David Hoffman Democrat for US SENATE

David Hoffman Proposes Four-Point Plan of Consumer Friendly Financial Industry Reforms

Create an Independent Consumer Financial Protection Agency

It is critical that consumer interests are protected; for too long the system has been weighted in a manner that puts corporate profits ahead of consumer protection. Overlapping jurisdictions and regulations coupled with haphazardly created rules have led to poor oversight of the financial industry.

None of the existing agencies responsible for oversight took action to stop the reckless lending and risk management that led to our economic crisis. Current enforcement functions and oversight of consumer financial services such as mortgage lending, credit card lending, auto loans, and other consumer finance products are spread over 17 statutes and seven federal agencies; it's easy to find loopholes and gaps with that much leeway in regulation.

Incredibly, there is no one responsible for consumer interests. Therefore, I support the creation of the federal Consumer Financial Protection Agency (CFPA) to be solely focused on the interests of ordinary people; it will be responsible for making and enforcing the rules over the full range of companies offering retail financial products such as mortgages, credit cards, and payday loans with the aim, as the current bill before Congress says, of ensuring that consumers "have, understand, and can use the information they need to make responsible decisions." CFPA will consolidate often contradictory or confusing duplication of rules and regulations enforced by seven existing agencies. The fact is, consumer spending drives 70% of our national economy. We cannot afford to back into government oversight in the public interest through this patchwork. The markets don't work that way and the regulators can't either. At the same time, this Agency should maintain the balance between State and federal authority over consumer protection; states must be empowered to continue to protect consumers and federal law should not preempt and thereby dilute stronger state consumer protections such as state predatory lending laws and local laws regarding loan disclosures.

Today, banks compete with payday lenders for triple digit financing. Depository institutions compete with non-banks to get mortgage origination business. For example, the infamous mortgage broker Countrywide sold an especially aggressive mortgage—the payment option ARM (POARM) through its national bank, its non-bank entities and its federal thrift charter. Literally dozens of federal and state regulators had partial responsibility for protecting the public interest in the face of these POARM's A single coordinated oversight function of protecting consumers will be more effective.

Indeed, a CFPA will reduce the administrative burdens of disclosure and public accountability of most financial institutions. As Professor Elizabeth Warren, said, "A streamlined new regulatory regime would have a serious impact on the credit industry. Today's complicated disclosure system favors big lenders that can hire a legion of lawyers to navigate the rules—and spread the costs among millions of customers. Those complex rules fall much harder on a smaller institution that must navigate the same regulatory twists and turns, but with far smaller administrative staffs." The CPFA will add a missing piece to federal oversight of our financial markets: an agency with a clear commitment to protecting consumers.

However, the latest proposal for the CFPA exempts from their full oversight 98% (8000 out of 8200) of the nation's banks, those with assets of less than $10 billion. Who are they protecting, or rather, who stands to benefit from this exemption? According to data released by Common Cause two weeks ago, commercial banks, finance and credit card companies have spent $42 million lobbying to make their case from January through June. On October 15, 2009, the Community Bankers Association of Illinois (CBAI) in a letter requesting support for this exemption stated that "Those smaller, community-oriented financial institutions did not engage in the high risk, predatory banking practices that have caused some in Congress and in the Administration to seek the creation of a new federal consumer protection agency." The size of the financial institution alone does not indicate whether that institution has engaged in predatory practices or whether that institution's business is consumer focused. Any bank — regardless of size — that lends money to people should be subject to consumer-based regulation and public disclosure obligations. In fact, seven banks in Illinois alone, with assets under $500 million, failed in July 2009; and according to statistics released by the FDIC, as of June 30, 2009, out of the 637 financial institutions in Illinois, only 4 had assets more than $10 billion. The threshold needs to be lowered and the reach of federal protection for ordinary citizens and consumer borrowers must be broad. As it stands now financial consumers will have fewer protections than originally envisioned. Illinois above all must be a state at the forefront of putting consumers' financial needs first.

Increase transparency in financial service companies

Derivatives Regulation

These financial instruments need highly sophisticated market actors but over 1000 banks now trade in derivatives, a 14% increase in one year. American banks earned $5.2 billion on derivative related transactions in the second quarter of 2009 alone, a 225% increase over the same period last year. Credit Default Swaps, a kind of derivative were especially pernicious forces in the financial meltdown. Trading in these complex risk-laden financial instruments grew from $918 billion at the end of 2001 to $54.6 trillion in mid-2008. This unchecked rush of capital to highly risky instruments has undermined our financial markets and severely constrained broad access to capital. Currently, the amount of capital invested in derivatives by entities other than banks is too large to exclude them from government oversight. Therefore, derivatives traded by banks should be presumptively executed through an exchange to increase transparency. In the case of custom made and highly complex derivatives, regulators should have access for examination. In addition, the more derivatives banks invest in, the higher their capital reserve requirements should be.

Executive Compensation

TARP has given us a much clearer look into matters such as executive compensation. For example, executives at the 29 largest public financial corporations that have taken government funding received a cumulative total of more than $11 million in compensation in 2008, up from $10.6 in 2007. Of that, $3.7 million was spent on executive's personal use of corporate jets, up 123% in a single year. Corporations also increased their spending on the amount of their executive's tax obligations that they paid by almost 10% (9.7%) to $2.8 million between 2007 and 2008. Companies paid more than $830,000 for cars & parking for their executives in 2008.

Given the unprecedented role of federal government in the well-being of the companies taking TARP funds, it is entirely appropriate and necessary for the government to intercede given excessive compensation packages and the business-as-usual attitude exhibited by these corporate executives & their Boards of Directors. In the longer term, however, healthy markets do not cap compensation. Instead government policies should assure independent oversight of executive compensation through increased disclosure mandates in SEC regulation. Government has an important role to ensure that corporate Boards of Directors fulfills their obligation to shareholders to manage risk & allocation of corporate assets. Federal law should require increased independence of compensation committees for financial companies. Compensation decisions should also be subject to more extensive disclosure. The timing, considerations and process of Board approval should be disclosed as well as the actual compensation amount. To answer concerns about privacy, regulators should focus actual compensation disclosures by function & business line not individual.

To protect taxpayer interests, the federal government should have the power to recoup excessive executive compensation when federal bailouts do not turn a financial institution around as expected. Under these circumstances, bank regulators must engage in a comprehensive analysis to determine whether or not to recoup excessive payouts that contributed either to bank failure or government takeover. The public has a right to know the overall outcome of this analysis. This "claw back" function was first created in the aftermath of the Enron, WorldCom era of corporate scandals when Congress enacted laws requiring increase disclosure and tighter practices on corporate executive compensation. The government should have the ability to recover taxpayer dollars in the face of significant restatement of financial positions in a company that continues to slide after a bailout.

Together, these changes would increase incentives for bank and financial institution executives and Boards of Directors to perform for bank soundness and long term stability not short term profit margins.

Strengthen Oversight and Public Disclosure of Financial Risk

Bank regulators should adopt more stringent risk-based capital requirements to minimize investment management designed to limit regulatory transaction costs rather than actually control risk. Capital, leveraging & liquidity requirements should be spelled out in regulation to ensure appropriate limits on risk. In addition, regulators should be given more power to limit systemic risk from shaky financial institutions. Federal law should expand the special resolution procedure beyond banks regulated by the FDIC. This would provide a more efficient, earlier resolution to financial instability & losses at corporations and add alternatives to the imprecise current alternatives—a bailout or bankruptcy.

These changes are especially urgent for the citizens of Illinois, the state with the greatest total number of banks. 652 banks are headquartered in Illinois. We also have the dubious distinction of being near the top of the FDIC failed bank list. This year alone twenty three banks, from Metropolis to Lemont, from Champaign to Eldred, in all corners of our state are being closed by federal banking regulators. In the same time period, 78 banks closed nationally; that means nearly 30% (29.4%) of **all** bank failures in the country took place in Illinois.

But size alone should not determine the reach of the government's work to protect consumers against short term, risk-laden corporate financial strategies. The larger the company, the tighter limits on leveraging and borrowing against debt assets should be. Too big to fail does not warrant less regulation, it warrants more stringent standards, as Paul Volker said in testimony to Congress in February 2009.

In addition, regulatory frameworks should incentivize transparency. During the last decade, we've seen an increasing number of corporations, especially in the banking sector, make business decisions to avoid regulatory mandates. The result has been vastly increased complexity in the structure of our financial institutions. Finance Professor Richard Herring, Wharton School of Business, University of Pennsylvania, reports that the 16 largest financial institutions control 2.5 times as many subsidiaries as the 16 largest non-financial firms. Encouraging United States-based chartering by increasing disclosure mandates regarding the existence of non-US chartered subsidiaries of US financial institutions would address this increased opacity and serve as a strong companion to risk-based capital requirements.

In addition to improved transparency, limiting risk and increased regulatory oversight, market discipline should be encouraged by the federal government. Financial services companies should be required to maintain and report on a "winding down" strategy should normal risk management approaches fail to achieve stable corporate growth & sound fiscal management.

Increase Access to Capital for Qualified Individuals and Small Businesses

Mortgage Lending

The federal government must do more to correct the disruptive impact that usurious and fraudulent mortgage lending practices have had on average Americans. The mortgage foreclosure rate continues to soar and too many hardworking, honest Illinois citizens are unable to work out debilitating mortgage rates. The foreclosure rates in the 6 county Chicago metropolitan area increased by nearly 9% in the first half of 2009 compared to last year. There were almost 30,000 foreclosures during the first six months of 2009 compared to about 25,000 during the same time in 2008. We need a federal law that requires mortgage originators to assess a borrower's ability to fully repay a mortgage and empower the Fed to prohibit yield spread premiums. In addition, Congress should lift the ban on judicial mortgage modifications on principal residences. Finally, we should fully support President Obama's efforts in his stimulus program to stem the tide of home foreclosures by supporting affordable mortgage refinancing and loan modifications on primary residences.

The number of Illinois households threatened with losing their homes rose 62% percent in February from last year's levels, more than twice the national rate. Illinois had one foreclosure filing for every 369 housing units in February, the seventh-highest rate in the nation. Illinois ranked sixth in January and 12th a year earlier. More than 14,000 homes in the state received at least one foreclosure-relate noticed last month, up 1.6% from January and 62.3% from February 2008.

Predatory Lending

In addition to marketing mortgages well beyond the financial capacity of consumers, financial institutions and other consumer finance corporations have aggressively marketed a wide range of high interest, quick access loans; payday loans, bank overdraft insurance, auto loans, title insurance loans and other low and narrow collateral loans abound. These loans carry interest rates as high as 700%. The Federal Reserve's Survey of Consumer Finances revealed that payday loans are disproportionately taken out by families headed by single women. In general, payday loans are taken by those least able to pay them back.

In Illinois, more than 200,000 people have taken at least one pay day loan since 2006 and roughly 70% of them become repeat borrowers. Nearly 25% of all payday loans are made to consumers holding more than 20 such loans. More than half of the payday loan consumers in Illinois had an average monthly income of 50% or less of the state median income. Illinois payday lenders generate between $17 million and $25 million in fees on an annual basis.

Instead of forcing low income families to take on debt they cannot afford, we should encourage simplified and explicit disclosures on payday loan documents. We should support establishment of a national usury rate for consumer credit transactions, ie pay day lending. We should also limit the use of bank accounts as collateral for payday loans, which will limit the damage these loans have on family income. Finally, we must continue to encourage savings for low income families through increased financial literacy and programs such as Individual Deposit Accounts, which match savings.

Overdraft loans should be prohibited absent consumer permission. As of now, 75% of banks automatically enroll their customers in overdraft "protection" programs. These are automatic high yield loans which subject consumers to unexpected and excessively high interest fees when there are insufficient funds in the consumer's account.

Small Business Lending

Our economy will only fully recover when jobs are plentiful again. Small business must have access to credit so that they can continue their critical role in the job market. President Obama recently called for an expansion of the Capital Purchase Program of the federal stimulus package and expanding the Small Business Administration (SBA) coverage to larger loans to increase help for small businesses. We also agree with the need for more short term capital infusions to community banks and Community Development Financial Institutions (CDFI) for their small business lending.

In addition, the federal government should create a program to make it easier for small businesses to obtain affordable market loans. Federally regulated banks in solid financial shape could get up to a two percent interest subsidy for five years or less on loans to small businesses. As an additional element of the stimulus program, the interest subsidy could be granted to banks originating small business loans during a 12 to 18 months timeframe. The program would act as a strong incentive for banks to get back into the business of making small business loans.

Community Development Financial Institutions (CDFI)

Broad capital access is a critical force for expanding wealth and strengthening our economy in the long run. The Community Development Financial Institution sector fills a market gap by combining private market discipline with public purpose missions. CDFI's are private financial services providers focused on otherwise un-served markets—incubating small businesses, funding mutual and cooperative affordable housing, financing community facilities for human service activities. The US Treasury CDFI Fund provides critical public investment leveraged by CDFI's in the form of CDFI Fund grants and New Markets Tax Credits.

Illinois has a robust CDFI sector. The Fund has made 211 awards in Illinois for a total investment nearing $65 million since 1996. There are 50 federally certified CDFI entities in Illinois. At the end of fiscal year 2006, they had more than $1.8 billion in financing outstanding to nearly 2000 customers. 64% of CDFI's borrowers & customers were low income and 79% are racial or ethnic minorities.

National estimates indicate that each dollar spent by a CDFI is leveraged 19-27 times with private sector investment. These consumer-focused financial institutions are a strong antidote to the kind of risk-taking financial management we've seen so many Illinois banks undertake.

We applaud the Obama administration's actions to deploy this creative tool to increase market access as part of the overall stimulus package. But, we can do better and maximize the long term role of CDFI's in increasing access to capital to small business, rural business, and affordable housing developers. Currently, CDFI Fund appropriation is approximately $215 million, of which $100 million is a one-time ARRA stimulus package award. Annual appropriations for the CDFI Fund should rise to at least $250 million

The Community Reinvestment Act

Enacted in 1977, The Community Reinvestment Act (CRA) requires banks to make loans throughout the communities they serve. It has been a powerful force to drive investment to low and moderate income neighborhoods, individuals starting up businesses and families seeking affordable housing.

Now its time to revisit CRA regulations in order to increase capital access and incentivize good lending practices in areas other than housing, the primary CRA focus area to date. In addition, CRA should be expanded to cover integrated financial services firms that provide significant capital investment as called for by numerous groups such as The Opportunity Finance Network and the Chicago-based Woodstock Institute. An investment threshold can be used to avoid regulatory creep that might impede market efficiencies. In addition, CRA jurisdiction should be defined by a measure of the reach of lending, not geographic proximity to banking corporate locations. With the dramatic consolidation of the banking sector, CRA efficacy has decreased, with much of the mega-banks' activities outside the geographic confines of CRA's regulatory constructs.
In fact, the narrowness of CRA is a significant impediment to its effectiveness. In 2005, the Bush administration weakened the CRA regulations, allowing small & mid-sized banks to opt-out of CRA reporting. Once again, corporate interests held sway over the interests of our communities & citizens. Half the sub-prime mortgages have come from institutions not covered by CRA; about 30% more have come from subsidiaries of banks that have less than full CRA coverage. Janet Yellen, president of the San Francisco Federal Reserve, offers this statistic: Independent mortgage companies, which are not covered by CRA, made high-priced loans at more than *twice* the rate of the banks and thrifts.