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Heidi Mandanis Schooner
Prof. of Law, Columbus School of Law, Catholic University of America

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Heidi Mandanis Schooner*

Predatory lending is an avaricious fraud that demands attention. Several states have enacted new laws to combat predatory lending. Moreover, the battle against predatory lending and other abusive practices has focused attention on the overall structure of consumer credit laws. The current structure is dual; both state and federal governments play significant roles in combating credit fraud. The dual structure has been the source of controversy as federal regulators have claimed the power to preempt state law. This article furthers the structural debate and the effort to combat predatory lending by examining the architecture of consumer credit laws within the federal system. The responsibility for enforcing federal consumer credit laws is divided among many federal agencies. This is confusing and inefficient. To compound the problem, much of the enforcement of consumer credit laws is in the hands of bank regulators rather than consumer protection agencies. The principal role of a bank regulator is to protect the solvency of a bank. The principal role of a consumer protection agency is to protect the consumer. While these two roles can be synergistic, they can also clash. Therefore, tasking the bank regulator with the job of consumer protection creates an intra-agency conflict. This article proposes a range of alternative regulatory structures that could provide for more efficient and fair consumer protection.

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Introduction

The proliferation of subprime[1] lending markets means that most Americans, even those with less than stellar credit ratings, have access to credit. A friend revels in the story of applying for a credit card in the name of his Labrador Retriever—who promptly received new plastic with a generous credit limit. Credit is so widely available that in 2004, total consumer debt rose above two trillion dollars, an almost 500-billion-dollar increase in just five years.[2]

Naturally, there is a dark side to all of this free flowing credit. Common sense suggests that the current unprecedented levels of consumer debt are unsustainable and may even pose a threat to the world economy. Consumer bankruptcy filings have reached record levels in recent years.[3] Moreover, many subprime customers pay more than they should for the credit that they receive (even given their risk profile) and, too often, are the victims of serious fraud.[4]

Congress has passed no legislation that addresses the recent proliferation of abuses in consumer credit.[5] In April 2005, Congress

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[1] Subprime lending is "'the extension of credit to higher-risk borrowers who do not qualify for traditional, prime credit, [m]ost often [because of] borrowers' tarnished credit records or uncertain income prospects.... Subprime loans naturally feature pricing and other contract terms that either compensate for or are intended to lessen some of these risks.'" Susan Lorde Martin, *The Litigation Financing Industry: The Wild West Should Be Tamed Not Outlawed*, 10 FORDHAM J. CORP. & FIN. L. 55, 65 (2004) (quoting Edward M. Gramlich, Federal Reserve Board Governor).

[2] *See* FEDERAL RESERVE 2004 REPORT ON CONSUMER CREDIT, 1 (2004), http://www.federalreserve.gov/releases/G19/20040908/g19.pdf.

[3] For calendar year 1990, non-business bankruptcy filings totaled 718,107. Bankruptcy Filing Statistics, http://www.uscourts.gov/bnkrpctystats/statistics.htm#calendar (last visited Sept. 23, 2005). By 2003, total non-business filings reached a record high of 1,625,208. *Id.* Non-business filings were down slightly for calendar year 2004, with non-business filings totaling 1,563,145. *Id.*

[4] *See* Association of Community Organizations For Reform Now, *Separate and Unequal 2004: Predatory Lending in America*, 44 available at http://www.acorn.org/index.php?id=8071 (last visited Sept. 23, 2005).

[5] In 1994, Congress imposed restrictions on high-cost loans by passing the Home Ownership and Equity Protection Act, an amendment to the Truth in Lending Act. The Home Ownership and Equity Protection Act, Pub. L. 103-325 §§ 151-158, 108 Stat. 2190-2198. Several agency reports have recommended legislative action to protect consumers from abusive lending. *See* Board of Governors of the Federal Reserve System and Department of Housing and Urban Development, *Joint Report to the Congress Concerning Reform to the Trust in Lending Act and the Real Estate Settlement Procedures Act* (July 1998); HUD-

passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, comprising the most sweeping bankruptcy reforms in twenty- five years. The new law will make it more difficult for some debtors to secure the protections that bankruptcy provides.[6] The bill enjoyed strong support among banks and other lenders, but critics complain that it does little to abate abusive practices by lenders. In other words, Congress focused on the wrong side of the lending transaction.

State legislators have been far more aggressive in their attempts to combat fraud in consumer credit transactions. Recently, several states have passed laws[7] aimed at responding to the problem of predatory[8] lending and other unfair lending practices. State attorneys general have focused their enforcement resources on the problem. Moreover, in contrast to Congress' relative lassitude, federal agencies have displayed fresh commitment to combating such abuses. Banking agencies[9] such as the FDIC and the OCC

Treasury Task Force on Predatory Lending, *Curbing Predatory Home Mortgage Lending: A Joint Report* (June 2000). In 2005, Congress considered several bills addressing abusive lending practices. *See* Responsible Lending Act, H.R. 1295, 109th Cong. (2005); The Prohibit Predatory Lending Act, H.R. 1182, 109th Cong. (2005).

[6] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. § 101 (2005).

[7] N.J. STAT. ANN. § 46:10B-22 (West 2003); 2003 Ark. Acts 2598; CAL. FIN. CODE § 4970-4979.7 (West 2003); GA. CODE ANN. § 7-6A-1-13 (2003); 2003 Ill. Laws 93-561; 2003 N.M. Laws 436; 2001 N.Y. Laws 11856; N.C. GEN. STAT. § 24-1.1e (2003); 2003 S.C. Acts 42; 2003 N.C. Sess. Laws 24-10.2.

[8] "Predatory" lending is a term often used but difficult to define. Professors Engel and McCoy developed one oft-cited definition. They define predatory lending as "a syndrome of abusive loan terms or practices that involved one or more of the following five problems: (1) loans structured to result in seriously disproportionate net harm to borrowers, (2) harmful rent seeking, (3) loans involving fraud or deceptive practices, (4) other forms of lack of transparency in loans that are not actionable as fraud, and (5) loans that require borrowers to waive meaningful legal redress." Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1260 (2002).

[9] The federal banking agencies are the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve Board (Federal Reserve). The FDIC is the primary federal regulator for state-chartered commercial banks that are not members of the Federal Reserve System. *See* 12 U.S.C. § 1813(q)(3) (2005). The OCC is the primary federal regulator for all federally chartered commercial banks. *See* 12 U.S.C. §§ 26, 93a (1988). The Federal Reserve is the primary federal regulator for bank holding companies and state-chartered commercial banks that are members of the Federal

prominently feature their extensive efforts at consumer protection.[10]

Despite significant efforts at the state level and by federal agencies, state and federal authorities have failed to achieve the benefits of a "two heads are better than one" approach. Serious conflict has emerged between federal and state authorities regarding the authority of each to regulate and enforce the consumer credit laws that apply to banks.[11] Last year, despite much criticism, the OCC issued regulations that seek to preempt the application of many state laws, including many consumer protection laws, to national banks and their subsidiaries.[12] National banks applaud the OCC's policy as allowing them the opportunity to operate under a single federal legal standard as opposed to varied state standards.[13] Conversely, state banks, state regulators, and state attorneys general deride this policy as allowing national banks, the state banks' competitors, to avoid more stringent state-law standards.[14] New York Attorney General Eliot Spitzer filed suit directly challenging the OCC's preemptive authority.[15] Pending Senate and House bills would explicitly repeal the OCC's rule.[16] Moreover, an appropriations amendment would have prevented the Department of Justice ("DOJ") from using funds to defend the legality of the OCC's rule.[17]

Reserve System. *See* 12 U.S.C. §§ 248, 1844 (2005).

[10] See the FDIC's website at www.fdic.gov and OCC's website at www.occ.treas.gov.

[11] While banks are by no means the only issuers of consumer credit, they hold the majority of such assets. *See* FEDERAL RESERVE 2004 REPORT ON CONSUMER CREDIT, *supra* note 2.

[12] Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904 (Jan. 13, 2004) (codified at 12 CFR pt. 34).

[13] *See* Consumer Bankers Association, CBA Strongly Supports OCC Preemption Rules, *available at* http://www.cbanet.org/news/Press%20Releases/OCC_Preemption/OCC1.htm ("The OCC rules address the need for greater uniformity and predictability for national banks operating in multiple jurisdictions nationwide.") (last visited Nov. 7, 2005).

[14] Bureau of National Affairs, *Banking – Predatory Lending: Attorney's General Activists Decry OCC Rules On Preemption of Predatory Lending Laws*, 72 U.S. LAW WEEK, 2199, 2199 (Oct. 14, 2003).

[15] *See* Complaint, New York v. First Horizon Home Loan Corp., 2004 WL 353923 (N.Y. Sup. Ct. 2004) *available at* http://www.oag.state.ny.us/press/2004/jan/Horizon5.pdf (last visited Sept. 23, 2005).

[16] *See* S.J. Res. 31, 108th Cong. (2004); S.J. Res. 32, 108th Cong. (2004); H.R. 4236, 108th Cong. (2004); and H.R. 4237, 108th Cong. (2004).

[17] This measure was directed at the DOJ because the OCC's operations are not

Attacks on the OCC's preemption policy typically derive from either objections to the OCC's legal authority to preempt state law, or reactions to a perceived laxity in agencies' consumer protection policy. This article does not seek to address the already well-debated question of whether the OCC has the legal authority to preempt state law.[18] Federal regulators will likely continue to play an important role in the future of consumer credit. Moreover, this article does not seek to attack the federal agencies as lax in their implementation or enforcement of consumer protection statutes.[19] Instead, this article considers the effectiveness of the current federal regulatory structure, identifies important defects, and proposes alternative structures that would better support the implementation of federal consumer credit laws.

Historically, the regulation of consumer credit was an issue left exclusively to the states. Beginning in the late 1960s, however, Congress began to pass laws like the Truth in Lending Act[20] that sought to protect credit customers.[21] In entering the consumer credit arena, Congress did not seek to federalize all consumer credit law, but rather invited the states to continue to legislate in the area.[22] As a result, a dual federal and state system was born. Moreover, at the federal level, Congress opted for a complex division of regulatory responsibilities. Rather than assigning responsibility for enforcement to one agency, Congress chose a primarily institutional approach by assigning responsibility according to the type of institution issuing the credit. Authority over banks was assigned to the federal bank

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funded by appropriations. *See infra* Part III. The amendment, introduced by Rep. Brad Sherman, was later withdrawn. *See* Bureau of National Affairs, *Preemption: Legislation to Bar Justice From Defending OCC Preemption Rules Withdrawn in House*, 73 U.S. LAW WEEK at 2022-23.

[18] *See* Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed The Agency's Authority And Present A Serious Threat To The Dual Banking System And Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225 (2004); Howard N. Cayne & Nancy L. Perkins, *National Bank Act Preemption: The OCC's New Rules Do Not Pose A Threat To Consumer Protection Or The Dual Banking System*, 23 ANN. REV. BANKING & FIN. L. 365 (2004).

[19] As discussed in Part II, laxity is not apparent.

[20] *See infra* Part I for a discussion of federal consumer protection statutes.

[21] The most recent example of the consumer protection trend is the Gramm-Leach-Bliley Act of 1999 (GLBA), which imposes significant privacy responsibilities on financial institutions. *See* 15 U.S.C. § 6801(a) (1999).

[22] *See* 15 U.S.C. § 1610 (2000).

regulators[23] and non-banks to the Federal Trade Commission ("FTC").[24] Congress did, however, recognize the need for uniform rulemaking and assigned that responsibility to the Federal Reserve.[25]

This complex division of regulatory responsibility, which places the bulk of responsibility for rulemaking and enforcement on bank regulators, ignored the significance of adding a consumer protection mandate to the job of bank regulators. Traditionally, a bank regulator's job is to protect the safety and soundness of bank institutions.[26] The purpose of a consumer protection agency, however, is quite different, i.e., protecting the interests of individual consumers.[27] While these two types of regulatory goals are often complementary, they also can be at odds. Moreover, the means for achieving these two goals are traditionally quite distinct. This article examines the nature and significance of the conflicting policy goals and of the differences in the means for pursuing those goals.

Part I provides a brief overview of the theoretical foundations of consumer protection versus the regulation of banks and their activities ("prudential regulation"). The important distinctions between the two goals serve as an underpinning for the remainder of the Article. Part II discusses current federal consumer protection legislation and examines the resources expended in the implementation of those regulations by the federal banking regulators.

Part III examines whether laws seeking consumer protection versus prudential regulation should be implemented in the same

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[23] *See* 15 U.S.C. § 1607(a) (2000) (describing enforcement authority over banks under TILA).

[24] *See* 15 U.S.C. § 1607(c) (2000) (describing enforcement authority over non-banks under TILA).

[25] *See* 15 U.S.C. § 1604(a) (2000) (describing rulemaking authority under TILA).

[26] The OCC website logo reads "Ensuring a Safe and Sound National Banking System for All Americans." *See* http://www.occ.treas.gov/.

[27] The mandate of the FTC's Bureau of Consumer Protection is "to protect consumers against unfair, deceptive or fraudulent practices." Guide to the FTC, http://www.ftc.gov/bcp/conline/pubs/general/guidetoftc.htm (last visited Sept. 23, 2005).

The FTC also has an antitrust division, the Bureau of Competition that "seeks to prevent anticompetitive mergers and other anticompetitive business practices in the marketplace. By protecting competition, the Bureau promotes consumers' freedom to choose goods and services in an open marketplace at a price and quality that fit their needs . . . ." *Id.*

fashion and by the same agencies. For example, prudential regulation, to the extent it is established to prevent systemic crisis, is enforced prophylactically. Although banking agencies also have broad enforcement powers, they are typically referred to as "supervisors." As supervisors, banking agencies seek to secure compliance before violations occur or become serious. This *ex ante* exercise in regulatory control relies heavily on annual examinations of individual banks. By contrast, consumer protection agencies are not supervisors but enforcement agencies. An enforcement system employs various means of investigating potential violations and a range of sanctions for violators (which in turn serves to deter future violations), but does not conduct regular examinations of firms in the industry.[28] Part III thus challenges the wisdom of combining prudential regulation and consumer protection and concludes that the combination may be inefficient and less effective than a regime in which the functions are separate.

Part IV proposes a range of alternatives to the current regulatory structure. A modest approach would address the structural flaws identified in Part III by operational changes within the existing agencies. Bolder approaches involve not only operational changes but also reassignment of regulatory responsibilities among the existing bank regulators or transfer of those responsibilities to the FTC. Each alternative could enhance the fairness and efficiency of the current system.

I. Foundations for Consumer Protection versus Prudential Regulation

In a society that relies on free-market principles, regulation intrudes upon the free market and, therefore, must be justified. Financial regulation is justified on the basis of market failures, i.e., defects in the efficient operation of the market.[29] The idea is that without government intervention financial markets cannot operate efficiently and therefore cannot achieve welfare maximization. Importantly, not all market failures are alike. Consequently, the regulatory responses to such failures must differ. Below is a brief discussion of the market failure addressed by consumer protection

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[28] *See infra* Part II.B. (discussing the method of regulation employed by the FTC and other consumer protection agencies).

[29] An inefficient market can be described as one in which at least one person can be put in a better position without putting anyone else in a worse position.

laws versus the failure addressed by traditional bank regulation, i.e., prudential regulation.

A. Consumer Protection and Asymmetric Information

The market for consumer goods and services fails to provide consumers with adequate and/or understandable information regarding the products or services that they seek. Without such information, consumers lack the freedom to obtain the maximum value for those goods and services. Professor Cartwright describes the informational deficits in the case of consumers of financial services as follows:

> First, it is extremely difficult for a consumer of financial services to identify the characteristics of a product prior to purchase. Second, financial products tend to be technically complex, and so even if the consumer received accurate and detailed information prior to purchase, it would be very difficult for that consumer to understand the information. Third, the effects of financial products are often not known until the future (a pension being a good example) . . . . Consumers are said to suffer from 'bounded rationality'. This means that 'the capacity of individuals to receive[,] store, and process information is limited'.[30]

To the extent that the rationale for consumer protection stems from the consumer's lack of information, much consumer protection legislation comes in the form of required disclosures.[31] Such disclosure seeks to correct the information asymmetry between the consumer and the service provider (here, the bank). Other types of consumer protection regulation are more positively regulatory in that they may prohibit a bank from charging a particular interest rate (e.g., usury laws) or prohibit the inclusion of a particular clause in a loan agreement (e.g., prohibitions on the inclusion of confession of judgment clauses).

B. Prudential Regulation and Systemic Risk

While consumer protection is important, it is not the driving

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[30] Peter Cartwright, *Consumer Protection in Financial Services: Putting the Law in Context, in* CONSUMER PROTECTION IN FINANCIAL SERVICES 10 (Peter Cartwright, ed., 1999).

[31] See *infra* Part II.A.

force behind bank regulation. At the heart of bank regulation beat two important concepts: the importance of banks to the macro-economy and the financial fragility of banks. Both concepts contribute to systemic instability – a market failure that is distinct from the information asymmetry discussed above.

First, banks often are described as "special" because of the unique role that they play in the macro-economy.[32] A well-known essay by E. Gerald Corrigan, a former president of the Minneapolis Federal Reserve, describes what makes banks special:

> Reduced to essentials, it would appear that . . . three characteristics . . . distinguish banks from all other classes of institutions – both financial and nonfinancial. They are: [sic]
>
> Banks offer transaction accounts.
>
> Banks are the backup source of liquidity for all other institutions.
>
> Banks are the transmission belt for monetary policy.[33]

Corrigan explained that only banks offer transaction accounts, i.e., accounts in which customers may access their funds on demand and at par.[34] If transaction accounts become unavailable to customers, the ripple effects throughout the economy are immediate. For

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[32] While the following discussion charts the traditional "banks are special" argument, it should be noted that the specialness of banks is not beyond debate. *See* e.g., Catherine England, *Are Banks Special?*, 14:2 REGULATION (Spring 1991) *available at*: http://www.cato.org/pubs/regulation/reg14n2a.html. The extent to which the specialness of banks is used to justify the cost of regulation is significant to the overall regulatory regime, but is beyond the scope of this article.

[33] E. Gerald Corrigan, *Are Banks Special?*, 1982 ANNUAL REPORT ESSAY, *available at* http://minneapolisfed.org/pubs/ar/ar1982a.cfm. For Corrigan's revisitation of his earlier essay, see E. Gerald Corrigan, *Are Banks Special? A Revisitation*, The Region, Special Issue 2000, Federal Reserve Bank of Minneapolis, *available at* http://minneapolisfed.org/pubs/region/00-03/corrigan.cfm.

[34] E. Gerald Corrigan, *Are Banks Special?*, 1982 ANNUAL REPORT ESSAY, *available at* http://minneapolisfed.org/pubs/ar/ar1982a.cfm. Corrigan does qualify this statement by noting that money market mutual funds bear very close resemblance to traditional bank accounts. *Id.*

example, if your bank refuses to honor the check you wrote to your landlord, then your landlord lacks the funds to make her mortgage payment, etc. This disrupts the smooth functioning of the economy. Further, Corrigan noted that banks serve as a backup source of liquidity, which means that when businesses lack capital, they secure bank loans to shore up their liquidity.[35]

Finally, and perhaps most importantly, Corrigan identified banks as the transmission belt for monetary policy.[36] As discussed below, banks' operations are constrained, *inter alia*, by reserve requirements that prohibit them from lending out all of the money they receive in deposits.[37] Setting the amount of the reserve at a particular level can expand or contract the money supply. In other words, if you require banks to hold greater reserves, the money supply will contract. If you allow banks to hold smaller reserves than before, the money supply expands. In this way, the Federal Reserve (the authority responsible for setting reserve ratios) can use banks to expand or contract the money supply. Similarly, to the extent that banks borrow money from the Federal Reserve, the Federal Reserve can expand or contract the money supply by lowering or raising the interest rates that it charges banks for loans.

Taken by itself, banks' special role in the economy might not justify the comprehensive regulatory regime that governs banks. Added to banks' "specialness" is the fact that banks, as institutions, are fragile. This inherent fragility stems from the fact that banks, as discussed above, maintain only fractional reserves, i.e., banks keep on hand only about one dollar for every ten dollars deposited by their customers. Banks lend the remaining nine dollars to other customers. Further adding to this fragility is the fact that a bank's assets (primarily loans) are typically illiquid, meaning that if a bank's creditor (e.g., a depositor) demands payment on a debt owed by the bank, the bank may not readily turn its assets into cash to satisfy that debt. The result is that a "bank run," a situation in which many depositors demand access to their funds at one time, can cause serious financial trouble for a bank, even a solvent one. Even worse, a run on one bank, even if caused by bad news solely regarding that bank, can prompt runs on other banks. Runs on many banks can cause problems for other businesses and result in a systemic crisis.

Therefore, the combination of the special place that banks

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[35] *See id.*

[36] *See id.*

[37] *See infra* Part I.B.

occupy in the economy and their inherent fragility creates an incentive for the government to prevent bank runs. Depression-era legislation provides the most poignant example of such government intervention. In 1933, following the tidal wave of bank runs and failures that coincided with the 1929 stock market crash, Congress created a comprehensive scheme of federal deposit insurance.[38] Since that time, and despite periods of significant bad news regarding banks, the United States has avoided contagious bank runs.

A regulatory system that attempts to protect an institution from failure is often referred to as "prudential regulation," or sometimes, "safety and soundness regulation." As will be discussed in Part II, it is important to bear in mind that prudential regulation is quite distinct from forms of regulation that seek to protect individual consumers. While bank customers may benefit from prudential regulation[39] because their deposits are guaranteed, prudential regulation seeks to protect the bank, not its customers.

II. Federal Consumer Protection Regulation and its Implementation by Federal Banking Regulators

Beginning in the 1960s, increasing complexity of financial products and the potential for resulting harm to consumers led legislators in the United States and other countries[40] to enact various types of consumer protection laws. With regard to banks, most such laws related to credit services, which are the focus of this article. Banks, however, are subject to other categories of consumer protection regulation as well. As discussed below, in addition to consumer credit compliance, banks are subject to regulations that seek to protect deposit customers or, more generally, seek to protect the privacy of customer information.[41] Moreover, the federal banking

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[38] For further discussion of Depression era bank legislation see Heidi Mandanis Schooner & Michael Taylor, *Convergence and Competition: The Case of Bank Regulation in Britain and the United States*, 20 MICH. J. OF INT'L L. 595 (1999).

[39] Bank customers may also suffer from prudential regulation to the extent that the costs of the comprehensive regulatory regime are passed onto consumers.

[40] For a discussion of the law in the United Kingdom and the European Union, see Peter Cartwright, *Consumer Protection in Financial Services: Putting the Law in Context*, *in* CONSUMER PROTECTION IN FINANCIAL SERVICES (Peter Cartwright, ed., 1999).

[41] The article is limited in its discussion to those consumer protection statutes that are aimed at addressing the problem of asymmetric information. Therefore, I

agencies have devoted substantial resources to ensuring compliance with consumer protection laws and to punishing violators of such laws.

A. Overview of Federal Consumer Protection Legislation

The most prominent example of the federal laws that regulate the extension of credit by banks is the Truth in Lending Act ("TILA"),[42] which requires lenders to disclose the terms and cost of the loan. Various amendments to TILA provide additional consumer protections. The Fair Credit Billing Act[43] requires lenders to correct promptly mistakes on credit card bills. The Home Equity Loan Consumer Protection Act of 1988[44] requires disclosure and regulates advertising of home equity loans. The Equal Credit Opportunity Act prohibits discrimination in credit transactions.[45] The Fair Credit Reporting Act[46] regulates the maintenance of credit histories by credit bureaus and their use by lenders. The Fair Credit and Charge Card Disclosure Act[47] requires issuers of credit cards to disclose information relating to interest rates and other fees. The Home Ownership and Equity Protection Act[48] mandates disclosure regarding the terms of certain mortgages. Finally, the Consumer Leasing Act requires disclosure of the terms of personal property leases.[49]

Federal laws also govern consumer protection in deposit-taking transactions. The Truth in Savings Act[50] requires depository

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have excluded discussion of statutes like the Community Reinvestment Act, Home Mortgage Disclosure Act and the Fair Housing Act. While compliance with such laws may have a positive impact on the members of affected communities, their overall purpose is to promote policies related to the fair allocation of credit and/or discrimination as opposed to problems of asymmetric information.

[42] 15 U.S.C. § 1601-93r (2000); 12 C.F.R. § 226 (2003).

[43] 15 U.S.C. § 1666 (2000).

[44] 15 U.S.C. §§ 1637a, 1665b, 1647 (2000).

[45] Equal Credit Opportunity Act, 15 U.S.C. § 1691a-c (2000).

[46] Fair Credit Reporting Act, 15 U.S.C. § 1681 (2000).

[47] Fair Credit Charge Card Disclosure Act of 1988, 15 U.S.C. § 1637 (2000).

[48] Home Ownership and Equity Protection Act of 1994, 15 U.S.C. § 1639 (1994).

[49] Consumer Leasing Act of 1976, 15 U.S.C. § 1601(b) (2000).

[50] Truth in Savings Act, 12 U.S.C. §§ 4301-4313 (2000).

institutions to make uniform disclosures regarding various terms of the deposit, including interest rates, annual percentage yields, and fees. The Expedited Funds Availability Act of 1987 requires depository institutions to make deposits available to customers within specified periods of time and to disclose their funds availability policies.[51] The Electronic Fund Transfer Act[52] establishes consumers' rights with regard to electronic funds transfer services. The Check 21 Act, effective October 28, 2004, allows for electronic check clearing and provides consumers with the right to an expedited re-credit to their account under certain circumstances.[53]

In addition, the information age has spurred interest in the privacy of consumers' financial information. In 1999, Congress passed the first federal law seeking to protect personal financial information. Title V of the Gramm-Leach-Bliley Act of 1999 ("GLBA"), provides that: "it is the policy of the Congress that each financial institution has an affirmative and continuing obligation to respect the privacy of its customers and to protect the security and confidentiality of those customers' nonpublic personal information."[54] Prior to the GLBA, Congress had restricted government access to financial information pursuant to the Right to Financial Privacy Act.[55]

B. Implementation of Consumer Protection Laws by Federal Banking Regulators

From the outset, Congress recognized that consumer credit laws would require extensive agency rulemaking in order to achieve full implementation. The difficult task was choosing the most appropriate agency to perform the task. Professor Ralph Rohner explains that the "reluctant choice was the Federal Reserve Board – partly because it was within the jurisdictional sphere of the Congressional banking committees from which the Truth in Lending Act originated, and partly because the other likely choice—the Federal Trade Commission—was then being criticized for

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[51] Expedited Funds Availability Act, 12 U.S.C. §§ 4001-4010 (2000).

[52] Electronic Fund Transfer Act, 15 U.S.C. §§ 1693, 1693a-1693r (2000).

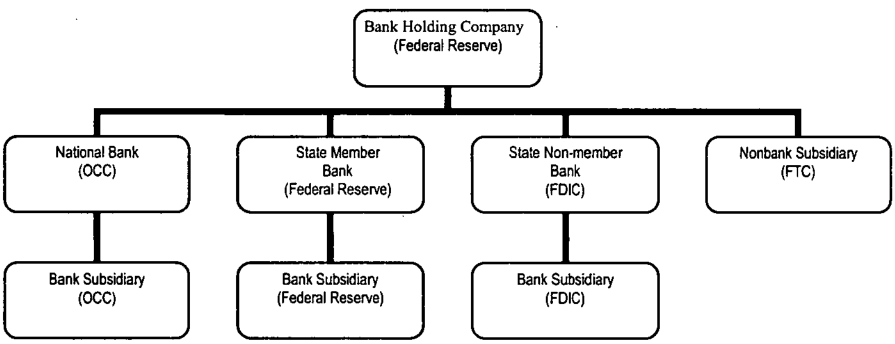
[53] Check Clearing for the 21st Century Act, 12 U.S.C. §§ 5001-5018 (2004).

[54] Gramm Leach Bliley Act, 15 U.S.C. § 6801(a) (2000).

[55] Right to Financial Privacy Act of 1978, 12 U.S.C. §§ 3401-22 (2003).

ineffectiveness."[56] With regard to the enforcement of such laws, Congress determined to spread authority among the various banking supervisory agencies with the FTC having enforcement responsibility for non-banks. Professor Rohner explains that the "rationale is that the agency which has general jurisdiction over an organization should oversee its consumer credit activities. The FTC is given enforcement authority with respect to everyone who does not fit into any one of the other neat regulatory pigeonholes."[57] The current division of responsibility for enforcement of consumer protection laws among the federal agencies and within a banking organization is provided in Figure 1.

Figure 1 – Division of Federal Consumer Protection Responsibility Within Banking Organizations



It is important to bear in mind, however, that bank regulators are in a unique position with regard to consumer protection. Part I discussed the *raison d'être* of bank regulation as prudential, i.e., protecting the safety and soundness of a bank. Bank regulators implement prudential laws through a supervisory system that relies on both onsite and offsite periodic examination,[58] as well as an

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[56] Ralph J. Rohner, *"For Lack of a National Policy on Consumer Credit . . ."; Preliminary Thoughts on the Need For Unified Federal Agency Rulemaking*, 35 BUS. LAW. 135, 136-37 (1979). Note that the Federal Reserve does not have sole rulemaking authority under Gramm-Leach-Bliley's privacy provisions. That authority is shared among the federal banking agencies, the National Credit Union Administration, the Secretary of the Treasury, the Securities and Exchange Commission, and the FTC. 15 U.S.C. § 6804(a)(1) (2000).

[57] Rohner, *supra* note 56, at 142.

[58] Bank regulators are required by statute to "conduct a full-scope, on-site

enforcement system.[59] This is quite distinct from the method of regulation employed by the FTC and other consumer protection agencies[60] that rely primarily on an enforcement regime.[61] In other words, most consumer protection agencies employ various forms of investigation and engage in other activities designed to root out compliance failures, while the banking agencies are unique in that they regularly examine individual banks. This unique quality distinguishes an enforcement regime from a supervisory regime. The supervisory regime allows banking agencies the opportunity to determine compliance of consumer protection laws *ex ante*, i.e., possibly before harm has accrued, rather than *ex post* and through investigations and administrative enforcement proceedings.

The FTC's description of what triggers action by the agency illustrates the *ex post* nature of most consumer protection regimes: "[l]etters from consumers or businesses, premerger notification filings, Congressional inquiries or articles on consumer or economic subjects may trigger FTC action."[62] Apart from the premerger notification filings,[63] all the triggering events postdate injury to the consumer. In contrast, the Federal Reserve identifies bank examinations as its "primary means of enforcing bank compliance with consumer protection laws."[64] Bank examinations, in which the

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examination" at least once every 12 months for most banks and every 18 months for certain small banks. 12 U.S.C. §§ 1820(d)(1), 1820(d)(4) (2004).

[59] 12 U.S.C. § 1818 (2000).

[60] The Securities and Exchange Commission is an example of a consumer protection agency that operates primarily as an enforcement agency but also conducts periodic examinations. The primary mission of the SEC "is to protect investors and maintain the integrity of the securities markets." *The Investor's Advocate: How the SEC Protects Investors and Maintains Market Integrity*, *available at* http://www.sec.gov/about/whatwedo.shtml (last modified Aug. 19, 2005). The operations of the SEC, however, are beyond the scope of this article because the SEC's jurisdiction is over securities products and not the traditional banking products.

[61] According to the SEC, "[c]rucial to the SEC's effectiveness is its enforcement authority. Each year the SEC brings between 400-500 civil enforcement actions against individuals and companies that break the securities laws. *Id.*

[62] Guide to the Federal Trade Commission, March (2004), *available at* http://www.ftc.gov/bcp/conline/pubs/general/guidetoftc.htm.

[63] These relate to the enforcement of laws that restrict competition. Such laws are not the subject of this article.

[64] BOARD OF GOVERNORS FOR THE FEDERAL RESERVE SYSTEM, 90th ANNUAL REPORT 63 (2003), *available at* http://www.federalreserve.gov/boarddocs/

bank's operations and control systems are scrutinized, can prevent consumer injury before it occurs. Therefore, a bank regulator's approach to consumer protection is prophylactic. Moreover, examinations can also serve the *ex post* function of uncovering existing consumer harm.

Review of the federal banking agencies' operations reveals extensive consumer compliance activities. In 2003,[65] the Federal Reserve conducted 402 compliance examinations, of which 368 were of state member banks, and 34 were of foreign banking organizations.[66] The same year, the OCC conducted 835 compliance examinations[67] and the FDIC conducted 1,610 compliance/CRA examinations and 307 compliance-only examinations.[68] In 2003, the Federal Reserve received 2,644 consumer complaints,[69] the OCC received 68,104 complaints,[70] and the FDIC received 8,026 complaints, of which 4,047 were against state-chartered banks.[71] In 2003, the federal banking agencies also initiated many administrative enforcement actions sanctioning consumer compliance violations.[72]

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rptcongress/annual03/ar03.pdf.

[65] The differences in the number of examinations reported is driven primarily by the number of banks each regulator supervises. In 2003, the Federal Reserve supervised 935 state member banks, the OCC supervised 2,001 national banks, and the FDIC supervised 4,833 state non-member banks. *See* FDIC's Statistics on Banking, *available at*: http://www2.fdic.gov/SDI/SOB/pdf/soball.pdf.

[66] FEDERAL RESERVE ANNUAL REPORT (2003), *supra* note 64, at 74.

[67] OCC FISCAL YEAR 2003 ANNUAL REPORT 12 (2003),. *available at* http://www.occ.treas.gov/annrpt/2003%20Annual%20Report.pdf.

[68] FDIC ANNUAL REPORT 15 (2003), *available at* http://www.fdic.gov/about/strategic/report/2003annualreport/ar03full.pdf.

[69] FEDERAL RESERVE ANNUAL REPORT (2003), *supra* note 64, at 74.

[70] OCC 2003 ANNUAL REPORT, *supra* note 67, at 9. Obviously, the OCC is fielding many more consumer complaints than the other agencies. The possible explanation, derived from anecdotal evidence only, is that most consumer complaints derive from credit card transactions. If that is true, the OCC, as regulator of national banks, would field most of those calls because many of the major credit card issuers are national banks.

[71] FDIC 2003 ANNUAL REPORT , *supra* note 68, at 17.

[72] *See e.g.*, In re Sedona Pac. Hous. P'ship, 2003 OCC Enf. Dec. LEXIS 163 (2003); In re Clear Lake Nat'l Bank, 2003 OCC Enf. Dec. LEXIS 113 (2003); In re Kinder, 2003 OCC Enf. Dec. LEXIS 159 (2003); In re Peoples Nat'l Bank, 2003 OCC Enf. Dec. LEXIS 2 (2003); In re First Nat'l Bank, 2003 OCC Enf. Dec LEXIS 1 (2003); In re Elderton State Bank, 2003 FDIC Enf. Dec. LEXIS 165 (2003); In re Centennial Bank, 2003 FDIC Enf. Dec. LEXIS 109 (2003); In re

These statistics demonstrate the depth of the federal bank regulators' involvement in consumer protection. Not only are bank regulators conducting regular compliance examinations, but they are also responding to a significant number of consumer complaints and initiating important enforcement proceedings. Not surprisingly, given the resources involved, the bank regulators report a high level of compliance in the industry. For 2003, the FDIC reported that only one institution received a "four" rating for compliance, and that no institution received a "five."[73] The OCC reported that 96% of national banks received a consumer compliance rating of one or two in 2003.[74] The Federal Reserve, which reports combined compliance results on behalf of all the members of the Federal Financial Institutions Examination Council ("FFIEC"),[75] also reported high rates of compliance.[76]

III. The Structural Impact of Bank Regulation on Consumer Protection

Examination of the division of consumer protection responsibilities among the federal regulators is informed by a broader issue of international debate. In recent years, a number of countries in Europe and elsewhere adopted important structural reforms to their financial regulatory regimes.[77] Generally, such reforms intended to address the blurring of boundaries that traditionally separated the three financial sectors (banking, insurance, and securities). Increasingly over the last several decades, firms in each of the three sectors have begun to offer services that are functionally equivalent. The blurring of boundaries can be traced to many roots including

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Centennial Bank, 2003 FDIC Enf. Dec. LEXIS 120 (2003); In re First Am. Bank, 2003 FDIC Enf. Dec. LEXIS 218 (2003); In re First Am. Bank, 2003 FDIC Enf. Dec. LEXIS 227 (2003).

[73] FDIC 2003 ANNUAL REPORT, *supra* note 68, at 15. On the relevant scale, one is the highest rating available and five is the lowest.

[74] OCC 2003 ANNUAL REPORT, *supra* note 67, at 9.

[75] The FFIEC is comprised of the Federal Reserve, FDIC, OCC, OTS, and NCUA.

[76] The Federal Reserve's statistics are broken down by statute. The lowest compliance rate was seventy-eight percent compliance with Regulation Z (Truth in Lending). *See* FEDERAL RESERVE ANNUAL REPORT (2003), *supra* note 64, at 69.

[77] *See generally* Heidi Mandanis Schooner & Michael Taylor, *United Kingdom and United States Responses to the Regulatory Challenges of Modern Financial Markets*, 38 TEX. INT'L L. J. 317 (2003).

conglomeration, globalization, technological advances, and growing sophistication of financial products. The blurring of boundaries means that the traditional division of regulatory authority, which once paralleled the three financial sectors, is obsolete.

Many countries have addressed this anachronism by structuring their regulatory regimes to mirror the industry. In other words, as the industry evolved towards conglomerate, one-stop-shopping financial firms, the regulatory agencies engaged in their own consolidation. These agencies are commonly referred to as "super regulators" or "unified regulators."[78] The United Kingdom's Financial Services Authority ("FSA") is a noteworthy example. The FSA is responsible for supervising financial firms of all types and for implementing both consumer protection and prudential regulations.

Another approach to reform divides regulatory responsibility by regulatory goal (or, as discussed in Part I, by type of market failure). This approach is sometimes referred to as a "goals-oriented" approach to regulatory structure.[79] A goals-oriented regime rejects both the traditional division of regulatory responsibility by type of firm (i.e., a bank versus an insurance company versus an investment bank) and the consolidated approach of the super regulator. Instead, under a goals-oriented regime, regulatory responsibility is divided by regulatory goal, e.g., consumer protection versus prudential regulation. The Australian regulatory scheme exemplifies the goals-based approach. In Australia, one agency is responsible for consumer protection for all financial products regardless of whether the products are sold by a bank or another financial institution.[80] A different agency is responsible for prudential regulation for all bank and non-bank financial services firms.[81] Obviously, the goals-oriented approach utilizes a greater number of regulatory agencies than the super-regulator approach. Although the goals-oriented approach subjects financial firms to more than one financial regulator, each regulator is responsible for implementing a single

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[78] For a discussion of integrated regulators among OECD countries, see Heidi Mandanis Schooner, *The Role of Central Banks in Bank Supervision in the United States and the United Kingdom*, 28 BROOKLYN J. OF INT'L L. 411, 423 (2003).

[79] Bert Ely, *Functional Regulation Flunks: It Disregards Category Blurring*, AM. BANKER, Feb. 21, 1997, at 4.

[80] The agency is the Australian Securities and Investments Commission ("ASIC").

[81] The agency is the Australian Prudential Regulatory Authority ("APRA"). The ASIC, however, is responsible for regulating securities firms.

regulatory goal.

The United States has not participated in the structural reform that has been popular abroad. Instead, the U.S. system remains largely institutional.[82] In general, this means that banks are regulated by bank regulators, securities firms are regulated by the Securities and Exchange Commission, and insurance firms are regulated by state insurance commissioners.[83] With regard to consumer protection issues, the institutional approach means that the federal bank regulators, rather than other consumer protection agencies, are also responsible for banks' compliance with consumer protection.[84] Several other federal regulators may also have overlapping jurisdiction, such as the FTC, the DOJ, and the U.S. Department of Housing and Urban Development ("HUD").[85]

Given the United States' failure to address the structural issues that have provoked widespread reform abroad, it is appropriate to consider the overall approach to the structure of financial regulation in this country.[86] This article, however, focuses on only one piece of the puzzle: the implications of the current regulatory structure for the implementation of federal laws that seek to protect consumers of credit. In particular, this Part considers whether it is appropriate to grant consumer protection and prudential regulation authority to a single regulator (following the "super regulator" concept) or whether it is preferable to separate the functions into distinct agencies (relying on the goals-oriented approach).

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[82] Although the Gramm-Leach-Bliley Act of 1999 purported to adopt a "functional" as opposed to institutional approach to regulation, in reality the U.S. system remains largely institutional. For an extensive discussion on this point, see Heidi Mandanis Schooner, *Functional Regulation: The Securitization of Banking Law, in* FINANCIAL MODERNIZATION AFTER GRAMM-LEACH-BLILEY 189 (Patricia A. McCoy ed., 2002).

[83] For a more detailed discussion of the division of regulatory responsibilities, see Heidi Mandanis Schooner, *Functional Regulation: The Securitization of Banking Law, in* FINANCIAL MODERNIZATION AFTER GRAMM-LEACH-BLILEY 189 (Patricia A. McCoy ed., 2002).

[84] *See infra* Part II.B.

[85] *See generally* GAO, Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending, GAO-04-280 (Jan. 2004).

[86] *See* Schooner & Taylor, *supra* note 77; Heidi Mandanis Schooner, *Regulating Risk Not Function*, 66 U. CIN. L. R. 441 (1998).

A. Advantages of Federal Bank Regulators' Role in Consumer Protection

The most important advantage of a unified regulatory regime (e.g., the U.K.'s FSA and others around the world) is that the unified or "super" regulator has the ability to take advantage of the synergies between prudential regulation and consumer protection. This is also true with regard to bank regulators' involvement in consumer protection. As discussed below, bank regulators have a keen interest in a bank's management practices because such practices have strong implications for the bank's safety and soundness. Experience with a bank's management practices also gives bank regulators access to potential consumer compliance failures. This overlap forms the strongest case for assigning consumer protection responsibilities to bank regulators.

i. Synergies in Consumer Protection and Prudential Regulation

The primary argument in favor of vesting federal bank regulators with responsibility for implementing consumer protection laws is the inherent overlap between consumer protection and prudential regulation. For example, a bank that is involved in predatory lending practices not only harms consumers by charging undisclosed fees, but also may threaten the bank's financial condition by systematically making overly risky loans. The overlapping occurrence of consumer protection and prudential problems is likely because often both problems stem from poor management practices.[87] Bank regulators are acutely aware of the importance of internal systems for managing banks. Scrutiny of a bank's management and internal controls is an essential part of safety and soundness supervision.[88] Quite simply, if bank regulators are already monitoring

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[87] In her comprehensive analysis of the exportation doctrine, Professor Schiltz summarizes two OCC enforcement actions in which "the OCC stressed that the banks' failure to properly supervise their payday lender partners resulted in both safety and soundness concerns and violations of federal consumer protection statutes." Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 594 (2004).

[88] Banks are examined in accordance with the "CAMELS" rating system. CAMELS is an acronym for the six categories: Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. *See* Meeting Notice, 61 Fed. Reg. 67,021 (Dec. 19, 1996).

internal controls for safety and soundness reasons, why not also monitor for consumer abuse?

ii. Synergies in Consumer Protection and Banking Agencies' Competition Responsibilities

In addition to the overlap with safety and soundness concerns, the bank regulators' role in protecting consumers overlaps with the agencies' antitrust responsibilities. While non-bank firms are subject to both the Sherman Act[89] and the Clayton Act,[90] combinations by banks are governed under the Bank Merger Act[91] and the Bank Holding Company Act.[92] Therefore, the federal banking agencies, rather than the FTC, have the responsibility for approving bank mergers.[93] Timothy Muris, former FTC chairman, noted the synergies between competition and consumer protection policy:

> There may be multiple ways to ensure that competition and consumer protection policy work together. . . .The Federal Trade Commission's experience suggests several synergies from this arrangement. First, the consumer protection function can provide useful insights about how to execute competition policy. . . . [E]nforcement of laws concerning advertising and marketing practices has improved the Commission's understanding of how markets operate. For example, the development of the agency's health care antitrust agenda benefited from what we learned about the manner in which truthful advertising informs consumer choice.
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> The more important form of osmosis runs from competition to consumer protection policy. Because of its antitrust responsibilities, the agency is well aware that robust

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89 Sherman Act, 15 U.S.C. §§ 1-2 (2000).

90 Clayton Act, 15 U.S.C. § 18 (2000).

91 Bank Merger Act, 12 U.S.C. § 1828(c) (2004).

92 Bank Holding Company Act of 1956, 12 U.S.C. § 1842(a), (c) (2001).

93 *But see* 12 U.S.C. § 1828(c)(4), (6)-(7) (noting that once approved by the appropriate federal banking agency, the DOJ conducts a second review).

> competition is the best, single means to protect consumers. Rivalry among incumbent producers, and the threat and fact of entry from new suppliers, fuels the contest to satisfy consumer needs.[94]

In the same way, the banking agencies' role in competition policy may benefit from their role in consumer protection. For example, fostering a competitive lending market may protect consumers by pushing out unscrupulous firms. In this way, competition policy enhances consumer protection.

iii. Systemic Implications of Consumer Abuse

Even in instances in which consumer protection violations do not implicate a bank's solvency, such violations will adversely affect the institution's reputation. The Basel Committee on Bank Supervision emphasized the importance of the compliance function, stating that "[c]ompliance with laws, rules and standards helps to maintain the bank's reputation with, and thus meet the expectations of, its customers, the markets and society as a whole."[95] The Basel Committee added that "a bank's reputation is closely connected with its adherence to principles of integrity and fair dealing."[96] The public's perception of a bank's integrity is important because the loss of confidence in one bank can cause the reputation of all banks to suffer. This, in turn, can create systemic crisis in the banking industry, because the loss of confidence in banks could lead to a run on deposits.

The OCC recently identified three types of credit card practices that "may entail unfair or deceptive acts or practices and may expose a bank to compliance and reputation risks."[97] First, the OCC identified "up to" marketing, a practice in which a credit card issuer advertises credit limits "up to" a maximum amount but rarely

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[94] Timothy J. Muris, *The Federal Trade Commission and the Future Development of U.S. Consumer Protection Policy*, GEORGE MASON U. L. & ECON. RESEARCH PAPER NO. 04-19, at 18-20 (2004), *available at* http://ssrn.com/abstract_id=545182.

[95] THE COMPLIANCE FUNCTION IN BANKS 1 (Bank for Int'l Settlements, Basel Comm. on Banking Supervision, Consultative Document, 2003), *available at* http://www.bis.org/publ/bcbs103.pdf.

[96] *Id.*

[97] Credit Card Practices, OCC Advisory Letter AL 2004-10, (Sept. 14, 2004), *available at* http://www.occ.treas.gov/ftp/advisory/2004-10.txt.

extends that amount.[98] Second, the OCC described the use of promotional rates, such as reduced annual percentage rates, in cases in which the application of the low rates is actually restricted.[99] Third, the OCC identified situations in which credit card issuers "re-price," or increase the charges to consumer accounts without proper disclosure.[100] According to the OCC, all of these practices can, among other things, "damage a bank's good name, and are contrary to the standards under which the OCC expects national banks to operate."[101]

iv. Cost of Supervision

Are the costs of an *ex ante* system of compliance justifiable? One answer is that the costs are not so great. Bank regulators, constrained by their staff and budgets, demonstrate great sensitivity to the costliness of traditional examinations. For example, the FDIC and other bank regulators traditionally took a transaction-based approach to examining banks for compliance with consumer protection rules. Under this approach, bank examiners would review actual bank transactions to determine compliance. Obviously, this process is labor intensive and therefore expensive. In response to the proliferation of new financial products combined with an increasing burden with respect to implementing new federal laws, the FDIC changed its approach. Today, the FDIC takes a risk-based approach to compliance examinations[102] under which the extent of transaction testing is determined by an assessment of the risk of non-compliance by the institution. The FDIC explained that its new examination technique:

> [A]ssesses how well a bank identifies emerging risks, remains current on changes to laws and regulations, ensures

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[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] It appears that the OCC has also adopted a risk-based approach. The OCC reports that it "supervises national banks' compliance with consumer protection laws and anti-predatory lending standards through programs of ongoing supervision that are tailored to the size, complexity and risk profile of different types of banks . . . ." OCC, PREEMPTION FINAL RULE QUESTIONS AND ANSWERS 10 (Jan. 7, 2004), *available at* http://www.occ.treas.gov/Consumer/2004-3dPreemptionQNAs.pdf.

> that employees understand compliance responsibilities, incorporates compliance into business operations, reviews operations to ensure compliance, and takes effective corrective action to address violations of law or regulation and weaknesses in the compliance program. Based on an assessment of the quality of the compliance management system, compliance examiners use transaction testing to pinpoint regulatory areas for further evaluation. The intensity and extent of transaction testing depend on a bank's risk profile.[103]

Another way to view the question of cost is to consider whether adding consumer compliance to the list of areas covered by an examination really adds much more to what an examiner would have to do when conducting a prudential exam. Perhaps the most compelling factor is that prudential exams involve a great deal of analysis of a bank's management systems and controls.[104] As discussed above, compliance exams focus on the same practices. To the extent that the competency of management is critical to both regulatory goals, it seems highly efficient to task the same agency with both responsibilities.

v. Preventing Consumer Abuse

Bank regulators rarely miss an opportunity to report the scarce evidence of consumer protection violations among banks and their subsidiaries.[105] It is not a stretch to conclude that the supervisory approach to consumer compliance has succeeded in preventing banking institutions from committing fraud. While an enforcement regime is an alternative mechanism for addressing consumer abuse, the fundamental problem with an enforcement regime is that it operates *ex post*. In theory, the enforcement regime works to compensate victims of abuse, but in practice, damages rarely provide adequate compensation for the injury suffered. Moreover, enforcement regimes generally do not seek to address every harm. Rather, an enforcement regime relies on selective enforcement to deter would-be offenders.

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[103] FDIC, *Compliance Examinations: A Change in Focus*, SUPERVISORY INSIGHTS, Summer 2004, at 14, *available at* http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/sisum04.pdf.

[104] *See supra* note 88 (discussing the CAMELS rating system).

[105] *See supra* Part II.B.

vi. Agencies' Expertise and Rulemaking

Ensuring compliance with existing consumer protection laws and regulations is not the only responsibility of a banking agency. As discussed in Part II, consumer protection statutes require implementation through agency rulemaking. The Federal Reserve is responsible for Regulation Z, which implements both the Truth-in-Lending Act and its amendments.[106] Responsibility for rulemaking under GLBA's privacy provisions is divided among all the federal banking regulators and other agencies.[107] More recently, the OCC engaged in a significant and controversial rulemaking process that not only staked out the OCC's position on the preemption of state consumer protection laws, but also clarified the agency's policies on predatory lending.[108] The banking agencies' expertise with bank operations makes them well-suited to create regulations that implement Congressional intent.

B. Disadvantages of Federal Bank Regulators' Role in Consumer Protection

The advantages of tasking federal bank regulators with consumer protection responsibilities emphasize the synergies between prudential bank regulation and consumer protection. The disadvantages of such a combination of regulatory responsibilities are found in the differences between the two regulatory goals. The discussion below illustrates that while consumer protection and prudential regulation may overlap, the differences between the two are quite significant. The theoretical analysis of these differences suggests the need for some empirical study. Such study might show that the current system costs too much and achieves suboptimal consumer protection.

i. Conflict Between Consumer Protection and Prudential Regulation

The prime disadvantage of combining consumer protection with safety and soundness regulation is that such a regime fails to appreciate the fundamental differences between these two regulatory

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[106] 12 C.F.R. § 226 (2005).

[107] 15 U.S.C. § 6801(a) (2001).

[108] Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1,904 (Jan. 13, 2004) (to be codified at 12 C.F.R. pts. 7 & 34).

goals.

Decades ago, in *Gulf Federal*,[109] the Fifth Circuit considered the propriety of the Federal Home Loan Bank Board's (the "Board")[110] use of its cease and desist authority to "enter the consumer protection field."[111] A federal banking agency's cease and desist authority is typically triggered by the agency's finding of an "unsafe or unsound" banking practice.[112] The Fifth Circuit considered whether Gulf Federal's failure to compute and charge interest in accordance with the loan documents in over 400 loans was unsafe or unsound. While the opinion centered on what Congress meant by the phrase "unsafe or unsound,"[113] the court made several interesting observations regarding the difference between prudential regulation and consumer protection.

The Fifth Circuit found that "unsafe or unsound" practices were limited to "practices with a reasonably direct effect on an association's financial soundness."[114] Given that constraint, the court found that Gulf Federal's overcharging of interest did not constitute a financial risk to the institution. The court explained that:

> the only risks the Board has identified are Gulf Federal's potential liability to repay overcharged interest, and an undifferentiated 'loss of public confidence' in the bona fides of Gulf Federal's operations. Such potential 'risks' bear only the most remote relationship to Gulf Federal's financial integrity and the government's insurance risk . . . . While the potential liability for repayment of the difference in interest charges could lead to a minor financial loss for Gulf Federal, the Board's order would consummate this 'risk' immediately by forcing Gulf Federal to repay the interest forthwith, whether or not it is owed. We fail to see

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[109] Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish v. Fed. Home Loan Bank, 651 F.2d 259 (5th Cir. 1981).

[110] The Board was the federal regulator of savings and loan associations prior to the creation of the Office of Thrift Supervision in 1989.

[111] Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish, 651 F.2d at 261.

[112] 12. U.S.C. §1818(b) (2000).

[113] For a discussion of the meaning of "unsafe or unsound banking practices," see Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175 (1995).

[114] Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish, 651 F.2d at 264.

> how the Board can safeguard Gulf Federal's finances by making definite and immediate an injury which is, at worst, contingent and remote.[115]

Gulf Federal offers an example of an instance in which the goals of consumer protection and prudential regulation are at odds. The court noted that Gulf Federal's financial condition might actually suffer if the Board sought to protect the contract rights of Gulf Federal's customers. While this finding might shock common sensibilities, it is consistent with avoiding systemic instability which is the market failure addressed by bank regulation. The purpose of the regulatory scheme is ultimately tied to the macro financial system and, accordingly, is not focused on individual harm.[116] Instead, the prudential regulatory system is concerned with the financial soundness of individual institutions only because of the potential for contagion. In other words, bank regulators care about the financial soundness of small banks (i.e., banks that on their own are not systemically important) only to the extent that their financial status might affect other banks and, ultimately, the whole system.

ii. Supervision Versus Enforcement

Traditional consumer protection is conducted by law enforcement agencies rather than supervisors. Supervisory schemes, which rely on *ex ante* examinations, are both costly and intrusive. Therefore, a political system that rankles at government intrusion and government spending should seek strong justification for the implementation of supervisory regimes. Even in such a political environment, a supervisory regime will be favored in cases in which noncompliance with applicable law will lead to harm which is difficult to compensate or is otherwise intolerable. A good example is the federal scheme for approval of new drugs. Relying on an *ex post* enforcement system for administering drug laws would work to punish companies that distribute harmful drugs. The obvious problem is that the resulting harm to consumers' health may be inadequately compensated through traditional damages and may offend our sense of justice. Therefore, the Food and Drug Administration reviews new drugs prior to their release to the public.[117] The regulatory system for

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115 *Id.*

116 *See infra* Part I.B.

117 The need for a prophylactic system of regulating new drugs was illuminated by a consumer protection crisis: "[i]n 1937, a public health disaster

the approval of new drugs seeks not only to punish for non-compliance, but also to prevent harm from occurring.

Traditional prudential bank regulation operates under a similar premise. As discussed in Part I, the prudential regime that applies to banks serves to prevent systemic crisis. Bank failures that would occur without government intervention are considered intolerable because bank failures can cause system-wide irreparable harm.

Not all consumer protection regimes require an *ex ante* approach. The question here is whether traditional banking services do. With regard to deposit taking, the prudential side of bank regulation has a forceful consumer protection effect. The Supreme Court has said that Congress established deposit insurance for the purpose of "ensuring that a deposit of 'hard earnings' entrusted by individuals to a bank would not lead to a tangible loss in the event of a bank failure."[118] Given the existence of deposit insurance, however, it is not clear that consumers need costly *ex ante* protection from fraud by deposit takers. If a bank fails to disclose the minimum balance requirement on a checking account, the depositor can be adequately compensated through damages.

Moreover, the analysis with regard to consumer credit fails to yield a strong justification for an *ex ante* system. If a bank charges excessive fees, the borrower can be compensated with damages. If this were not true, then the laws that apply to non-bank lenders would be in need of reform. In other words, lenders that are not banks or subsidiaries of banks are not subject to a supervisory regime. Rather, they are regulated under *ex post* enforcement regime implemented by

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tragically drove home the need for a stronger federal law. Sulfanilamide, the first 'wonder drug' and a popular and effective treatment for diseases like strep throat and gonorrhea, was formulated into an Elixir of Sulfanilamide and marketed for use in children. But the liquid formulation contained a poison, the same chemical used in antifreeze, and it killed 107 people, most of them children. The earlier law did not require the drug's manufacturer to test the formulation for safety before it was sold . . . . Congress corrected this weakness in the law the next year when it passed the Federal Food, Drug, and Cosmetic Act. This law, for the first time, required companies to prove the safety of new drugs before putting them on the market." Overview of the FDA, http://www.fda.gov/oc/opacom/fda101/sld013.html (last visited Nov. 4, 2005).

[118] Fed. Deposit Ins. Corp. v. Phila. Gear Corp., 476 U.S. 426, 433 (1986). The justification for prudential regulation tells us that the real purpose behind deposit insurance is that it avoids systemic instability by protecting banks from deposit runs. The fact that individual consumers are protected is an external good, but it is not the goal of the scheme. *See infra* Part I.B.

the FTC.[119] If such a system is good enough for non-bank lenders, it is hard to argue that the same system is not good enough for bank lenders.

iii. Agency Independence and Capture

Consideration of an agency's independence is important to structuring any regulatory regime. Independent agencies differ from other agencies in that the President may remove the head of the agency for cause only (as opposed to at will).[120] But the removal feature is just one aspect of independence. The question of independence ranges from the extent to which lawmakers have delegated substantive legal authority, to the governing structure of the agency, to the agency's funding. With regard to regulators of financial markets, the issue of political independence is often raised in the context of the structuring of a central bank.[121] Monetary policy is seen as a function best served without expedient political influences.[122] For that reason, the United States' Federal Reserve System serves as a model of an independent central bank.[123]

Although rarely discussed in detail, the question of independence is also important to the structure of prudential regulation.[124] Some have argued, for example, that lack of agency independence was a contributing factor in the 1980s savings and loan crisis.[125] While the federal bank regulators enjoy many features of independence, the OCC lacks the independent status of the FDIC and

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[119] *See infra* Part II.B.

[120] *See generally* Geoffrey P. Miller, *Introduction: The Debate Over Independent Agencies in Light of Empirical Evidence*, 1988 DUKE L. J. 215 (1988).

[121] *See generally* Michael Taylor, *Central Bank Independence: The Policy Background*, *in* BLACKSTONE'S GUIDE TO THE BANK OF ENGLAND ACT 10 (1998); Geoffrey Miller, *An Interest-group Theory of Central Bank Independence*, 27 J. LEGAL STUD. 433 (1998).

[122] *See* Schooner, *supra* note 78 at 434 (discussing international support for central bank independence).

[123] *See id.* at 435 (discussing the independence of the Federal Reserve).

[124] For an extensive discussion, see Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 WM. & MARY L. REV. 503 (2000).

[125] *See* Rosa Maria Lastra, *Central Banking and Banking Regulation*, 55 LONDON SCH. ECON. 329 (1996) (in which Lastra contends "that the US Savings and Loan Associations' debacle might have been prevented or at least mitigated had non-political considerations more firmly prevailed in their supervision").

Federal Reserve.[126] Unlike the other federal banking regulators, the OCC resides within the executive branch as a bureau of the United States Treasury. Still, the OCC enjoys some characteristics of independence that might not otherwise be found in an executive agency. The Comptroller is appointed by the President, with the advice and consent of the Senate, for a five-year term.[127] The Comptroller may be removed by the President "upon reasons to be communicated by [the President] to the Senate."[128] The Secretary of Treasury is prohibited from delaying or preventing the issuance of any OCC rule.[129] The OCC enjoys certain fiscal independence in that it does not rely on appropriations to fund its operations. Rather, its operations are funded by assessments on national banks and on revenue from its investment income.[130]

While the broad question of prudential regulator independence is beyond the scope of the present discussion, the OCC's link to the executive branch has undoubtedly inflamed the already heated debate over the OCC's position on preemption of state

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[126] The FDIC and the Federal Reserve are independent agencies. The Board of Directors of the FDIC is comprised of five members: the Comptroller of the Currency, the Director of the OTS, and three members appointed by the President, with advice and consent of the Senate. 12 U.S.C. § 1812(a)(1) (2000). No more than three members of the Board may be members of the same political party. 12 U.S.C. § 1812(a)(2) (2000). Board members serve a six year term. 12 U.S.C. § 1812(c)(1) (2000). The President appoints the Chairperson for a term of five years. 12 U.S.C. § 1812(b)(1) (2000). The Board of Governors of the Federal Reserve System is comprised of seven governors. 12 U.S.C. § 241 (2000). Each is appointed by the President with advice and consent of the Senate for a 14 year term. *Id.* "In selecting the members of the Board . . . the President shall have due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, and geographical divisions of the country." *Id.* The President, with the consent of the Senate, chooses the Chairman and the Vice Chairman from among the board members for a term of four years. 12 U.S.C. § 242 (2000). Both agencies enjoy fiscal independence. The FDIC's operations are funded by premiums paid for deposit insurance and earnings on its U.S. Treasury securities. The Federal Reserve's operations are funded primarily through earnings on its U.S. Treasury securities but also from fees paid by banks for services provided by the Federal Reserve (e.g., check clearing, loans).

[127] 12 U.S.C. § 2 (2000).

[128] *Id.*

[129] This provision was added in 1994 and states that "[t]he Secretary of the Treasury may not delay or prevent the issuance of any rule or the promulgation of any regulation by the Comptroller of the Currency." 12 U.S.C. § 1 (2000).

[130] About the OCC, http://www.occ.treas.gov/aboutocc.htm (last visited Nov. 3, 2005).

law.[131] When the OCC engages in rulemaking, despite its statutory independence from the Secretary of the Treasury, the rule is susceptible to being labeled "the Bush Administration's" rule.[132] This label has a tendency to infuse the atmosphere with political cynicism that might not be as palpable if an independent agency issued the rule. This cynicism remains even though the OCC's position on preemption seems relatively consistent with its approach to similarly heated legal issues during the Clinton Administration.[133] In other words, the OCC has taken aggressive legal positions promoting the value of the national charter across administrations. Despite this, the OCC's link to the executive branch gives commentators the opportunity to imply[134] that the OCC's position is nothing more than an extension of a political platform.

Closely related to the question of independence is that of regulatory capture. While agency independence tends to focus on the influence, in particular, of the President, regulatory capture involves the influence of the regulated over the regulator. The OCC suffers particularly when it is under scrutiny for capture because the OCC's operations are funded by the banks that the OCC supervises. The simple notion that "one should not bite the hand that feeds you" leads to a cynical view of the OCC's seriousness about combating consumer fraud. This cynicism persists despite several high profile enforcement actions addressing consumer compliance issues and the OCC's quite vocal commitment to combating fraud.

iv. Inefficiency

One reason for reassigning consumer protection

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[131] *See supra* notes 12 - 17 and accompanying text.

[132] *See* James C. McKinley, Jr., *Spitzer Files Suit Opposing Effort by U.S. to Limit Bank Oversight*, N.Y. TIMES (January 17, 2004) at C1; *Spitzer Charges Feds Conspiring to Shield Banks Against State Consumer Protection Laws* (June 17, 2005), *available at* http://www.consumeraffairs.com/news04/2005/occ_spitzer2.html; *Spitzer Taking Aim At Preemption of Bank Rules* (January 26, 2004), *available at* http://www.keepmedia.com/ShowItemDetails.do?item_id=534934&extID=10026.

[133] *See* NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co., 513 U.S. 251 (1995) (OCC advocated a broad interpretation of the "business of banking" under the National Bank Act).

[134] *See* James C. McKinley Jr., *Spitzer Files Suit Opposing Effort By U.S. to Limit Bank Oversight*, N.Y. TIMES (Jan. 17, 2004), at C1 (referencing the OCC's rule on preemption as a Bush Administration rule).

responsibilities among the federal regulators is that the current system is unnecessarily complex. No one designing a consumer protection regime from scratch would conceive of establishing *eight*[135] separate federal agencies, not to mention the fifty states *and* the SEC (whose primary purpose is to promote consumer protection in the securities markets) *and* the CFTC (whose primary purpose is to promote consumer protection in the commodities markets). Without an empirical study, one cannot qualify the costs of such complexity. Yet common sense suggests that the costs are excessive.

Consider a consumer with a complaint about a loan obtained from a lender that is a subsidiary of a national bank. Unless the consumer is an expert in bank regulation, there is little chance that the consumer will call the correct federal regulator on the first try. Even an expert would labor to uncover several not-so-obvious facts about the lender before she would be able to determine the appropriate federal authority. First, the consumer would have to determine whether the lender is the subsidiary of a bank. If so, then one of the federal bank regulators would be the appropriate authority. If not, then the appropriate authority is the FTC. Next, if the lender is the subsidiary of a bank, then the consumer must determine whether the bank holds a state or federal charter. If the bank holds a state charter, the consumer must then determine whether the state bank is a member of the Federal Reserve System. All this, just so the consumer can place the first call!

Another aspect of the cost issue is the efficiency of combining prudential and consumer protection responsibilities in the same agency because both regulatory goals involve essentially an intense review of management practices. While the observation is true, it is and argument that (as law professors love to tell their first year students) proves too much. Compliance with almost any regulatory regime is reflective of management practices. Strict application of this reasoning to bank regulators would require them to implement all government regulation that applies to banks. Under such a regime, bank regulators would even implement labor laws.

v. Systemic Implications of Consumer Abuse

The classical architecture of many bank headquarters speaks volumes of the importance of a bank's image. A bank's reputation for

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[135] The eight federal agencies include the Federal Reserve, FDIC, OCC, Office of Thrift Supervision ("OTS"), National Credit Union Administration ("NCUA"), FTC, HUD, and DOJ.

integrity and stability is a considerable asset. No small part of the justification for the separation between commercial and investment banking in the 1930s was that a bank's involvement in the stock market might damage the bank's reputation and spur a run on deposits.[136] Certainly, in the absence of deposit insurance, negative information regarding the solvency of one bank can be highly detrimental and can cause contagious runs on deposits.

Does public knowledge of consumer protection abuses have this sort of systemic impact? Perhaps it should. Consumer protection violations stem inherently from management failure or fraud. The same type of behavior is often at the root of bank insolvency.[137] Still, anecdotal evidence suggests a very jaded public. A subsidiary of Citigroup recently agreed to pay up to $70 million in penalties in connection with consumer protection violations in subprime lending programs.[138] The *lack* of public outcry against the management of Citigroup, or attacks on its reputation, was deafening. Perhaps the public recognizes that the misdeeds of one subsidiary do not implicate the good work of related companies. Perhaps the public is apathetic because of extensive federal deposit insurance. Perhaps the public does not read the newspaper. Whatever the reason, it appears that the question of harm to reputation is complex.

Many events, after all, negatively impact reputation. Recently, Boeing fired its chief executive, Harry Stonecipher, after learning that Stonecipher was having a consensual, extramarital affair with a Boeing employee. Apparently, Boeing's board was concerned, among other things, that its government customers are "uncomfortable about doing business with notorious philanderers."[139] Reputation is everything. But, not every harm to a business' reputation poses a safety and soundness concern. If Stonecipher had been a chief executive of Wachovia Corporation, would the OCC

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136 The United States Supreme Court explained that "Congress feared that the promotional needs of investment banking might lead commercial banks to lend their reputation for prudence and restraint to the enterprise of selling particular stocks and securities, and that this could not be done without that reputation being undercut by the risks necessarily incident to the investment banking business." Inv. Co. Inst. v. Camp, 401 U.S. 617, 632 (1971).

137 FDIC, 1 HISTORY OF THE EIGHTIES – LESSONS FOR THE FUTURE 33-34 (1997), *available at* http://www.fdic.gov/bank/historical/history/3_85.pdf.

138 Mitchell Pacelle, *Citigroup Will Pay $70 Million to Settle Fed's Lending Charges*, WALL ST. J., May 28, 2004, at C3.

139 Steven Pearlstein, *Ethics Pedestal Assures Some Hard Falls*, WASH. POST, Mar. 9, 2005, at E1.

find that his extramarital affair constituted an "unsafe or unsound banking practice" because it would have the potential to harm the reputation of the bank and thereby implicate the bank's financial stability? Doubtful. So too, it is doubtful that the reputation risk associated with the vast majority of consumer fraud implicates a bank's safety and soundness.

At the very least, the potential for reputation harm should not be used to justify the structure of a regulatory regime without compelling empirical evidence. In this context, such an empirical study would examine whether publicity of consumer fraud or other abuse by one institution (as opposed to news of an institution's insolvency) causes a run on or boycott of that institution and if, in turn, the news causes runs on or boycotts of other financial institutions.

vi. Agencies' Expertise and Rulemaking

Bank regulators' consumer protection responsibilities are not limited to supervision and enforcement. Bank regulators are also responsible for interpreting consumer protection statutes and, in some cases, issuing formal rules that implement Congress' intent.[140] As discussed above, bank regulators' expertise with bank operations is valuable to the rulemaking process in that bank regulators better understand the practical impact of new rules on the business of banking.

On the other hand, bank regulators do not embody any particular expertise in consumer protection and probably have not been given much incentive to develop it.[141] Consumer protection

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[140] *See infra* Part II.B.

[141] Julie Williams, First Senior Deputy Comptroller and Chief Counsel, is a frequent critic of current consumer compliance disclosure. She notes that "disclosure is at the heart of our system of consumer protection. Lately, however, there has been much criticism of the state of credit card disclosures and marketing practices. Clearly, there is room for improvement." *Examining the Current Legal and Regulatory Requirements and Industry Practices for Credit Card Issuers With Respect to Consumer Disclosures and Marketing Efforts: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 109th Cong. 2 (2005) (Statement of Julie L. Williams, Acting Comptroller of the Currency), *available at* http://www.occ.treas.gov/ftp/release/2005-49a.pdf). Williams is pushing for far greater reliance on consumer testing to determine how to effectively convey useful information to the consumers and frequently cites to the Food and Drug Administration's Nutrition Facts as and example of successful consumer disclosure. *Id.*

laws, as discussed in Part I, have a different purpose from prudential laws. Because consumer protection laws address asymmetric information, such laws often mandate disclosure. Prudential laws, however, have not traditionally relied on disclosure but rather have sought to regulate positively the business of banking. In fact, prudential regulators, as opposed to consumer protection agencies, have traditionally operated under a system that relies on a great deal of secrecy.[142] It was not until 1989 that bank regulators were required to publicize their administrative enforcement proceedings and bank regulators still do not disclose the results of bank examinations.[143] Prudential regulation's focus on preventing bank failure is inconsistent with disclosing bad news about banks.

It is therefore possible that: (1) bank regulators lack expertise in consumer protection rules that require disclosure, and (2) other agencies, like the FTC, would be better at writing those sorts of rules. Indeed, when TILA was enacted, Congress only reluctantly chose the Federal Reserve as the rulemaking agency. While the FTC was the more logical choice, it lacked the reputation for effectiveness to support the accumulation of new regulatory responsibilities.[144] Today, the FTC suffers no such lack of reputation. With respect to the FTC's relative lack of experience with bank operations, that deficit can certainly be replenished through the notice and comment process.[145] Banks, unlike consumers, do not suffer a collective action problem. Banks have the resources necessary to inform any regulator of their particular concerns with regard to new rules. And, the fact that a non-bank regulator, like the FTC, might be less responsive to such concerns than a bank regulator is not necessarily bad for consumers.

IV. Structural Reform of Federal Consumer Protection Laws

Part III suggested that, while there are benefits to combining

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[142] *See* Heidi Mandanis Schooner, *The Secrets of Bank Regulation: A Reply to Professor Cohen*, 6 THE GREEN BAG 2d 389 (2003).

[143] *See* Meeting Notice, 61 Fed. Reg. 67,021 (Dec. 19, 1996).The CAMELS rating is, however, disclosed to the board of directors of the bank under examination. *Id.*

[144] *See* Rohner, *supra* note 56, at 136-37.

[145] *See* 5 U.S.C. § 553 (describing the procedures for notice and comment in agency rulemaking).

prudential regulation and consumer protection, serious doubt remains as to whether it is the best arrangement. Assuming that an alternative arrangement holds the potential for improved consumer protection, this Part considers a range of alternatives that would realize the benefits of separating the two regulatory functions.

A recent U.S. Government Accountability Office ("GAO")[146] report recommended that Congress consider expanding the Federal Reserve's role in combating predatory lending. The GAO found that the Federal Reserve's lack of supervisory authority over non-bank subsidiaries of bank holding companies presented a weakness. Specifically, the GAO concluded:

> [t]o enable greater oversight of and potentially deter predatory lending from occurring at certain nonbank lenders, Congress should consider making appropriate statutory changes to grant the . . . Federal Reserve . . . the authority to routinely monitor and, as necessary, examine the nonbank mortgage lending subsidiaries of financial and bank holding companies for compliance with federal consumer protection laws applicable to the predatory lending practices. Also, Congress should consider giving the Board specific authority to initiate enforcement actions under those laws against these nonbank mortgage lending subsidiaries.[147]

The GAO's recommendations fail to analyze whether bank regulators' supervisory approach to consumer compliance is really superior to the FTC's enforcement approach. Indeed, if the GAO has concluded that the supervisory approach is superior, then one must wonder why the GAO's recommendations for increased supervisory authority did not extend to independent mortgage lenders. In other words, the GAO recommended that non-bank subsidiaries of bank-holding companies – which are currently subject to the FTC's jurisdiction – be brought within the Federal Reserve's supervisory regime. Why then should independent mortgage lenders – which are

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[146] Effective July 7, 2004, the GAO's legal name was changed to the Government Accountability Office. *See* GAO's Name Change and Other Provisions of the GAO Human Capital Reform Act of 2004, *available at* http://www.gao.gov/about/namechange.html (last visited Oct. 4, 2005).

[147] GAO Report GAO-04-280, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending: Report to the S. Spec. Comm. on Aging*, 108^{th} Cong. 15 (2004), , *available at* http://www.gao.gov/ new.items/d04280.pdf.

also currently subject to the FTC's jurisdiction – not be subjected to a supervisory regime as well? The GAO's recommendation continues the already troubling trend of treating consumers of products offered by bank and bank-affiliated companies differently from consumers of products offered by other companies.

The following reform proposals challenge the benefits of a supervisory approach to consumer protection. In addition, they seek the benefits of a goals-oriented approach to regulation. Several alternative approaches are set forth below. They include: (1) consideration of internal changes within the current agency structure, (2) a proposal to rearrange the responsibilities of bank regulators, and (3) a proposal to eliminate the bank regulators' role from consumer protection.

A. An Enforcement Approach to Consumer Compliance by the Federal Bank Regulators

Perhaps the least radical approach toward improving the efficiency of consumer protection would be for the bank regulators to consider the effectiveness of adopting an enforcement model similar to that used by the FTC. Congress has not mandated that bank regulators periodically examine banks and their subsidiaries for compliance with consumer protection statutes.[148] Moreover, the FTC does not employ a supervisory approach for independent companies.[149] Therefore, it seems reasonable to conclude that an enforcement-based approach to consumer protection may be as effective and less costly than the current supervisory approach.

Under such an approach, rather than conducting regular examinations for compliance with consumer protection statutes, the federal banking regulators would rely on consumer complaints, media reports, and Congressional inquiries as a triggering mechanism for investigations.[150] The federal banking regulators would then employ their general administrative enforcement powers to address

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[148] Bank regulators are required to conduct full-scope, on-site examinations once a year. *See* 12 U.S.C. § 1820(d)(1)(2004). Arguably, consumer compliance is part of a full-scope examination, but to the extent that periodic examination is primarily conducted to maintain safety and soundness, a compelling argument can be made that Congress did not intend to require the federal banking regulators to conduct yearly examinations for consumer compliance.

[149] *See infra* Part II.B.

[150] As indicated *infra* at Part II.B., this is the methodology employed by the FTC.

violations[151] or rely on specific statutory provisions within the various consumer protection statutes to provide for other forms of recovery.

The primary objection to such reform is that it might lead to an increase in consumer protection violations. Since the supervisory system is prophylactic, it prevents fraud. Thus, if the supervisory system is removed, fraud will likely increase. In answer to this opposition, consideration must be given to the high levels of compliance reported by the federal bank regulators under the current scheme. Of course, it is quite possible that banks generally comply with consumer protection laws because they face regular examinations for compliance. On the other hand, it is quite possible that banks achieve high rates of compliance because banks are generally well-managed. And, banks are generally well-managed because of the prudential regulatory scheme that protects their solvency. Just as deposit insurance has an important, but ancillary, effect of protecting depositors,[152] prudential regulation in general may have the same ancillary effect.

Moreover, even if bank regulators shifted away from a supervisory approach to consumer protection, regulators need not abandon their examination of the general compliance function[153] of a bank. In other words, bank examinations would continue to include an assessment of a bank's ability to manage its compliance risk.

B. Consolidate Consumer Protection Within One Federal Banking Regulator

In addition to adopting an enforcement approach to consumer protection with existing agencies, further economies could be achieved by reassigning the responsibilities of the existing bank regulators. Under the current system, three federal banking regulators share essentially the same supervisory and regulatory responsibilities. The workload among the three regulators is divided according to type of charter: the OCC supervises national banks, the Federal Reserve supervises state-chartered member banks, and the FDIC supervises

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[151] *See, e.g.*, 12 U.S.C. § 1818(b) (2000) (indicating that banking agencies can bring an administrative cease and desist action for a violation of "a law, rule, or regulation," and seek restitution under certain circumstances)..

[152] *See supra* note 118 and accompanying text (discussing *Philadelphia Gear*).

[153] *See The Compliance Function in Banks*, *supra* note 95, at 1.

state-chartered non-member banks.[154] The benefits of a goals-oriented approach could be achieved by dividing responsibility between the federal banking regulator according to regulatory goal rather than bank charter.

One approach would be to designate one of the federal bank regulators as the consumer protection agency for bank customers without reassigning any of the current prudential responsibilities. For example, the FDIC could be given responsibility for all consumer protection issues regardless of the charter of the bank involved. Assigning the FDIC this task avoids some of the independence and capture problems that are implicated by the OCC's role in consumer protection.[155] On the other hand, the OCC's significant commitment to combating predatory lending suggests that it is already on the road to developing an expertise in consumer protection issues in credit markets.

A bolder approach would reassign both consumer protection and prudential responsibilities among bank regulators. Regulatory responsibility could be divided among federal regulators so that one federal regulator would be responsible for prudential regulation of individual banks, one for consumer protection, and, a third would maintain overall systemic issues. The revolutionary aspect of this approach is that it rejects the current institutional approach to regulatory division and ignores charter distinctions in placing regulatory responsibility at the federal level. For example, under this scheme only one federal banking agency would implement federal consumer protection laws for national banks, state-chartered member banks, and state-chartered non-member banks.

The practical advantage of this approach is that it puts no existing agencies out of business. Regulatory responsibilities (and, presumably, personnel and other resources) would be reassigned in accordance with distinct regulatory categories. For example, the FDIC could be designated as the prudential regulator for all banks.[156] The OCC might serve as the consumer protection agency for banks, and the Federal Reserve could be designated the agency responsible for overall systemic issues.

The practical disadvantage of this approach is that all banks would be regulated by all three federal banking regulators. Under the

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[154] *See supra* note 9.

[155] *See infra* Part III.B.

[156] The FDIC's responsibility as administrator of the bank insurance fund gives it strong ties to the prudential regulation of banks.

current system, an independent,[157] state-chartered non-member bank is subject to FDIC supervision only.[158] This proposal would not be popular with the president of such a bank. Most banks, however, either because they are owned by a bank-holding company or because they have a federal charter, are currently regulated by two of the three federal bank regulators.[159]

C. Transfer Consumer Protection to the FTC

The most sensible approach to correcting the structural defect in the current regime would be to eliminate entirely the federal banking regulators' role in consumer protection. This approach has the potential to enhance both the fairness and the efficiency of the current system. This proposal would create a more fair system because banks and non-banks would be treated alike. This would level the playing field among providers of similar financial services. In addition, this proposal provides many potential efficiencies that derive from the recognition of consumer protection as a distinct regulatory goal from prudential regulation. The FTC is a consumer protection agency and maintains expertise in this field. This proposal avoids the cost of developing and maintaining many expert agencies to perform the same function. Moreover, this proposal eliminates conflicting regulatory goals within an agency. Finally, the FTC maintains independence from the industry in that it relies on appropriations, rather than fees from the "regulates," to fund its operations.

Of course, the FTC is an enforcement agency, not a supervisor. Transfer of regulatory authority to the FTC—without a major shift in the operations and appropriations of the agency—would eliminate the supervisory approach to consumer protection in the banking industry. As suggested above, however, it is not clear that such a shift would harm consumers. Further study should focus on the relative benefits of the supervisory versus enforcement approach. If a supervisory approach is clearly superior, then non-banks should be subjected to a supervisory regime along with their bank competitors.

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[157] "Independent" in this context means not owned by a bank holding company.

[158] *See supra* Figure 1.

[159] *Id.*

V. Conclusion

Surging consumer debt and the growing complexity of financial services mean that laws seeking to protect consumers will continue to multiply and evolve. Moreover, the heated debate over the role of federal authorities in consumer protection will not likely lead to a diminished federal role.[160] Rather, federal authorities will expend greater resources to combat consumer fraud in response to public and Congressional scrutiny.

While attempting to resolve the current argument over federal preemption of state consumer protection laws, Congress and the federal banking agencies should also consider whether the federal scheme functions fairly and efficiently. If the federal scheme does, the question of preemption is purely a turf battle between the federal and state authorities, offering no benefit to consumers. If, however, the federal scheme is deficient, then the debate should center specifically on its failings and not purely on preemption. After all, most consumers care little whether their interests are protected by a state prosecutor or a federal agency.

Officials at the OCC recently advocated reform of the system of disclosure under Truth In Lending laws.[161] Current disclosures do not appear to provide customers with the kind of understandable information that they need. As lawmakers revisit the effectiveness of Truth In Lending and other disclosure schemes, careful consideration should be given to the structure of the regime. True reform of consumer protection laws can only be achieved through an effective mechanism for implementation and enforcement. Giving the job of consumer protection to a consumer protection agency seems the most logical choice. Asking bank regulators to do the job of a consumer protection agency not only poses conflicts of interest and creates inefficiencies, but could also distract bank regulators from their mandate: to protect the solvency of banks.

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[160] With regard to the legal question of whether the OCC possesses the legal authority to preempt state laws, the likelihood, given traditional deference to agencies' interpretations of their enabling statutes, is that reviewing courts will continue to side with the agency.

[161] *See supra* note 141 (discussing speech by Julie Williams).

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