IMPROVING AMERICANS' FINANCIAL SECURITY:

The Importance of a CFPB Director

December 2011

EMBARGOED UNTIL 8:00 PM EST, DECEMBER 4, 2011

THE WHITE HOUSE
WASHINGTON

The Importance of a CFPB Director

A little over a year ago, the President overcame the fierce lobbying from the financial industry and signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new law put in place reforms that reduce excessive risk-taking on Wall Street, as well as protections that encourage a strong, stable financial system that can support sustained economic growth.

The Act also established the strongest consumer protections in our history, for the first time charging one agency—the Consumer Financial Protection Bureau (CFPB)—with the responsibility of protecting and educating Americans who use financial products. Implementation of Wall Street Reform and the stand-up of the CFPB have already started transforming our financial system and benefiting consumers by ensuring that financial service providers compete on the basis of the services they provide and not on hidden fees or other harmful practices.

However, one of the most important components of Wall Street reform is putting in place a Director of the new CFPB. It is only with a Director that the CFPB can exercise its full authorities and make good on the consumer protection goals of Wall Street Reform. Without a Director, the CFPB cannot fully supervise[1] non-bank financial institutions such as independent payday lenders, non-bank mortgage lenders, non-bank mortgage servicers, debt collectors, credit reporting agencies and private student lenders.[2] Without a Director, Americans will not be protected from falling prey to many of the harmful practices that contributed to the worst financial crisis since the Great Depression.

CFPB's inability to exercise its full authority while it awaits a Director affects the lives and financial security of tens of millions of American families who rely on non-bank financial institutions for their financial needs. Indeed, whether it is shopping for a mortgage or private student loan, or having one's credit report used in a lending decision, many middle class families are reliant upon non-bank financial actors.

A CFPB without its full authorities is also hamstrung in its ability to help level the playing field between small banks and nonbank financial service providers. For too long, banks were playing by one set of rules, while other parts of the financial industry, like some payday lenders or independent mortgage brokers, were playing by another, often with little or no oversight.

This report outlines the role that these non-bank actors have in affecting the lives of typical American families. It documents the degree to which middle class families rely on non-bank financial institutions; highlights some of the harmful, non-transparent practices that consumers could fall victim to in these

[1]Supervision includes the authority to, among other things, examine or require reports from an institution, to ensure compliance with federal consumer financial law, and to monitor to detect and assess risk to consumers. Historically, federal agencies have had supervisory authority over banks, but generally no such authority over non-bank financial providers.

[2] The CFPB can currently supervise large banks, credit unions, and their affiliates. With a Director, the CFPB will be able to supervise non-bank financial institutions in the mortgage, payday, and private student lending markets, as well as "larger participants" in other consumer markets as defined by regulation.

markets; and explains that these practices will continue to exist without comprehensive federal oversight as long as the CFPB lacks a Director.

The conclusion is clear: We cannot afford a system in which consumers are left in the dark about the risks they face when making financial decisions. And while Congress, the President, and the American public have made historic progress in establishing a single agency dedicated to protecting consumers, every day that CFPB goes without a Director is another day that American families remain at risk.

An Overview of Non-Bank Institutions’ Role in the Lives of Americans

Summary

Non-bank financial institutions like payday lenders interact daily with many American consumers. These non-bank institutions can offer consumers important financial services like credit and access to payment systems. In many instance they provide these valuable services to customers who may not have ready access to other forms of credit.

Yet, non-bank financial institutions such as payday lenders and debt collectors have generally not been subject to federal supervision. This has made it easier for some of them to engage in predatory business practices, often by providing poor information or misleading terms. This lack of federal oversight can pose serious risks to consumers because compliance with consumer protection standards is particularly important in these markets in order for consumers to understand the relevant costs and risks.

For example, while banks are examined by federal regulators to ensure compliance with federal consumer financial laws (such as the Truth-in-Lending Act), payday lenders are not subject to federal supervision to ensure such compliance. This is especially critical because some studies have found that payday lenders on average charge fees of roughly $16 for a $100 two-week loan. This translates into an annual percentage rate of roughly 400 percent for borrowers often already struggling with debt.[3] The fact that the CFPB cannot currently supervise payday lenders creates a serious regulatory gap that puts consumers at substantial risk.

Thus, while non-bank financial institutions can provide valuable financial services for communities with minimal exposure to financial markets, their products can be more expensive and less transparent than other alternatives in the market. These consumers deserve a full and clear accounting of the costs and benefits of these practices and fair service from these institutions.

[3] King and Parrish. Center for Responsible Lending. “Springing the Debt Trap: Rate caps are only proven payday lending reform.”

Measuring the Impact of Non-Banks in the Lives of Americans[4]

Across the country, tens of millions of American families use non-bank financial institutions for their financial needs. Although these non-bank institutions are often overlooked, they have a significant impact on the everyday lives of American families.

Sometimes the relationship between non-banks and consumers is undertaken knowingly and voluntarily, but in many cases American consumers are largely unaware of their indirect (e.g., credit bureaus) or perhaps involuntary (e.g., debt collectors) relationship with these institutions.

Highlighted below are some statistics that give a sense of the scale of non-bank activities and their impact.

- **Non-Banks Affect the Lives of Millions of Americans.**
  - Roughly ***200 million Americans*** rely on credit reporting agencies to report their credit histories accurately when applying for mortgages, loans to purchase cars and other goods, or credit cards to facilitate their daily financial transactions.[5]
  - Studies estimate that nearly ***20 million* individuals** use payday lenders.[6]
  - More than ***14% of consumers*** have one or more debts in collections.[7]
  - ***Over 4 million Americans*** have used prepaid cards.[8]

- **Each year Non-Banks Engage in Hundreds of Billions of Dollars of Transactions with American Families.**
  - Some industry forecasts expect the total dollars loaded onto prepaid cards climbing to ***$672 billion*** over the next few years, more than double the ***$330 billion*** put on prepaid cards in 2009.[9]
  - Industry estimates find that payday loans totaled more than ***$29 billion*** in 2010.[10] Additionally, other studies estimate that every year payday lending costs Americans ***$4.2 billion*** in high fees.[11]
  - Debt collectors receive over ***$40 billion*** annually from third party collections.[12]

---

[4] These numbers quantifying both the number of Americans affected and the amount of activity in each market are taken from a range of sources at different times using different methodologies. In addition, many consumers engage in multiple types of non-bank activities. As result these numbers should not be aggregated and instead should be taken as illustrative of activity that exists in the non-bank financial space.

[5] Stuart Pratt. Comments of Consumer Data Industry Association (CDIA). "RE: Information privacy and innovation in the internet economy." CDIA to National Telecommunications and Information Administration.

[6] Center for Responsible Lending. CRL Issue Brief. "A 36% APR cap on high-cost loans promotes financial recovery."

[7] Federal Reserve Bank of New York. "Quarterly Report on Household Debt and Credit."

[8] Federal Deposit Insurance Corporation. "National Survey of Unbanked and Underbanked Households."

[9] Mercator Advisory Group. "Seventh Annual Prepaid Card Forecast."

[10] Stephens Inc. Industry Report. "Payday Loan Industry."

[11] King, Parris, and Tanik. Center for Responsible Lending. "Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year."

[12] ACA International and Pricewaterhouse Coopers. "Value of Third-party Debt Collection to the U.S. Economy in 2007: Survey and Analysis."

A Deeper Look into Specific Areas of the Non-Bank Sector

Payday Loans:

Payday loans offer short-term funds at very high rates of interest (on average 400 percent according to some studies[13]) that are not always clearly disclosed. The borrower typically writes a post-dated personal check in the amount he or she wishes to borrow plus a fee, in exchange for cash. The lender cashes the check at the agreed-upon date, which is usually the borrower's next payday. These loans are also called "cash advance loans" or "check advance loans." Borrowers in desperate need of cash may agree to disadvantageous loan terms. The payday loan industry has grown significantly over the past decade.

- **Some reports indicate that nearly 20 million Americans use payday lenders**.[14] The payday lending space is especially important as studies have found that payday lenders on average charge fees of roughly $16 for a $100 two-week loan.[15] If borrowers miss payments these fees can begin to accumulate resulting in extremely high total payments. Some studies have found that as a result payday loan borrowers are paying nearly $4.2 billion in high fees annually.[16] Payday loans can thus create a debt-and-fee-spiral that some customers may find extremely difficult to exit.

- **Payday loans are used more often by individuals with poor credit.**[17] In some cases their financial resources have been depleted by an emergency, sustained unemployment, or family illness. These individuals are particularly vulnerable to unfair payday lending practices.

The CFPB will also be able to establish federal supervision and oversight over payday lenders and larger participants in other financial service markets. The CFPB's full authorities will permit action to help prevent unfair, deceptive, or abusive practices affecting the Americans, which frequently rely on non-bank financial institutions.

Money Services Businesses and Prepaid Cards:

Many consumers depend on non-bank money services to meet their day-to-day financial needs. These services include money transmitting, money orders and check cashing, which consumers may use to cash their paychecks, pay their rent and utilities, or meet other routine and emergency financial needs. Money transmitting is a significant money services business. It generally involves the receipt of funds by a transmitter that then sends the funds to a recipient in another location on behalf of a consumer, for a fee. Prepaid cards often serve as substitutes for a checking or a savings account for those that lack them.

---

[13] King and Parrish. Center for Responsible Lending. "Springing the Debt Trap: Rate caps are only proven payday lending reform."
[14] Center for Responsible Lending. CRL Issue Brief. "A 36% APR cap on high-cost loans promotes financial recovery."
[15] King and Parrish. Center for Responsible Lending. "Springing the Debt Trap: Rate caps are only proven payday lending reform."
[16] King, Parris, and Tanik. Center for Responsible Lending. "Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year."
[17] Chatterjee, Goetz, and Palmer. "An Examination of Short-Term Borrowing in the United States."

There are many types of prepaid cards, including general purpose reloadable open-loop payment cards,[18] electronic benefits transfer cards,[19] and payroll cards.

- **Money transmitting businesses are used to send funds internationally and domestically, often for paying routine bills.** One study estimates that total transaction volume for money transmission could be over $70 billion.[20]

- **Prepaid card products affect a large number of consumers.** Industry estimates find that the prepaid card business involves over $330 billion[21] with millions of individuals having used these cards.[22] Some industry forecasts expect the prepaid card business to grow to $672 billion over the next few years. [23]

Independent Non-Bank Mortgage Lenders and Servicers:

Independent non-bank lenders originate, close, and fund loans using sources of funds other than bank deposit capital. Servicers manage payments on performing loans and work through options for addressing distressed homeowners.

- **Many of the largest subprime lenders during the housing bubble were independent non-bank mortgage bankers who were not federally supervised.** During the run-up to the financial crisis, independent non-bank mortgage bankers were amongst the largest originators of subprime mortgages.[24]

- **Default rates on subprime loans originated during the bubble are often much higher than prime loans:** The cumulative default rate on subprime mortgages made in 2006, when the housing bubble reached its height, now exceeds 50 percent. Prime loans of the same vintage were less than 10 percent.[25]

Debt Collectors:

Debt collectors are in the business of recovering money owed on delinquent accounts. Many debt collectors are hired by companies that are owed money by consumer debtors; debt collectors often operate for a fee or for a percentage of the total amount collected.

---

[18] An open-loop card usually carries the logo of a major payment network, such as American Express, Discover, MasterCard, or Visa, and can be used wherever those cards are accepted.
[19] Electronic benefits transfer cards are made available by the federal government and by state and local governments to allow individuals to access government benefits such as Social Security or unemployment compensation.
[20] KPMG. "2005 Money Services Business Industry Survey Study."
[21] Mercator Advisory Group. "Seventh Annual Prepaid Card Forecast."
[22] Federal Deposit Insurance Corporation. "National Survey of Unbanked and Underbanked Households."
[23] Mercator Advisory Group. "Seventh Annual Prepaid Card Forecast."
[24] Inside Mortgage Finance. *2011 Mortgage Market Statistical Annual.*
[25] Standard and Poors. "U.S. Residential Mortgage Default Index: Defaults Are Waning But Cumulative Default Rates Remain Extremely High For Recent Vintages."

- **Debt collection is a multi-billion dollar industry.** About $1.2 trillion of consumer debt is currently delinquent, with $834 billion seriously delinquent (at least 90 days late).[26] Debt collectors received over $40 billion from American consumers for third party collections.[27]

- **While collection activities can create economic and social value, they can also be a source of abuse.** Personal hardships such as divorce, family member death, illness or job loss are often the precursors to a household falling behind on debt payments. These consumers may lack the resources to protect themselves from predatory collection behavior. According to the FTC, 27 percent of all complaints received pertain to the debt collection industry.[28] Of the complaints against collectors under the Fair Debt Collection Practices Act (FDCPA), nearly 50 percent cited harassment.[29]

Credit Bureaus:

A credit bureau is an agency that collects and maintains individual credit information and sells it to lenders, creditors, and consumers in the form of a credit report. Credit bureaus receive consumer credit information from banks and other businesses. When another business with a "permissible purpose" requests to see a credit report, the credit bureau sells it to them.

- **Most Americans have credit files.** The major consumer credit reporting agencies maintain credit files on over 200 million adults. These Americans rely on credit reporting agencies to report their credit histories accurately when they apply for mortgages, loans to purchase cars and other goods, or credit cards to meet their day to day needs.[30] Many consumers have filed complaints to the FTC regarding errors in these reports.

- **There can be differences between credit scores sold to consumers and scores used by lenders to make credit decisions.** Consumers who are unaware of the variety of credit scores available in the marketplace may purchase a score believing it to be their "true" score. The most significant adverse impact on a consumer from score differences would likely occur if the credit scores the consumer buys give a substantially different impression of his or her credit risk than credit scores that a lender would use.

- **The current system involves several different actors, all governed by the Fair Credit Reporting Act (FCRA):** Credit bureaus, which collect and sell credit information; furnishers of information to the credit bureaus, such as creditors and debt collectors; and lenders, who use consumer reports. Effective oversight requires authority over all the actors that make up the system.

---

[26] Federal Reserve Bank of New York. "Quarterly Report on Household Debt and Credit."
[27] ACA International and Pricewaterhouse Coopers. "Value of Third-party Debt Collection to the U.S. Economy in 2007: Survey and Analysis."
[28] Federal Trade Commission. "Federal Trade Commission Annual Report 2011: Fair Debt Collection Practices Act."
[29] Ibid.
[30] Stuart Pratt. Comments of Consumer Data Industry Association (CDIA). "RE: Information privacy and innovation in the internet economy." CDIA to National Telecommunications and Information Administration.

If credit bureaus and other larger consumer reporting agencies are brought within the CFPB's scope of supervision, the CFPB could examine and require reports from them to help ensure compliance with the federal consumer financial laws, obtain information about their activities and compliance systems or procedures, and detect and assess the risk to consumers.

The Impact of Non-Bank Financial Institutions' Practices on Specific Communities

As discussed earlier, non-bank institutions have a significant footprint in the lives of many Americans. Below are some of the problems that members of specific communities have confronted when dealing with non-bank institutions.

Service members

- **The Problem:** After receiving their first steady paycheck, enlisted service members are often lured into easy credit offers. According to the Department of Defense, nearly 50 percent of enlisted Service members are under the age of 25, often lacking experience in managing finances, and without a cushion of savings to help them through emergencies.[31]Even older military members often move to new locations where they may be unfamiliar with local financial institutions and susceptible to deceptive marketing practices. Installment loan companies often have offices near military bases and market their loans online exclusively to the military. The Department of Defense found that the cost of loans was often not disclosed on installment lender sites and annual rates ranged from 391 percent to 782 percent APR for two-week installment loans.[32]

- **How the CFPB will help:** Without a Director, the CFPB will not be able to establish robust federal supervision over key non-bank financial service providers, such as high cost lenders and debt collectors. With a Director, the CFPB will be able to combat practices by non-bank actors that harm consumers, helping our service members to avoid hidden fees and keep more money in their wallets.

Older Americans

- **The Problem:** In some surveys, one out of every five Americans over the age of 65 have reported to be victimized by financial scams.[33] Financial abuse directed towards the elderly is a growing threat to the economic security of our country's senior citizens.

- **How the CFPB will help:** When it can exercise its full authorities, the CFPB will, for the first time, provide ongoing federal oversight of both non-bank companies and banks in the mortgage market, and protect borrowers from unfair, deceptive or abusive lending practices regardless of the type of lender. Older Americans also take payday loans, and the CFPB's full authorities will include examining payday lenders to ensure compliance with federal consumer financial laws.

[31] Department of Defense. "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents."
[32] Ibid.
[33] Investor Protection Trust. "Elder Investor Fraud Survey."

Students

- **The Problem:** According to a National Endowment for Financial Education poll of young people aged 22 to 29 years old, survey respondents with debt indicated that having debt had influenced important decisions, including causing them to delay or not pursue further education (29 percent), to take a job they would not otherwise have taken (22 percent), or to move in with parents or other relatives (19 percent).[34]

- **How the CFPB will help:** With its full authorities, the CFPB will be able to supervise private student lenders, fight unfair lending practices, and require lenders within its jurisdiction to follow the rules.

Latinos

- **The Problem:** Of the Latino households that send international electronic transfers ("remittances") to Latin America, many use a remittance company to do so. In recent years, more than one-in-three Latinos say they sent remittances.[35] Many of these consumers are unfamiliar with the terms and conditions of the remittance or its fees. Studies have also found that 36 percent of payday loan borrowers in California were Latino-Americans and 34 percent of borrowers in Texas were Latino-Americans, as well.[36]

- **How the CFPB will help:** The CFPB has the authority to issue a regulation requiring important disclosures to remittance customers, but it needs its full authorities to examine remittance providers for compliance with current law and future regulations. With its full authorities, the CFPB will be able to establish, for the first time, federal oversight over the larger participants in a market such as certain companies that provide money transfer services to consumers, and will enforce new protections for certain remittances, including requirements to provide consumers easy-to-understand, pre-transactional pricing disclosures and receipts.

[34] National Endowment for Financial Education. "Young Adults' Finances Poll."
[35] Pew Center. "Hispanics and the Economic Downturn: Housing Woes and Remittance Cuts."
[36] Center for American Progress. "A Word of Caution on Payday Loans."