Consumer Federation of America

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Statement of the Consumer Federation of America in Response to the Department of the Treasury's Blueprint for a Modernized Financial Regulatory Structure

The Blueprint for Regulatory Reform rolled out by the Treasury Department today offers nothing to the millions of Americans currently facing foreclosure or nervously eying the effects of market turmoil on their retirement accounts. Rolling out this plan in the middle of the current crisis is like telling Hurricane Katrina victims stranded on their rooftops in New Orleans, "Don't worry, if you can hold for a few years, we've got a really great plan to restructure the federal emergency response system." Moreover, because it fails to tackle the underlying causes of ineffective regulation, this plan doesn't even do much to prevent the recurrence of similar financial crises in the future.

As Secretary Paulson has acknowledged, faults in our financial regulatory structure did not cause the current market turmoil. In fact, it was regulators' mindless belief that the market is always right that made them deaf to warnings of risks in the subprime mortgage market, blind to the fact that securitization didn't so much reduce risk as spread it into every corner of the marketplace, and unwilling to use the authority at their disposal to rein in those risks. Until that attitude changes, consumers and investors are unlikely to see any benefits from changes in the regulatory structure.

This plan had its genesis in Secretary Paulson's conviction that over-regulation and inefficient regulation were hurting the global competitiveness of U.S. markets. In fact, experience has repeatedly shown that regulatory failure, not over-regulation, is the greatest threat to the health of our markets. Despite the fact that we once again find ourselves in the midst of a financial crisis brought about by regulatory failure, that anti-regulatory bias is evident in the plan's details, if not its broad-brush structural proposals.

This is not to suggest that the Treasury Blueprint is devoid of good ideas that may lead to a productive debate about the best approach to financial regulation. However, Congress and the next administration will need to review these and other proposals very carefully to separate the good from the bad. More importantly, they will need to recognize that any structural changes that are not accompanied by adequate resources and regulatory authority and are not implemented by independent regulators with the determination to regulate, will do nothing to reform the real weaknesses in our regulatory system.

Regulatory Restructuring

1) New market stability authority for the Federal Reserve

If the federal government is going to stand behind investment banks, it makes sense to give federal regulators greater authority to monitor risks within the investment banking system. However, there are two basic flaws with Treasury's plan to expand the Federal Reserve's authority in this area.

First, the blueprint specifically limits Fed authority to take corrective action to "instances where overall financial market stability was threatened." This proposal, if adopted, would institutionalize the kind of crisis management approach to regulation that we have witnessed in recent weeks, an approach that is hardly conducive to promoting market stability.

Second, the Fed's failure to heed warnings about problems in the subprime mortgage market and failure to recognize other risks in the market is directly responsible for the crisis we find ourselves in today. Giving the Fed new responsibility to monitor market risks will do nothing if it is not accompanied by much broader authority for the Federal Reserve to act than this proposal provides and, even more important, by a willingness for the Federal Reserve to use the authority it has.

2) New market conduct regulator

Having, for better or worse, largely erased the lines that separate the banking, insurance, and securities industries, it makes sense to adopt consumer protections based on the nature of products and services offered rather than on archaic industry divisions. We therefore see the kernel of a good idea in the proposal to create a broad market conduct regulator with sales practice authority that cuts across industry sectors. However, consumers and investors will only benefit if that new agency has the regulatory authority, resources, independence, and will to impose high standards of conduct and enforce compliance with those standards.

The blueprint's suggestion that the Commodity Futures Trading Commission's industry-cozy, "principles-based" approach to regulation should prevail suggests that this is not what the Treasury Department has in mind. The same message is sent by the plan's proposal to rely more heavily on self-regulation and to loosen regulatory oversight of self-regulatory organizations. Wall Street's enthusiasm for the plan suggests that they too see it as applying the lighter touch approach to regulation they have long sought. This does not bode well for consumers.

Mortgage Origination

The blueprint's main proposal to deal with the current credit crisis consists of creation of a new U.S. oversight system for mortgage origination. This appears to be little more than a warmed over version of the administration's response to congressional proposals, favoring licensing and disclosure over substantive consumer protections. This proposal doesn't go nearly far enough to rein in the predatory practices that helped to create the current crisis. There are far stronger consumer protection proposals in Congress – including legislation introduced in the Senate and another measure that has passed the House with strong bipartisan support – which the administration would do better to support.

Optional Federal Charter for Insurance

CFA strongly opposes an optional federal charter for insurance that allows the regulated entity, at its sole discretion, to pick its regulator. This is a prescription for regulatory arbitrage that can only undermine needed consumer protections. If the goal is to increase the "speed to market" of insurance products and achieve other advantages that uniform federal regulation would provide, the appropriate approach is to create a federal regulator with strong consumer protections and not allow insurers to run back to the states when oversight is tougher than they would like. That is a proposal that, unlike an optional federal charter, would be worth debating.

Federal Preemption of State Protections

The plan seems to anticipate a diminished role for states in the regulation of the financial services industries. We oppose any such sweeping preemption of stronger state laws. States play a vital role in overseeing those who do business in their states and in enforcing laws to protect the citizens of their states. Any federal regulatory restructuring plan should not serve as a Trojan Horse to advance Wall Street and the banking industry's preemption agenda.

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The Consumer Federation of America is a non-profit association of some 300 national, state, and local pro-consumer organizations founded in 1968 to represent the consumer interest through research, advocacy, and education.