

**Remarks by  
FDIC Chairman Sheila C. Bair  
Financial Regulatory Reform  
The Way Forward to the Consumer  
Federation of America,  
Financial Services Conference,  
Washington, DC  
December 3, 2010**

I am honored and delighted to be here. Throughout my public career, I have always viewed consumer protection as the core of what I do. And I have long admired your effective advocacy and all that you have accomplished. Regardless of the issue, housing finance, consumer credit, payday lending, auto insurance, there is no stronger voice for the hardworking public than the Consumer Federation.

Perhaps your biggest accomplishment came just a few months ago, when you helped us win passage of the Dodd-Frank financial reform act, closing the books on the doctrine of Too Big To Fail and creating a new consumer watchdog for financial products. Our two years of hard work and persistence paid off, and it is now up to us to ensure that the new law is implemented strongly and fairly.

What I would like to do this morning is outline the rationale for the new reforms and the way forward. Aside from the CFPB, many of the reforms might not at first-blush appear to be relevant to consumers, such as the FDIC's new resolution authority for large institutions or the new Financial Stability Oversight Council. I admit they can be arcane and as difficult to understand as the terms on your credit card statement.

But in fact most, if not all of the reforms, are vital to protecting the financial well-being of every American and the broader public good – whether it is preventing another massive bailout shouldered by all taxpayers or preventing a foreclosure that should have been a modification for a family.

### **Level Playing Field Benefits Consumers**

The mortgage crisis points to the need for leveling the playing field between banks and non-bank providers for consumer lending. The lack of sensible, consistent mortgage lending standards and consumer protections in the run-up to the crisis ended up destabilizing housing markets and the entire financial system. This "race to the bottom" mentality imposed large losses on banks and non-banks alike, and imposed long-term damage on household balance sheets and consumer confidence.

The CFPB provides a real opportunity to simplify consumer rules and make them work in the interest of consumers. It subjects non-bank financial providers to more rigorous rules and examinations while enhancing the competitive position of responsible lenders,

including many community banks, who are trying to do the right thing by their customers.

I welcome the addition of the CFPB Director to the FDIC Board. This will help to not only enhance the FDIC's strong reputation for consumer protection, but also give the CFPB some insights into the wide range of depository institutions with retail operations.

### **Dodd-Frank Implementation**

The financial crisis also has exposed other critical flaws in how our financial system operated and was regulated. The reforms authorized under the Dodd-Frank Act include far-reaching changes to restore market discipline, internalize the costs of risk-taking, and make our regulatory process more attuned to systemic risks.

A key reform is the new resolution authority for large bank-holding companies and systemically important non-bank financial companies. This new authority directly addresses the dilemma we faced in the fall of 2008, when a number of these companies ran into serious trouble.

We all saw the result of the Lehman bankruptcy, which threw global financial markets into chaos. In contrast, the FDIC regularly carries out a prompt and orderly resolution process using its receivership authority for insured banks and thrifts. The Dodd-Frank Act for the first time gives the FDIC a similar set of receivership powers to close and liquidate systemically-important financial firms that are failing.

### **Practical Significance of Ending Too Big To Fail**

Let me briefly describe to you the practical significance of this new resolution authority. In the old world of Too Big To Fail, risk taking was subsidized. Systemically-important companies took on too much risk because the gains were private while the losses are absorbed by the government.

Market discipline failed to rein in the excesses at these institutions because equity and debt holders – who should rightly be at risk if things go wrong – enjoy an implicit government backstop. This skewing of financial incentives inevitably leads to a misallocation of capital and credit flows.

During the boom, too much credit was directed to single-family housing, when it might have been put to better use in other sectors. And much of that credit was structured in ways that did not meet the long-term needs of household borrowers.

But implementing the new resolution authority and ending Too Big To Fail is a game changer in terms of economic incentives. It is the key to restoring market discipline on the nation's largest financial institutions and better aligning their financial incentives to control risks. Capital and credit will be allocated more efficiently. And taxpayers will no longer be on the hook when these companies get it wrong.

## **FDIC Organizational Changes**

The task that now falls to us as regulators is to promptly and effectively implement the reform measures.

The FDIC has created an Office of Complex Institutions to work with our counterparts in monitoring systemically important institutions and seeing that they establish credible resolution plans that will ensure that they are not Too Big to Fail. They need to clearly lay out the structure and activities of the organization, as well as its counterparty exposures, so that we are never again forced to make the choice between bailing out an institution or creating real and lasting harm to our financial system.

The FDIC also sits on the newly-established Financial Stability Oversight Council, or FSO, whose task is to identify and address macro risks and coordinate the regulation of systemically important institutions. This group must be ever vigilant in monitoring emerging risks, and regulators must have the courage to address those risks early, before they damage our economy.

In addition, the FDIC has created a new Division of Depositor and Consumer Protection to sharpen our focus on consumer protection issues. The new Division is led by Mark Pearce, who has worked as a state bank regulator and a consumer advocate at the Center for Responsible Lending. In establishing this Division, we are acting on our longstanding belief that consumer protection and safe and sound banking are two sides of the same coin.

### **The FDIC's Role in Consumer Protection**

Consumer protection does not take a back seat at the FDIC. While the FDIC does not have rulemaking authority for unfair or deceptive acts or practices (or "UDAP") and other consumer laws, we do have examination and enforcement authority which we aggressively pursue on a case by case basis.

For instance, since 2008, our enforcement actions involving UDAP violations resulted in more than \$180 million in penalties and restitution. Over the past 10 years, we have taken over 1,500 formal and informal enforcement actions and have required more than 900 institutions to make restitution to consumers.

In addition, the FDIC uses public advocacy and the rulemaking comment process to raise alarms about consumer protection problems that affect both consumers and the economy as a whole.

We were early advocates for stronger underwriting standards for non-traditional and subprime mortgage products. We argued vigorously for banning yield-spread premiums, cracking down on prepayment penalties, and requiring full income documentation and underwriting based on the fully indexed rate.

## **New Guidance on Overdraft Protection**

We have also consistently advocated for stronger rules and regulatory guidance to address misuse of fee-based overdraft protection. I believe overall that the vast majority of community banks which the FDIC oversees have a good record on consumer protection. The success of their high-touch business model depends on it.

Yet, fee-based overdraft protection is one area where we have seen large increases in consumer complaints. The FDIC's 2008 Study of Bank Overdraft Programs found that a small number of consumers bear a disproportionate burden of overdraft fees.

We found that while only around 5 percent of bank customers had 20 or more overdrafts per year, this group accounted for nearly 70 percent of all overdraft fees. On average, these customers were charged more than \$1,600 per year in overdraft fees.

Amendments to Regulation E by the Federal Reserve that went into effect this summer address many aspects of this problem. The amendments prohibit banks from charging overdraft fees on ATM and one-time debit card transactions unless a consumer specifically opts-in to the overdraft service for those types of transactions.

Also, the Truth in Savings Act will now require banks to show the dollar amounts charged for overdrafts and non-sufficient-funds, or NSF, fees on your account statement. Last week, the FDIC issued overdraft guidance for the banks we supervise that establish expectations for them to actively monitor the use of automated overdrafts, and to limit overdraft use by customers as a form of short-term, high-cost credit.

Institutions are expected to contact customers who overdraw their accounts more than six times in a 12-month period, and to discuss with them less-costly alternatives such as linked savings accounts, a more reasonably priced line of credit, or a safe and affordable small-dollar loan. The guidelines recommend that banks allow consumers to affirmatively choose the overdraft payment product that best suits their needs.

They also call for daily limits on overdraft fees and an end to practices that are simply geared towards maximizing fees, such as by clearing the largest checks first. These guidelines are a common-sense approach that can help mitigate risk to both consumers and banks.

One important lesson from the mortgage crisis is that selling consumer products that do not serve them well ends up hurting both consumers and banks, and weakening public confidence in the financial system as a whole.

## **The FDIC Safe Accounts Pilot**

The adverse impact of overdraft fees is especially acute for low-income consumers. Our 2008 study showed that low-income consumers earning \$30,000 or less were twice as likely as upper-income consumers to incur 20 or more overdrafts a year.

Addressing issues that deeply affect lower-income and underserved consumers is a priority at the FDIC. That's why, in 2006, I created the Advisory Committee on Economic Inclusion – comprised of individuals from banking, academia, government, and consumer and philanthropic groups – to advise the FDIC on how to make the financial system more accessible to the more than 25 percent of the population that is unbanked or underbanked.

One of the initial projects recommended by the Committee – the Small-Dollar Loan Pilot Program – recently wrapped up after two years. This pilot demonstrated that banks can offer safe, affordable small-dollar loans as an alternative to high-priced sources of emergency credit, like payday loans or fee-based overdrafts.

We are now conducting a year-long case study at nine volunteer banks to evaluate how they can offer safe, low-cost transactional and savings accounts that are responsive to the needs of underserved consumers. These checkless accounts are largely electronic, and they strongly encourage automatic savings. Most importantly, there are no overdraft or NSF fees.

We are hopeful that the findings of this case study will encourage more institutions to offer safe and low-cost accounts for underserved consumers.

### **Robo-Signing & Reforming Mortgage Servicing**

One of the most urgent consumer protection issues that we see now involves serious weaknesses in mortgage servicing and foreclosure practices that have come to be associated with the practice of "robo-signing."

Some mortgage servicers have failed to properly assemble the paperwork needed to establish ownership of mortgages and the right to foreclose on delinquent loans. And some have pursued foreclosure and loan modification in an uncoordinated dual-track process. This has often led to needless confusion for borrowers, and can result in costly and unnecessary foreclosures.

These mortgage servicing weaknesses are a byproduct of both rapid growth in the number of problem loans and a compensation structure for servicers that is not well designed to support loss-mitigation measures.

In my testimony before the Senate Banking Committee earlier this week, I outlined what I see as steps that mortgage servicers can and should institute now as they seek agreements with major stakeholders that can help resolve servicing defects.

One such step is to establish a single point of contact for struggling homeowners. This will go a long way towards eliminating the conflicts and miscommunications between loan modifications and foreclosures, and will provide borrowers assurance that their application for modification is being considered in good faith.

Another is to dramatically simplify the private loan modification process, which remains far too complicated. Modifications need to be put in place at an early stage of delinquency, and should provide for a significant reduction in the borrower's monthly payment – practices that have been shown to raise the odds that the modification will succeed.

In exchange, mortgage servicers should have a "safe harbor" that would assure them that their claims will be recognized if foreclosure becomes unavoidable. Servicers also need to make certain that their staffing resources and quality control processes are appropriate to the scale and complexity of their business. And second-lien holders should be required to take a meaningful write-down if the first mortgage loan is modified or approved for a short sale.

All stakeholders must be willing to come to the table and compromise if we are to find solutions to the foreclosure problem and set the stage for recovery in our housing markets.

### **The Need for Improved Servicing Standards**

The FDIC has been working on a number of fronts, in concert with other regulatory agencies, to institute reforms in loan securitization that can get this market moving again by better aligning the financial incentives of issuers and servicers with those of investors and borrowers.

First, we have updated our rules for safe harbor protection with regard to the sale treatment of securitized assets in failed bank receiverships. Our final rule, approved in September, establishes standards for disclosure, loan quality, loan documentation, and the oversight of servicers.

Importantly, the new rule requires that the issue of servicer incentives be addressed in order to obtain safe-harbor status. Servicing agreements must provide servicers with the authority to act to mitigate losses in a timely manner and modify loans in order to address reasonably foreseeable defaults to avoid the perverse incentives created when loans must be delinquent before they can be restructured. The agreements must require the servicer to act for the benefit of all investors, not for any particular class of investors.

The rule also addresses a recurring problem in servicing: the obligation for servicers to continue funding payments missed by borrowers. Under most current servicing agreements, this obligation has the effect of accelerating foreclosures as servicers seek to recover these payments by selling the home. Our new rule strictly limits advances to

just three payments unless there is a way to repay the servicer that does not rely on foreclosure.

While the FDIC's new rule will help create positive incentives for servicing, it is, by the nature of our authority, limited to banks. The Dodd-Frank financial reform law now provides a chance to improve incentives across the market, whether the securitization is issued by a bank or not. Dodd-Frank requires regulations governing the risk retained by any issuer of asset-backed securities. Those regulations may reduce the standard 5 percent risk-retention for Qualifying Residential Mortgages, or QRMs, that pose a reduced risk of default.

Given the important role that quality servicing plays in mitigating the incidence of default, I believe that the new regulations – like our safe harbor -- should address the need for reform of the servicing process.

### **Conclusion: Time for Fiscal Responsibility**

The many challenges we have faced in the past few years have taught all of us the value of financial stability. During times of turmoil, there is a tendency to try to regain that stability by going back to old and familiar ways. But we know that the financial practices of the past led to excessive risk taking, misallocation of resources, and a failure to enforce accountability. The result was the worst financial crisis since the 1930s.

Financial reform is now taking us into new territory, which is disconcerting to some. But it is time to move forward, not back. And we must do so with a clear sense that we can make our system safe only by making tough choices and ensuring that everyone plays by the rules.

Washington, too, must mend its ways if we are to preserve financial stability in the years ahead. Total U.S. public debt has doubled in just the past seven years to almost \$14 trillion, or more than \$100,000 for every U.S. household. This explosive growth in federal borrowing is not only the result of the financial crisis, but also the unwillingness of our government over many years to make the hard choices necessary to rein in our long-term structural deficit.

On Wednesday, the National Commission on Fiscal Responsibility and Reform released a report outlining some of the tough choices that we as a nation must make to rein in this borrowing and preserve our nation's credibility in the global financial markets.

For now, U.S. government obligations continue to enjoy a uniquely favored status as a safe haven during times of crisis. But excessive government borrowing poses a clear danger to our long-term financial stability. The time is now for all of us to put aside narrow interests and develop a comprehensive long-term plan to restore our fiscal strength.

Financial stability and public confidence are the foundation of our prosperity and represent consumer protection in the truest sense. Let us work together as Americans to rebuild that foundation and secure our economic future for the broad public good. Thank you.

Last Updated 12/3/2010