.[6] This report concluded that "[p]lummeting house values were the principal cause of the recent erosion in household wealth among all groups."[7] CRL's research also shows that African-American and Hispanic families have borne a disproportionate share of the harm from the foreclosure crisis. Although the majority of foreclosures have affected white borrowers, *Lost Ground* confirms that African-American and Latino borrowers have faced a disproportionate number of foreclosures and delinquencies than white borrowers within every income range.[8] These disproportionate outcomes are not surprising given that CRL's research also shows that African-American and Latino borrowers were much more likely to receive mortgages with harmful features. For example, African-American and Latino borrowers with FICO scores above 660 were *three times* as likely to have a higher interest rate mortgage than white borrowers in the same credit range.[9]

### B. Abusive lending practices thrived in private label mortgage-backed securities market with scant regulation

These hardships and economic costs were preventable, yet Federal regulators sat on the sidelines during the years leading up to the foreclosure crisis. As bad lending was beginning to infect the banking system, CRL warned in 2004 that "[a]busive practices may well be profitable in the short term, but are ticking time bombs waiting to explode

[3] *See* Debbie Gruenstein Bocian, Wei Li, and Roberto G. Quercia, *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures*, (November 2011) (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf).
[4] *See* CoreLogic, *CoreLogic Reports Negative Equity Decreases in First Quarter of 2012*, (July 12, 2012) available at http://www.corelogic.com/about-us/researchtrends/asset_upload_file912_15196.pdf.
[5] *See* Nick Timiraos and Ruth Simon, *Borrowers Face Big Delays in Refinancing Mortgages*, The Wall Street Journal (May 9, 2012).
[6] *See* Paul Taylor, Rakesh Kochhar, Richard Fry, Gabriel Velasco, and Seth Motel, *Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics*, Pew Research Center at 1 (July 26, 2011) (available at http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf).
[7] *Id.* at 2.
[8] *Supra* note 3, at 19-20.
[9] *Id.* at 21.

the safety and soundness of national banks in the years ahead."[10] Instead of reigning in the abusive and predatory lending taking place throughout the private market, regulators failed to act.

This regulatory vacuum allowed the private market to engage in its experiment in widespread mortgage lending without governmental oversight. Subprime abuses first developed in the nonbank sector with large subprime lenders, which had no federal regulator to mind the store. The same was true with mortgage brokers and servicers. A race to the bottom ensued, where bank practices progressively deteriorated as banks struggled to compete. This experiment resulted in a dominant private label securitization (PLS) machine that churned out securities filled with designed-to-fail subprime and Alt-A mortgages.

The mortgages that moved through the PLS system had harmful features that made borrowers much more likely to default. CRL's *Lost Ground* 2011 report shows that for mortgages originated between 2004 and 2008, loans originated by a mortgage broker, containing hybrid or option adjustable rate mortgages (ARMs), having prepayment penalties, and featuring high interest rates (i.e., subprime loans) were all significantly more likely to be seriously delinquent or foreclosed upon than a 30-year fixed-rate mortgage without a prepayment penalty.[11]

These increased foreclosure rates are not surprising. The increasing prevalence of mortgage brokers led many homeowners to pay increased interest rates and fees as a result of yield spread premiums (YSPs), which provided kick-backs to brokers for steering borrowers into mortgages with higher interest rates than the borrowers qualified for.[12] Products like 2/28s where starter interest rates reset after the first two years built in payment shock when increased interest rates led to higher monthly payments. Additionally, loans that allowed temporary interest-only payments or negative amortization where the principal balance actually increased during the loan often resulted in payment shock for borrowers who were not prepared for their monthly payment amounts to increase..Mortgages with no escrow accounts also left many homeowners unprepared for tax and insurance bills. Additionally, many borrowers facing payment shocks also faced prepayment penalties when trying to exit into a new mortgage or to sell the property.

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[10] *See* Testimony of Martin Eakes, Chief Executive Officer, Center for Responsible Lending, Before the Senate Banking Committee, at 31 (April 7, 2004) (available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/congress/20040407_testimony_eakes_preemption.pdf).

[11] *Supra* note 3, at 4.

[12] CRL released a study in 2008 showing that brokered loans, when compared to direct lender loans, cost subprime borrowers additional interest payments ranging from $17,000 to $43,000 per $100,000 borrowed over the scheduled life of the loan. Even over a fairly typical four-year loan term of an average-sized loan, the subprime consumer paid over $5,000 more for brokered loans. *See* Keith Ernst, Debbie Bocian & Wei Li, *Steered Wrong: Brokers, Borrowers, and Subprime Loans*, at 3, 15 (April 8, 2008) (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/steered-wrong-brokers-borrowers-and-subprime-loans.pdf).

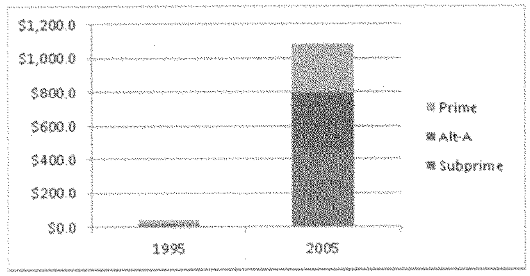
On top of these harmful mortgage features, underwriting practices deteriorated during this subprime and Alt-A lending spree. First, the practice of failing to document a borrower's income and assets in so-called low-doc or no-doc loans was prevalent in the subprime and Alt-A market. For example, low-doc loans comprised 52 percent of Alt-A originations in April 2004 and rose to 78 percent at the end of 2006.[13] By 2006, no-doc or low-doc loans made up 27% of all mortgages.[14] Second, many lenders failed to determine whether a borrower had an actual ability to repay their mortgage. Proper underwriting is particularly important for mortgages with resetting interest rates or negative amortization or interest-only payments (or all of the above) to ensure that borrowers can afford the larger monthly payments when they kick in down the road. However, for many mortgage originators, this straightforward underwriting never happened.

Market participants readily admit that they were motivated by the increased fees offered by Wall Street firms in return for riskier loans. After filing for bankruptcy, the CEO of one mortgage lender explained it this way to the New York Times, "The market is paying me to do a no-income-verification loan more than it is paying me to do the full documentation loans...What would you do?"[15] Beginning in 2000, subprime lender New Century implemented a plan that "concentrated on 'originating loans with characteristics for which 'whole loan buyers' [i.e., Wall Street firms] will pay a high premium,'" and increased its sale of loans from $3.1 billion in 2000 to $20.8 billion in 2003.[16]

These unsustainable mortgages helped expand the housing bubble and primed the financial system for the 2008 financial crisis. Leading up to the foreclosure crisis there was a substantial and rapid increase in the volume and share of non-prime mortgage originations. As the chart below illustrates, the growth in the PLS market was heavily driven by subprime loans, which increased from $17.6 billion to $464 billion between 1995 and 2005, and Alt-A loans, which though virtually non-existent in 1995, reached $333.6 billion by 2005.

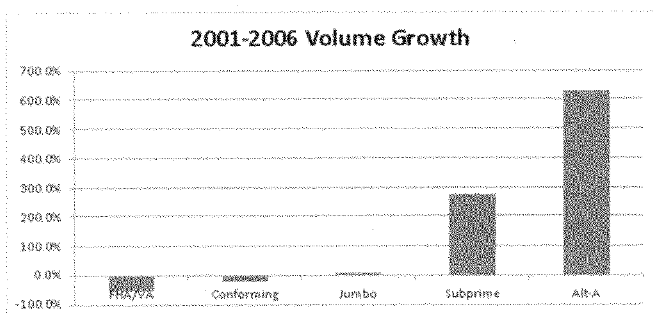
[13] Rajdeep Sengupta, *Atl-A: The Forgotten Segment of the Mortgage Market*, Federal Reserve Bank of St. Louis *Review*, January/February 2010, 92(1), pp. 55-71 at 60 (available at http://research.stlouisfed.org/publications/review/10/01/Sengupta.pdf).
[14] *See* Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* at 165 (Jan. 2011) [hereinafter *FCIC Report*], available at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.
[15] Vikas Bajaj & Christine Haughney, "Tremors at the Door: More People with Weak Credit Are Defaulting on Mortgages," *New York Times* (Jan. 26, 2007), (available at http://www.nytimes.com/2007/01/26/business/26mortgage.html).
[16] *FCIC Report* at 89 (citing *In re: New Century TRS Holdings, Chapter 11*, Case No. 07-10416 (KJC) (Bankr. D.Del. February 29, 2008) (Final Report of Michael J. Missal, Bankruptcy Court Examiner at 42)).

**Non-Agency Issuance of Mortgage Backed Securities (in $billions)**

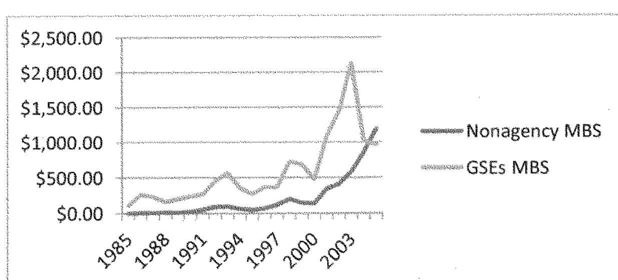



**Source: CRL calculations based on data from**
**http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fall01_chart02.html**

Additionally, as the subprime and Alt-A markets rapidly grew in size from 2001-2006, the volume of conforming (i.e., loans purchased by Fannie Mae or Freddie Mac) and government-backed mortgages actually decreased.




**Source: CRL calculations of data from Inside Mortgage Finance's 2008 Mortgage Market Statistical Annual, Volume 1.**




**Source: CRL calculations based on data from**
**http://www.fdic.gov/bank/analytical/regional/ro20063q/na/2006_fall01_chart02.html**

The subprime and Alt-A originations bundled into PLS failed at much greater rates than GSE-backed mortgages – even the ill-advised GSE Alt-A mortgages that have caused their greatest losses. While the GSEs generally required strict underwriting (until they followed the private market in to the no-doc fray by purchasing Alt-A loans), and used standardized forms, documents and financial models to provide stability and liquidity in the market, subprime and Alt-A originators, backed by private securitizations, did not have such standards or homogeneity. And, private label securitization was responsible for 42% of all serious delinquencies in 2009, despite accounting for only 13% of all outstanding loans. In contrast, Fannie Mae and Freddie Mac, which had a combined share of 57% of loans outstanding, accounted for only 22% of serious delinquencies.[17]

As these failures demonstrate, the Federal regulatory system did not rise to the challenge of preventing abuses in the mortgage market. Not only did individual regulators ignore risky lending by their institutions, but the system as a whole also lacked the tools to survey the marketplace and target growing practices harming consumers. Instead of protecting consumers and bank safety and soundness, lax regulation led to a foreclosure crisis that has harmed homeowners, taxpayers and the economy.

**2. Dodd-Frank, and the creation of the CFPB, are important reforms to prevent a future housing crisis.**

It was in the context of these massive federal regulatory and private market failures that Congress enacted Dodd-Frank, which included the creation of an independent CFPB. By establishing the CFPB, Congress wisely consolidated the consumer protection functions of the federal prudential regulators into an independent agency with a mission to protect borrowers from abusive financial practices. These consolidated consumer protection responsibilities include rule-writing authority as well as supervision and enforcement authority. The CFPB's supervisory authority extends to depositories with more than $10 billion in assets, payday lenders, mortgage-related companies, private student lenders, and other large non-bank entities.

Dodd-Frank also includes basic reforms to ensure that the mortgage market remains focused on sound underwriting and sustainable lending, and the law charges the CFPB with implementing many of these reforms. As a result of these reforms, loan originators such as mortgage brokers can no longer receive more compensation for putting borrowers in higher rate loans than they qualify for – compensation cannot vary according to the terms and conditions of the loan (except for principal balance). Prepayment penalties that lock borrowers into bad loans are significantly restricted. No-doc lending is prohibited. Escrows of taxes and insurance are required for higher interest rate loans (except for rural community banks). Up-front fees are limited to 5 percent or the loan becomes a disfavored HOEPA loan (though interest rates can rise to 6.5 percent over conventional

[17] James B. Lockhart, *FHFA's First Anniversary and Challenges Ahead*, Speech before the National Press Club (July 30, 2009) (available online at http://www.fhfa.gov/webfiles/14715/FHFA1stAnnSpeechandPPT73009.pdf).

rates without the loan hitting these limits). Loans must be underwritten to the fully indexed rate.

One of the mortgage market reforms in Dodd-Frank is a straightforward and good one. Title XIV requires lenders to make a reasonable and good faith determination on whether the borrower has an ability to repay the offered mortgage. Said a different way, this section requires lenders to do the basic underwriting that so often failed to happen in the years leading up to the crisis. In making its determination on whether the borrower has an ability to make the monthly payments, this section requires the lender to look at a fully amortizing payment schedule.

It's important to highlight a few of the things that the Ability-to-Repay section does not require lenders to do. First, they need not predict the future, and need only determine whether at the time the loan is consummated the borrower has an ability to repay and make the monthly payments. Second, they are not mandated to offer loans once an ability to repay determination has been completed. The Ability-to-Repay requirement does not prevent lenders from also – and separately – considering whether borrowers have a willingness or propensity to repay a mortgage. In other words, the ability to repay factor is just one part of a lender's underwriting decision-making process.

Dodd-Frank also establishes a category of mortgages called Qualified Mortgages (QM), which is a default standard that lenders can use to demonstrate that the borrower has an ability to repay the mortgage. This designation has benefits for lenders and borrowers. For lenders, it makes it significantly easier to demonstrate compliance with their ability-to-repay determination and substantially reduces the risk of investor buy-back claims and borrower litigation. Reduced exposure to buy-back claims is a substantial lender benefit that should not be underestimated. For borrowers, the QM category means they can avoid a list of risky mortgage features that are either prohibited or restricted, including interest only loans, loans with negative amortization, and balloon payment loans. Additionally, lenders must underwrite all ARMs by looking at the maximum interest rate that could apply during the first five years of the mortgage and fully amortize the remaining payments. The allowable points and fees that lenders can charge on QM loans are also limited to 3 percent.

In addition to these mortgage lending reforms, Dodd-Frank also corrects the regulatory failure of ignoring risks to consumers in the nonbanking sector. This is addressed in the CFPB's authority to supervise so-called "larger participants" in the nonbank sector who offer financial products and services to consumers. Dodd-Frank provides the CFPB with rulemaking authority to define "larger participants," requires the CFPB to consult with the Federal Trade Commission prior to finalizing these rulemakings, and to issue the first of these rulemakings within one-year of the transfer date. This reform will provide businesses with incentives to prioritize consumer protection and will ensure that Federal regulators are able to prevent harmful practices.

### 3. Dodd-Frank implementation can level the playing field without restricting access to affordable credit.

The consumer protections included in Dodd-Frank reforms will result in a healthier financial system where prices are transparent and lenders play by the same rules. This is not only better for consumers, but it also benefits those businesses operating fairly by creating a level playing field.

Other regulatory reforms – such as the CARD Act and state predatory lending laws – demonstrate that reforms benefiting consumers do not result in restricted access to credit. In assessing the CARD Act, which became law in 2009 and creates more transparent and standardized credit card pricing, CRL analysis shows that access to credit through credit cards remained stable once accounting for the economic downturn.[18] Furthermore, this research shows that the new rules did not cause prices to go up, and that pricing, in fact, became more transparent. Following implementation of the CARD Act in 2010, CRL research found that stated credit card rates now more accurately reflect actual rates, providing consumers with a much better picture of their true costs.[19] In addition, CRL research has shown that cracking down on unfair and deceptive practices benefits financial institutions and the financial system – companies that engaged in credit card practices now outlawed by the CARD Act had greater losses during the downturn than those companies avoiding these practices.[20]

Additionally, state anti-predatory lending laws also have not led to restricted access to credit. State anti-predatory lending laws have the aim of reducing the number of harmful loans with abusive terms, and CRL's research in 2006 shows that borrowers still had access to subprime mortgages in states with these laws on the books.[21] At the same time, many states with these laws were successful in reducing the number of predatory loans with harmful terms, and borrowers did not pay significantly higher interest rates in these states. In fact, eight states with anti-predatory lending laws had subprime interest rates that were statistically equivalent to the rates in other states, and 19 states had lower interest rates.[22]

Similar to these two examples, the CFPB's rulemaking on the Ability-to-Repay and Qualified Mortgage provisions in Dodd-Frank do not need to restrict access to credit. These provisions can be implemented so that homeowners have broad access to 30-year, fixed-rate (or long-term ARM fully-amortizing) loans with limited fees instead of

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[18] Joshua M. Frank, *Credit Card Clarity: CARD Act Reform Works*, (February 16, 2011) (available at http://www.responsiblelending.org/credit-cards/research-analysis/FinalCRL-CARD-Clarity-Report2-16-11.pdf).

[19] *Id.*

[20] Joshua M. Frank, *Predatory Credit Card Lending: Unsafe, Unsound for Consumers and Companies* (May 2012) (available at http://www.responsiblelending.org/credit-cards/research-analysis/Unsafe-Unsound-Report-May-2012.pdf).

[21] *See* Wei Li and Keith Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms*, (February 23, 2006) available at http://www.responsiblelending.org/mortgage-lending/research-analysis/rr010-State_Effects-0206.pdf.

[22] *Id.*

products with high fees and deceptive terms that borrowers cannot afford. Additionally, there is significant consensus on the principles the CFPB should follow in completing this rulemaking.

Earlier this year, CRL submitted joint recommendations – along with The Clearing House Association[23], which is owned by banks comprising a significant share of the mortgage market, the Consumer Federation of America, and The Leadership Conference on Civil and Human Rights – to the CFPB on designing this rulemaking. As reflected in these joint recommendations, there are three aspects to how CRL believes that Qualified Mortgage should be defined:

- **Qualified Mortgage should be broadly defined:** We recommend a broad definition that protects against shrinking the conventional market further, and allows room for the conventional market to appropriately expand beyond current tightened lending standards.

- **Qualified Mortgage should include the use of clear, bright line standards:** The Qualified Mortgage definition should also use clear, bright line standards instead of guiding principles that provide less clarity about whether an individual mortgage should count as a Qualified Mortgage. Bright line standards will provide easy-to-understand rules of the game so everyone will know if a loan is a QM or not. This is good for both lenders and borrowers.

- **Rebuttable presumption standard, not a lender safe harbor:** A broad Qualified Mortgage definition using clear, bright line standards should also have a rebuttable presumption and not a safe harbor. Putting in place a rebuttable presumption hurdle for borrower litigation gives lenders a considerable litigation advantage but allows a borrower to bring a case when there is a rare, starkly unaffordable QM loan and strong evidence available.

In addition to using these inter-related recommendations for the QM rulemaking, CRL also supports using the same standards in defining the Qualified Residential Mortgage (QRM) definition. In other words, the same definition should apply for both QM and QRM. The QRM statute says that it can be no broader than QM, but it does not need to be narrower either. This provision in Dodd-Frank requires originators to hold on to a percentage of the risk for mortgages they originate unless those mortgages meet the QRM definition, and this is a joint rulemaking undertaken by agencies that does not include the CFPB. Using the same definitions in defining both QM and QRM will make compliance easier for lenders, will not restrict access to affordable credit and will prevent the re-creation of the dual credit market that existed in the years leading up the foreclosure crisis. Most importantly, we do not believe that there should be a government-mandated

[23] The Clearing House Owner Banks are: Banco Santander, Bank of America, The Bank of New York Mellon, BB&T, Capital One, Citibank, Comerica, Deutsche Bank, HSBC, JPMorgan Chase, KeyBank, PNC, RBS Citizens, UBS, U.S. Bank, Union Bank, and Wells Fargo.

downpayment requirement as part of the QRM definition.[24]

The CFPB's supervisory authority for larger participants in the nonbank sector will also ensure that consumers have affordable and improved access to credit. Last week, under its "largest participants" authority, the CFPB finalized a rule that allows it to supervise the largest credit reporting agencies that track credit histories and impact a substantial number of lending decisions. Specifically, this final rule will result in the CFPB supervision of credit reporting agencies that exceed $7 million in revenue per year. The positive impact this can have on consumer access to credit is obvious, since these entities have never been supervised at the Federal level, notwithstanding their importance to millions of Americans every day.

Additionally, the CFPB's recent enforcement settlement with Capital One shows the benefits of having a consolidated consumer protection entity pro-actively looking out for consumer interests. This settlement pertained to the CFPB's investigation of Capital One's marketing to consumers for credit card-related products. As part of the settlement, Capital One agreed to pay $25 million toward the CFPB's Civil Penalty Fund and approximately $140 million to about 2 million customers.

Thank you for the opportunity to testify today, and I look forward to answering your questions.

[24] *See* Roberto G. Quercia, UNC Center for Community Capital, Lei Ding, Wayne State University, Carolina Reid, Center for Responsible Lending, *Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages* (March 5, 2012) (available at http://www.responsiblelending.org/mortgage-lending/research-analysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf).

Mr. MCHENRY. Thank you.
Dr. Calabria.

**STATEMENT OF MARK A. CALABRIA**

Mr. CALABRIA. Chairman McHenry, Ranking Member Quigley, distinguished members of the Subcommittee, I thank you for the invitation to appear at today's hearing.

Before I begin, I would like to really commend the Chairman's efforts to bring oversight to the Consumer Financial Protection Bureau. Given the unusual structure of the CFPB, one that I believe reduces transparency and accountability, and the questionable manner in which its leadership was put into place, diligent and constant congressional oversight is badly needed.

In my opinion, had Congress fulfilled its responsibilities in previous years in regards to such entities as Fannie Mae and Freddie Mac, we might have avoided the financial crisis altogether. As the CFPB runs the same risk of politicizing our consumer credit markets in a manner similar to which our mortgage markets were so highly politicized, I believe aggressive congressional oversight is needed in order to avoid both future crises and to maintain a healthy economy.

A particular focus of my experience has been in the area of federal mortgage finance. As housing remains one of the largest drags on the economy and is particularly sensitive to credit conditions, I will place the bulk of my testimony on CFPB's activities in this area. I will emphasize, however, the point has been repeatedly made that I agree with that the CFPB has not issued a whole slew of regulations. I see the larger problem as the whole body of regulations and law which the CFPB inherited.

The problem facing our housing market is a combination of weak demand and excess supply. One of the constraints on demand is mortgage availability. If your borrower is prime and can make a substantial down payment, the mortgages are both cheap and plentiful. If one is not, then a mortgage is difficult, if not impossible, to get.

This decline in mortgage availability drives from a variety of factors, some good and some bad. For instance, the most irresponsible lending, with the exception of FHA, in my opinion, is gone, at least for the moment. I think that is a good thing. Unfortunately, most of the Alt-A and higher quality subprime is also gone. That is not such a good thing. By my estimate, about a fifth of the mortgage market has disappeared, holding back housing demand. I would again emphasize we don't want all of that to come back.

As I noted in my written testimony, the Federal Reserve has made the same observations in relation to our mortgage market.

One of the factors contributing to that disappearance, in my opinion, is Federal Reserve interest rate policy as it combines with mortgage regulation. Under HOEPA, which was mentioned, there are two triggers: one is the HOEPA and one is the higher-cost, which was created under Federal Reserve regulations. Under the HOEPA trigger, with the Federal Reserve's current interest rate, any mortgage over 5.5 percent is considered high-cost. These mortgages now carry considerable regulatory regulation and litigation risk. I think it is fair to say that historically 5.5 percent is a great rate, not a predatory one.

While one should always keep in mind that economics does not offer the luxury of a natural experiment, we cannot hold all equal, I believe the expansion of consumer finance regulation since the financial crisis has increased consumer credit costs while decreasing its availability.

This expansion has also reduced the effectiveness of monetary policy. While the Federal Reserve can lower its target rate, its ability to impact the economy is limited by the willingness of lenders to extend credit. One area that appears adversely impacted has been the area of credit cards. Despite a 5 percentage point decline in the federal funds rate since 2007, the interest rate on credit cards has fallen by only 1 percentage point. As the credit card market, in my opinion, is fairly competitive and rates can be adjusted to cover interest rate, the increased spread of rates over other benchmarks suggests increased credit and legal risk. The largest declines in credit card lending did not occur during the depths of the financial crisis, but since the implementation of the CARD Act.

Economists Josh Wright at George Mason University and David Evans at the University of Chicago predicted in 2010 that the CFPB would raise the cost of consumer credit by an average of 160 basis points. Examining the spread of various forms of consumer credit, especially that in the credit card market, over the treasury rate, it would seem to me that that estimate is too low. Again, as mentioned earlier in the earlier panel, my guess is that the CFPB, given its inherited body of regulation, has increased consumer credit by at least 2 full percentage points.

Evans and Wright use that estimate to say that the CFPB will likely decrease job creation by 4.3 percent. Accepting that their predicted increase in borrowing cost is likely low, we can surmise that net job creation has been reduced by about 5 percent. This translates to about 150,000 fewer jobs that would have been created that were not.

Further evidence that regulatory and litigation risks are holding back lending and other sectors less subject to regulation, I think if you compare those other markets. For instance, take the auto loan market. Subprime credit is readily available for auto loans, and despite seeing a similar decline to that in the housing market, the auto market has rebound. Of course, the auto market is not subject to the same consumer protections as the mortgage market. If you don't pay your car loan, for instance, they take your car. It is not the situation that if you don't pay your mortgage, you can be in your house for years on end without ever making a payment. While some would claim that by being able to drag out these obligations is consumer friendly, the result is clearly a reduction in credit and a weaker economy.

In closing, I would like to emphasize that I think CFPB is only one of many obstacles. In fact, I think I should emphasize that much of the problems at CFPB were created by Congress and Congress deserves probably far more burden of the blame than does the CFPB. So, again, I should emphasize that I think our entire body of financial protection laws needs to be reexamined, rewritten in a way that would be both protective of consumers and the economy.

Thank you. I look forward to your comments and questions.

[Prepared statement of Mr. Calabria follows:]

**Testimony of Mark A. Calabria, Ph.D.**
**Director, Financial Regulation Studies, Cato Institute**
**Before the**
**U.S. House Committee on Oversight and Government Reform**
**Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs**

**On "Credit Crunch: Is the CFPB Restricting Consumer Access to Credit?"**
**July 24, 2012**

Chairman McHenry, Ranking Member Quigley, and distinguished members of the Subcommittees, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington, DC. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official policy positions of the Cato Institute. In addition, outside of my interest as a citizen and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

First I would like to commend the Chairman's effort to bring oversight to the Consumer Financial Protection Bureau (CFPB), which last week marked its first year in operation. Given the unusual structure of the CFPB, one that I believe reduces transparency and accountability, and the questionable manner in which its current leadership was put into place, diligent and constant Congressional oversight is badly needed.

Had Congress fulfilled its responsibilities in previous years in regards to such entities as Fannie Mae and Freddie Mac, we might have avoided the recent financial crisis. As the CFPB runs the same risk of politicizing our consumer credits markets in a manner similar to which our mortgage market was so highly politicized, I believe aggressive Congressional oversight is needed in order to both avoid future financial crises and to maintain a healthy economy.

***Credit Market Conditions***

In order to assess the impact of the CFPB on consumer credit, we must first look to the overall conditions in our credit markets. Last week the Federal Reserve presented its Monetary Report to the Congress[1]. The Federal Reserve observed that (page 15):

> "Consumer credit expanded at an annual rate of about 6¼ percent in the first five months of 2012, driven by an increase in nonrevolving credit. This component accounts for about two-thirds of total consumer credit and primarily consists of auto and student loans. The rise in nonrevolving credit so far this year was primarily due to the strength in student loans, which were almost entirely originated and funded by the federal government. Meanwhile, auto loans maintained a steady pace of increase. Revolving consumer credit (primarily credit card lending) remained much more subdued in the first five months of the year in part because nonprime borrowers continued to face tight underwriting standards. Overall, the increase in consumer credit is consistent with recent responses to the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) indicating that demand had strengthened and standards had eased, on net, for all consumer loan categories.
>
> Interest rates on consumer loans generally edged down in the first half of 2012, and spreads on these loans relative to Treasury securities of comparable maturity held fairly steady. In particular, interest rates on new auto loans continued to be quite low. However, the spread of rates on credit card loans relative to the two-year Treasury yield has remained wide since the end of 2008 in part because of pricing adjustments made in response to provisions included in the Credit Card Accountability Responsibility and Disclosure Act of 2009."

In plain English, the Federal Reserve is stating that other than student loans, which are almost completely now backed by the government, and auto loans, our credit markets remain constrained. To its credit, the Federal Reserve notes that the Card Act of 2009 has significantly increased the interest spread for credit card loans. Responsibility for the Card Act has shifted to the CFPB.

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[1] http://www.federalreserve.gov/monetarypolicy/files/20120717_mprfullreport.pdf

***Mortgage Market Conditions***

A particular focus of my experience has been in the area of federal mortgage finance. As housing remains one of the largest drags on the economy and is particularly sensitive to credit conditions, I will place the emphasis of my testimony on the CFPB's activities in this area, particularly as it relates to the CPFB's rule-making activities under the HOEPA, RESPA and TILA.

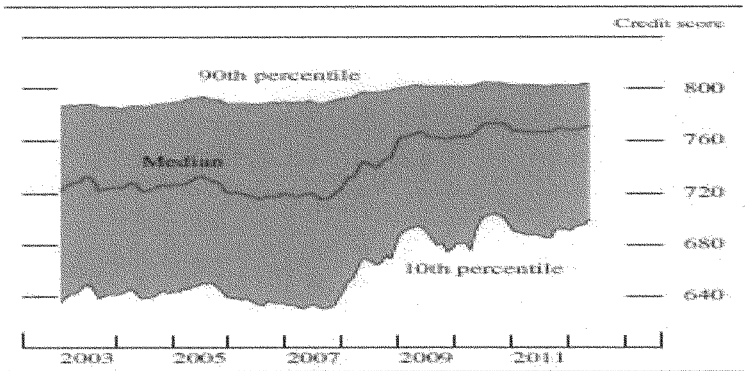
The problem facing our housing market is a combination of weak demand and excess supply. One of the constraints on housing demand is mortgage availability. If one is a prime borrower, who can make a substantial down-payment, then mortgages are both cheap and plentiful. If one is not, then a mortgage is difficult, if not impossible to get.

Again to quote from the Federal Reserve Monetary Report to Congress (page 18):

> "Access to mortgage credit is among the important factors that affect the demand for housing and thus the recovery in the housing sector. Lending standards appear to be considerably tighter than they were even before the housing boom, likely preventing many households from purchasing homes.
>
> According to the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS), from mid-2007 into 2009, many lenders tightened their standards for residential mortgages originated to borrowers with prime credit scores, and very few have eased standards since then. Moreover, the market for nontraditional mortgages continues to be impaired, while the market for subprime mortgages remains effectively closed. Similarly, the range of credit scores on newly originated prime mortgages has remained elevated since lenders shifted toward higher-rated borrowers in 2008. The upward shift in credit scores is also evident for prime borrowers who refinanced their mortgages and for Federal Housing Administration mortgages."

This decline in mortgage availability derives from a variety of factors, some good, and some bad. For instance the most irresponsible lending, with the exception of FHA, is gone, at least for the moment. That is a good thing. As the Federal Reserve, however, has noted, mortgage lending standards are tighter than that witnessed *pre-boom*, indicating that we are not simply seeing a correction in reaction to the boom, but a restriction in credit beyond what would be expected. As noted, much of the Alt-A and higher quality subprime lending is also gone. That is not such a good thing. By my estimate about a fifth of the mortgage market has disappeared, holding back housing demand.

B. . Credit scores on new prime mortgages, 2003–12




NOTE: Includes purchase mortgages only. The data are monthly and extend through May 2012.
SOURCE: LPS Applied Analytics.

The reduction in mortgage availability is illustrated by the dramatic increase in median credit scores on new prime loans, which have increased from just under 720 in 2007 to almost 770 today. Most of his increase has been driven by an increase in the bottom of the credit score distribution. Recall that this considers prime loans only. Of course there are substantial differences in default probabilities within prime. Lenders appear to be reducing credit to those borrowers within prime that are most likely to default, and hence most likely to invoke various "consumer protections" in order to avoid foreclosure. These are the loans which would entail the largest regulatory and litigation costs, so it is not surprisingly that lenders have reacted to these increased costs by limiting credit to borrowers most prone to litigation and regulatory enforcement. Reductions in subprime and Alt-A credit have been even more dramatic.

One of the factors contributing to that disappearance is the combination of Federal Reserve interest rate policy with federal mortgage regulation.

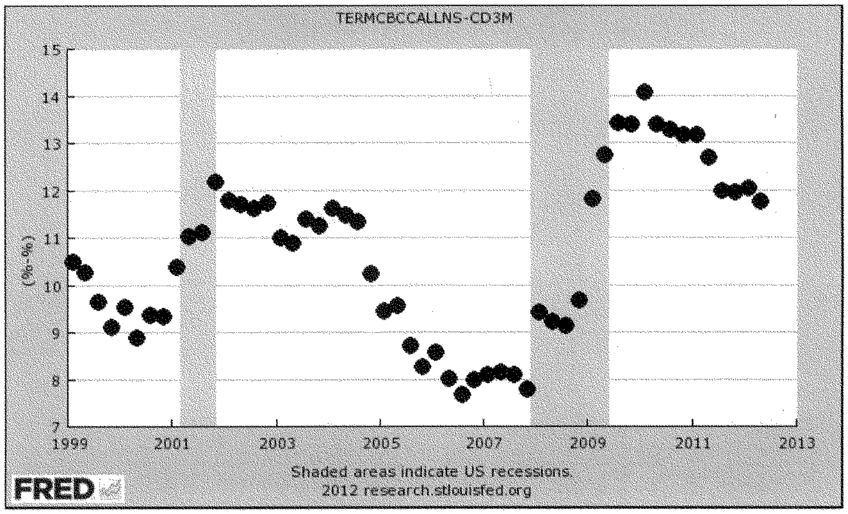
Under HOEPA, whose administration has transferred from the Federal Reserve to the CFPB, any mortgage over 5.5 percent is considered "high-cost" in the current interest rate environment. Such mortgages now carry considerable regulatory, reputation and litigation risk. Historically speaking, 5.5 percent is a great rate, not a predatory one. Charts, at the end of this testimony, display the distribution of mortgages rates charged in 2006 and 2011. It should be immediately clear that 2006 largely resembled a normal distribution. 2011, however, has seen the right side of that distribution largely eliminated. Clearly the distribution of mortgage rates in 2011 is nowhere near normal or symmetric.

While one should always keep in mind that economics does not offer one the luxury of a natural experiment, we do not get to hold everything constant, I believe the expansion of consumer finance regulation since the financial crisis has increased the cost of consumer credit while decreasing its availability.

***Credit Crunch and Monetary Policy***

This expansion has also reduced the effectiveness of monetary policy. While the Federal Reserve can lower its target policy rate, its ability to impact the economy is limited by the willingness of lenders to extend credit. One area that appears to be adversely impacted has been in the area of credit cards. Despite a five percentage point decline in the federal funds rate since 2007, the interest rate on credit card accounts have only fallen by a little more than 1 percentage point. As the credit card market is fairly competitive and rates can adjust relatively quickly to cover interest rate risk, the increased spread of credit card rates over other benchmarks suggests increased credit and legal risk. The largest declines in credit card lending did not occur during the depths of the financial crisis or the recession but after the implementation of the Card Act.

The following chart displays the spread between credit card rates and 3 month certificate of deposit rates, which controls for a bank's cost of funds. As the chart clearly illustrates, the spread of credit card rates over cost of funds dramatically increased following the implementation of the Card Act. While this spread would be expected in increase in a recessionary environment, the increased was considerably greater than witnessed in previous recessions and the subsequent decline was been relatively lower.




***Macroeconomic Impacts of Credit Crunch***

Interestingly enough economists Josh Wright at George Mason University and David Evans at the University of Chicago predicted in late 2010 that the CFPB would raise the cost of consumer credit by on average 160 basis points[2]. Examining the spread of various forms of consumer credit over the Treasury rate, it would appear that if anything their estimate was too conservative. As an educated guess, I would say that the CFPB has likely increased the cost of consumer credit by at least 2 full percentage points.

Wright and Evans use their prediction of 160 basis points to estimate that the CFPB would reduce net new jobs created in the economy by 4.3 percent. Accepting that their predicted increase in borrowing costs is likely low, we can surmise that net new jobs created has been reduced since the establishment of the CFPB by at least 5 percent. This translates to approximately 150,000 fewer jobs that have been created, that would have otherwise, since the CFPB opened its doors.

[2] The Effect of the Consumer Financial Protection Agency Act of 2009 on Consumer Credit, by Joshua Wright and David Evans, George Mason Law & Economics Research Paper No. 09-50 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1483906

***Standards for Regulatory Consideration***

Under Section 1022(b)(2)(A)(i) of the Dodd-Frank Act, the CFPB is required to consider "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products of services resulting from such rule." Without question the CFPB is required by statute to consider the impact of its rules on consumer access to credit. Unfortunately I believe the CFPB has failed in this regard, giving little consideration to reductions in access.

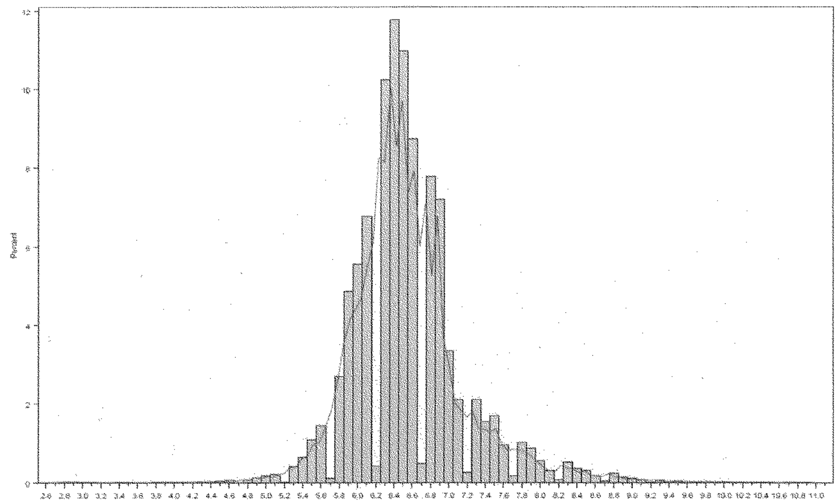
Part of the problem is the CFPB's structure where the Research area, which conducts cost-benefit analysis, is under the same Associate Director responsible for the rule-making. The cost-benefit analysis will not be independent of the rule-making process under such circumstances. I would urge the CFPB to establish an independent economics/research function that reports directly to the Director. As we have repeatedly seen with other agencies, the cost-benefit analysis has simply been an after-the-fact box-checking exercise, rather than a serious attempt to inform the rule-making process.

***Conclusions***

In closing I would like to emphasis that the CFPB is only one of the many obstacles to job creation and consumer credit in our economy. Restructuring or eliminating the agency would certainly improve outcomes, both for our economy and consumers in general, but such a change alone would be insufficient to cure everything holding back our economy. The CFPB's structure is only part of its problem. Of greater concern is the flawed body of consumer protection law inherited by the CFPB. This body of law did not prevent the financial crisis, despite the fact that pre-crisis our mortgage and credit markets were extensively regulated. In fact it was this extensive regulation that contributed to the crisis. Eliminating or restructuring the CFPB in the absence of significant change to the underlying statutes would offer only modest improvements.

I thank you for your attention and look forward to your comments and questions.

**2006**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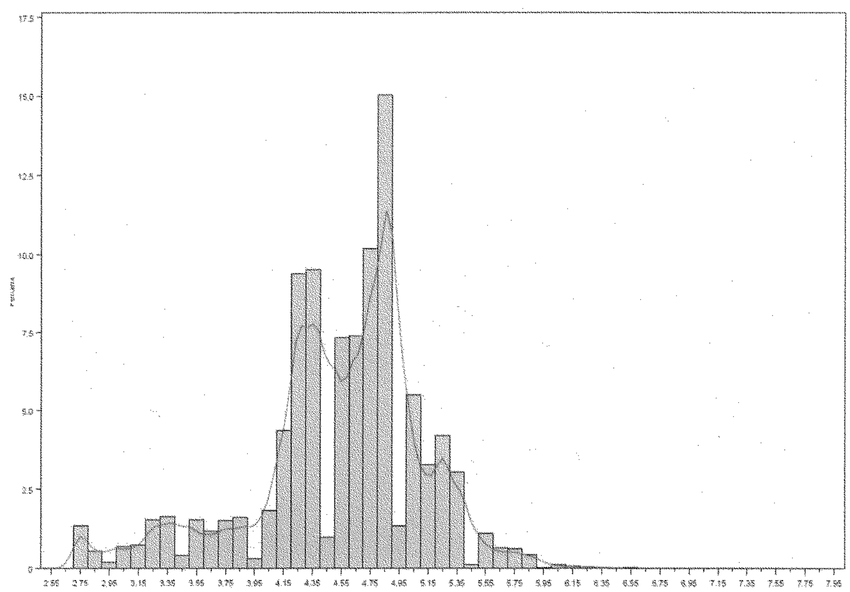
**2011**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Mr. MCHENRY. Thank you for your testimony.

I certainly appreciate the panel being here. I know you are all busy individuals, but I certainly appreciate you taking the time, either traveling across town or traveling to Washington especially for this.

I will begin by recognizing myself for five minutes.

Mr. Zeisel, with the Consumer Bankers Association, when you are talking to your members, what are their biggest concerns? What are the biggest issues that they are facing with the CFPB?

Mr. ZEISEL. Thank you, Mr. Chairman. In many ways there are two aspects of our attention that is relevant to this Committee's oversight. One is the potential for actions by the CFPB. And as has been noted, only one significant substantive regulation has been issue to date. A lot of it is uncertainty about what the CFPB is likely to do going forward as it regulates products and services using the powers that have been given to it under the Dodd-Frank Act, but also through the examination process itself.

A lot of our members are examined by the CFPB, they are banks over $10 billion, and the examination process is new, a lot of new examiners who are under a new boss, as it were, and operating with a new set of supervisory guidelines, and there is a lot of learning process going on there. So banks are facing it on the exam side; they are facing sort of the uncertainty about the future on the regulatory side.

I will add that the one regulation that they have issued, the remittance rule, already seems to have an impact on the products that they can offer, so there is some very real concern there as well.

Mr. MCHENRY. Mr. Fecher, have you seen that with the question of remittances?

Mr. FECHER. Yes. Actually, as was stated before, that was the one rule. Credit unions look at the CFPB with a great amount of uncertainty also, and the first clues that we get are the remittance rule. Now, there is an exemption built into that rule, but that exemption is so low as to not really—the only people it exempts are the people that weren't doing it in the first place.

My own credit union makes about 25 remittance payments a month. It is quite likely we will discontinue that service because the cost of the regulation simply won't support such a small number. We were hoping for our larger exception.

And then the next clue we get is an 1,100 page document, and with all due respect to the Director when he said that most of it is just justification, the fact of the matter is we ignore most of that at our own peril. We have to read the whole thing. There are parts of that thing that we just can't take the risk of not understanding what is in that. So while the comment and point was made earlier that these regulations, very few of them have been put out yet, the amount of uncertainty and, frankly, fear among small credit unions that this thing will roll up on them is real, on the street real.

Mr. MCHENRY. So how large is your credit union?

Mr. FECHER. We are a large credit union, we are $2.5 billion in assets.

Mr. MCHENRY. And how many folks do you employ?

Mr. FECHER. We have about 490.

Mr. MCHENRY. Okay. Substantial. So in terms of transactions, you do 25 remittances a month? Is that a very small, give me some sort of understanding of is that a significant number of transactions or very insignificant?

Mr. FECHER. It is not even a decimal place in terms of our total number of transactions. And the reason it is so small is most credit unions are community-based. We are in the heartland of Ohio. We don't do a lot of remittance outside of the Country, but we do some.

Mr. MCHENRY. But some, because you have some folks, Wright Patterson Air Force Base right there.

Mr. FECHER. Correct.

Mr. MCHENRY. Okay. So that would be discontinued.

Now, Dr. Calabria, in terms of this question about access to credit, two of my Democratic colleagues mentioned your testimony. Congratulations, they read it.

Mr. CALABRIA. I am touched.

Mr. MCHENRY. Unfortunately, they didn't agree with it, and I wanted to see if you had any response. One question was directed to the availability and the cost of credit that you outline as a direct result of the CFPB, meaning, as you outline, there is less credit available and it is more costly as a direct result of the CFPB. Will you outline?

Mr. CALABRIA. Let me first, because I am not sure that I think, certainly Mrs. Maloney and I might have put different emphasis on it, but I certainly agree, and I guess I should say as a broad matter, all of these things have costs and benefits. The question is whether the costs outweigh the benefits. So I would never be one to say that the CARD Act has not had some benefits, but I would say that consumers have had to pay for those benefits; they did not come free. We didn't turn lead into gold here.

So the question is whether, again, those costs outweigh those benefits. So I wouldn't disagree with anything she actually factually said; I would just say consumers are paying for those benefits, and they are not necessarily given a choice whether to pay for those benefits or not. So that is part of it.

The other part of it, in terms of the interest rate increase, is, again, looking at the spreads that we have seen, and as I detailed in my testimony, a lot of this is from regulations that preexisted the CFPB, that transferred to the CFPB. As I also note in my testimony, the increase in spreads for the credit card market was after the CARD Act was implemented. You saw an initial increase in the recession and a very large increase, there is a nice chart in there that I like to think anybody could understand.

So, again, very duet that these are costs. We have seen interest rate increases. I put it this way, if we believe that the Federal Reserve lowering interest rates creates jobs, then we must, therefore, believe that interest rate increases destroy jobs. So if we believe that these things have costs and those costs are going to be borne in interest rates, then we must believe, of course, that they have job consequences.

Mr. MCHENRY. So you are not from the south, are you?

Mr. CALABRIA. Well, I will say that I was very fortunate that all of my mother's family grew up in Guilford County in North Carolina.

Mr. McHENRY. That is amazing. You are the fastest talker I have heard.

Mr. CALABRIA. Well, my father was from Brooklyn, so they kind of split the difference.

Mr. McHENRY. Okay. There we have it. No, I certainly appreciate that.

With that, I recognize the Ranking Member, Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Mr. Calhoun, the financial crisis, coupled with housing mortgage crisis that went with it, and the topics that you alluded to, much has been said about the quality of lenders that was the principal reason that they were borrowing to people who couldn't afford the product and that led to this problem. To what extent do you credit that? To what extent do you credit the features of the loans in this process? And, generally, how would you rate the two in terms of how important they are, the terms of the loan products determining loan performance versus the quality of the lender?

Mr. CALHOUN. Thank you. We have done extensive research in this area and published it late last year, and one of the striking things you find is one of the primary determinants of how a loan performed is what type of loan the borrower got after controlling for the borrower profile, credit score, loan-to-value, et cetera. Same apples-to-apples borrowers, one gets a subprime loan with lots of abusive practices, much, much higher default rates than the same borrower who is put in a better loan. And one of the real challenges is, and I think for all the industry representatives here are part of the responsible industry, and they found that they had to compete with those folks who were offering the deceptive and abusive products, and it is hard to do.

If somebody comes and offers a tricked-up loan for $1,000 a month payment, you see ads for these still on the Internet today, that doesn't have escrow, that has a teaser rate that jumps after a year, it is hard to offer a sustainable loan that would have maybe a $1,300 or $1,400 initial payment. That is a hard loan to offer to compete with.

And if I may just quickly, I want to respond on the credit cards, where we have also done extensive research. I want to point out three things, and these reports are also on our website.

First is the main change that you saw following these reforms was there was a change in the rates that people paid and it moved by close to 2 percent. People started paying the rate that they were being offered. Before there was about a 2 percent gap between the rates that people were being offered and then you measured the rates they were actually being charged, and that gap has almost entirely disappeared.

Second, we looked at impact on credit. So there is a bit of an experiment out there. We looked at how business cards performed, and consumer cards did as well or better than business cards, which is noteworthy, because the CARD Act protections don't apply to business cards but do apply to consumer cards.

And, third, our most recent study looked at what happens to the credit card lenders. If you look at the credit card lenders, those who offered the most abusive products suffered the greatest losses in this downturn and, in fact, a number of them went out of business.

So I think the CARD Act is a good example of how consumer protection, if done carefully, helps consumers, responsible industry people, and the overall economy. We want to acknowledge, though, it is very hard to get this stuff right, and everybody wants the easy answer, but this stuff is hard to get right because there are huge impacts on consumers and businesses.

Mr. QUIGLEY. Doctor, if anyone can squeeze in a reaction to that in a minute, you can.

Mr. CALABRIA. I am trying to be respectful of time, which is the speed of talking here to some extent.

Most of that I agree with. I mean, I think it is very hard to get right. I spent a number of years working at staff on Senate Banking and my walking away from seeing the reaction of, all due respect, much of Congress and Washington during the crisis was they are not going to get it right, and so some of my sense of having that constrained, Mike Ensign mentioned bright lines earlier. I think part of the problem with our vast array of consumer protection, both pre-and post-crisis, is it is expost, it is a lottery; it is somebody finds a technical violation without actually giving clear. I think it is reflected in my bio. I spent some time at HUD running the RESPA office, which has since transferred to CFPB. I would be the first to say it, our concern the disclosures work horribly. I spent fair amount of time trying to fix them so they would work with consumers. But the tension was I found many of the consumer advocates didn't want simpler disclosures because they wanted to be able to sue under various deal or reasonable tests, and they wanted a whole lot of detail because they——

Mr. QUIGLEY. Just one second.

Mr. Chairman, can he be allowed to answer without—I don't want you to feel as rushed as you perhaps might feel.

Mr. CALABRIA. Okay.

Mr. MCHENRY. Sure. Absolutely. I ask unanimous consent for, how much time do you want, two minutes?

Mr. QUIGLEY. Two more minutes.

Mr. MCHENRY. I ask unanimous consent for two more minutes.

Mr. CALABRIA. So let me mention a couple of things that I think I very much agree with and will emphasize.

As Mike mentioned, many of these worst businesses went out of business, and that is part of our financial system, is any market that works, if you have bad practices, you take losses, you go out of business. Now, if we are going to bail people out and protect them, then of course bad practices are going to proliferate. So the first thing should be no bailouts, and we will weed out the bad characters, which do eventually get weeded out.

Mike also mentioned in terms of looking at mortgages, that they held constant credit in LTV. I would say that there is nothing more predictive of the performance of a mortgage than credit and loan-to-value. So I would be the first to say all those little other things do matter, but they matter far less than whether someone has equity or not. For instance, it was mentioned the ability to pay, and Michael mentioned the number 45 percent.

Well, FHA, today, you can get up to 42, 43 percent debt-to-income with 3.5 percent down. That is reckless lending, to me. That is predatory lending. But the Federal Government is pushing it because, God forbid we ask—wanted to come up with a down payment and put their own skin in the game.

So what I would say is my skepticism is, and I think this is particularly important when the CFPB has on its agenda, later in the year, to roll out small business data that mirrors the home-to-collection, is that we have seen this pressure over the years. The regulators were foremost. I mean, if you haven't read the Boston Fed study and the Boston Fed guidance from the early 1990s, where they said look at things like reduce the debt-to-income, more flexible underwriting.

So my concern is that where we have seen this play out in the past is that you have seen the pressure to get more people the loans that, in my opinion, were predatory features because they did not protect the borrower. And, of course, there are some things we will disagree on. For instance, I think the fact that most of our mortgage market is non-recourse is problematic. You go to France, socialist France of all places, if you don't pay your mortgage there, they garnish your wages. And guess what? They have much lower default rates.

So if you want to avoid a crisis, we have to ask the consumer to actually live up to their obligations as well. I know that that is never going to be politically popular, but if you give people a free option to walk away and bet on the housing market, they will take it; and that is how we get into these gambles as well So I would say there was absolutely fraud; absolutely predatory lending, but I disagree that I think that those were the main drivers. I think those were the result of the bubble, rather than the driver of the bubble.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Mr. MCHENRY. I thank the Ranking Member; it is a solid set of questions.

Mr. Kelly of Pennsylvania is recognized.

Mr. KELLY. Thank you, Chairman.

And thank you all for being here.

I am in the automobile industry, so I have really watched over the years what has happened. I think the number one thing that happened to us was the ability to finance negative equity and putting people out there 48 months and 60 months and 72 months on something that depreciates very quickly. But the great realization was when we would sell somebody a car and then they come in and they say, wait a minute, this doesn't make sense. And I would say, well, you have negative equity from your trade, and they would say, what does that mean? You owe more than it is worth.

I also sat on a bank advisory board. I used to watch them okay loans and I would say, you can't possibly do this; this isn't going to work. They would say if we want to participate at the government level, we have to with Fannie Mae and Freddie Mac.

So a lot of what we are experiencing are just market fluctuations and people allowing people to do bad things. I often thing that if we had followed the 5 Cs as carefully as we should, and you all know what those are, I don't want to go into them now.

But what concerns me, because the hearing today was on the restriction of consumer access to credit. Please tell me, as you go through this process and as you look, and I know some of the things aren't on paper yet, but it is the uncertainty, truly. If this economy is to get back on track, access to capital is the same as the body needs blood; and, unfortunately, there is a transfusion that is necessary right now, and most people don't have access to it.

The cost of credit, Mr. Fecher.

Mr. FECHER. Well, I think that is a great point that is to be made. As a practical matter, what the average credit union will do as they seek to try to figure out how to absorb these increased regulatory costs into their operation, is they won't just raise the interest rates on the loans or increase their fees, A, because the market won't let them and, B, because it is simply against what we try to do.

What we will do instead is try to control the cost that we can control. You can't control the regulatory cost, but you can control who you lend to. So, again, as a practical matter, as this crisis unfolded at my credit union, we increased our credit standards; we just stopped lending to people on the credit margin, because we wanted to control our loan loss cost in the end, and it worked. Our loan loss cost went down, and that is the way we managed that whole crisis. But by doing that we stopped making loans to people that probably would have paid the loans; we just couldn't take the risk anymore.

So when you talk about what happens when the cost of your operation goes up, it is not as if it is obvious in the rate of the loan, at least at first, or in the fees that you charge; you make other changes to try to absorb those, and those changes very often result in a reduction of service to the member. That was one example I gave.

My other, frankly, favorite example is, I believe, my opinion, the reason pay-day lending got such a great start in this Country is because we made it so expensive for traditional lenders to make small dollar loans that they just stopped making them. So as soon as they stopped making them, it created a market void that was filled by people who exploited that void.

So we couldn't be stronger supporters of strong consumer protection, but it has to be balanced with the cost of providing that because the result is not necessarily going to be higher loan rates, at least at first; it will be a reduction in access to products that, frankly, people need. And it does play out and, again, I say as a practical matter, because that is what has happened at our credit union.

Mr. KELLY. Mr. Zeisel?

Mr. ZEISEL. Yes, absolutely. When the access to credit is constricted, people at the margin are the ones who suffer, and they are the first to lose availability of products and the first to be unable to afford the products that are charged. For the most part, costs that go up do get passed on in one form to the consumer.

Mr. KELLY. Well, they have to.

Mr. ZEISEL. There is no other way to operate a business. Eventually somebody pays. The customer will pay in one form or another or the product gets dropped and the customer loses the availability of something that is valuable, that is a valuable product or service that they need and they end up going elsewhere to find it.

Mr. KELLY. Dr. Calabria?

The reason I wonder about this, truly, because competition truly does drive quality and cost, and whenever we start eliminating smaller banks and credit unions and the ability to compete, then all of a sudden it goes to one place, and that is why I said earlier too big to fail means too small to survive. You can game this thing to the point that you take people out of the market that they were in before. So I really think that sometimes we lose the fact of that down here.

Mr. CALABRIA. I absolutely agree, and I think one of the things we did not fix was too big to fail. If you look at the largest banks and institutions, before 2008, the largest banks had a higher cost of funds than the smallest banks. Now they have a lower cost of funds than the smallest banks, and they will be able to gain market share and they will become even bigger.

Another element of that, as I mentioned before, if you have bad business practices, you should go out of business. But that doesn't happen when people think you are going to be bailed out. There is no market discipline; there is no constraint on use. One of the real problems in our mortgage market is an absolute lack of market discipline on our largest lenders; not just Fannie and Freddie, but Bank of America and the whole slew of them were just not subject to market discipline, and that, to me, should have been the first and last objective of financial reform.

Mr. KELLY. Really, if there is no consequences for bad business practices, then keep doing them. Why would you stop if someone is going to bail you out? I know in our business, you do the wrong thing, you can do it for a while, but you can't do it for too long because you are out of business. I think that is what we are witnessing now and my real fear is this cost of capital and the availability of capital, the access to it, is really hindering our recovery right now. I know we talk about we want to make sure it doesn't, we are protecting consumers, but what we are really doing is we are limiting the access of capital to people who need it.

Mr. CALABRIA. And we shouldn't. We give capital to those who look like they are going to be backed by the Government.

Mr. KELLY. Thank you, Mr. Chairman.

Mr. MCHENRY. I certainly appreciate the member, my colleague from Pennsylvania and his line of questioning.

I have just a small set of questions left.

Mr. Zeisel, based on your experience, and this is what I want to get to the heart of. In my questioning I asked Director Cordray about the term abusive. Now, unfair and deceptive have been well defined legal terms. There has been a significant amount of legislation and litigation to define those terms. Very costly terms to define. But we have a body of law to look at now. There is an understanding by the private sector, there is an understanding by regulators what those two terms mean.

Abusive, however, as the Director testified before this Subcommittee at the beginning of this year, they don't intend to, they are going to use fact and circumstance to determine that. It is not something we are likely to be able to define in the abstract, which is interesting.

What is that effect?

Mr. ZEISEL. Well, that goes directly to the issue of uncertainty that we have been talking about, and the expectations of financial institutions as they are being either supervised by the CFPB or enforcement or simply rule-writing.

So, as you say, unfair and deceptive have been around for a long time; they are defined terms; they have been through the courts and they have sort of been vetted for the system, so financial institutions have a sense of what that means and how they can develop strong compliance management systems to deal with that and to anticipate and make sure that they are not in violation of the law. You have a new term here, and that new term is in Dodd-Frank and there is, as he said, sort of a three-part or a multi-part——

Mr. MCHENRY. But in their manual they only discuss about a half of a page to define abusive.

Mr. ZEISEL. That is right. And the manual actually has sort of language throughout that addresses issues involving general risk to consumers and that appear to go to issues——

Mr. MCHENRY. So how does that affect——

Mr. ZEISEL.—that might be UDAP related, and I think it raises a lot of doubts and uncertainties in the minds of financial institutions. How do you prepare, how do you plan, how do you develop your products and services and know that they won't later be found to be in violation? It is a difficult problem.

Mr. MCHENRY. So what does that mean for access to credit?

Mr. ZEISEL. Inevitably, as everybody has said, the products and services that are being developed by those financial institutions to meet consumers' needs are the ones that get affected and the ones at the margin are the first to get affected.

Mr. MCHENRY. Sure.

Now, my questions for the whole panel is on the qualified mortgage, the QM and this definition, its importance. Tell me how you would get it right? If everybody could very briefly summarize your view on how we get this thing right so mortgages can still be made by large and small institutions and there is still a competitive marketplace for consumers.

Mr. FECHER. That QRM is one of the biggest fears that we have. Getting it right is going to be critical, especially to the small institution. Just to make my remarks short, I think the safe harbor portions of it are going to be really important, especially for the smaller institution that is going to want to be serving their member with mortgage loans and not wanting to be looking over their shoulder the entire time they are doing it that somehow they have tripped over some trip wire in a regulation that will get them in trouble at some point. So the safe harbor provisions, to me, are one of the most important aspects of that entire regulation.

Mr. ZEISEL. Well, I would have to agree. I think that, again, to keep it brief, we are dealing here with the need for a broad standard. This is essentially a box and people aren't going to make loans outside of the box, for the most part. So if there is going to be lending done, and even I think I hard Mr. Cordray say he didn't expect, at least in the short run, that there should be a lot of lending outside of QM.

That makes it all the more important that QM be broadly defined in a way that it makes sure that lenders can make safe loans to the widest number of people possible; and the clarity of those rules are also critical. The safe harbor is important because there is a great deal of liability risk associated with getting it wrong, and that will happen. It will come up in the foreclosure stage and it will involve a great deal of cost to litigate, at the very least.

So if you are going to create some kind of sense of certainty around what it is you are doing and feel comfort that you will have and met, that meet the ability to repay test by using the QM standard, you really need to have a safe harbor.

Mr. CALHOUN. I think there is good news on this issue in that there is broad consensus on the goals and a lot of the specifics. There is agreement that mortgage credit is too constrained. I don't hear any groups arguing otherwise on that, so there is broad consensus that it should be a broad QM market. Second, I think the industry has convinced others that there should be bright line standards, although there are some down sides to that.

The Fed raised the question of maybe it should be just a general bar do you meet, generally recognized underwriting standards. That was going to be the test of whether or not it was a QM, but I think now there is a consensus. There is still disagreement on the rebuttable presumption. I think, though, there is a lot of consensus around that. People want litigation to be very rare. Fixing mortgages is not that helpful for borrowers and is very inefficient. It should be a deterrent, but not by any means a frequent occurrence.

And I think there is positive news there, too. The liability and standards proposed under QM are much less than those that are in the North Carolina Mortgage Act. That has been on the books for over a decade and has produced virtually zero litigation. So I think there is some assurance in that because CRL has not supported any State or federal laws that have generated widespread litigation; we just don't think it is effective. It is not politically sustainable, either, so we are not going to advocate that.

Finally, there is, I think, consensus again on the relationship between the QM and the QRM. The QRM, as everyone knows, was written by six different agencies jointly. Those agencies are given it must contain all the same standards as QM, but then they have authority to add on to that; and, quite frankly, their original proposal piled onto that with deep restrictions that our analysis showed would knock out about 25 percent of people who should be in the mortgage market.

We think there is no basis for that, that particularly at this time they should get the QM, get it right, preserve raw credit, and make the QRM no additional requirements. If you meet QM, you meet QRM. Take a look at it in five years and adjust it whichever way you need to. That is what we would recommend.

Mr. CALABRIA. I think there is a tremendous amount of consensus here. I would echo some of the very same things. I do think it needs to be broad and I do think that anything outside of the box will disappear, at least for a few years, if not permanently. I will echo that I do think you need bright lines. As a general matter, I think a basic principal of law should be you should know whether you are in conformity with the law ahead of time or not. There shouldn't be a lot of ambiguity with that.

Again, I think safe harbor is a very important part of this, particularly during the foreclosure stage. I don't think we want to move to a world where mortgages become unsecured lending. That will very much see rates go up.

One of my concerns, and I would echo, I think the QRM and the QM should be coordinated and made as close as possible. One of my concerns is that in the QRM we have exempted some government loans, so as someone who doesn't want to see us put hundreds of billions into another bailout again for Fannie, Freddie, or FHA coming down the line, I would suggest that the CFPB treat government loans equally, as it treats other loans, and show no preference and no exemptions for that, because again, ultimately, the taxpayer stands behind those.

Mr. MCHENRY. Thank you. Thank you for that.

Does the Ranking Member have any additional questions or comments?

Mr. QUIGLEY. No. Thank you, Mr. Chairman. I thank our panelists.

Mr. MCHENRY. Mr. Kelly, do you have anything additional? Okay.

I thank the panel. Thank you for your patience and waiting through the questions this morning. It is refreshing to have a panel, a diverse panel actually find some agreement on QM. That is very encouraging and refreshing, and I don't want to describe it further, but——

[Laughter.]

Mr. MCHENRY.—let's just say it is rare. So thank you so much for your testimony. Your interest in these issues and your willingness to engage in an adverse array of questions as it relates to access to credit. Thanks so much.

This meeting is now adjourned.

[Whereupon, at 1:05 p.m., the subcommittee was adjourned.]

NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
F: 703.522.2734
fbecker@nafcu.org
National Association of Federal Credit Unions | www.nafcu.org

**Fred R. Becker, Jr.**
President/CEO

July 23, 2012

The Honorable Patrick McHenry
Chairman
House Oversight and Government Reform
Subcommittee on TARP, Financial Services & Bailouts
United States House of Representatives
Washington, D.C. 20515

The Honorable Mike Quigley
Ranking Member
House Oversight and Government Reform
Subcommittee on TARP, Financial Services & Bailouts
United States House of Representatives
Washington, D.C. 20515

**Re: Credit Crunch: Is the CFPB Restricting Consumer Access to Credit?**

Dear Chairman McHenry and Ranking Member Quigley:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federally chartered credit unions, I write in conjunction with tomorrow's hearing, "Credit Crunch: Is the Consumer Financial Protection Bureau Restricting Consumer Access to Credit?" As you know, despite not having contributed to the financial crisis, all credit unions are subject to the rule making authority of the CFPB. Given that every dollar a credit union uses for regulatory compliance could have been used to better serve their member-owners, NAFCU appreciates the subcommittee's attention to the impact the CFPB is having on consumer access to credit.

With no end in sight, the steady stream of mandated regulation coming from the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (P.L. 111-203), including those regulations expected from the CFPB, only adds to the existing compliance burden our nation's credit unions already face from the National Credit Union Administration and various other agencies. Many regulations may be well-intentioned to correct the abuses of some bad actors in the financial services arena, but for credit unions they are often a solution in search of a problem.

While NAFCU believes that credit unions should not be subjects of CFPB authority, there are steps that can be taken to help alleviate our nation's community-based financial institutions from the onslaught of regulatory burden they face. Congress must urge regulators to do more robust cost-benefit analysis of potential regulations. Once regulations are in place they should be monitored and adjusted when the costs are too high. Congress must also urge the various agencies to review and streamline regulations where possible. In this regard, the Financial Stability Oversight Council (FSOC) has a distinct responsibility to facilitate regulatory coordination among its member agencies in terms of policy development, rulemaking, examination requirements, reporting requirements, and enforcement actions. Congressional oversight, including tomorrow's hearing, is an important step in ensuring that credit unions are able to provide their members with basic financial services instead of focusing all of their resources on keeping up with the over-accumulation of unnecessary regulation.

Again, we thank you for holding this important hearing. Should you have any questions about the regulatory burden credit unions face in the wake of the Dodd-Frank Act, please contact me or Brad Thaler, NAFCU's Vice President of Legislative Affairs, at 703-842-2204 or bthaler@nafcu.org.

Sincerely,

Fred R. Becker, Jr.
President and CEO

cc: Members of the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs had strengthened and standards had eased, on net, for all consumer loan categories.[1]

Interest rates on consumer loans generally edged down in the first half of 2012, and spreads on these loans relative to Treasury securities of comparable maturity held fairly steady. In particular, interest rates on new auto loans continued to be quite low. However, the spread of rates on credit card loans relative to the two-year Treasury yield has remained wide since the end of 2008 in part because of pricing adjustments made in response to provisions included in the Credit Card Accountability Responsibility and Disclosure Act of 2009.[2]

Aggregate indicators of consumer credit quality improved further in the first quarter of 2012. The delinquency rate on credit card loans registered its lowest level since the series began in 1991. The recent improvement importantly reflects an ongoing compositional shift in total credit card balances toward borrowers with higher credit scores, due in part to tighter lending standards. Charge-offs on credit card loans also declined, reaching levels last seen at the end of 2007. Delinquencies and charge-offs on nonrevolving consumer loans at commercial banks also edged lower, to levels slightly below their historical averages. In addition, the delinquency rate on auto loans at finance companies decreased slightly to a level that is near the middle of its historical range.

Issuance of consumer asset-backed securities (ABS) in the first half of 2012 exceeded issuance for the same period in 2011 but was still below pre-crisis levels (figure 9). Issuances of securities backed by auto loans dominated the market for most of the first half, while student loan ABS issuance was about the same as in the past two years. In contrast, issuance of credit card ABS remained weak for most of the first half of 2012 as growth of credit card loans continued to be somewhat subdued and most major banks have chosen to fund such loans on their balance sheets. Yields on ABS and their spreads over comparable-maturity swap rates were little changed, on net, over the first half of 2012 and held steady in the low ranges that have prevailed since early 2010.

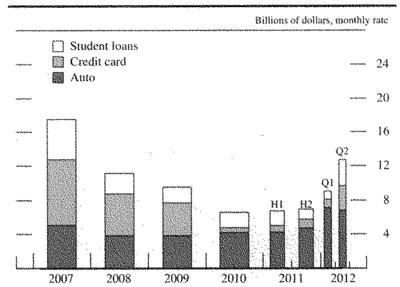
### *Housing Activity and Housing Finance*

Activity in the housing sector appears to be on a gradual uptrend, albeit from a very depressed level.

1. The SLOOS is available on the Federal Reserve Board's website at www.federalreserve.gov/boarddocs/SnLoanSurvey.

2. The act includes some provisions that place restrictions on issuers' ability to impose certain fees and to engage in risk-based pricing.

9. Gross consumer asset-backed security issuance, 2007–12




SOURCE: Bloomberg.

Sales of new and existing homes have risen so far this year, likely supported by the low level of house prices and by low interest rates for conventional mortgages. Nonetheless, the factors that have restrained demand for owner-occupied housing in recent years have yet to dissipate. Many potential buyers are reluctant to purchase homes because of ongoing concerns about future income, employment, and the direction of house prices. In addition, tight mortgage finance conditions preclude many borrowers from obtaining mortgage credit. Much of the home purchase demand that does exist has been channeled to the abundant stock of vacant houses, thereby limiting the response of new construction activity to such expansion of demand as has occurred. Given the large numbers of properties still in, or at risk of being in, foreclosure, this overhang seems likely to continue to weigh on new construction activity for some time.

Despite these factors, housing starts have risen gradually so far this year (figure 10). From January to May, single-family houses were started at an annual rate of about 495,000 units, up from 450,000 in the second half of 2011 but less than half of the average pace of the past 50 years. Although the unseasonably warm winter may have contributed to the increase, the underlying pace of activity likely rose some as well. Indeed, data on single-family permit issuance, which is less likely to be affected by weather, also moved up a little from its level late last year. In the multifamily sector, demand has remained robust, as many individuals and families that are unable or unwilling to purchase homes have sought out rental units. As a result, the vacancy rate for rental housing has fallen to its lowest level since 2002, putting upward pressure on rents and spurring new construction. Over the first five months