American Financial Services Association

June 1, 2012

The Honorable Darrell Issa
Chairman
House of Representatives Committee on Oversight and Government Reform
B350 RHOB
Washington, DC 20515

Dear Mr. Chairman:

The American Financial Services Association (AFSA) is pleased to respond to your letter of May 16, 2012, which seeks to identify existing and proposed regulations that negatively impact jobs and the economy. Founded in 1916, AFSA is the national trade association for the consumer credit industry protecting access to credit and consumer choice. Our 350 members include consumer and commercial finance companies, auto finance and leasing companies, mortgage lenders, credit card issuers, industrial banks and industry suppliers.

Our comments address two broad policy concerns. First, reflecting our membership and mission, we will discuss regulations affecting the financial services sector. Next, we will discuss the need for systemic reform of the regulatory process.

We are very appreciative of your continuation of this process and look forward to working with you and your Committee as you work to remove federal regulatory impediments to our economic recovery.

Financial Regulations Inhibiting Job Creation

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

The passage of the Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), ostensibly designed to prevent another Wall Street crisis, creates a staggering 533 rulemakings scattered throughout a number of federal agencies.

The myriad of regulations mandated by the Dodd-Frank Act have a disproportionate impact on the many AFSA members that are finance companies, sales finance companies or retail installment sales finance companies.

These companies, many of whom are small, local, or regional businesses, are licensed and supervised in each and every state in which they do business by state banking agencies or a consumer credit authority. They are not federally chartered and are funded by putting their own capital at risk, not by federally-insured deposits. They had no part in the causing the financial crisis the Dodd-Frank Act purports to address.

Thanks to the Dodd-Frank Act, the companies find themselves subject to an additional level of federal regulation and enforcement that will dramatically raise their compliance costs. Every dollar spent on additional compliance burdens is a dollar not loaned to American consumers.

Consumer Financial Protection Bureau

The Dodd-Frank Act also created a new and autonomous Consumer Financial Protection Bureau (CFPB) that has extraordinary authority over all facets of consumer credit. Unlike traditional agencies governed by a bipartisan commission, the CFPB is directed by a single regulator. Although nominally housed within the Federal Reserve Board (FRB), the FRB cannot direct activities, terminate staff, review or block regulatory or enforcement activities. Also unlike the traditional independent agency model, the CFPB is guaranteed a percentage of the FRB's budget; hence, there is no congressional oversight through the normal budget process.

The CFPB has authority over "unfair, deceptive, and abusive" practices that may impact consumers. While the former have been defined over the years by federal regulations and court decisions, the latter term is virtually undefined and gives the CFPB untrammeled discretion to deem "abusive" any product it dislikes.

The CFPB also has independent litigating authority and need not notify the Department of Justice (DOJ) of any proposed action – far outside the usual norms of federal agency practice. AFSA believes DOJ consultation is necessary to coordinate enforcement activities across agencies and to provide a critical check on the CFPB's discretion when a company is exposed to damaging penalties.

The Dodd-Frank Act further fails to give any statutory direction to the new CFPB to determine the adequacy of existing state laws and regulations under which these companies operate before imposing new federal burdens.

The CFPB may promulgate regulations impacting these companies without:

- finding that existing state law or regulation is inadequate;
- determining an estimate of the number of state-licensed or supervised entities to which the proposed rule will apply;
- describing the projected reporting, recordkeeping and other compliance requirements of proposed rule; and
- identifying the relevant state statutes, regulations and enforcement proceedings with which the new federal regulation may duplicate, overlap or conflict.

Credit Card Accountability, Responsibility, and Disclosure Act (CARD Act)

AFSA members who issue credit cards are still adjusting to the impact of the CARD Act of 2009 – the most comprehensive rewriting of federal law in this area since the 1980's. The CARD Act has already impacted lower income Americans and, even, stay-at-home parents. Restricting the ability of issuer to price for risk and adjust pricing as risk profiles change, lower income borrowers face higher interest rates at the inception of their accounts and lower credit limits. The cost of complying with the CARD Act has already shifted many banks away from free checking.

Like many federal regulations, those implementing the CARD Act have consequence, whether unintended or not, that impact the very people the regulations are supposed to protect. For example, one of the “reforms” in the CARD Act resulted in a FRB proposed rule that requires credit-card issuers to consider only a borrower's “independent” income rather than household income. This new standard, which would apply to new credit-card accounts and requests to increase limits on existing accounts, will make it difficult for some customers to get instant credit on the spot in retail, especially for stay-at-home parents without separate income.

Our economy is still consumer driven and relies on credit availability. Both the CFPB and the CARD Act have, or threaten to, impose extraordinary compliance costs on lenders that will translate into reduced credit availability and higher credit costs, and will be a drag on retail sales that will inhibit economic recovery and job growth. According to a recent study by the academics at the George Mason University Law School, regulations implemented under the Dodd-Frank Act could reduce economic growth by 4%.

Systemically Important Financial Institutions

The Financial Stability Oversight Council (FSOC) recently released a final rule detailing the criteria that will be used to determine whether certain nonbank financial companies should be subject to enhanced prudential standards and supervision by the FRB under Section 113 of the Dodd-Frank Act.

Section 113 designations will have significant and far-reaching regulatory implications and costs, both in terms of time and resources, for nonbank financial companies. Designation under Section 113 by the Council will, without question, have a tremendous impact on the identified nonbank financial company, from a cost, compliance and operational perspective, including supervision and oversight by the FRB, fee assessments by the Treasury Department to fund the Office of Financial Research, enhanced capital and liquidity standards, enhanced risk management and concentration limit requirements and development of resolution plans or “living wills.” Also, the resources, time and attention needed to fulfill its obligations for nonbank financial companies so designated will draw heavily on the FRB, and must be considered in terms of the appropriate allocation of limited regulatory resources in a manner that most effectively accomplishes statutory mandates.

With that in mind, we hope that the FSOC will be very careful in designating companies under Section 113, and will provide companies with a meaningful opportunity to contest a proposed designation, including the right to an oral evidentiary hearing. Specifically, we note that it was not the intent of the Dodd-Frank Act to subject nondepository captive finance companies to designation as systemically important or to heightened prudential standards.

Residential Mortgage Rules

Most economists and housing market analysts in government and in the private sector agree that today's underwriting standards are tight and are contributing to a slow housing recovery. AFSA believes that an unnecessarily narrow definition of "qualified mortgage" (QM) or "qualified residential mortgage" (QRM) that covers only a modest proportion of loan products and underwriting standards and serves only a small proportion of borrowers would undermine prospects for a housing recovery and threaten the redevelopment of a sound mortgage market.

We also believe that the QM rule should include a safe harbor. AFSA believes that a broad QM rule with a safe harbor is the only way to help the economy and at the same time ensure that the largest number of credit worthy borrowers are able to access safe, quality loan products for all housing types, as Congress intended in enacting the Dodd-Frank Act.

Additionally, the mortgage servicing rule outline proposed by the CFPB also may limit the growth of small servicers or drive them from the business altogether, particularly if the CFPB imposes mandates that exceed those required by the Dodd-Frank Act. For example, the existing items the CFPB wants to add to the closed-end mortgage periodic statement may be very onerous for mortgage servicers.

Perhaps as important as the substance of the new rules is the need to synchronize all of the forthcoming reforms that will impact mortgage origination. In addition to the aforementioned QM and QRM rules, lenders face new disclosures as well as restrictions on product characteristics and origination practices under the Mortgage Reform and Anti-Predatory Lending Act (Title IV of the Dodd-Frank Act). Furthermore, the CFPB is currently revising the prescribed documentation to combine the overlapping and conflicting disclosures required at the shopping and settlement stages under the Real Estate Settlement Procedures Act and the Truth in Lending Act. Were the CFPB to issue new model forms and compel their implementation by lenders prior to the completion of other major changes in the pipeline, the forms might need to be redesigned yet again and thus impose substantial costs on industry to repeat the implementation process. This hardship can be avoided if regulators take a coordinated, deliberate approach to rolling out these interrelated reforms.

The Volcker Rule

While we recognize there is real concern about proprietary trading risks by insured institutions, we believe the Volcker Rule has been expanded far beyond what was originally contemplated.

AFSA believes that Congress amended the Bank Holding Company Act in the context of a bank holding company whose subsidiaries only engage in banking and closely related activities and did not see the potential of the Volcker rule applying to non financial companies. This seems implicit in the definition of "banking entity" set forth in Section 619(h) of the Dodd-Frank Act. It is inconceivable that Congress meant to define an auto parts manufacturer in Thailand, a light bulb manufacturer in Hungary or a worldwide auto manufacturer which happens to own an industrial bank in the United States, as to be treated as a "bank" on an enterprise wide basis for the purposes of the Volcker Rule. For this reason, AFSA believes an industrial bank, the only class of insured bank that may have an industrial parent company, or at least all affiliates of an industrial bank that do not directly control the industrial bank, should be exempt from the Volcker rule. Imposing the requirements of the Volcker rule on all of these entities will be a massively disruptive unintended consequence. In addition, the Volcker Rule, as proposed, could inadvertently apply to securitization vehicles who share the same Investment Company Act exemptions as traditional hedge funds and private equity funds. If institutions cannot access capital markets to fund financial assets through securitization, there will be negative constraints on liquidity and capital and the ability to make loans. Also, the resultant recordkeeping burdens and disruption will have no corresponding benefit for institutions.

Over the Counter Swaps

Title VII of the Dodd-Frank Act – titled the Wall Street Transparency and Accountability Act of 2010 – imposed many new regulations on the use of over the counter (OTC) swaps. In crafting the Dodd-Frank Act, Congress clearly intended a reasonably broad exception to many of the more burdensome regulations – most notably the posting of margin – for commercial end-users who use derivatives or swaps to hedge commercial risks. Several colloquies took place during Congressional debate over the Dodd-Frank Act emphasizing this point.

Unfortunately, despite clear Congressional intent, regulators have proposed rulemakings that would result in an unduly limited interpretation of the commercial end-user exception. End-users enter into derivatives or swaps to manage risk in order to maintain competitiveness, provide stable financing and pricing to customers, and limit risk to the financial system as a whole. If implemented as currently drafted, these rules would cause significant harm to the economy by increasing regulatory costs and tying up vital capital that could otherwise be used for job creation and economic growth.

The currently proposed rules could have a particularly pernicious impact on captive finance companies, which provide financing for the sale of products manufactured by their parent company. In recognizing the unique role captive finance companies play in facilitating the sale of manufactured products and limited, if any, systemic risk they pose, the Dodd-Frank Act specifically exempted such entities from the more burdensome aspects of Title VII. However, the Commodity Futures Trading Commission's (CFTC) rulemaking in this area has been ambiguous, leading to uncertainty for captive finance companies regarding whether they qualify for the exemption.

In addition to running counter to clear Congressional intent, subjecting captive finance companies to mandatory clearing and margin requirements would hurt the U.S. economy and job creation in several important respects. First, it would significantly increase the cost of hedging, creating a disincentive for companies to hedge their legitimate commercial risks. This would push risk and volatility back into the manufacturing sector. It would also drain vital liquidity from the captive finance companies.

Increased costs combined with less liquidity will result in higher borrowing costs and increased prices for consumers. Most captive finance companies are in the vehicle and equipment space – industries that play an essential role in the success of their manufacturing parents and directly contribute to thousands of U.S. jobs. It is incomprehensible that regulators want to impose excessively burdensome regulations on entities that act as market stabilizers because they continue to make credit available, regardless of the economic climate.

Another concern with imposing margin requirements is the potential disruption in the asset-backed securitization markets, since securitization transactions often use derivatives to protect investors from market risks and support high credit ratings required to access these markets. Margin requirements could force major structural changes on securitization transactions, which enable many captive finance companies to fund loans and leases to dealers and consumers at competitive rates.

Annual Privacy Notices

Regulation P of the Board of Governors of the Federal Reserve System and parallel regulations of other Federal agencies govern the treatment of nonpublic personal information about consumers. These regulations generally require that financial services providers give a privacy notice to a customer annually during a customer relationship.

AFSA does not believe that providing consumers annual notices where the provider's privacy practices have not changed since the last notice, at least where the provider does not share information with other firms (or shares in narrow cases), benefits consumers. On the contrary, we believe that there should be an exception from the requirement to provide an annual privacy notice where the provider’s privacy practices have not changed since the last notice. Sending annual notices is extremely expensive and there seems little point to doing so if the provider’s practices have not changed. Consumers can always access a provider’s practices on-line or by contacting the provider and requesting a copy.

Electronic Disclosures

We believe that in light of the pervasive usage of the internet and email, there are many opportunities to streamline regulations by permitting issuers to provide disclosures electronically, without regard to the requirements of the Electronic Signatures in Global and National Commerce Act (E-Sign Act), especially when the transaction to which the disclosure relates is being conducted by the consumer electronically. In such instances, the consumer’s decision to engage in that transaction online should be deemed the functional equivalent of consent to electronic disclosures. For example, when a consumer applies online for a card, an issuer should be permitted to deliver the account-opening disclosures, if the customer is approved, or the adverse action notice, if the consumer is declined, electronically, without regard to the E-Sign Act requirements. Moreover, consumers who wish to take advantage of a promotional rate for a credit card online, such as by transferring a balance, should be permitted to do so, provided the promotional rate disclosures are delivered electronically without regard to the E-Sign Act. Similarly, card issuers should be permitted to electronically provide consumers who have provided their email addresses with cardholder agreements and billing statements, even without regard to the requirements of the E-Sign Act. Requiring these disclosures to be provided in writing or electronically only if the E-Sign Act requirements are met only serves to prevent the disclosures from being provided in a timely manner and inhibits the ability of a consumer to use the features and benefits of the consumer's account.

Systemic Reform of the Federal Regulatory Process

The complexity, likely impact and lack of Congressional oversight over the Dodd-Frank Act is merely one example of a broken regulatory process and its problems are doubtlessly manifested in other major regulatory initiatives impacting all segments of the economy. In fact, the role of the regulators has become so pervasive that: a) management is impeded from making basic operational decisions with checking with and getting approval from regulators and b) the cost of regulatory compliance has gone up dramatically without any increase in effectiveness.

Therefore, AFSA believes that the entire regulatory process is in need of comprehensive, systemic reform. AFSA appreciates your sponsorship of the Regulations from the Executive In Need of Scrutiny (REINS) Act (H.R. 10), which would prevent federal agencies from implementing major regulatory initiatives without Congressional approval. We urge you to do so again and seek its passage as soon as possible.

That bill ensures that new major rules that impose annual economic costs in excess of $100 million or otherwise have significant economic or anticompetitive effects cannot take effect unless Congress passes a Joint Resolution approving the regulation within 90 session or legislative days of the rule's submission to Congress.

We believe enactment of the REINS Act would restore Congressional oversight over federal agencies that are, all too often, adopting rules that either exceed their underlying statutory authority or reflect the views of unelected bureaucrats rather than elected officeholders constitutionally charged with creating public policy.

Most federal agencies promulgate rules subject under authority of the Administrative Procedures Act of 1946 (APA), which requires agencies to keep the public informed of their organization, procedures and rules; provides for public participation in the rulemaking process; establishes uniform standards for the conduct of formal rulemaking and adjudication and defines the scope of judicial review.

Unfortunately, the APA provides little protection when federal agencies exceed their congressional mandates. Happily, there is a model that does so. In 1975, in response to concerns with the Federal Trade Commission (FTC), Congress enacted the Magnuson-Moss Warranty Act that imposed procedural safeguards on FTC rulemaking.

Under Magnuson-Moss, the FTC must first show "substantial evidence" before it is able to regulate "prevalent" unfair and deceptive acts. In addition to APA procedures, the Magnuson-Moss Act requires two notices of proposed notification, prior notification to Congress, an opportunity for informal hearings, and, importantly, possible cross-examination of witnesses. Magnuson-Moss also requires that the FTC justify a new rule with "particularity" after obtaining objective evidence based on a relevant market taken as a whole rather than the FTC's (and doubtless other agencies) previous reliance on anecdotal evidence.

AFSA believes that, at a minimum, the procedural safeguards of the Magnuson-Moss Act should be extended to other forms of federal regulatory rulemaking.

*

AFSA looks forward to working with you. Please feel free to contact me with any questions at 202-466-8616 or bhimpler@afsamail.org.

Sincerely,

Bill Himpler
Executive Vice President
American Financial Services Association