The Consumer Financial Protection Agency

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Summary

The Obama administration has proposed restructuring financial services regulation by transferring all consumer protection functions from existing agencies to a new Consumer Financial Protection Agency (CFPA). The goal of the CFPA legislation is to address the flaws in the regulatory architecture that have inhibited effective responses to the substantive problems, rather than mandate specific new substantive consumer protection laws.

The current consumer financial protection is based on disclosure regime and is policed through supervisory feedback, enforcement actions, and occasionally prohibitions on terms, products, and practices that are deemed inherently unfair and deceptive. On the federal level, consumer protection in financial services is divided among a number of agencies: the OCC, OTS, NCUA, Federal Reserve Board, FDIC, FHFA, HUD, VA, FTC and DOJ. Some of these agencies have the ability to promulgate regulations, some also exercise supervisory authority over financial institutions, and some may only enforce existing regulations. Sometimes authority is over a class of institutions, and sometimes it is over a particular type of product.

There are four main structural criticisms of the current regulatory structure: that consumer protection is a so-called "orphan" mission; that consumer protection conflicts with, and is subordinated to, safety-and-soundness concerns; that no agency has developed an expertise in consumer protection in financial services, and; that regulatory arbitrage of the current system fuels a regulatory race-to-the-bottom.

Consolidation of consumer financial services protection authority could: place all financial services companies, regardless of the form of their charter, under a single regulator, thus ending its orphan status; separate consumer protection from safety-and-soundness regulation, thus ending subordination; encourage the development of a deep bench of regulatory expertise and knowledge, and; end the opportunity for regulatory arbitrage and any potential race to the bottom.

There are several potential concerns about a CFPA: conflicts with prudential regulators; ambiguity with respect to Consumer Reinvestment Act authority, and; potential overregulation resulting in higher costs of financial products, less product availability, and discouragement of innovation. Still, there are compelling reasons to believe that the present regulatory architecture cannot produce the optimal consumer protection regime and will continue to fail in its task, resulting in unfair treatment of consumers and a potentially significant source of systemic risk. To this extent, consideration of a CFPA should strive to distinguish between the basic thrust of the legislation—a consolidation of the regulatory authority of—and the proposed new substantive powers granted to the agency.

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Introduction

The Obama administration has proposed restructuring financial services regulation by transferring all primary consumer protection functions from existing agencies to a new Consumer Financial Protection Agency (CFPA).[2] The proposed legislation focuses mainly on the regulatory architecture of consumer protection; it does not mandate specific new substantive consumer protection laws, but rather proposes a new regulatory structure for the promulgation of substantive regulations and enforcement actions.

This brief paper is a guide to the issues involved in creating a CFPA. It begins by reviewing the current state of consumer protection in financial services and the criticisms of the current regulatory regime. Next it considers how a CFPA would address the criticisms of the current regulatory system. The paper concludes with a consideration of the potential concerns about a CFPA.

The Current System of Consumer Protection in Financial Services

Consumer protection in financial services currently involves a mixture of disclosure requirements, supervisory feedback, product and practice prohibitions, and enforcement actions. The centerpiece of the current regime, however, is disclosure. The basic conceit of consumer financial services regulation is that the market is the best guarantor of consumer protection. Markets rely on information. If all material information is readily available to consumers in a form they can easily process, then consumers will be able to make intelligent, informed decisions, which will presumably maximize consumer welfare and discipline product and practice offerings.

The disclosure regime is policed through supervisory feedback, enforcement actions, and occasionally prohibitions on terms, products, and practices that are deemed inherently unfair and deceptive, and therefore not conducive to a disclosure-based regime. Disclosure, though, is the heart of consumer protection; other regulatory tools are merely designed to enhance its operation.

Currently, consumer protection authority in financial services is split between federal and state

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[2] Title X, Consumer Financial Protection Agency Act of 2009, *at* http://www.financialstability.gov/docs/CFPA-Act.pdf; Consumer Financial Protection Agency Act of 2009, H.R. 3126 *at* http://www.house.gov/apps/list/press/financialsvcs_dem/21frank_011_xml.pdf.

governments. Traditionally, consumer protection, including in financial services, was part of the general police power of the states. States generally focused on anti-fraud and unfair-and-deceptive acts and practices enforcement through litigation, but also imposed some product and practice prohibitions and disclosure requirements. Increasingly, though (with the exclusion of insurance), it has been federalized as the result of preemption, either by legislation,[3] by agency regulation,[4] or by court rulings.[5] While states have become increasingly excluded from consumer financial services regulation, the preempted state protections have not been replaced with equivalent federal protections.[6]

On the federal level, consumer protection in financial services is divided among a number of agencies. Some of these agencies have the ability to promulgate regulations, some also exercise supervisory authority over financial institutions, and some may only enforce existing regulations. Sometimes authority is over a class of institutions, and sometimes it is over a particular type of product. Thus, responsibility for consumer protection is split among the OCC (national banks, federally-chartered branches, agencies of foreign banks), OTS (federal thrifts and thrift holding companies), NCUA (federal credit unions and federally-insured state credit unions), Federal Reserve (bank holding companies, state-chartered member banks, nonblank subsidiaries of bank holding companies, Edge and agreement corporations, branches and agencies of foreign banking organizations operating in the United States and their parent banks and some aspects of checks and electronic payment systems), FDIC (state-charted insured banks and insured branches of foreign banks), FHFA (the mortgage industry in general through Federal Home Loan Banks, Fannie Mae and Freddie Mac), HUD (real estate settlement procedures and FHA-insured mortgage loans), VA (VA-guaranteed mortgage loans), IRS (tax preparers), FTC (non-banks, including debt collectors), and Department of Justice (residual anti-fraud authority). While Congress backstops these agencies, it lacks a dedicated monitoring capacity or particular expertise in consumer finance issues and is poorly positioned to serve as a routine consumer protection regulator.

[3] *See, e.g.*, Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified at 12 U.S.C. § 1831d (2006)); Alternative Mortgage Transaction Parity Act of 1982, Pub. L. No. 97-320, 96 Stat. 1545 (codified at 12 U.S.C. § 3803(a)(3)).
[4] *See, e.g.,* 12 C.F.R. §§ 7.4001, 7.4002, 7.4003, 7.4007, 7.4008, 7.4009, 734.4(a), 560.2, 560.2, 557.11, 545.2 (2008).
[5] *See, e.g.*, Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp., 439 U.S. 299 (1978); Watters v. Wachovia Bank, N.A., 127 S. Ct. 1559, 1567 (2007).
[6] *See* Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143 (2009).

Criticisms of the Current Regulatory System

Many of the criticisms of the current regulatory system are closed tied to the regime's structural flaws. There are four main structural flaws with the current regulatory structure: that consumer protection is a so-called "orphan" mission; that consumer protection conflicts with, and is subordinated to, safety-and-soundness concerns; that no agency has developed an expertise in consumer protection in financial services, and; that regulatory arbitrage of the current system fuels a regulatory race-to-the-bottom.

Consumer Protection Is an Orphan Mission

The fracturing of the consumer protection role in financial services among multiple agencies creates a number of regulatory problems. First, it makes consumer protection an orphan mission. Because no agency has an exclusive role of consumer protection in financial services, there is a dangerous tendency for consumer protection to fall between the cracks. Only one agency, the Federal Trade Commission, even has consumer protection as its primary role. The FTC, however, has very limited jurisdiction in financial services—it cannot regulate federally-chartered or insured banks, thrifts or credit unions. This leaves only bit-players in financial services within the FTC's regulatory ken. The result is that because consumer protection is everyone's responsibility, it becomes no one's responsibility, and accountability and performance suffer therewith.

Consumer Protection Is Inevitably Subordinated to Safety-and-Soundness by Banking Regulators

For federal banking regulators, there is a conflict between their primary mission—bank safety-and-soundness—and the consumer protection mission. Safety-and-soundness ultimately means profitability because only profitable financial institutions can be safe and sound. Unfair, deceptive, and abusive practices, however, can be highly profitable; that is the only reason to engage in them. If they are even mildly profitable, the regulatory and reputational risk would make the practice not worthwhile. Placing the two missions together in a single agency ensures that one will trump the other, and historically consumer protection has not won out, except when the most egregious practices are at stake.

Federal Banking Regulators Lack of Consumer Protection Expertise

The dispersion of consumer protection among multiple agencies limits any particular agency's incentive to develop a deep expertise in the area in terms of data collection and analysis, consumer product testing, or litigation. Empirical analysis is crucial to setting consumer finance policy; theoretical economics cannot provide a guide in complex market situations. Empirical analysis, however, requires data, and as a general matter federal regulators collect precious little information on consumer financial products.[7] There is no federal statistic on the total volume of credit card debt, on checking account overdrafts, on payday loans, on refund anticipation loans, or auto title loans, much less their terms and performance. For mortgages, there are no nationwide governmental measures of terms, performance, or foreclosures. At best, particular agencies collect data on some aspect of their regulatees' business, but there is no coordination of the data to provide an economy-wide picture.

Not only do agencies presently lack data, but they also lack dedicated teams of economists, statisticians, psychologists, and attorneys to analyze the data to understand how product design and legal regulation shape consumer finances and what optimal policies might be. For example, only 12 of the Federal Reserve Board's 128 economists on its research and statistics staff list consumer finance as a focus, even thought consumer spending accounts for approximately 70% of GDP and a sizable share of bank lending.[8] Other federal financial regulators have far fewer staffers working full-time on consumer financial issues.

As far as litigation goes, only the OCC has significant and routine litigation experience, but it is against state attorneys general, not consumer protection actions against banks, while the FDIC, which has been one of the more proactive bank regulators in terms of consumer protection recently, has so little experience in consumer protection litigation that it recently hired outside counsel to handle litigation against subprime credit card rent-a-BIN operations.[9] Again, in contrast, the FTC, which does have a

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[7] The crowning piece of federal consumer financial data, the Fed's triennial Survey of Consumer Finances (SCF), provides a good window on household finances but only at least two years after the fact. Moreover, the SCF is limited to reporting on a sampling of households, so it does not provide information about the overall debt and transaction volumes in the economy.

[8] *See* Federal Reserve Board, Economists by Field of Interest, *at* http://www.federalreserve.gov/research/finance.htm.

[9] Rent-a-BIN operations allow non-bank payday lenders to rent the charters of federally-regulated banks to avoid state usury

wealth of consumer protection litigation experience, lacks jurisdiction over banks.

Regulatory Arbitrage In Bank Chartering Has Created a Race-to-the-Bottom in Consumer Protection Regulation

The current environment provides opportunities for financial institutions to engage in regulatory arbitrage, and this has set off a race-to-the-bottom among regulators competing for regulatory turf. Federal banking authorities compete with state regulators and with each other for the business of chartering banks. Banks can and do switch their charters from state to federal and vice versa, as well as change the type of federal charter they have, such as from a banking to a thrift charter.

Chartering is a crucial business for banking regulatory agencies for two reasons: their primary authority is largely coextensive with the extent of their chartering, and some federal and state banking regulators receive the majority of their budgets from their chartering fees, unlike other potential consumer-protection regulators.[10] Because no single regulator has complete primary authority over the entire banking system, any single regulator moving by itself for more vigorous consumer-protection regulations or enforcement would put its regulatees at a disadvantage relative to the entities regulated by other banking regulators. These relative costs would cause a flight of charters from the first-mover regulator, which would affect the regulator's budget. Similarly, a regulator that adopts a more lax consumer-protection stance will find itself receiving more chartering business and a greater budget. [11]

An example of chartering competition creating a race-to-the-bottom is the fate of state usury laws,

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[10] Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 93 (2008) ("Assessments comprise 95% of OCC's budget, with the twenty largest national banks covering nearly three-fifths of these assessments."). In 2007, the assessments paid by a single institution, Washington Mutual, made up 12% of OTS's budget. Cheyenne Hopkins, *Side Effect: Questions on Future of OTS*, AM. BANKER, Jan. 14, 2008, at 1; *Corrections*, AM. BANKER, Jan. 15, 2008, at 20. Washington Mutual comprised 20.41% of the assets regulated by the OTS. FDIC, Statistics on Depository Institutions, http://www2.fdic.gov/sdi/main.asp (last visited April 10, 2009). The FDIC and Federal Reserve do not issue charters. State banking regulators are also largely funded by charter assessments (directly or indirectly). Consumer protection on the state level, however, is primarily the ken of attorneys'-general offices, which are not budgetarily beholden to the entities they regulate. *See* Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225, 276 (2004) (discussing the OCC's explicit recognition that preemption provided a strong incentive for large multistate banks to select national charters).

[11] It is telling that non-chartering regulators, such as the FDIC, have been more aggressive on the consumer-protection front, perhaps because of the reduced conflict of interest.

which capped the maximum rate of interest on loans. State usury laws were largely eviscerated following the Supreme Court's 1978 decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp*.[12] *Marquette* held that the usury ceiling that applied to a federally-chartered bank's lending operations was that of the state in which the bank is located, not the state of the borrower. This ruling meant that national banks could base themselves in states with high or nonexistent usury ceilings, like Delaware and South Dakota, and export the rate ceilings to other states. This situation in turn set off a two-part regulatory race toward the bottom, as banks began to switch to federal charters and look for states with high or no usury ceilings. Some states responded by eliminating or raising usury ceilings to keep national bank operations in their states. Other states adopted parity laws that would allow their state-chartered banks the same leeway as national banks.[13] Federal bank regulators subsequently pushed to expand the definition of interest in cover various bank fees and the thinly regulated subsidiaries of national banks.[14] The result was that usury laws and any ability of states to regulate financial services fees were effectively eviscerated, not as the result of a considered policy decision, but as a result of the Supreme Court's interpretation of passing language in the 1863 National Bank Act.

How a CFPA Would Address the Problems in the Current Regulatory System

The administration's proposal would transfer regulatory authority for consumer protection from the current collection of agencies to the CFPA. Consolidation of consumer financial services protection authority would address most of the problems identified in the current system. Consolidation of consumer financial services protection authority could: place all financial services companies, regardless of the form of their charter, under a single regulator, thus ending its orphan status and increasing

[12] 439 U.S. 299 (1978).

[13] *See* Donald C. Langevoort, Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation, 85 MICH. L. REV. 672 (1987); Elizabeth R. Schiltz, The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation, 88 MINN. L. REV. 518 (2004). Moreover, Congress subsequently enacted section 521 of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified at 12 U.S.C. § 1831d (2006)), which grants FDIC-insured state banks the power to export local interest rates.

[14] *See e.g.,*, Smiley v. Citibank (S.D.), N.A. 517 U.S. 735 (1996) (late fees); 12 C.F.R. § 7.4001(a) (providing an expansive definition of the term "interest"); OCC Interpretive Letter #744, Aug.21, 1996 (prepayment fees); OCC Interpretive Letter #803, Oct. 1997 (account opening fees, fixed rate option fee, prepayment fees, early account closure fees, rejected draw fees); OCC Interpretive Letter #817, Feb. 1998 (late fees and NSF fees); OCC Interpretive Letter #974, Sept. 2003 (extended Marquette ruling to operating subsidiaries of national banks).

accountability; separate consumer protection from safety-and-soundness regulation, thus ending subordination; encourage the development of a deep bench of regulatory expertise and knowledge, and; end the opportunity for regulatory arbitrage and any potential race to the bottom.

Further, what is crucial to understand about all the versions of the proposed CFPA legislation is that they are not focused on addressing any particular substantive problems in consumer protection regulation. Instead, the goal of the CFPA legislation is to address the flaws in the regulatory architecture that have inhibited effective responses to the substantive problems. The legislation does envision the CFPA regulating with an eye towards improving market function through better disclosure, and it would arm the CFPA with tools to limit products that are inimical to disclosure, but no specific regulations are contemplated by the legislation. The goal is to make consumer financial products clear so that consumers can make better choices, and there is little in the CFPA Act that deviates from this long-standing approach to consumer protection, although some of the emphases are different.

To carry out the consolidated regulatory mission, the proposed CFPA would have three major tools: research, rule-making, and enforcement. First, the CFPA would be authorized to gather a broad range of data about consumer financial products in order to permit informed regulation. Second, it would have the rule-writing authority. And third, the CFPA could bring regulatory enforcement actions.

Data and Resesarch

The data collection and research function is a hugely important aspect of the CFPA. It would allow the CFPA to evaluate financial products and their impact on consumer welfare. This could include product testing, risk modeling, and examination of product performance over time. Data collection and analysis would also permit the CFPA to make rule-making and enforcement decisions based on the best possible information.

Rule-Making Authority

The CFPA would acquire rule-making authority under the Truth-in-Lending Act, the Truth-in-Savings Act, the Home Owner Equity Protection Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, the Electronic Funds Transfer Act, the Fair Debt Collection Practices Act, and in the administration's proposed legislation, but not in the legislation introduced by Rep. Barney Frank, the Community Reinvestment Act. The CFPA would also have organic rule-making authority under the CFPA Act to prohibit unfair, deceptive, and abusive acts or practices, just as the FTC has under the Federal Trade Commission Act.[15] The standard for this, though, would be a finding that "the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers and such substantial injury is not outweighed by countervailing benefits to consumers or to competition."[16] This cost-benefit standard is very similar to the one courts use in evaluating most antitrust claims.

The CFPA would also have power to prescribe duties (e.g., fiduciary obligations, or a know-the-customer obligation) for financial service providers,[17] prescribe operational procedures for those consumer financial service providers not subject to federal or state banking regulators,[18] and to limit binding mandatory arbitration provision.[19] The CFPA would, however, be explicitly prohibited from imposing any usury caps.[20] Finally, the CFPA would be authorized to define "standard", low-risk, transparent default products and to require that these "plain-vanilla" products be offered if an alternative, non-standard product is also offered, along with disclosures about the risks of the non-standard product. With all of the rule-making authority, it is important to emphasize that it is discretionary, not mandatory, and still subject to traditional Administrative Procedure Act limitations on agency actions.

Civil Enforcement

Finally, the CFPA would have a civil enforcement capability to ensure that its regulations were carried out. The CFPA Act would not create any new private rights of action.

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[15] CFPA Act § 136. *Cf.* 15 U.S.C. § 57a (FTC rulemaking authority).

[16] CFPA Act § 136(c).

[17] CFPA Act §137.

[18] CFPA Act § 135.

[19] CFPA Act § 125.

[20] CFPA Act § 122(g).

Potential Concerns and Questions about a CFPA

There are several potential concerns about a CFPA: interaction with prudential regulators, consumer reinvestment act authority and potential overregulation resulting in higher costs of financial products, less product availability, and discouragement of innovation.

Interaction with Banking Regulators

Concerns about the CFPA's interaction with prudential banking regulators only matters to the extent that there is a conflict between consumer protection and safety-and-soundness; if the two goals are in harmony, the mere fact that multiple regulators are involved should not create major problems. A CFPA would not create a conflict where none exists. Instead, it would merely move the conflict from being intra-agency to inter-agency, and in so doing make consumer protection an equal concern to safety-and-soundness, not a subordinated one.

Three specific concerns have been raised with respect to the potential for conflict between a CFPA and bank regulators : consumers may want immediate funds availability on checks, but safety-and-soundness concerns about check-kiting and other fraud argue for delayed funds availability; issues involving electronic funds transfers (basically debit cards), and; conflicts between consumer protection and anti-money laundering "know your customer" rules. [21] Close examination of the proposed CFPA legislation, however, shows that it would avoid conflicts between safety-and-soundness and consumer protection in these situations.

In the first case, the proposed legislation does not create a conflict because the CFPA Act does not give the CFPA authority over depositary funds availability. Such authority remains with the Fed. Section 185 of the CFPA Act merely instructs the Fed to consult with the CFPA regarding model fund availability disclosures and regulations under the Expedited Finds Availability Act[22], but rule-making on funds availability would remain the Fed's purview.

[21] Testimony of Edward Yingling before the Senate Committee on Banking, Housing, and Urban Development, July 14, 2009, *at* http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=4fc68607-d571-435d-b1a3-6cee97f23713 at 6-7.

[22] 12 U.S.C. §§ 4001-4010.

In the second case, the CFPA would have rule making authority under the Electronic Funds Transfer Act (EFTA).[23] But many of the entities subject to the EFTA are not subject to bank safety-and-soundness regulation. For example, PayPal is subject to the EFTA, but it is not a federally-chartered or insured entity. A federal agency may not issue regulations that go beyond what is authorized by the statute, and nothing in the substance of the EFTA relates directly to safety-and-soundness. Instead, the EFTA covers disclosure of funds transfer fees, documentation of transfers, error resolution procedures, and consumer liability limits. The EFTA's provisions dealing with preauthorized transfers and issuance of cards and other access devices arguably have safety-and-soundness implications, but the statute itself places strict limits on preauthorized transactions and card issuance.[24] Thus, there seems to be little reason for concern that new types of fraud or technology would create a tension between consumer protection under the EFTA and safety-and-soundness.

Third, the opening of a bank account is subject to anti-money laundering rules that require certain identification of the customer. Nothing in the CFPA Act would give the CFPA authority to regulate in this area. Section 135 of the CFPA Act provides that the CFPA would have authority to prescribe operational standards for consumer financial services providers to deter unfair, deceptive, or abusive acts and practices, but this authority does not extend to "insured depository institutions or credit unions." Likewise, the CFPA's authority to regulate disclosure and to ban particular product terms and practices remains a far cry from regulating the procedures involved in opening a bank account.

In practice the relationship between the CFPA and banking regulators would work like a mutual veto, which would not impinge on the safety mission of either regulator. A conflict could arise in one of two ways. Either the CFPA or the banking regulators would attempt to regulate a product or practice. If banking regulators thought a practice was safe-and-sound, but the CFPA was concerned about the consumer impact, the reasonable solution is for the CFPA to be able to regulate the practice. If the CFPA regulation would change the banking regulators' safety-and-soundness evaluation, they can raise this concern with the CFPA and also regulate the product or practice themselves.

[23] 15 U.S.C. §§ 1693 et seq.

[24] 15 U.S.C. §§ 1693e, 1693i.

If the conflict arose the other way, and banking regulators deemed a product or practice unsafe or unsound (including as a result of CFPA action), they would have full authority to prevent their charges from continuing to sell the product or engage in the practice. If the CFPA does not object to the product or practice, entities outside of the bank regulatory sphere, like non-bank finance companies, would be able to continue with the product or practice. Bank regulators might not like that the CFPA could impose requirements or limitations on how their charges do business, and these requirements or limitations might affect their charges' profitability, but CFPA regulation would not impede bank regulators' ability to ensure that banks are well-capitalized and not engaged in unsafe and unsound operations.

At worst, then, there might be some coordination costs, but they should not be significantly higher than those of intra-agency coordination, and the administration's proposal attempts to solve some of this by appointing the National Bank Supervisor to the CFPA board, with the goal of promoting coordination. (Arguably, the inclusion of the National Bank Supervisor as the swing vote on the five-member board undercuts the separation of consumer protection from safety-and-soundness.)

Community Reinvestment Act Authority

An unresolved area is whether the CFPA should have authority of the Community Reinvestment Act (CRA). The administration's proposed legislative language includes such authority; the Frank bill in the House (H.R. 3126) lacks such language. Arguably, inclusion of the CRA in the CFPA's authority would ensure that the CFPA would be attentive to access to credit issues as well as to disclosure and predatory lending problems; communities that are underserved by traditional consumer financial products providers are particularly vulnerable to predatory products and practices. The CRA, however, involves its own distinct set of issues that are beyond the scope of this paper, but there could be a potential tension between the CRA, which encourages financial institutions to provide broader access to credit, especially in low-to-middle income communities, and a CFPA that is chary of financial products targeted at low-to-middle income consumers because of the history of predatory lending in this area.

Overregulation Resulting in Higher Costs of Financial Products, Less Product Availability, and Discouragement of Innovation

Another concern is potential over-regulation and over-enforcement resulting in higher credit costs, less credit availability, and discouragement of innovation. Much of the concern relates specifically to the CFPA's proposed authority to designate low-risk plain vanilla default products and require financial institutions to offer these products if they offer another alternative product in the same class. The theory behind the plain vanilla product provision is that a plain vanilla product would both provide consumers with a product they know they can trust and also provide a basis for comparison if they consider alternative products.[25] Some argue that it is both too permissive in permitting risky products and too easily manipulated through advertising, pricing, and agency. Others contend that it will add to the cost of financial services by forcing financial services companies to offer products they otherwise would not have done and restrict consumer choice. It is not clear whether a CFPA would ever act on its plain vanilla authority, and much would depend on the specific nature of the regulations, but this particular provision has generated a great deal of concern.

Costs of Financial Products

While the plain vanilla product provision raises specific concerns, others stem from the belief that a dedicated consumer protection agency will be motivated to engage in more regulation than the current mélange of conflicted agencies. The clear intention behind the CFPA Act is that there will be more effective consumer protection regulation, which might well mean more regulation overall, but could also result in more streamlined regulation.

From this, critics of the CRA intuit that regulatory costs will go up and these will be passed on to consumers in the form of higher costs of financial services and, to the extent that risk-based pricing is

[25] *See* Michael S. Barr, *et al.*, *Behaviorally Informed Financial Services Regulation,* New America Foundation, Oct. 2008, *at* http://www.newamerica.net/files/naf_behavioral_v5.pdf. The idea of the government establishing a default product is nothing new. The 30-year fixed-rate mortgage was an affordability product that became the market standard in the 1950s only through massive government subsidization via Fannie Mae, FHA, and the VA. Likewise, the par-clearing check only developed as a standard because of tremendous regulatory intervention by the Federal Reserve over nearly seven decades. Similarly, the terms of the demand deposit account are entirely a function of detailed government regulation on access to funds.

curtailed, more limited access to financial services for riskier consumers, and that the balance will be suboptimal in terms of consumer welfare. This conclusion hardly follows from its premise, however; if a CFPA can improve information disclosure to the market, then consumer financial services marketplace will be more competitive on total price. Most consumer financial products differ in their class primarily on price, not functionality, but product pricing structure is designed to make comparison shopping difficult in order to avoid commoditization (and inevitably lower profit margins). Better disclosure should encourage commoditization and price competition, which should actually bring down prices.

Access to Financial Products

Greater commoditization of consumer financial products would likely have a mixed impact on product availability. Commodity products depend on volume, which would encourage greater access to financial services, but some products are only profitable because of a high degree of cross-subsidization among users. For example, credit card defaults are compensated for by paying customers. If the margins attainable on paying customers were to fall, there would be less tolerance for defaults, and thus underwriting standards would tighten, restricting access to credit, but also reducing cross-subsidization and encouraging cost internalization.

Impact on Innovation

An agency whose sole raison d'être is consumer protection might be overly cautious in dealing with new products, with the result of keeping new, innovative products from the market, thereby hurting net consumer welfare. The CFPA Act does not anticipate the CFPA licensing products, like the FDA; new products could come to market without CFPA approval.

Even if CFPA regulations functioned as de facto licensing, however, concerns about impeded innovation seem greatly overstated. Financial product innovation is not the same as pharmaceutical innovation. If a financial product reaches the market a year later, it is not the same as the cure for cancer being delayed by a year.

Financial product innovation is not innovation in functionality, but innovation in pricing structure and marketing. There have been precious few innovative financial functions. A 2001 Bank Administration

Institute study concluded that there have been only three innovations in the past half century in retail financial services that are "transformational": the emergence of mortgage brokers, credit scoring, and monoline credit card issuance, such as from Capital One and MBNA.[26] The benefits for the first two to consumers are questionable, as are their safety-and-soundness benefits, and the third helped foster marketing nuances, but not new product functionality. A CFPA could, in theory, have limited the first two innovations, but not the third.

Other arguably innovative products are debit cards, both PIN and signature cards. The financial services industry has resisted the adoption of PIN debit and instead pushed signature-debit cards that are less secure and have slower clearance, but which generate more NSF fees and greater interchange fees. Middlemen, such as financial institutions in payment transactions, thrive on inefficiency. Arguably, this is a case where CFPA regulation could ensure that the better technology standard was adopted by the market.

Ultimately, a CFPA might well spur innovation, rather than hinder it. To the extent that consumer financial products become more price competitive, margins will fall for the financial services industry. The only way to break out of commoditization will be through innovation. If financial products cannot be differentiated through price structures, product bundling, and advertisements, then they will have to be differentiated on function.

Conclusion

There are serious policy disagreements about what substantive consumer protection policy should be. But it is important that those debates remain separate from debates over regulatory architecture. Regardless of one's view of substantive consumer protection regulation, there are compelling reasons to believe that the present regulatory architecture cannot produce the optimal consumer protection regime and will continue to fail in its task, resulting in unfair treatment of consumers and a potentially significant source of systemic risk.

[26] *See* Steve Mott, *The Fed Should Regulate Bank Cards Even More*, 6 *Cards and Payments* 29 (July, 2009).

To this extent, consideration of a CFPA should strive to distinguish between the basic thrust of the legislation—a consolidation of the regulatory authority of numerous agencies under some 12 different statutes into a single agency responsible solely for consumer protection in financial services—and the proposed new substantive powers granted to the agency, such as the "plain vanilla" mandate. The need for regulatory consolidation absent any new powers is an area in which broad bipartisan consensus can likely be reached.