



# Lombard Street

September 14, 2009

*The collapse of the world's financial markets has resulted in intense examination of how to restructure and reform regulation for banking, securities, insurance, and other parts of the financial services industry. Various regulatory proposals are already being circulated in academic and public policy circles. Governments around the world are considering reforms. The conversation and decisions surrounding these proposals will fundamentally impact how financial services is structured and conducted across the globe throughout the 21st century.*

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## About Lombard Street

Lombard Street is the first ever e-journal focused exclusively on financial services regulation. Titled after the famous treatise on banking regulation authored by Walter Bagehot in 1873, this biweekly journal is filled with original pieces from prominent thought leaders across the globe.

Overseen by a multi-disciplinary editorial board led by David S. Evans of the University of Chicago and University College London, Lombard Street delivers original articles that will shape and chronicle the evolution of the impending 21st century financial services regulation reform.

Lombard Street leverages the power of the Web to provide germane and timely thought leadership to a broad and relevant audience. The online format works to fuel interaction between readers and authors, extending the dialogue beyond just the articles.

Lombard Street lives within [www.finreg21.com](http://www.finreg21.com), a non-partisan online media entity developed for, and by, those involved in or affected by financial services regulation. Launched in March 2009, it provides a platform for community members to express a diverse set of opinions, and allows the community to own and operate the discussion. FinReg21 both aggregates and produces a rich mix of content underscoring expert commentary: dedicated experts blogging daily, original reporting from Washington, D.C., virtual roundtable webinars lead by the leading lights in this space, a library of papers and reports, expert-to-expert interviews, among other features.

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## Consumer Protection and the Financial Crisis: An Indepth Look at the Proposed Consumer Financial Protection Agency Act of 2009

David S. Evans<sup>†</sup>, *Editor in Chief Lombard Street*

This September 14<sup>th</sup> issue of *Lombard Street* comes a day before the one-year anniversary of the collapse of Lehman Brothers. Rightly or not that event is often used to mark the start of the global financial crisis that had central bankers scurrying to come up with quick solutions to prevent a meltdown of the financial system. With the deepening crisis came calls for reform of financial regulatory institutions which were widely seen to have failed to avert the crisis and slow to deal with it effectively. The Obama Administration's *Financial Regulatory Reform: A New Foundation* which was released in mid-June 2009 has proposed many changes in U.S. regulation in response.

A sweeping overhaul of consumer financial regulation is one of the central underpinnings of the Administration's plan. The Administration's report proposed consolidating most enforcement of federal consumer protection in a new agency that would assume responsibility for regulating most existing consumer protection laws and have additional powers as well. A month later the Administration presented Congress with the "Consumer Financial Protection Agency Act of 2009 to create this agency and make other modifications to consumer financial protection laws.

That legislation and the agency it would create is the subject of this issue. We begin with an article by Professor Oren Bar-Gill who teaches at the law school at New York University. He makes the case for the CFPA Act and responds to many of the criticisms that have been leveled so far. He concludes that the new agency could enhance consumer protection even if some of its more controversial aspects were eliminated. The CFPA Act envisions a stronger role for the states than is provided by current laws. Commissioner Sarah Bloom Raskin from the Maryland Department of Financial Regulation endorses that approach. She argues that the states are closer to consumer protection problems and can identify and react to these problems more quickly than federal regulators. She sees value in the CFPA Act making federal regulation a floor rather than a ceiling for the states. The CFPA Act strips the Federal Trade Commission of much of its role in consumer financial protection and would move staff that work on these issues from the FTC, along with the federal banking regulators that enforce consumer protection laws, over to the new CFPA. FTC Commission William Kovacic,

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who was the past FTC Chairman, makes the case for why that is a bad idea. He argues that the FTC has been a leader in enforcing consumer protection laws and has benefited from having special capabilities in economics. He also expresses concern that the CFPB Act would interfere with the FTC's other consumer protection functions since the Act gives the new agency wide latitude to interpret many activities as involving consumer financial services and taking authority over them. Confusion and jurisdictional disputes would result. Lastly, Professors Joshua Wright and Todd Zwyicki of George Mason University conclude that the CFPB Act has no merits. They dispute that failed consumer financial protection contributed to the financial crisis, argue that the CFPB would reduce credit availability to consumers, and express concern that the CFPB would risk "expensive and wasteful regulatory overlap at both the federal and state levels".

This issue also begins a new occasional feature. FinReg21.com interviewed credit-card veteran Philip Tomlinson who heads TSYS which is one of the leading payment card processors in the world. Mr. Tomlinson offers his perspectives on what the financial crisis has meant for the payment card industry and how things look going forward.

There is a wide range of views in this issue of Lombard Street and much for readers to debate and dispute. We would encourage readers to come to [www.finreg21.com](http://www.finreg21.com) and post comments on the articles or submit a blog post. LinkedIn users can also participate in our discussion group by [clicking here](#).



## The Consumer Financial Protection Agency: Sorting the Critiques

Oren Bar-Gill<sup>†</sup>

On June 30, 2009, the Obama Administration delivered to Congress the draft Consumer Financial Protection Agency (CFPA) Act of 2009. On July 8, House Financial Services Committee Chairman Barney Frank unveiled the Consumer Financial Protection Agency Act of 2009 (HR 3126), which shares key features with the President's proposal. The proposal to create a new agency to police consumer financial products has been the subject of much debate. My goal, in this article, is to sort out and evaluate the different critiques levied against the proposed CFPA Act, in light of the underlying case for a new agency charged with the regulation of Consumer Financial Products (CFPs). To that end I begin by recounting the arguments for a CFPA. I then examine the critiques of the CFPA Act, reframed as challenges or counterarguments to the arguments for a CFPA. I conclude that there is broad agreement on the need for institutional reform, which would include a CFPA. At the same time, there is much disagreement about what mandate and authority the CFPA should have. I end with an optimistic note, suggesting that even a CFPA with less power than envisioned in the proposed Act could do much good. Specifically, I argue that a presumably less controversial section of the proposed CFPA Act – the section establishing a consumer right to access information – could promote efficiency and consumer welfare in the market for CFPs.

### A. The Case for a CFPA

I begin by recounting the main reasons for the creation of a new federal agency with the mandate and authority to police consumer financial products.<sup>1</sup> A new agency is needed because (1) market forces fail to maximize welfare in important CFP markets, and (2) the current regulatory structure that was supposed to deal with this market failure has proved inadequate. I discuss these two elements in turn.

#### 1. Market Failure

The proposed CFPA Act is a solution to a problem – excessively risky CFPs, or, more accurately, CFPs that impose underappreciated risks on consumers. The claim is that market forces have not worked to constrain

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<sup>1</sup> This Section is based on Oren Bar-Gill and Elizabeth Warren, Making Credit Safer, 157 U. Penn. L. Rev. 1 (2008) [hereinafter "Making Credit Safer"].

CFP risks. This claim is based on theoretical arguments about the limits of market discipline in the CFP context. More importantly, the claim is supported by empirical evidence that many consumers do not make informed, welfare-maximizing choices in CFP markets.

**Starting with theory.** Markets work well when consumers are rational and well-informed. Acquiring information, however, is costly, and thus consumers in all markets, not only in CFP markets, are imperfectly informed. Moreover, there is reason to believe that consumers have even less information in CFP markets. The main difference between CFPs and physical products, like toasters or lawnmowers, is that CFPs are mere contracts and as such can be changed quickly and at a low cost, even after the product has been sold and “delivered” to the consumer. For example, a credit card issuer can change its product simply by mailing a bill-stuffer “change-of-terms” notice.

This malleability of CFPs reduces consumers’ incentives to become informed. Why spend time reading credit card contracts and comparing among contracts offered by different issuers if these contracts can be easily changed? The malleability of CFPs also reduces the efficacy of information intermediaries, like Consumer Reports. The large number of ever-changing contracts makes it more costly for Consumer Reports to collect, analyze, and report timely information on CFPs. Finally, the malleability of CFPs reduces the incentives of responsible sellers to offer safer CFPs. A seller that offers an improved but more expensive product must invest money in convincing consumers that the higher price is worth it. The problem is that after the responsible seller convinces consumers to switch to the better product, other sellers will try to imitate the improved product and compete away the responsible seller’s profits. Unable to recoup her investment in educating consumers, the responsible seller might decide not to offer the improved product in the first place. This problem is less acute in the market for physical products, because it takes more time for the copying sellers to replicate the improved product. The responsible seller thus enjoys a first-mover advantage that allows her to recoup her investment in consumer education. In the CFP market, on the other hand, copying sellers can quickly amend their contracts, to mimic the responsible seller’s contract, thus eliminating the prospect of a meaningful first-mover advantage.

**Moving from theory to evidence.** The prevalence of imperfect information and imperfect rationality in CFP markets has been demonstrated by numerous studies. There are three types of evidence: First, survey studies have shown that consumers do not comprehend basic financial concepts and do not understand, or are entirely unaware of, key terms in their CFP contracts. Second, a series of studies have documented mistakes that consumers make in product choice. When a consumer, faced with a choice among multiple CFPs, chooses the wrong product, i.e., not the product that maximizes the consumer’s welfare, then the CFP market cannot operate efficiently. Finally, various design features of CFP contracts, like double-cycle billing and certain payment allocation methods in credit card contracts, are difficult to explain if consumers are perfectly informed and perfectly rational. The prevalence of these design features suggests that sellers of

CFPs are designing their products in response to the imperfectly informed and imperfectly rational demand that they face.<sup>2</sup>

## 2. Regulatory Failure

Some argue that markets work well and regulation is not needed. These free-market enthusiasts would do away with any regulation of CFPs and with any regulator charged with policing CFPs. Most policymakers and commentators, however, agree that some regulatory intervention in the CFP market is required. But CFP markets are already regulated. The case for a CFPA must, therefore, rest on a claim that the current regulatory structure is inadequate. And this claim should go beyond the common assertions that the current system failed to prevent the home mortgage crisis and the recession that followed. The antecedents of the financial crisis are many, and the causal links between each of them, including the financial regulatory structure, and the crisis are still being investigated. Rather, I will highlight particular structural deficits and specific failings of the current system.

The first structural deficit is the multiplicity of regulators. At the federal level, CFPs are currently regulated by five banking agencies – the Federal Reserve Board (Fed), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA) – and by the Federal Trade Commission (FTC). In addition, State authorities also regulate certain lenders and certain CFPs.

This is one case where more is not merrier. Overlapping jurisdictions lead to conflicting rules. Overlapping jurisdictions may also lead to regulatory gaps, for example, when one regulator fails to act by relying on a second regulator with overlapping authority and the second regulator also fails to act by relying on the first regulator. More importantly, the financial crisis revealed a major gap in the regulation of CFPs offered by non-depository financial institutions.<sup>3</sup>

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<sup>2</sup> For a detailed survey of the evidence, see Making Credit Safer, *supra* note 1. It should be noted that some of the design features that I refer to as examples of sellers' responses to imperfectly informed and imperfectly rational demand have been recently banned by the CARD Act of 2009.

<sup>3</sup> These problems were recognized by the Treasury as part of the impetus for the creation of the new agency. See Press Release, Administration's Regulatory Reform Agenda Moves Forward: Legislation for Strengthening Consumer Protection Delivered To Capitol Hill, June 30, 2009 (available at <http://www.treasury.gov/press/releases/tg189.htm>) [hereinafter "Press Release"] ("The agency will help to simplify and reduce regulatory burdens in areas where current authorities overlap or conflict."; "By consolidating accountability in one place, we will reduce gaps in federal supervision and enforcement....") See also Michael Barr, Testimony before the Subcommittee on Commerce, Trade, and Consumer Protection (House Energy and Commerce Committee), Hearing on "The Proposed Consumer Financial Protection Agency: Implications for Consumers and FTC," July 8, 2009 (available at [http://energycommerce.house.gov/Press\\_111/20090708/testimony\\_barr.pdf](http://energycommerce.house.gov/Press_111/20090708/testimony_barr.pdf)) ("We Need One Agency for One Marketplace with One Mission – to Protect Consumers – and the Authority to Achieve It.")

In addition, the multiplicity of regulators leads to a race-to-the-bottom, with regulators competing among themselves by offering increasingly lax rules. The race-to-the-bottom is a product of two factors. The first factor is budgetary: a significant portion of the regulators' budgets comes from fees assessed on regulated banks. A regulator with more banks under its jurisdiction enjoys more revenues and more influence. The second factor is bank mobility. The current regulatory scheme allows banks to pick their regulator by choosing where to incorporate and what kind of charter to adopt (state vs. federal, bank vs. savings association vs. credit union, member of the Federal Reserve System or not). When banks can pick their regulator and regulators have an incentive to be picked, it is not surprising that regulators offer a regulatory product that is attractive to banks, i.e., lax rules. Several high-profile moves by banks from one regulator to another are consistent with the race-to-the-bottom hypothesis.<sup>4</sup>

The second structural deficit is the mismatch between authority and motivation among the multiple regulators. Focusing on the federal level, the banking agencies had the authority to police CFPs, as evidenced by the recent, and belated, regulations, promulgated by the Fed, but they had little motivation to vigorously protect consumers. Consumer protection was simply not their central mission; safety and soundness was. On the other hand, the FTC, for which consumer protection is the main mission, was stripped of the authority to regulate banks. The result: Regulators with authority to police CFPs lack the motivation to do so and the regulator with motivation to protect consumers lacks authority over important CFP sellers.<sup>5</sup>

The multiple regulators problem and the mismatch problem created a regulatory environment where CFPs were not adequately scrutinized. Consumer financial products, and the potential risks they impose, simply did not receive sufficient regulatory attention. The Fed and the OCC received numerous warnings about the

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<sup>4</sup> See Making Credit Safer, supra note 1, at 82 (describing the decisions by JPMorgan Chase, HSBC, and Bank of Montreal (Harris Trust) to convert from state to national charters). Another example is the move by Countrywide Financial from the OCC to the OTS. See also Richard A. Posner, "The President's Blueprint for Reforming Financial Regulation: A Critique: Part II," Lombard Street, Volume 1, Issue 9, August 3, 2009, at p. 25 (arguing that when regulatory agencies are funded by fees paid by the regulated firms, regulators will adopt "a softer regulatory touch" to attract firms). The race-to-the-bottom problem with respect to bank regulation is, in some ways, different and more severe than the famous race-to-the-bottom problem in corporate law. In the general corporate context, the concern is that managers will choose to incorporate in states with lax corporate law rules that benefit managers but hurt shareholders. In the bank regulation context, lax consumer protection may benefit both managers and shareholders of financial institutions. So, while shareholders of non-banks may try to stop managers from choosing lax corporate law, shareholders of financial institutions may well support management's choice of a more lenient bank regulator.

<sup>5</sup> The mismatch problem was recognized by the Treasury as part of the impetus for the creation of the new agency. See Press Release, supra note 3 ("The current financial system spreads responsibility for consumer protection across multiple agencies, many of which are primarily focused on the prudential supervision of financial institutions, not consumers."; "This agency will have only one mission – to protect consumers – and have the authority and accountability to make sure that consumer-protection regulations are written fairly and enforced vigorously.") Available at SSRN: <http://ssrn.com/abstract=1137981>

risks of CFPs – from credit cards to mortgages – but no action was taken until after the financial crisis erupted and much public and political pressure was felt.<sup>6</sup>

## B. Critiques of the Proposed CFPA Act

The critiques of the CFPA Act can be divided into two categories, mirroring the two underlying reasons for a CFPA. In the first camp of critics are those that question the very existence of a market failure. They question not only the need for a CFPA, but the need for any regulation of CFP. In the second camp are those who recognize the need for regulation but argue that the regulatory scheme set forth in the CFPA Act is flawed. These critics reject or downplay the shortcomings of the current regulatory scheme, specifically the multiple regulators problem and the mismatch problem, to which the proposed CFPA Act responds. I discuss these two sets of critiques in turn. For each set of critiques, I start with the stronger version of the critique and end with the weaker, more plausible version.

### 1. The Market for CFPs Is Doing Just Fine on Its Own

It is reassuring that this rather extreme position is not commonly held. Still, some commentators seem to argue that CFP markets are doing just fine. For example, Thomas Brown and Lacey Plache have argued, in a recent Lombard Street article, that evidence of consumer mistakes in credit card choice and use is “weak to non-existent.”<sup>7</sup> Brown and Plache recognize that behavioral economics has shown that individuals are not the perfectly rational decisionmakers posited by neo-classical economics. But they argue that behavioral economics “[has] not yet shown that consumers fail to make rational decisions regarding their use of revolving credit.”<sup>8</sup> This broad statement is perplexing in light of the evidence of consumer mistakes in CFP markets, including in the credit card market, that I have noted above. Even if Brown and Plache disagree with the methodology and analysis of all of the reported studies, transparency would require them to acknowledge the studies and discuss their limitations, rather than dismissing them offhand (or even refusing to acknowledge their existence).

The belief that “the market is doing just fine on its own” was also implicit in actions taken by the OCC in the Lockyer case,<sup>9</sup> although admittedly these actions were taken before the financial crisis hit and the OCC’s

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<sup>6</sup> See Making Credit Safer, *supra* note 1. Another possible reason for the regulatory inaction is that regulators, specifically the Fed and the OCC, believed that CFP markets were working well and that there was no need for regulation. The market failure question and the regulatory failure question, while distinct, are interdependent.

<sup>7</sup> Thomas P. Brown and Lacey L. Plache, “Credit Where Credit Is Due,” Lombard Street, Vol. 1, Issue 6, June 22, 2009. Available at [www.finreg21.com/lombard-street/credit-where-credit-is-due](http://www.finreg21.com/lombard-street/credit-where-credit-is-due)

<sup>8</sup> *Id.*

<sup>9</sup> *Am. Bankers Assn. v. Lockyer*, 239 F. Supp. 2d 1000 (E.D. Cal 2002).

position may have changed. In 2002, the California legislature passed a law requiring credit card companies to reveal how long a customer would have to make minimum payments on a card before the balance would be paid in full and how much interest the customer would pay in the meantime.<sup>10</sup> The California statute reflected a conclusion that credit cards impose underappreciated risks. After the law was enacted, banks sued to enjoin enforcement. The OCC intervened—on the side of the banks. The OCC took the position that only the OCC could impose such disclosure requirements on the banks. And the district court agreed.<sup>11</sup> The question was a question of preemption – federal law preempting state law. More precisely, it was the absence of federal law that preempted state law, since the OCC did not propose competing regulations. The OCC’s position was that there was no problem – that the market produced the optimal level of risk and that consumers understood the risk that the market produced.

This position proved untenable. Congress followed the example set by the California legislature and required a similar disclosure.<sup>12</sup> The Fed has gone a step further – offering, on its website, calculators that allow individual consumers to figure out the time it would take them to fully repay their debt, given the size of their monthly payment, and the total interest they will end up paying.<sup>13</sup>

To be fair, there is a more plausible version of the claim that “the market is doing just fine on its own.” This version recognizes that the CFP market, like most other markets, suffers from certain imperfections, but that the welfare costs of these imperfections are outweighed by the costs of regulatory intervention to fix the imperfections.<sup>14</sup> In fact, I believe that most opponents of regulation would sign-off on an even milder version of the claim that “the market is doing just fine on its own.” This milder version accepts basic disclosure mandates as helpful facilitators of market forces. So regulatory intervention is ok, as long as it is limited to minimally intrusive disclosure mandates. I would guess that even the Comptroller of the

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<sup>10</sup> Cal. Civ. Code § 1748.13.

<sup>11</sup> Am. Bankers Assn. v. Lockyer, 239 F. Supp. 2d 1000 (E.D. Cal 2002).

<sup>12</sup> See the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Sec. 1301. Of course, the fact that Congress voted to mandate disclosure does not prove that a market failure exists (sec. 1301 could be the result of interest group pressure, for example).

<sup>13</sup> See FRB, Credit Card Repayment Calculator (available at [www.federalreserve.gov/creditcardcalculator](http://www.federalreserve.gov/creditcardcalculator)). Some issuers now voluntarily offer similar calculators on their websites, as a service to their customers. See CardFlash, Chase Pricing, November 20, 2007 (Chase introduced payment calculators).

<sup>14</sup> I take this to be the position of Professor Richard Epstein. See Richard A. Epstein, Behavioral Economics: Human Error and Market Corrections, Symposium: Homo Economicus, Homo Myopicus, and the Law and Economics of Consumer Choice, 73 *U. Chi. L. Rev.* 111 (2006). See also Statement of Edward L. Yingling, President of the American Bankers Association, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, July 14, 2009 (focusing on the regulatory burden that the CFPB would impose and arguing that this burden will be passed-on to consumers).

Currency and Brown and Plache accept this milder version of the claim that “the market is doing just fine on its own.”<sup>15</sup>

If I am right, then there is broad agreement that some kind of regulatory intervention is needed, and the “only” questions are who should regulate and what kind of regulation should be preferred. I now turn to critiques of the CFPB Act that focus on these questions.

## 2. The Current Regulatory System Is Doing Fine without a CFPB

Again, I believe that, in light of the financial crisis, few adhere to the claim that the current regulatory system is doing a good job. Still, there are many voices that seek to minimize the scope of reform and, specifically, to limit the role of the CFPB.

The position of the American Bankers Association is that the CFPB’s authority should be limited to non-banks.<sup>16</sup> The OCC, the OTS, and the FDIC adopted a similar, though less extreme, position, arguing that the CFPB can have broad rulemaking authority, but that its enforcement powers should be limited to non-banks.<sup>17</sup> These positions are based on the view that the main failing of the current regulatory system is the enforcement gap with respect to non-depository institutions. As argued above, while important, this gap is not the only problem with the current system. The multiple regulators problem and the mismatch problem prevented effective consumer protection regulation of banks by banking agencies.

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<sup>15</sup> See also Epstein, *id.* (acknowledging that disclosure mandates can be useful); Richard A. Posner, “Treating Financial Consumers as Consenting Adults,” *Wall Street Journal*, July 23, 2009, p. A15 (expressing concern that the CFPB “would go beyond the conventional consumer-protection function of providing information.”)

<sup>16</sup> Statement of Edward L. Yingling, President of the American Bankers Association, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, July 14, 2009 (arguing that the main failure of the current system was with respect to non-banks and that’s where reform efforts should focus)

<sup>17</sup> Statement of John C. Dugan, Comptroller of the Currency, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, August 4, 2009 [hereinafter “Dugan Testimony”] (arguing that rulewriting authority with respect to consumer financial protection “could be centralized in the CFPB” and that “the CFPB could be focused on supervision and/or enforcement mechanisms that raise consumer protection compliance for nonbank financial providers to a similar level as exists for banks – but without diminishing the existing regime for bank compliance.”); Statement of John E. Bowman, Acting Director, Office of Thrift Supervision, regarding the Administration’s Financial Regulatory Reform Proposal, before the Committee on Financial Services, U.S. House of Representatives, July 24, 2009 (arguing that the CFPB can have general rulemaking authority but that the banking agencies should retain examination and supervision powers); Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation on Strengthening and Streamlining Prudential Bank Supervision before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, August 4, 2009 (“The CFPB would eliminate regulatory gaps between insured depository institutions and non-bank providers of financial products and services by establishing strong, consistent consumer protection standards across the board. It also would address another gap by giving the CFPB authority to examine non-bank financial service providers that are not currently examined by the federal banking agencies.”)

Nevertheless, the argument that enforcement authority should remain with the banking regulators deserves consideration. If the proposed CFPB promulgates strong consumer protection regulations, it may be efficient for the OCC, OTS, and FDIC to enforce these regulations with respect to their member banks, as long as there are mechanisms in place to ensure uniform and strict enforcement.

The Fed adopted an even more extreme position, opposing the shift of even rulemaking authority to the CFPB (from the Fed).<sup>18</sup> In his testimony before the House Financial Services Committee, Federal Reserve Chairman Ben Bernanke noted that "[i]n the last three years, the Federal Reserve has adopted strong consumer protection measures in the mortgage and credit card areas."<sup>19</sup> But many of these regulations were adopted after the financial crisis hit, when the Fed was under intense pressure to act. As Secretary Geithner told Congress: "it is very hard to look at that system and say that it did anything close to an adequate job of what it was designed to do."<sup>20</sup> Even Chairman Bernanke's fellow bank supervisors conceded that the rulemaking record under the current system is less than impressive.<sup>21</sup>

Secretary Geithner told Congress that the bank regulators are "[defending] the traditional prerogative of their agencies," and that their opposition to different components of the proposed CFPB Act "should be viewed through that prism."<sup>22</sup> A less political, more substantive, account would explain the reluctance to deviate from the status quo as the result of a failure to fully appreciate the structural weaknesses of the current regulatory scheme.

### 3. The CFPB Would Regulate Too Much

A different set of criticisms focuses not on the "who should regulate" question, but rather on the "how to regulate" question. Are market-facilitating disclosure mandates sufficient or should the CFPB have the power to supplant the market and determine what products would be offered? Indeed, much of the opposition to the proposed CFPB Act targets the provisions that would give the CFPB authority to require and regulate the offering of standard "Plain Vanilla" consumer financial products.

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<sup>18</sup> See Statement of Ben. S Bernanke, Chairman, Board of Governors of the Federal Reserve System, before the Committee on Financial Services, U.S. House of Representatives, July 24, 2009, pp. 15-16 (Bernanke pointed out the costs of moving rulewriting and enforcement authority from the Fed to the CFPB, arguing that consumer protection is complementary to prudential supervision.)

<sup>19</sup> Id.

<sup>20</sup> See Donna Rosato, "Bernanke and Geithner Clash Over Consumer Protection," CNNMoney.com, July 29, 2009 (quoting from Secretary Geithner's testimony).

<sup>21</sup> See, e.g., Dugan Testimony, supra note 17 ("The first gap relates to consumer protection rules themselves, which were written under a patchwork of authorities scattered among different agencies; [they] were in some cases not sufficiently robust or timely....")

<sup>22</sup> See Donna Rosato, "Bernanke and Geithner Clash Over Consumer Protection," CNNMoney.com, July 29, 2009 (quoting from Secretary Geithner's testimony).

The concern is that these government-sponsored “Plain Vanilla” products would crowd out other products.<sup>23</sup> This is a valid concern. If a product that deviates from the CFPA-defined “Plain Vanilla” design is subject to substantial regulatory compliance costs, then financial institutions would be reluctant to offer Chocolate or even French Vanilla. This would entail a welfare cost, since not all consumers like “Plain Vanilla.” Congress should make sure that “Plain Vanilla” does not crowd-out Chocolate. But this can be done without discarding Plain Vanilla. Rather the CFPA Act, and the CFPA, should keep the regulatory burden on Chocolate sufficiently low.

#### 4. Summary: The Who and the How

The claim that “the market is doing just fine on its own” is untenable, at least in its extreme form. We are thus left with two questions “who should regulate” and “how to regulate.” I have attempted to categorize the objections to the CFPA Act, distinguishing between the “who” question and the “how” question. While I believe that this distinction is helpful, I acknowledge that the two questions are linked. They are linked because different regulators, and different regulatory structures, would have different regulatory philosophies, different constraints, and different incentives that would influence their regulatory output. The Fed already has broad authority to impose strict consumer protection rules – an authority that is almost as broad as the authority that would be given to the CFPA under the proposed Act. While the Fed has used its authority sparingly, perhaps excessively so, at least until the financial crisis erupted, critics of the CFPA fear that the new agency will use its authority expansively. Congress, in structuring the CFPA and defining its powers, should be mindful of this valid concern.

#### C. Enhanced Disclosure: A Common Ground with Some Bite

There is much debate over the proper scope of authority for the proposed CFPA. I do not presume to resolve this debate here. Rather I wish to end by highlighting one section of the proposed CFPA Act that should be less controversial – the section establishing a consumer right to access information. This is, in essence, a mandatory disclosure section. And, as noted above, even hard-core free-market proponents, who have been critical of the proposed CFPA Act, generally support disclosure mandates. I wish to highlight this less controversial section not only because it is less controversial, but also because it can actually make a difference.<sup>24</sup>

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<sup>23</sup> See Statement of Edward L. Yingling, President of the American Bankers Association, before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, July 14, 2009; Richard A. Posner, “Treating Financial Consumers as Consenting Adults,” *Wall Street Journal*, July 23, 2009, p. A15.

<sup>24</sup> While the Fed already has broad authority to mandate disclosure, the CFPA Act would give the new agency even broader authority. More importantly, the Fed was slow to exercise its authority, even with respect to disclosure mandates. For example, the Fed announced an overhaul of TILA regulations in December 2004. See Advance Notice of Proposed Rulemaking (ANPR), Federal Reserve System, 12 CFR Part 226 [Regulation Z; Docket No. R-1217] (available at [www.federalreserve.gov/](http://www.federalreserve.gov/)

The proposed CFPA Act gives the new agency the authority to issue broad disclosure mandates.<sup>25</sup> The disclosures envisioned by the proposed Act have three crucial components. First, they would apply to all sellers of the target CFP. Second, the disclosures go beyond information about product attributes, such as interest rates and fees, and specifically include information about how the individual consumer uses the product. As I argued elsewhere, consumer mistakes – mistakes that impede the efficient operation of CFP markets – are often mistakes about product-use information.<sup>26</sup>

Third, the CFPA would have power to require disclosures in electronic form, which is especially important for detailed information on how the individual consumer uses the CFP. I do not pretend that many consumers could actually digest this kind of information. But they would not need to. Consumers would transfer the information, in electronic form, to third-parties that could then provide consumers with advice about product choice. Such third parties, like BillShrink.com, already exist, but they currently rely on the partial and imperfect product-use information that consumers supply.<sup>27</sup> The advice would be much more valuable when it is based on the product-use information that sellers disclose. The new disclosures could promote efficiency and consumer welfare in the market for CFPs, while bypassing much of the controversy that the CFPA Act has stirred.

## Conclusion

When Congress returns from its August recess, it will have to deal with the various critiques of the proposed CFPA Act. Some critiques challenge the very need for a new agency. Most other critiques are concerned about how the proposed CFPA will integrate into the larger regulatory scheme and about the scope of its powers. In sorting and analyzing the critiques, in light of the basic arguments for a CFPA, I hope to assist Congress in evaluating the merits of the different critiques, as well as their implications; while accepting some critiques implies abandoning the proposed CFPA Act, accepting others necessitates only minor adjustments to the proposed Act. Finally, I have tried to show that even stripped of its more controversial components, the CFPA Act could have a meaningful impact on consumer protection in financial product markets.

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[BoardDocs/press/bcreg/2004/20041203/attachment.pdf](#)). The new regulations were issued only in December 2008 after the financial crisis hit. See [http://www.federalreserve.gov/newsevents/press/bcreg/20081218a .htm](http://www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm).

<sup>25</sup> See H.R. 3126, Sec. 138 and Section 1038 of the Treasury's proposal.

<sup>26</sup> See Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. Rev. 1373 (2004); Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 Cornell L. Rev. 1073 (2009).

<sup>27</sup> Sellers also provide advice based on self-reported product-use information, but this advice is restricted to choice among the seller's products. Third-parties help consumers choose among products offered by many different sellers.



## Proposed CFPB Must Partner with States to Be Successful

Sarah Bloom Raskin<sup>†</sup>

From the perspective of local regulation and local law enforcement, the idea of a “new and improved” federal financial products regulator is generally met with skepticism. After all, the mission of consumer protection in the realm of financial products has been one in which state attorney generals, banking commissioners, and local law enforcement authorities have been the center-stage players for at least the last decade.<sup>1</sup>

This center-stage position is partly attributable to the fact that federal regulators have seemingly devoted more focus to preempting state laws that are designed to protect consumers than they have to enforcing or crafting federal protections. This center-stage position is also attributable to plain old better positioning; i.e., it is the natural result of being “closer to the customer” that consumer issues are most quickly and easily identified and resolved at the local level. Likewise, state enforcement officers are directly accountable to their governors, their state legislators, and their citizenry, and are required to respond expeditiously and accurately to consumer protection concerns as they arise.

And yet, despite the fact that state attorney generals, banking commissioners, and local law enforcement authorities have a proximity to the entities they supervise, have a granular knowledge and expertise of the variations in their local communities, and must remain accessible to the citizens in their states, the proposed federal Consumer Financial Products Agency (the “CFPA”) has the possibility and potential of becoming a successful regulatory mechanism in the arena of consumer protection. Although our nation’s other examples of federal protection agencies have been criticized as weak and generally ineffective,<sup>2</sup> there

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<sup>†</sup> Commissioner, Maryland Office of Financial Regulation

<sup>1</sup> This proximity to the supervised entity and the ability to act quickly is reflected in the number of enforcement actions taken by state regulators. In 2007 and 2008 alone, states took approximately 13,000 enforcement actions against mortgage brokers and mortgage lenders. These actions, together with thousands of other enforcement actions against non-mortgage financial service providers, were initiated at the same time that states became increasingly excluded from consumer financial services regulation. In other words, despite the obstacle imposed by preemption – enacted either by legislation, by agency regulation, or by court rulings – state regulators and law enforcement officials have been active proponents of consumer protection. Unfortunately, and to the detriment of our country, preempted state protections have not been replaced with equivalent federal protections. See Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 Yale J. on Reg. 143 (2009).

<sup>2</sup> Among the federal bank agencies, no single one has an exclusive role of consumer protection. The Federal Trade Commission has consumer protection as its primary role. However, it has limited jurisdiction in financial services in that it cannot regulate federally-

are possibilities inherent in the proposed CFPA that represent at least opportunities for an improved model of federal consumer protection.

Our current system of regulatory architecture contains an invaluable “on the ground” presence in the form of state government. I can think of a useful case study in the state I know best. In my home state of Maryland, as in most states, there have been successive waves of foreclosures, each triggered by a particular set of circumstances. While many of the underlying forces are national and driven by, for example, capital market trends and excessive risk tolerances, other drivers have been localized. Localized drivers include the configuration of our regional and local economies, the type of mortgages our citizens have used, the variety and distribution of mortgage providers, and the state regulatory structure overseeing them. The way in which these circumstances intermingle to produce a particular foreclosure spike differs by state. Certain states have been plagued by option ARMs while others have had virtually none. Certain states, particularly those with high levels of investor properties like Florida, are most affected by negative equity when home values depreciate to such an extent that people owe more on their mortgages than their homes are worth (a situation commonly referred to as being “upside down”). Other states, like Michigan, are more adversely affected by their underlying regional economies as unemployment becomes a major driver of foreclosure. These differences impact the scope of the problem, its timing, and the nature of the policy response required. In other words, the ability to engage in meaningful consumer protection in the foreclosure arena depends on the ability of local officials to perceive the trends, diagnose their causes accurately, and devise policy, regulatory, and enforcement responses, if necessary, to deal with those particular root causes. These must all be done in a timely manner, be tailored to the problem to minimize collateral effects, and address not just the manifestation of the problem but also its root cause.

The foreclosure example is a useful one, but states and localities engage in this exercise not merely in the foreclosure realm, but also in the realm of a host of financial products and providers. Simply stated, this is what state regulators do on a daily basis. These products and providers include check cashiers, debt management companies, payday loans, refund anticipation loans, money transmission companies, credit repair organizations, loan modification products, and debt collectors, to name a few (and some of which are evolving and morphing as this is being written).

For example, the rise in delinquent loans and subsequent government efforts to encourage loan modifications has given rise to a new industry of so-called loan modification consultants. These “consultants” charge exorbitant up-front fees in exchange for promising to obtain a modification for homeowners. Hundreds of consumer complaints later, we have found that all too often nothing has been

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chartered or insured banks, thrifts, or credit unions. The Securities and Exchange Commission distinguishes itself as having a mission that promotes investor protection rather than consumer protection. And the consumer Product Safety Commission has been criticized as hobbled by a lack of resources.

accomplished while the borrower hurtles toward foreclosure. The result is a waste of money and, even worse, time – time that is better spent getting a real and sustainable modification. Because of the proximity to the ground, states are able to respond rapidly, by using localized investigative authority to gather information. States coordinate their efforts and their expertise to protect their citizens through statutory provisions that require licensing, disclosure, and, in Maryland, a ban of up-front fees. This rapid and local response is critical in attacking an issue such as this which (1) evolves rapidly in response to temporary conditions in the local or even national economy and (2) involves small providers who fly easily under the federal radar for months if not years.

In Maryland, in the case of local modification consultants, we were able to identify this problem and launch a response virtually immediately. Even before consumers specifically complained about consultants, my department noticed that more and more consumers facing foreclosure often paid a “consultant” an average of \$2,500 before they had filed a complaint with the state regulator’s office. Armed with a statute that prohibits such up-front fees, we were able to launch consumer outreach and investigations of these “consultants” as early as August of 2008. Further, the advance work done by the states in identifying and proposing methods for dealing with predatory loan modification consultants in our communities became a relevant policy tool to the Obama administration and the federal agencies as they developed the “Making Homeownership Affordable Plan.”<sup>3</sup>

This is an example of a successful federalist system of financial supervision that draws upon the expertise and resources of both state and federal regulatory authorities. Financial supervision is most successful and seamless when a certain pattern is followed. First, state authorities, relying upon local knowledge and accountability, identify threatening products and practices as they emerge. Second, the state warns consumers and reacts through either regulation or legislation to curb the practices or products in an effort to protect citizens and maintain the integrity of the state’s financial system. Finally, if the troublesome products or practices emerge on a national scale, and if a state’s reaction has been successful, the federal government will implement a similar regulation or statute on a nationwide scale. This model allows the states, which by their very nature are able to act more rapidly than the federal government, to experiment with regulatory fixes to emerging threats.

While the states are much better positioned to detect such emerging financial products, the problems associated with such products often become federal in scope. This clearly was the case in the problems associated with subprime mortgage products. These products, which state regulators began to detect at

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<sup>3</sup> U.S. Department of Treasury, Press Release, *Federal, State Partners Announce Multi-Agency Crackdown Targeting Foreclosure Rescue Scams, Loan Modification Fraud*, April 6, 2009, available at <http://www.ustreas.gov/press/releases/tg83.htm>.

least a decade ago, were fueled by funding in secondary markets and by mega financial institutions to such an extent that a federal response would have been desirable had one emerged in a timely way.<sup>4</sup>

Presumably, this absence in providing a timely federal response is what the proposed CFPA would be designed to handle. The goal of the CFPA legislation is to address the flaws in the regulatory architecture that have inhibited effective federal responses to substantive problems of consumer protection.<sup>5</sup> The CFPA would be authorized to gather data, promulgate rules, and bring regulatory enforcement actions. It would have jurisdiction over the broad swath of consumer financial products. Significantly, the proposed CFPA would preserve for state attorney generals and financial regulators the ability to continue to respond quickly and effectively: the proposal provides that federal standards promulgated by the CPFA would constitute a “floor” for state action.<sup>6</sup>

In the vast world of financial products, the “floor – not ceiling” approach is critical for ensuring that consumers – no matter where they live in the United States – be afforded at least some level of minimum protection, and for providing a scaled, national response where appropriate. At the same time, if those national standards are absent (as historically they have been for most financial services), or if those national standards are too slow in evolving (as is often the case, since a federal bureaucracy is almost by definition, very slow to act), or if those national standards are too weak (as they may be in an attempt to be balanced or in an attempt to minimize collateral effects), then residents will want to be able to prevail upon their state legislatures and other elected officials to force their state regulators to raise standards for their own residents.

States are suspicious of federal regulatory power in the realm of financial products. In the words of Professor Adam Levitin of Georgetown Law School, consumer protection at the federal level has historically been an “orphan” mission.<sup>7</sup> That is, since no federal agency has an exclusive mission to provide consumer protection in financial services, there is a dangerous tendency for consumer protection to fall between the cracks. The result has been that states have been left to fight the evolving practices and products that had consumer protection ramifications.

In the rapidly changing and dynamic mortgage market, the states fought alone. As complaints began to mount regarding subprime mortgage products, state authorities attempted to craft regulatory and

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<sup>4</sup> Robert Berner and Brian Grow, “They Warned Us About the Mortgage Crisis,” *Business Week*, October 9, 2008.

<sup>5</sup> Adam J. Levitin, “The Consumer Financial Protection Agency, PEW Financial Reform Project, Briefing Paper #3: The CFPA,” Aug 6, 2009.

<sup>6</sup> In the loan modification area, the beginning of such an approach is taking place: the Federal Trade Commission has joined several states in dealing with the problems associated with the larger loan modification consultants that have emerged.

<sup>7</sup> Levitin, *Briefing Paper*, at 4

legislative responses, only to be challenged in court by aggressive federal banking agencies concerned about how the regulation of these activities would impact the business plans of their supervised entities or would undermine their own authority. Congress, too, was caught up in a deregulatory fervor, giving the federal agencies wide berth in crafting necessary consumer protections. For reasons that have more to do with regulatory capture than good policymaking, the result was a federal absence of regulatory protections of the greatest magnitude in the mortgage context.<sup>8</sup>

It took the harms associated with the beginning of our current crisis to prompt Congress to respond, in part, with the passage of the so-called SAFE Act (the Secure and Fair Enforcement for Mortgage Licensing Act of 2008). The SAFE Act set uniform, minimum standards for the licensing of mortgage originators in this country. These standards were a floor, not a ceiling, thereby allowing state legislatures to adopt more stringent statutes if they see fit. Falling in line with such federal guidance, 49 states and the District of Columbia have enacted or introduced legislation to implement these minimum mortgage lending standards within one short year of the SAFE Act's passage. And while critics of the CFPA's anti-preemption provisions claim that enactment of the CFPA as proposed would create a "patchwork" of varying state laws and regulations, this argument becomes largely unconvincing as state after state adopts the provisions of the SAFE Act in a manner consistent with the federal standards. Put plainly, if federal standards are sufficient, states will not be obligated to implement more appropriate – and sometimes more stringent – standards.

As in the case of the federal consumer protection standards set through the SAFE Act, state regulators would likely welcome the articulation of such standards in the realms of loan modification consultants, check cashiers, payday lenders, debt management companies, debt settlement companies, refund anticipation loans, and advanced litigation funding products. Consumers could benefit from the articulation of federal standards in contexts in which their state legislatures or regulatory officials are, for whatever reason, inadequate or ineffective. This ability to set by rule a minimal standard will be a powerful pro-consumer protection mechanism

At the same time, state authorities do not want to be hamstrung in their efforts to protect consumers. They are the cops on the beat, and they are ultimately responsible to their fellow state residents. Therefore, they must be able to react swiftly and correctly. By establishing a floor and not a ceiling, the CFPA can provide explicit safeguards, while preserving the local presence and power that remains flexible to adjust to ever-emerging financial industry practices and products.

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<sup>8</sup> For example, anti-predatory lending laws have been enacted in 35 states and the District of Columbia. In contrast, Congress has not enacted a federal anti-predatory lending law in the last decade. To underscore the absence of federal protection against predatory lending, it is worth noting that these state anti-predatory lending laws are not effective against federally chartered institutions because of the interpretations of preemption by the Office of the Comptroller of the Currency and the Office of Thrift Supervision. Accordingly, fewer consumer protections exist than might be suggested by the number of state efforts in this regard.



## The Consumer Financial Protection Agency and the Hazards of Regulatory Restructuring

William E. Kovacic<sup>†</sup>

The United States is in the midst of an important debate about how best to protect consumers of financial services and products. The Administration has proposed the creation of a new agency, the Consumer Financial Protection Agency (CFPA), which would have exclusive rulemaking authority and primary enforcement authority over consumer financial protection statutes and any rules promulgated by the CFPA.<sup>1</sup> The legislation divests consumer financial protection functions from the Federal Trade Commission (FTC) and certain other federal regulators and places them in the CFPA.<sup>2</sup> Although the legislation leaves wholly intact the authority of the Department of Justice, the Securities and Exchange Commission, and the Commodity Futures Trading Commission,<sup>3</sup> proponents of the CFPA argue that consolidation of consumer financial protection in the CFPA will provide more robust protection for consumers than our current system.

The periodic reassessment of the distribution of regulatory authority and the routine evaluation of the performance of individual regulatory bodies are sound elements of public administration. No single agency or collection of bodies entrusted with shared regulatory tasks should be exempt from a regular, probing examination of how well they carry out their responsibilities. Good regulatory design is the product of a continuous process of experimentation and evaluation, and one would expect the configuration of regulatory authority to change over time in light of experience.

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<sup>1</sup> For purposes of this discussion, the Administration's legislative proposal, the Consumer Financial Protection Agency Act of 2009 (CFPA Act), does not differ materially from H.R. 3126, the legislation proposed by Representative Barney Frank, Chairman of the House Financial Services Committee. All statute citations refer to sections of the CFPA Act.

<sup>2</sup> The other federal regulators affected by the legislation are: the Federal Reserve Board; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Office of Thrift Supervision; and the National Credit Union Administration.

<sup>3</sup> Section 1021(f) of the Consumer Financial Protection Agency Act of 2009, H.R. 3126 (introduced in the House of Representatives on July 8m 2009) specifies that the legislation is not intended to affect the authority of the Department of Justice, the Securities and Exchange Commission, or the Commodity Futures Trading Commission, though coordination between the two agencies and the CFPA is required with respect to any rule regarding a product or service that is the same type of product, or that competes directly with, a product or service subject to the CFPA's jurisdiction.

My primary concern with the CFPB proposal is that it will not improve consumer financial protection but will degrade it. As now conceived, the CFPB also may have the unexpected consequence of diminishing the quality of consumer protection in non-financial sectors. The proposed alternative consumer protection framework for financial services reflects a terribly imperfect understanding of the FTC's work in this area and how the suggested redistribution of regulatory tasks will affect the quality of financial services oversight and alter the Commission's capacity to fulfill duties in other areas of the economy.

Two critical public policy problems attend the proposed divestiture of consumer financial protection functions from the FTC and other federal regulatory authorities and the placement of these functions at the federal level within the CFPB. Each deserves careful consideration as Congress contemplates the adoption of these and related proposed reforms.

### ***The CFPB Will Weaken Consumer Financial Protection***

Divesting the FTC of all of its consumer financial protection functions will reduce – not enhance – the quality of consumer protection involving financial services. Unlike the other federal agencies with consumer financial protection responsibilities, the FTC's distinctive institutional design combines a valuable collection of policy perspectives. The FTC's consumer protection work benefits significantly from the agency's capabilities in economic analysis and competition policy. Like the FTC's Bureau of Consumer Protection, the agency's Bureau of Economics and Bureau of Competition report directly to the Commission and its Chairman. The FTC's unique institutional framework has evolved over decades and ensures that the FTC is more than just a law enforcement agency. The FTC protects consumers through law enforcement, policy research and development, rulemaking, consumer education, and the issuance of guidance.<sup>39</sup> The FTC's Bureau of Economics influences the agency's consumer protection work in two important ways. First, the Bureau of Economics reviews every proposed consumer protection enforcement matter, settlement, and rulemaking, and can make its own independent recommendation to the Commission. The independence of the FTC's economists strengthens the vetting of the agency's consumer protection initiatives and helps ensure that policies designed to protect consumers do so without having adverse economic consequences.

Second, the Bureau of Economics conducts vital research that shapes the FTC's policy and educational initiatives. A prominent example includes the Bureau's seminal research on mortgage disclosures, which found that mortgage disclosure forms fail to convey key mortgage costs and terms to many consumers.<sup>40</sup>

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<sup>39</sup> See generally Prepared Statement of Stephen Calkins, Testimony Before the Subcommittee on Commerce, Trade, and Consumer Protection, Committee on Energy and Commerce, United States House of Representatives, Jul. 8, 2009, available at [http://energycommerce.house.gov/Press\\_111/20090708/testimony\\_calkins.pdf](http://energycommerce.house.gov/Press_111/20090708/testimony_calkins.pdf) (hereinafter "Calkins testimony").

<sup>40</sup> See Federal Trade Commission, Bureau of Economics Staff Report, *Improving*

*Consumer Mortgage Disclosures: An Empirical Assessment of Current and Prototype Disclosure Forms* (June 2007), available at <http://www.ftc.gov/os/2007/06/P025505mortgagedisclosurereport.pdf>.

The Bureau of Economics built upon its state of the art research by convening a conference at which experts on real estate economics, information economics, consumer behavior, and consumer information policy examined how consumer information and information regulation affects consumer choices, mortgage outcomes, and consumer welfare with the goal of developing concrete policy proposals.<sup>41</sup> This type of research and intellectual leadership guides the FTC's policy initiatives and helps direct the FTC's consumer education activities in the financial services area and beyond.

Similarly, the FTC's Bureau of Competition provides a valuable competition policy perspective that informs and enhances the Commission's consumer protection work. In the area of deceptive advertising, for example, the FTC has long recognized that deception harms consumers and damages the functioning of the marketplace.<sup>42</sup> Since the time of its establishment almost a century ago, the FTC has pursued two complementary goals – to eliminate deception and to challenge restraints on truthful advertising. The agency's efforts to promote the flow of truthful information complement the agency's goal of eliminating deception in the marketplace. In this way, the FTC's competition perspective strengthens its consumer protection work.<sup>43</sup> The CFPA might try to replicate the institutional arrangements by which the FTC ensures that rigorous economic analysis and the contributions of an independent unit of economists proficient in theory and empirical research guide the formulation of consumer protection policy for financial services. There is no guarantee that the new agency will attempt to do so or succeed in the effort. Nor is it apparent that the team that drafted the CFPA proposal considered this valuable dimension of FTC policymaking or regarded it as worth preserving. The legislative proposal merely contemplates the creation of a "research unit . . . whose functions shall include researching, analyzing, and reporting on" developments in consumer financial product/service markets and consumer understanding of disclosures, among other things.<sup>44</sup> The legislation does not mandate the independence of the CFPA's research unit. Nor does it determine the particular role that such research unit must play in the CFPA's enforcement and regulatory activities. The CFPA lacks these institutional features and will lose the considerable benefits that have flowed from them at the Commission. For this reason alone, the CFPA's consumer protection work

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<sup>41</sup> See Federal Trade Commission, *Consumer Information and the Mortgage Market* (May 2008), Conference Transcript, available at <http://www2.ftc.gov/be/workshops/mortgage/transcript.pdf>.

<sup>42</sup> Early FTC deception cases relied on the FTC's authority to proscribe unfair methods of competition. See, e.g., *FTC v. Raladam Co.*, 283 U.S. 643 (1931) (challenging advertisements of dietary supplement manufacturer as misleading or deceptive under the FTC's authority to prohibit unfair methods of competition).

<sup>43</sup> Two of my predecessors, former Chairmen Robert Pitofsky and Timothy Muris, also have discussed these advantages in *More Than Law Enforcement: The FTC's Many Tools—A Conversation With Tim Muris and Bob Pitofsky*, 72 Antitrust L.J. 773 (2005).

<sup>44</sup> Section 1014(c)(1).

will not be as robust or well-grounded as its proponents anticipate and, almost inevitably, will be inferior to the FTC's work in this area.

Drawing upon the strength of its institutional framework and its superior experience in a wide variety of consumer protection areas, the FTC has been a leader in financial consumer protection. Nevertheless, as a practical matter, the legislation eliminates the FTC's role in financial consumer protection. Based on the FTC's extensive experience, it is difficult to understand why the FTC should be excluded even from enforcing the rules promulgated by the new agency.

Although jurisdictional limits significantly curb the range of entities subject to the FTC's authority in this sector,<sup>45</sup> the FTC has a strong record of enforcing the FTC Act and other consumer protection laws in the areas of mortgage advertising and marketing, mortgage servicing, loan modification and foreclosure rescue, debt settlement and credit counseling, debt collection, and credit repair.<sup>46</sup> During the last five years alone, the FTC has brought more than 70 consumer protection cases involving the offering or provision of financial services. In many of these cases, the FTC has obtained immediate injunctive relief in federal court to halt the illegal activity and preserve assets for consumer redress.

In addition to pursuing an active law enforcement program, the FTC has led public education campaigns to help ensure that consumers do not succumb to fraudulent financial services schemes. Recently, the FTC collaborated with a wide array of government, non-profit, and mortgage industry members to launch a new consumer education campaign to help consumers avoid loan modification and foreclosure rescue scams. The FTC also issued a new consumer education publication on this topic, which several mortgage servicers have provided directly to consumers through various means, including loan counseling sessions, monthly statements, correspondence to delinquent borrowers, and on their websites.<sup>47</sup> These consumer education

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<sup>45</sup> Financial service providers that are banks, thrifts, and federal credit unions are exempt from the Commission's jurisdiction under the FTC Act. The Commission's jurisdiction under the FTC Act extends only to non-bank financial companies, including non-bank mortgage companies, mortgage brokers, and finance companies. Similarly, under the Fair Debt Collection Practices Act and the Credit Repair Organization Act, the Commission has jurisdiction over non-bank entities, including debt collectors and credit repair organizations, respectively.

<sup>46</sup> In tandem with its law enforcement program, the FTC also recently issued a report recommending legislative and other changes to reform and modernize the debt collection regulatory system. See FTC Workshop Report, *Collecting Consumer Debts – The Challenges of Change* (Feb. 2009), available at <http://www.ftc.gov/bcp/workshops/debtcollection/dcwr.pdf>.

<sup>47</sup> See FTC Publication, *A Note to Homeowners*, available at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea16.pdf>; FTC Publication, *Foreclosure Rescue Scams: Another Potential Stress for Homeowners in Distress*, available at <http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre42.shtm>.

materials complement the FTC's other publications that explain to consumers how to manage their mortgages in a variety of circumstances.<sup>48</sup>

The FTC also has been a leader in financial privacy policy. The FTC's Chairman co-chairs the President's Identity Theft Task Force, and the Commission has had a robust law enforcement program.<sup>49</sup> The FTC also has promulgated, individually or in conjunction with other agencies, approximately twenty implementing rules, guidelines, compliance forms, and notices in connection with the FACT Act.<sup>50</sup>

Using its unique combination of institutional capabilities, the FTC has achieved an excellent record of law enforcement, rulemaking, research, and consumer education in the financial services field. It has done so through a conscious, decades-long process of policy innovation. Yet the CFPA Act will have the effect of divesting the FTC of *all* of its financial consumer protection functions in a manner that provides no assurances that the new regulatory body will attain the FTC's existing level of effectiveness or develop an institutional platform that yields future enhancements. Not only does the CFPA Act transfer "[a]ll consumer financial protection functions of the Federal Trade Commission" to the CFPA, but the legislation also defines consumer financial protection functions so broadly as to include "research, rulemaking, issuance of orders or guidance. . . ."<sup>51</sup> This expansive definition would include the Bureau of Economics' research as well as the FTC's enormously valuable public workshops and consumer education programs.

Moreover, the legislation grants the CFPA exclusive authority to issue rules prohibiting unlawful unfair, deceptive, or abusive acts or practices in connection with consumer financial product/service transactions, but does not authorize the FTC to enforce those rules. It is conceivable that one aim of the CFPA's drafters was to unify policymaking and eliminate the costs associated with having multiple public entities enforce consumer protection commands for financial services. Yet the CFPA on its own terms falls well short of that aim, for it leaves a major independent source of enforcement in place: it authorizes the states to enforce

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<sup>48</sup> See FTC Publication, *Mortgage Servicing: Making Sure Your Payments Count*, available at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea10.shtm>; FTC Publication, *Mortgage Payments Sending You Reeling? Here's What to Do*, available at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea04.shtm>; FTC Publication, *How to Manage Your Mortgage If Your Lender Closes or Files for Bankruptcy*, available at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/rea12.shtm>.

<sup>49</sup> See, e.g., *United States v. ChoicePoint, Inc.*, No. 106-CV-0198 (N.D. Ga.) (settlement entered on Feb. 15, 2006 for alleged violations of the FTC Act involving the sale of sensitive information to a criminal gang that then used that information in some instances to commit identity theft).

<sup>50</sup> See generally Prepared Statement of the Federal Trade Commission on Protecting Consumer Privacy and Combating Identity Theft, Testimony Before the Subcommittee on Crime, Terrorism, and Homeland Security of the Committee on the Judiciary, United States House of Representatives, Dec. 18, 2007, available at <http://www.ftc.gov/os/testimony/P065404idtheft.pdf>.

<sup>51</sup> Sections 1061(a)(5)(A), 1061(d)

the CFPA's rules. If the states are to remain as significant enforcement agents in this policy domain, it makes no sense to exclude the FTC. The FTC's authority under the FTC Act to prohibit unfair or deceptive acts or practices overlaps heavily with the CFPA's authority to prevent "unfair, deceptive, or abusive" acts or practices in connection with consumer financial product/service transactions.<sup>52</sup> In light of the strong similarities between the FTC's unfair or deceptive authority and the CFPA's authority with respect to unfair, deceptive, or abusive practices, it would be wise to authorize the FTC to enforce CFPA rules. The FTC already has proven that it is a valuable enforcer of rules issued by other agencies, such as the Federal Reserve Board's Regulation Z (under the Truth in Lending Act).

Although the legislation will effectively extinguish the FTC's consumer protection authority for financial services, the CPFA reveals an evident ambivalence about doing so. The legislation purports to preserve some FTC role by providing the FTC with "backstop authority" to bring enforcement actions in the financial services area. This authority promises to be a mirage.<sup>53</sup> A regulatory agency's capacity to do good work depends crucially on the expertise of its staff. With no expertise there is no program – at least not a program in which one would place any confidence. Once the FTC has fulfilled the CFPA's command that it transfer its core functions and financial services personnel to the new regulatory entity, the Commission's ability to do effective work in this area will vanish. The FTC will lose the deep pool of financial services expertise it has worked hard for decades to build in its Bureau of Consumer Protection and Bureau of Economics. It is conceivable that some of the FTC's experts might remain, but it is difficult to imagine that a talented attorney or investigator will want to work on cases that another agency will litigate or the FTC, at best, will pursue subject to a 120-day delay.<sup>54</sup> As now planned, the new regulator will pay its employees salaries that will exceed the FTC's by fifteen percent or more – a further inducement for Commission financial services personnel to depart.

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<sup>52</sup> Section 1031. When the FTC interpreted a statutory prohibition on "abusive" practices in its promulgation of the "Do Not Call" amendments to the Telemarketing Sales Rule, the FTC chose, except for practices related to broadly-construed privacy interests (which it found to merit special consideration in light of specific examples in the underlying statute), to identify as abusive only those practices that would also qualify as unfair under the FTC's traditional unfairness analysis. *Telemarketing Sales Rule; Final Rule*, 68 Fed. Reg. 4580, 4614 (2003). Under the FTC's unfairness statement and section 5(n) of the FTC Act, 15 U.S.C. § 45(n), the agency can find unfairness when a practice causes substantial consumer injury, not reasonably avoidable by the consumer, whose costs are not outweighed by countervailing benefits to consumers or competition.

<sup>53</sup> Section 1022(e) provides that the FTC may "recommend in writing to the [CFPA] that the [CFPA] initiate an enforcement proceeding" and that if the CFPA does not "initiate an enforcement proceeding" within 120 days of receipt of the FTC's recommendation, the FTC may initiate an enforcement proceeding.

<sup>54</sup> The legislation mandates that all CFPA employees receive compensation and benefits that are at least equivalent to those provided by the Board of Governors. Section 1014. Therefore, even if FTC staff with relevant expertise were not automatically transferred to the CFPA, the higher benefits at the new agency could lure many of the FTC's staff.

Even assuming that the FTC retained the bare minimum resources to bring cases in the consumer financial protection area, the delay associated with the 120-day referral process will be problematic at the very least. One hallmark of the FTC's work is its ability to respond quickly to fraud and to obtain immediate relief in federal court. Based on our enforcement experience, a delay of 120 days would be plenty of time for many of our targets to close up shop and reopen under new names or with new individual aliases. It is precisely because many FTC targets are skilled at evading law enforcement that the Commission seeks temporary relief, even on an *ex parte* basis where necessary, to ensure that defendants do not destroy documents and that their assets are preserved for the possibility of consumer redress. In certain cases involving ongoing, hard-core fraud, the FTC has foregone civil penalties in order to seek immediate injunctive relief without the 45-day delay associated with referrals to DOJ. The 120-day referral process entails a delay in FTC action that could be the difference between a successful law enforcement action that returns money to consumer victims and a failed attempt to shut down a financial scam.

Rather than divest the FTC of all of its consumer financial protection functions and give it hollow "backstop authority," a more promising approach could be to remove jurisdictional limits that currently constrain the FTC's regulatory and enforcement authority in the financial services sector. As noted above, the FTC has a strong enforcement record in the financial services sector, even though many entities fall outside the agency's enforcement authority. Unlike other financial services regulators, the FTC applies its consumer protection authority in many sectors of the U.S. economy. Even if the FTC obtained jurisdiction over additional financial services actors, the Commission would be far less susceptible to "agency capture" than other financial regulators.<sup>55</sup>

### **The CFPA Will Jeopardize Certain Core Consumer Protection Functions that the FTC Will Retain**

A second major problem with the CFPA proposal is that it will jeopardize the FTC's ability to carry out its core non-financial consumer protection functions. The CFPA defines "financial activity" and "financial product or service" so broadly as to provide no meaningful limits on the new entity's jurisdiction. The legislation defines "financial activity" to include, among other things, the extension of credit, consumer reporting activities, debt collection, financial data processing, transmitting money, or "*any other activity that the [CFPA] defines, by rule, as a financial activity.*"<sup>56</sup> "Credit" is defined as "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property

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<sup>55</sup> There also may be significant advantages to ensuring that congressional oversight of consumer financial protection is vested in a committee that does not also oversee financial safety and soundness.

<sup>56</sup> Section 1002(18) (emphasis added).

or services and defer payment therefor.”<sup>57</sup> The legislation also defines “financial product or service” to mean “any product or service that, directly or indirectly, results from or is related to engaging in 1 or more financial activities.”<sup>58</sup>

Even though the CFPA’s announced aim is to enhance consumer protection in the financial services sector, the legislation defines financial activity and financial services so expansively as to sweep within the CFPA’s jurisdiction any activity that is even *indirectly related* to engaging in any activity that the CFPA defines as a “financial activity.” For example, the legislation’s definition of “credit” might encompass the CFPA’s primary enforcement jurisdiction of every business that does not require cash on the barrelhead – regardless of the products or services offered. Furthermore, the CFPA could decide by rulemaking that the definition of financial activity includes the payment side of every business, whether in the financial services sector or not. The new regulatory body could assert primary enforcement authority over all businesses and relegate the FTC to the illusory backstop enforcement role even as to these non-financial businesses. Because the CFPA’s primary enforcement authority might extend even to those areas of core consumer protection enforcement relating to non-financial products and services, the proposed legislation could limit, hinder, or even disable the FTC’s primary enforcement authority in key areas of consumer protection such as telemarketing fraud involving non-financial products and services.<sup>59</sup>

Let’s suppose that the legislation made it clear that the CFPA’s primary enforcement authority did not cover the activities of entities such as payment processors when such entities provide services to enterprises offering non-financial products or services. The FTC still would be hindered by the increased costs of coordinating enforcement actions with the CFPA and other agencies in cases involving both financial and non-financial entities. The FTC also would spend more resources to litigate these types of jurisdictional questions. The delays associated with resolving disputes over jurisdictional boundaries will diminish the FTC’s effectiveness in pursuing targets that offer products or services traditionally considered outside the financial services sector.

As the CFPA carries out its primary enforcement authority for unfair, deceptive, or abusive acts or practices under Federal law regarding consumer financial products or services, and as the FTC continues to enforce

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<sup>57</sup> Section 1002(10).

<sup>58</sup> Section 1002(19).

<sup>59</sup> The legislation also authorizes the CFPA to take action against “an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service.” Section 1031. The legislation thus appears to allow the CFPA to enforce the FTC Act’s prohibition against unfair or deceptive acts or practices, thereby bringing enforcement of the FTC Act under the CFPA’s primary enforcement authority. See § 1022(e).

consumer protection laws as to non-financial products and services, there is no assurance – beyond aspirational mandates for interagency coordination – that the CFPA will account properly for the FTC’s views about the appropriate content of unfairness and deception jurisprudence. Conflicts in interpretation and in litigation strategies will adversely affect every core area of consumer protection for which the FTC will continue to exercise primary responsibility.

Besides the impact on the FTC’s law enforcement program described above, the legislation requires the CFPA to collect financial consumer complaints. The FTC already performs this function through its Consumer Sentinel database, a rich body of information whose creation and enhancement ranks as one of the most important modern innovations in public policy for consumer protection. As things stand now, individual consumers, consumer groups, and a wide range of law enforcement authorities at home and abroad contribute complaints to the FTC’s complaint database. The creation of the CFPA could cause massive consumer confusion about where to file financial-related complaints. The disorientation will be particularly acute if the definitions for financial activity and financial products/services were to include entities not typically identified as part of the financial services sector. Because the FTC relies heavily on its consumer complaint system to identify law enforcement targets, such consumer confusion also could lead to delays in enforcement in non-financial areas of consumer protection for which the FTC will continue to exercise primary responsibility.

The proposal to create the CFPA also appears to take away the FTC’s capacity to use non-litigation policy instruments to achieve important consumer protection goals. Among other means, the FTC in recent decades has made major contributions in the financial services field by providing guidance, issuing reports, and convening public workshops. Section 1022(d) provides that “the [CFPA] shall have the exclusive authority to prescribe rules, issue guidance, conduct examinations, require reports, or issue exemptions with regard to any person subject to that law,” including the consumer financial protection functions transferred from the FTC to the CFPA. Thus the legislative proposal appears to eliminate the FTC’s important role in providing guidance to the public. In recent years the FTC has played this useful role with respect to mortgage disclosures, alternative mortgage products, debt collection, debt settlement, and other financial issues.<sup>1</sup> Because the legislation defines consumer financial protection functions expansively, the proposal jeopardizes the FTC’s ability to continue providing guidance even with respect to non-financial areas of consumer protection.

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<sup>1</sup> For example, on August 5-6, 2009, the FTC convened a roundtable discussion to address issues concerning debt collection litigation and arbitration. Participants included judges, academics, government officials, consumer advocates, and industry representatives. See *Debt Collection: Protecting Consumers Roundtable Transcript* (Aug. 5-6, 2009), available at <http://www2.ftc.gov/bcp/workshops/debtcollectround/090805-CHIL/transcript-90805.pdf> and <http://www2.ftc.gov/bcp/workshops/debtcollectround/090805-CHIL/transcript-90806.pdf>.

Finally, the draft legislation could be read to divest the FTC of certain competition authority and resources where the product market at issue involves the issuance of credit. Here, too, the legislation provides a sweeping definition for financial product or service and authorizes the agency to expand upon its jurisdiction by rule. The transfer of all functions “relating to the provision of consumer financial products or services” conceivably could include parts of the FTC’s Bureau of Competition and those personnel in the Bureau of Economics who work on competition matters. As Professor Stephen Calkins has pointed out, cases such as *FTC v. Tigor Title Insurance Co.*,<sup>2</sup> which involved the joint setting of title insurance rates as an unfair method of competition, would fall within the incredibly broad jurisdiction of the new agency.<sup>3</sup>

### **Conclusion**

The protection of consumers of financial services products is a crucial domestic priority. Institutions are the conduits that deliver public policy, and the quality of protection afforded American consumers depends vitally on the proper design and allocation of regulatory authority. My experiences as an FTC Commissioner, former Chairman, former General Counsel, and a junior case handler have reinforced what I learned in studying consumer protection and competition policy issues as an academic: good institutions are the necessary foundations of good public policy. I strongly believe that the current proposal to create the CFPA makes the unwise decision of cutting the FTC out of consumer financial protection altogether. I also am concerned that the proposed legislation will have major, unintended consequences on the FTC’s ability to carry out even those core consumer protection functions that will remain the FTC’s primary responsibility after creation of the CFPA. With further discussion, careful crafting, and a thorough examination of what jurisdictional boundaries still remain sensible, we can and must get these complex and important public policy decisions right.

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<sup>2</sup> *FTC v. Tigor Title Insurance Co.*, 504 U.S. 621 (1992).

<sup>3</sup> Calkins testimony, p. 5.



## Three Problematic Truths About the Consumer Financial Protection Agency Act of 2009

Joshua D. Wright & Todd J. Zywicki<sup>†</sup>

The creation of a new Consumer Financial Protection Agency (“CFPA”) is a very bad idea and should be rejected. The proposal is not salvageable and cannot be improved in substance or in form. The proposal is premised on a fundamental misunderstanding of the causes of the financial crisis. The Obama Administration’s *Financial Regulatory Reform White Paper*, and the intellectual underpinnings of the new CFPA as articulated by law professors Elizabeth Warren of Harvard and Oren Bar-Gill of New York University, set forth the blueprints for a powerful regulatory agency designed to react to a perceived failure of consumers to understand innovative financial products. The foundational premise of the CFPA is that a failure of consumer protection, and specifically irrational consumer behavior in lending markets, was a meaningful cause of the financial crisis and that the CFPA would have or could have averted the crisis or lessened its effects.

Neither the White Paper nor Bar-Gill and Warren offer a scintilla of evidence to support these claims. Let us repeat that to make it clear—there is *no* evidence that consumer ignorance or irrationality was a substantial cause of the crisis or that the existence of a CFPA could have prevented the problems that occurred. In this article, we highlight three fundamentally problematic truths about the CFPA:

- (1) The CFPA is premised on a flawed understanding of the financial crisis.
- (2) The CFPA will have significant unintended consequences, including but not limited to reducing competition, consumer choice, and availability of credit to consumers for productive uses;
- (3) The CFPA creates a powerful bureaucracy with undefined scope, risking expensive and wasteful regulatory overlap at both the federal and state levels without any evidence of its own expertise in the core areas it is designed to regulate.

### I. The CFPA Is Premised on a Flawed Understanding of the Causes of the Financial Crisis

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The U.S. Department of the Treasury proposed the creation of a new agency for protecting consumers of financial products on June 17, 2009.<sup>4</sup> About a month later it submitted draft legislation to Congress for the Consumer Financial Protection Agency Act of 2009.<sup>5</sup> The CFPA would “promote transparency, simplicity, fairness, accountability, and access in the market for consumer financial products or services”<sup>6</sup> and take over the consumer protection functions of all other federal regulatory agencies.<sup>7</sup> The CFPA will impose more stringent disclosure requirements on lenders and other qualifying institutions,<sup>8</sup> require that lenders offer “plain vanilla” products designed and approved by the agency,<sup>9</sup> and prohibit products and contract terms that it determines are problematic for consumers according to an unspecified form of cost-benefit analysis.<sup>10</sup> Importantly, the CFPA will also permit and encourage states to impose even stricter regulations on financial products and services than those adopted by the CFPA.<sup>11</sup>

The U.S. Department of the Treasury claims that the failure of consumer protection helped caused the financial crisis and that a new federal agency with enhanced powers is therefore needed.<sup>12</sup> The White Paper argues that this situation resulted because of inadequate consumer protection regulation:

The spread of unsustainable subprime mortgages and abusive credit card contracts highlighted a serious shortcoming of our present regulatory infrastructure. It too easily allows consumer protection values to be

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<sup>4</sup> UNITED STATES DEPARTMENT OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 55-75 (2009) [hereinafter New Foundation], available at [http://www.financialstability.gov/docs/regs/FinalReport\\_web.pdf](http://www.financialstability.gov/docs/regs/FinalReport_web.pdf) (outlining proposals for various governmental regulations of financial services and credit products).

<sup>5</sup> UNITED STATES DEPARTMENT OF THE TREASURY, CONSUMER FINANCIAL PROTECTION AGENCY ACT OF 2009 (2009), available at <http://www.financialstability.gov/docs/CFPA-Act.pdf> [hereinafter CFPA Act] (proposing 2009 Consumer Financial Protection Agency legislation for passage by Congress).

<sup>6</sup> *Id.* at § 1021(a).

<sup>7</sup> These include the Federal Reserve Board of Governors, Comptroller of the Currency, Office of Thrift Supervision, Federal Deposit Insurance Corporation, National Credit Union Administration, and the Federal Trade Commission. *See id.* at § 1061(a). The CFPA would regulate all consumer financial products and services with two principle exceptions: (1) insurance would be excluded except for credit insurance, mortgage insurance, and title insurance; (2) investment products that are already regulated by the SEC or CFTC would be excluded. *Id.* at § 1082(d).

<sup>8</sup> CFPA Act, *supra* note 2, at § 1032.

<sup>9</sup> *Id.* at § 1036(b).

<sup>10</sup> *Id.* at § 1031(c).

<sup>11</sup> *Id.* at § 1035(a). Currently, OCC rules preempt states from supervising, examining and regulating the business activities of national banks and their operating subsidiaries. 12 C.F.R. pt. 7, 34; UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, OCC PREEMPTION RULES: OCC SHOULD FURTHER CLARIFY THE APPLICABILITY OF STATE CONSUMER PROTECTION LAWS TO NATIONAL BANKS (2006), available at <http://www.gao.gov/new.items/d06387.pdf>.

<sup>12</sup> New Foundation, *supra* note 1, at 55.

overwhelmed by other imperatives – whether short-term gain, innovation for its own sake, or keeping up with the competition. To instill a genuine culture of consumer protection and not merely of legal compliance in our financial institutions, we need first to instill that culture in the federal regulatory structure. For the public to have confidence that consumer protection is important to regulators, there must be clear accountability in government for this task.<sup>13</sup>

President Obama also suggested that the new consumer protection agency was needed in part because consumers had chosen to take out too much credit: “And this is essential, for this crisis was not just the result of decisions made by the mightiest of financial firms; it was also the result of decisions made by ordinary Americans to open credit cards and take out home loans and take on other financial obligations.”<sup>14</sup>

Professors Bar-Gill and Warren, prominent legal academics who have provided the original intellectual foundation for the CFPA,<sup>15</sup> have argued that a new and powerful agency is required to deal with “dangerous” financial products and services that can “as evidenced by the recent subprime crisis . . . have devastating effects on communities and the economy.”<sup>16</sup> Along similar lines, Professor Michael Barr, a University of Michigan Law School professor who is now the Assistant Secretary of the Treasury responsible for the draft legislation, and several co-authors, have expanded upon the proposed Bar-Gill/Warren agency by detailing key aspects of its regulatory approach in an October 2008 paper.<sup>17</sup> These intellectual architects of the CFPA assert that irrational consumer behavior is at the heart of the financial crisis, and that the CFPA is needed to “nudge” consumers toward better decision making in lending markets.

The creators and the defenders of the CFPA are wrong on both counts. They misunderstand actual causes of the financial crisis. They also erroneously assume that the behavioral law and economics literature, which consists of a number of studies in economics and psychology that find that consumers appear to make various systematic mistakes evaluating probabilities and discounting future values, and, further, that consumers make various choices that appear inconsistent with each other, provides an adequate intellectual and evidentiary basis for the creation of the CFPA and its proposed regulations. We discuss each in turn.

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<sup>13</sup> *Id.* at 56.

<sup>14</sup> Barack Obama, President of the United States, Speech on 21st Century Financial Regulatory Reform (June 17, 2009), available at [http://www.cfr.org/publication/19658/obamas\\_speech\\_on\\_21st\\_century\\_financial\\_regulatory\\_reform.html](http://www.cfr.org/publication/19658/obamas_speech_on_21st_century_financial_regulatory_reform.html).

<sup>15</sup> Professor Warren is currently is currently the head of the Congressional Oversight Panel on TARP funding.

<sup>16</sup> Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 101, 101 (2008).

<sup>17</sup> Michael S. Barr, Sendhil Mullainathan & Eldar Shafir, *Behaviorally Informed Financial Services Regulation* (New American Foundation, Working Paper, October 2008).

## A. The Causes of the Financial Crisis

It is true that lenders made a huge number of loans that were foolish in retrospect and perhaps should have been recognized as foolish at the time. And these unwise loans presented, and continue to present, major problems for the safety and soundness of the American banking sector. But it is critical to understand that these loans were foolish *not* because consumers did not understand them but because lenders failed to appreciate the incentives for rational, fully-informed consumers to default on these loans if circumstances changed.

Consider an extreme, but not unrealistic scenario: A California borrower took a nothing-down, interest-only, adjustable-rate mortgage to buy a new home in the far-flung exurbs of Northern California, planning to live in the house for a few years and then resell it for a profit. Assume further that the borrower could continue to make his mortgage payment if he chose to do so. Instead, the house plunged in value so that it is worth much less than the outstanding mortgage and with widespread oversupply of housing there is no reasonable likelihood that it will come back above water in the near future. Under California's defaulter-friendly, antideficiency laws, the lender is limited to foreclosing on the house and cannot sue the borrower for the difference between the value of the house and the amount owed on the mortgage. As a result of all of this, the homeowner crunches the number, consults his lawyer, and decides to walk away from the house and allow foreclosure.

This scenario raises substantial concerns about the safety and soundness of such loans. One can ask whether banks should be permitted to make loans that provide such strong incentives for a borrower to default when the loan falls in value. In fact, empirical evidence suggests that many of the terms that have drawn much criticism (such as low-documentation loans) proved to be problematic only when combined with other provisions that reduced borrower equity, such as nothing-down.<sup>18</sup> But while this scenario presents major concerns about the safety and soundness of such a loan, it does *not* present a consumer protection issue. The end result of foreclosure results from the set of incentives confronting the borrower and the borrower's rational response to them—empirical research indicates that loans with no down payment or which otherwise cause borrowers to have low or no equity in their homes (including interest-only, home equity loans, and cash-out refinances) have proven to be especially prone to foreclosure in the recent crisis as stripping equity out of ones' house makes it more likely that a price drop will push the house into negative equity territory thereby providing incentives to default on the loan.

One can reasonably ask whether banks should be permitted to make loans that provide such strong incentives for a borrower to default when the loan falls in value. In fact, empirical evidence suggests that many of the terms that have drawn much criticism (such as low-documentation loans) proved to be problematic only when combined with other provisions that reduced borrower equity, such as nothing-down.<sup>19</sup> But while this scenario presents major concerns about the safety and soundness of such a loan, it

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<sup>18</sup> KRISTOPHER GERARDI ET AL., MAKING SENSE OF THE SUBPRIME CRISIS, BROOKINGS PAPERS ON ECONOMIC ACTIVITY (Douglas W. Elmendorf, N. Gregory Mankiw, and Lawrence Summers eds., Fall 2008).

<sup>19</sup> *Id.*

does *not* present a consumer protection issue. Foreclosure is the end result culminating from a set of incentives confronting the borrower and the borrower's rational response to them.

Rather than recognizing the financial crisis as the product of misaligned incentives that has created major safety and soundness issues, the Obama Administration's proposal for a CFPB rests on the assumption that the financial crisis was produced by hapless consumer victims being exploited and defrauded by unscrupulous lenders and turns to policies informed by behavioral economics to "nudge" consumers into "more rational" decisions.

## **B. New Paternalism of Behavioral Economics Does Not Provide an Adequate Justification for the CFPB and Its Proposed Regulations**

- The CFPB is predicated on the fundamentally mistaken assumption that consumer irrationality led to the financial crisis. The CFPB, led by the work of Bar-Gill and Warren and others, rely on the "behavioral law and economics" literature<sup>20</sup> to lay the intellectual foundation for the CFPB and its proposed regulations that would, in theory, "nudge" consumers towards correcting these mistakes. The proponents argue that "[m]any consumers are uninformed and irrational,"<sup>21</sup> that consumers make "systematic mistakes in their choice of credit products and in the use of these products,"<sup>22</sup> and that regulators should adopt a number of "behaviorally informed" policies designed to address the consequences of consumer ignorance and irrationality.<sup>23</sup> There are a number of problems with this set of assumptions. For example, as we will discuss below, how will regulators insulated from the pressures of competitive markets, who are presumably also afflicted with the same cognitive biases and prone to the same sorts of mistakes, objectively identify and distinguish harmful from beneficial lending products?
- But even holding aside these unanswered questions, the very core assumptions that consumer irrationality has been adequately linked to the financial crisis is misplaced. As noted above, while there was undoubtedly fraud during the housing boom (both by borrowers and lenders) the problems that have been seen in the mortgage market are the result of rational consumer responses to incentives, not a problem of fraud, consumer confusion, or systematic

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<sup>20</sup> This literature consists of a number of studies in economics and psychology that find that consumers appear to make various systematic mistakes evaluating probabilities and discounting future values, and, further, that consumers make various choices that appear inconsistent with each other. For a summary of this literature, see Christine Jolls, *Behavioral Law and Economics*, in *ECONOMIC INSTITUTIONS AND BEHAVIORAL ECONOMICS* (Peter Diamond ed., Princeton University Press 2006); Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 *STAN. L. REV.* 1471 (1998).

<sup>21</sup> See Bar-Gill & Warren, *supra* note 13, at 21; Barr et al., *supra* note 14, at 1.

<sup>22</sup> Bar-Gill & Warren, *supra* note 13, at 26.

<sup>23</sup> See generally Barr et al., *supra* note 14, at 1.

irrationality. The housing crisis—referring specifically to the problem of foreclosures—has little to do with the issues identified by the White Paper and thus an entity such as the CFPB would make little difference in averting a similar problem in the future.

At its core, the CFPB mission embraces the view that consumer finance regulation should be based on the notion that consumers don't make rational decisions because they don't understand financial products. At least one appropriate regulatory response, it is assumed, is to design "plain vanilla" products that must be offered to borrowers while consumers are "nudged" toward the selection of those products rather than more exotic non-vanilla variants. Unfortunately, at this point there is simply no evidence that consumer irrationality contributed to the financial crisis. Consider the substantial empirical evidence, for example, that buyers in consumer markets such as credit cards and supermarkets act quite rationally most of the time and frequently learn from mistakes when the costs of doing so are low.<sup>24</sup>

Even if one assumed without evidence that consumer irrationality was a substantial contributor to the financial crisis warranting additional regulation, regulations pushing consumers toward "plain vanilla" lending products is problematic from an economic perspective for several reasons.

First, while non-vanilla products might not be best for everyone, raising the costs to consumers for whom those products make economic sense will lower welfare. Consumers have a heterogeneous preferences and it does not generally make economic sense to impose regulatory hurdles limiting consumers' ability to satisfy those preferences.

Second, it is no defense to argue that the CFPB will allow lenders to include non-standard products, maintaining consumer choice, so long as they also include the CFPB-approved product design. There are a variety of "nudge" style requirements that might be imposed on consumers who rationally would prefer to adopt the disfavored mortgage products, including the power to prohibit disfavored products entirely.<sup>25</sup> Further, it would seem doubtful that the CFPB would have the ability and knowledge to determine that a "plain vanilla" product is better for a consumer, who knows their own preferences and circumstances, than the other products being provided by the lender

Third, to the extent that consumer irrationality is a problem, this paternalistic approach reduces the incentives for consumers to improve decision making over time by learning. The practical and economic significance of these effects are important factors that should have been considered and weighed against the merits of the current proposal. All of these are potentially significant costs of the new regulatory approach to financial products for consumers. However, consumer irrationality has not been

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<sup>24</sup> See Joshua D. Wright, *Behavioral Law and Economics, Paternalism, and Consumer Contracts: An Empirical Perspective*, 2 NYU J. L. & LIBERTY 470 (2007) (surveying empirical evidence of consumer behavior in consumer credit and other contexts).

<sup>25</sup> CFPB Act, *supra* note 2, at §§ 1041(a)(1)-(a)(2).

demonstrated to be an important causal factor in the financial crisis. Rather, proponents of the CFPB have assumed irrationality to have a significant causal role without empirical evidence and proposed solutions that are more likely to harm than help most consumers.

As mentioned, it is also problematic that the so-called behavioral economic approach to regulating consumer products shifts decision making from consumers to regulators who are presumably afflicted with the same cognitive biases and irrationalities as everyone else. Defenders of the proposal, such as Richard Thaler, have minimized this concern by arguing that consumers rely on experts frequently and even if our regulators are imperfect, they certainly can improve matters because of their superior expertise relative to the average consumer.<sup>26</sup> For instance, consumers trust trained but imperfect mechanics because it beats fixing the car ourselves. The critical distinction here, of course, is that we trust mechanics because they are specialists who operate under the pressure of competitive forces and reputation and have incentives to perform well that differ greatly from those of government agents who are relatively immune from those forces.

It bears repeating that there is simply no empirical evidence demonstrating that consumer irrationality was a significant cause of the financial crisis, much less that the proposed regulations envisioned by the CFPB would have solved any existing problems.

Consider, for example, that despite assertions by proponents of the CFPB to the contrary about the economic consequences of non-standard mortgage products, economic research has overwhelmingly concluded that one factor that was *not* important were so-called “teaser rates” on subprime mortgages. Critics have claimed that these hybrid mortgages were “exploding” mortgages in that the initial teaser rate was set excessively low and that there would be a dramatic upward shot in interest rates after the interest rate reset that would surprise borrowers with high interest rates, and that this has helped to generate rising foreclosure rates. Although often cited, this theory appears to lack any empirical foundation.

One estimate of subprime loans facing foreclosure in the early wave of foreclosures found that 36% were for hybrid loans, fixed-rate loans accounted for 31%, and adjustable-rate loans for 26%.<sup>27</sup> Of hybrid loans in foreclosure, the overwhelming majority entered foreclosure *before* there was an upward reset of the interest rate.<sup>28</sup> Most defaults on subprime hybrid loans occurred within the first 12 months of the loan, well

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<sup>26</sup> See Paul Solman, Thaler Responds to Posner on Consumer Protection (last visited Sep. 8, 2009), <http://www.pbs.org/newshour/businessdesk/2009/07/thaler-responds-to-posner-on-c.html>.

<sup>27</sup> James R. Barth et al., *Mortgage Market Turmoil: The Role of Interest-Rate Resets*, in SUBPRIME MORTGAGE DATA SERIES (Milken Inst. 2007); C.L. Foote, K. Gerardi, L. Goette & P.S. Willen, *Subprime Facts: What (We Think) We Know about the Subprime Crisis and What we Don't*, FED. RES. BANK BOSTON PUBLICLY POLICY DISCUSSION PAPER 08-02 (2007); C. Mayer, K. Pence, & S.M. Sherlund, *The Rise in Mortgage Defaults: Facts and Myths*, 23 J. ECON. PERSPECTIVES 27 (2009).

<sup>28</sup> Barth et al., *supra* note 24, at 2. Of those subprime loans in foreclosure at the time of his study, 57% of 2/28 hybrids and 83% of 3/27 hybrids “had not yet undergone any upward reset of the interest rate.”

before any interest adjustment.<sup>29</sup> For those borrowers who actually underwent an interest-rate reset, the new rate was higher, but not dramatically so when compared to the original rate.<sup>30</sup> On average, the rate for subprime borrowers from the period 2003-2007 adjusted from an initial rate of about 8% to about 11%—a substantial adjustment, but not one that can fairly be characterized as “exploding.” Moreover, mortgage interest rates generally were increasing during this period (the spread between the initial and reset rates generally narrowed during this period), so the higher rate on reset also might have reflected a general rise in ARM interest rates, not the hybrid nature of the loan. Economists Anthony Pennington-Cross and Giang Ho find that the transition in a hybrid loan from an initial fixed period to the adjustable rate period results in heightened rates of prepayment but *not* default.<sup>31</sup> They also find that the termination rate for subprime hybrid loans (whether by prepayment or default) was comparable to that for prime hybrid loans. In light of these facts, economists have almost universally concluded that hybrid mortgages (at least alone) cannot explain the rise in foreclosures. After examining the evidence, several economists from the Boston Federal Reserve flatly stated last year, “Interest-rate resets are not the main problem in the subprime market.”<sup>32</sup> We are aware of no evidence that contradicts that conclusion.

### C. The CFPA and Credit Cards

Credit cards are singled out for special criticism in the Obama Administration’s White Paper, as well as Bar-Gill and Warren’s article, despite the fact there is scant evidence that borrowers are unable to meaningfully understand their credit cards or shop effectively for credit cards. According to a survey by former Federal Reserve economist Thomas Durkin, 90% of consumers report that they are “Very” or “Somewhat Satisfied” with their credit cards.<sup>33</sup> Durkin also found that two-thirds of credit card owners find it “very easy” or “somewhat easy” to find out information about their credit card terms, and only six percent believed that obtaining this information was “very difficult.” Two-thirds of respondents also reported that credit card companies usually provide enough information to enable them to use credit cards wisely. In an ideal world, these figures might be even higher, but the White Paper does a great disservice to American consumers when it implies that consumers are unable comprehend their credit cards or to acquire the information that they need to make reasonable choices.

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<sup>29</sup> Mayer, Pence & Sherlund, *supra* note 24, at 11 (Mayer, Pence, and Sherlund find a dramatic rise in “early payment defaults” well before any interest rate adjustment takes place.); Shane Sherlund, *The Past, Present, and Future of Subprime Mortgages*, Federal Reserve Board (Sept. 2008); Kristopher Gerardi, Adam Hale Shapiro, and Paul S. Willen, *Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures* (Federal Reserve Bank of Boston, Working Paper no. 07-15, 2008).

<sup>30</sup> See Foote et al., *supra* note 24, at 16.

<sup>31</sup> See Anthony Pennington-Cross & Giang Ho, *The Termination of Subprime Hybrid and Fixed Rate Mortgages* 18 (Fed. Reserve Bank of St. Louis, Working Paper No. 2006-042A, 2006).

<sup>32</sup> See Foote et al., *supra* note 24, at 48.

<sup>33</sup> Thomas Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, FEDERAL RESERVE BULLETIN (April 2002).

More importantly, consumers pay attention to and understand the credit card terms that matter most *to them* personally. Consumers who revolve credit card balances are extremely likely to be aware of the interest rate on their credit cards and to comparison shop among cards on that basis, and those who carry larger balances are even more likely to be aware of and comparison shop on this term than those who revolve smaller balances.<sup>34</sup> By contrast, those who do not revolve balances tend to focus on other aspects of credit card contracts, such as whether there is an annual fee, the grace period for payment, or benefits such as frequent flier miles. In fact, consistent with the observation of more aggressive interest rate shopping by revolvers, those who revolve balances are charged *lower* interest rates on average than those who do not.<sup>35</sup> American consumers are not passive sheep timidly waiting to be shorn, as implied by the White Paper.

Elevating certain “plain vanilla” loans for exalted status also poses a risk of chilling vigorous competition and innovation in lending products. Consider the dramatic innovations and improvements in credit cards over the past several decades.<sup>36</sup> Thirty years ago credit cards were an immensely simple product—a high annual fee, a high fixed interest-rate, and no benefits such as cash-back, frequent-flyer miles, purchase-price protection, etc. Bank cards were available only to a lucky few. The remainder of middle-class consumers who needed credit were forced to rely on credit from local department stores or appliance stores, thereby obliging them to shop at those stores. These cards were simple—but lousy. The simplicity and uniformity of pricing stifled innovation and, some have alleged, made it easier for credit card issuers to collude to fix prices and stifle competition.

The effective deregulation of the credit card market by the Supreme Court’s decision in *Marquette National Bank* set off a process of competition and innovation that continues to this day.<sup>37</sup> Annual fees have disappeared on all “plain vanilla” credit cards, remaining only for those cards that provide frequent flyer miles and the like. Virtually all credit cards have variable interest rates. And there is a much greater reliance on behavior-based fees, such as over-the-limit fees, late fees, and the like. The combination of these innovations has resulted in more accurate risk-based pricing for cards and less cross-subsidization by low-risk users of higher-risk users of credit cards. True, credit card pricing has become more complicated—but that is largely because consumer use of credit cards is so much more complicated and varied than in the past. It would be extremely unwise for a hypothetical CFPA to try elevate simplicity above all else without considering the impact of its actions on competition, innovation, and consumer choice. The parable of credit card innovation provides a warning lesson about a narrow fixation on simplicity.

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<sup>34</sup> See Thomas A. Durkin, *Credit Card Disclosures, Solicitations, and Privacy Notices: Survey Results of Consumer Knowledge and Behavior*, FEDERAL RESERVE BULLETIN, 2006, at A 109.

<sup>35</sup> Tom Brown & Lacey Plache, *Paying with Plastic: Maybe Not So Crazy*, 73 U. CHICAGO L. REV. 63 (2006).

<sup>36</sup> For a discussion of this history, see generally Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79 (2000).

<sup>37</sup> *Marquette Nat’l Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299, 318 (1978).

## II. The CFPB Will Have Unintended Consequences

A second major problem with the concept of the CFPB is the high likelihood of unintended consequences that will result from its actions, including reducing competition and valuable consumer choice. Consider, for example, the proposal to ban (or strongly discourage) prepayment penalties in mortgage products. This would likely prove counterproductive and harmful to consumers.

Prepayment penalties are a common term in many subprime mortgages, although they remain uncommon in most prime mortgages in the United States. Prepayment penalties are also included in most commercial loans and are present in virtually all European mortgages. Yet the White Paper contemplates banning prepayment penalties in mortgages. This reasoning is based on faulty economic logic and fails to recognize the overwhelming economic evidence supporting the efficiency of prepayment penalties.

The traditional American right to prepay and refinance a mortgage is relatively unique in the world. Available empirical evidence indicates that American consumers pay a substantial premium for this unlimited prepayment right. Borrowers pay a premium for the unlimited right to prepay of approximately 20 to 50 basis points (.2 to .5 percentage points) with subprime borrowers generally paying a higher premium for the right to prepay than prime borrowers because of the increased risk of subprime borrower prepayment.<sup>38</sup> Borrowers pay this premium to compensate lenders for the risk of having to reinvest funds at lower market interest rates when interest rates fall. Where prepayment penalties are banned lenders also take other precautions to guard against the risk of prepayment, such as charging increased points or upfront fees at the time of the loan, which raise the initial cost of the loan.

Nor is there any evidence that prepayment penalties are excessively risky for consumers. Empirical evidence indicates that prepayment penalties do not increase the risk of borrower default. In fact, subprime loans that contain prepayment penalty clauses are less likely to default than those without such clauses, perhaps because of the lower interest rate on loans with prepayment penalties or perhaps because the acceptance of a prepayment penalty provides a valuable and accurate signal of the borrower's intentions.<sup>39</sup> Acceptance by a borrower of a prepayment penalty may also provide a credible signal by the borrower of his intent not to prepay the loan, thus overcoming an adverse selection in the marketplace and permitting a reduction in interest rates. Borrowers obviously have greater knowledge than lenders about

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<sup>38</sup> See Todd J. Zywicki & Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1, 18-20 (2009) (summarizing studies); Gregory Elliehausen, Michael E. Staten & Jevgenijs Steinbuks, *The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages*, 60 J. ECON. & BUS. 33, 34 (2008) (reviewing studies); Chris Mayer, Tomasz Piskorski & Alexei Tchisty, *The Inefficiency of Refinancing: Why Prepayment Penalties Are Good for Risky Borrowers* (Columbia Business School, Working Paper, 2008). Term sheets offered to mortgage brokers similarly quoted interest-rate increases of approximately 50 basis points in those states that prohibited prepayment penalties.

<sup>39</sup> Mayer et al., *supra* note 34, at 3; Sherlund also finds that the presence of prepayment penalties does not raise the propensity for default. Sherlund, *supra* note 26, at 11.

the relative likelihood that the borrower will prepay the mortgage, especially in the subprime market where prepayment tends to be highly idiosyncratic and borrower-specific.<sup>40</sup>

The White Paper's approach to prepayment penalties is also internally illogical, stating that prepayment penalties "should be banned for certain types of products, such as subprime or nontraditional mortgages, or for all products, because the penalties make loans too complex for the least sophisticated consumers to shop effectively."<sup>41</sup> This statement is confused in two respects. First, it conflates two different concepts—the complexity of prepayment terms on one hand and the ability of consumers to shop effectively on the other. If the concern is the ability to shop effectively, such as being able to compare competing offers, then the White Paper's concern could be met equally well by *mandating* prepayment penalties in every mortgage, thereby standardizing this term. In which case, it would no longer be a term on which consumers would need to compare across mortgages thereby rendering moot the question of the complexity of the term. Second, the statement refers to the inability of the "least sophisticated consumers" to be able to shop effectively. According to research by the Federal Trade Commission, however, those who have subprime mortgages are just as capable of understanding their mortgage terms as prime borrowers (or more accurately, neither group understands their loan terms very well).<sup>42</sup>

In still other cases the White Paper fails to consider the sophistication of the covered group at all. For instance, it identifies negative amortization loans as being especially complex and subject to particular scrutiny.<sup>43</sup> Mayer et al. find that negative amortization and interest-only loans were present in a significant minority of alt-A mortgages, but virtually nonexistent in subprime mortgages.<sup>44</sup> Yet although alt-A and subprime loans are often lumped together, there is reason to believe that many alt-A borrowers were highly-sophisticated borrowers who fully understood the risks of those products and alt-A mortgages were often used precisely to purchase larger and more expensive houses. More generally, negative amortization features do not appear to have been common in loans to ordinary borrowers or to subprime borrowers, but were limited to a particular subset of borrowers who often were highly-sophisticated and fully understood the risk of the loan and consciously chose to speculate that the home price would increase. We are aware of no evidence that those who held negative amortization loans failed to recognize or understand this term or the risks it entailed. Nor does the White Paper present any such evidence.

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<sup>40</sup> See Zywicki & Adamson, *supra* note 35, at 16.

<sup>41</sup> New Foundation, *supra* note 1, at 68.

<sup>42</sup> JAMES M. LACKO AND JANIS K. PAPPALARDO, IMPROVING CONSUMER MORTGAGE DISCLOSURES: AN EMPIRICAL ASSESSMENT OF CURRENT AND PROTOTYPE DISCLOSURE FORMS (2007) available at <http://www.ftc.gov/os/2007/06/P025505MortgageDisclosureReport.pdf>.

<sup>43</sup> New Foundation, *supra* note 1, at 66.

<sup>44</sup> Mayer, Pence & Sherlund, *supra* note 24, at 32-33. Mayer et al. find that 40% of alt-A mortgages had interest-only features, compared to 10% of subprime; 30% of alt-A mortgages permitted negative amortization, while subprime loans did not have these features. *Id.*

Finally, the ability of American consumers to freely prepay and refinance their mortgages may have exacerbated the current mortgage crisis—and banning prepayment penalties might thus exacerbate a similar situation in the future. When home prices were rising, many consumers refinanced their mortgages to withdraw equity from their homes. These “cash-out” refinancings became increasingly common during the duration of the housing boom: from 2003 to 2006, the percentage of refinances that involved cash-out rose doubled from under 40% to over 80%<sup>45</sup> and among subprime refinanced loans in the 2006-2007 period around 90% involved some cash-out.<sup>46</sup> In fact, even though there was a documented rise in LTV ratios between 2003-2007, even that may underestimate the true increase in the LTV ratio if appraisals for refinance purposes were inflated (either intentionally or unintentionally), as appraisals are a less-accurate measure of value than actual sales.<sup>47</sup> The ability to freely prepay and refinance one’s mortgage may help to explain the higher propensity for American consumers to default than in comparably-situated countries where prepayment is more difficult and thus cash-out refinancings are not as common.

This suggests that a ban or limitation on contractual agreements for prepayment penalties would encourage even more refinancing activity and further equity depletion than would otherwise be the case—thereby having the unintended consequence of *increasing* the number of foreclosures.

More generally, the CFPA implicitly rests on the assumption that consumer credit is a commodity, and that product differentiation among consumer credit products is purely artificial, not a reflection of differences among credit users. Georgetown Law Professor Adam Levitin, a leading proponent of the establishment of the CFPA has summarized the argument succinctly (citing to a Credit Slips post of his):

Credit is at core a commodity. A dollar from Chase is no different than a dollar from Bank of America. The only way high-cost products that skim consumer surplus are able to compete in the credit market is through price obfuscation. Some of this obfuscation is through fine-print. Some is through product design, as complexity and exploitation of consumers’ cognitive biases can mask pricing. Credit cards have led the way with price obfuscation, but mortgages made up the gap, and other products are not far behind. Basically, the consumer credit market is a market in which competition often encourages bad products, and this calls for regulatory

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<sup>45</sup> Luci Ellis, *The Housing Meltdown: Why Did it Happen in the United States* 22 (Bank For International Settlements, BIS Working Paper 259, Sep. 2008), available at <http://www.bis.org/publ/work259.pdf>.

<sup>46</sup> C J Mayer & Karen Pence, *Subprime Mortgages: What, Where, and To Whom* (NBER, Working Paper no. 14083, 2008).

<sup>47</sup> Ellis, *supra* note 42, at 22; Mayer et al., *supra* note 24, at 6.

intervention.<sup>48</sup>

As Professor Levitin suggests, this proposition that consumer credit at root is a commodity is a fundamental intellectual linchpin of the case for a consumer financial protection agency: that product differentiation and product heterogeneity is artificial and fundamentally misleading and that government can identify and standardize the “proper” terms on which lenders should be permitted to compete. This view that product differentiation, satisfaction of heterogeneous consumer preferences, and competition on margins that are not pre-approved by regulators and scholars are somehow “artificial” is one that highlights the risks of unintended consequences for the CFPA. If this fundamental assumption is inaccurate—as it almost certainly is for at least small business users of credit and most individual users as well—then the intellectual justification for the coerced standardization promoted by the CFPA collapses.

### III. The CFPA Will Be a Bureaucratic Nightmare

A final problem with the CFPA is that it creates a new bureaucracy with a defined scope, expertise, and mission, separate from other consumer protection agencies and safety and soundness regulators. In so doing, it will promote the very bureaucratic balkanization and inconsistency that it aspires to address.

#### A. Problems of Vagueness

The standard that the CFPA seeks to achieve is also unrealistic and suggests a virtually unlimited scope of authority for its action. The White Paper proposes that CFPA “should be authorized to use a variety of measures to help ensure alternative mortgages were obtained only by consumers who understood the risks and could manage them.”<sup>49</sup> This statement fails to recognize, however, that very few homeowners understand all of the risks associated with their mortgages—whether traditional or alternative.<sup>50</sup> To establish such an unrealistic and implausible standard is to open up a capaciousness of regulatory discretion and authority that is simply stunning. This standard of perfect understanding has probably never been met in practice, even for the most simple mortgage and most sophisticated borrower. Yet most mortgages work well for most borrowers without mishap.

The CFPA Act adopts similarly vague standards that empower the new agency to regulate lenders, prohibit financial products and services, create exemptions, and design products unconstrained by any rigorous cost-benefit analysis or understanding of the likely impact of the regulation on competition, innovation or consumer choice. The CFPA grants incredibly broad statutory authority by design. Authority to determine

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<sup>48</sup> Adam Levitin, *The Case for a Consumer Financial Protection Agency, Credit Slips*, <http://www.creditslips.org/creditslips/2009/07/the-case-for-a-consumer-financial-protection-agency.html> (last visited Sep. 9, 2009).

<sup>49</sup> New Foundation, *supra* note 1, at 66.

<sup>50</sup> LACKO & PAPPALARDO, *supra* note 39, at ES-12.

what is a “standard financial product or service” subject to regulation by the CFPB “means a consumer financial product or service containing terms, conditions, and features defined by the Agency.”<sup>51</sup> More specifically, the agency is given the authority to take actions to prevent “unfair,” “deceptive,” or “abusive” practices in connection with a consumer financial product or service as defined by the agency.<sup>52</sup> While there is a substantial body of consumer protection jurisprudence interpreting the terms “unfair” and “deceptive,” the introduction of the heretofore undefined term “abusive” suggests that the CFPB will be substantially broader than traditional state level consumer protection legislation.

## B. Federal Regulatory Overlap and Inconsistencies

Of primary concern is the distinguishing of the CFPB’s consumer protection mission from the Federal Reserve’s safety and soundness regulatory authority. Under the White Paper’s proposal, the CFPB would have authority to enforce regulations and impose substantial financial penalties. Inevitably, this power to impose financial penalties will threaten the financial condition of banks, thereby bringing the CFPB into conflict with the safety and soundness regulatory authority of the Federal Reserve.

The CFPB would attempt to carve off the regulation of consumer financial products and services from all other consumer protection agencies. Scholars and policy-makers have long recognized that governmental bureaucracies are prone to “tunnel vision,” especially those bureaucracies defined by the substantive sector that they regulate rather than by their function. Such agencies are prone to interest-group capture that undermines their effectiveness. Instead of creating a new bureaucracy, Congress instead should consider expanding the jurisdiction of the Federal Trade Commission and strengthen the Federal Reserve to meet the discrete categories of true consumer protection issues that arise under current law. The FTC has longstanding expertise in consumer financial protection issues as well as related areas of consumer information, labeling, and advertising. In particular, Congress should consider the FTC’s study of consumer disclosure regulations which provides numerous useful recommendations for improving consumer disclosures in a more user-friendly (and less lawyer-friendly) manner. As currently articulated by the CFPB Act, the CFPB creates a significant risk that the expertise of the Federal Trade Commission and its influence on judicial interpretation of vague terms like “unfair” and “deceptive” to ensure that the terms are interpreted in a manner consistent with the public interest and consumer welfare, will be eliminated. Historically, the Federal Trade Commission has imposed important restraints on the judicial interpretation of state consumer protection legislation.<sup>53</sup> This monumental shift in authority, without any constraint that CFPB interpretations harmonize with those at the Federal Trade Commission, may be problematic. For

<sup>51</sup> CFPB Act, *supra* note 2, at § 1002(31).

<sup>52</sup> *Id.* at § 1031.

<sup>53</sup> See Henry Butler & Jason Johnson, *Consumer Harm Acts? An Economic Analysis of State Consumer Protection Acts* (Northwestern Law & Economics Research Working Paper, No. 08-02, April 24, 2008), available at <http://ssrn.com/abstract=1125305>.

instance, unhinged from Federal Trade Commission interpretations, lending practices might be found “abusive” without an actual demonstration of consumer harm or that enforcement is in the public (consumer) interest.<sup>54</sup>

### C. State Regulatory Overlap and Inconsistencies

The CFPB Act of 2009 eliminates the federal preemption of consumer protection regulation of nationally chartered financial institutions.<sup>55</sup> It specifically allows and encourages the states to adopt more stringent regulations than those adopted by the CFPB itself.<sup>56</sup> The Treasury Department’s *Financial Regulatory Reform* plan seems to suggest even further that the CFPB will encourage state enforcement actions.<sup>57</sup>

As discussed above, the new agency does not have to follow the Federal Trade Commission jurisprudence concerning which practices are “unfair or deceptive” under Section 5 of the FTC Act.<sup>58</sup> It also leaves the term “abusive” undefined and simply authorizes the new agency to take any action to “prevent a person from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service.”<sup>59</sup> When read in conjunction with the CFPB Act’s encouragement for states to adopt even stricter sets of regulations for financial products and services, and undefined terms such as “abusive” practices, it becomes likely that we observe highly variable state law develop through statute and judicial interpretation regarding consumer protection in lending markets. The vagueness of the standard, the fact that it is unconstrained by either FTC jurisprudence or expertise concerning consumer protection, and the likely variance between state regulations will raise the costs of litigation to lenders because these factors will expand lenders’ potential liability to some undefined, broader range of circumstances. These increased costs will, in turn,

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<sup>54</sup> For an explanation as to harm requirements and other questions in the construction and application of consumer protection acts, see generally Victor E. Schwartz & Cary Silvermann, *Common Sense Construction of Consumer Protection Acts*, 54 U. KAN. L. REV. 1 (2005).

<sup>55</sup> CFPB Act, *supra* note 2, at § 1041(a)(1).

<sup>56</sup> *Id.* at § 1041(b).

<sup>57</sup> New Foundations, *supra* note 1, at 50-51.

<sup>58</sup> CFPB Act, *supra* note 2, at § 1031(c). Specifically, the proposed Agency merely need “consider established public policies as evidence to be considered with all other evidence” in concluding whether or not a given business practice is “unfair” under the CFPB Act. *Id.* At least one Federal Trade Commissioner has expressed concerns about this feature of the CFPB. See William E. Kovacic, Statement on the Proposal to Create a Consumer Financial Protection Agency to the Committee on Energy and Commerce and the Committee on Financial Services (July 28, 2009), available at <http://www.ftc.gov/speeches/kovacic/090728stmtrecord.pdf>. Commissioner Kovacic notes that “conflicts in interpretation and in litigation strategies, along with an increase in litigation over jurisdictional questions, will adversely affect every core area of consumer protection for which the FTC will continue to exercise primary responsibility.” *Id.*

<sup>59</sup> CFPB Act, *supra* note 2, at § 1031.

result in higher prices for consumers without any demonstrable offsetting benefits in the way of increased consumer protections.

The CFPA is an idea that begins with a mistaken understanding of the causes of the financial crisis. The problem is only compounded by granting unbounded powers to regulate and design financial products and services to an agency without any expertise at the expense of at least one that does, all while encouraging states adopt even more stringent rules. If one looks to the proposed set of “behaviorally informed” regulations likely to be proposed by the CFPA, we predict that competition and consumer choice in these markets will decrease, product variety and innovation will fall, access to credit for disadvantaged consumers will be restricted, and the cost of this “consumer protection” experiment will fall disproportionately on those it was designed to protect.



## What the Financial Crisis has meant for the Payment Card Industry: An Interview with Phillip Tomlinson

Philip W. Tomlinson

David Evans from FinReg21.com interviewed Phil Tomlinson, CEO of TSYS, one of the largest payment card processors in the world. Phil has been in the payments business for over 40 years and with TSYS since the mid-1970s. He's been at the helm of TSYS since 2004, navigating some of the toughest waters in history. He spoke to David about the changing industry and how TSYS has managed to maintain its dominance as a payment card processor with increasingly targeted legislation. To watch the video of this interview [click here](#).

**DE:** It's been just about a year since the collapse of Lehman Brothers helped send the global economy into a tailspin. How has the card industry weathered the storm?

**PT:** I think it's been spread out in the media pretty well that the card business has really struggled in a lot of different ways. Obviously we needed to start thinking about high unemployment. Following that will be higher delinquencies and then higher charge-off rates (and we've seen all of those in many banks reach historic heights). Also, I think we are probably paying for some of our past sins. We've seen two huge regulatory efforts come down out of Washington in the U.S., and we're dealing with those as we speak. I think certainly that's going to make doing business a little bit harder for the near term and I think it's going to hurt the bottom line for the near term.

**DE:** In your opinion, what parts of the industry have fared better than others?

**PT:** I think commercial card has done well. I think the merchant business has done well. I think that typically the Visa and MasterCard branded consumer cards and a lot of the private label cards have really struggled to keep up. Again, it's primarily due to charge-offs and the cost of higher delinquency rates.

**DE:** You mentioned charge-offs a couple of times. Have we got any more nasty surprises as banks rack up more write downs from charge-offs and credit card defaults?

**PT:** Well, I think there's still a bubble coming. I think it was Jamie Dimon [Chairman & CEO, JP Morgan Chase & Co.] a couple of weeks ago who said that they were still looking at some difficult times through 2010. I think we're starting to see some stability in the smaller banks. I think the larger banks' data that is very public speaks for itself. Those numbers are still pretty high, although there are some things out there going on that are somewhat encouraging.

- DE:** What are the things that are encouraging?
- PT:** Well, you know, the real estate market seems to be finding some footing. The unemployment rate is slowing down. I think the vast majority of analysts and economists and even the Federal Reserve think we've probably bottomed out in this recession. I've been working in this business a long time and this is my fourth major recession, but this one has affected the card business much more than any in the past have.
- DE:** And it's affected just about everyone much more than anything in the past.
- PT:** It has. I don't know that anybody has been unscathed by this recession and I think that will continue for some time. What we've told the analysts, the TSYS analysts on Wall Street, is that we just want to get 2009 behind us. Let's move on to another year and see if things can't look better on a go forward basis into the future.
- DE:** You mentioned real estate and unemployment and so forth. Are there other leading indicators that you're looking at to try to gauge how the card business is going to be doing in 2010 and 2011?
- PT:** Everywhere I go, I make judgments about what's happening, particularly to the card business. Every time I go in a restaurant, every time I look in the restaurant parking lot, every time I go into a department store or get on an airplane, I'm making judgments as to whether we are making progress or whether we are backsliding. I do think we're starting to see some confidence build up; maybe the consumer is just tired of not buying and wants to buy a little bit. We also have seen the transaction level, if you will, on cards stabilize in at least the same range as it was this time last year. We had some pretty dramatic drops in those transactions in the fourth quarter of '08 and the first quarter of '09.
- DE:** Especially the first quarter of '09, people seemed pretty scared.
- PT:** And I think they had good reason to be. I mean it was kind of unknown ground for most of us and by every measurement you can come up with, it's the worst economy since the Great Depression.
- DE:** Do you think the credit card industry contributed to the crisis by extending consumers too much credit that they just couldn't afford?
- PT:** You know, I think that we probably had some part of it. I mean I don't think there's any question, we probably extended credit to some people who frankly couldn't afford it and were counting on the fees to make up for it. And I think the subprime caught up with some of the banks that were really playing subprime – and when you look at the availability of credit in general with the mortgage business, I think a lot of people basically just got in over their heads and as things start slowing down, there was a snowball effect. These factory jobs, as people quit buying things, they

started cutting back in factories and it was a snowball effect. It's going to take some confidence for us to start working our way through that. I don't know that there's a massive change yet, but there is change and it's to the positive.

**DE:** Like mortgages, most credit card debt has been sold off into the market; it's been securitized for the last decade or more. How has credit card debt done relative to mortgage debt? Do you have any idea?

**PT:** You know, I think they both have performed in general pretty poorly. Again, you read about it in the media every day, particularly about the mortgage industry. Card debt is unsecured, so that's one of the first things that people might not think about paying – it might not be at the top of their list. If you're in trouble, I think you'd want to pay your house, your power and your utility bills, buy groceries, and you're down to the basics. I know the mortgage dilemma caught me by surprise. I didn't realize that we had gone that deep into the mortgage cycle and had that many problems. I certainly was not by myself in that area.

**DE:** You weren't by yourself and it seems like the Federal Reserve Board, Congress, the banks, and just about everyone else didn't realize it either.

**PT:** I think what happens is when times are so good for so long that you just start feeling like you're bulletproof and maybe that you can always overcome any obstacle. It's a great lesson for all of us. I spoke to a crowd of young people who were probably from 25 to 35 years old and I said, we need to learn lessons from this. We need to really be thoughtful about what we've seen happen during this recession and particularly the younger people who will continue to be working over the next 20, 30, 40 years. We say this every time we have a recession, but certainly this is the first recession that has really, truly affected the entire country, in my opinion. It's the worst one I've ever seen.

**DE:** TSYS works with many banks in the U.S. and around the world. What are you hearing from them on what their biggest challenges are, and where you see their prospects in the next few years, either for cards or just generally?

**PT:** Particularly the large banks, they're working on surviving. It goes back to difficult economic times, past dues, charge-offs, and capital issues and it's not only in the U.S., it's around the world. Again, I come back to these regulatory issues that we're having to deal with that are a much bigger issue for the U.S. issuers. Nobody else in the world (that I'm aware of) has passed anything quite of that magnitude.

**DE:** The Credit Card Accountability Disclosure and Responsibility Act that we've all gotten to know and love as the CARD Act of 2009 was signed into law at the end of May by President Obama, and the first round of new rules and regulations hit on August 20th. How has the CARD Act affected your customers?

- PT:** I think they've had to become more focused on working with us to make sure that all of the appropriate changes are made; certainly when you're that focused on anything, you lose focus on growth, and growth certainly has not been anyone's focus here in the last year. I think most people are trying to get their house in order and get their past dues or delinquencies down, and this is just another layer of burden that we're going to have to deal with on a go forward basis. The card industry has been regulated for a long time, particularly in the U.S. We'll get through this. Cards have too much utility to go away. Imagine trying to check into a hotel with cash. Imagine trying to buy an airplane ticket. They'd probably call Homeland Security to check you out. So the utility of a card is really rather incredible. And so I think cards are here to stay. But I think we've got to be more disciplined. I think the card industry has a history of being very innovative; I think tough times will bring new ideas, and I think we'll recover.
- DE:** Nevertheless, Congress was pretty mad at the credit card industry. It seemed to be something the Democrats and the Republicans could really agree on.
- PT:** That's right, and I think that they had some examples that would probably embarrass most all of us in this industry.
- DE:** What got them so irritated?
- PT:** According to the Congressmen that I have spent some time with, they had a lot of complaints from card holders. Certainly some of those complaints were founded and some were not, but the truth is that we just need to continue to improve our service. We need to make sure that we're being fair and that we're getting a fair return. I'm not in the issuing business but we are in the processing side of it and we want to do the right thing with card issuers. I know that I can't think of one of our clients who does not want to do the right thing, but things happen. Sometimes there are problems in the authorization system; I'm talking about the worldwide system or the settlement system where sometimes it's very difficult to track down what went wrong. Frankly, the card industry has always been a fairly easy target for politicians to rail on about and to complain about because I think a lot of consumers think that their interest rates may be too high and they've paid on their cards a long time. And so I think some of these disclosures that we are putting in place now, they won't be harmful long term. Others will have some financial ramifications that we'll struggle with for awhile, but again, I have total faith in this industry to rebound. We'll think of new products, we'll think of new ways of doing business. I go back to the Carter presidency when the prime rate went up to about 22% and we were all scrambling, trying to figure out ways to continue making money in this business and we got through that and we'll get through this. It's going to take awhile, but I think the industry will come out maybe more healthy than ever.

- DE:** There have been some articles in the *Wall Street Journal* suggesting that at least in the near term, one effect of the CARD Act is going to be to reduce the availability of credit to consumers. Do you think that's likely to happen?
- PT:** I think that's probably going to happen. I'd probably be willing to bet you dinner on that. I think it's just the fact that you are so restrained by your ability to price things. For years, we had the ability to do risk-based pricing and the new regulations have really hamstrung those types of capabilities. So I do think that for younger people, people who have had impaired credit in the past, I think there will be some tightening up of credit.
- DE:** Let's talk a little bit about the challenges and the opportunities ahead. There are always lots of opportunities and risks facing the card industry. Going forward, what do you think are the biggest challenges facing the industry, putting aside the regulatory environment?
- PT:** I think we've got to continue to make the card valuable to consumers and to the commercial card user. Certainly it's very valuable today. I think that we have got to improve our reputation. I think it has been sullied somewhat by all of the discussion of these new laws. I think probably the most pressing issue is to get back to strong profitability because without that, you don't have anything, and all of that goes back to this surge in delinquency and ultimately charge-offs.
- DE:** One of the things that has happened, in part as a result of the financial crisis, is that home equity loans, which have provided a fair amount of competition for credit cards, have been reduced dramatically. Do you see that as possibly helping out the credit card business?
- PT:** I really don't know at this point. You would think that people will continue to be looking for lines of credit, and cards are an easy way to do that. You can manage it, but I do think that the consumer will be held to a higher standard for the foreseeable future.
- DE:** Phil, you've been working at implementing Six Sigma strategies to improve TSYS. Do you mind telling us a little bit about Six Sigma and what you've been doing?
- PT:** I have a mantra that says you've got to be faster, better, and cheaper to survive in this economy we have today, and one of the ways to be faster, better, and cheaper is through Six Sigma efforts. As a matter of fact, every other Tuesday we have what we call a group leadership meeting in which about 300 of us come together. We've awarded green belts to six different people for running projects that really made a difference; we improved processes, we saved money, and we got things out the door faster. As a matter of fact, I'm a green belt myself. I figured if I was going to ask people to do it, I should do it. And of course at TSYS, the security badges that have the green border around them signify that you are a certified green belt holder and that's a pretty big thing around here. We're starting to get more and more black belts who lead projects. It's just good old

common sense to me that you do anything you can to improve the ultimate product that your customer is going to get.

**DE:** True.

**PT:** And anything that you can do to reduce cost and prices is good for everybody.

**DE:** You've been in the card industry for four decades now. What has surprised you the most?

**PT:** That sounds like a really long time, but it's pretty amazing. I'm still having lots of fun in this business, on most days. I'll say the last year hasn't been quite as much fun as some previous years.

**DE:** Certainly challenging.

**PT:** I think the thing that surprises me, that I love about this industry, is that I've seen a couple of generations of management and team members come and go at TSYS. And the issuers in the group that we have today are smarter, better educated, and they've got more drive. I just get astounded at how much better the people become and I think it's part of our industry. We push people, expect a lot out of them. I mean we're subject to put you on a plane to India tonight – we have expats all over the world. Frankly, it probably took me longer than anybody around here to understand that Columbus, Georgia is not the center of the universe. It's been fun watching our business expand internationally. We've done that in a big way and have had a lot of great success; the resiliency of this business just amazes me and that's why I'm so confident that this industry will bounce back pretty quickly.

**DE:** Implicit in what you're saying is that despite the fact that the industry has been around for awhile, there are really very significant growth opportunities ahead.

**PT:** I think there are growth opportunities. I think you'll see new products. I can think back to when I got in this business in the mid-1970's. It was a pretty simple, straightforward business and now it is so much more sophisticated. We had one interchange rate and basically one finance charge routine, one late charge routine. Today, I think we've got 250, 270 interchange rates around the world. We've got thousands of finance charge routines, late charges – I mean tens of thousands. You can get a card with your dog's picture on it or you can just get a regular old Visa or MasterCard. There's so much more flexibility. It is so much more customized than it's ever been and that's going to continue. Reward programs, which I thought originally might be just an idea-of-the-month, have turned out to be great programs; they've been good for charities, they've been good for education, and they've been good for people personally.

**DE:** Last question, Phil. Where do you see TSYS in ten years?

**PT:** Ten years is a long time, but if I had my druthers, we would truly cover the Earth. We'll be a very, very international company. We will be the dominant payments processor on this globe and although the competition out there is very, very tough, that's what we've got our sights set on. We want to create opportunities for our people. We want to create a wealth system where people can make some money around here and retire in good stead. We want to have a reputation that is above and beyond anyone else's in this industry for doing quality work, for being transparent and being honest and doing the right thing. I think we're making progress towards all of those goals.