



## Consumer Federation of America

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**NEW CFA REPORT: FINANCIAL REFORM IS ON TRACK,  
BUT DARK CLOUDS ARE FORMING**

*--Big Banks and their Congressional Allies Working to Delay, Defund and Debilitate Landmark  
Consumer Bureau and Investor Protection Achievements--*

Washington, D.C. – One year after enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, regulators have made great strides implementing its sweeping reforms, according to a progress report issued today by the Consumer Federation of America (CFA). That progress is threatened, however, by the unrelenting efforts of industry groups and their congressional allies to weaken and delay the rules and defund the agencies primarily responsible for making those reforms a reality, CFA warns. (The full report is available at: [www.consumerfed.org/pdfs/Dodd-Frank-progress-report.pdf](http://www.consumerfed.org/pdfs/Dodd-Frank-progress-report.pdf).)

“Financial reforms that could protect consumers, investors, and our financial system for decades rose from the ashes of a near-death experience by the American economy,” said CFA Legislative Director Travis Plunkett. “Our report finds that the fate of the Dodd-Frank Wall Street Reform and Consumer Protection Act hangs in the balance. While key investor and consumer protections are generally on schedule and on track, large financial interests and their allies in Congress have taken steps that endanger the long-term success of these reforms.”

The CFA report looks at key consumer and investor protection provisions of the bill, assesses progress in implementing those provisions, and identifies threats that could undermine effective implementation. These reforms include: the creation of a new agency devoted to protecting financial consumers, provisions to strengthen protections for retail investors, initiatives to bring much needed transparency and regulatory oversight to the over-the-counter derivatives markets, and credit rating agency reforms.

“The financial crisis was hugely traumatic for American consumers and investors, undermining their faith in the integrity and stability of our financial markets and in our regulators’ ability to protect their interests,” said CFA Director of Investor Protection Barbara Roper. “The Dodd-Frank Act created a sound framework for strengthening consumer and investor protections. Regulators are working furiously to put those protections in place. It is up to Congress and the President to ensure that they get the oversight, backing, and resources they need to make the promises of Dodd-Frank a reality.”

## Consumer Financial Protection Bureau

Dodd-Frank established a Consumer Financial Protection Bureau (CFPB), which becomes operational on July 21, 2011. The CFPB was created because massive regulatory failures by federal banking and consumer regulators led to a proliferation of unfair and unsustainable lending practices, particularly in the mortgage and credit card sectors. CFPB has a single mission: to protect consumers in the financial services marketplace.

In little more than six months, the CFPB has accomplished much. Professor Elizabeth Warren and senior CFPB staff members have hired about 400 staff members from extremely diverse backgrounds, developed and implemented an organizational structure, and hired senior leaders to fill four of the six top leadership positions in the agency. The CFPB has also created a consumer-friendly website, initiated a complaint response system to help consumers with credit card problems, and finalized protocols to supervise large banks regarding their compliance with federal consumer laws. The agency is also developing procedures for the crucial task of supervising non-banks, including mortgage, payday, and student lenders. Most recently, the President nominated CFPB enforcement director (and former Ohio Attorney General) Richard Cordray to be the agency's first director. While these are important steps forward, much more needs to be done for the agency to fulfill its promise.

CFPB leaders have said that their top early policy priorities will be to require companies to provide better information to consumers so that they can understand the true costs and financial risks of the credit products they are buying. The agency is developing innovative mortgage loan disclosure forms and plans to do the same soon with credit card contracts. Consumer organizations have applauded the CFPB's disclosure efforts and urged the agency to also address abusive financial practices, including unfair overdraft loans, plentiful fees and few protections for prepaid cards, wrongful mortgage foreclosures and abusive mortgage servicing practices, and high-cost online payday loans.

The CFPB faces a number of threats to its ability to effectively protect consumers:

- The Bureau has no director, which means that it can only use some of its consumer protection powers. In May 2011, 44 Senate Republicans said that they will not confirm anyone for the director position unless weakening changes are made to the Bureau's structure, funding, and independence.
- Funding for the Bureau is under attack. Appropriations legislation on the House floor would require taxpayer funding of the CFPB and reduce the CFPB's fiscal year 2012 budget to \$200 million, a reduction of almost 50 percent. This will increase taxpayer costs and allow powerful financial interests to pressure Congress to obstruct CFPB funding.
- Legislation to weaken the Bureau is moving in Congress. The House of Representatives will soon vote on H.R. 1315, which would increase the power of other financial regulators to block CFPB consumer protection measures, ensuring that bank-friendly regulators have an

easy excuse when they want to stop the CFPB from curbing abusive but lucrative financial practices. This legislation would also alter the Bureau's leadership structure from a single director to a five-member commission, which could drive the CFPB decision-making process toward gridlock and inaction.

## **Investor Protection**

To address critical failures in the regulation of the nation's securities markets in the years leading up to the crisis, the Dodd-Frank Act includes a package of provisions to strengthen basic investor protections both by providing the SEC with improved tools to enforce the securities laws effectively and by authorizing the agency to strengthen investor protections in specific areas. These include high-priority provisions to: require brokers to act in their customers' best interests when they give personalized investment advice to retail investors and to create a potentially powerful new Office of Investor Advocate within the SEC.

- Broker-dealer Fiduciary Duty: The SEC has completed a study of the issue, and Chairman Mary Schapiro has announced plans to proceed with rule-making in coming months. The general approach advocated by the agency has won broad support, but some members of Congress continue to question the need for a heightened standard. Although there is a risk that continued congressional pressure could impede progress, the SEC appears to be on track in implementing this long-time investor priority.
- Office of Investor Advocate: The SEC must get approval from House and Senate appropriators for its funding reprogramming plan before it can move forward with establishing this office and hiring a director. It has submitted a plan and is awaiting that approval.

Progress on these and a host of other investor protection priorities hinge in part on the agency's receiving a funding increase commensurate with its expanded responsibilities under Dodd-Frank. Thanks to the efforts of Senate Democrats, Congress came through with a modest increase to \$1.18 billion for 2011, very welcome in light of House efforts to cut the SEC budget but still below the \$1.3 billion authorized in Dodd-Frank. Meanwhile, the House is soon expected to take up its 2012 financial services funding bill, which would keep agency funding flat at that level in the coming year even as it takes on vastly expanded responsibilities for oversight of securities-based swaps, hedge funds, and credit rating agencies. While leading Senate Democrats continue to make the case for funding at the \$1.4 billion level requested by the Administration (still short of the \$1.5 billion authorized in Dodd-Frank), the outcome of this year's budget battle is far from clear.

## **Derivatives**

While average investors do not typically participate directly in derivatives markets, they nonetheless suffered extensive collateral damage from the failure to regulate over-the-counter derivatives in the years leading up to the crisis. Dodd-Frank seeks to fill this regulatory gap by

providing the CFTC and SEC with shared responsibility and broad new authority to oversee this roughly \$600 trillion market. Among the most important reforms are those designed to heighten transparency and reduce the potential for financial contagion by requiring most standardized swaps to trade through central clearinghouses and, where possible, on exchange-like “swap execution facilities.” In addition, Dodd-Frank subjects swap dealers and major swap participants to regulatory oversight, including capital and margin requirements, reporting and record-keeping rules, and business conduct standards. Banks that are swap dealers are required to move certain derivatives activities from the bank to affiliates, and the CFTC is directed to develop position limit rules to curb excessive speculation that contributes to high food and fuel costs.

Both the SEC and CFTC have fallen behind the one-year deadline set for completion of the rule-making process. The delay can be attributed in part to the overly ambitious deadline set in the legislation, in part to funding constraints, and in part to pressure from some in Congress to slow down and do more to accommodate industry concerns. Despite these pressures, both the SEC and CFTC have released all the rules called for under Dodd-Frank for public comment, and both have indicated they expect to complete the rulemaking process by year’s end. Overall, the rule proposals have generally been well-received by investor advocates, with a few significant exceptions. Of particular concern are the Treasury Department’s plans to exempt foreign exchange swaps and forwards from the Act’s requirements, the SEC’s swap execution facility rule, which does too little to ensure transparency and price competition, and the CFTC’s failure to produce tough new position limit rules. In addition, some members of Congress continue to exert pressure to delay and weaken the rules, in particular by greatly expanding the end-user loophole.

Without question, however, the biggest threat to effective implementation of the derivatives reforms is under-funding of the SEC (see above) and CFTC. While the House has proposed to keep SEC funding flat in 2012, it has proposed to significantly cut the CFTC’s budget to \$171.9 million. This would leave the agency with a staffing level roughly equivalent to what it had when the agency was first created in the 1970s to oversee a relatively sleepy commodity and futures market. The Administration continues to seek a funding increase to \$308 million, and leading Senate Democrats have pledged their support. But, as with SEC funding, it is difficult to predict how that funding battle is likely to play out.

### **Credit Rating Agencies**

The willingness of credit rating agencies to assign AAA ratings to toxic mortgage-backed securities was a major contributing cause of the financial crisis and thus a source of indirect harm to investors. To address this problem, the Dodd-Frank Act includes a package of reforms designed to improve regulatory oversight credit rating agencies, increase ratings transparency, increase rating agencies’ legal accountability for following appropriate procedures, and reduce the financial system’s vulnerability to ratings failures.

The provisions are still very much a work in progress, however. Still awaiting approval by House and Senate appropriators of its funding reprogramming plan, the agency has yet to establish the new Office of Credit Ratings required by the act. However, it has begun both the rule-making process and the yearly inspections called for in Dodd-Frank using existing agency personnel. Recently, the SEC issued the rule proposals implementing the Act's new regulatory requirements for public comment, and it and other federal financial regulators have begun the process of eliminating regulatory references to ratings. Because regulators have so far not succeeded in finding acceptable alternative measures of creditworthiness, however, the latter efforts could inadvertently increase risks in the financial system rather than reduce them. Meanwhile, on the issue of legal accountability, the SEC has issued and then indefinitely extended a no action position designed to shield the ratings agencies from expert liability with regard to their ratings of mortgage-backed securities. Finally, since the legislation does not address the massive conflict of interest inherent in the issuer-pays business model, it relies for the effectiveness of its reforms on the ability of the SEC to provide tough and effective oversight, a risky proposition given the lack of increased funding provided to the agency for this purpose.

## **Conclusion**

“By far the biggest threat to investor protection reforms in each of these areas is that the agencies responsible for carrying out those reforms – the SEC and CFTC – will be denied the funding necessary to do so,” Roper said. “It is frankly inconceivable that Congress, having witnessed the devastation that the financial crisis has wreaked on American investors and the U.S. economy, would so quickly abandon its commitment to clean up the system and rein in Wall Street excess, but that is the very real threat posed by those seeking to defund these critically important investor protection agencies.”

“To his great credit, President Obama made the creation of a Consumer Financial Protection Bureau the centerpiece of his successful efforts to dramatically reform financial regulation in this country,” said Plunkett. “Consumers now need the President to show the same kind of leadership in fending off attacks on CFPB's effectiveness and independence and in getting a permanent director in place as soon as possible.”

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