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U.S. Consumer Agency Gears Up for New Supervision of Non-Banks

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By Carter Dougherty

Jan. 18 (Bloomberg) -- Thousands of storefront mortgage shops, payday lenders and debt collectors are set to get visits from U.S. inspectors for the first time under provisions of the Dodd-Frank regulatory overhaul.

The new Bureau of Consumer Financial Protection, which officially begins work in July, is gearing up to inspect more than 70,000 non-bank financial firms similar to the way other regulators oversee banks. Its focus, at least at the start, is likely to fall on larger, publicly listed financial firms, according to regulators and industry officials.

"It reminds me of the old saying, 'Pigs get fed and hogs get slaughtered,'" John Bley, chairman of the financial institutions group at the law firm Foster Pepper in Seattle and a former Washington state bank regulator, said in an interview. "The bigger the animal, the greater the chance of getting supervisory scrutiny."

In some states, the new agency will subject firms to examinations for the first time. In others, federal supervision may take place in addition to state supervision. The result will likely be new compliance burdens for debt collectors such as Encore Capital Group Inc., payday lenders such as Advance America Cash Advance Centers Inc. and credit bureaus including Equifax Inc., CitiFinancial, the consumer credit division that Citigroup Inc. wants to sell, and SLM Corp., the education lender known as Sallie Mae, could also be affected.

Information Sharing

Non-bank financial firms, such as mortgage originators, helped fuel the 2008 financial crisis by marketing loans to borrowers with shaky credit. Consumer groups have blamed other non-bank firms, such as title loan companies and payday lenders, of taking advantage of hard-pressed consumers and charging abusively high interest rates.

The new bureau struck an information-sharing deal with state banking supervisors this month, the first step toward developing common standards for examinations of non-depository firms, Thomas Gronstal, Iowa's superintendent of banking and chairman of the Conference of State Banking Supervisors, said in an interview.

Elizabeth Warren, the special adviser President Barack Obama appointed to set up the bureau, said in an interview that that supervising non-bank firms will be the "single most expensive" task the bureau undertakes.

Warren hired Peggy Twohig, a 17-year veteran of the Federal Trade Commission who helped prosecute debt collectors, to put together the bureau's non-bank supervision team. Richard

Cordray, the former attorney general of Ohio, has been named to head the agency's enforcement division.

Avoiding Lawsuits

Supervision -- a process where government officials physically walk into firms and examine records -- is shaping up as an important form of influencing those businesses, David Cotney, acting commissioner of banks in Massachusetts, said in an interview. Visiting businesses in person gives agency officials a chance to change behavior without resorting to a formal rule or lawsuit. "We don't think the procedure will be that different from what we do today" for banks, Cotney said.

Supervision and regulation of non-bank financial firms, which will also affect mortgage originators not linked to a depository bank, is also a political priority for Warren.

Bank Competitors

Warren is under pressure from community banks -- a constituency she is wooing -- to regulate an industry that competes with the banks. Alex Sanchez, chief executive of the Florida Bankers Association, said federal supervision will be an important step. "Saying the states will supervise the non-financial firms is like saying no one will," Sanchez said in an interview. "They don't have the money."

Mark Tarpey, supervisor of the consumer division of the Indiana Department of Financial Institutions, said the goal of the federal agency isn't to put non-financial firms out of business but to raise the profile of consumer issues. Tarpey is also president of the National Association of Consumer Credit Administrators, a group of state officials who supervise non-bank firms.

The financial-regulation overhaul that President Barack Obama signed in July subjects all non-bank firms to federal regulation and supervision for the first time, a step intended to help build a legal framework for financial services.

For example, debt collectors who do business in Indiana must register yet the state's 11 field examiners have no authority to examine their books, Tarpey said. As a result, any supervision would have to come from the federal government.

'A Lot of People'

Raymond Natter, a lawyer with Barnett Sison & Natter PC in Washington, said the sheer numbers of non-financial firms suggest supervision will be difficult for the new agency. "The numbers just don't make sense," said Natter, a former deputy chief counsel at the Office of the Comptroller of the Currency. "Just to walk in the door of many thousands of institutions you need a lot of people."

The Conference of State Banking Supervisors found there were 71,121 non-bank firms at the end of 2009, roughly 10 times the number of banks and thrifts. A separate survey found more than 121,000 mortgage originators.

Bley predicted that the large number of firms would lead supervisors to prioritize in areas where they already do work, and focus on larger companies about which state officials have fielded complaints.

'Chaotic'

"Early on it is going to be absolutely chaotic," he said. "Supervision will have to happen incrementally."

In areas where supervision is spotty to non-existent, like debt collection, the industry "will squeal like a pig stuck under the door," said William R. Bartmann, chief executive of CFS II, a Tulsa, Oklahoma-based collection firm.

Bartmann has long experience in the debt collection business. His previous company, Commercial Financial Services, was shut down by regulators amid allegations of fraud and mismanagement; a partner served jail time but Bartmann was acquitted of charges of conspiracy, fraud and money laundering.

Oklahoma currently does no examination of debt collection agencies, Bartmann said: "If the supervisory arm of CFPB were to require agencies to go through an annual audit, that would be a big change. Elizabeth Warren could do that on day one if she wanted to."

Adam Peterman, director of federal government affairs for ACA International, a group that includes debt collectors, said the industry will need to see the agency's exam practices before it can fully understand the costs. "It's hard to understand what they will be examining because there is not an apples-to-apples comparison between a community bank and a debt collector," Peterman said in an interview.

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