

The dark heart of banking regulation

LA Times 5/19/10 B1, B6

MICHAEL HILTZIK

Over the years, Daniel J. B. Mitchell has consulted for many economic institutions at the national level, including the Congressional Budget Office and the Federal Reserve.



So you'd think that when he tried to sic the nation's banking regulators on E-Trade Bank over what he regarded as a deceptive policy, he'd be taken seriously.

You'd be wrong. What E-Trade pulled on Mitchell, 67, was bad enough. But what government regulators have pulled on him is even worse.

As evidenced by the voluminous file of e-mails and faxes assembled by the professor emeritus of management and public policy at UCLA — a veritable log-

book of his journey into the dark heart of federal banking regulation — regulators passed the case to one another like a cheap juggling act, willfully misconstrued his complaint, groused about him behind his back, and (here's the bottom line) failed to take any action. Unless you think doing nothing is a form of action.

Congress is trying to decide at this very moment which federal agency should have the responsibility for protecting the banking consumer from sharp practice. So I asked Mitchell which of the agencies he had dealt with stood out as the best candidate for the job.

"They all stood out," he told me. "They stood out as not wanting to handle this problem."

Mitchell's complaint dates from September 2009, when E-Trade Bank notified him that one of his certificates of deposit was about to mature. He could cash out the 30-month CD if he

[See Hiltzik, B6]

Federal bank regulators spring to inaction on CD grievance

[Hiltzik, from B1] wished. Otherwise it would automatically renew for another 30 months at the "prevailing interest rate."

He checked around, determined that the prevailing annual rate in the marketplace for such CDs was somewhere in the 2% to 3% range, and decided to let his money ride. A few weeks later, he got a notice from E-Trade that the CD had been rolled over — for 0.65%.

The notice arrived after the grace period for penalty-free redemptions had passed, and E-Trade told Mitchell that if he still wished to cash out, he'd have to pay a fee of \$16.64.

Mitchell interpreted E-Trade's policy as a bait-and-switch. The firm hadn't disclosed in advance that its definition of "prevailing rate" was "simply the current rate offered by E-Trade," as a company executive later explained. To Mitchell, this sounded like the rate "prevailing" in a very small geographical area, namely the space inside E-Trade's Virginia headquarters.

He elected to turn the experience into a case study of how regulators do their jobs — a question of public policy, not of \$16.64. His first task was to determine which of the myriad bank regulators in Washington was E-Trade Bank's. The answer, according to "not-us" letters from the Federal Reserve and FDIC, was the Office of Thrift Supervision.

OTS, as it happens, acquired a reputation during the recent financial crisis as the poster child for lax regulation. To give you an idea, its portfolio included Washington Mutual and Countrywide Financial, neither of which will go down in history as a victory for aggressive oversight.

OTS treated Mitchell as just another customer irked at earning less on his money than he wanted. The agency parroted E-Trade's responses to him — one agency rep told him the bank's rates "are appropriately based on the federal funds rate," even

though that's the rate charged on overnight bank borrowings, not 30-month CDs, and it's being kept almost at zero by the Fed to assist financial recovery.

When Mitchell persisted, OTS treated him like a pest. In an e-mail exchange Mitchell obtained through a Freedom of Information Act request, OTS Consumer Affairs Analyst Carol Reap passed one of his messages on to a colleague with a notation calling it "my Christmas Eve present.... No matter what he said I knew he wouldn't be happy."

Reap added that Mitchell "has been fairly abusive to E-Trade staff over the phone," though it isn't clear where she got that impression or why it should be any of her business. Mitchell, for the record, says he had only one phone conversation with anyone at E-Trade, and it wasn't "abusive."

Reap's colleague, by the way, wondered to her "why someone so knowledgeable about ... certificate pricing would invest at a non-competitive rate." Apparently he failed to comprehend that Mitchell was saying E-Trade had *deceived* him into taking the low rate. Some regulator.

I asked OTS about these matters, and to give credit where credit is due, the agency responded in record time. Its response was "no comment." For its part, E-Trade said that it doesn't comment on "customer interactions," but that Mitchell could always have gone online to check its "prevailing" rates, which it says were posted up to 14 days before his CD's maturity date.

Mitchell's document file suggests that OTS never tried to determine whether E-Trade was engaged in widespread misrepresentation. "They didn't treat this as a problem that applied to more than one guy," he says. "They didn't say, 'Maybe we ought to find out how many CDs E-Trade is turning over this way.'"

The company's annual report for 2009 states that

its CD balances that year averaged more than \$17 billion, and that it paid an average 2.58% on that money, or a total of about \$45 million in interest. If it could cut its average rate on all CDs to the 0.65% it's paying Mitchell rather than, say, the 1.5% some banks are paying even for one-year CDs, that would pencil out to a possible savings of \$14 million a year. E-Trade has lost money in each of the last three years, so one would guess that it counts every penny.

In February, E-Trade announced that it would no longer automatically renew CDs in the future, but would cash them out on maturity. It's remotely possible that the change resulted from pressure from the OTS, though it's more likely merely a reflection of E-Trade's desire to shed the CD business — earlier this year the firm said it would no longer sell new CDs to anyone.

In any case, E-Trade didn't change the rules retroactively, so Mitchell is still stuck with his cheese-paring rate. (He's keeping the CD so his complaint will stay in OTS' active file.)

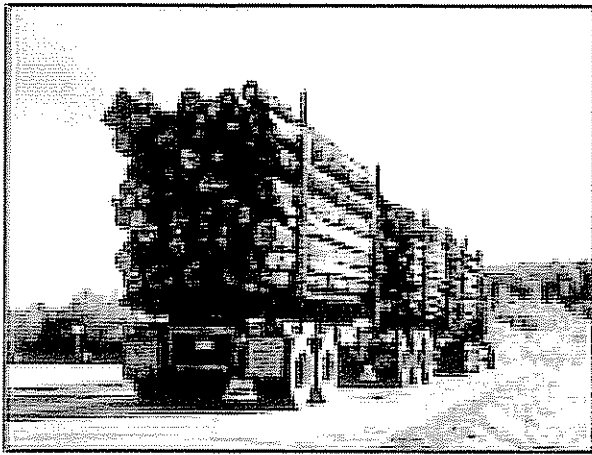
Mitchell's fruitless campaign should make us wonder why some people in Congress are so resistant to creating a unified financial consumer protection agency. As it is today, it's a daunting task even to figure out where to take a complaint.

But his experience also suggests that creating a single agency won't be enough, as long as regulators think they work for the banks, not the taxpayers. "It would be nice to have one agency to go to," Mitchell says. "But if you do have that place, it would be nice if they actually tried to handle your problem."

Michael Hiltzik's column appears Wednesdays and Sundays. Reach him at mhiltzik@latimes.com, read past columns at www.latimes.com/hiltzik, and follow @latimeshiltzik on Twitter.

BUSINESS

REGISTRATION REQUIRED FOR BUSINESS CLASS SEATING



Stacks of lumber at a mill in British Columbia, Canada.

Pact halts timber harvest in large swath of Canada

Lumber industry agrees to three-year moratorium

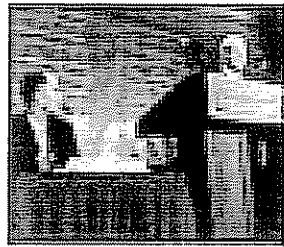
The lumber industry has agreed to a three-year moratorium on logging in a large swath of British Columbia, Canada, in a landmark pact with the provincial government.

The agreement, which was announced today, covers about 10 million acres of forest land in the province's interior. It is the largest logging moratorium in the world.

The pact, which was negotiated over several months, calls for a complete halt to logging in the designated areas for three years. During that time, the forest will be protected and managed for future generations.

The agreement also calls for the creation of a new forest management plan for the province. This plan will take into account the needs of the timber industry, the environment, and the local communities.

The pact is a significant step towards sustainable forest management in British Columbia. It will help to ensure that the province's forests are protected and managed for the long term.



"The forest business has been pretty bad for a few years now," said a representative of the industry.

CalPERS wants more tax money

CalPERS, the state's largest pension fund, is asking for more tax money to help cover its obligations.

The fund, which manages about \$100 billion in assets, says it needs an additional \$1 billion in tax revenue to meet its obligations.

NEW 'FLASH CRASH' DEFENSE

SEC officials are working on a new defense against "flash crashes" in the stock market.

The defense would allow the SEC to intervene in the market during a flash crash to prevent further price drops.

Senators grapple with derivatives

Senators are struggling to pass legislation that would regulate derivatives markets.

The legislation would require derivatives to be traded on regulated exchanges.



The bill would also require derivatives to be cleared through a central clearinghouse.

The dark heart of banking regulation

Banking regulators are facing a difficult task in regulating the derivatives market.

The regulators must ensure that the derivatives market is stable and transparent.

The article continues with a detailed analysis of the challenges facing regulators in the derivatives market.