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Federal Reserve Officials Said to Be Wary of Consumer Agency

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By Robert Schmidt and Scott Lanman

April 12 (Bloomberg) -- Federal Reserve governors are discussing whether to publicly oppose placing within the central bank a consumer-protection agency that they would not be able to control, three officials familiar with the matter said.

Under regulatory-overhaul legislation approved last month by the Senate Banking Committee, the Fed would house the autonomous organization while having no control over its budget, personnel or rulemaking. Central bank staffers have concluded that the Fed may nevertheless be held accountable for possible missteps by the new entity, according to the three officials who spoke on condition of anonymity.

"It's a no-win situation," said Kevin Petrasic, a banking attorney at the Paul, Hastings, Janofsky & Walker LLP law firm in Washington who formerly worked at the Office of Thrift Supervision.

Fed governors are reluctant to alienate lawmakers by coming out against the plan, which was proposed by the committee's chairman, Christopher Dodd, as part of a compromise to attract Republican votes. The Fed's board has remained silent because it doesn't want to undo the other part of the deal that would allow it to retain bank supervisory powers.

In negotiating the bill, Senate Republicans, led by Bob Corker of Tennessee, last month sought to keep prudential oversight and consumer protection under the same roof to prevent banks from getting conflicting orders from separate regulators. At the same time, Republicans did not want the consumer unit to be under the Treasury Department for fear it would be influenced by the White House.

Stand-Alone Agency

President Barack Obama, on the other hand, wanted Congress to create a stand-alone agency to make sure consumer protection received priority treatment.

The compromise, housing the consumer unit within the Fed, was suggested by Corker in part because the Fed, as an independent agency, has a chairman who is presidentially appointed yet is not part of the Cabinet. The Fed also has a funding source that is not dependent on congressional appropriations. To satisfy the White House's demand for independence, Dodd would not let the Fed board exercise authority over the unit.

At the same time, the banking committee's bill would keep the central bank's supervision of the biggest financial firms after Dodd previously proposed stripping all its oversight powers.

Floor Debate

The Dodd proposal could be subject to change once debate begins on the Senate floor, possibly later this month, when lawmakers will have their first real chance to offer amendments.

Alabama Senator Richard Shelby, the banking panel's senior Republican, earlier this month privately floated a new plan for a consumer-protection agency separate from the Fed, an official familiar with the matter said.

Chairman Ben S. Bernanke was originally opposed to setting up such an entity because it would take away a division at the Fed. He has softened that position in congressional testimony.

For now, staffers have advised Bernanke to provide a noncommittal answer in case lawmakers ask for his position on having the agency within the Fed. The main talking point, said one official, is that the Fed is not sure how the relationship with the consumer bureau will work.

"There will be a great deal of confusion, and one of the tasks the Federal Reserve would have to do is put on a major teaching campaign to try to dispel that," said Andrew Brimmer, a former Fed governor who is now president of Brimmer & Co., a Washington-based consulting firm.

Oversight Failures

The Fed has been a target of attacks over the past three years by lawmakers and consumer groups over its failure to enforce mortgage rules that helped fuel the subprime loan crisis that led to bailouts of American International Group Inc. and the bankruptcy of Lehman Brothers Holdings Inc.

Dodd has been critical of the central bank for years. He said several times in 2009 that the Fed's record on consumer protection and bank regulation was an "abysmal failure." In March 2007, he castigated the central bank for sitting on the sidelines while "hard-working Americans" were preyed upon by "unscrupulous financial actors."

While Bernanke has gained some plaudits for mortgage regulations since becoming chairman, not all of the criticism has faded. House Financial Services Committee Chairman Barney Frank, who shepherded through his chamber legislation that includes a stand-alone consumer agency, said the Dodd plan to place the organization within the Fed was a "joke."

Guilt by Association

Fed officials are concerned that the consumer protection division's location within the central bank may give people the idea that it is run by the board, even though the entity is slated to have a presidentially appointed leader and control over its own budget.

In a March meeting Bernanke held with community development bankers, some officials were struck that the attendees were under the impression that the consumer agency would be operated by the central bank. A Fed staff member politely corrected the record, one official said.

The Fed's concerns may be unfounded, one former U.S. regulator said. Should the proposal become law, members of Congress may let the central bank off the hook for any failures of the new entity, said Eugene A. Ludwig, chief executive officer of Promontory Financial Group, who served as U.S. comptroller of the currency from 1993 to 1998.

"Congress won't be unfair in this regard," Ludwig said. "It's just not how they work." As an analogy, if the Office of Thrift Supervision, housed within the Treasury Department, makes a misstep, lawmakers don't blame the Treasury, he said.

$300 Million

Still, the Fed is also beginning to confront the need to add what may be thousands of new workers for the consumer group across the country without controlling a budget that could be as much as $300 million.

The Fed does not know whether the new workers will be Fed employees or whether the consumer agency will need its own human resources department. Another issue: will the unit use Fed letterhead and its seal, the officials said.

Former St. Louis Fed President William Poole said the arrangement will be "administratively awkward" and has the potential to mislead the public.

"There can only be one captain on a ship," said Poole, now a senior fellow at the Cato Institute in Washington and distinguished fellow in residence at the University of Delaware. "If you want to have a separate ship, then it really ought to be a separate ship."

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