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ASSESSING THE EFFECTS OF CONSUMER FINANCE REGULATIONS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

SECOND SESSION

ON

ASSESSING THE EFFECTS OF CONSUMER FINANCE REGULATIONS ON CONSUMERS AND EXPLORING WAYS TO IMPROVE REGULATION TO ENSURE THE CONSUMER FINANCE PROTECTION BUREAU ISSUES RULES THAT PROVIDE STAUNCH CONSUMER PROTECTION

APRIL 5, 2016

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ASSESSING THE EFFECTS OF CONSUMER FINANCE REGULATIONS

TUESDAY, APRIL 5, 2016

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Richard Shelby, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The Committee will come to order.

Today the Committee will hear from private sector experts on consumer finance regulation. This Thursday, we will hear from Director Richard Cordray.

Nearly 5 years ago, the Bureau of Consumer Financial Protection opened its doors. Because of the Bureau's structure and the means by which it is financed, it remains one of least accountable agencies in the Federal Government.

As a result, the very consumers that the CFPB was designed to help have been harmed by the Bureau because some of its rules make it more difficult for companies to lend and offer products in the marketplace.

For example, certain rules will make it more difficult for a consumer to get a prepaid card or take out a short-term, small-dollar loan. Such regulations may restrict access to credit entirely for individuals, households, and businesses.

I have long advocated for sensible consumer protections, but I do not believe they should be used as a substitute for an individual consumer's independent—yes, independent—judgment. Also, so-called protections should not be implemented without regard to their costs or their effects on economic growth or the safety and soundness of any particular financial institution.

The Bureau has enormous power over consumer financial matters. It has, however, no statutory mandate to write balanced regulations that protect the economy or promote institutional safety and soundness. As it continues to exercise its considerable regulatory powers, it does so without any meaningful statutory check by Congress.

For example, its actions in the indirect auto lending space have pushed the envelope on its jurisdiction under Dodd-Frank. In order to circumvent Dodd-Frank's explicit exemption for auto dealers, the Bureau has targeted auto lenders.

To do so, it has also circumvented the regular rulemaking process that has been in place for 70 years. This process ensures transparency and accountability in Federal regulations.

Instead of setting clear rules, the Bureau is using enforcement actions to reshape the auto finance industry. As demonstrated by settlements with the Bureau, its goal has been to limit the interest rate that dealerships charge based on factors other than financial risk.

What is more, these limits often differ leading to an uneven playing field not only among companies that have settled, but also between them and the rest of the market. I fear that this sets a dangerous precedent for the role of a regulator in our financial markets.

In addition, the Bureau continues to base its fair lending enforcement on the controversial legal theory of disparate impact, under which a company can be held liable for policies that lead to different results, without any intent to discriminate.

Further, as part of this process, the Bureau uses a methodology to identify "victims" that is known to produce inaccurate results. As a consequence, settlement funds may regularly go to individuals who have not been harmed in any way.

Outcomes like this should cause the Bureau to seriously reevaluate its approach in this area. Instead, we have seen the Bureau and its Director double-down on the same faulty methodology.

Equally troubling is the Bureau's look at the use of arbitration clauses for financial products. Its 2015 study on this matter relies on a series of questionable assumptions and conclusions.

I think it should surprise no one that the final study makes sweeping conclusions that arbitration agreements harm consumers and downplays or altogether ignores its potential benefits to individuals. One can only assume that any final rule on arbitration will incorporate many of these dubious findings.

As the Bureau continues to reshape the consumer finance landscape, it is important that these and other issues be fully vetted before Congress and the American public. Today we will hear from our witnesses on how we can improve the regulation of consumer finance and ways to prevent the Bureau from overstepping its boundaries at the consumer's expense.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Chairman Shelby, for holding this important hearing on consumer finance regulation.

Nine years ago this week, New Century Financial, once the second largest subprime mortgage originator in the country, filed for bankruptcy. This marked the beginning of the worst financial crisis this country has seen since the Great Depression, something many on this Committee seem to have forgotten.

Over the next 3 years, the crisis ravaged the country. Nine million homes went into foreclosure between 2007 and 2010. Think of the family with young teenagers that paid their mortgage every month, lost their jobs, or were victimized by speculation and all the things that played into that crisis. Billions of dollars of household

wealth disappeared overnight. Think of the senior citizen in a 401(k) or savings they had, much of which they lost.

Estimates on the costs of this crisis in the American economy are at least $10 trillion—that is $10,000 billion. It could be as high as $25 trillion.

We learned that large companies gambled with retirement savings and homes of everyday Americans, that millions of Americans were put into predatory mortgage products they could not afford.

As that happened, regulators all too often were looking the other way. In response, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created the Consumer Financial Protection Bureau.

The crisis revealed that Americans needed a Federal watchdog that would put their interests first. The CFPB has been absolutely a success. The agency has taken strong actions in a number of consumer finance markets that previously had no Federal oversight: credit reporting, debt collection, payday loans, student loan servicing, and auto finance.

The benefits of CFPB are clear. Its actions have resulted in more than $11 billion being returned to 25 million consumers. Over and over, CFPB has exposed unfair and abusive behavior by financial companies, companies adding on hidden fees to credit cards, companies attempting to collect on debt that has already been paid off, companies discriminating against minorities, companies deceptively marketing financial products. CFPB has made consumer financial products safer and better for consumers.

Its work is not done. The Bureau is working on rules to rein in payday loans, prepaid cards, and debt collection. It is working to limit forced arbitration clauses in consumer finance products—forced arbitration clauses, I would emphasize—clauses which deny consumers the right to litigate when they are harmed.

It is critical that CFPB be allowed to finalize and implement these rules. It is also critical for the agency to be vigilant against new threats to consumers. Americans have a record $3.5 trillion in consumer debt, not even including mortgage debt. This number, including $1 trillion in student loan debt, $1 trillion in auto loan debt, is a full $1 trillion more than it was in 2010.

Those who say that credit is not available to consumers today are not paying attention. Credit is available and it is growing month after month. We are seeing increasing levels of lending to subprime borrowers in mortgages and credit cards and auto loans. We are seeing nonbank lenders expanding their role in consumer lending from FinTech companies to nonbank mortgage originators.

It is vital that CFPB exist. It is vital that they exist to watch these developments and take action when needed. It is our duty on the Banking Committee in both parties, it is our duty in Congress to resist the collective amnesia that is all too present in this hearing room and in this Congress, and to ensure that the same bad practices that led to the crisis that hurt so many Americans, that those practices are not repeated by a new set of players. It is why I continue to be troubled by Republican efforts to undermine and in some cases eliminate the CFPB.

Three years ago, Director Cordray said he wants the Bureau to "make sure we stay in touch with the people who need us most to

do our work." That is why I am pleased that Reverend Willie Gable could be with us here today from New Orleans. I understand you are a graduate of Union Theological Seminary in Dayton, Ohio. Good move—for us and for you. Dr. Gable has seen firsthand the effects of too little financial regulation in communities.

I know, Mr. Chairman, that Dr. Gable is the only witness on this panel representing consumers, representing everyday Americans. The other three witnesses, by and large, represent the views of the financial industry. I regret—as much as Dr. Gable, I know, can hold his own—I regret that this Committee's panel today is not more balanced. Dr. Gable is by no means alone. I ask consent to enter 11 statements I have received from consumer advocacy organizations in the record.

Chairman SHELBY. Without objection.

Senator BROWN. Thank you, Mr. Chairman. I look forward to the testimony of all four of you. Thank you.

Chairman SHELBY. I think as we start this hearing, we need to recognize that we are all consumers, every single one of us, you know, with some degree.

First, we will today receive testimony from Mr. Leonard Chanin, Of Counsel at Morrison & Foerster.

Next we will hear from Mr. David Hirschmann, President and CEO of the U.S. Chamber of Commerce Center for Capital Markets Competitiveness.

Then we will hear from Reverend Willie Gable, Jr., Doctor of Ministry, Chairman of the Board, National Baptist Convention USA, Housing and Economic Development Commission, and Pastor, Progressive Baptist Church.

Finally, we will receive testimony from Mr. Todd Zywicki, Foundation Professor of Law and Executive Director of the Law and Economics Center at the George Mason University School of Law.

We welcome all of you. Your written testimony will be made part of the hearing record. We will start with you, Mr. Chanin.

STATEMENT OF LEONARD CHANIN, OF COUNSEL, MORRISON & FOERSTER LLP

Mr. CHANIN. Good morning. Chairman Shelby, Ranking Member Brown, and Members of the Committee, my name is Leonard Chanin. I am Of Counsel in the financial services practice group of the law firm Morrison & Foerster here in Washington, DC, and have more than 30 years' experience working as an attorney on consumer financial services issues. I spent 20 years at the Federal Reserve Board, including 6 years as Assistant Director and Deputy Director of the Division of Consumer Affairs, and 18 months as Assistant Director of Regulations at the Consumer Financial Protection Bureau. I have spent nearly 10 years in private practice advising financial institutions on Federal consumer financial services laws. I am pleased to be here today to discuss the effects of consumer finance regulations.

The primary Federal agency entrusted with regulating consumer financial products is the CFPB. I would like to address two issues: the impact of regulations on the consumer financial services market; and, second, the use of enforcement orders to create policy.

If properly designed, regulations can better ensure a standardized approach is used to provide disclosures to consumers to allow them to compare products and choose the ones they prefer. However, there are many risks to regulating too much. Regulations need to be clear, but also provide flexibility to accommodate new products, new delivery channels, and new ways of doing business. Clear rules ensure that institutions know what is required to comply and manage risks, but detailed, proscriptive rules inhibit the availability of products and development of new products.

While it is difficult to quantify the precise impact that CFPB rules have had on consumers and the market for financial products and services, it seems clear that such rules have had a significant adverse impact on the ability and willingness of institutions to offer those products and services. Anecdotal evidence clearly indicates because of the rules' complexity, some institutions that previously offered mortgages have simply stopped doing so. Other institutions have reduced the mortgage products and services offered to consumers, and some institutions have been reluctant to offer new products and services.

Despite the problems associated with regulations, they are vastly preferable to regulating by the use of enforcement orders to establish policy. It is quite clear that the CFPB uses enforcement orders to create new policies and rules. When enforcement orders are used to establish policies, there can be many drawbacks.

First, most enforcement orders lack specificity about the practices involved, so it is difficult to discern how to apply any guidance in the orders to a variety of products availability. This creates inconsistencies in the marketplace.

Second, unlike rules, enforcement orders are not published for public comment. This deprives the public of the opportunity to comment and deprives the agency of the ability to consider operational and other issues as well as potential negative or unforeseen consequences.

Finally, enforcement orders that contain broad statements and allege unfair or deceptive acts and practices may result in financial institutions simply choosing not to offer products or develop new products due to lack of certainty about what is required and how to manage potential risks.

The use of fair lending enforcement orders dealing with the pricing of indirect auto loans illustrates this problem, as it has created an unlevel playing field in the automobile loan market. There are hundreds of banks, credit unions, and finance companies that purchase auto loans. Institutions take a variety of approaches in how they deal with pricing and the purchase of loans made by auto dealers due to competition in the local markets and other factors. By using enforcement orders to create a policy that provides only three options for ways lenders can compensate dealers for their work in originating auto loans, the CFPB has failed to recognize that there are many other legitimate means institutions can use to compensate dealers and still comply with fair lending laws. By using enforcement orders to create new legal requirements, the CFPB has failed to provide critical guidance to lenders on what laws require or permit.

In conclusion, the CFPB is less than 5 years old, and the question remains as to how the agency will balance its mandated purpose of ensuring consumer access to financial products while ensuring fairness in these markets.

Thank you for the opportunity to be here today. I would be happy to respond to any questions.

Chairman SHELBY. Thank you.

Mr. Hirschmann.

STATEMENT OF DAVID HIRSCHMANN, PRESIDENT AND CEO, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

Mr. HIRSCHMANN. Senator Shelby, Ranking Member Brown, Members of the Committee, thank you for the opportunity to testify today on behalf of the Chamber's Center for Capital Markets Competitiveness.

The Chamber shares the Committee's goal of ensuring that consumers are both treated fairly and that they retain access to the financial products they need. After all, in today's economy consumer products are critical sources of financing, not just for consumers but for small businesses as well. Fully 4 in 10 small businesses rely on personal credit cards and other forms of consumer credit to finance their business. So whether you are managing the finances of a small business or those of a family of four, everyone benefits from a system that deters fraud, creates clear rules of the road within an evenhanded enforcement across the board, ensures consumer products are clearly explained and disclosed, and creates a level playing field to spur competition and encourage innovation to serve diverse consumer needs.

We have engaged with the CFPB from the day it first opened its doors nearly 5 years ago now to promote those basic principles. While we certainly do not expect to agree with the CFPB on every decision it makes, we have urged them to clarify the rules of the road by doing two things: creating a system to provide guidance and no-action relief to companies seeking to do the right thing, and avoiding regulating through one-off enforcement or supervision. Unfortunately, progress has been slow, and over time that means fewer choices, higher prices, and less credit available for consumers and small businesses.

Today I would like to address two specific Bureau initiatives: the first is the CFPB's forthcoming rule on arbitration, and the second is the CFPB's continued efforts to regulate auto dealers through consent orders with loan underwriters.

First, on arbitration. One way in which businesses compete in the consumer financial marketplace is by subsidizing dispute resolution programs like arbitration that provide a better customer experience than any court litigation. The Bureau's 2015 study reaches four conclusions on arbitration.

First, it points out that arbitration is faster and more convenient than litigation. Consumers can initiate arbitrations by filing claims online. They can submit documents by email and participate in hearings by telephone.

Second, arbitration is cheaper for the consumer. Many companies actually pay for a consumer to file a complaint in arbitration. Some

even pay double legal fees and a bonus award to consumers who prevail.

Third, consumers generally receive bigger awards in arbitration than they would in litigation.

And, finally, arbitration is often presided over by a neutral arbitrator who has expertise in the specific area of the law, unlike a judge who is usually a generalist.

Despite these benefits, the Bureau has indicated it is planning to propose a rule this spring that will have the practical effect of eliminating consumer arbitration. If that happens, consumers with small, individualized disputes will have a much harder time getting quick and effective resolutions to their claims. But the Bureau appears not to have considered the likelihood of that outcome.

The Chamber's CCMC, our Institute for Legal Reform, and, in fact, many Members of this Committee and throughout the Senate have expressed serious concerns about the arbitration study, including its omission of certain data and critical analysis that led to flawed conclusions. We hope, for example, that the Bureau has considered the impact of the loss of arbitration in drafting its rule.

Turning to auto loan underwriting, in my remaining time I would like to briefly add a few thoughts on that topic.

For over 2 years, the Chamber has urged the Bureau to abandon its effort to regulate auto dealers through regulation by enforcement campaign against auto loan underwriters. Intentional discrimination is both morally repugnant and has no place in the 21st century society or economy, period. But the Chamber rejects the argument that the Equal Credit Opportunity Act permits claims to be brought under the disparate impact theory of discrimination. The Bureau has, nonetheless, used this approach in enforcement actions against a handful of underwriters.

If the Bureau believes that the auto loan market needs regulating, we would welcome an open public debate about how best to do it. The Bureau should pursue a transparent rulemaking, complete with notice and comment. In fact, if they had taken us up on our suggestion, it is highly possible they could have concluded a rulemaking by now. The Bureau has instead preferred to push for one-off settlements. I strongly believe the CFPB could have found a swifter, more effective path for both consumers and credit providers if they engaged with lenders, auto dealers, and the American public on a more sensible approach to regulatory policy.

The Chamber will continue to encourage the Bureau to consider the significant negative impact of its indirect auto campaign on consumers and small businesses and urge it to develop a transparent and effective resolution on this issue. We encourage the Committee, Mr. Chairman, to continue its oversight over this program as well.

Mr. Chairman, I am happy to answer any questions you or Members of the Committee may have.

Chairman SHELBY. Reverend Gable.

STATEMENT OF REVEREND DR. WILLIE GABLE, JR., D. MIN., PASTOR, PROGRESSIVE BAPTIST CHURCH, NEW ORLEANS, LOUISIANA, AND CHAIR, HOUSING AND ECONOMIC DEVELOPMENT COMMISSION, NATIONAL BAPTIST CONVENTION USA, INC.

Mr. GABLE. Chairman Shelby, Ranking Member Brown, and Members of the Committee, thank you for inviting me to testify today. I am Reverend Willie Gable, Pastor of the Progressive Baptist Church in New Orleans, Louisiana. Our congregation is a member of the National Baptist Convention USA, the Nation's largest predominantly African American religious denomination.

I am also Chair of the National Baptist Convention Housing and Economic Development Board, and over the past 20 years, the commission has developed over 1,000 affordable homes for seniors in 14 different States.

Home—I would ask you to think about that word for a minute, Senators, to think about that place. Perhaps you live with family there, with a spouse or a family or a child. Now imagine being kicked out of your home, your possessions scattered on the curb. Twelve million families lost their homes as a result of the financial crisis. Twelve million lives turned upside down. Life savings washed away, $2.2 million lost property value, trillions lost in property value. Over half of the communities that lost this were people of color.

Predatory lending practices caused that financial crisis, and the lax oversight enabled predatory lending. The whole Nation suffered, many worse than others. Some will continue to suffer for the rest of their lives.

The Consumer Financial Protection Bureau was formed in the wake of that crisis by this body, Congress. It was vested with the authority by this body to prevent financial practices. That is mandated, and it was handed down by this body.

CFPB implemented mortgage rules that have made the mortgage market far safer, have required lenders to determine borrowers' ability to repay, have offered some assurances that mortgage credit will grow the community rather than implode it. But other abuses continue to run rampant. Some may be more obscure than mortgage lending, but they are ever powerful and ever destructive. And if not controlled, they will relegate some communities to a state of perpetual poverty.

Payday lending is an abomination in plain sight, a debt trap—legalized loan sharking, I think. The CFPB is studying and proposing a rule in this area, and rightly so. Bank overdraft fees are the banks' version of exploiting the most vulnerable among us, billions of dollars annually in fees derived mainly from a select few unlucky people. The CFPB is studying and considering rules in this area, and rightly so.

In the auto lending industry, predatory discrimination practices have been evidenced for years. The CFPB is studying and proposing guidance and taking enforcement actions in this area, and, again, rightly so.

Debt collectors routinely break the law. The CFPB has appropriately taken action against some, and again I say rightly so. Mandatory arbitration clauses stuck in fine print of so many

predatory loan contracts is an affront, I think, to our constitutional rights. Congress mandated that the CFPB study this. It has, and it is considering rules to limit it to permit individuals to join together and pursue justice, and rightly so.

And the list goes on: student loans, credit cards, protection against elder abuse. It is clear that a strong, well-funded, independent agency whose job is to wake up in the morning thinking about protecting the most vulnerable among us is necessary to ensure the financial service practices do not drain the hard-earned income and savings for many of my constituents and many Americans across this country.

Please allow me to be clear. The notion that the struggling Americans need access to products like these the Bureau has been working on so hard to address is an insult to the basic dignity of every vulnerable person. The predatory practices the CFPB is addressing siphons off what little resources targeted persons have and leave them in worse-off situations.

I thank you for the opportunity to share my experiences, and I look forward to your questions.

Chairman SHELBY. Thank you.

Professor.

STATEMENT OF TODD ZYWICKI, GEORGE MASON UNIVERSITY FOUNDATION PROFESSOR OF LAW, ANTONIN SCALIA SCHOOL OF LAW, GEORGE MASON UNIVERSITY, EXECUTIVE DIRECTOR, LAW AND ECONOMICS CENTER, AND MERCATUS CENTER SENIOR SCHOLAR

Mr. ZYWICKI. Thank you, Senator Shelby, Ranking Member Brown, and Members of the Committee. It is my pleasure to testify at this hearing this morning on this crucially important issue of access to consumer credit and consumer credit regulation.

Let me make clear at the outset that as a scholar of consumer credit and the former Director of the Office of Policy Planning at the Federal Trade Commission, I was a strong supporter at the time of Dodd-Frank of creating a new, modernized, scientifically based consumer financial protection system. I think the old system did not work very well, and I agreed with the idea of centralizing this in one regulatory agency.

Unfortunately, by creating a super regulator that lacks the democratic accountability and checks and balances of a traditional Government regulatory agency, we have created a monster that is passing regulations that are harming American consumers and American families.

During the time since the financial crisis, Dodd-Frank, and the creation of the CFPB, we have seen Washington impose a series of laws and regulations that have reduced access to credit for consumers, stifled innovation, substituted the will of Washington's bureaucrats for the good, sound judgment of American families of how to manage their finances, and driven millions of consumers out of the mainstream financial system, forcing increased reliance on alternative products such as payday loans, auto title loans, and the like.

Most tragic, the cost of this regulatory onslaught has fallen most heavily on lower-income, younger, and the most vulnerable consumers in the American economy.

I will start with the Durbin amendment, which was attached as a midnight amendment to Dodd-Frank. It imposed price controls on debit card interchange enrollees, not credit card but debit card interchange fees, which one thing we could say did not contribute to the financial crisis by consumers overusing their debit cards. Nevertheless, it was attached to Dodd-Frank and passed through.

The results of these price controls have been disastrous for American consumers as the loss in revenues has been passed on to consumers in the form of higher bank accounts. We have seen——

Chairman SHELBY. Can you take a second to digress and explain its effects?

Mr. ZYWICKI. Certainly, Senator, yes. Under the Durbin amendment, it reduced the interchange fees on debit cards, which are the fees that are paid when you swipe your debit card at, say, Target or the grocery store. Under the Durbin amendment, they basically cut in half what could be compensated for with respect to the recovery. That loss of several billion dollars of revenues by banks that are most affected by that has been passed on to consumers. It has been passed on in two ways, which is the loss of free checking. Before the Durbin amendment went into effect, 76 percent of bank accounts in America were eligible for free checking. Today that number has been reduced to 38 percent.

It has been passed on a second way, which is that the bank fees that people pay on a monthly basis have doubled during that period. So we have seen a reduction of free checking and a doubling of bank fees.

Chairman SHELBY. [off microphone] I don't get to [inaudible] but can you explain what consumers lost on this from the—what they gained, if anything—in other words, the cost-benefit there?

Mr. ZYWICKI. Certainly, yes. What consumers lost was that—access to debit cards had been a huge driver, the introduction of debit cards into the market at the beginning of 2000, had raised free checking from under 10 percent to 76 percent. Why? Because the 44 cents or whatever that was generated on average from those payments were enough to cover the bank accounts for most consumers and especially low-income consumers who lack the ability to have the high minimum balances and that sort of thing that otherwise make them eligible——

Senator BROWN. Mr. Chairman, if we are going to begin the questioning, which apparently we are already, I would have to——

Chairman SHELBY. Observations.

Senator BROWN. Well, and I will make observations, also, in—just for fair play, the Durbin rule, maybe it was added in the middle of the night, as you claim, but it was a Senate vote, and it was a heavily lobbied Senate vote on both sides.

Second, the millions of dollars that the Durbin amendment may have cost banks——

Mr. ZYWICKI. Billions.

Senator BROWN. I am sorry, excuse me. I stand corrected. The billions of dollars it may have cost banks, to imply that that was

not passed on in large numbers to consumers is also a bit misleading.

Mr. ZYWICKI. Actually——

Senator BROWN. I would add that you really—you make the statement that all of a sudden because of the Durbin rule, these banks cut down on the number of free checking accounts, the amount of free checking they were doing, that is a pretty tentative cause and effect that you really cannot prove. And you can prove in a timeline, but considering what banks have done in fees over the years, they are always looking for opportunities, and that is how they nicked Dr. Gable's congregation and so many others. But that was just an observation also since we have begun the questioning, Mr. Chairman.

Mr. ZYWICKI. Well, thanks for that. I will just elaborate and then move on.

First, you mentioned in theory these costs could be passed on to consumers. According to a study by the Richmond Federal Reserve that was conducted this fall, there is zero evidence that anything has yet been passed on to consumers by retailers. And, in fact, because of the way the market has adjusted, small businesses look like, many of them, have actually paid higher interchange fees. Big-box retailers certainly have generated a huge multi-billion-dollar windfall to big-box retailers. Yet according to the study by the Richmond Federal Reserve this fall, there is no evidence that any of that has been passed on to consumers.

With respect to whether it was the Durbin amendment, what we can say is that free checking has disappeared only at the banks that were affected by the Durbin amendment. Small banks have not so far scaled back—and community banks and credit unions have not scaled back on access to free checking. And so I think the evidence overwhelmingly supports that.

The second thing I want to point to that has driven consumers—and the impact of that for consumers has been tragic, maybe a million consumers, especially lower-income consumers, have lost access to bank accounts as a result of the higher fees and less access to free checking relative to the Durbin amendment.

The Credit CARD Act, which was passed in the wake of the financial crisis, has had a similar effect. By interfering with the ability to price risk accurately, certainly it has helped some consumers, especially middle-class consumers who may be paying less fees than they did otherwise. Yet according to research by CFPB and other researchers, the impact of the Credit CARD Act—and it is hard to disentangle from the recession—275 million credit card accounts were closed, $1.7 billion of credit card lines disappeared, and, unfortunately and most tragically, many of those who lost their credit cards have had to turn to things like payday loans, auto title loans, and overdraft protection to make ends meet.

With respect to mortgages, the qualified mortgages rule and other regulations have driven up the cost, the regulatory cost, and the risk of making loans substantially and imposed a one-size-fits-all system of mortgage underwriting that has stifled innovation and consumer choice in the consumer financial system. Since the qualified mortgages rule has gone into effect, mortgage originations have fallen and have not recovered.

A report this fall finds most strikingly by the National Association of Realtors that the share of mortgages going to first-time borrowers has fallen for the third straight year last year and now stands at the lowest rate since 1987, largely because of the inability of first-time home buyers to be able to get access to mortgages as a result of the regulations such as the qualified mortgages rule.

At the same time, it has driven community banks out of the mortgage market. According to a study done by the Mercatus Center at George Mason University, 64 percent of community banks reported they changed their mortgage offerings, and 15 percent have left the market completely as a result of the regulatory cost and risk associated with the qualified mortgages rule and other regulations.

Finally, the imposition of one-size-fits-all underwriting has deprived community banks of their competitive advantage in the market, which is the relationship lending that they have with their consumers. Now, basically because of the one-size-fits-all blanket of uniformity that has been thrown over the mortgage market, it has eliminated the ability of community banks to compete with the mega banks. And, unfortunately, as banks have exited this market because of the regulatory costs, as Senator Brown mentioned so well at the outset, nonbank lenders have stepped in to fill this voice; nonbank lenders have dramatically increased their market share as traditional banks and lenders have been driven out of the market by regulatory and liability risks.

Unfortunately, as consumers have been driven out of the mainstream financial system, they have lost access to bank accounts, credit cards, mortgages, and the like, and they have turned increasingly to products like payday loans, overdraft protection, and auto title loans to try to make ends meet.

Unfortunately, as we stand here today, the CFPB stands poised to shoot holes in the life rafts to which consumers are increasingly clinging to as they try to make ends meet to these alternative financial products.

Now, these products serve an important function in the American system of providing a buffer between mainstream lenders and the black market. They serve an important role, but I think we—and we want to be careful about driving them out of the market and making vulnerable consumers even more desperate.

In closing, let me reiterate I support, supported then and support now a modern consumer financial protection system in one centralized agency that has the ability to basically bring coherence and innovation and promote competition in our consumer credit market. Unfortunately, in the period since the financial crisis and the imposition of Dodd-Frank, we have seen exactly the opposite. We have seen a stifling of competition. We have seen consumers being driven out of mainstream financial products. We have seen small banks disappearing at twice the rate they were before Dodd-Frank was enacted. And we are seeing increase misery for American consumers in this market.

I think it is important to reform the CFPB, to bring democratic checks and balances and democratic accountability to this process in order to help American consumers.

Thank you for your time.

Chairman SHELBY. Thank you, Professor.

I will start with you, Mr. Chanin. Your background, having been at the Fed how many years? A number of years?

Mr. CHANIN. Twenty years, sir.

Chairman SHELBY. And also you worked at the consumer agency for, what, a year and a half?

Mr. CHANIN. Correct, a year and a half.

Chairman SHELBY. You have a unique background here. And I will also direct this question to Mr. Hirschmann. As you both mentioned in your testimony, the CFPB, the consumer agency, has habitually used enforcement actions against companies to try to—companies and individuals, small companies—to set market standards rather than going through the formal rulemaking process to set clear rules of the road where people will have something definite, yes or no? Could you provide a little more detail—I will start with you, Mr. Chanin—to the Committee and the record here regarding the downsides of using such enforcement actions in lieu of a more formal rulemaking process?

Mr. CHANIN. Sure, I would be happy to. So there are a number of drawbacks to using enforcement actions to create a policy or really create rules.

First, the enforcement actions are solely between the parties involved, so usually a bank or other financial institution, and the CFPB. So they do not affect the thousands of other institutions out there. So other institutions can choose to abide by those, the principles in them, or not. And institutions differ. Some do choose to abide by them, and others take different approaches there. What that does is to lead to inconsistencies in the marketplace in terms of how lenders deal with fair lending issues.

The other problem is they are not published for public comment, so no one has an opportunity to point to problems, unforeseen consequences, and those sort of things in terms of the orders. So you are dealing with a marketplace that has thousands of lenders. The CFPB in the case of fair lending and the enforcement orders has not obtained or provided the public with the opportunity to comment on those and point out some of the problems.

Chairman SHELBY. Basically, it is narrow in scope. Is that right?

Mr. CHANIN. The enforcement orders are quite narrow in scope. They also do not provide very many details about what the issues are. It is very narrowly drawn in terms of the facts and what the remedies are.

Chairman SHELBY. Mr. Hirschmann, do you have any comments?

Mr. HIRSCHMANN. First, I think we would agree with every Member of this Committee that strong, effective enforcement is important. The real issue is: Do you use enforcement to change the rules of the road, or do you write a new rule? Let me give you a couple specific examples.

Recently, the Bureau did an enforcement action against a company that it felt exaggerated its cybersecurity claims. Now, it did not just tell the company adjust your—your claims are invalid, but it said here is a best practice of what we think cybersecurity should be.

Now, nobody knows if the Bureau is now getting into regulating cybersecurity and joining all the other players in this space, if that

is the standard the CFPB wants, or if it is going to do a separate rulemaking. So it is very hard for those trying to comply to understand how to read the tea leaves from one enforcement action and understand what the rules of the road are going to be.

Now, in the case of indirect auto, it is particularly troublesome because that is such a diffuse market that even doing enforcement against one, two, three, five, or ten players only gets you a small fraction of the marketplace, and, therefore, it does not solve the problem more broadly. So in that case in particular, we thought that writing a rule would make much more sense than one-off enforcement.

Chairman SHELBY. I will start with you, Professor. Last year, the consumer agency began publishing consumer narratives in its consumer complaint database. The Bureau admits that it does not verify the accuracy of complaints. Meanwhile, it uses this unverified data to inform its supervisory activities and for other purposes.

Should a Government agency be publishing narratives about companies that are known to be inaccurate? And, second, is it appropriate for the consumer agency to use this unverified information as part of its supervision and regulation? Is this anecdotal versus real hard statistics? What is it?

Mr. ZYWICKI. Thank you, Senator Shelby, for calling attention to that issue, and I know some of the other witnesses have spoken to this.

Chairman SHELBY. I think Mr. Hirschmann has a view on this.

Mr. ZYWICKI. Yes, and I am very concerned by that, really based—drawing on my experience at the Federal Trade Commission. The idea of just dumping unverified consumer narratives out on the public record, I cannot see how that furthers any coherent regulatory purpose. Certainly, it has always been the case, it has been an important part of consumer protection to collect complaint data and use complaint data in the aggregate as a way of marshalling resources for enforcement regulatory purposes and the like. But the idea of basically creating a Government-sponsored Yelp where people can just simply, you know, put their own unverified views out on the market and basically have the Government endorse it I think serves no coherent regulatory purpose that I can see, just these isolated, unverified, often inaccurate, one-sided complaints.

Chairman SHELBY. Mr. Hirschmann, do you have any comments? This area you have worked in.

Mr. HIRSCHMANN. Yes. Senator, nobody argues that gathering complaints is a good idea. We just take particular issue with the way the Bureau has done it. By gathering the unfiltered data, it is not providing consumers with——

Chairman SHELBY. Is it the methodology?

Mr. HIRSCHMANN. It is the way they are doing it. So it is hard, particularly when you look at these monthly press releases they do, kind of the naming and shaming approach, it is hard for a consumer to know if a particular company is a bad actor they should avoid or is simply larger than the other players. So the unfiltered data, the raw data, without providing any way of verifying, cre-

ates—might actually make it harder for consumers to really understand what is going on.

So what we have said is let us work together to find ways to improve and make the consumer data that is available verified and more useful for consumers rather than potentially misleading consumers.

Chairman SHELBY. The consumer agency has also brought enforcement cases against indirect auto lenders for violating fair lending laws using the theory of disparate impact. In these instances the companies being accused of discrimination are by law not even allowed to know the race of the purported victims. In your opinion, is this an appropriate way to enforce fair lending laws? Because I think all of us believe that you should not discriminate against anybody, period; we should be fair in lending; we should do everything with it. But is this fair itself?

Mr. HIRSCHMANN. Well, it has created a particular problem for companies who want to be compliant and want to avoid even an allegation that they might be dealing with consumers unfairly. Nobody wants to do that. So, you know, the approach of doing it through enforcement and using a proxy methodology that has been questioned by a number of places is not working toward solving the ultimate problem the Consumer Bureau sought to solve. It had a view, initially perhaps, that flat pricing was better. Now in some enforcement cases, it has put a cap. Why not have an open debate where everybody can participate? Let us agree on clear rules of the road, and then we can all follow them.

Chairman SHELBY. Where you have some certainty?

Mr. HIRSCHMANN. Exactly.

Chairman SHELBY. Mr. Hirschmann, the consumer agency's March 2015 study on arbitration has been criticized for its lack of transparency and for incorporating limited input from interested parties. Director Cordray has repeatedly defended the study and has said that it is, and I will quote, "the most comprehensive study ever done." Nobody disputes that.

Do you agree with this? And if not, why not?

Mr. HIRSCHMANN. Well, we urged them, for example, to look at how consumers fare in arbitration and what would happen if you limit arbitration and whether consumers are better off in a world where arbitration goes away and class actions come in. The Bureau did look at a number of class actions before it existed, and even its own data found that 87 percent of consumers get absolutely nothing, nada, zilch out of those cases.

So you cannot just look at class actions and say should we add this to the system. You have to look at what system will provide the best, cheapest way for consumers to get redress. Today they get redress by calling their credit providers, and in most cases companies want to do right. They also do complain to the CFPB. The CFPB is a new actor in this space and has brought enforcement actions in a number of areas. It would be smart to look at how all those things work together and then determine: Is arbitration a valuable tool, or should we replace it with something else? That is not what the Bureau did.

Chairman SHELBY. That is what real analysis is about, is it not? Thank you.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

I do not even know where to start. I want to—I just am incredulous today at this testimony. I have been on this Committee for close to 10 years. I have never quite heard the unsubstantiated claims, and let me start with, first, the Richmond Fed study was not really a study. It was a survey. It did not find savings were passed through—it did not find savings were not passed through. It just found that merchants actually did not get savings. So, again, it was not an economic study. It was a survey.

Number two, the Durbin amendment was not part of Dodd-Frank. It is not part of CFPB. It was debated with heavy, heavy, heavy lobbying and still was affirmed on the Senate floor.

But the most troubling was when I hear three of you—or maybe not all three talked on this—talk about the one-sided, inaccurate—you used another—unverifiable complaints from consumers—I mean, this is a town that specializes in one-sided, inaccurate, un—I cannot even read my writing, I was so agitated—unverifiable complaints, I mean, this town—look after Dodd-Frank. Do you remember when Dodd-Frank passed? The day the President signed it, the chief financial service lobbyists in this town said, "Now it is half-time." Well, what that meant is it was time for a cascading of one-sided, inaccurate, unverifiable complaints from industry that did not want these rules and regulations.

Look at the ratio. We are trying to find specifics on this, but 2:1, 3:1 ratio from industry—one being the consumer side—2:1, 3:1, 4:1 ratio from industry on all of these—on so many of these issues. So to just say, well, these consumers, they have got one-sided, inaccurate, unverifiable complaints, but to never say that about industry—because you know the agencies, whether it is the Consumer Bureau, whether it is the Fed, whether it is any other agency, they do not have time to track the thousands of complaints, whether they are one-sided, whether they are inaccurate, whether they are unverifiable. So to put it on the CFPB is collecting and then releasing all these unverifiable complaints is disingenuous, and that is a rather kind description of that.

Let me move on. I have a question for Dr. Gable. You have done significant work on payday lending. I love how you started your testimony when you have seen—as an observer of this Committee, you have seen the amnesia, the collective amnesia, like there was not that big a problem 10 years ago, and certainly nobody in industry caused it, it was all those consumers and all those GSEs and all. But you have done significant work on payday lending and what it meant. I love how you started your testimony by talking about what foreclosure means to families. I know my colleagues on this Committee are tired of me saying this, but I live in Zip code 44105, my wife and I, in Cleveland. My Zip code in the first half of 2007 had more foreclosures than any Zip code in America. I know some of those people. I know what happens to a teenaged kid who is told by his mom and dad you are losing your house. They have to sell their pets first, and then they give away their pets. They have to move their kids to another school district—all the things that happened to far to many of your parishioners in New

Orleans and happened to my constituents on Cleveland because of this.

So talk narrowly, if you would, about your experience with payday lending, why it is important for CFPB to write a strong rule in the next few weeks .

Mr. GABLE. It is very important that the rules be—that we have a strong rule. First of all, let me explain that I have had firsthand experience where we have had individuals, Senators, that have ended up in these debt traps. One of the most heart-wrenching ones was a young member of the congregation who came in and found out that her mother had nine payday loans. But to make it even more exasperating and incredulous is the fact that her mother was in pre-dementia, and there was no ability to pay that was investigated by these payday loans.

Over and over, what has happened in our churches is this: Through our benevolent funds—and it is almost a shameful thing, but our benevolent funds, we have individuals come to the churches, and they ask for support for their utility bills. But we found out, once we started presenting and asking the questions about, you know, how did you get into this situation, because of shame they did not tell us that they had payday loans.

So some of the things that we are hoping the rule will do is, in fact, have a strong rule that will allow for the ability to pay. And, second, not only a strong rule that will allow for the ability to pay before making the loan, we are asking that the rule also has some cap in terms of the number of loans, so that individuals cannot go from "Get Your Money Here" or "I Have Got Money for You Over There" and you have got 10. The industry establishes the fact that it takes—they make money off of those folks who have at least 10 loans, continued loans, and that is just unnecessary.

And I might just add this here, and let me add this: This Congress found that it was necessary and saw fit to pass a 36-percent cap for the military. I believe if it is good for the military, it ought to be good for America. And I know that you asked me about payday lending, and I know we have had some discussion, and my colleague here, Mr. Zywicki, talked about, you know, what was happening in arbitration on both sides and about the consumers putting in unverifiable claims because of the CFPB. I do not know of any consumer who would take time out of their schedule and just write an arbitrary complaint just to fill out a piece of paper.

Senator BROWN. Well said.

Mr. GABLE. It just does not happen. And when we come to the arbitration in terms of finding it, what the study did show after two decades, before it was looked into by auto dealers and the lending, is that those who were targeted were women; and to my dismay, preachers, pastors were the ones who were most vulnerable to these high increases.

Senator BROWN. Thank you. And I think you—and a couple comments and one last question, Mr. Chairman. I think your comments about the 36-percent cap in the statute for military families is exactly right. I am very happy we did that. I am very happy that is the law. But why should it not apply to others?

And you also made a couple other comments along those lines, that, you know, there are 12 or 13 States that do not allow payday

lending, and access to credit does not seem to be a particularly huge problem in States like—I know Senator Warren's State is one of those.

Mr. GABLE. New York.

Senator BROWN. I wish my State—my State used to be one of those until 1994. But a couple of comments first.

You know, if arbitration is better for consumers, one would expect groups representing consumers would oppose CFPB's efforts, but they are not. And I think that is pretty interesting.

Also, some comments about the CARD Act that were made, the CFPB published a report that the CARD Act reduced credit card fees by more than $16 billion. In 2014 alone, consumers opened more than 100 million credit card accounts, so it is not like credit card access has been particularly restricted.

And I wanted to apologize. I did say that the Durbin amendment was not part of Dodd-Frank. I should have said it is not a CFPB rule. It was voted on the Senate floor. I apologize to Professor Zywicki that I did not say that quite precisely.

My last question, Mr. Chanin, for you, if I could. You were—the Financial Crisis Inquiry Commission found that the Fed would not exert its authority over nonbank lenders nor others that came under its purview in 1994 with any real force until after the housing bubble burst; in other words, there was no CFPB, and the Fed, it appears, did not do what it should have. And that is really my two questions to you. Sitting in that position, which you were as the Deputy Director of the Division of Consumer and Community Affairs, do you think that what the Fed did to enforce consumer protection laws was sufficient? And, second, should the Fed have acted sooner to protect consumers from products that could have been updated by the HOPE Act if we had done that? So if you would answer those two questions for the remainder of my time. Thank you.

Mr. CHANIN. Senator, the Fed has fundamentally two authorities. One is a rulemaking authority. Those rules in the consumer space apply to all financial institutions, banks and nonbanks, and the Fed exercised that authority particularly in the late 1990s as well as later 2006 and 2007, I believe it was, dealing with high-cost mortgages and the like.

The Fed also has supervisory authority. That authority is limited; that is, it only applies to banks and certain other institutions. For example, it does not apply to national banks, credit unions, nondepository institutions. So the Fed has no authority to deal with those institutions in terms of supervisory or enforcement actions.

In hindsight, it is easy to say that the Fed could have acted sooner in terms of high-cost mortgages, in terms of predatory lending practices. My experience at the time was the data was not there that showed the problem. It was only later—2008, 2009—that the data emerged that said there is a significant problem in terms of lender activities in this space. And the Fed took action at that point, not prior to that because it simply did not have any data that suggested there was systemic of fundamental issues in terms of those types of loans.

Senator BROWN. So were they not getting complaints as the only consumer—as kind of the consumer bureau, were they not getting complaints that—that is why you need an agency to anticipate those problems when consumers—or to respond to the number of them?

Mr. CHANIN. The Fed, like all of the banking agencies, as well as the Federal Trade Commission, gets complaints on lots of things. The way the agencies operate those, if the complaint deals with an institution not under the jurisdiction of the Fed, such as a national bank, those complaints would go to the Comptroller of the Currency. If it dealt with a nonbank, they would go to the Federal Trade Commission or another entity. So the Fed did get complaints, but it had supervisory authority over a fairly small number of institutions. There was no dramatic increase, as I recall, in terms of the complaints over those entities that the Fed had jurisdiction over.

Senator BROWN. Well, Mr. Chairman, I will close. Whether wittingly or unwittingly, I think Mr. Chanin just made a pretty good case for the Consumer Bureau, so thank you for that.

Chairman SHELBY. Senator Heller.

Senator HELLER. Mr. Chairman, thank you, and to the Ranking Member, for this discussion. There are very few topics that have both sides so far apart on a particular issue, and I want to thank our witnesses also for being here and for what you are bringing to this hearing.

We can go on and on about who is right and who is wrong, but let us talk about the practical effect of what we are talking about today.

During our last recess, I had an opportunity to talk to our lenders in the State of Nevada. I am going to guess that the comments that I got from these lenders in the State of Nevada are very similar to probably what the lenders would be saying in Ohio and probably what they would be saying in Alabama today, and let me give you some examples.

One particular lender said that 75 percent of all their new employees were compliance officers because of the new regulations. Community lenders in Nevada have stopped originating mortgages—you brought that up, Professor—stopped originating mortgages because they are now too overregulated. I have them telling me that it takes just as much time and effort to service a deposit customer as a person with a loan, again, because of all the new regulations. And I will tell you in Nevada we have half as many credit unions and community banks in Nevada than we did 5 years ago.

I think these are pretty stark messages, and like I said, I have no doubt that the same comments would be made in Ohio and the same comments would be made in Alabama.

And thanks for your comments because they played very much into what is going on in my State. But to Mr. Chanin and also to Mr. Hirschmann, does the CFPB have the authority to exempt small community lenders from these regulations that were meant for big banks?

Mr. CHANIN. Yes, the CFPB has a great many authorities in the Dodd-Frank Act, and those authorities are under the statute itself,

but also for each individual law that it implements, like the Truth in Lending Act, the Equal Credit Opportunity Act, *et cetera.* It has separate authorities to make exemptions. So it has a great deal of authority, if it wants to, to either exempt small institutions from some of the requirements or all of the requirements, assuming there is evidence that shows that institutions by complying would not make credit available to consumers or other things. So there is a test they have to use before they create an exemption, but I do think they have sufficient authority to make exemptions if the evidence supports that.

Senator HELLER. Are you aware of them ever exempting a small community lender from these regulations?

Mr. CHANIN. They have created some exceptions in some of their regulations from some of the requirements. For example, in the mortgage rules dealing with balloon payment provisions and those sort of things, they have created exemptions in some of their rules in Truth in Lending, for example, from some requirements, but not a blanket exemption that I am aware of.

Senator HELLER. Mr. Hirschmann, do you support tailoring regulations based on the size of institutions?

Mr. HIRSCHMANN. Absolutely. I think it is also important that the lenders in your State and other States, even if the rules do not directly apply to them, find that rules meant for larger institutions kind of roll downstream, and when it comes to their safety and soundness regulators, that they are asked to comply with some of the things that maybe were never intended for them. You know, certainly even smaller institutions want to be compliant. But our Nation benefits from having every size of financial institution, and we should continue to ensure that we do not force smaller institutions to merge just to have the scale to meet the compliance requirements.

Senator HELLER. Mr. Zywicki, do you believe that America is better served having fewer banks and fewer credit unions?

Mr. ZYWICKI. No, most certainly not. America's consumers are better served when there is robust competition and an equal playing field where you do not have banks getting bigger and succeeding simply because they can more readily bear the regulatory costs than smaller banks. We have known this for decades: proportionally small businesses bear higher regulatory costs per unit, and not just consumers but also community banks make most of the small business loans in this country. And so what we have seen in several studies is, as small banks have been hammered by Dodd-Frank and driven out of business, access to credit for small businesses has disappeared as well. So it is not just consumers who lose, it is not just communities that lose when credit unions and community banks go under. It is also small business and the entrepreneurs and the dynamism that we see in the economy. And it is probably not just a coincidence that 2 years ago it was documented for the first time in measured memory more small businesses disappeared than were created. And part of that is because of the costs that Dodd-Frank is imposing on small banks and thereby reducing access for small businesses to credit.

Senator HELLER. Professor, thank you.

Mr. Chairman, I am a big believer that big banks serve big businesses, small banks serve small businesses.

Chairman SHELBY. Right.

Senator HELLER. And that is why we are seeing the problems that the professor just expressed. So, anyway, thank you for the time.

Chairman SHELBY. Thank you.

Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair.

Mr. Chanin, did mortgage lending increase or decrease over the last 3 years?

Mr. CHANIN. So I do not know the answer to that, quite honestly. I do not have data in front of me.

Senator MERKLEY. OK. Thank you. You do not know the answer. But it is relevant because all of this testimony about all this imposition on mortgage lending, in fact, it has increased between 2012 and 2015 by $500 billion. You divide that by $250,000 for a family home, you are talking about 2 million more mortgages, or the equivalent of that, then than now. It just does not fit the argument you are making that mortgage lending is under oppression.

And let me just add that a lot of those loans previously, before Dodd-Frank, that were predatory loans where after 2 years you had a prepayment penalty, you could not get out of the loan and the interest rate doubled after 2 years, they did not help families. They destroyed families. So not only do we have mortgages, but mortgages that are helping families build wealth, which is what we had before those predatory practices that helped tear down, losing trillions of dollars for working families in America.

Mr. Hirschmann, has car lending gone up or down over the last 3 years?

Mr. HIRSCHMANN. Car lending has gone up.

Senator MERKLEY. Thank you. You are right. It has gone up. It has gone up from $60 billion to $84 billion, and 2015 was a record number of sales. I mean, people are buying cars at unprecedented numbers. So, again, that is really a great contrast to the argument that something is seriously wrong in the car lending business or the car sale business. The system is working very well, and people are getting fair loans.

Mr. Zywicki, consumers of payday loans in States that have put an interest rate cap can now borrow at 25 to 36 percent rather than at 500 percent. Do you think from a consumer's point is it better to get a 25- or 36-percent loan or better to get a 500-percent loan?

Mr. ZYWICKI. Well, actually, they do not borrow at 25 or 36 percent because the product—payday loans disappear from the market in places that have——

Senator MERKLEY. OK. Well, thank you, because—thank you for that answer. They disappear, because that was exactly the argument in State after State. In Oregon, we wrestled with this argument because the payday loan industry said: You know what? If you lower the interest rate to 36 percent, we are just going to disappear. So we looked at every State that had such a cap, and you know what? You are wrong. They did not disappear, and we went ahead and put a cap in Oregon, and you know what? They did not

disappear. You can still find payday loan storefronts throughout our metropolitan area, title loan fronts. But the consumer is getting a far better deal.

So let me just point out that if you are going to make the argument, at least know the facts, that they do not disappear when you put a cap on the interest rate.

Mr. ZYWICKI. The research I have seen on that by Jon Zinman, which is the study of the Oregon payday loan, indicates that there was a substantial drop in payday loans and an increase in use of overdraft protection and a slight increase in auto title loans.

Senator MERKLEY. Well, you can come out to the State, and we can—I will take you—we can visit some payday loan places and——

Mr. ZYWICKI. You are saying the volume of payday loan was completely unaffected by the law?

Senator MERKLEY. No, I am not saying that, but that was not the question. The question was: Can the consumer get a payday loan at a much lower interest rate now than before? And the answer is yes. And I can tell you, for example, I went to a food bank, and the head of the food bank said, "Senator, the biggest change is that we no longer have people bankrupted by this vortex of debt from payday loans. They are not coming to our food bank because of the 500-percent interest rates. Thank you so much for putting a cap on the interest rate."

And then she proceeded to say, "Now, the economy as a result of the crash"—of course, that goes back to the predatory mortgage loans. "Unfortunately, a lot of people have lost work, and they are coming to our food bank." But the victims of payday loans disappeared.

Now, let us just look at the model. This is the model that we are putting up the chart of. This is the model payday loan interest—payday loan companies use. Their model is to trap people in debt. This happens to come from a training manual for a payday loan company. It is called "ACE," and they say consumer applies, consumer exhausts—they get the loan, they exhaust the cash, and they do not have the ability to pay, because those are the folks they make money off of. And then the consumer cannot make the payment, the account enters collections, so we come along and we give them a new loan. And that is the cycle of debt, the vortex of debt. If you take $1,000 at 500 percent, you can do the math, I am sure, in your head. That is $25,000. Do you think any low-income family can pay off $25,000 debt when they started out with $1,000 2 years earlier? Of course the answer is no. They end up in bankruptcy. Their finances are destroyed. Their marriages are stressed. Their children are shortchanged.

So my time is up, but I have never heard a hearing where the testimony from industry is so apart from the reality on the ground across America. Getting rid of predatory practices in the credit card industry, in the mortgage industry, in the lending industry in general allows middle-class families and families of modest means to be successful rather than to be victims of tricks and traps. And that is a plus for America.

Chairman SHELBY. Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman. Thank you to the witnesses for investing your time in trying to help us to understand and appreciate the actual impact of Dodd-Frank on our country and specifically on the most vulnerable.

To me, as I listen to both sides have this conversation, I am disappointed in the tone. I am concerned that as viewers watch this at home, the reality of it is that they are missing the point. We are missing the point for the average person in the average place in this country who suffers on a daily basis because of financial stress. The facts are very simple.

Mr. Zywicki, I would love to chat with you about the facts. As a kid growing up, just by circumstance I went to four different elementary schools because poverty has a transient nature. You move a lot. And so when I think about the impact of Dodd-Frank, I think about the impact on Dodd-Frank on the poor very specifically. And to me it is pretty clear, the facts are very clear, that Dodd-Frank makes it worse for people living in poverty and people living on the threshold of poverty.

Question: If, in fact, Dodd-Frank stays as it is, there will be, in my opinion, more payday lending and not fewer loans. Is that accurate from your perspective?

Mr. ZYWICKI. Yes, Senator. First, let me say I went to high school in Greenville, South Carolina, so I feel like you are my honorary Senator in some sense.

Senator SCOTT. Thank you. Move back and vote, please.

[Laughter.]

Senator SCOTT. If you agree with me. If no, just stay where you are.

[Laughter.]

Mr. ZYWICKI. Well, I agree with you, yes, that that is who has borne the biggest impact of this, and basically what happens if we have known this for decades, which is, if you take mainstream products away from people, you drive people down the credit ladder from credit cards to payday loans and overdraft protection to pawnshops and so forth. And so that is what we are seeing, unfortunately.

Senator SCOTT. I only have 5 minutes. I want to try to use my 5 minutes as quickly as possible. But, in other words, there is a correlation. The higher the fee, the lower the access.

Mr. ZYWICKI. Correct.

Senator SCOTT. It is kind of a simple concept.

Mr. ZYWICKI. Yes.

Senator SCOTT. So in the end, then, if we have, according to some studies, 2009 through 2011, a million more unbanked consumers, that translates to more people finding access to credit outside of the banking system——

Mr. ZYWICKI. That is right.

Senator SCOTT.——which means higher interest rates.

Mr. ZYWICKI. Check casher, payday loans, pawnshops, and the like. Exactly right. They are forced to rely on those products instead.

Senator SCOTT. This should be a simple concept for us to understand and digest here.

Mr. ZYWICKI. It seems like it to me.

Senator SCOTT. I must be missing something.

Third point: First-time home buyers fell for the third straight year. Now, according to the statistics, 74.1 percent, I think it is, of white folks own their homes. Around 45 percent of African Americans own their homes. If first-time home buyers have fallen for the third consecutive year, logically the disproportionate impact is on people of color and folks living toward that threshold of poverty. Is that a fair conclusion based on deductive reasoning?

Mr. ZYWICKI. Yes, that would follow.

Senator SCOTT. And the data, frankly?

Mr. ZYWICKI. Yes, as a percentage of home buyers, yes.

Senator SCOTT. Another outstanding and stunning fact that is hard to argue with is that the African American unemployment rate is about 70 or 80 percent higher consistently than the white unemployment rate. The Dodd-Frank legislation makes it far more difficult for first-time business owners to find access to credit.

In South Carolina, small business is the heartbeat of our economy. From my perspective, having been a small business owner for about 15 years, the reality of it is that you hire folks from your neighborhood, from the place where you do business, which means that if you have fewer businesses in minority areas, you are going to have a higher unemployment rate in those areas.

Dodd-Frank has had—have we seen more small businesses or fewer small businesses?

Mr. ZYWICKI. We have seen fewer small businesses. We have seen a loss of small banks. And, of course, as you know, women in particular disproportionately start small businesses as well as minorities, so that is particularly important to those communities and those folks.

Senator SCOTT. And the final thought before I wrap this up on the Durbin amendment, which we have heard so much about, if billions of dollars were transferred from banks to big-box retailers, one of the ways that you can figure out whether or not there has been a passing on to the consumers, look at the prices. This is not a hard thing to discuss. Here is what you will hear as I depart and go to my next meeting. You will hear from both sides a conversation about how we need to do better for the consumer and how we need to protect the consumer, when the reality of it is that the goal of protecting the consumer has been lost in Dodd-Frank, and the CFPB is not making it easier for consumers to have access to credit, not making it easier for people to experience the American dream. They are not making it easier for any of us to see the goal of the most vulnerable in our society being protected.

It may be well intended, maybe the intentions of the legislation, but the facts are inconsistent with the reality, no matter how we spin it up here. Thank you.

Mr. GABLE. Mr. Chairman, may I just respond to that?

Senator Scott, one of the statements you made was that the payday lenders, when they come in and they are driving individuals out of the banking business——

Senator SCOTT. Actually, I did not make that statement. My statement was simply this: that as a result of higher fees, you will have more people unbanked. And if you have a million people

unbanked, the question then is: Where do they go to get their access to credit?

Mr. GABLE. Absolutely.

Senator SCOTT. And they get their access to credit from, as you call it, predatory lenders or payday loans or some other access, whether it is pawnshops or something else that is close in proximity to where they live. And then so the question becomes: What is the interest rate because of the result of Dodd-Frank increasing the cost of doing business and running some folks out of banks, what is the cost to society and what is the cost to the poorest communities? The actual cost is a higher interest rate because of the result of Dodd-Frank.

Mr. GABLE. What I wanted to point out, first of all, payday lenders were around—started out in 1985 before Dodd-Frank. Second, payday lenders require individuals to have bank accounts, so they have bank accounts. And they have first access to those bank accounts. And that is how they keep them in the cycle, and it has been consistent in poor communities in our country that poor individuals, the weakest and the most vulnerable individuals, have to pay more for everything. When they are purchase in their community, their prices are high. When they go to get credit, their prices are high. We use the statement, "They are at risk." In fact, what we do is we develop a consistent area where people are in perpetual poverty.

So my position on this, my view on this is that when we have these predatory lending practices, when we have—everybody in here has arbitration clauses that are bad in their contracts. Unless we have somebody, some watchdog group like the CFPB looking out for the most vulnerable, we are going to always have that small cadre of community in America who will have to pay the most and get the least out of what this country offers.

Senator SCOTT. Well, let me just say this, Reverend. Thank you for your service to the country. Without any question, the National Baptist Association is a fantastic organization. I think your passion for people is right on spot. I would just disagree with our conclusions.

My conclusion is a simple conclusion, that the way that we increase the costs to the most vulnerable in our society is to increase the costs in an area where the fees are lower, that the interest rates are lower. So if you increase the fees and you shrink that market, the unintended consequence is going to be higher unemployment in those very areas that we both want to help, higher costs at the grocery stores or whatever the food mart is in those areas, and a very difficult time to increase the employment opportunities and entrepreneurs in those communities because those communities are the communities where I have lived the vast majority of my life.

So the goal of having a watchdog agency that provides the type of protection that we both hope for is not happening as we are watching it unfold today around this country.

So I do not disagree with the fact that the goal of having an agency that provides greater protection is a wonderful goal. I am simply saying that the CFPB is not that agency, and the results of Dodd-Frank have not been—that goal has not been achieved. It

is not getting closer to being achieved. It is getting further away. The fact of the matter is that as we eliminate small banks in small communities, the reality of it is they do not go to bigger banks; they go to a different market for their access to credit. That is just the unfortunate reality of the facts, no matter our goals. I do not disagree with the goal. I would love to work with you on seeing that goal become a reality. If we study the CFPB, we will conclude that, unfortunately, with all the good intentions, the reality is the poor are still getting poorer and that is why the poverty rate in America is 15 percent and in the African American community it is 28 percent.

So when we look at the facts, we find ourselves with a big question mark on why are these not changing. And I will submit this to you, I will suggest this to you: that as we watch this unfold for the next couple of years, let us just see what happens. And if we are both around in 24 months, I would love to have the conversation about what has happened because of our conversation and Dodd-Frank.

Mr. GABLE. I certainly appreciate that. I just want to make one comment.

Senator SCOTT. Yes, sir.

Mr. GABLE. Maybe it is just in New Orleans, Chairman Shelby.

Chairman SHELBY. Go ahead.

Mr. GABLE. Or in Louisiana, and I have heard my colleague here, Mr. Zywicki, talk about the disappearance of small banks. We have to understand there are some variables in terms of their disappearance. Some disappeared because they were just bad banks. But many community banks purchased those small banks. So I deal with small banks. Most of our churches in the National Baptist Convention deal with community banks. But many of those communities banks are the ones that are providing access for us.

Senator SCOTT. Yes, sir.

Mr. GABLE. But they bought up other small banks. We have a plethora of small banks. They are not mega banks. But they are still community banks. What I am simply saying is that when it comes to payday loans, when we have some banks in some communities move out, then we have payday loan individuals move in. Individuals who are purchasing—who are going in for payday loans, it is not a matter of the fact that they do not have banking or they do not have a job. They have a crisis in their lives, and small-dollar loans are not available from some of our banks the way they should be.

Our National Baptist Convention is in the process of establishing a structure with our 31,000 churches, and we hope to be able to provide small-dollar loans. But if we do not have some enforcement on the process, there is just no reason why someone has to pay who is at the bottom already, has to pay 400 or 500 percent when the interest rate that the Feds have been giving over the last 8 years has been 0.25 percent.

Senator SCOTT. Yes, sir.

Mr. GABLE. It is immoral, it is unbiblical, and it is a shame.

Senator SCOTT. I do not disagree with you at all, sir, and I will say thank you to the Committee for your indulgence here. I am a fan of the Bible and a fan of the Proverbs about usury, usury fees.

So there is no doubt that I do not disagree with you at all. The only question I have is: Can we achieve the goal that you want us to achieve through the CFPB? And my answer is: I do not think we are getting closer. And we can measure this progress or the lack thereof over the next couple of years. We will hear a lot of conversation, and some will—Senator Warren will tear up what I have said to pieces. I would love to have a chance to come back and respond to her as well. But the fact of the matter is that let us just watch and see what happens to the most vulnerable in our society as the good wishes and the good intentions of this Congress does not produce the results that we want.

Mr. GABLE. Since you mandated the CFPB to do these things, let us work together with them so that we both reach that outcome.

Senator SCOTT. I would love to replace them and work with you anyway.

[Laughter.]

Mr. GABLE. Well, that is the difference. Thank you, sir.

Chairman SHELBY. Senator Warren, thank you for your indulgence.

Senator WARREN. That is fine. Thank you, Mr. Chairman.

Senate Republicans called this hearing today to talk about the costs of regulating consumer financial products like mortgages and payday loans and credit cards. I want to focus on the other side of the equation, and that is, the cost to American families of failing to regulate consumer financial products.

Mr. Chanin, as Senator Brown mentioned, from 2005 to 2011, you held top positions in the Federal Reserve's Division of Consumer and Community Affairs, and in those positions you had both the legal authority and the legal responsibility to regulate deceptive mortgages, including dangerous subprime lending that sparked the 2008 financial crisis. But you did not do it despite years of calls and even begging from consumer advocates and others asking you to act. Instead, you did essentially nothing.

Now, your failure had devastating consequences. The bipartisan Financial Crisis Inquiry Commission identified, and I am quoting here, "the Federal Reserve's pivotal failure to stem the flow of toxic mortgages" as the "prime example" of the kind of hands-off regulatory approach that allowed the 2008 crisis to happen.

Now, according to the Dallas Fed, that crisis cost the American economy an estimated $14 trillion. It cost millions of families their homes, their jobs, their savings, devastated communities across America.

So when you talk now about how certain regulations are too costly or too difficult to comply with, you sound a lot like you did before the 2008 crisis when you failed to act. So my question is: Given your track record at the Fed, why should anyone take you seriously now?

Mr. CHANIN. So since you were responsible for creating the CFPB, you know and set forth the notion that they should be a data-driven organization. And we can debate whether they are or not, but I can assure you the Fed was and is a data-driven organization. There was simply no data provided to the Fed on a——

Senator WARREN. I——

Mr. CHANIN. Let me finish, please, Senator.——on a statistical basis that suggested that there was a meltdown in the mortgage market in 2005 and 2006——

Senator WARREN. I am sorry. Are you saying there were no data in the lead-up to the financial crash that showed the increasing default rates on subprime mortgages and what they were doing to communities across America? Did you have your eyes——

Mr. CHANIN. There was——

Senator WARREN.——stitched closed?

Mr. CHANIN. There was anecdotal evidence to be sure——

Senator WARREN. I am not talking——

Mr. CHANIN.——but there was no hard data——

Senator WARREN.——anecdotal—are you telling me you never saw any data about the increases in mortgage foreclosure rates before the crash in 2008? Is that what you are saying here?

Mr. CHANIN. No hard data was——

Senator WARREN. Oh, my——

Mr. CHANIN.——presented to the Fed until the crisis erupted——

Senator WARREN. Mr. Chanin, let us just be——

Mr. CHANIN.——in 2008.

Senator WARREN. Let us just be clear. You want to defend your tenure. It is not just me or consumer advocates who are calling your Fed tenure a disaster. The bipartisan Financial Crisis Inquiry Commission spent years looking into the causes of the crisis and identifying the Fed's failure to regulate subprime mortgages as one of the key drivers of the collapse of 2008. That was you. Even former Chair Greenspan admitted that the Fed made a mistake by failing to regulate subprime mortgages. That was you.

If you are still defending your time at the Fed and saying you had no information about a problem that was emerging, then, frankly, that raises even more questions about your judgment. You know——

Mr. CHANIN. Senator, do you have a question?

Senator WARREN. I do.

Mr. CHANIN. OK. Thank you.

Senator WARREN. And I will get there, but thank you for indulging me on this, Mr. Chanin.

After the crisis, you joined the CFPB to oversee the agency's rulemaking. Within a couple of years, though, you sailed through the revolving door to a big law firm where, according to the Web site for this law firm, your job is "to counsel financial institutions on consumer finance issues."

Now, after taking that job, working for banks you were quoted as saying that you "lost faith that the agency would become a truly independent entity and carefully balance consumer costs and access to credit with consumer protection."

So the question I have is: Does that mean that you want the CFPB to operate more like your Division of Consumer and Community Affairs at the Fed did before the 2008 crash?

Mr. CHANIN. No. In my view, the CFPB does not appropriately balance consumers' need for access to products and the fact that if costs are excessive, the institutions simply will not offer those products.

Senator WARREN. I am sorry, Mr. Chanin. If you would answer the question that I asked. The question is: Do you want it to operate more like your Division of Consumer and Community Affairs did at the Fed before the 2008 crash?

Mr. CHANIN. The CFPB was created as an independent agency. I do not think it fulfills that role if it does not serve the two mandates set forth in the Dodd-Frank Act of access——

Senator WARREN. I am sorry, Mr. Chanin. I asked you a question. You wanted to hear a question. Could I have an answer to the question? Are you asking for the CFPB to operate more like the agency that you directed that the Financial Crisis Inquiry Commission said played the pivotal role in the crash of 2008?

Mr. CHANIN. I do not think that is the goal of the CFPB. The goal is twin: access and fairness. And it has not satisfied that need for access, in my——

Senator WARREN. I will take it, then, that you do not want to answer this question.

You know, Mr. Chanin, when I was setting up the CFPB, I was told that even though you played a key role in blowing up the economy, that I needed to hire you because you were one of the few people within the technical expertise needed to write the Dodd-Frank rules. Now, people said that you and your team made a terrible decision that helped crash the economy, but we needed to keep you all around because you were the only ones who really understood the mistakes that had been made. And when you wanted the job at the CFPB, you claimed that you had learned from your failure. But I see today that is obviously not the case.

Of all the people who might be called on to advise Congress about how to weigh the costs and benefits of consumer regulations, I am surprised that my Republican colleagues would choose a witness who might have one of the worst track records in history on this issue.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Senator Warren.

Senator Cotton.

Senator COTTON. Goodness. Mr. Chanin, if you think it is tough being questioned by Senator Warren, try to be on her first-year contract class panel one day. That is even tougher.

I would like to turn my attention to the Credit Repair Organizations Act of 1996, also known as CROA. This is a law that was designed to root out the fraudulent practice of credit repair clinics promising consumers that they can remove negative but accurate information from consumers' credit histories. The law's strict obligations and penalties enforced through public and private cause of actions have been useful in preventing some forms of fraud peddled by credit clinics. But at the same time, over the past several years, the plaintiffs' bar has pushed courts to expand CROA's reach to cover important services never intended by lawmakers to be subject to CROA's requirements and penalties, including credit monitoring and credit education services.

One way that companies providing these services have been able to limit their exposure to CROA has been through arbitration clauses. Mr. Hirschmann, I would like to ask you: Does the CFPB's

forthcoming arbitration rule expected next year make the need for CROA reform more urgent or less urgent?

Mr. HIRSCHMANN. Senator, I honestly do not know the answer to your question, but I am happy to get back to you on that. We are expecting the CFPB to issue an arbitration rule literally within months, and I am happy to get back to you on that.

Senator COTTON. OK. The FTC, which is charged with enforcing CROA, has been on the record in Senate testimony stating that it is very sympathetic about the need for reform to protect credit monitoring and similar services. Do you see any risks with the intersection of the CFPB's potential arbitration rule and the FTC's position?

Mr. HIRSCHMANN. I am happy to get back to you on the question.

Senator COTTON. OK.

Senator COTTON. Are there any other unique issues with respect to the application of this potential arbitration rule as it applies to credit bureaus that the CFPB should have in mind as it goes forward with its arbitration rule?

Mr. HIRSCHMANN. Well, arbitration is certainly a much more cost-effective and timely way for consumers to get redress, and, particularly when it is very expensive for individual claims that are not classable to get into the courts, it is unlikely that consumers will want to go to the expense to take those claims into the court if they are not classable. Even the class action—you know, even with the low percentage of consumer benefits that come from class action, they are unlikely to take those as well. So we have to look carefully to make sure that—and it is one of the things we have urged the CFPB to do, is to look carefully at what consumers would lose if they take away arbitration.

Senator COTTON. Thank you. And if you can take those earlier questions for the record and respond, I appreciate very much the analysis that you have submitted to this Committee, and CROA reform is something on which I will continue to be engaged, particularly as we look forward to the new arbitration rulemaking, impacting not just Arkansas consumers but also many Arkansas jobs as well. So I would like to receive your insights in the future on the record, if you could get back to us.

Thank you.

Chairman SHELBY. Mr. Chanin, is it not true that the Fed actually did several rulemakings in 2007 and 2008 while you were there on mortgages under its UDAP and other authorities?

Mr. CHANIN. That is correct, Mr. Chairman. The Federal Reserve Board both proposed and adopted a final rule that set forth an ability-to-repay requirement for basically high-cost mortgages that became part of Truth in Lending Regulation Z, and applied to all lenders who offered those mortgages.

Chairman SHELBY. Let me direct this at you, Professor Zywicki. How important is it that the regulators do cost-benefit analysis on any regulations that they propose?

Mr. ZYWICKI. It is really the single most important thing that a regulator can do. The regulation of consumer credit is a very complicated, challenging issue because of the tradeoffs involved, which is we know that, as I described earlier, as you choke off access to

certain products, it drives consumers to other products, and eventually may drive them out of all products.

So, for example, in 1968, for example, there was a U.S. Senate report that found that the second largest revenue source of the Mafia was loan sharking. When "Fat Tony" Salerno was indicted, the head of the Genovese crime family was indicted in 1974 on 14 counts of loan sharking, and, in fact, one count of having a victim's legs broken for not paying their debts, he was running $80 million a day, which is $463 million a day in today's dollars, in his territory in New York City. And what we saw was the regulatory structure at that period in the 1960s and 1970s led to everybody coming together and basically saying, look, we need to make sure that consumers have access to credit products in a competitive market, even if they are expensive. And that is what we have always wrestled with.

And so cost-benefit analysis is the key issue to try to get at these questions of access, competition, price, and doing so in a way that promotes transparency, competition, and consumer choice, because if we do not do that, if the costs do exceed the benefits, it can be really tragic for consumers, I am afraid.

Chairman SHELBY. But it is not just cost to the lender. It is the loss or cost to the consumer that is part of this study. Is that not right?

Mr. ZYWICKI. Yeah, let me make clear, I do not care personally. I do not work for the banking industry, and I personally do not care about the cost to the lender, except to the extent that it affects the cost to the consumer.

Chairman SHELBY. But we do care about the cost of regulation.

Mr. ZYWICKI. Absolutely. We care about the cost——

Chairman SHELBY. Considering all of it together.

Mr. ZYWICKI. Absolutely. I care about the cost to the lender to the extent that it impacts the consumer. And what we are seeing now is we are imposing costs that do not have offsetting benefits, I think, to the consumer, imposing costs, imposing especially high costs on small banks that are hurting consumers, and that is why I think it is so important. Yes, a good, robust, modernized, educated consumer protection policy can help consumers, can help the economy, can help competition, innovation, consumer choice. Innovation is so important. The biggest issue, I think, in this sector we have today is financial inclusion, and I think innovation is the goal to that. And to the extent we pass policies where the costs exceed the benefits, that stifle competition, innovation, and consumer choice, we are moving in the opposite direction.

Chairman SHELBY. Senator Brown.

Senator BROWN. Just a couple of comments, and I want to ask UC to insert a couple of things in the record, Mr. Chairman, but first a few comments.

I am going back to the statement that hundreds of thousands of one-sided, inaccurate, unverifiable complaints have been filed with the Consumer Bureau. I want to put that in perspective, and I will quote from a law review article in the Arizona Law Review from Kimberly Krawiec and then quote from an article in the Washington Monthly by Haley Sweetland Edwards called "He Who Makes the Rules." Again, I want to put in perspective the claims

that these hundreds of thousands of complaints filed by individual Americans—I cannot think that is not who they were—put that into perspective about what happened to them.

First, financial institutions, financial industry trade groups, law firms representing such institutions, and trade groups collectively accounted for 93 percent of all Federal agency contacts on the Volcker rule during the time period studied. In contrast, public interest, labor advocacy research groups, and other persons and organizations accounted for only 7 percent. Again, think of that perspective. You claim hundreds of thousands of unverifiable, one-sided, inaccurate complaints were filed by real live consumer people—individual consumers.

A second point to make: According to public records, representatives from the financial industry have met with a dozen or so agencies that regulate them thousands of times in the past 2 ½ years. According to the Sunlight Foundation, the top 20 banks and banking associates met with just three agencies—the Treasury, the Federal Reserve, and the CFTC—an average of 12.5 times per week for a total of 1,298 meetings over the 2-year period from July 2010 to July 2012. JPMorgan Chase and Goldman Sachs alone met with those agencies 356 times. That is 114 more times—a ratio of 114:1—than the financial reform groups combined.

Third point. Since the passage of Dodd-Frank, the industry has estimated—it has been estimated $1.5 billion in registered lobbyists alone, a number that most dismiss as comically low as it does not take into account the industry's much more influential allies and proxies, including a battalion of groups like the U.S. Chamber of Commerce, the Business Roundtable, the American Bankers Association, also does not take into account the public relations firms and think tanks or the silos of campaign cash the industry has dumped into lawmakers' reelection campaigns.

Now, the reason for the agitation of many of us on this side, I am—it is a personal affront in many ways to talk about the hundreds of thousands of one-sided, inaccurate, unverifiable complaints. It is insulting to those consumers all over the country that have been wronged time and time again. It is another example of how this town sings with an upper-class accent on issue after issue after issue.

I will close with this. In the last quarter of 2010, just a few months after Dodd-Frank passed, the financial industry raked in $58 billion in profits—$58 billion in profits. That was 30 percent of all U.S. corporate profits that year, $58 billion in profits. That was close to a third of all profits that corporations raked in that year. So there's something amiss, and to lay it all on these ill-informed consumers that file these complaints that were not vetted when by a factor of whatever it is, the number of lobbying hits and discussions coming from a very well-organized, well-capitalized, well-funded group of interest groups is, frankly, insulting.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Chanin, I would just like to take a moment to thank you for your dedication to consumer protection over the years and your decades of work in the Federal Government at the Federal Reserve and at the CFPB. I only regret that you are no longer at the consumer agency because I think your guidance

and your experience and wisdom would help guide its efforts toward sensible regulation that is open, transparent, accountable, and in the consumers' and all of our best interests. You know, we all go to the basic premise that I said earlier. We are consumers. We want the market to work.

Mr. CHANIN. Thank you, Mr. Chairman.

Chairman SHELBY. Overregulation does not work. Cost-benefit analysis, I pushed it for years, and I am going to continue to push it. We will get there someday, because that would protect and weigh the benefits and the costs to the consumer, for the consumer, and the people who loan money both. I think we need both.

Thank you very much, all of you. The hearing is adjourned.

[Whereupon, at 11:47 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF LEONARD CHANIN

OF COUNSEL, MORRISON & FOERSTER LLP

APRIL 5, 2016

Chairman Shelby, Ranking Member Brown, and Members of the Committee, my name is Leonard Chanin. I am Of Counsel in the financial services practice group of the firm here in Washington, DC, and have more than 30 years' experience working as an attorney on consumer financial services issues. I spent 20 years with the Federal Reserve Board, including 6 years as Assistant Director and Deputy Director of the Division of Consumer and Community Affairs. In addition, for 18 months I was Assistant Director of Regulations at the Consumer Financial Protection Bureau ("CFPB"). I have spent nearly 10 years in private practice advising banks and other financial institutions on a number of Federal consumer financial services laws. I am pleased to be here today to address the effects of consumer finance regulations.

The primary Federal agency entrusted with regulating consumer financial products and services is the CFPB, a creation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Dodd-Frank Act sets out in broad terms the purpose of the CFPB. The Act states that the CFPB shall:

> seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.

This goal is challenging to achieve. "Fairness" to consumers depends on what one views as being "fair," and it is open to a wide variety of perspectives. The overzealous pursuit of "fairness" adversely affects the ability and willingness of financial institutions to offer products to consumers and, thus, negatively affects the ability of consumers to obtain such products. In addition, access to financial products is affected—both directly and indirectly and both positively and negatively—by rules and other actions taken by Federal agencies that regulate consumer financial services products and services.

While it is difficult to quantify the precise impact that CFPB rules, guidance, enforcement orders and other actions, as well as activities by other Federal banking agencies, have had on consumers and the broader market for financial products and services, it seems clear that such rules and other actions have had a significant adverse impact on the ability and willingness of institutions to offer those products and services. Anecdotal and other evidence clearly indicates that institutions have reduced the products and services offered to consumers and some institutions have been reluctant to offer new products and services. Recent CFPB rules on mortgages illustrate this result. In addition, the use of enforcement orders by the CFPB to establish policy has had adverse results; for example, enforcement orders dealing with the pricing of indirect auto loans and alleged discriminatory practices have created an unlevel playing field in the automobile loan market.

THE IMPACT OF REGULATIONS

Federal consumer financial regulations unquestionably have a significant impact on consumers, financial institutions and the broader economy. The effect rules have and whether they actually harm consumers, hinder competition, or reduce the products available to consumers, likely depends on the specific rule and which consumers are considered.

There can be benefits to regulation. If properly designed, regulations can better ensure that standardized approaches are used to provide disclosures to consumers to enable them to compare products and choose the ones that best suit their needs. Regulations are most effective when they require all institutions that offer consumer financial products to "play by the same rules." This better ensures a competitive marketplace, where all participants are subject to the same legal requirements.

But, there are many risks and dangers to regulating "too much." Regulations need to be clear, but at the same time provide flexibility to accommodate new products, new delivery channels and new ways of doing business. Clear rules are needed to ensure that institutions know what is required to comply and manage risks. However, detailed, proscriptive rules can inhibit the development of new products and new ways of doing business. In addition, rules that lack flexibility can discourage, and, in some cases, stifle the development of new products or services or new features of financial products or services. Furthermore, new rules can be very costly, particularly, for example, for smaller institutions that may make few loans. For those institutions, the overall costs to support a small loan program may be so great that they may simply exit the business.

So, what impact have the CFPB mortgage rules had on the market? Some institutions that previously offered mortgages have stopped doing so because the costs of complying with the new rules cannot be spread over a sufficient number of loans to enable them to effectively compete in the marketplace. In addition, a number of institutions have reduced the products offered to consumers. In fact, a recent American Bankers Association survey revealed that, due to the CFPB mortgage rules, 75 percent of banks surveyed eliminated one or more mortgage product offerings, such as construction loans and loans with payout options.

An examination of the CFPB rules that integrate mortgage disclosures under the Truth in Lending Act (Regulation Z) and the Real Estate Settlement Procedures Act (Regulation X) illustrates the adverse impact that regulations can have on consumers and the broader market.

The CFPB's integrated mortgage disclosure rules and explanatory information are hundreds of pages long. They contain dozens upon dozens of sub-rules and prohibitions dealing with how creditors must disclose information about mortgages to consumers. A small bank or credit union cannot hope to comply with the extraordinary level of detail required. And even the largest institutions face great difficulties in ensuring compliance and likely face litigation risks if they make a mistake.

One example illustrates the extraordinary level of detail required under the integrated mortgage disclosure rules. There are several different rounding rules for the disclosure of dollar amounts and percentages (rates). One sub-rule states that the principal and interest payments must be disclosed using decimal places, even if the amount of cents is zero. (Thus, a disclosure of a payment of "$800" violates the rule, whereas a disclosure of "$800.00" complies.) This sub-rule is in contrast to the sub-rule for disclosing the loan amount, which actually prohibits the use of decimal places in disclosures. (Thus, a disclosure of a loan amount of "$240,000.00" violates the rule, whereas a disclosure of "$240,000" complies.)

The adoption of such a proscriptive rule can only lead to errors and ultimately can result in litigation, even if a consumer did not rely on the information and was not harmed by the error. In addition to litigation risks, failure to comply with the integrated mortgage disclosure rules could lead investors who purchase loans to require lenders to buy back any loans where lenders make errors in providing disclosures.

USE OF GUIDANCE AND ENFORCEMENT ORDERS TO ESTABLISH POLICY

In spite of the "dangers" and problems associated with regulations, they are vastly preferable to "regulating" by the issuance of guidance, or, even worse, use of enforcement orders to establish policy.

Guidance

Guidance can be helpful to institutions in understanding laws that apply to specific transactions or products. But any such guidance should be published for public comment. Failure to do so can lead to confusion as to the scope and meaning of the guidance and create operational and other compliance problems. In addition, agencies benefit by allowing the public to comment, as it results in clearer and better guidance. The CFPB has issued dozens of guidance documents, in the form of official CFPB bulletins, as well as by using blog posts and other ways of communicating its views on issues. These documents are not published for public comment. Failure to get public input creates significant problems.

By way of an example, one of the most problematic documents deals with indirect auto lending and the application of the Equal Credit Opportunity Act ("ECOA") and implementing Regulation B to institutions that purchase loans made by automobile dealers. The CFPB issued a bulletin interpreting Regulation B on this issue, rather than publishing a proposed revision to the Regulation for public comment. The bulletin addresses the obligation of indirect auto lenders (those who purchase loans made by auto dealers) to address potential discrimination in the pricing of loans by auto dealers.

The failure of the CFPB to issue guidance for comment on issues such as this creates significant problems. Because the public was not afforded the opportunity to comment on the indirect auto lending bulletin, the guidance fails to address important issues. The bulletin does not state that use of discretionary pricing to compensate auto dealers is illegal, but states that lenders should monitor and address the effects of such policies to ensure that discrimination does not occur. However, aside from "conducting regular analyses" of dealer-specific and portfolio-wide loan pricing data, the guidance fails to inform lenders about what analysis would be satisfactory to avoid fair lending violations. For example, should analysis be done on a monthly, quarterly, or annual basis? What if a quarterly analysis shows potential

issues, but a semi-annual analysis shows no statistically significant disparities? What action should a lender take to address any risks in these circumstances? Neither lenders nor consumers are helped when guidance issued is not clear. Such guidance frequently leads to inconsistencies in the marketplace, due to differing interpretations of such guidance.

Enforcement Orders

"Regulating" institutions that offer consumer financial products and services by use of enforcement orders is a new trend. Although the prudential banking agencies and other agencies have long entered into public enforcement orders with institutions, this practice has increased exponentially by the CFPB. Moreover, it seems quite clear that the CFPB uses enforcement orders to establish policy.

Public enforcement orders are not inherently inappropriate or a "bad" tool for agencies to use. But, when enforcement orders are used to establish policy, there can be many problems and drawbacks. First, enforcement orders do not apply to any company or person that is not a party to the order; thus, other companies can take a variety of approaches regarding their views of such orders. Oftentimes, some companies may "comply" in a certain way and others may take a different approach. This results in inconsistency—inconsistency for consumers and for institutions' practices—which results in a marketplace that offers products and services not governed by the same standards. Second, most CFPB enforcement orders lack specificity about the practices involved and only give a brief statement of facts and issues. It is often difficult to discern how to "apply" any guidance in orders to the variety of products or practices that exist in the marketplace. This also creates inconsistency. Third, the failure to create rules that apply to all players in the marketplace can have the unintended effect of driving some parties to entities that "don't comply." Anecdotal information suggests that this is precisely what is happening with so-called discretionary dealer pricing and auto loans, where the marketplace is highly diffuse and where some auto dealers may do business with those lenders who offer dealers greater compensation for loans the dealers originate. Fourth, unlike rules, enforcement orders are not published for comment. This deprives the public of the opportunity to comment on significant issues and also deprives an agency of the ability to consider operational and other issues as well as potential negative or unforeseen consequences. Fifth, enforcement orders that contain broad statements and allege unfair, deceptive or abusive acts or practices may result in financial institutions simply choosing not to offer new products, certain product options or new ways of delivering products due to lack of certainty about what is "required," as well as uncertainty about how to effectively manage potential risks.

For these reasons, use of enforcement orders to establish policy is both inappropriate and unsuccessful. The pricing of auto loans and use of fair lending enforcement orders illustrates this problem. The CFPB has entered into several enforcement orders with financial institutions asserting that institutions that purchased consumer car loans made by multiple auto dealers have violated the ECOA. While recognizing that it is appropriate for dealers to be compensated for work done on transactions, the CFPB orders conclude that financial institutions that purchase auto loans violate the ECOA because the CFPB determined that the pricing approach used had a discriminatory impact on consumers on the basis of race or ethnicity.

Leaving aside the significant issue of the validity of the CFPB's methodology and analysis in the orders, the use of enforcement orders in this circumstance has resulted in an unlevel playing field and has raised numerous questions for which the orders provide no answers. For example, the most recent orders state that an institution must select one of three options. One option is for the institution to limit dealer discretion to no more than 1.25 percentage points above the buy rate for loans with a term of 60 months or less, and 1 percentage point for loans with a term longer than 60 months. For this option, the institution must "monitor for compliance" with the limits.

But, what if institutions not subject to the orders want to retain a dealer discretion model of compensation to effectively compete in the marketplace? The orders only recognize two options. There are hundreds and perhaps thousands of banks, credit unions and finance companies that purchase auto loans. Anecdotal evidence indicates that institutions have taken a variety of approaches in how they deal with pricing and the purchase of loans made by auto dealers, due to competition in local markets and a variety of other factors. By using enforcement orders to create a policy addressing how lenders can compensate dealers for dealers' work in originating auto loans, the CFPB has failed to recognize that there may be many other legitimate methods institutions can use to compensate dealers and still comply with the ECOA. By using enforcement orders to create new legal requirements, and doing so

without publishing proposed changes to Regulation B to address these issues, the CFPB has failed to provide critical guidance to lenders on what the law requires or permits.

In this case, if the CFPB believes the way in which institutions interact with auto dealers regarding the pricing of car loans is contrary to the ECOA, the far better approach for consumers and financial institutions would be for the CFPB to formally propose changes to Regulation B. This would ensure that any policy applies consistently to all financial institutions. In addition, engaging in a rulemaking proceeding would allow the public to comment on the approach, ensuring that the CFPB has an opportunity to address any concerns or issues raised. Rulemaking, of course, takes more time than issuing "guidance" or entering into enforcement orders. But such an approach better ensures the creation of sound policy. Establishing a policy by regulation also enables a company or person who disagrees with a rule to challenge that policy and have a court independently review the agency action.

CONCLUSION

The CFPB is a new agency—less than 5 years old. It continues to develop expertise and a broader understanding of consumer financial services markets. The question remains as to how the CFPB will balance its mandated purposes of ensuring consumer access to financial products and services while ensuring fairness in these markets.

Thank you for the opportunity to be here today. I would be happy to respond to any questions.

Statement of the U.S. Chamber of Commerce

ON: Assessing the Effects of Consumer Finance Regulations

TO: Senate Committee on Banking, Housing, and Urban Affairs

BY: David Hirschmann, President and CEO of the Center for Capital Markets Competitiveness

DATE: April 5, 2016

1615 H Street NW | Washington, DC | 20062
The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Testimony of David Hirschmann
President and CEO, Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce

Before the Senate Committee on Banking, Housing, and Urban Affairs

April 5, 2016

CHAIRMAN SHELBY, RANKING MEMBER BROWN, AND MEMBERS OF THE BANKING COMMITTEE:

The U.S. Chamber of Commerce (the "Chamber"), the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors and regions, as well as state and local chambers and industry associations, is dedicated to promoting, protecting and defending America's free enterprise system. The Chamber appreciates the opportunity to submit this testimony to the Committee as you examine the impact of recent consumer financial regulation.

The Chamber strongly supports sound consumer protection regulation that deters and punishes financial fraud and predation and ensures that consumers receive clear, concise, and accurate disclosures about financial products. Everyone—businesses as well as consumers—benefits from a marketplace free of fraud and other deceptive and exploitative practices. We have welcomed efforts by the Bureau that advance this important goal.

The Chamber also firmly believes, however, that consumers benefit from access to a broad range of competitive financial products and services. Choice empowers consumers, allowing them to find the product that will best allow them to go to college, participate in the digital economy, build equity in their homes, or deal with financial adversity. A regulator's responsibility is to ensure that competitive and transparent markets flourish within the bounds of clear and consistently enforced rules of the road. That allows consumers to make their own decisions, based on accurate, understandable information and free from government dictates.

Notably, Congress shared this belief when it established the Consumer Financial Protection Bureau (the "CFPB" or "Bureau") in passing the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). It specifically tasked the Bureau with implementing and enforcing "Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for

consumer financial products and services and, that markets for consumer financial products and services are fair, transparent, and competitive."[1]

As we approach the five-year anniversary of the CFPB's regulatory record, the Chamber sees a distinctly mixed record on achieving this goal. In some areas, the Chamber has welcomed the opportunity to work together with the Bureau. Still, the Bureau can and must take a number of basic—but overdue—steps to fulfill its statutory mandates to implement and enforce Federal consumer financial laws "consistently," to ensure that consumers have access to a range of financial services from which they can choose the alternative they deem best, and to ensure that the markets for financial products and services remain "fair, transparent, and competitive."

Specifically, to ensure that consumer financial regulation achieves these ends, the Bureau should:

- Provide clear rules of the road for financial services companies so they can compete on a level playing field;
- Use enforcement actions to deter fraud and predation, not to announce new, broadly applicable regulatory policies;
- Strengthen the Bureau's own accountability by enhancing transparency and committing itself to fair administrative processes;
- Limit regulatory duplication and conflict by coordinating with other agencies; and
- Preserve companies' use of diverse tools, like arbitration agreements, to manage their relationships with the customers they serve.

While it is true that the CFPB's unique structure relieves it of the many checks and balances that apply to other federal regulators, that lack of democratic accountability heightens, rather than negates, the Bureau's obligation to develop a sound and broadly accepted regulatory system that will stand the test of time.

As it has throughout the past five years, the Chamber stands ready to work with the Bureau to identify concrete and practical steps toward achieving these goals. To that end, my testimony today provides recommendations for each of the five fundamental steps that the CFPB can and should take to improve its regulatory approach and better protect the long-term interests of American consumers.

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. 111-203, § 1021(a) (July 21, 2010) (codified at 12 U.S.C. § 5511(a)).

1. The CFPB Should Provide Clear Rules Of The Road For Financial Services Companies So That They Can Compete on a Level Playing Field.

In the Chamber's view, one of the fundamental principles of good government is that the rules and regulations that the government establishes should at a minimum be clearly knowable by those who have to live by those standards. That is especially important when the regulated entity is a business—especially a financial services business. Businesses want to compete on a level playing field under well-defined rules, but they cannot do so when they cannot figure out what the rules are. For that reason, the Chamber has repeatedly called upon the Bureau to provide clear rules of the road for financial services companies. Too often, the Bureau has rejected this approach, preferring instead to regulate through means that leave businesses guessing about whether they are complying with applicable law.

While the Chamber of course understands that no regulatory agency wants to bind itself to overly prescriptive rules that eliminate the flexibility needed to respond to changing circumstances, there are numerous steps that the Bureau can take to improve regulatory clarity without running any such risk. Here, I suggest two: adopting robust no-action and advisory opinion letter processes; and engaging stakeholders prior to announcing or enforcing any *de facto* regulatory requirements, "best practices," or policy expectations intended to apply broadly to one or more markets.

a) The Bureau Should Adopt A Robust No-Action Letter And Advisory Opinion Process.

The Chamber believes that one of the foundational principles of transparent and open government is the ability of a business or consumer to ask the government a question, inclusive of all relevant facts and circumstances, and get an answer as to whether the government will prohibit or permit a specific practice or activity. After all, the answer "no" is a much better answer, from a business perspective, than "I'm not going to tell you." That is why the Consumer Product Safety Commission ("CPSC"), the Justice Department, the Federal Trade Commission ("FTC"), the Securities and Exchange Commission[2] ("SEC"), and other federal regulatory agencies routinely issue written opinions that clarify governing legal requirements. These opinions typically take one of two forms: a "no-action" letter stating that staff would not recommend that an enforcement action be pursued under stipulated facts, and an advisory opinion that interprets a governing legal standard for an entire market, thus leveling the playing field for everyone in it. Unfortunately, the CFPB has no advisory

[2] The Chamber issued a report in 2009, Examining the Efficiency and Effectiveness of the U.S. Securities and Exchange Commission, that made specific recommendation on improving that agencies mo-action letter and approval processes.

opinion process; its no action letter policy is, by design, helpful in only the rarest of circumstances. The policy recently finalized by the Bureau permits the agency's staff to issue a no-action letter only if an applicant satisfies a series of burdensome and intrusive requirements.[3] No other federal agency imposes anything close to the Bureau's extremely restrictive criteria.

For example, to have a reasonable hope of demonstrating the "exceptional circumstances" that the Bureau requires for issuance of a no-action letter, a company must (among other things):

- Establish that the product is innovative and beneficial for consumers;
- Identify the substantial regulatory uncertainty that the company faces and the risks posed to consumers;
- Explain why the company cannot avoid regulatory uncertainty by modifying its product;
- Not ask about the meaning of the prohibition of unfair, deceptive, or abusive acts and practices; and
- Agree to provide data about the product on an ongoing basis.

These substantial burdens and intrusive document production requirements ensure that companies are very unlikely to even request such a letter. Indeed, the Bureau itself estimates that it will receive no more than three actionable requests for no-action letters each year.[4]

The Bureau claims that its approach to issuing no action letters is designed to promote innovation. The Chamber questions, though, whether a company is likely to invest in innovation given existing regulatory risk in the market and such high barriers to obtain clarity. When the first step toward innovation is to hire a compliance department, it is more likely that a company will decide against creating innovative products—an unfortunate result that ultimately restricts consumer choice and opportunity. At a minimum, the Bureau appears not to have considered the costs and benefits of creating such a narrow no action letter process instead of one that offered clear rules of the road to a greater number of market participants, including those who provide already established financial products or services. The Bureau also appears not to have considered whether its policy will have the effect of disproportionately benefitting large companies that already have large regulatory budgets, which may find it easier to pass muster to obtain a no action letter than a smaller company that would have to hire new staff to prepare the required paperwork.

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[3] *See* Policy on No-Action Letters; Information Collection, 81 Fed. Reg. 8686 (Feb. 22, 2016).
[4] *Id.* at 8691.

The Bureau's other processes for answering questions from regulated entities do not compensate for the absence of meaningful no-action and advisory opinion processes. Those processes are robust; when published, they provide well-considered, prospective guidance to an entire market. In contrast, providing one-off advice to those who call the Bureau with questions or to entities during the supervision process do nothing to standardize industry behavior. Instead, the effect of those private conversations is the creation of regulatory arbitrage—some companies know the Bureau's expectations because they called on the phone and got some advice, while others do not. At a minimum, even if the Bureau did not want to broaden its no action letter policy or create an advisory opinion program (the Bureau has sometimes claimed it lacks the resources to do so), the Bureau could at a minimum simply write down and publish on its website the advice it provides in these closed-door settings.

The Bureau thus should meet the standard set by other agencies and provide meaningful regulatory clarity through no-action letters and advisory opinions. By doing so, it would allow responsible companies to understand and follow the rules of the road, and to compete on the same basis for consumers' business. Innovation and competition would flourish, and consumers would benefit from lower prices and broader product options. The Bureau's drastically-circumscribed policy offers none of these benefits and should be replaced by a policy that supports the meaningful use of no-action letters and advisory opinions to increase regulatory clarity in the consumer financial services market.

b) The Bureau Should Engage With Stakeholders Prior To Announcing Or Enforcing Any De Facto Regulatory Requirements, "Best Practices," Or Policy Expectations.

The Bureau has employed an array of informal missives and publications to convey its expectations for behavior in certain areas of consumer finance policy—all without soliciting notice and comment from stakeholders or engaging in the rulemaking process specified in law for imposing regulatory obligations. The Bureau may believe that its communications help businesses by providing the Bureau's views regarding a particular market, product, or practice; but in fact these informal issuances, which come as a surprise to the consumer financial services industry, create tremendous uncertainty and unfairness.

Letters from the Bureau to business executives "urging" them to take action not required by law and the Bureau's publication of "best practices," for example, raise questions about what will happen if they do not take the action requested or adhere to these "best" practices. Will the Bureau deem their inaction an "unfair, deceptive, or abusive act or practice" actionable under the CFPA? Similarly, financial

institutions wonder what consequences they will face—including behind closed doors in the supervisory process—if they elect not to offer a product that their regulator has "urged" them to create. One wonders why, if these expectations do have practical force, the public been denied the notice and opportunity to comment contemplated by the Administrative Procedure Act. And because the Bureau has not been informed by public comment its issuances often fail to take account of practical realities, causing significant marketplace confusion for businesses and consumers alike. In short, the Bureau's activities in these regulatory gray areas are creating confusion and unlevel playing fields in the market, not bringing the clarity that the Bureau perhaps believes it is providing.

On February 3, 2016, for example, Director Cordray sent a letter to the CEOs of the nation's largest financial institutions concerning accounts that feature overdraft protection. He wrote, "This letter is not being sent in reference to any sort of regulatory requirement, but instead is simply a *suggestion* that I *urge* you to consider in serving your customers."[5] Even though framed as a mere "suggestion," a regulated entity cannot be certain of the consequences of failing to comply with a public statement of its regulator's preferences for whether and how it should offer overdraft products. Will it be asked to justify that decision as part of the supervision process? Will such a "failure" impact the conclusions in its examination? We also wonder what the basis is for the Director's "suggestions." Other than the Bureau's years-long interest in regulating the market for overdraft products, which to date remains unresolved, the Chamber is not aware of any public discussion of this idea; certainly there was no transparent notice and comment period. What if the adoption of the "suggestions" has adverse consequences for the availability of consumer credit?

The Bureau's March 23, 2016, *Advisory for Financial Institutions on Preventing and Responding to Elder Financial Exploitation* similarly "makes [] recommendations to banks and credit unions" to undertake a variety of efforts, such as the development of protocols for protecting account holders from elder financial exploitation and the training of staff and the use of technology to detect such exploitation.[6] The Bureau's press release accompanying the Advisory called these recommendations "an extensive set of voluntary best practices to help banks and credit unions fight" elder exploitation.[7] Here again, the Bureau uses hortatory language—these

[5] *See* Form Letter from Dir. Richard Cordray to CEOs of Financial Institutions (Feb. 3, 2016)(emphasis added), http://files.consumerfinance.gov/f/201602_cfpb_letter-to-banks-on-lower-risk-accounts.pdf.
[6] CFPB, Advisory for Financial Institutions on Preventing and Responding to Elder Financial Exploitation (Mar. 23, 2016), http://files.consumerfinance.gov/f/201603_cfpb_advisory-for-financial-institutions-on-preventing-and-responding-to-elder-financial-exploitation.pdf.
[7] Press Release, CFPB, CFPB Issues Advisory and Report for Financial Institutions on Preventing Elder Financial Abuse (Mar. 23, 2016), http://www.consumerfinance.gov/newsroom/cfpb-issues-advisory-and-report-for-financial-institutions-on-preventing-elder-financial-abuse.

recommendations are "voluntary," not required—without any appreciation of how its recommendations will be received in the consumer financial marketplace. Financial institutions may well wonder whether, if they do not adhere to these "voluntary" best practices, a cause of action will lie against them—including under the vague "abusiveness" standard under the CFPA.

Here again, there was never any opportunity for transparent, meaningful public engagement in the development of these recommendations. The report that accompanied the Advisory described the Bureau's methodology in some detail, including, "in-depth, unstructured interviews with a broad spectrum of stakeholders."[8] Conspicuously missing from this methodology is input (or at least public notice of input) from those whom the Bureau did not select to interview, including academics, business associations, and consumer groups. If they were consulted, the transcript of those consultations remains hidden from the public view, as does any evidence of a cost-benefit analysis for the Bureau's suggestions.

The Chamber believes that the critical importance of open, public dialogue on key issues in the consumer financial services market is self-evident. Given the Bureau's stated commitment to transparency and public engagement, the Bureau should not continue to fail to engage with the public before issuing de facto regulatory standards. Going forward, it should undertake notice and comment before trying to move the market through informal guidance, "best practices," or other such means.

2. The CFPB Should Use Enforcement Actions To Deter Fraud and Predation, Not To Announce New, Broadly-Applicable Regulatory Policies.

As with any regulation through enforcement situation, the Chamber has had a longstanding concern with the Bureau's continued preference for regulating the consumer financial marketplace through enforcement actions and consent orders rather than through processes that give stakeholders notice and the opportunity to comment. Without increased transparency in the regulatory process, the market for consumer financial products will continue to be burdened by unnecessary confusion, regulatory duplication, and uncertainty, which, in turn, yields increased costs and decreased opportunities for customers. Recent developments, explained below, have heightened our concern, clarifying once again that regulation by enforcement imposes rules that are not only unclear, but that, to the extent that they are discernible, have weak factual and legal justifications. Nevertheless, we continue to stand ready to work with the Bureau to ensure that the Bureau's regulation of the consumer financial

[8] CFPB, Recommendations and Report for Financial Institutions on Preventing and Responding to Elder Financial Exploitation 7 (Mar. 2016), http://files.consumerfinance.gov/f/201603_cfpb_recommendations-and-report-for-financial-institutions-on-preventing-and-responding-to-elder-financial-exploitation.pdf.

market does not have the effect of denying consumers access to financial products that help them manage their personal finances.

a) The Bureau Should Ameliorate the Regulatory Uncertainty Caused By Its Enforcement Actions on Indirect Auto-Lending, Abusive Acts or Practices, and Service Provider Liability.

The Committee is very familiar with the confusion in the marketplace caused by the Bureau's enforcement actions on indirect auto lending, abusive acts or practices, and service provider liability. A retelling of the full history of that uncertainty is therefore not necessary here,[9] but a few highlights make clear that the Bureau has not changed its approach in any of these areas, ensuring that substantial regulatory uncertainty—and all of its attendant harmful consequences for businesses and consumers—continues to prevail.

Indirect Auto: The Chamber has joined numerous other industry stakeholders in expressing serious concerns about the Bureau's vigorous "indirect auto campaign" and our doubts about the legal validity of its claims (doubts which employees of the Bureau appear to share, based on a review of documents appended to a recent staff report of the House Financial Services Committee). The February 2, 2016 settlement among the Bureau, the Justice Department, and Toyota Motor Credit Corporation[10] begged the question, yet again, why the Bureau does not simply embark on a more formal process to try to satisfy its obvious desire to regulate the market. Its efforts to regulate the auto dealer market through enforcement actions against non-dealers have failed to date, and there is no reason to think that continuing on the same path will bring the Bureau a different result in the future. The answer is perhaps that the Bureau recognizes it does not have the authority to regulate the dealer market (section 1029 of Dodd-Frank prohibits it) and so is using its regulatory muscle to accomplish an end-run around express statutory language and congressional intent.

Abusiveness: The Chamber has repeatedly called upon the Bureau to issue formal guidance on the meaning of "abusive" acts or practices, as used in the Consumer Financial Protection Act, which would be consistent with the prior Federal Trade Commission policy statements addressing the meaning of "unfair" and "deceptive" practices.[11] The Bureau has continued to refuse to do so, however, preferring instead

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[9] We detailed our concerns on these issues in a letter to the Bureau over two years ago. *See* Letter from David Hirschmann, Pres., CCMC, to Richard Cordray, Dir., CFPB (Feb. 12, 2014),http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/02/2014-2.12-CFPB-Letter.pdf.

[10] *See In the Matter of Toyota Motor Credit Corp.*, File No. 2016-CFPB-0002 (Feb. 2, 2016),http://files.consumerfinance.gov/f/201602_cfpb_consent-order-toyota-motor-credit-corporation.pdf.

[11] *See* FTC Policy Statement on Deception (Oct. 14, 1983), *appended to* Cliffdale Associates, Inc., 103 F.T.C. 110, 174 (1984), http://www.ftc.gov/bcp/policystmt/ad-decept.htm; FTC Policy Statement on Unfairness (Dec. 17, 1980),

to recite the vague statutory standard when questioned on this subject and requiring financial services companies to try to decipher the term's meaning from a limited number of consent orders.[12] Given this approach, businesses are unsure whether to implement a compliance system based on the broadest possible interpretation of the term—even if that will have adverse consequences for credit availability—or implement a system based on a narrower view (such as requiring intentional wrongdoing) and risk the possibility that the Bureau will subsequently interpret the provision more broadly. The Bureau could very easily answer these broad questions—and assess whether its current approach will in fact have adverse consequences for consumers—by seeking notice and comment on the question and issuing at least some guidance, even if it does not now wish to adopt a definitive construction of the term "abusive." Instead, by leaving these critical questions unanswered, and by failing to inform itself of the consequences of the extremely broad approach it seems to be taking in uncontested consent orders, the Bureau risks causing real consumer harm through increased costs for consumers, reduced product offerings, and restricted credit availability.

Service Provider Liability: The Bureau also continues to maintain unnecessary ambiguity regarding the scope of a financial service company's liability for the actions of a service provider. The Bureau has authority to issue rules covering service providers, to supervise those providers, and to bring enforcement actions against them.[13] In contrast, the Dodd-Frank Act does not specify a basis for holding a company liable for the unlawful acts of its service provider. The absence of statutory guidance on this significant question argues strongly for the Bureau to at least issue clear guidance informed by public comment on the subject before imposing liability on a business for the unlawful acts of its service providers.[14]

Instead, the Bureau has preferred to pursue enforcement actions that create even more uncertainty for financial services companies. For example, a recent consent order imposed liability on a bank based on the fraudulent actions of third-

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appended to International Harvester Co., 104 F.T.C. 949, 1070 (1984), http://www.ftc.gov/bcp/policystmt/ad-unfair.htm.

[12] *See* 12 U.S.C. § 5531(d); *CFPB Supervision and Examination Manual*, Part II.C (Oct. 2012), http://files.consumerfinance.gov/f/201210_cfpb_supervision-and-examination-manual-v2.pdf; CFPB Bulletin 2013-07, Prohibition of Unfair, Deceptive, or Abusive Acts or Practices in the Collection of Consumer Debts (July 10, 2013), http://files.consumerfinance.gov/f/201307-_cfpb_bulletin_unfair-deceptive -abusive-practices.pdf.

[13] *See* 12 U.S.C. §§ 5514(e), 5515(d) (providing supervisory authority over service providers); *id.* § 5531(a) (providing enforcement authority over service providers); *id.* § 5531(b) (providing authority to prescribe rules applicable to service providers regarding unfair, deceptive, or abusive acts or practices).

[14] The Bureau clearly has the authority to consider a matter so "necessary or appropriate" to the administration of the Federal consumer financial laws. *See* 12 U.S.C. § 5512(b)(1).

party lawyers.[15] Without explaining why, the consent order treated these fraudulent actions of a service provider as the covered person's own actions. In this manner, the consent order seems to suggest that the Bureau believes that a company can be liable even if its service provider engaged in criminal conduct that violated the company's express instructions. If the Bureau were to subject this belief to public comment rather than using it, untested, to sustain a consent order, we would strongly caution the Bureau against holding such a sweeping theory of liability for actions that a company expressly prohibited.

b) The Bureau Should Abandon Efforts To Expand Regulation By Enforcement Into New Areas Of The Consumer Financial Services Market.

Our concerns about regulation by enforcement have been elevated by Director Cordray's March 9, 2016, speech to the Consumer Bankers Association, which seemingly redoubled the Bureau's commitment to that approach for the foreseeable future.[16] Indeed, the number of areas in which the Bureau is taking a regulation-by-enforcement approach appears only to be growing. As the example of debt sales enforcement actions demonstrates, this growth of regulation by enforcement has not even been slowed by the Bureau's ongoing rulemaking processes.

Bureau consent orders regarding debt sales appear to announce standards concerning the sale of charged-off debts to third-party debt buyers—a topic that apparently may be addressed in the delayed debt collection rulemaking discussed above. As stated (or at least implied) in the consent orders,[17] these requirements include:

- The provision of records concerning disputes between the creditor and the customer in the past year, even for those disputes that have been mutually resolved;
- A prohibition on selling debt within 150 days of the expiration of a statute of limitations; and

[15] *In the Matter of Citibank N.A.*, 2016-CFPB-0004 (Feb. 23, 2016),http://files.consumerfinance.gov/f/201602_cfpb_consent-order-citibank-na-department-stores-national-bank-and-citifinancial-servicing-llc.pdf.

[16] Dir. Richard Cordray, Prepared Remarks at the Consumer Bankers Association (Mar. 9, 2016),http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-consumer-bankers-association/.

[17] *See In the Matter of Chase Bank USA, N.A.*, 2015-CFPB-0013 (July 8, 2015),http://files.consumerfinance.gov/f/201507_cfpb_consent-order-chase-bank-usa-na-and-chase-bankcard-services-inc.pdf; *In the Matter of Citibank, N.A.*, 2016-CFPB-0003 (Feb. 23, 2016), http://files.consumerfinance.gov/f/201602_cfpb_consent-order-citibank-na.pdf.

- A requirement that a creditor include a term in a debt sale contract to prohibit the debt buyer from reselling the debt to a purchaser other than the creditor.

The specificity of these consent order terms and their repetition in multiple actions strongly suggest that they will be imposed routinely after alleged legal violations. But it is unclear whether these requirements are a form of penalty for allegedly illegal conduct or whether all market participants should (or must) meet them in order to comply with existing laws. After all, consent orders represent only the *Bureau's* views; they have no judicial imprimatur.

Take, for example, the blanket prohibition on reselling debt. This would be a radical change to the debt market if proposed as a rule. It is unclear whether the Bureau expects covered persons to make such a change based only on the relief imposed in a few consent orders. Nor is it clear that the Bureau has any record that supports the need for such a requirement, as opposed to less burdensome requirements (*e.g.*, the required inclusion of certain documentation with any resale of debt). These consent order terms leave these and many other questions unanswered, such as what liability (if any) a creditor has if the debt buyer violates the contractual prohibition on the resale of purchased debt, and on what basis such liability would rest—questions that could have been addressed if the Bureau had engaged in a rulemaking process that incorporated dialogue with the financial services community.

The Bureau's consent orders regarding debt sales and other topics, as well as Director Cordray's March 9, 2015 remarks, demonstrate the Bureau's continued commitment to regulation by enforcement. This is a mistake. The Bureau should write rules if it wishes to make rules. Regulation by enforcement is a shortcut that undermines public engagement—and public confidence—in the regulatory process, and consequently will undermine rather than support the long-term success of the Bureau.

3. The CFPB Should Strengthen Accountability By Enhancing Transparency And Committing To Fair Administrative Processes.

The CFPB's history to date has confirmed the Chamber's fears that the Bureau's unprecedented structure, with its lack of routine checks and balances, would produce agency action inconsistent with federal agency norms. The Chamber consequently has supported legislation that would incorporate the controls and oversight that apply to other federal regulatory agencies, which would in turn ensure far greater stability over the long-term for those who provide and rely on consumer credit. These include proposals that would:

- Increase the agency's transparency;
- Increase the CFPB's accountability to Congress;
- Strengthen checks and balances on the exercise of the CFPB's authority and, thereby, to the American people;
- Limit the CFPB's discretion to impose new requirements and burdens on financial institutions without first soliciting public input; and
- Clarify legal requirements imposed by the Dodd-Frank Act.

The Chamber believes that undertaking such structural reform is the most important step that Congress can take to put the Bureau on a sound long-term footing. Until such changes are made, we believe that Director Cordray and his leadership team have a special responsibility, if they expect to build a lasting foundation for the Bureau, to embrace transparency and accountability, rather than working to blurry the limits on its legal authority. It is regrettable that, to date, many of the Bureau's most significant mistakes have shared common threads of failure to engage with the public in a transparent process, adopting tactics that insulate the Bureau's decisions from judicial review (all while announcing broadly applicable principles), and refusing to engage with external experts even when they present the very data that a purportedly research-oriented agency should welcome.

Following are three examples of the Bureau's failure to meet the requirements of administrative law, failure to engage with the public in a meaningful dialogue, and to otherwise undermine the credibility of its regulatory processes. The Chamber stands ready to work with the Bureau in each area to help it bring its approach into line with the regulatory best practices developed at peer agencies.

a) The Bureau Should Take Seriously The Public Interest In Transparency And Proper Oversight Of Bureau Information Collection Activities.

Congress long ago recognized the public interest in preventing federal government agencies from undertaking unduly burdensome or intrusive collections of information from members of the public. It consequently enacted the Paperwork Reduction Act (PRA) to impose procedural safeguards—including public notice and comment—to help guard against unduly broad and burdensome data collections and to ensure that regulators use high-quality information in their decision-making.

The CFPB, however, has repeatedly made clear that it does not take seriously its obligations under the PRA, but regards that statute as an impediment to be circumvented or minimized at every opportunity. I would particularly highlight three ways that the Bureau has defeated the public policy objectives manifested in that statute:

- First, the Bureau has gathered enormous amounts of information about consumers' use of financial products and services through the supervisory process, prompting numerous questions about the need for these collections as well as whether their benefits outweigh both the costs to businesses and the risks they pose to consumer privacy.

- Second, as detailed in a September 22, 2014 report, the Government Accountability Office concluded that the OCC and the CFPB agreed to each collect credit card data from nine financial institutions (one less than the threshold for triggering the PRA) and then to share that information with each other. (The OCC could not even manage to limit itself to this cynical attempt to sidestep the PRA, but blatantly violated it by collecting credit card data from sixteen financial institutions, not nine.)[18]

- Third, the Bureau has relied heavily on "generic" collection proposals that seek approval for an entire means of information collection. For example, the Bureau has sought and received approval "to gather primary data from purposive samples through controlled trials in field and economic laboratory settings."[19] What sort of actual information would be collected under this proposal is anyone's guess, meaning that the purpose of the PRA—to allow the public to understand and comment on the need for particular information collections—is entirely defeated.

We recognize that compliance with the PRA requires significant time and energy. But that is true of all of the legal requirements that make up the regulatory process and that maintain its credibility through accountability to the public. The Bureau should not shirk its responsibilities under the PRA or take shortcuts just because it views the statute as an impediment to the goals it wants to achieve. Instead, the Bureau should embrace the transparency provided by the PRA and other

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[18] *See* Gov't Accountability Office, Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced 47 (Sept. 2014), http://www.gao.gov/assets/670/666000.pdf.
[19] Agency Information Collection Activities: Comment Request, Docket No. CFPB-2014-0018; OMB Control No. 3170-XXXX, 79 Fed. Reg. 53,422 (Sep. 9, 2014),

regulatory processes as the very basis of its credibility and, thus, its long-term success as a regulatory agency.

b) The Bureau Should Welcome Meaningful Discussions with the Public, Not Just Host Well-Scripted Field Hearings.

The risk of lost credibility also is on full display at the CFPB's field hearings, which are largely public relations exercises devoid of any meaningful debate about the subject of the hearing. While the Bureau purports to use these hearing to listen to all interested stakeholders, it is plain to any even slightly disinterested observer that they are part and parcel of the Bureau's press strategy to promote its initiatives Thus, while industry representatives nominally are allowed to participate, they are permitted only to make a short statement and then answer two or three general questions posed by Bureau staff. Never is there any actual engagement between the Bureau and panelists: the Bureau does not answer any of the tough questions raised by panelists and there is no meaningful dialogue among the panelists themselves.

Again, there is a better approach available: other agencies host highly-substantive roundtables and day-long conferences that permit longer presentations and extended exchanges among panel members as well as with agency staff—along with an opportunity for all interested persons to submit written comments. For example:

- In 2011, the FTC, to which the Dodd-Frank Act granted exclusive rulemaking authority over auto dealers that engage in indirect financing, conducted three roundtables to learn about automobile financing. It began this process with a notice in the Federal Register, solicited public comments (100 were received and docketed), and invited thirty-one speakers representing consumers, industry, and other government agencies (including the Bureau) to participate in even-handed discussions at each of the three events.[20]

- In 2014, the SEC hosted a cybersecurity roundtable that featured 29 panelists, permitted notice and comment (14 comments were received), and published the resulting transcript.[21]

In the Chamber's view, the Bureau has not adequately explained why it cannot apply these practices in its own deliberative process. After all, the Bureau does not

[20] *See generally* Fed. Trade Comm'n, The Road Ahead: Selling, Financing & Leasing Motor Vehicles, http://www.ftc.gov/news-events/events-calendar/2011/08/road-ahead-selling-financing-leasing-motor-vehicles.
[21] *See generally* Secs. & Exch. Comm'n, SEC Announces Agenda, Panelists for Cybersecurity Roundtable (Mar. 24, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541253749#.UzCB2ijip9U.

hold a monopoly on wisdom on consumer financial services policy. Our democratic system is based on the assumption that public debate makes policies stronger, not weaker. The Bureau consequently should seek meaningful public engagement rather than further jeopardize the integrity of its actions by continuing to hold events that qualify primarily as political theater.

c) The Bureau Should Ensure Due Process in Its Internal Administrative Adjudication Process.

The Dodd-Frank Act authorizes the Bureau to preside over administrative hearings to adjudicate enforcement actions not brought in federal court.[22] As we have seen in other agencies, this authority is susceptible to misuse and consequently should be exercised with particular care. The Bureau should recognize the need to protect the due process right of those who appear before its internal tribunal, ultimately presided over by the director of the Bureau,[23] especially to offset any suspicion about the Bureau's impartiality. Unfortunately, because of the Director's remarkable intervention in the *PHH Corporation* matter, the administrative adjudication process so far appears more like an extension of the Bureau's enforcement function than an independent decision-making body.

As the Chamber explained in its amicus brief to the U.S. Court of Appeals for the D.C. Circuit, the *PHH Corporation* matter involved a disputed interpretation of the Real Estate Settlement Procedures Act. While we disagree with the Bureau on its interpretation of that statute, what is more remarkable, for present purposes, is that the Bureau announced its interpretation for the first time in an enforcement action and imposed substantial retroactive liability on the basis of that interpretation. Then, apparently dissatisfied with the Bureau's apparent victory over the company, the Director increased the money judgment imposed on the company by a factor of eighteen from the amount recommended by the presiding independent administrative law judge. As the Chamber's brief explains:

> First, [the Bureau] violates the most basic requirement of due process—fair notice of what the law requires—by overturning a settled interpretation of law and then imposing a sanction of $109 million for conduct that was lawful under the longstanding prior interpretation.
>
> Second, it claims the authority to ignore clear statutes of limitations applicable to enforcement actions brought in court

[22] *See* 12 U.S.C. § 5563.
[23] *See* 12 C.F.R. § 1081.405.

> whenever it exercises its unreviewable discretion to institute an administrative enforcement action.
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> The combination of these two rulings means that the Bureau has arrogated to itself the ability to change a settled legal interpretation, impose enormous penalties for conduct that complies with that interpretation, and to do so without regard to the limitations periods specified by Congress. That breathtaking assertion of raw administrative power, if permitted to stand, would open the door to similarly unfair and unauthorized sanctions by the Bureau, under its broad enforcement authority, and by other agencies as well.[24]

The *PHH Corporation* case is still pending before the D.C. Circuit Court of Appeals. Regardless of the outcome in that case, expecting a Court of Appeals to round off the rough edges of a flawed administrative adjudication process is hardly a strategy for successful regulatory policymaking.

4. The CFPB Should Limit Regulatory Duplication And Conflict By Cooperating And Coordinating With Other Agencies.

The Bureau holds an expansive range of authorities and responsibilities that explicitly overlap with the authorities and responsibilities of other federal agencies. Effective coordination is essential, as Congress itself recognized.[25] To date, while the Bureau has announced various formal tools for cooperation, such as memoranda of understanding, the actual level of coordination between the Bureau and other agencies appears to have been low. For example, this Committee is surely familiar with the overlapping and mixed messages sent to banks by their prudential regulators and the CFPB on deposit advance products. Such confusion benefits no one. Going forward, the Bureau should commit itself to enhancing coordination, both by avoiding duplication and by thinking proactively about how to ensure that the regulatory response to a single issue makes sense when considered as a whole.

a) The CFPB Should Focus Its Resources On Areas Where It Has Clear Jurisdiction And That Are Not Already Crowded With Other Regulators.

The CFPB has clear authority across wide portions of the consumer financial services market. That authority has limits, however, because Congress specifically deprived the Bureau of authority in a number of areas. To date, the Bureau has

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[24] Br. of Am. Cur. U.S. Chamber of Commerce, *PHH Corp. v. CFPB*, No. 15–1177 (D.C. Cir. Oct. 5, 2015).
[25] *See* 12 U.S.C. § 5581(b)(5)(D) (requiring coordination between the FTC and the CFPB).

appeared to seek out opportunities to test—and, in our view, breach—the limits of its authority, including by crossing into territory already regulated by other agencies. The Bureau should reconsider this approach; at a minimum, it should commit itself not to create standards that conflict with those already applicable to entities within its jurisdiction.

The Bureau's entry into the data security field in March 2016 provides a good example of a Bureau decision to press its jurisdiction in a manner that raises a substantial threat of conflicting regulatory standards. To our knowledge, the Bureau's enforcement action against and consent order with Dwolla, Inc., represented its first public assertion of jurisdiction over a company's data security. As an initial matter, we were puzzled by the apparent asymmetry between the allegations recited in the order and the agreed-to remedies: Dwolla's alleged violation was that its statements about its data security were inflated; the remedy, however, was not limited to improving the accuracy of those *statements* but included substantive requirements that Dwolla actually change its data security *practices*.[26]

But our greater concern was with the Bureau's expectation that the data security standards found in the Dwolla consent order will be exported to the consumer financial marketplace writ large. Needless to say, those standards were not the product of a rulemaking pursuant to the Administrative Procedure Act, so there was no public input on important questions surrounding them, such as whether they are flexible enough to adapt to rapidly changing cybersecurity threats or consistent with President Obama's ongoing efforts to develop a Cybersecurity National Action Plan.[27] Instead, they were the product of a one-off consent order, fashioned pursuant to the Bureau's belief in its seemingly boundless authority to root out "unfair, deceptive, or abusive act[s] or practice[s]."[28]

Moreover, the Chamber, which has worked constructively with other federal regulators on data security issues for years, is concerned that the Dwolla consent order represented the sudden addition of yet another regulator to the already crowded consumer data security landscape. Indeed, the Bureau's abrupt entry onto the data security scene was unexpected given Congress's specific decision to prohibit the Bureau from enforcing the so-called "safeguards rule" under the Gramm-Leach-Bliley Act.[29] Countless federal and state regulators, including the Federal Trade Commission,

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[26] *Compare In the Matter of Dwolla, Inc* ¶¶ 15-27, 2016-CFPB-0007 (Mar. 2, 2016) (describing alleged misstatements about data security) *with id.* ¶¶ 52-62 (ordering substantive changes to Dwolla's data security),http://files.consumerfinance.gov/f/201603_cfpb_consent-order-dwolla-inc.pdf.

[27] *See* The White House, *Fact Sheet: Cybersecurity National Action Plan* (Feb. 9, 2016), https://www.whitehouse.gov/the-press-office/2016/02/09/fact-sheet-cybersecurity-national-action-plan.

[28] Dodd-Frank Act §§ 1031, 1036 (codified at 12 U.S.C. §§ 5531, 5536).

[29] Dodd-Frank Act § 1093 (codified at 15 U.S.C. § 6805(a)(8)).

already regulate data security; it is unclear what deficiency the Bureau is trying to fill in this overcrowded field. There also is no evidence that the Bureau evaluated the likelihood of regulatory duplication (or worse, dissonance) with other regulators or considered whether its regulation, whether duplicative or not, would impose unnecessary costs on businesses subject to its authority. We consequently have strongly urged the Bureau to coordinate any future data security actions with other banking regulators to ensure compatibility between the respective agencies' views on data security and to leverage existing expertise in the field.

Unfortunately, this is not the only instance in which the Bureau has ventured into an area falling into the core expertise of another federal regulator. Another example is a pair of enforcement actions against mobile phone companies for billing errors caused by third parties—even though such actions are firmly within the jurisdiction of the Federal Communications Commission and FTC.[30]

These actions smack of attempts to test, and expand, the boundaries of jurisdiction and to compete with other agencies in claiming authority over activities that are "in the news." The Bureau has more than enough to do in its core areas of responsibility. It should focus on those obligations, and eschew exercises in regulatory adventurism designed to plant its flag in areas well within the authority of other federal agencies.

b) The CFPB Should Build Deep And Sustained Working Relationships With Other Regulators.

The Bureau's commitment to coordination should not be limited to merely avoiding obvious intrusions into areas in which the Bureau has limited authority and that already are the subject of sustained attention by other regulators. In addition, the Bureau should work proactively with other regulators to ensure that the overall regulatory response to an issue is coherent and prudent. While the CFPB is an independent agency, that does not justify its working in isolation. Rather, the Bureau and other agencies should work together to ensure that their supervisory guidance is not at cross purposes and that their enforcement actions do not point to different policy outcomes.

For example, the Bureau should work with other regulators to understand and manage any consequences of a Bureau enforcement action, such as its effect on a financial services company's rating under the Community Reinvestment Act or upon

[30] *See* CFPB, CFPB Takes Action to Obtain $120 Million in Redress from Sprint and Verizon for Illegal Mobile Cramming (May 12, 2015), http://www.consumerfinance.gov/newsroom/cfpb-takes-action-to-obtain-120-million-in-redress-from-sprint-and-verizon-for-illegal-mobile-cramming/ (describing proposed consent orders).

measures of safety and soundness. In addition, the Bureau should understand how its future policymaking will interact with that of other federal agencies, again to avoid unnecessary and unproductive conflict and to ensure that those policies interact in a coherent manner. To do so, the Bureau must build deep and sustained working relationships with other regulators. It is our impression that further work remains to be done on that score, and we hope that the Bureau will embrace it as an opportunity going forward.

5. The CFPB Should Preserve Companies' Use of Diverse Tools, Including Arbitration Agreements, To Manage Their Relationships with the Customers They Serve.

Financial services companies know that customers are their most important asset and consequently work very hard to satisfy customers' expectations and to address any concerns that arise. Indeed, customer service is the foundation of the most successful companies. The Bureau should facilitate and encourage customer service efforts, rather than push consumers toward adversary relationships and litigation.

a) The CFPB Should Support Effective Customer Service Rather Than Harm Consumers' Confidence In Their Financial Services Companies.

We share the Bureau's goal of ensuring that consumers are satisfied with the financial products and services they use. American financial institutions and providers dedicate enormous resources to their customer service processes and carefully listen to customer concerns. We, accordingly, would welcome any effort by the Bureau to strengthen financial services companies' relationships with their customers and to support effective customer service processes. Unfortunately, the Bureau has taken another approach, encouraging and publicizing consumer complaints that are full of misleading information about financial institutions, and that consequently create confusion in the marketplace while disrupting existing customer service relationships.

A financial institution that published "factually inaccurate" information knowing that "some consumers may draw (or be led to) erroneous conclusions"—phrases the Bureau uses to describe the information about financial services providers it publishes on its website—would be subject to a Bureau enforcement action for deceptive conduct. The Bureau should not hold itself to a lower standard. It should cease its publication of misleading information through its complaint database and related reports.

The Chamber and many other stakeholders have exhaustively detailed the many flaws in the consumer complaint database. For present purposes, consider the following four:

- The complaint database is subject to manipulation, such as by a potential litigant seeking to inflate apparent complaints against a prospective defendant. The Bureau has acknowledged this risk,[31] but makes only limited efforts to confirm a commercial relationship between the complainant and the subject company. Those limited steps cannot prevent publication of complaints based on intentional misrepresentations or omissions.

- As the Bureau has put it, complaints may be based on "factually incorrect information as a result of, for example, a complainant's misunderstanding or misrecollection of what happened."[32]

- Most of the "complaints" in the database are not really complaints at all. Two-thirds of submissions to the database are closed with an explanation, not relief, from the company.[33] The bulk of these "complaints," in other words, involve no wrongdoing by the financial institution (or even other circumstances that prompt a financial institution to offer monetary relief).[34]

- The complaint data is not representative and has not been normalized. As a result, a consumer reviewing the contents of the database will be left with the misleading impression that companies with the largest customer bases are the subject of a disproportionate number of complaints.

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[31] CFPB, *Disclosure of Certain Credit Card Data*, No. CFPB-2011-0040 ("2012 Complaint Policy Statement"), 77 Fed. Reg. 37,558, 37,562 (June 22, 2012).

[32] *See* CFPB, Disclosure of Consumer Complaint Narrative Data, No. CFPB-2014-0016 ("2014 Complaint Proposal"), 79 Fed. Reg. 42,765, 42,767 (July 23, 2014).

[33] CFPB, *Consumer Response Annual Report: January 1-December 31, 2014*, at 41 (Mar. 2015) (indicating that 70% of complaints are closed with explanation), http://files.consumerfinance.gov/f/201503_cfpb_consumer-response-annual-report-2014.pdf.

[34] For example, the Bureau has reported that various consumers have not realized that they generally must dispute a charge on a credit card statement within 60 days or that a credit card issuer may not override a merchant's "no-return policy." *See* CFPB, *Consumer Response: A Snapshot of Complaints Received* 20 (July 2014), http://files.consumerfinance.gov/f/201407_cfpb_report_consumer-complaint-snapshot.pdf.

The Bureau is well aware of all these fundamental flaws, but, rather than fix them, it has worked aggressively to expand and publicize the complaint database,[35] providing what it has described as a government "megaphone" for misleading data.[36]

Its justifications for doing so make no sense. Most notably, the Bureau has justified its publication of misleading information with the claim that a "marketplace of ideas" will determine what the complaint data shows.[37] But a "marketplace of ideas," cannot exist without the ability to transparently study the data and correct the flaws. The Bureau's policy in this area is directly juxtaposed to Justice Brandeis' famous axiom that sunlight is the best disinfectant.

And there is no evidence that such a "marketplace of ideas" has emerged. Indeed, the Bureau appears to have tried to make up for this absence, publishing very unfair reports on the Top-Ten "Most Complained-About Companies." These reports appear to have gained very little traction in the press (which we assume was the Bureau's primary goal), which is unsurprising because an unbiased observer can immediately see these reports for what they are: lists of the ten financial services companies that interface with the most customers in the United States (i.e. the credit reporting agencies and the largest banks and mortgage companies).

The inadequacy of the consumer complaint database has very unfortunate consequences for consumers and businesses. Specifically, the complaint database:

- Misleads consumers, distorting the very consumer financial services marketplace that the Bureau is charged with protecting by causing consumers to make *less* informed decisions;

- Disrupts existing customer care relationships by (a) encouraging consumers to tell their stories to the Bureau first, rather than to their financial services provider; (b) prompting companies to settle even unreasonable claims that are the subject of a complaint, thus

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[35] Congress tasked the Bureau with establishing a process for receiving and handling complaints against financial services companies; Congress said nothing about publication of complaints. But in retrospect, it is possible to see that the Bureau had publication in mind at the beginning of the process for establishing the complaint database. *See* Disclosure of Certain Credit Card Complaint Data, 76 Fed. Reg. 76,628, 76,632 (Dec. 8, 2011) (indicating that the Bureau would not publish complaint narrative data at that time because of privacy concerns, but noting the view (which ultimately was adopted by the Bureau) that "Publishing narratives only if a consumer affirmatively opts in to—or fails to opt out of—publication might alleviate this problem.").

[36] *See* Prepared Remarks of CFPB Director Richard Cordray at the Consumer Response Field Hearing (July 16, 2014) ("We have many tools at hand to ensure fairness and dignity for consumers, but we also can offer people a megaphone to empower them to tell their own stories in their own words."), http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-consumer-response-field-hearing/.

[37] *See* 2012 Complaint Policy Statement, 77 Fed. Reg. at 37,561.

disadvantaging customers who do not submit their complaint to the Bureau; and (c) generating suspicion of and hostility towards financial services providers;

- Imposes undue reputational harm on responsible financial services companies, as well as significant direct costs as they process and address complaints; and

- Exposes consumers to invasions of privacy through the reidentification of consumers who submit complaints to the complaint database.[38] The harm caused by this reidentification will be even greater if complaint narratives are published, as consumers then will face the additional risk of intimate details of their financial experiences being reassociated with their name and address.

The Bureau is right to insist that companies respond to consumer complaints: we agree that resolving consumer concerns is a basic element of good business. But the Bureau's goal should be to encourage consumers to use effective customer service systems. While a complaint system can provide an early warning system, the CFPB's system should not displace existing customer service relationships. More broadly, the Bureau should focus on building consumers' confidence in their financial services companies, not tearing it down through ceaseless publication of exaggerated, inaccurate complaint data. Informed consumers necessarily have some degree of caution, but the Bureau should not be in the business of casting doubt over the whole marketplace and fostering dissension and litigation, rather than strong, trust-based customer relationships.

b) The CFPB Should Prioritize Protecting Consumers Over Protecting Trial Lawyers.

As this Committee knows, Congress tasked the Bureau with studying the use of arbitration agreements in the Dodd-Frank Act, and authorized it to take regulatory steps consistent with that study and the public interest.[39] As I describe herethe

[38] *See* 2014 Complaint Proposal at 42,768 ("[T]he Bureau will take reasonable steps to remove personal information from the complaint to minimize (but not eliminate) the risk of re-identification.").

[39] Section 1028 of the Dodd-Frank Act (12 U.S.C. § 5518) directed the Bureau to study and report to Congress on "the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services." Such agreements are often referred to as "pre-dispute arbitration agreements" because they represent the mutual, voluntary agreement between parties to present future disputes between them in an arbitration forum rather than in court. Section 1028 goes on to permit, but not require, the Bureau to issue a rule to impose conditions or limitations on the use of pre-dispute arbitration agreements if such restrictions would be "in the public interest" and "for the protection of consumers." Any rule must also be "consistent with the study" the Bureau conducts.

Bureau has exercised this authority in a non-transparent, unfair manner, appears likely to lead to proposal of a rule that will not benefit consumers, and will only benefit trial lawyers.

The Bureau conducted its study from 2012 to 2015 (the "Study") and reported its results to Congress in March 2015. Many members of Congress and business associations—other than those representing the interests of plaintiffs' lawyers who stand to benefit from increases in litigation—heavily criticized the Bureau for its staunch refusal to consider factors and data relevant (if not entirely central) to its inquiry, its contorted attempt to present data and analysis that put class action litigation in a good light, and, consequently, the resulting flawed conclusions of the study. Undeterred, the Bureau published materials last fall that foreshadow a Bureau rulemaking that, as a practical matter, will likely eliminate arbitration altogether and force consumers to pursue their legal claims—even those for as little as $20—through expensive litigation in America's already overcrowded courts.

Given the clear benefits of arbitration, it is disappointing that the Bureau is about to propose a rule that is likely to have the practical effect of eliminating consumer arbitration in the financial services industry.[40] Of course, the Bureau's proposal will not say that; it will be framed as a requirement that class procedures be permitted either in arbitration or in court. And it will do so, the Bureau will say, in order to "preserve" class actions—even though class actions provide little benefit to consumers, and focus their massive financial rewards on lawyers.

The bottom line is that if arbitration is regulated out of existence, consumers will lose the ability to vindicate most of the small injuries they suffer in any forum whatsoever because the claims are not classable and they are too expensive to pursue individually.

Pursuant to section 1028 of the Dodd-Frank Act, the Bureau will purport to base its proposed rule on the Study. But the Study is the result of a closed process that solicited public comment once at the outset in 2012 and never again for the three years that followed. The Bureau never informed the public of the topics it had decided to study and never sought public comment on them—even though a number of commenters suggested that the Bureau utilize that procedure. The Bureau never

[40] Arbitration imposes significant additional transaction costs on companies—paying consumers' filing fees and other costs of arbitration, for example. Thus, as one group of businesses has explained, "when there is no assurance that all claims will be arbitrated in lieu of litigation, and a [company] must shoulder the additional costs of class action litigation, subsidizing the costs of individual arbitration is no longer a rational business option"; the only logical decision is to "disengage from arbitration altogether." Br. of Am. Cur. CTIA—the Wireless Association at 21, *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

convened public roundtable discussions on key issues, as many other agencies routinely do. And the Bureau never sought public input on its tentative findings.[41]

More than 80 members of the House and Senate sent a letter to the Bureau stating that:

> The process that led to the Bureau's Arbitration Study has not been fair, transparent, or comprehensive. The Bureau ignored requests from senior Members of Congress for basic information about the study preparation process. The Bureau also ignored requests to disclose the topics that would be covered by the study, and failed to provide the general public with any meaningful opportunities to provide input on the topics. Because the materials were kept behind closed doors, the final Arbitration Study included entire sections that were not included in the preliminary report that was provided to the public.
>
> As a result, the flawed process produced a fatally-flawed study. Rather than focusing on the critical question—whether regulating or prohibiting arbitration will benefit consumers—and devising a plan to address the issues relevant to resolving that question, the Bureau failed to provide even the most basic of comparisons needed to evaluate the use of arbitration agreements.[42]

It is particularly remarkable that the Bureau's proposal apparently will be justified by the asserted benefits of class actions, when the plain reality is that consumer class actions deliver little to anyone other than lawyers. Thus, eliminating arbitration in order to preserve class actions sells out the interests of consumers in order to benefit plaintiffs' lawyers.

Indeed, plaintiffs' lawyers are the chief proponents—and the principal beneficiaries—of restrictions on arbitration. Because arbitration is quicker and more efficient than litigation, it is less expensive, which means that plaintiffs' lawyers cannot extract large settlements and attorneys' fees for meritless claims in arbitration as easily as they could in class actions in court. As Professor Martin Redish has noted, this confirms that "[t]he real parties in interest in… [many] class actions are… the plaintiffs' lawyers."[43] The Bureau's own study found that plaintiffs' lawyers average

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[41] The Bureau staff would meet with interested parties and accept written submissions. But the staff refused to provide any information regarding the topics that the Bureau was studying or the timeline for its study process, and those one-way conversations therefore were not conducive to meaningful input.

42 http://www.cfpbmonitor.com/files/2015/06/McHenry-Scott-to-Cordray-Letter-re-arbitration.pdf.

[43] Testimony of Martin H. Redish at 7, *Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at http://judiciary.house.gov/hearings/Hearings%202012/-Redish%2006012012.pdf.

class action fee is $1 million per case, while the average recovery by consumers in class actions is just $32.35. This alone should have dissuaded the Bureau from its misguided plan to ban arbitration by rule.

The Bureau's work on arbitration has been infected by many of the process problems I have highlighted in this testimony. Unsurprisingly, a bad process is poised to lead to a bad result—and one that will benefit plaintiff's lawyers, not consumers.

* * * * *

Thank you again for the opportunity to testify to the Committee on the effect of regulation on the consumer financial services marketplace. Continued innovation and competition continue to propel the marketplace forward, creating ever more choices and benefits for consumers. Prudent regulation can play an important role in preserving competition and advancing customer choice. Unfortunately, however, the Bureau too frequently has taken another path, overstepping its bounds; preferring regulatory uncertainty to clear rules of the road; and disrupting, rather than encouraging, effective and amicable relationships between financial services companies and their customers.

An improved regulatory approach could ensure a bright future for the consumer financial services market. Consumers want, need, and benefit from safe consumer financial services; countless responsible and innovative companies want to provide these products. With clear rules of the road developed through sound and open processes, the market will thrive and consumers will benefit. We hope that the Bureau will join with all stakeholders in pursuing these goals.

PREPARED STATEMENT OF REVEREND DR. WILLIE GABLE, JR., D. MIN.

PASTOR, PROGRESSIVE BAPTIST CHURCH, NEW ORLEANS, LOUISIANA, AND CHAIR, HOUSING AND ECONOMIC DEVELOPMENT COMMISSION, NATIONAL BAPTIST CONVENTION USA, INC.

APRIL 5, 2016

Chairman Shelby, Ranking Member Brown, and Members of the Committee, thank you for inviting me to testify today.

I am the Reverend Willie Gable, Jr. I serve as Pastor of Progressive Baptist Church in New Orleans. My congregation is a member of the National Baptist Convention USA, Inc. the Nation's largest predominantly African American religious denomination.

I also serve as Chair of the Housing and Economic Development Commission of the National Baptist Convention USA, Inc. This Commission's mission is to develop affordable housing for low- and moderate-income persons, particularly for senior citizens and the disabled, allowing them to live with pride in a place they can proudly call home. Over 20 years, the Commission has developed over a thousand homes at 30 housing sites across 14 State.

I appear before you today to bear witness to the utter devastation that predatory financial practices have wrought on my community and on communities across this Nation; to the safer mortgage market we have now thanks to newly implemented reasonable rules; and to a desperate need for further regulatory action to weed out the abhorrent financial abuses in other product areas that continue today.

The financial crisis

It is impossible to overstate the damage done to the families and communities most impacted by the worst financial crisis since the Great Depression. Over 12 million homes lost, representing families displaced, lives turned upside down, life savings washed away. Over $2.2 trillion in lost property value for communities surrounding foreclosed properties, with over half of that lost value sapped from communities of color. The wealth gap, already a chasm, made wider still.

This crisis was caused by unrestrained predatory mortgage lending practices and a failure to stop them. These practices included steering borrowers with 30-year fixed-rate mortgages, and with significant equity in their homes, into toxic refinance products that would inevitably become unaffordable—exploding adjustable rate mortgages, balloon loans, loans that negatively amortized. There were no requirements to determine whether the borrower had the ability to repay the loan. Often, lenders paid brokers perverse kickbacks, or yield-spread premiums, to steer borrowers into riskier, more expensive loans when they could have qualified for a safer, more affordable one—a practice that disproportionately impacted borrowers of color.

These predatory lending practices were permitted because the existing regulators, with whom consumer protection authority had been vested, failed to prohibit them. Congress gave the Federal Reserve Board rulemaking authority in 1994 to prohibit unfair and deceptive practices in the high-cost mortgage market. The Board failed to use this authority until 2008; by then, the damage had been done. The national bank and thrift regulators, the OCC and the OTS, had enforcement authority against unfair practices. But they treated their supervisee banks like clients, competing for their charters by being most willing to ignore the abusive practices that the agencies' own supervisory guidance advised against. *The existing Federal regulators failed,* and the whole Nation suffered. Some suffered far more profoundly than others. Many continue to suffer. Full recovery will take decades.

Mortgage market

Today, we can be thankful for a safer mortgage market, one with reasonable rules in place to prevent predatory practices. Lenders must determine a borrower's ability to repay a loan. Kickbacks for steering borrowers into more expensive or riskier loans are prohibited.

Contrary to lender predictions, the implementation of ability-to-pay rules in 2014 did not result in a constriction of the credit market, according to Home Mortgage Disclosure Act data[1] Recovery, to be sure, is slow. And there is much work to be done to increase the availability of home loans to people of color and low- and moderate-income families. But we can rest easier knowing that when a borrower receives a loan, it is a reasonably designed, affordable loan where responsible underwriting has been conducted, instead of a toxic one designed to fail; that

[1] *http://www.federalreserve.gov/pubs/bulletin/2015/pdf/2014_HMDA.pdf.*

mortgage credit will again serve to help stabilize, rather than shatter, our neighborhoods.

The Consumer Financial Protection Bureau (CFPB or Bureau) has played a critical role in the implementation of these mortgage rules. The mortgage market is, of course, an absolutely vital one. Homeownership is the primary vehicle through which families build wealth and pass it on to future generations. Homeownership brings tangible benefits to neighborhoods, schools, and cities, and carries immense intangible value as well. This is particularly important for families of color, who still lag so far behind economically. The predatory practices in the market had catastrophic consequences, and ones that became evident to all.

But other, often less conspicuous, predatory practices also wreak destruction. And in my experience working with people in need, families do not tend to experience a predatory practice in isolation. These predatory practices tend to be interconnected, raiding families' resources and assaulting their dignity from every direction.

Congress created the CFPB in the wake of the financial crisis precisely to protect consumers from abusive financial practices, be they mortgages or any other kind. The Bureau has begun good work in many areas, and there remains much more to be done.

Payday and car title loans

Payday loans and their close cousins, car title loans, are an abomination in plain sight. Consider the plight of one Louisiana mother who lost one of her two jobs when a rehabilitation center where she worked closed. Down one income stream and struggling to pay her bills, she took out a $300 payday loan. As lenders hope, she could not afford the repayment 2 weeks later, so a lender gave her another loan to repay the first, charging her new interest and fees. This happened five times, ultimately costing her $2,500 and, as payday loans often do, her bank account. She also lost her car and mementos from her children she pawned, all in an effort to escape the debt trap.[2]

She is not alone. Payday lenders make loans to 57,000 Louisianans each year. In my community, we often encounter elderly individuals who have taken out payday loans. Their younger family members often don't learn of it until they are caught deep in the trap. It is not surprising these loans are kept secret. For many, payday loans carry a deep sense of shame.

These lenders weave themselves into the fabric of our neighborhood and purport to lend a helping hand. But they are wolves in sheep's clothing. They claim to be for a once-in-a-blue moon emergency, but three-fourths of their loan volume comes from borrowers with more than 10 loans a year. And they use this blood money to pad the pockets of legislators to prevent enactment of any reasonable restrictions. In Louisiana, this strategy has been sadly successful, despite widespread opposition from churches and other organizations who work directly with families these loans hurt.

In Louisiana, there are more than four times as many payday loan storefronts as McDonald's. They are concentrated in African American communities. I do not believe this is an indication that people "need" or "desire" payday loans. The most common reason people "need" a payday loan is because a previous payday loan was designed to be unaffordable. It's a cycle, by design—so-called "demand" that generates and feeds itself. It is intentional exploitation of the desperate.

My comments here have focused on short-term balloon-payment payday loans. But as we speak, many payday lenders are restructuring their payday loans to be high-cost, longer-term installment loans, designed to work essentially the same way—by trapping the borrower in a cycle of high-cost debt. In Louisiana, payday lenders are currently pushing a bill that would authorize loans of up to $1,500 at 240 percent APR. This is immoral.

In total, payday loans in Louisiana strip $146 million in fees and interest from working families, costing residents an average of over $800 for every $300 borrowed.[3] The destructive business model caused a net loss of $42 million to the State's economy in 2013, costing the State a net 614 jobs.[4]

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[2] Addo Koran, *Lawmakers eyeing limits on payday loan industry,* The Advocate, March 24, 2014.

[3] Together Louisiana. (April 2014). The economic impact of payday lending in Louisiana, *An analysis of the Office of Financial Institutions report "Deferred Presentment and Small Loans 2013 Data"* issued on April 1, 2013. *Available at http://www.togetherbr.org/wp-content/uploads/2010/09/Economic-impact-of-payday-lending-in-Louisiana_4-5-14.pdf.*

[4] *Id,* applying methodology from Lohrentz, T. (March 2013). The New Economic Impact of Payday Lending in the U.S. Insight Center for Community Economic Development.

My community has helped to pay the payday loan debts of many individuals. Like so many churches across the country, we wish that they would have come to us sooner, before the first payday loan, so that more of our congregation's funds could benefit people in need instead of paying off economic predators. Last year, a diverse group of faith organizations formally came together to establish Faith for Just Lending, a national coalition that shares the belief that Scripture speaks to the problem of predatory lending. Our coalition condemns usury and the exploitation of financial vulnerability.

We will continue to fight in Louisiana, and in States across this Nation, for State legislators to limit the cost of credit to 36 percent annual interest or less. Absent Congressional action to do the same at the Federal level—which, to be clear, is warranted and overdue—the CFPB is exactly who must, by the Congressional mandate it was given, address abusive payday and car title loan practices. The Bureau lacks authority to limit interest rates, but it can and should require lenders to determine whether a borrower has the ability to repay a loan, without reborrowing or refinancing. This is a reasonable requirement—far from extreme—that should serve as a Federal floor for State and national regulation. Many States already go much further than this, prohibiting the loans altogether. Other States don't, but they always can, and we will continue to press for just laws at the State level.

Bank overdraft practices

Overdraft fees are the banks' version of preying on those with the least, of taking advantage of those in need and leaving them only worse off. Already, too many low-income people are unbanked or underbanked, and this is particularly so for people of color. We should be seeking to bring these individuals into the banking mainstream, which can facilitate low-cost financial transactions and saving for economic emergencies. But overdraft fees, common on bank accounts, undermine this aspiration.

Banks spin their overdraft programs as a courtesy, but they collect the large majority of overdraft fees from a select few who get hammered, some paying thousands of dollars annually. Overdraft fees fund the checking account business model, and they drive those struggling to make ends meet out of the banking system altogether. When accounts go too far negative, banks close them and report the account holder to a black list like Chexsystems, which prevents the individual from opening another checking account for years. In an environment where distrust of banks is very strong, overdraft practices only exacerbate economic disenfranchisement.

The disturbing reality is that banks design their practices to maximize overdraft incidents. They charge $35 overdraft fees on small debit card transactions they could easily decline when the account lacks funds. Why are credit practices that would no longer be permitted on credit cards permitted on debit cards? This is the sort of inconsistency the CFPB can and should address.

Overdraft is credit and should be extended only when, again, the individual can afford to repay it. With this overdraft fee cash cow, it is not surprising that banks do not more often offer reasonably priced credit to those living on the margins, or more safe bank accounts that do not carry these fees. The Bureau is rightly studying overdraft practices extensively and plans to issue rules. Curbing high cost overdraft fees would help move banks toward offering affordable products, without hidden penalty fees or gotcha fees, for people living paycheck to paycheck.

Prepaid cards

Driven out of the banking system by overdraft fees, or wary of the banking system generally, many low- and moderate-income families turn to prepaid cards. Well-designed prepaid cards can be a useful tool for many families. But they have lacked basic protections for far too long. High-cost credit on prepaid cards is especially concerning given that many families turn to prepaid cards precisely to avoid taking out credit, and given that prepaid cards are often sold by payday lenders. Overdraft fees on prepaid cards are a dangerous and deceptive notion, and they should be prohibited. The Bureau has taken a close look at prepaid cards and issued a proposal that would provide important protections in this area, including critical protections around credit on prepaid cards.

Auto lending

After one's home, the largest purchase many will make is their car. Here, too, predatory practices abound. Car dealer interest rate mark-ups, much like yield-spread premiums in the mortgage market, make car loans more expensive for many consumers. This is also a practice with a long history of discriminatory impact on borrowers of color. However, this is not the only abusive practice in auto lending, and the Federal Trade Commission's car lending roundtables 5 years ago brought many to the surface. Yo-yo scams force consumers into higher priced financing than

they agreed to—the dealer claims the original financing deal fell through after the borrower has left the lot with the new car. Consumers are faced with the loss of a down payment or trade-in if they don't agree to more expensive financing. Expensive and sometimes worthless add-on products are financed into the loan. Evidence suggests these products are sold disproportionately to borrowers of color, who are more frequently told their loans require these products when they do not. And buy-here, pay-here operators churn high-cost used car loans through our communities, using, as the CFPB has found, high-pressure and sometimes illegal collections tactics to extract payments.

Abuses that are in this industry have escaped attention until recently. But CFPB has taken important action in this area, including providing guidelines aimed at preventing discriminatory practices and taking much-needed enforcement actions. As a result, the Bureau has come under fire from Members of Congress. This fire is misplaced. Instead, the focus should be directed at why, for more than two decades, auto lenders' and dealers' practices have operated under a cloud of discrimination and abuse of low-income borrowers. Rather than defending a system that continues to fail many of our communities, Congress should push for a more transparent, fair system of auto finance.

Debt collection

Debt collectors commonly engage in harassment and threats; they commonly attempt to collect debts consumers never owed, or no longer owe. They induce dread, fear, embarrassment, panic in good, honest, hard-working individuals and in their family members, their children. Though existing laws are not as strong as they must be, debt collectors routinely break them.

The CFPB has taken strong enforcement actions to address illegal debt collection practices. And it has indicated it will propose rules in this area in the coming months. These new rules will permit collection of debts while, we hope, requiring that this collection be done without employing abusive tactics. This is reasonable and necessary. This is not extreme.

Forced arbitration

There is no question that predatory practices are a violation of both biblical and social moral norms. Often, they also violate the law. But remedies are seldom available, as the financial industry has cloaked itself in a shield of impunity in the form of pre-dispute mandatory arbitration clauses.

These clauses, often in the fine print of take-it-or-leave-it contracts for payday loans, bank accounts, auto financing, student loans, and other products, deprive ordinary Americans of their liberty and constitutional rights. They require that complaints be brought on an individual basis to a private arbitration system where the arbiter has every incentive to rule in favor of the private company that brings them repeat business. The fine print also often prohibits individuals—with little power standing alone—from joining together with others in class actions. The effect is to strip individuals of their ability to secure redress when they have been wronged by a clearly illegal practice.

This is wrong. And we need the Bureau to exercise its authority to limit pre-dispute mandatory arbitration clauses and restore the right of individuals to join together to seek justice when they are cheated.

Conclusion

The Bureau has taken important action in other areas as well, like credit cards, student loans, and, an often-overlooked rampant problem, prevention of elder abuse. To date, CFPB has returned over $10 billion to consumers through enforcement actions against illegal practices. To be sure, this is to be commended. But relative to the funds predatory practices strip, this amount is quite modest; some individual predatory practices cost consumers more over the course of only a single year. This means that the Bureau has far more work to do.

Other Federal regulators have an important role to play as well—the Department of Education with student lending; the Department of Defense with important new rules limiting costs on consumer loans made to our military service members; the prudential banking regulators, who have worked to prevent the payments system from being used to violate the law and reined in abusive payday lending directly by banks.

But it is clear that a strong, well-funded, independent agency whose job it is to wake up in the morning thinking about protecting the most vulnerable among us is necessary—to ensure that financial services practices do not drain hard-earned income and savings from my constituents, and from the millions of other Americans who are affected by predatory lending every day.

Please let me be clear: the notion that struggling Americans need access to products like those the Bureau has been working so hard to address is, at best, an insult to the basic dignity of every vulnerable person. At worst, it is a thin veil for the influence corporate money and power hold in our Nation's politics at every level. The predatory practices CFPB is addressing drain what little resources targeted persons have and leave them worse off. Not controlled, they will relegate some communities to a state of perpetual poverty.

I implore you to let the CFPB be the consumer watchdog this body mandated that it be in the wake of the financial crisis. We have seen what happened when there was none. And we all deserve far better.

Thank you for the opportunity to share my experiences with you. I look forward to your questions.

ASSESSING THE EFFECTS OF CONSUMER FINANCE REGULATIONS

April 5, 2016

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United States Senate
Committee on Banking, Housing, and Urban Affairs

Thank you chairman Shelby, ranking member Brown, and members of the committee. It is my pleasure to testify this morning on the crucially important topic of "Assessing the Effects of Consumer Finance Regulations."

Enacted into law in July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was animated in large part by the belief that a primary source of financial instability was an inadequate consumer financial protection regime at the federal level. Dodd-Frank sought to address those perceived deficiencies both by substantive legislation (for example, by banning binding arbitration provisions in mortgages) and by creating the Bureau of Consumer Financial Protection (CFPB) within the Federal Reserve and vesting that new super-bureaucracy with vast rule-making, litigation, and supervisory powers over all consumer credit products and services.

Let me stress at the outset that at the time of Dodd-Frank I supported the need to unify consumer financial protection policy under a single agency. Based on my long study of consumer finance and its regulation as well as my hands-on experience as the Director of the Federal Trade Commission's Office of Policy Planning I believe that the regulatory framework that existed prior to Dodd-Frank was too fragmented and too cumbersome to effectively regulate the full range of consumer financial protection products at the federal level. Competition and consumer choice in consumer financial products doesn't follow arbitrary product and geographic lines—for example, many consumers view payday loans and overdraft protection as close substitutes even though overdraft protection is provided by billion-dollar banks and payday loans are offered by street-corner storefronts. Strong, consistent, economically-informed consumer protection policy is essential to a thriving consumer credit system that allows consumers to access credit,

build wealth, and climb the ladder of opportunity, through access to credit cards, bank accounts, and mortgages.

The tragedy of Dodd-Frank and the CFPB is that it squandered this unprecedented opportunity to modernize the consumer credit system to promote competition, consumer choice, and innovation. Instead, the post-crisis regulatory framework has resulted in higher prices and reduced choice for consumers and little improvement in consumer financial protection. Indeed, by stifling competition and driving millions of Americans out of the mainstream financial system, it may actually result in more consumer protection problems.

Although this sorry result for American consumers is tragic, it is hardly surprising. The failure of Dodd-Frank's regulatory agenda to promote the interests of consumers was built in from the beginning.[1] The CFPB is vested with extraordinarily broad powers to regulate virtually every consumer credit product in America under the vague charge to prevent "unfair, deceptive, and abusive" acts and practices. At the same time, this vast power is vested in an agency with an unprecedented lack of democratic accountability. Under the statute, the president can nominate the director, but once confirmed the director can be removed only "for cause."[2] Furthermore, the CFPB is outside Congress's appropriations power, and is authorized to spend hundreds of millions of taxpayer dollars every year with no accountability to the American people.

Given this extreme lack of democratic accountability, the CFPB has done what all bureaucracies tend to do: it has constantly expanded its power, promoted its own bureaucratic interests at the expense of the public and American families, and trampled under foot other public policies, such as consumer choice and financial innovation.

The impact on American families and the economy from the actions of this unaccountable super-regulator has been disastrous:

- By imposing a regulatory regime that substitutes the judgment of bureaucrats for consumer decisions, Dodd-Frank has raised prices and cut off access to mortgages, credit cards, and bank accounts, harming millions of American families that use credit to improve their lives and depressing economic growth.[3]
- By stripping consumers of mainstream financial products such as mortgages, credit cards, and bank accounts, Dodd-Frank has driven the most vulnerable

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[1] Todd J. Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEORGE WASHINGTON L. REV. 856 (2013).

[2] *But see* Statement of Barney Frank, "Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, U.S. House of Representatives, (Feb. 15, 2012) at p. 8 ("Just a couple of points—first of all, this notion that the director cannot be removed is fanciful. It says in the statute that, yes, the director is appointed for a 5-year term, but can be removed by the president for insufficiency, neglect of duty, or malfeasance. No one doubts that if a change in administration comes, and the new president disagrees with the existing director, he or she can be removed. And proving that you were not inefficient, the burden of proof being on you, would be overwhelming.").

[3] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (Oxford, 2014).

Americans into the arms of check cashers, pawn shops, and payday lenders, increasing their reliance on those products for which sharp practices are most feared. Those products meet an urgent need for many consumers, yet there are few who believe that consumers are made better off when they are driven to use these products involuntarily because of their loss of mainstream products.

- The crushing regulatory compliance cost burden and destruction of community banks' traditional relationship lending model has accelerated consolidation of the retail banking system, making big banks even bigger and further eliminating competition and choices for consumers.
- The CFPB has launched a massive data-mining program that collects data on hundreds of millions of consumer credit cards, mortgages, bank accounts, and other products, an appetite for consumer information that far exceeds any reasonable regulatory purpose. Not only do these data-mining operations impose costs on banks and their customers, the scale of the data-collection efforts creates unprecedented threats to privacy and risks to personal information security.
- The CFPB has announced plans to effectively prohibit consumers and financial institutions from agreeing to have disputes under the contract resolved through arbitration by prohibiting bans on class action litigation. Yet the agency's proposed action is based on a terribly flawed study that fails to demonstrate the CFPB's premise that consumers are harmed by agreeing to arbitration or that they will be benefited by unleashing class action lawyers. Moreover, the findings of the study actually rebut much conventional wisdom regarding arbitration.
- The CFPB has announced plans to regulate payday loans and other small dollar lending products in a fashion that dramatically reduce access to their use yet has provided no workable plan for addressing the lack of financial inclusion for which many small dollar loans are the response.
- Because many small, independent, kitchen-table businesses use products such as personal credit cards, home equity loans, and auto title loans in financing their businesses, the CFPB's powers reach into all of these small businesses as well.

After five years, have Dodd-Frank and the CFPB made American families better off? No. Instead, the overall impact of Dodd-Frank has been to slow our economic recovery, raise prices, reduce choice, and eliminate access to the financial mainstream for American families. And low-income Americans have been hit the hardest.

Bank Accounts and The End of Free Checking for Millions of Americans

The years 2001 to 2009 saw one of the most important pro-consumer innovations in the history of retail consumer financial services: the rapid spread of near-universal consumer access to free checking.[4] It is estimated that during that period, consumer access to free checking accounts increased from under 10 percent of all bank accounts to 76 percent. In the years since Dodd-Frank, however, the number has collapsed to half of that amount—38 percent, as shown in figure 1.[5]

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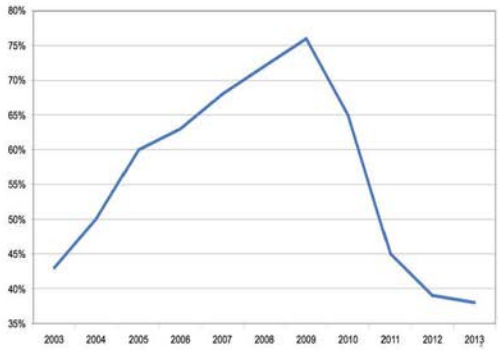
[4] Todd J. Zywicki, Geoffrey A. Manne, and Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (June 4, 2014), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.

[5] *Id.* at 6, figure 1.

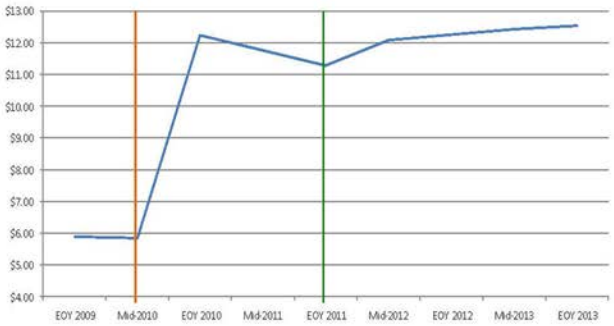
Figure 1. Banks Offering Free Checking from 2003 to 2013



Source: Bankrate.com.

Not only are more consumers forced to pay fees to maintain their checking accounts, those (and other) fees have soared. Fees are twice as high on average as before Dodd-Frank was enacted, as shown in figure 2.[6]

Figure 2. Monthly Maintenance Fee (Non-Free Checking)



[6] *Id.* at 8, figure 4. Mid-2010, of course, is when Dodd-Frank was passed into law. EOY 2011 marks the period at which regulations from the Federal Reserve System (Federal Reserve) regulations implementing the "Durbin Amendment" to Dodd-Frank became effective.

Source: MoneyRates.com.

Figure 2 shows trends in the amounts of monthly maintenance fees for non-free checking accounts since 2009. The first bar (marked mid-2010) marks the date on which Dodd-Frank was signed into law in July 2010, including the Durbin Amendment. Moreover, the passage of the Durbin Amendment with its "hard cap" price controls on permissible interchange fees was completely unexpected. The Durbin Amendment was a last-minute floor amendment to Dodd-Frank and had never been seriously considered previously in any committee prior to being proposed and adopted on the floor. As a result, there was not anticipatory increase in bank fees prior to July 2010, as would have been the case had the enactment of the Durbin Amendment been expected.

The second bar (marked EOY 2011) captures the date at which the Federal Reserve's rule-making went into effect (October 2011). As can be seen, there was a second jump in average bank fees around the period that the Durbin Amendment went into effect.

Moreover, this decline in access to free checking and increase in bank fees has taken place *only* at those banks subject to the Durbin Amendment, larger banks with over $10 billion in assets.[7] In contrast to the dramatic reduction in free checking at large banks, there is no sign of a reduction in access to free checking or increased fees at banks that are not subject to the Durbin Amendment's price controls. In fact, there is some evidence that free checking might have actually increased slightly at exempt banks. This suggests that the loss of access to free checking and higher bank fees is the result of the Durbin Amendment, a factor unique to larger banks, and not general economic conditions or heightened regulation generally.

Most troubling, however, is that low-income and other vulnerable populations have been most adversely impacted by Dodd-Frank's destruction of access to free checking: according to the FDIC, the number of unbanked consumers increased by 1 million between 2009 and 2011 and the number of underbanked consumers increased still faster.[8] While economic recovery has reversed some of those losses for lower-income consumers, the impact of Dodd-Frank has put bank accounts—once the first rung on the ladder of financial inclusion—out of the reach of millions of young and lower-income Americans, forcing them to rely on alternative financial services such as check cashers and pawn shops.

And while the Durbin Amendment has saved big box retailers billions of dollars per year in interchange fees, there is no evidence to date that those cost savings have been passed on to retail consumers. In short, consumers are paying higher fees for bank accounts and receiving no rebates from retailers.[9] Indeed, unlike big box retailers that have received

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[7] *Id.* at 10-13.

[8] FEDERAL DEPOSIT INSURANCE CORPORATION, 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf;

[9] Zhu Wang, Scarlett Schwartz, and Neil Mitchell, *The Impact of the Durbin Amendment on Merchants: A Survey Study*, 100(3) RICHMOND FEDERAL RESERVE ECONOMIC QUARTERLY 183 (3Q 2014).

multi-billion dollar windfalls, many small retailers are actually paying *higher* merchant discount rates than before the Durbin Amendment's enactment.[10]

Credit Cards

Consumers have also suffered a loss of access to credit cards in the post-crisis era, not only because of Dodd-Frank but also the impact of the Credit Card Accountability Responsibility and Disclosure Act—and once again, low-income consumers have suffered the most. According to the CFPB's own estimates, the period between July 2008 and December 2012 saw the closure of 275 million credit card accounts and elimination of $1.7 trillion in credit card line of credit.[11] Overall, the CFPB found a significant decline in the percentage of households that had cards, from 76 percent to 71 percent. But even this figure understates the disproportionate impact on low-income consumers. According to Federal Reserve Board economists Glenn Canner and Gregory Elliehausen, the percentage of households in the lowest quintile of credit scores with credit cards fell from 65 percent in 2008 to 54 percent in 2010.[12] Loss of access to credit cards has forced those consumers into great reliance on higher-cost products such as payday loans and overdraft protection.[13]

Mortgages

The CFPB's "qualified mortgage" (QM) and "ability to repay" rules have dramatically slowed the recovery of the housing market, and fears of government liability have caused even large lenders to reduce lending substantially, especially to riskier borrowers. As Janet Yellen has noted, "banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores."[14] Despite the heavy regulatory burden imposed by the CFPB's mortgage rules, however, the rules are silent with respect to one of the most important risk factors for mortgage foreclosures—the reduction or elimination of minimum down payment requirements.[15] Nor do the rules address state antideficiency laws or cash-out

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[10] *See* Zywicki, *et al.*, *supra* note 4.

[11] CONSUMER FINANCIAL PROTECTION BUREAU, CARD ACT REPORT: A REVIEW OF THE IMPACT OF THE CARD ACT ON THE CONSUMER CREDIT MARKET 56 (Oct. 1, 2013).

[12] Glenn B. Canner and Gregory Elliehausen, *Consumer Experiences with Credit Cards* at 10 Table 2, FEDERAL RESERVE BULLETIN (Dec 2013), online at http://www.federalreserve.gov/pubs/bulletin/2013/pdf/consumer-experiences-with-credit-cards-201312.pdf. By contrast, for highest-quintile households, card holding fell only one percentage point (from 91 percent to 90 percent of households).

[13] *See* Robert L. Clarke and Todd J. Zywicki, *Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau*, 33 REVIEW OF BANKING AND FINANCIAL LAW 235 (2013-14).

[14] *See* Federal Reserve Board, *Transcript of Chairman Yellen's Press Conference* at p. 12 (June 18, 2014):

> Banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores. They mention in meetings with us consistently their concerns about put-back risk, and I think they are—it is difficult for any homeowner who doesn't have pristine credit these days to get a mortgage. I think that is one of the factors that is causing the housing recovery to be slow. And of course, you know, there were a lot of practices in connection with mortgage lending that really needed to be changed, we don't want to go back to those days, but it is important to clarify—for us to work to clarify the rules around mortgage lending to create an environment of greater certainty for lenders to be willing to extend mortgage credit.

[15] *See* Zywicki, *supra* note 1, at 913.

refinancing by homeowners, both of which have been shown to have materially contributed to the foreclosure crisis.[16]

As a result of the regulations imposed by Dodd-Frank and the CFPB many smaller banks have simply chosen to exit the market rather than to bear the regulatory cost and risk. According to a survey of small banks conducted by the Mercatus Center at George Mason University, 64% of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank and 15 percent said that they had either exited or were considering exiting residential mortgage markets entirely.[17] Nearly 60 percent of small banks reported that the CFPB or the qualified mortgage rule had a "significant negative impact" on their mortgage operations. Nearly 60 percent said that the CFPB has had a significant negative effect on bank earnings and more than 60 percent said that changes in mortgage regulations had had a significant negative effect on bank earnings.

Moreover, by imposing a one-size-fits-all mechanical underwriting system for mortgages, the Qualified Mortgage rule has deprived community banks of a significant competitive advantage over megabanks: their intimate familiarity with their customers and their ability to engage in relationship lending with their customers. One illustration of the value of the traditional relationship-lending model for residential mortgages is that the default rate for residential mortgages made by community banks (with less than $1 billion in assets) was 3.47 percent in 2013 compared to a default rate of 10.42 percent for banks with more than $1 billion in assets.[18] Thus, this regulatory-induced decline in the market share of small banks is not only hurting consumers, it is making the banking system less stable and less effective. Consumers face a market with fewer choices, less innovation, and less competition than before.

As many banks have exited the mortgage market,[19] non-bank lenders (typically less-regulated than banks) have filled the market demand, increasing their share of mortgage lending from 10 percent in 2009 to 43 percent in 2015.[20] Ironically, one consequence of

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[16] *See* Todd J. Zywicki and Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 UNIVERSITY OF COLORADO L. REV. 1 (2009) (summarizing studies). In fact, Section 1414(g) of Dodd-Frank Dodd-Frank actually mandates new disclosures before a consumer loses his or her anti-deficiency law protection, a provision that will increase defaults and foreclosures in the event of a future downturn in housing prices. Other provisions of Dodd-Frank, including new regulations on mortgage servicing companies and new substantive regulations on foreclosure processes under Dodd-Frank Section 1413, will also increase the cost and length of the mortgage foreclosure process, which also has been shown to lead to increased defaults and foreclosures.

[17] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Fairing Under Dodd-Frank?* Mercatus Center Working Paper No. 14-05 (Feb. 2014).

[18] *See* FDIC Statistics on Depository Institutions, accessed July 16, 2013, http://www2.fdic.gov/sdi/main.asp. Loans in default are defined as nonaccrual loans or loans past due 30 or more days. These data include one to four family residential properties.

[19] *See supra* note 14.

[20] *See* Diana Olick, *How Dodd-Frank Changed Housing, for Good and Bad*, CNBC.COM (Jul. 16, 2015), *available in* http://www.cnbc.com/2015/07/16/how-dodd-frank-changed-housing-for-good-and-bad.html.

Dodd-Frank and the CFPB's aggressive regulation and litigation against banks has been to drive consumers toward a variety of lenders with less regulatory scrutiny.[21]

At the same time, because the Qualified Mortgages rule and other elements of Dodd-Frank fail to address the underlying structure of incentives for consumers when housing prices fall, there is little evidence that Dodd-Frank and the regulations promulgated pursuant to it will actually accomplish their goal of reducing foreclosures in a future downturn. Peter Wallison, former general counsel of the Department of the Treasury, estimated that had the QM rules applied in the period leading up the financial crisis, the default rate on QM–conforming mortgages would have still been 23 percent.[22] Summarizing the assembled conclusions of several studies, economist Mark Calabria concluded that the proposed restrictions on debt to income ratios in the QM and QRM (Qualified Residential Mortgages) rules "appear to have very modest impacts on projected defaults."[23] Requiring lower loan-to-value ratios (such as by requiring larger down payments or restricting cash-out refinancing), by contrast, would have substantially reduced defaults and foreclosures during the financial crisis[24]; however, the final mortgage rules eliminated any minimum down payment requirements for QM and QRM mortgages, thus eliminating one of the reforms that would have had the most significant effect on foreclosures.

Although the new mortgage rules are expected to have very little impact on reducing defaults, they have had a large impact on reducing mortgage lending, especially in the subprime market.[25] In substantial part, the imposition of reams of bureaucratic red-tape and paperwork has made it more of a hassle for consumers to apply for and receive a mortgage.[26] For example, the "average large bank underwriter could process about 165 loans per month in 2005 but can only do about 33 today."[27] According to industry analyst

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[21] Let me emphasize that I am *not* implying that just because non-bank lenders are less lightly regulated and supervised that one should infer that they are engaging in malfeasance. But for the architects of Dodd-Frank it is hard to see how this would be considered a desirable effect of the law and regulation.

[22] PETER WALLISON, HIDDEN IN PLAIN SIGHT: WHAT REALLY CAUSED THE WORLD'S WORST FINANCIAL CRISIS AND WHY IT COULD HAPPEN AGAIN (2015).

[23] Testimony of Mark A. Calabria, Ph.D. Director, Financial Regulation Studies, Cato Institute Before the Committee on Financial Services United States House of Representatives Hearing entitled "The Dodd-Frank Act Five Years Later: Are We More Stable?" (July 9, 2015) at 13; *see also id.* at 13 n.16 ("The presence of a DTI in excess of 41 percent increases the probability of default by 0.25, 0.08, and 0.59 for fixed rate, long-term ARM and Hybrid ARM, respectively. Accordingly to GAO's analysis, reducing the prevalence of mortgages with a DTI in excess of 41 will have barely notice effects (although statistically significant in all cases)" (citing UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE. 2010. NONPRIME MORTGAGES: ANALYSIS OF LOAN PERFORMANCE, FACTORS ASSOCIATED WITH DEFAULTS, AND DATA SOURCES. Report to Congress, GAO-10-805 (Aug. 2010).

[24] Calabria Testimony, *supra* note 23, at 13-14 ("For fixed rate non-prime purchase loans, moving from a LTV of 100 to under 80 percent reduces projected default probabilities by over 3 percentage points. For hybrid non-prime ARMs, the reduction in projected default probabilities is just over 6 percentage points. Coupled with full documentation and a LTV under 80 percent, one could eliminate over 70 percent of the standardized default risk among hybrid non-prime ARMs. Academic studies have arrived at similar conclusions when examining the drivers of default among subprime mortgages.").

[25] *Id.*

[26] *See* Olick, *supra* note 20.

[27] *Id.*

Realtytrac, by 2013 the U.S. Mortgage market had recovered to the extent that mortgage originations had increased to over 2.5 million per quarter, exceeding $600 billion in mortgages originated. Following the roll out of the QM proposal in 2013, however, mortgage originations collapsed to under1.5 million per quarter (and less than $400 billion in amount) and have remained below the pre-QM levels since.[28] Although the high costs imposed by the implementation of the CFPB's new TRID integrated mortgage disclosure forms may be temporary to some extent, it has imposed still further regulatory cost and complexity that has continued to drag down recovery in the mortgage market.[29]

Disappearing Small Banks

The regulatory costs imposed by CFPB and Dodd-Frank have fallen particularly heavily on smaller community banks and credit unions. Although consolidation in the banking industry was occurring prior to Dodd-Frank, Dodd-Frank has accelerated these trends by driving out smaller community banks that comparatively lack the resources to comply with Dodd-Frank's crushing and ham-fisted regulatory burden. For example, a recent study by scholars at the Kennedy School of Government found that in the period since Dodd-Frank was enacted, the asset bases of smaller banks have shrunk twice as fast after Dodd-Frank's enactment compared to before, a result that they attribute to the high regulatory costs imposed by Dodd-Frank.[30] In addition, the Mercatus Center study of the impact of Dodd-Frank on smaller banks found that the law has imposed huge compliance costs on small banks and that they have been less able to bear those costs than large banks.[31] Overall, according to the Mercatus Center study, 71 percent of small banks stated that the CFPB has affected their business activities.[32]

The ripple effects of the displacement of smaller banks by large banks are not limited to the direct impact on the consumer banking system but carry over to other markets as well, including agricultural and small business loans. Community banks traditionally have provided a disproportionate share of small-business lending in the economy.[33] According to the summary of one report by Goldman Sachs:

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[28] Realtytrac, U.S. Residential Loan Originations Increase 17 percent in Q1 From a Year Ago Depsite 6 Percent Drop From Previous Quarter (May 14, 2015), *available in* http://www.realtytrac.com/news/realtytrac-reports/q1-2015-u-s-residential-loan-origination-report/.

[29] *See* RealtyTrac, *U.S. Residential Loan Originations Decrease14 Percent in Fourth Quarter Driven by 24 Percent Drop in Purchase Loans*, REALTYTRAC.COM (Feb. 16, 2016), *available in* http://www.realtytrac.com/news/mortgage-and-finance/q4-2015-u-s-residential-property-loan-origination-report/; *see also* Brena Swanson, *It's Official: TRID Kills Mortgage Profits*, HOUSINGWIRE.COM (March 17, 2016), http://www.housingwire.com/articles/36541-trid-slashes-independent-mortgage-banks-profits-by-60.

[30] Marshall Lux and Robert Greene, *The State and Fate of Community Banking*, M-RCBG Associate Working Paper No.37 (February 2015) online at http://www.valuewalk.com/wp-content/uploads/2015/02/Final_State_and_Fate_Lux_Greene.pdf.

[31] Hester Pierce, Ian Robinson and Thomas Stratmann, *How Are Small Banks Fairing under Dodd-Frank?*, George Mason University Mercatus Center Working Paper No. 14-05 (February 2014), online at http://mercatus.org/publication/how-are-small-banks-faring-under-dodd-frank; *see also*

[32] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Fairing Under Dodd-Frank?* Mercatus Center Working Paper No. 14-05 (Feb. 2014).

[33] GOLDMAN SACHS, THE TWO-SPEED ECONOMY (Apr. 2015), *available in* http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/2-speed-economy-report.pdf;

> While there is some added subtlety to the results of our analysis, we find in general that low-income consumers and small businesses – which generally have fewer or less effective alternatives to bank credit – have paid the largest price for increased bank regulation. For example, for a near-minimum wage worker who has maintained some access to bank credit (and it is important to note that many have not in the wake of the financial crisis), the added annual interest expenses associated with a typical level of debt would be roughly equivalent to one week's wages. For small and mid-sized businesses the damage from increased bank regulation is even greater: their funding costs have increased 175 basis points more than those of their larger peers, when measured against the pre-crisis period. That funding cost differential is enough to seriously damage the ability of smaller firms to compete with their larger competitors. This fact has become all too evident in the economic statistics and is already changing the shape of American business, as small and mid-sized firms, the historic engines of US job creation, shrink and sometimes disappear, displaced by large corporations.[34]

As community banks have been driven out of the market by regulatory costs, small business credit has contracted as well, dampening entrepreneurship and economic growth. As noted by one analysis, large firms have performed well since the financial crisis and subsequent recovery, but small firms have suffered low rates of formation, employment growth, and wage growth.[35] Indeed, the number of small firms in the economy actually declined over the period since the crisis, as more small firms disappeared than were created, the first time that this has happened since data became available in the 1970s.[36]

A primary explanation for this drop in small business formation and growth is Dodd-Frank and increased financial regulation since the financial crisis, which has fallen especially hard on smaller banks relative to larger banks.[37] Overall, a recent analysis of FDIC data found that while bank loans to small businesses had declined by 16% since 2008, loans to large businesses had increased by 37% over that same period.[38] As one commenter described the situation, large banks "have effectively abandoned the small business market."[39] Another analysis concluded that small business loans are down about 20 percent since the financial crisis while loans to larger businesses have increased by

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Lux & Greene, *supra* note, at 1 (noting that community banks provide 77 percent of agricultural and over half of small business loans).

[34] GOLDMAN SACHS, WHO PAYS FOR BANK REGULATION? 2-3 (June 2014); http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/who-pays-for-bank-regulation-pdf.pdf.

[35] Goldman Sachs, *The Two-Speed Economy* 2 (April 2015).

[36] *Id.*

[37] Goldman Sachs, *Who Pays for Bank Regulation*, *supra* note.

[38] Ruth Simon, *Big Banks Cut Back on Loans to Small Business*, WALL ST. J. (Nov. 26, 2015).

[39] *Id.*

about 4 percent over the same period.[40] It appears that some of the unmet demand from the reduction in community bank lending is being served by non-bank lenders that charge higher rates than traditional small business bank loans and which, ironically, are much less-regulated that the traditional banks that they have replaced.[41]

According to Wells Fargo Quarterly survey of small business owners, in the 3rd Quarter of 2015, just 33% of small business owners surveyed stated that it would be "very easy" to obtain credit if they needed it and 22% said that it would be "somewhat difficult" or "very difficult."[42] By contrast, during the period from the 1Q2004-4Q2007, an average 51% of small business owners said that it was "very easy" or "somewhat easy" to obtain credit if they needed it, and about 12% said it would be difficult. In addition, among those who said that it was easy to obtain credit in the 2004-07 period, 2/3 of those reported it was "very easy" compared to "somewhat easy," whereas only about half of those who said that it would be easy in the 2015 pool reported that it would be "very easy."

As smaller banks have been disappearing and exiting certain markets, large banks have grown still larger and Dodd-Frank has increased their insulation from competitive pressures. In fact, large banks have admitted as much. For example, JP Morgan Chase CEO Jamie Dimon observed that the aggregate costs of complying with all of the rules, regulations, and capital costs associated with Dodd-Frank has built a "bigger moat" to protect his bank from competition from smaller rivals.[43] Similarly, Goldman Sachs CEO Lloyd Blankfein announced in 2010 that the bank would be "among the biggest beneficiaries" of Dodd-Frank as its regulatory costs and regulatory-created profit opportunities would be particularly advantageous to large banks that could bear those costs more easily than smaller competitors.[44]

Moreover, because many of Dodd-Frank's most expensive rules kick-in once a bank reaches $10 billion in assets, that figure acts as a sort of tripwire—either banks try to remain below that threshold, or if they do cross it, then they accelerate their merger activities to try to gain the size and economies of scale necessary to cope with heightened regulatory costs. Thus, the market is becoming increasingly bifurcated between large

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[40] *See* Karen Gordon Mills & Brayden McCarthy, *The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game*, Harvard Business School Working Paper 15-004 (July 22, 2014).
[41] *Id.*
[42] Gallup/Wells Fargo Small Business Survey 24-25, https://wellsfargoworks.com/File/Index/btDsu4gv9UqK07hpFKVbgw (Oct. 3, 2015) (responses to Question 11).
[43] Rick Rouan, *Dimon says Dodd-Frank puts 'bigger moat' around JPMorgan Chase*, COLUMBUS BUSINESS FIRST (Feb. 5, 2013), *available in* http://www.bizjournals.com/ columbus/blog/2013/02/dimon-says-dodd-frank-puts-bigger.html.
[44] Timothy P. Carney, *Goldman and JPMorgan sit safely behind the walls of Dodd-Frank*, WASHINGTON EXAMINER (Feb. 12, 2015), *available in* http://www.washingtonexaminer .com/goldman-and-jpmorgan-sit-safely-behind-the-walls-of-dodd-frank/article/ 2560179.

banks and very small banks, as medium-sized banks grow larger.[45] On the other hand, only one new bank has been formed since the financial crisis and small banks continue to merge or otherwise disappear as a result of their own regulatory costs. This phenomenon of the disappearance of small banks and the lack of creation of new ones led economists from the Dallas Federal Reserve bank to ask whether small banks are "too small to succeed" in light of the huge growth in regulatory cost and complexity imposed in the period since the financial crisis.[46] They too note the important role played by community banks in small business lending and agricultural markets and the adverse effects on small-business formation and growth as a result of this trend toward the disappearance of small banks.

Perhaps most remarkable, despite the thousands of pages of the Dodd-Frank statute and hundreds of regulations promulgated under it, there is broad agreement that the problem of so-called "Too-Big-To-Fail" institutions persists. Thus, although there is some evidence that the "subsidy" for large banks from implicit government guarantees may have narrowed in the wake of Dodd-Frank, few believe it has been eliminated completely. A report by the Government Accountability Office concluded that while Dodd-Frank may have reduced the size of the so-called "TBTF subsidy" for large banks it did not eliminate it, indicating that large banks still retain an implicit government guarantee.[47] A study by the International Monetary Fund concluded that the subsidy to TBTF banks in the United States amounts to some $70 billion per year in lower capital costs and that in turn the existence of an implicit government guarantee promotes the moral hazard problem of greater risk-taking by large banks.[48]

In short, Dodd-Frank appears to have entrenched the dominance of large banks in the market while simultaneously crushing small banks.

The CFPB's Data Mining Operations

Government power unconstrained by the rule of law also has direct implications for consumers by cultivating an environment of bureaucratic hubris at the expense of the rest of us. Consider the CFPB's extraordinary data mining program of American families' financial accounts. According to a report by the Government Accountability Office, the CFPB collects information on 10.7 million individual consumer credit reports on a monthly and quarterly basis, more than 500 million credit card accounts on a monthly basis, and 29 million active mortgages and 173 million total mortgages on a monthly

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[45] Leslie Picker and Matthew Monks, *Small Banks Feel the Urge to Merge*, BLOOMBERG BUSINESS (Oct. 3, 2013); http://www.bloomberg.com/bw/articles/2013-10-03/dodd-frank-fills-small-banks-with-the-urge-to-merge.

[46] *See* Preston Ash, Chistoffer Koch, and Thomas F. Siems, *Too Small to Succeed?—Community Banks in a New Regulatory Environment*, DALLAS FED FINANCIAL INSIGHTS, Vol. 4, Issue 4 (Dec. 31, 2015).

[47] GOVERNMENT ACCOUNTABILITY OFFICE, LARGE BANK HOLDING COMPANIES: EXPECTATIONS OF GOVERNMENT SUPPORT (July 2014).

[48] International Monetary Fund, *Big Banks Benefit from Government Subsidies*, Global Financial Stability Report (2014) online at http://www.imf.org/external/pubs/ft/survey/so/2014/POL033114A.htm. Other studies reach different conclusions on the continued existence of the TBTF subsidy. For a summary of the literature as well as a caveat on the conclusions that can be drawn, *see* Todd J. Zywicki, *The Rule of Law During Times of Economic Crisis* (Aug. 26, 2015), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2651893.

basis.[49] Moreover, because this data-mining program was not initiated according to any sort of formal notice and comment rulemaking procedure, it is not subject to cost-benefit analysis or any other evaluation as to whether such extensive snooping is necessary to further any legitimate regulatory purpose. In fact, George Mason University economist Thomas Stratmann has estimated that the number of credit card accounts for which the CFPB wants to collect consumer information is some 70,000 times greater than is necessary for the agency to execute its regulatory mission.[50] Indeed, the Bureau itself has refused to permit consumers an opportunity to opt-out of the program, admitting that if consumers were permitted to withdraw consent to the program the government would be unable to obtain the data.[51]

But the costs of CFPB's demand for information do not fall solely on the banks that must provide it. While the CFPB claims that this data is anonymous, every bit of information increases the risk to consumers of identity theft and other misuse of their information. In fact, testifying before this committee last year, CFPB director Richard Cordray admitted that the information the CFPB collects is not 100 percent secure and could be hacked.[52] Moreover, according to a recent article in *Science*, using only three months of anonymous credit card data, the researchers were able to reidentify 90 percent of individuals, with women being more readily reidentifiable than men.[53]

While the unnecessary acquisition and retention of troves of Americans' information is troubling enough in itself, it is especially worrisome in light of repeated rebukes of the CFPB's faulty data security systems.[54] Following massive data security breaches and compromising of personal information by the Internal Revenue Service and Office of Personnel Management, it is inexplicable that the CFPB continues to insist on vacuuming up excessive amounts of consumer data without considering the privacy threat to consumers. Leaving aside the risk of creating a massive trove of financial data for private hackers to target, Americans also have a fundamental interest in not having their purchases tracked by the federal government and an expectation that the government should not demand any more personal financial data than is necessary to advance its legitimate regulatory purposes.

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[49] GOVERNMENT ACCOUNTABILITY OFFICE, CONSUMER FINANCIAL PROTECTION BUREAU: SOME PRIVACY AND SECURITY PROCEDURES FOR DATA COLLECTIONS SHOULD CONTINUE BEING ENHANCED (2014).

[50] *See* Letter of Professor Thomas Stratmann to Congressman Scott Garrett (Jan. 23, 2014), *available in* http://mercatus.org/sites/default/files/StratmannCFPBStatisticMethods.pdf.

[51] *See* Richard Pollock, *Federal Consumer Bureau Data-Mining Hundreds of Millions of Consumer Credit Card Accounts, Mortgages*, WASHINGTON EXAMINER (Jan. 29, 2014), *available in* http://www.washingtonexaminer.com/consumer-bureau-data-mining-hundreds-of-millions-of-consumer-credit-card-accounts-mortgages/article/2543039.

[52] *Id.*

[53] Yves-Alexandre de Montjoye, Laura Radaelli, Vivek Kumar Singh, and Alex "Sandy" Pentland, *Unique in the Shopping Mall: On the Reidentifiability of Credit Card Metadata*, 347 SCIENCE No. 6221 536-39 (Jan. 30, 2015).

[54] *See* Government Accountability Office, *Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced* (Sept. 2014); Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Office of Inspector General, *Security Control Review of the CFPB's Cloud Computing–Based General Support System*, 2014-IT-C-010 (Washington, D.C.: July 17, 2014).

Remaking the Auto Finance Market Through Regulatory Overreach

A particularly striking example of the CFPB's tendency toward jurisdictional overreach and lawless behavior is its efforts to remake the auto finance market by indirectly regulating loans made by auto dealers. Fair lending laws that prohibit discrimination in making loans apply to auto dealers. It is clear, however, that Dodd-Frank prohibits the CFPB from exercising jurisdiction over loans made by auto dealers, leaving that responsibility by implication to other federal agencies such as the Federal Trade Commission and DOJ.[55]

Lacking the authority to reach the auto dealers, the CFPB came up with a creative solution—it decided to hold the financial institutions (the indirect lenders) responsible for any alleged discriminatory lending patterns by the auto dealers themselves. Under the CFPB's new regime, indirect lenders bear this responsibility even though they have no interaction with the borrower, information about the borrower's race, or any reason to believe that the dealers is engaged in discriminatory lending patterns. Moreover, the indirect lenders would be held responsible according to the theory of "disparate impact," making the indirect lenders responsible for any statistical anomalies that seemed to exist, regardless of the lack of any evidence of intentional discrimination.

A prime illustration of the CFPB's regulatory approach was its decision to target Ally Financial for its first high-profile settlement for alleged discrimination in auto dealer markups.[56] According to internal documents examined by the House Financial Services Committee, the CFPB identified Ally as its first target not because Ally had acted in a particularly improper fashion, but because Ally was particularly vulnerable to being strong-armed into a settlement. This was for three reasons. First, as a result of the continued legacy of the auto bailouts, the federal government still held a 73.8% stake in Ally at that time (and still held 63.4% at the time the case was actually settled). Second, Ally had an application pending in front of the Federal Reserve to become a financial holding company, approval of which was necessary to continue its insurance and used-car remarketing operations. Third, the FDIC was conducting a Community Reinvestment Act review of Ally and settlement of the CFPB investigation was a precondition to receive a satisfactory CRA rating, which in turn was necessary for approval of Ally's status change to become a financial holding company. Notably, the CFPB's Director is one of five members of the FDIC's board of directors.[57] Faced with these obstacles, Ally eventually capitulated and finally paid $98 million for restitution and civil penalties. More than one observer has analogized the CFPB's behavior in the matter to a "shakedown" or "extortion" racket.

On the other hand, because the CFPB never identified particular victims of discrimination but relied on statistical aggregates, it had no way of identifying the race of the supposed

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[55] Dodd-Frank Wall Street Reform and Consumer Protection Act § 1029(a), Pub.L 111-203, H.R. 4173 (2010).

[56] Report of Republican Staff of the Committee on Financial Services, U.S. House of Representatives, *Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending* (Nov. 24, 2015).

[57] *See* Ronald L. Rubin, *The Rogue Regulator*, THE WEEKLY STANDARD (Feb. 15, 2016).

victims or to identify those to whom restitution should be paid. Instead, the CFPB relied on a statistical technique known as Bayesian Improved Surname Geocoding, which has been demonstrated to be statistically invalid for these purposes.[58] Indeed, according to documents secured by the House of Representatives Financial Services Committee, the CFPB itself was aware of the flaws in the methodology and the CFPB's proposed use, yet nevertheless persevered, using it as a basis to establish liability. The result has been to issue "restitution" checks to many people who have provided no evidence that they were the subject of racial discrimination—including at least one identified beneficiary who is not even a minority.[59] Ally's former CEO Michael Carpenter estimates that up to 20% of the checks being sent out by the government as a result of the settlement are being sent to non-minorities and Ally itself has decided to randomly cut refund checks to some of its customers outside of the settlement as a preemptive strike to try to avoid future risk of liability.[60] And while the settlement has delivered millions of dollars of "recourse" to consumers who may have suffered no harm, even possibly including many non-minorities, according to a report in the *Wall Street Journal*, by narrowing the range over which dealers and consumers can bargain, the overall effect of the CFPB's micro-managing of the auto finance market has resulted in higher interest rates on car loans for consumers.[61]

Notably, the CFPB's attack on indirect auto lenders was issued through a five page "Guidance" document that provided no information about the basis for the CFPB's claim of widespread discrimination or, originally, any methodology for determining liability, no opportunity for public comment or other due process protections, and no assessment of

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[58] *See* Arthur P. Baines and Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, American Financial Services Association (November 19, 2014), *available in* http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf.

[59] *See Do Two Half Victims Make a Whole Case?*, WALL ST. J. (Apr. 13, 2015), *available in* http://www.wsj.com/articles/do-two-half-victims-make-a-whole-case-1428966741.

[60] Paul Sperry, *Bank CEO Reveals How Obama Administration Shook Him Down*, NY POST (Feb. 21, 2016). According to a second report by the House Financial Services Committee, the CFPB never even examined many of these relevant factors. *See* REPORT PREPARED BY REPUBLICAN STAFF OF THE COMMITTEE ON FINANCIAL SERVICES, U.S. HOUSE OF REPRESENTATIVES, HON. JEB HENSARLING, CHAIRMAN, UNSAFE AT ANY BUREAUCRACY, PART II: HOW THE BUREAU OF CONSUMER FINANCIAL PROTECTION REMOVED ANTI-FRAUD SAFEGUARDS TO ACHIEVE POLITICAL GOALS at 8 (Jan. 20, 2016) ("The fact that a particular consumer paid more or less than average says nothing about whether that consumer was treated unfairly. Only by comparing that consumer to other similarly situated consumers – those with a similar creditworthiness, financing a similar amount at the same dealer at around the same time, etc. – can the Bureau draw a meaningful conclusion about whether a particular consumer was 'overcharged.").

[61] *See* Annamaria Andriotis & Gautham Nagesh, *Crackdown on Racial Bias Could Boost Drivers' Costs for Auto Loans*, WALL ST. J. (Aug. 31, 2015), http://www.wsj.com/articles/crackdown-on-racial-bias-could-boost-drivers-costs-for-auto-loans-1441038864. The CFPB ignores other important elements of the inquiry especially that, unlike many other credit transactions, a car loan from an auto dealer is not a stand-alone transaction but is linked to the purchase of a car. For example, auto dealers offer promotional financing deals on particular car models in order to move inventory (rather than cutting the sticker price), which can result in spurious implications of differential pricing overall.

the impact on consumers.[62] According to Ally's Carpenter, the CFPB "tried to hide" the methodology it used to determine that discrimination had occurred and when Ally finally obtained the underlying data and analysis, it concluded that "non-discriminatory factors," such as "credit differences, vehicle type purchased, trade-ins, and down payments" accounted for "virtually all of the disparities in the loan data."[63]

This practice of regulating consumer credit through informal means such as regulatory guidance, letters, and other informal means of what the Competitive Enterprise Institute's Wayne Crews has dubbed "regulatory dark matter,"[64] seems to have become commonplace with respect to the making of consumer credit policy. A similar example is a recent letter from CFPB Director Richard Cordray that reportedly "asks" the nation's 25 largest banks to "voluntarily" make low cost, no overdraft accounts available to consumers, presumably at a loss to the bank and subsidized by other bank customers.[65] The request, of course, has no legal significance, yet the decision by the CFPB to make the request in public is clearly intended to nudge certain banks toward taking this step. Indeed, most banks have interpreted this "request" as functionally equivalent to a regulatory mandate. Common sense and compliance with the principles of the rule of law suggest that an agency action that could impose millions of dollars of costs on certain banks within the industry should be undertaken with proper procedural regularities, not through a "letter" from the CFPB Director to the targeted banks. This tendency to make consumer protection policy through such "regulatory dark matter" processes should be scrutinized closely and the use of abusive tools that circumvent proper regulatory processes should be stopped.

Arbitration

The CFPB's latest regulatory target is to effectively prohibit consumers and retail financial services providers from contracting voluntarily to agree to have any disputes that arise from being subjected to arbitration instead of retaining the right to engage in class action litigation.[66] In so doing, the CFPB would be rejecting decades of federal policy that supports the use of arbitration and other forms of alternative dispute resolution processes as opposed to litigation as less-expensive, faster, less contentious, and less taxing on the public court system.[67] Before undertaking such an aggressive rejection of longstanding federal policy, one would expect the CFPB to have an especially sound

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[62] Consumer Financial Protection Bureau, *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act*, CFPB Bulletin 2013-02 (March 21, 2013), *available in* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

[63] Sperry, *supra* note 60.

[64] *See* CLYDE WAYNE CREWS, JR., MAPPING WASHINGTON'S LAWLESSNESS 2016: A PRELIMINARY INVENTORY OF "REGULATORY DARK MATTER," Competitive Enterprise Institute Issue Analysis 2015 No. 6 (Dec. 2015).

[65] *See* Yuka Hayashi, *CFPB Asks Banks to Make Low-Cost Accounts Available to Consumers*, WSJ.COM (Feb. 3, 2016).

[66] *See* Joe Adler, *CFPB Plan would all but Ban Arbitration Clauses*, AM. BANKER (Oct. 7, 2015) ("It may not be an outright ban on arbitration clauses, but the Consumer Financial Protection Bureau's impending proposal to enable more class action lawsuits comes close.").

[67] *See, e.g.*, *AT&T Mobility v. Concepcion*, 563 U.S. 321 (2011).

basis for its action. Yet the CFPB's proposal is based almost completely on a single report, one that is plagued by junk social science and flawed methodology.[68]

In fact, many of the findings in the CFPB's Report actually undermine the agency's conclusion that arbitration is unfair to consumers.[69] First, contrary to the claims of many critics of arbitration, the report finds that consumers generally have great choice in whether to enter into a contract that contains an agreement to arbitrate. For example—*according to the CFPB's own findings*—many financial services providers do not include arbitration clauses in their contracts. For example, only 8% of banks include arbitration providions in their checking account contracts and only 16% of credit card issuers do the same. In other words, if a consumer prefers a checking account or credit card agreement that does not have an arbitration clause, he or she can choose among hundreds or thousands of providers. Although arbitration clauses are more common in contracts in other industries (such as prepaid cards and payday loans) the variety among issuers and industries suggests that choice is plentiful and consumers are not required to enter into such contracts on a "take it or leave it" basis.

The CFPB further finds, however, that very few consumers know whether they have an arbitration clause in their contracts with financial services providers and do not generally shop for providers based on the ability to enter a class action suit if things go wrong. According to the CFPB, this failure to shop suggests a market failure—that consumers are unaware that they are waiving their right to sue in the event that they have a disagreement with their provider.

A more plausible explanation readily presents itself: Consumers recognize that although class action lawsuits benefit the lawyers that bring them, those lawsuits rarely provide much benefit to consumers beyond their other options of redress that remains available, including arbitration. It is important to recognize that consumer arbitration is not completely unregulated: courts rigorously scrutinize arbitration processes to ensure that they are fair and efficacious for consumers. Moreover, as the CFPB Report demonstrates, almost 2/3 of consumers are represented by counsel in arbitration proceedings, a figure that exceeds 90% for disputes involving student and payday loans. Most arbitration disputes are resolved in less than 5 months—far faster than litigation—and 57% end in a settlement and 6% in an award in the consumer's favor, comparable to 48% and 6% in individual litigation. Indeed, research by othe scholars finds that consumers generally win *more frequently* in arbitration of some types of disputes than in litigation, in part because of the cosumer-friendly features of arbitration, such as reduced expense and complexity.[70] Moreover, the development of arbitration proceedings by Skype and telephone makes such proceedings even faster and less expensive. Indeed, only 1% of consumers in the CFPB's study even said that they would consider suing if they had a

[68] CONSUMER FINANCIAL PROTECTION BUREAU (CFPB), ARBITRATION STUDY: REPORT TO CONGRESS 2015 (March 2015).

[69] The following discussion relies on JASON SCOTT JOHNSON & TODD ZYWICKI, THE CONSUMER FINANCIAL PROTECTION BUREAU'S ARBITRATION STUDY: A SUMMARY AND CRITIQUE (Mercatus Working Paper, Aug. 2015).

[70] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77 (2011).

dispute with their financial services provider. Consumers don't value the right to join class action lawsuits against their financial services provider because they recognize that while class aciton litigation benefits the lawyers that bring the cases they rarely provide much in redress to consumers compared to the alternative measures available to resolve their disputes.

More important, the CFPB ignored the most common method by which consumers resolve disputes—through an internal complaint and dispute resolution process. Indeed, most consumers in the CFPB's survey said that if they were dissatisfied, they would simply cancel their credit card or bank account and walk across the street to another provider. And banks, like other businesses, take this threat seriously.[71] data provided to Professor Jason Johnston and me by a mid-size bank in Texas, 68% of complaints about bank fees and the like were resolved in the customer's favor with a refund and the average size of the refund was $58, compared to an average recovery of $32 in the average class action recovery in the CFPB's Report. In short, most consumers seem to implicity recognize that the availability of powerful competitive market checks backed up by the potential to arbitrate if necessary, are much more potent methods of redress than a class action suit, with its accompanying delay and expense.

Yet the CFPB contends that arbitration is an ineffective tool for consumers, pointing to the relatively small number of small-dollar arbitration cases it found in its database of cases. Yet even if accurate, the finding of a relatively small number of small-dollar arbitration cases does not necessarily imply the conclusion that arbitration is an ineffective tool for consumers. This is for several reasons.

First, as noted, a large number of consumer disputes are resolved through internal complaint-resolution processes and without resorting to litigation or arbitration. Indeed, according to the data that Johnston and I reviewed, that one mid-sized bank alone provided over $2 million in refunds to consumers last year. Across the banking system as a whole, consumers likley receive hundreds of millions of dollars or even billions in voluntary refunds every year, without ever resorting to litigation or arbitration or even threatening to do so. Yet in the CFPB's upside-down worldview, arbitration could be thought to be effective only if banks refused to issue refunds and forced consumers to arbitrate to get redress. Thus, the absence of small-dollar arbitration proceedings might simply reflect the effectivenss of informal complaint resolution processes rather than a failure of the efficacy of arbitration. Moreover, as noted above, the average refund given in response to a complaint was substantially higher than the average redress provided to consumers through class action lawsuits. Before banning arbitration clauses on the basis that arbitration is ineffective for consumers, the CFPB *must* first consider alternative explanations for the apparently small number of small-dollar arbitrations—such as the use of internal dispute resolutions processes.

[71] The logic is straightforward: It is estimated that it costs as much as several hundred dollars for banks to acquire one new account. Given that reality, few banks are going to alienate good customers over a $3 ATM fee or $29 overdraft fee, even if the fee was assessed appropriately.

But the failure to account for internal complaint resolution processes is just one of the methodological flaws in the CFPB's analysis on this point. For example, available data (although spotty) suggests that small-dollar aribtrations are quite common in other industries, such as cellphone contracts, which suggests that their absence in financial services may be attributable to reasons other than the lack of cost-effective arbitration processes. Finally, the CFPB fails to recognize that although small-dollar arbitration cases are infreqent for financial service providers, there are also very few small-dollar *litigation* cases as well. Yet this finding may have little to do with the cost-effectiveness of the processes—instead, it may reflect that many consumer financial protection statutes provide for minimum "statutory damages" for a violation of the statute, regardless of the actual harm to consumers. Thus, for example, many statutes provide for a minimum of $1,000 or $1,500 per violation, regardless of consumer harm. As a result, consumers tend to bring actions for the minimum statutory damage amount, which results in n apparent absence of small-dollar arbitrations.

The CFPB Report also grossly overstates the apparent benefits to consumers from class action litigation. The CFPB finds that in its study of class action cases, the average claim rate was 21% and that lawyers fees represented only 21% of the total recovery to consumers.

Yet the CFPB's methodology was highly flawed—it lumped all class action cases together and came up with an overall average for the entire data base based on the total average recovery for consumers and total average attorneys' fee.[72] In particular, just 6 class action cases in the CFPB's database accounted for 83% of the cash payouts to consumers from 241 total settlements. Yet by lumping these 6 very large settlements with 235 other smaller settlements, the CFPB obscured the reality of the typical class action case that produces minimal benefit for consumers and an outsized benefit for lawyers. For example, in large class actions where the recovery was over $100 million, lawyers' fees accounted for only 9% of the costs on average. Yet for cases of less than $100,000 in consumer recoveries, attorneys' fees were 57% of the recoveries on average.

Finally, it is important to put to rest one final claim about the superiority of class action cases over arbitration—the claim that somehow access to class action cases furthers the cause of "justice" by ensuring tha consumers get their "day in court." Yet in the period covered by the CFPB's Report, *not a single class action case went to court*. Whatever is happening with class action cases involving consumer financial products, the idea that consumers are being provided with a "day in court" is little more than a myth.

There is still one final point I would like to make about the CFPB's arbitration study that represents a larger problem: The repeated practice of the CFPB of issuing studies that make dubious factual claims and use questionable methodological techniques, while

[72] In addition, the CFPB arbitrarily excluded some cases that seemingly should have been included, such as a series of cases involving violations of the Electronic Funds Transfer Act for the failure to display physical signs on ATMs, cases where the harm so non-existent that Congress eventually amended the law to eliminate the requirement.

refusing to make the underlying data available to independent researchers for analysis.[73] This lack of transparency is particularly ironic for an agency that persists in describing itself as a "data-driven agency" that basis its policies on sound social science.

Payday Lending, Small Loans, and Financial Inclusion

Sometime this spring the CFPB is expected to release its proposed rule on payday loans and other small loan products. The CFPB has indicated that the rule would impose "ability-to-pay" requirements on providers of small loans, such as payday loans, auto title loans, and certain installment loans. An analysis by economists at Charles River Associates estimates that approximately 80% of payday lenders in America will be driven out of business if the rule goes into effect.[74]

Yet there is little reason to believe that the already-difficult plight of those who rely on short-term loan products will be made better off by banning access to these products. Surveys of payday loan customers, for example, routinely find that a majority of payday loan customers rely on payday loans to pay for food, rent, and other necessities.[75] Choking off access to payday loans, auto title loans, and other similar products without ensuring the availability of reasonable alternatives could impose substantial harm on many consumers, resulting in bounced checks, eviction, termination of utilities, or even reliance on illegal loan sharks.[76]

Even more important, concentrating on consumer use of payday loans and other small loan products focuses on the symptoms without addressing the underlying disease of financial exclusion. As noted at the outset, the tragedy of the Dodd-Frank era has been the systematic reduction of access to mainstream financial services such as credit cards and bank accounts for millions of consumers. Consumers suffering from regulatory-induced exclusion from mainstream financial services increasingly have turned to alternative products such as payday loans, overdraft protection, as a financial life raft. Yet along comes the CFPB threatening to shoot holes in the life raft to which they have tried to cling for support.

The CFPB has also announced plans to dramatically reduce access to overdraft proection for many consumers who use the service frequently, such as by limiting their total number of overdrafts per year. Again, this is a regulatory policy that could prove extremely harmful for consumers who rely on overdraft protection to make important

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[73] *See* G. Michael Flores and Todd J. Zywicki, *Commentary on CFPB Report: Data Point: Checking Account Overdraft* (Sept. 22, 2014), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2499716 (noting that CFPB Data Report on overdraft protection made available only median values and failed to disclose many other descriptive features, such as mean values, standard deviations, and the like).

[74] Arthur Baines, Marsha Courchane, and Steli Stoianovici, Economic Impact on Small Lenders of the Payday Lending Rules under Consideration by the CFPB Prepared for: Community Financial Services Association of America (Charles River Associates, May 12, 2015).

[75] *See* discussion in Clarke & Zywicki, *supra* note 13.

[76] *See* U.S. Senate, Committee on Government Operations, Subcommittee on Legal and Monetary Affairs, Federal Effort Against Organized Crime: Report of Agency Operations (June 1968) (reporting that illegal loan-sharking operations were the second-largest revenue source of the mafia at that time).

payments. Michael Flores and I analyzed the MCC codes for point-of-sale debit card usage for one bank's overdraft usage and found that a majority of purchases that triggered overdraft usage were for products that were arguably necessities, such as groceries, gasoline, insurance, utilities, and financial services.[77] Moreover, research indicates that those who use overdraft protection tend to have poor credit and a lack of access to alternative credit options, such as credit cards or bank lines of credit.[78] In fact, many of those who rely on overdraft protection most heavily report that if they were to lose access they would be forced to turn to payday lending as a substitute.[79] At the same time, when combined with the Durbin Amendment's price controls on interchange fees, restricting access to overdraft protection has exacerbated the loss of access to free checking, especially for lower-income Americans that cannot bear the higher costs of bank accounts.

This onslaught of regulation is driving a growth in financial exclusion, especially for low-income and younger consumers. For example, as a result of the Durbin Amendment and other regulations, Bank of America's CEO stated that the bank would focus on the top 20 per cent of its most profitable customers and get rid of the unprofitable ones.[80] J.P. Morgan Chase estimated that new regulations on overdraft programs and price controls on debit card interchange fees made unprofitable 70 per cent of customers with less than $100,000 in deposits, which required the bank to raise fees, reduce costs and services, or shed unprofitable customers.[81] One industry analyst estimated that approximately 40% of bank customers would become unprofitable as a result of various regulations, including most of those with incomes under $40,000 per year.[82] Thus, the effect of these various regulations has been highly regressive, an ironic consequence of reforms that supposedly were intended to benefit consumers.

A better strategy for financial inclusion would be to start by examining the causes of financial exclusion and eliminating the regulatory barriers that prevent banks and other financial service providers from treating low-income and non-traditional consumers as valuable customers and innovating new products to meet their needs. For example, although aimed at traditional debit cards, the Durbin Amendment also extends its price

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[77] *See* Flores & Zywicki, *supra* note 73.

[78] For a review of various new regulations on overdraft protection in the United States, see Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 68 WASH. & LEE L. REV. 1141, 1155-62 (2012).

[79] *See* Clarke & Zywicki, *supra* note 13.

[80] *See* Claes Bell, *Prepaid Debit: Oasis for Unbanked?*, BANKRATE (Jan. 11, 2012), http://www.bankrate.com/financing/banking/prepaid-debit-oasis-for-unbanked/.

[81] *See* Dan Fitzpatrick & David Enrich, *Big Bank Weighs Fee Revamp*, WALL ST. J. (Mar. 1, 2012), http://online.wsj.com/article/SB10001424052970204571404577253742237347180.html.

[82] *See* Theodore Iacobuzio, *Innovative Strategies for Dealing with No-Longer-Profitable Customers*, MASTERCARD ADVISORS U.S. INSIGHTS (2010), *available at* http://insights.mastercard.com/position-papers/innovative-strategies-for-dealing-with-no-longer-profitable-consumers-us/. Although Iacobuzio's estimate of a 50% drop in debit card revenues as a result of the Durbin Amendment appears to be largely accurate, overdraft revenues have not dropped by 30%. From a high of $37 billion in 2009, overdraft revenue fell to under $32 billion in 2011 but rose in 2012. *See* Kevin Wack, *Overdraft Revenue Makes First Climb in Three Years: Report*, AM. BANKER (Mar. 18, 2013), *available at* http://www.moebs.com/Portals/0/pdf/Articles/31_Moebs American%20Banker.3.18.13.Overdraft%20Revenue%20Makes%20First%20Climb%20in%20Three%20Years_Report.pdf.

controls to prepaid cards that offer consumers more than a rudimentary degree of services.[83] In so doing, the presence of the Durbin Amendment presents one of the leading obstacles to the development of a low-cost, highly-functional mobile banking platform that could provide not only essential financial services for millions of low-income and young consumers, but also their first step toward full financial inclusion.

Consumer Complaint Database

Another problematic activity of the CFPB is its decision to post "consumer narratives" on its webpage as part of a consumer complaint database.[84] The collection of consumer complaints can provide a crucially important role in promoting consumer protection regulatory and enforcement policy by providing early-warning signals of emerging problems in various regions of the country or products and practices. Collecting complaints and analyzing them in a statistically-rigorous fashion in the aggregate thus is an important element of a responsive and aggressive consumer protection policy.

On the other hand, it is hard to see how the CFPB's practice of permitting consumers to post isolated, unverified complaints on the agency's website furthers any coherent consumer protection purpose. Indeed, the CFPB's complaint database appears to be little more than a government-sponsored version of Yelp, where disgruntled consumers can vent their anecdotal complaints about providers of financial services. There is no doubt, of course, that consumers often have legitimate complaints with providers of financial services, just as with any other businesses. But it is doubtful that providing a forum for anecdotal, unverified complaints—as opposed to collecting and analyzing complaints by the agency—furthers any coherent regulatory purpose.

Conclusion

It is disappointing that Dodd-Frank squandered the historic opportunity presented by the financial crisis to create a modern and coherent consumer protection regime—one that would not only protect consumers from sharp practices but promote competition, innovation, and consumer choice. Even worse, Dodd-Frank imposed a regime that instead has led to higher prices, less innovation, and less choice in consumer credit products, while doing little to improve consumer protection. By taking away preferred choices for consumers, such as mortgages, bank accounts, and credit cards, Dodd-Frank and other laws have increased consumer dependence on less preferred products like payday loans, pawn shops, and check cashers. Most tragic of all, low-income and younger consumers—who already had the fewest choices—are those who have suffered the most from Dodd-Frank's regulatory onslaught.

Thank you.

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[83] Todd J. Zywicki, *The Economics and Regulation of Network Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013).

[84] *See* "Consumer Complaints with Consumer Complaint Narratives," *available in* https://data.consumerfinance.gov/dataset/Consumer-Complaints-with-Consumer-Complaint-Narrat/nsyy-je5y.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN SHELBY FROM LEONARD CHANIN

Q.1. On April 7th, CFPB Director Richard Cordray testified before the Committee and was questioned by numerous Members on the Bureau's approach to indirect auto lending. Director Cordray stated:

> [w]e join our fellow agencies and the Justice Department in believing disparate impact is the law of the land. That was then challenged up to the Supreme Court, and the Supreme Court reaffirmed that that's the law of the land. And to me that's pretty conclusive on this subject.

However, the Supreme Court decision in *Texas Department of Housing and Community Affairs v. Inclusive Communities* applied specifically to the use of disparate impact under the Fair Housing Act, and referenced features unique to that statute, while the CFPB has invoked disparate impact under the Equal Credit Opportunity Act as authority for its approach to indirect auto lending. Has the Supreme Court ruled on the application of disparate impact theory to the Equal Credit Opportunity Act?

A.1. The "Official Interpretations" of the CFPB's Regulation B (which implements the Equal Credit Opportunity Act (ECOA)) state that the disparate impact doctrine applies under the ECOA and Regulation B. However, the U.S. Supreme Court has not issued a decision evaluating whether disparate impact is a valid basis for asserting discrimination under the ECOA and implementing Regulation B. The Supreme Court's recent decision evaluating disparate impact under the Fair Housing Act and the Department of Housing and Urban Development's implementing regulation does not deal with the question of whether disparate impact is "valid" under the ECOA and implementing Regulation B.

Q.2. During the hearing, you were questioned about the actions the Federal Reserve took to evaluate and address subprime mortgages before the crisis. Please explain what specific rulemakings and other actions regarding subprime mortgages you were involved in before the crisis while you served at the Division of Consumer and Community Affairs at the Federal Reserve.

A.2. I served in the Division of Consumer and Community Affairs at the Federal Reserve from 2005 to 2011. The Federal Reserve took several actions, including adopting rules, to address subprime mortgage issues prior to the financial crisis.

In 2005, the Federal Reserve, along with the other Federal banking agencies, proposed guidance to address nontraditional mortgage loans and to address "risk layering" issues. Final guidance was issued in 2006, and addressed layering risks of nontraditional mortgages to subprime borrowers. In 2006, the Federal Reserve held four hearings in four cities to obtain information from consumer advocates, community development groups, researchers,

mortgage lenders, and others about nontraditional mortgage products and the effects on consumers of State predatory lending laws.

In addition, in the fall of 2005, as well as on three occasions in 2006, the Federal Reserve gathered information from its Consumer Advisory Council meetings dealing with subprime mortgages and nontraditional mortgage products.

In March 2007, the Federal Reserve, along with the other Federal banking agencies, proposed guidance addressing heightened risks to consumers for certain adjustable rate mortgage loans. Final guidance issued in 2007 set out standards institutions should follow to ensure borrowers in the subprime market obtain loans they can afford to repay.

In June 2007, the Federal Reserve held an additional hearing to explore how the Federal Reserve could use its authority to prevent abusive practices in the subprime market while at the same time preserving responsible subprime lending. In January 2008, the Federal Reserve proposed a rule that would protect consumers against unfairness and deception, while preserving responsible and sustainable home ownership. In July 2008, the Federal Reserve approved a final rule addressing these matters.

Q.3. Before the creation of the CFPB, the prudential banking regulators collected consumer complaints on a regular basis. How did that process differ from the CFPB's current process for collecting and publishing consumer complaints?

A.3. Historically and currently, consumers can submit complaints to the Federal Reserve about various practices. The Federal Reserve investigates complaints against State member banks (and certain other entities) and forwards complaints against other banks and businesses to the appropriate enforcement agency. In its annual report, the Federal Reserve provides detailed statistical information about the complaints it receives. For example, the report lists the number of complaints received, including the number referred to other Federal/State agencies. However, the report and other information made available by the Federal Reserve do not provide information about specific banks or specific consumer complaints.

The annual report also lists the number of complaints received against State member banks (and certain other entities) based on the specific law/rule the consumer alleged the bank violated. For example, in 2014, 25 complaints alleged that State member banks violated Regulation B, which implements the Equal Credit Opportunity Act.

Importantly, the Federal Reserve investigates complaints it receives against State member banks (and certain other entities). The vast majority of investigated complaints reveal that institutions "correctly handled" the matter. For example, of complaints received in 2014 against State member banks (and certain other entities), the Federal Reserve found that 86 percent were "correctly handled" by institutions. Of the remaining 14 percent, 4 percent were deemed violations of law, 4 percent were errors (corrected by the bank), and the remaining 6 percent were withdrawn, or involved litigation or other matters. The Federal Reserve does not publish information on individual complaints or information about

specific State member banks. While it is unclear why such individualized data is not published, it may be that because the overwhelming majority of complaints were deemed "correctly handled" by the Federal Reserve, it could be viewed as misleading to publish data about complaints and the names of specific institutions suggesting either violations of laws or other problems.

In the CFPB's Consumer Response Report published in 2015 (for 2014 complaints), the CFPB provides results of consumer complaints. Of the complaints addressed to companies within the CFPB's authority, 70 percent of the companies closed the complaint with an "explanation" (without providing monetary or nonmonetary relief to the consumer). For 84 percent of those complaints, consumers were given the option to provide feedback to the company's response. For those complaints, 66 percent of consumers did not dispute the response by the company, while 19 percent did dispute the company's response (with 15 percent pending). Thus, the overwhelming majority of consumers did not dispute the company's findings for complaints, which were closed without providing any monetary or nonmonetary relief to the consumer.

RESPONSE TO WRITTEN QUESTION OF CHAIRMAN SHELBY FROM DAVID HIRSCHMANN

Q.1. Several commenters have expressed concerns that upcoming CFPB rules on pre-dispute arbitration clauses may prohibit such clauses or make it impractical to include such clauses in consumer contracts. In your opinion, what would be the cost to consumers if such clauses were prohibited or made impractical?

A.1. The bottom line is that consumers will be harmed if arbitration ceases to be an available dispute resolution forum for them. Let me explain in more detail. Arbitration is a dispute resolution process that is faster, less expensive, more user-friendly, and altogether more efficient than in-court litigation. Consumers are more easily made whole in arbitration-certainly much more so than they are in class actions. Particularly in the consumer context, consumers can seek and obtain redress for the many claims for which a lawyer is too expensive or that lawyers are unwilling or unable to take on. Indeed, one study reported that a claim must be worth at least $60,000; in some markets, this threshold may be as high as $200,000.[1] Plaintiffs who brave the court system find that a hearing on their claims is long delayed by overcrowded dockets in our underfunded courts.[2]

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[1] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association,* 18 Ohio St. J. on Disp. Resol. 777, 783 (2003); Recommendations of the Minnesota Supreme Court Civil Justice Reform Task Force 10 (Nov. 23, 2011), *http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%-20Reform.pdf.*

[2] In California, for example, repeated budget cuts have forced 52 courthouses and 202 courtrooms to close, prompting the State judiciary to warn that funding for the State's courts is no longer "enough to sustain a healthy [judicial system]." Judicial Council of Cal., *InFocus: Judicial Branch Budget Crisis, available at http://www.courts.ca.gov/partners/courtsbudget.htm.* Los Angeles County, the State's largest, reported this year that its remaining courts are facing "unmanageably high" workloads, which is producing "intolerable delay" in civil cases. Judicial Council of Cal., *2015 Budget Snapshot: County of Los Angeles* (Feb. 2015), *available at http://www.courts.ca.gov/partners/-documents/County__Budget__Snapshot__Combined__2015.pdf.*

Most injuries that consumers suffer are small and individualized-excess charges on a bill, a defective piece of merchandise, and the like. These claims are too small to justify paying a lawyer to handle the matter; in any event, most consumers do not have the resources to do so. And because they are individualized, they cannot be asserted in class actions. As Justice Breyer has recognized—in a decision joined by Justices Stevens, Souter, and Ginsburg—"the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)" would be left "without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery."[3]

Arbitration is inexpensive and easy for consumers to use. The American Arbitration Association ("AAA"), for example, requires the business to bear most arbitration costs; many companies pay even the consumer's share, which the AAA caps at $200.[4] The AAA offers hearings by telephone, and participants can file documents and otherwise communicate with the AAA and arbitrator through email. Consumers forced to go to court have to sit through lengthy proceedings and postponements—losing pay while seeking justice. That does not happen in arbitration.

And arbitration works. ***Studies show that consumers and employees who use this efficient dispute-resolution system prevail in arbitration at least as frequently as—and often more frequently than—they do in court:***

- A recent study by scholars Christopher Drahozal and Samantha Zyontz of claims filed with the AAA found that consumers win relief 53.3 percent of the time.[5] By contrast, empirical studies that have sampled wide ranges of claims have similarly reported that plaintiffs win in State and Federal court approximately 50 percent of the time.[6]
- Drahozal and Zyontz found that "the consumer claimant[s] won some relief against the business more than half of the time," and were generally awarded between 42 percent and 73 percent of the amount they claimed, depending on the size of the claim and how average recoveries were calculated (mean or median). The authors found little evidence for a purported "repeat player" effect. Consumers prevailed more than half the time against repeat and nonrepeat businesses alike; prevailing claimants were "awarded on average an almost identical percent of the amount claimed" (approximately 52 percent). The authors concluded that any discrepancy could be explained by

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[3] *Allied-Bruce Terminix Cos., Inc. v. Dobson,* 513 U.S. 265, 281 (1995). Professor Peter Rutledge has observed that, without access to arbitration, consumers would be "far worse off, for they would find it far harder to obtain a lawyer, find the cost of dispute resolution far more expensive, wait far longer to obtain relief and may well never see a day in court." Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act,* 9 Cardozo J. Conflict Resolution 267, 267 (2008).

[4] AAA, *Costs of Arbitration, https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2026862.*

[5] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations,* 25 Ohio St. J. on Disp. Resol. 843, 896–904 (2010).

[6] *See, e.g.,* Theodore Eisenberg *et al., Litigation Outcomes in State and Federal Courts: A Statistical Portrait,* 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991–92, plaintiffs won 51 percent of jury trials in State court and 56 percent of jury trials in Federal court, while in 1979–1993 plaintiffs won 50 percent of jury trials).

businesses becoming better at screening cases ahead of time to "settle meritorious claims and arbitrate only weaker claims."[7]

- A study of 186 claimants who pursued employment arbitration in the securities industry concluded that employees who arbitrate were more likely to win their disputes than employees who litigate in Federal court. The study found that 46 percent of those who arbitrated won, as compared to only 34 percent in litigation; the median monetary award in arbitration was higher; only 3.8 percent of the litigated cases studied ever reached a jury trial; and the arbitrations were resolved 33 percent faster than in court.[8]
- One study of 200 AAA employment awards concluded that low-income employees brought 43.5 percent of arbitration claims, most of which were low-value enough that the employees would not have been able to find an attorney willing to bring litigation on their behalf. These employees were often able to pursue their arbitrations without an attorney, and won at the same rate as individuals with representation.[9]
- A later study of 261 AAA employment awards from the same period found that for higher-income employees, ***win rates in like cases in arbitration and litigation were essentially equal,*** as were median damages. The study attempted to compare "apples" to "apples" by considering separately cases that involved and those that did not involve discrimination claims. With respect to discrimination and nondiscrimination claims alike, the study found no statistically significant difference in the success rates of higher-income employees in arbitration and in litigation. For lower-income employees, the study did not attempt to draw comparisons between results in arbitration and in litigation, because lower-income employees appeared to lack meaningful access to the courts—and therefore could not bring a sufficient volume of court cases to provide a baseline for comparison.[10]
- Another study of arbitration of employment-discrimination claims concluded that arbitration is "substantially fair to employees, including those employees at the lower end of the income scale," with employees enjoying a win rate comparable to the win rate for employees proceeding in Federal court.[11]
- In 2004, the National Workrights Institute compiled all available employment arbitration studies, and concluded that employees were almost 20 percent more likely to win in arbitration than in litigated employment cases. It also concluded that

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[7] Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 898, 912–13.

[8] Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where do Plaintiffs Better Vindicate Their Rights?,* 58 Disp. Resol. J. 56, 58 (Nov. 2003—Jan. 2004).

[9] Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association,* 18 Ohio St. J. on Disp. Resol. 777, 785–88 (2003) (summarizing results of past studies by Lisa Bingham that lacked empirical evidence proving the existence of an alleged "repeat player" and "repeat arbitrator" effect).

[10] *See* Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison,* 58 Disp. Resol. J. 44, 45, 47–50 (Nov. 2003–Jan. 2004).

[11] *See* Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost,* 58 Disp. Resol. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); *see also* Eisenberg & Hill, 58 Disp. Resol. J. at 48 tbl. 1 (reporting employee win rate in Federal district court during the same time period was 36.4 percent).

in almost half of employment arbitrations, employees were seeking redress for claims too small to support cost-effective litigation. Median awards received by plaintiffs were the same as in court, although the distorting effect of occasional large jury awards resulted in higher average recoveries in litigation.[12]

- Critics of arbitration sometimes point to a now-discredited report from the advocacy group Public Citizen,[13] as purported support for the assertion that arbitration is unfair. That report shows the folly of examining outcomes in arbitration without comparing them to analogous outcomes in court.
- Public Citizen examined data about claims brought by creditors against consumer debtors, and concluded from a high win rate for creditors that arbitration is biased. In those cases, however, the consumer often does not appear and does not contest the claim, and is therefore liable either because he has defaulted or "because he owes the debt."[14]
- A more rigorous empirical study showed that "consumers fare better" in debt-collection arbitrations than in court: "creditors won some relief before the AAA in 77.8 percent of individual AAA debt collection arbitrations and either 64.1 percent or 85.2 percent of the AAA debt collection program arbitrations," depending on how the research parameters were defined. By contrast, in contested court cases creditors won relief against consumers between 80 percent and 100 percent of the time, depending on the court.[15]

As one study published in the *Stanford Law Review* explained in surveying the empirical research, "[w]hat seems clear from the results of these studies is that the assertions of many ***arbitration critics were either overstated or simply wrong.***"[16] There simply is no empirical support for the contention that arbitration leads to unfair or subpar outcomes when compared with litigation in our overcrowded court system. Rather, the overwhelming weight of the available evidence establishes reflects that arbitration allows consumers and employees to obtain redress faster, cheaper, and more effectively than they could in court.

Arbitration also has built-in fairness guarantees. ***The rules of arbitration organizations along with existing law protect consumers and employees against unfair procedures and biased arbitrators.***

Thus, when courts find arbitration provisions unfair to consumers or employees under generally applicable principles, they do not hesitate to invalidate the agreements. Thus, courts have repeatedly invalidated provisions of arbitration agreements that purported to impose:

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[12] National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), *http://workrights.us.*

[13] Public Citizen, *The Arbitration Trap,* Sept. 2007, *http://www.citizen.org/documents/ArbitrationTrap.pdf.*

[14] Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration,* 15 Disp. Resol. Mag. 30, 31 (Fall 2008).

[15] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court,* 7 Hastings Bus. L.J. 77, 91, 97, 111–16 (Winter 2011).

[16] Sherwyn *et al.,* 57 Stan. L. Rev. at 1567 (emphasis added).

- excessive costs and fees to the consumer or employee for accessing the arbitral forum;[17]
- limits on damages that can be awarded by an arbitrator when such damages would be available to an individual consumer or employee in court;[18]
- requirements that arbitration take place in inconvenient locations;[19]
- biased procedures for selecting the arbitrator;[20]
- unreasonably shortened statutes of limitations;[21] and

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[17] The Supreme Court has held that a party to an arbitration agreement may challenge enforcement of the agreement if the claimant would be required to pay excessive filing fees or arbitrator fees in order to arbitrate a claim. *See Green Tree Fin. Corp.—Ala. v. Randolph,* 531 U.S. 79, 90–92 (2000). Since *Randolph,* courts have aggressively protected consumers and employees who show that they would be forced to bear excessive costs to access the arbitral forum. *See, e.g., Chavarria v. Ralphs Grocery Co.,* 733 F.3d 916, 923–25 (9th Cir. 2013) (refusing to enforce an arbitration agreement that required the employee to pay an unrecoverable portion of the arbitrator's fees "regardless of the merits of the claim"); *Am. Express Co. v. Italian Colors Rest.,* 133 S. Ct. 2304, 2310–11 (2013) (reaffirming that a challenge to an arbitration agreement might be successful if "filing and administrative fees attached to arbitration . . . are so high as to make access to the forum impracticable" for a plaintiff). Courts also have reached the same conclusion under State unconscionability law. *See, e.g., Brunke v. Ohio State Home Servs., Inc.,* 2008 WL 4615578 (Ohio Ct. App. Oct. 20, 2008); *Liebrand v. Brinker Rest. Corp.,* 2008 WL 2445544 (Cal. Ct. App. June 18, 2008); *Murphy v. Mid-West Nat'l Life Ins. Co. of Tenn.,* 78 P.3d 766 (Idaho 2003).

[18] *See, e.g., Venture Cotton Coop. v. Freeman,* 395 S.W.3d 272 (Tex. Ct. App. 2013) (limit on damages and attorney's fees under State consumer protection law); *Mortg. Elec. Registration Sys., Inc. v. Abner,* 260 S.W.3d 351, 352, 355 (Ky. Ct. App. 2008) (limited to "actual and direct" damages); *see also Carll v. Terminix Int'l Co.,* 793 A.2d 921 (Pa. Super. Ct. 2002) (limit on damages for personal injury); *Alexander v. Anthony Int'l, L.P.,* 341 F.3d 256 (3d Cir. 2003) (limit on punitive damages); *Woebse v. Health Care & Retirement Corp. of Am.,* 977 So. 2d 630 (Fla. Dist. Ct. App. 2008) (limit on punitive damages); *cf. Am. Express Co.,* 133 S. Ct. at 2310 (explaining that Federal law would require invalidating "a provision in an arbitration agreement forbidding the assertion of certain [Federal] statutory rights").

[19] *See, e.g., Willis v. Nationwide Debt Settlement Grp.,* 878 F. Supp. 2d 1208 (D. Or. 2012) (travel from Oregon to California); *College Park Pentecostal Holiness Church v. Gen. Steel Corp.,* 847 F. Supp. 2d 807 (D. Md. 2012) (travel from Maryland to Colorado); *Hollins v. Debt Relief of Am.,* 479 F. Supp. 2d 1099 (D. Neb. 2007) (travel from Nebraska to Texas); *Philyaw v. Platinum Enters., Inc.,* 54 Va. Cir. 364 (Va. Cir. Ct. Spotsylvania Cnty. 2001) (travel from Virginia to Los Angeles); *see also, e.g., Dominguez v. Finish Line, Inc.,* 439 F. Supp. 2d 688 (W.D. Tex. 2006) (travel from Texas to Indiana); *Swain v. Auto Servs., Inc.,* 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) (travel from Missouri to Arkansas); *Pinedo v. Premium Tobacco Stores, Inc.,* 102 Cal. Rptr. 2d 435 (Ct. App. 2000) (travel from Los Angeles to Oakland).

[20] *See, e.g., Chavarria,* 733 F.3d at 923–25 (holding that an arbitration agreement was unconscionable and unenforceable when it "would always produce an arbitrator proposed by [the company] in employee-initiated arbitration[s]," and barred selection of "institutional arbitration administrators"); *see also, e.g., Murray v. United Food & Commercial Workers Int'l Union,* 289 F.3d 297 (4th Cir. 2002) (striking down an arbitration agreement that gave the employer the sole right to create a list of arbitrators from whom the employee could then pick); *Hooters of Am., Inc. v. Phillips,* 173 F.3d 933 (4th Cir. 1999); *Newton v. American Debt Services, Inc.,* 854 F. Supp. 2d 712, 726 (N.D. Cal. 2012) (refusing to enforce a provision that would have granted a company sole discretion to choose an "independent and qualified" arbitrator for its consumer disputes because, under the circumstances, there was no guarantee that the arbitrator would be neutral); *Roberts v. Time Plus Payroll Servs., Inc.,* 2008 WL 376288 (E.D. Pa. Feb. 7, 2008) (refusing to enforce provision that would have given employer sole discretion to select arbitrator, and instead requiring parties to select arbitrator jointly); *Missouri ex rel. Vincent v. Schneider,* 194 S.W.3d 853 (Mo. 2006) (invalidating provision giving president of a local home-builder association sole discretion to pick arbitrator for disputes between local home builders and home buyers).

[21] *See, e.g., Zaborowski v. MHN Gov't Servs., Inc.,* 2013 WL 1363568 (N.D. Cal. Apr. 3, 2013); Adler v. Fred Lind Manor, 103 P.3d 773 (Wash. 2004) (180 days); *see also Gandee v. LDL Freedom Enters., Inc.,* 293 P.3d 1197 (Wash. 2013) (refusing to enforce arbitration agreement in debt-collection contract that required debtor to present claim within 30 days after dispute arose); *Alexander,* 341 F.3d at 256 (same, for an employee); *Stirlen,* 60 Cal. Rptr. 2d at 138 (rejecting provision that imposed shortened 1-year statute of limitations).

- "loser pays" provisions under which a consumer or employee might have to pay the full costs of the arbitration,[22] or must pay the drafting party's costs regardless of who wins.[23]

Of course, the vast majority of arbitration agreements do not exhibit these sorts of defects; and the clear trend has been for companies to make arbitration provisions ever more favorable to their customers and employees. But when courts find that overreaching occurs, they have not hesitated to strike down the offending provision.

In addition to the courts' oversight of arbitration provisions, the ***leading arbitration forums provide additional fairness protections.*** The AAA and JAMS—the Nation's leading arbitration service providers—recognize that independence, due process, and reasonable costs to consumers are vital elements of a fair and accessible arbitration system. They therefore adhere to standards that establish basic requirements of fairness that provide strong protections for consumers and employees—and refuse to administer arbitrations unless the operative clause is consistent with those standards.

Furthermore, ***companies increasingly are adopting consumer-friendly arbitration agreements.*** In the wake of the Supreme Court's decision in Concepcion, an increasing number of arbitration agreements include consumer- and employee-friendly provisions modeled on the elements of the arbitration agreement upheld in that case. That should not be surprising. As the Solicitor General of the United States explained in its briefing before the Supreme Court in *American Express v. Italian Colors Restaurant,* "many companies have modified their agreements to include streamlined procedures and premiums designed to encourage customers to bring claims."[24] The Government recognized that consumer-friendly clauses ensure that instances where individuals cannot bring their claims "remain rare." As the brief explained:

> AT&T Mobility modified its arbitration agreement during the course of the litigation to include cost- and fee-shifting provisions and premiums designed to ensure that ***customers could bring low-value claims on an individual basis.*** These modifications left consumers ***'better off under their arbitration agreement' than they would have been in class litigation.*** And by obviating a potential objection to enforcement of the arbitration agreement, those modifications simultaneously served the company's interest in avoiding litigation.

Consistent with these observations, arbitration agreements include a variety of consumer-friendly provisions:

- Many require businesses to shoulder all of the costs of arbitration, including filing fees and the arbitrator's compensation.
- Some agreements, such as the one the Supreme Court considered in *Concepcion,* provide for "bounty payments" as an incentive for an individual to bring a claim in arbitration, and agree

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[22] *See Gandee,* 293 P.3d at 1197; *Alexander,* 341 F.3d at 256; *Sosa v. Paulos,* 924 P.2d 357 (Utah 1996).

[23] *See, e.g., In re Checking Account Overdraft Litig.,* MDL No. 2036, 485 F. App'x 403 (11th Cir. 2012); *see also Samaniego v. Empire Today LLC,* 140 Cal. Rptr. 3d 492 (Cal. Ct. App. 2012) (attorneys' fees).

[24] Brief for the United States as Amicus Curiae Supporting Respondents at 28–29, *American Express Co. v. Italian Colors Restaurant,* 133 S. Ct. 2304 (2013) (No. 12–133), 2013 WL 367051 (emphasis added).

not only to pay any attorney's fees that would be authorized by the underlying law, but double the attorney's fees if the arbitrator awards more than the company's last pre-hearing settlement offer.

- In some very complex cases, it is possible that a consumer or employee might require an expert witness or even complex discovery in order to pursue a claim against a company. Many agreements contain provisions that allow for such costs to be shifted to the company if the claimant prevails—even when the underlying law does not provide for such cost-shifting, which thus would not be available in a lawsuit in court.
- Agreements often adopt informal procedures that make it easy for claimants to pursue their disputes. For example, these agreements enable consumers and employees to choose whether the dispute should be resolved on the basis of a written submission, a telephonic hearing, or in-person proceedings.

In addition to all these direct benefits, ***consumers and employees also benefit*** through the systematic reduction of litigation-related transaction costs, which leads to ***lower prices for products and services*** and ***higher wages.***

How does this work? Businesses face many costs in bringing products and services to market. On top of the ordinary costs of running a business, they must absorb costs of litigating business-related claims. The transaction costs of litigation are high; they include settlements, judgments resolving meritorious claims, and the costs of defending against *all* lawsuits. Because those transaction costs are lower in arbitration, businesses can reduce costs that otherwise inflate product and service prices and reduce the availability of margins that could pay for wage increases.

The CFPB's Effort To Ban Arbitration

Given the clear benefits of arbitration, it is disappointing that the CFPB has now proposed a rule that will eliminate arbitration. Of course, the Bureau's proposal does not say that; it is framed as a requirement that class procedures be permitted either in arbitration or in court. But the practical effect of that will be a ban on arbitration, and the Bureau knows it.[25]

The bottom line: consumers will lose the ability to vindicate most of the injuries they suffer—which cannot be addressed in class action because they are individualized—so that lawyers can continue to reap the benefits of class actions.

The Bureau is basing its proposal on its "study" of arbitration. But that study is the result of a closed process that solicited public comment once at the outset and never again for the 3 years that the study was underway. The Bureau never informed the public of the topics it had decided to study and never sought public comment on them—even though a number of commenters suggested that the

[25] Arbitration imposes significant additional transaction costs on companies—paying consumers' filing fees and other costs of arbitration, for example. Thus, as one group of businesses has explained, "when there is no assurance that all claims will be arbitrated in lieu of litigation, and a [company] must shoulder the additional costs of class action litigation, subsidizing the costs of individual arbitration is no longer a rational business option"; the only logical decision is to "disengage from arbitration altogether." Brief for CTIA—the Wireless Association as Amicus Curiae at 21, *AT&T Mobility LLC v. Concepcion.*

Bureau utilize that procedure. The Bureau never convened public roundtable discussions on key issues, as many other agencies routinely do. And the Bureau never sought public input on its tentative findings.[26]

The product of this closed process is flawed in numerous respects. The Bureau's study:

- ignores the practical benefits of arbitration as compared to the court system for vindicating the types of disputes that consumers most often have;
- fails to consider the benefits that arbitration provides to injured parties in a variety of contexts—benefits that plainly would accrue to consumers as well if they were not discouraged by plaintiffs' lawyers and others from invoking arbitration;
- fails to consider the reduced transaction costs resulting from arbitration, which under basic economic theory produce lower prices to consumers;
- exaggerates the supposed benefits of class actions to consumers and ignores the grossly disproportionate gains reaped by self-interested plaintiffs' lawyers; and
- ignores the significant role of Government enforcement—particularly the CFPB's own enforcement and supervision processes—in protecting consumers.

More than 80 Members of the House and Senate sent a letter to the Bureau stating that:

> the process that led to the Bureau's Arbitration Study has not been fair, transparent, or comprehensive. The Bureau ignored requests from senior Members of Congress for basic information about the study preparation process.
>
> The Bureau also ignored requests to disclose the topics that would be covered by the study, and failed to provide the general public with any meaningful opportunities to provide input on the topics. Because the materials were kept behind closed doors, the final Arbitration Study included entire sections that were not included in the preliminary report that was provided to the public.
>
> As a result, the flawed process produced a fatally flawed study. Rather than focusing on the critical question—whether regulating or prohibiting arbitration will benefit consumers—and devising a plan to address the issues relevant to resolving that question, the Bureau failed to provide even the most basic of comparisons needed to evaluate the use of arbitration agreements."[27]

Two prominent academics conducted an independent analysis of the CFPB's study, concluding that it "provides no foundation for imposing new restrictions or prohibitions on mandatory arbitration clauses in consumer contracts."[28] In particular, the study "fail[s] to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class

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[26] The Bureau staff would meet with interested parties and accept written submissions. But the staff refused to provide any information regarding the topics that the Bureau was studying or the timeline for its study process, and those oneway conversations therefore did not permit anything resembling meaningful input.

[27] *http://www.cfpbmonitor.com/files/2015/06/McHenry-Scott-to-Cordray-Letter-re-Arbitration.pdf.*

[28] Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique* 5 (Mercatus Ctr., George Mason Univ., Working Paper, Aug. 2015), *available at http://www.law.gmu.edu/assets/files/publications/working_papers/LS1507.pdf.*

action litigation would be beneficial to consumers and the economy."[29]

It is particularly remarkable that the Bureau's proposal apparently will be justified by the asserted benefits of class actions when the plain reality is that ***consumer class actions deliver little to anyone other than lawyers.*** **Thus, eliminating arbitration in order to preserve class actions sells out the interests of consumers in order to benefit plaintiffs' lawyers.**

A recent empirical study found that the overwhelming majority of putative class actions studied resulted in ***no recovery at all for members of the putative class.*** The idea that class actions consistently provide benefits to consumers is just plain wrong.

The ***chief proponents—and the principal beneficiaries—of restrictions on arbitration are the plaintiffs' lawyers.*** Because arbitration is quicker and more efficient than litigation, it is less expensive, which means that ***they cannot extract large settlements and attorneys' fees*** for meritless claims in arbitration as easily as they could in class actions in court. As Professor Martin Redish has noted, this confirms that "[t]he real parties in interest in . . . [many] class actions are . . . the plaintiffs' lawyers."[30] Indeed, the CFPB's own study found that plaintiffs' lawyers average class action fee is $1 million per case; the average recovery by consumers: $32.35.

Also, as Justice Kagan has recognized, "nonclass options abound" for effectively pursuing claims on an individual basis.[31] Many arbitration agreements require businesses to pay all or most filing fees, authorize recovery of attorney's fees and other costs, and provide other incentives for plaintiffs, making it easier for consumers to bring claims individually. Class actions are not needed to enable consumers to vindicate their rights—particularly when the cost of providing class actions will be the elimination of arbitration, which enables consumers to vindicate claims that as a practical matter cannot and are not asserted in court.

Finally, to the extent there are practices that inflict harm on broad classes of consumers that might go unremedied, the Bureau's enforcement and supervision authority provides strong protection that did not previously exist. There is no need to rely on self-interested class action lawyers given the obvious flaws of the class action system and the benefits to consumers from arbitration.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM DAVID HIRSCHMANN

Q.1. Since the 2008 financial crisis, the U.S. Chamber of Commerce has devoted enormous resources to lobbying against rules that would protect consumers, strengthen the financial markets, and hold the financial industry accountable when it breaks the law. You testified before the Banking Committee as a representative of the U.S. Chamber of Commerce. For members of Congress to interpret the information and advice you are providing, it is

[29] *Id.* at 6.

[30] Testimony of Martin H. Redish at 7, *Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), *available at http://judiciary.house.gov/hearings/Hearings%202012/-Redish%2006012012.pdf.*

[31] *Am. Express Co. v. Italian Colors Rest.,* 133 S. Ct. 2304, 2319 (2013) (Kagan, J., dissenting).

critically important for us to have a better sense of who is behind that work.

- Please explain to the Committee how much funding the Chamber of Commerce has received from the six largest banks in the country—JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, and Morgan Stanley—in each of the following years.

  i. 2016
  ii. 2015
  iii. 2014
  iv. 2013
  v. 2012
  vi. 2011
  vii. 2010
  viii. 2009
  ix. 2008
- Please explain to the Committee how much funding the Chamber of Commerce received from all other depository institutions in:

  i. 2016
  ii. 2015
  iii. 2014
  iv. 2013
  v. 2012
  vi. 2011
  vii. 2010
  viii. 2009
  ix. 2008
- Please explain to the Committee how much funding the Chamber of Commerce received from nondepository financial institutions in:

  i. 2016
  ii. 2015
  iii. 2014
  iv. 2013
  v. 2012
  vi. 2011
  vii. 2010
  viii. 2009
  ix. 2008
- Is there any reason that you would be unwilling to inform Congress which financial institutions are funding your work, including your testimony before the Senate Banking Committee? If so, please explain.
- If you will not disclose your funding, why should Congress give your testimony the same weight as the testimony of those who

appear before this Committee and are willing to make clear who funded their work?

A.1. The Chamber supports strong, clear, and predictable consumer financial protection policies that deter fraud and predation and contribute to well-functioning capital markets.

As you know, the Chamber is under no obligation to disclose its membership or the manner in which it prepares testimony. It does, however, represent the interests of over 3 million businesses of every size, sector, and region of this country; over 95 percent of the Chamber's members are small businesses.

Q.2. Did you share drafts of your testimony with any representatives of any financial institutions or employees of organizations representing financial institutions prior to this hearing? If so, who, and what kind of access did you provide them?

Is there any reason that you would be unwilling to inform Congress which representatives of financial institutions participated in the drafting of your testimony or reviewed your testimony before it was submitted? If so, please explain.

A.2. The Chamber supports strong, clear, and predictable consumer financial protection policies that deter fraud and predation and contribute to well-functioning capital markets.

As you know, the Chamber is under no obligation to disclose its membership or the manner in which it prepares testimony. It does, however, represent the interests of over 3 million businesses of every size, sector, and region of this country; over 95 percent of the Chamber's members are small businesses.

FOLLOW-UP RESPONSE TO HEARING QUESTION OF SENATOR COTTON FROM DAVID HIRSCHMANN

Q.1. Does the CFPB's forthcoming arbitration rule expected next year make the need for CROA reform more urgent or less urgent? (Page 29)

A.1. The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions. The Chamber created the Center for Capital Markets Competitiveness to promote a modern and effective regulatory structure for capital markets to function well in a 21st century economy.

I write to follow up with you and your colleagues on the Committee on Banking, Housing, and Urban Affairs regarding your questions from yesterday's hearing concerning the impact of the forthcoming Consumer Financial Protection Bureau (CFPB) rule that, as a practical matter, will eliminate arbitration from the consumer financial services industry. In particular, you asked about its likely impact on the ability of credit bureaus to provide helpful credit monitoring and credit education services to consumers. Thank you for your question; my thoughts on this subject are set forth below.

As you mentioned in your question to me, the Credit Repair Organizations Act of 1996 (CROA) was enacted to prohibit fraudulent representations by companies offering credit repair services about their ability to remove true but negative information from an

individual's credit history.[1] In addition to Government enforcement, CROA is enforced through a strict liability private right of action, including a statutorily authorized class action.[2] This means that even the most insignificant, immaterial error by a credit repair organization is actionable. Needless to say, under this particular strict liability statute, the potential liability of any "credit repair organization" is immense.[3]

The question of who is a "credit repair organization" is more than a proverbial "million dollar question"—the class action plaintiffs' bar has recently turned it into a literal one. In February 2014, the Ninth Circuit Court of Appeals issued its opinion in *Stout v. FreeScore, LLC,* concerning whether the district court properly dismissed a putative class action case alleging that FreeScore, a company that provided consumers with credit scores, credit reports, and credit monitoring services, was strictly liable under CROA for various violations of the statute. To be sure, FreeScore did not at any time actually perform credit repair services—a point the Court did not dispute.[4] Instead, the Court's opinion focused on FreeScore's advertising, which state that having access to credit reports and scores and using credit monitoring services could help consumers improve their overall credit. Incredibly, the Court took the view that stating the most basic principle of financial literacy—that knowing more about your credit can help you improve your credit—was exactly the type of nefarious "representation" that CROA was enacted to root out.[5] That holding is at odds with congressional testimony by the Federal Trade Commission, the agency tasked with enforcing CROA, in which the Commission said it "sees little basis on which to subject the sale of legitimate credit monitoring and similar educational products and services to CROA's specific prohibitions and requirements, which were intended to address deceptive and abusive credit repair business practices."[6]

Class action lawsuits under CROA are existential threats to companies actually subject to its jurisdiction; more perniciously, in light of cases like Stout, they threaten the existence of companies not intended to be subject to CROA that provide credit monitoring and education services to millions of Americans worried about identity theft, hacking, and other cybersecurity threats. The Chamber is very concerned that Stout and cases like it, which we believe seriously misread CROA's statutory text, defy congressional intent, and subject more companies to class action litigation, will harm consumers by reducing or eliminating their access to helpful

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[1] *See generally* Credit Repair Organizations Act of 1996, Pub. L. No. 104–208 § 2451 (Sept. 30, 1996) (codified at 15 U.S.C. §§ 1679–1679j).

[2] *Id.* § 1679g, 1679h.

[3] Under CROA, the defined term "credit repair organization" (A) means any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of (i) improving any consumer's credit record, credit history, or credit rating; or (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i)[.] It does not include a 501(c)(3) nonprofit organization, a creditor that is helping a person restructure debt, or a depository institution or credit union. 15 U.S.C. § 1679a(3).

[4] *See generally* Stout v. Freescore, LLC, 743 F.3d 680 (9th Cir. 2014).

[5] *Id.*

[6] *Oversight of Telemarketing Practices and the Credit Repair Organizations Act (CROA): Hearing Before the Senate Committee on Commerce, Science, and Transportation,* 110th Cong. 8 (2007) (written statement of Lydia B. Parnes, Dir., Bureau of Consumer Prot., Fed. Trade Comm'n).

products that help them take more control over their financial well-being. We therefore take this opportunity to encourage Congress to clarify that the provision of credit monitoring and credit education services is not covered by CROA.

Moreover, as you foreshadowed in your question to me at yesterday's hearing, the CFPB's forthcoming arbitration rule will further jeopardize the availability of consumer credit monitoring and education services—a strange result for a Government agency charged with improving financial literacy.[7] Like many financial services providers, many credit monitoring service providers use pre-dispute arbitration agreements to provide their customers a faster, cheaper, more efficient way of recovering a greater amount of money for claims they have against the company. That shouldn't be surprising—after all, the CFPB's own *2015 Arbitration Study and Report to Congress* confirms these benefits of consumer arbitration; it also concludes that 87 percent of class action lawsuits result in absolutely no recovery for consumers. Despite this data, the CFPB's arbitration rule is likely to prohibit consumer financial contracts from requiring that claims be filed in arbitration rather than class action litigation, which will likely have the practical effect of eliminating arbitration altogether. The impact of CFPB's rule on the continued availability of consumer arbitration is a critically important question that should be answered before any such rule is proposed; regrettably, the CFPB did not even bother to study it. The Chamber has and will continue to encourage the CFPB to preserve consumer arbitration in financial services contracts. I hope that I have answered your questions. If not, please do not hesitate to contact me.

RESPONSE TO WRITTEN QUESTION OF CHAIRMAN SHELBY FROM REVEREND DR. WILLIE GABLE, JR., D. MIN

Q.1. Dr. Gable, in addition to your many other roles, you are also the founder and Executive Director of a nonprofit that offers housing and rental assistance to low-income individuals.

Can you talk about what you saw during and after the crisis in the housing market?

A.1. Foreclosure Impact in Louisiana

- Louisiana continued to suffer financial devastation due to Hurricane Katrina when the foreclosure crisis hit.
- The Center for Responsible Lending projected that 26,306 homes in the State would be lost to foreclosure from 2008 through 2009. As a result, it was estimated that an additional 400,306 homes in close proximity to those foreclosed properties would see a decrease in home values and tax bases of $1 billion dollars. The average decrease in home value affected per unit totaled $2,578. (See *http://www.responsiblelending.org/mortgage-lending/research-analysis/louisiana-state-info-with-fc-starts.pdf*). A later 2012 report by CRL showed that Louisiana had 88,898 foreclosure starts affecting 1,042,210 households

[7] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203 § 1013(d) (July 21, 2010) (creating the CFPB's Office of Financial Education to "educate and empower consumers to make better informed financial decisions").

with each household facing a home equity loss of 2.7 percent and $4,587. Families living in minority census tracts in the State loss 36.2 percent of their wealth to foreclosure. (See *http://www.responsiblelending.org/sites/default/files/uploads/3-mortgages.pdf.*)

- In 2012, the Brookings Institute conducted a study titled, "The Ongoing Impact of Foreclosures on Children," and found that 2.3 million children who lived in single family homes during the crisis lost their homes. In Louisiana, 45,000 children were displaced due to completed foreclosures on home loans that were originated between 2004–2008. (See *http://www.brookings.edu/~/media/research/files/papers/2012/4/18-foreclosures-children-isaacs/0418_foreclosures_children_isaacs.pdf.*)
- According to RealtyTrac, as of April 2016 1 in every 1593 homes in the State of Louisiana is facing a foreclosure action despite being 7 years post "Great Recession". (See "America's foreclosure crisis isn't over"—*http://www.cbsnews.com/news/americas-foreclosure-crisis-isnt-over/.*)
- Credit accessibility has become overly constrained as a result of the market over correction in response to the foreclosure crisis. Lower wealth families and people of color with a history of success with mortgages are now basically locked out of the housing finance system except for the Government-insured mortgages they received. In Louisiana, African Americans received only 10,655 mortgages and Latinos only 1,618 in 2014 according to Home Mortgage Disclosure Act data. These low numbers are in comparison to the 60,177 whites in the State received. Home ownership is the primary way that most families build wealth and move into the middle class. Lower-wealth families have been sidelined by conventional mortgage lenders when interest rates are at historical lows and home prices are relatively affordable. (See *http://www.consumerfinance.gov/data-research/hmda/explore#filters.*)

Q.2. Dr. Gable, in your testimony, you stated "in the auto lending industry, predatory discrimination practices have been evidenced for years"? Can you describe those practices, including what you have observed in your community?

A.2. Auto Lending

- The issue of discrimination in auto lending has persisted for the past few decades.
- The first evidence of discrimination came as a result of a series of lawsuits filed in the mid-1990s against the largest finance companies in the country alleging discriminatory impact from the practice of dealer interest rate markups. Data from those lawsuits showed that borrowers of color were more likely to have their interest rates marked up by the dealer, and paid substantially more than white borrowers.
- To settle these cases, the lenders agreed to cap the amount dealers could add to the interest rate at 2–2.5 percent. These caps have all expired, and while most lenders have maintained those caps, they are voluntary and lenders could increase them

at any time. *http://www.nclc.org/images/pdf/car__sales/ib-auto-dealers-racial__disparites.pdf.*

- In 2007, the Department of Justice settled cases with Pacifico Ford and Springfield Ford in Pennsylvania in which the DOJ found that African American borrowers were charged higher markups than white borrowers. Those dealers agreed to take steps to reduce or eliminate racial disparities, although there is no data available to show whether those steps actually did reduce or eliminate that discrimination. *https://www.justice.gov/archive/opa/pr/2007/August/07__crt__639.html.*
- More recently, the CFPB and DOJ have entered into a series of settlements with lenders in which the CFPB said that data indicated continued discrimination. While the levels of discrimination were not the eye-popping levels found in the cases from the mid-1990s, CFPB's data still shows unacceptable levels of discrimination.
- The Federal Trade Commission's (FTC) 2011 Roundtables on auto lending also shone light on practices that those presenting said have been problematic for quite some time. Those include yo-yo scams, issues with add-on products, and other sales and financing abuses. The FTC has taken strong action on car dealer advertising issues, but we still await action on many of the other abuses identified.
- Specifically in Louisiana auto dealers seek to target minorities who are unaware the higher financing charges added to the vehicle they chose to purchase. I personally have been seduced into deals like these. However, I persist in showing my FICO score and then informed the dealer I have a rate from my bank which they can match if they desire my business. Many bi-vocational pastor/clergy in my community fall prey to this predatory practice.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

Consumer Federation of America

The Honorable Richard Shelby
Chairman
Committee on Banking, Housing and Urban Affairs
U.S. Senate
Washington D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing and Urban Affairs
U.S. Senate
Washington D.C. 20510

Re: April 5, 2016 hearing on the Effects of Consumer Finance Regulations and April 7, 2016 hearing on The Consumer Financial Protection Bureau's Semi-Annual Report to Congress

Dear Chairman Shelby, Ranking Member Brown and Members of the Committee:

Consumer Federation of America (CFA)[1] would like to submit the following statement for the record for the hearing entitled "Effects of Consumer Finance Regulations" held on April 5, 2016 and the hearing entitled "The Consumer Financial Protection Bureau's Semi-Annual Report to Congress" held on April 7, 2016. This statement addresses the critical work underway at the Consumer Financial Protection Bureau to protect consumers from the harmful practices of payday and auto title lenders. CFA strongly supports this work and urges you to support this and other efforts to protect consumer from abusive lending and oppose any efforts to delay the Bureau's much-needed rule.

The Consumer Federation of America also supports the important consumer financial protection efforts undertaken by the Bureau in other areas addressed in the statements prepared by members of Americans for Financial Reform. Although we do not have a position on every consumer regulatory issue discussed by other AFR members, we associate ourselves with other remarks defending the CFPB's work and structure.

1. A Strong CFPB Rule is Necessary to Protect Consumers from the Financial Harm Caused by Payday, Auto Title and Payday Installment Loans

According to the Center for Responsible Lending, the failure to limit abusive repeat loans issued by payday lenders results in $3.5 billion in additional fees paid by payday loan borrowers[2] and $3.6 billion in

[1] CFA is an association of over 250 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy and education.

[2] Parrish, Leslie, and Uriah King. *Phantom Demand: Short-Term Due Date Generates Need for Repeat Payday Loans, Accounting for 76% of Total Volume*. Washington, DC, July 9, 2009. http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

additional fees paid by title loan borrowers each year.[3] Currently 35 states authorize triple digit interest rate payday loans made without any consideration of a borrower's ability to repay.[4] As a result, 71 percent of Americans live in states that would see a considerable improvement in consumer protections for payday and auto title loans if a strong CFPB rule is enacted.

As a data-driven regulator committed to improving the financial market place and protecting consumers, the CFPB has exhaustively documented the frequency of repeat borrowing and other harmful practices that its current proposal seeks to address. In March 2014, the CFPB released research documenting that repeat borrowing is standard practice—over 80 percent of loans are renewed because a borrower is unable to repay in full and on time and half of all loans are part of a series of ten or more loans.[5] In a 2013 white paper on payday lending, the CFPB also found that 75 percent of loan fees were charged to borrowers that used 11 or more payday loans in a 12-month period.[6]

2. Recent Enforcement Actions Demonstrate Harm Caused by Payday and Auto Title Loans

The CFPB has also taken strong action against payday lenders who have violated current consumer protections and these actions have helped expose harmful practices.

In 2014, the CFPB took enforcement action against ACE Cash Express, one of the largest payday lenders in the country for using illegal debt collection tactics to push borrowers into taking out additional loans they could not afford.[7] By using false threats, intimidation and harassing phone calls, the CFPB found that ACE Cash Express pressured overdue borrowers to temporarily repay their short-term loans then quickly re-borrow—resulting in mounting fees and a long-term cycle of debt. ACE Cash Express's training manual confirmed that this tactic was common practice in the company, going so far as to include a graphic explaining how short-term borrowing results in an inability to repay followed by a new loan and commensurate fees (see Figure 1). ACE Cash Express was ordered to pay $5 million in consumer refunds to borrowers that were harmed by this abusive practice.

In November 2015, the CFPB took enforcement action against Integrity Advance, LLC an online lender. The Bureau alleged that Integrity Advance had hidden the true cost of the loan by only disclosing the cost of borrowing based on a single payment and then automatically renewing the loan and charging additional finance charges. The Bureau also alleged that the online lender unfairly used a little-known payment

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[3] *Driven to Disaster: Car-Title Lending and Its Impact on Consumers*. Washington, DC: Center for Responsible Lending and Consumer Federation of America, February 28, 2013. http://www.responsiblelending.org/other-consumer-loans/car-title-loans/research-analysis/CRL-Car-Title-Report-FINAL.pdf.

[4] *State Payday Loan Regulation and Usage Rates*. The Pew Charitable Trusts, July 11, 2012. http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/~/media/Data%20Visualizations/Interactives/2014/State%20Payday%20Loan%20Regulation%20and%20Usage%20Rates/Report/State_Payday_Loan_Regulation_and_Usage_Rates.pdf.

[5] *CFPB Data Point: Payday Lending*. Washington, D.C.: Consumer Financial Protection Bureau, March 2014. http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

[6] *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings*. Washington, DC: Consumer Financial Protection Bureau, April 13, 2013. http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[7] "CFPB Takes Action Against ACE Cash Express for Pushing Payday Borrowers Into Cycle of Debt." Washington, DC: Consumer Financial Protection Bureau, July 10, 2014. http://files.consumerfinance.gov/f/201407_cfpb_consent-order_ace-cash-express.pdf.

mechanism called a remotely-created check to debit consumers' checking accounts even after they have revoked the lender's authorization to make automatic checking account withdrawals.

These enforcement actions, and others undertaken by the Bureau, demonstrate the harm caused by high-cost, short-term loans originated with no consideration of a borrower's ability to repay the loan without re-borrowing or financial hardship. Both actions described above show that repeat borrowing and unfettered access to a borrowers checking account is the business model of payday lenders. While ongoing enforcement of existing consumer protection laws are critical to prevent widespread abuse, we believe that additional protections, such as those that the Bureau has proposed, are necessary to protect consumers going forward.

3. The ability to repay standard proposed by the CFPB will protect consumers who take out payday and auto title loans

At a March 2015 field hearing in Richmond, Virginia, the CFPB issued a working draft of possible consumer protections under consideration for a proposed rule – a critical first step to ensuring that consumers are protected from abusive practices such as poor underwriting and back-to-back lending.[8] The proposal contains a straight-forward, common-sense ability to repay standard that requires lenders to review borrowers' income and expenses before issuing a loan to ensure that they can repay the loan in full and on time without additional borrowing. The adoption of such a standard that applies to short-term and long-term payday and auto title loans, without loopholes for unsafe repeat borrowing, is critical to protecting consumers and stopping the debt trap caused by unsafe credit products. An ability to repay standard is already in place for other types of lending, such as mortgage and credit card lending, and those products remain widely available.

4. Protecting consumers from short- and longer-term payday loans will prevent current and future abusive practices

The CFPB proposal rightly applies the ability to repay standard to short- and long-term payday and auto title lending, as well as to similar, harmful products structured as open-end lines of credit. The scope of the proposal is fundamental to protecting consumers and to ensuring that lenders do not develop new products to evade a final rule.

Payday and title lenders are already shifting to longer-term loans and the Bureau's application of a strong ability to repay standard to longer-term payday loans is critical to preventing evasions. A 2014 report by payday lending analysts Stephens, Inc., documents the shift from balloon payment payday loans to payday installment loans among storefront lenders and illustrates the need to apply consumer protections to both short- and long-term payday and auto title loans and open-end credit. The Stephens report found that, as of 2014, installment loan growth represented well over half of the total growth for payday industry participants who experienced growth in 2013."[9] One of the largest lenders, Cash America has

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[8] "Small Business Advisory Review Panel for Potential Rulemakings for Payday, Vehicle Title, and Similar Loans: Outline of Proposals Under Consideration and Alternatives Considered." Washington, DC: Consumer Financial Protection Bureau, March 26, 2015. http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf.

[9] Hecht, John. "Alternative Financial Services: Innovating to Meet Customer Needs in an Evolving Regulatory Framework." presented at the CFSA Solutions, Little Rock, AR, February 27, 2014. http://cfsaa.com/Portals/0/cfsa2014_conference/Presentations/CFSA2014_THURSDAY_GeneralSession_JohnHecht_Stephens.pdf.

also shifted from balloon payment payday loans to longer-term payday loans and open-end lines of credit. Including both storefront and online lending, Stephens, Inc. noted that Cash America's installment and open-end products now comprise about 56 percent of the company's domestic loan balance as of December 2013.[10]

This shift to long-term lending means that the longer-term payday loan ability to repay standard is a critical part of the CFPB proposal and must be strong enough to ensure that lenders do not simply shift to this form of lending to avoid new restrictions on short-term payday loans.

5. Recommendations to improve the current CFPB payday proposal

CFA encourages the Bureau to consider four key improvements to ensure that the rule adequately protects consumers. The final rule should apply an ability to repay requirement to all covered credit without any exemption or safe harbor for loans that do not consider and document a borrowers' income and expenses to ensure affordability. To protect borrowers from the well-documented cycle of debt caused by high-cost, short-term payday loans, the CFPB should prohibit lenders from making short-term payday loans that would put borrowers in debt for more than 90 days in a 12-month period. To protect consumers from common abuses associated with the longer-term payday loans discussed previously, the CFPB should strengthen underwriting requirements and limit abusive refinancing designed to mast defaults and extend the term of the loan. The rule should also explicitly recognize the importance of the usury caps adopted by state legislatures as an important consumer protection to preventing abusive lending.

6. Borrowers can and do turn to lower-cost, more sustainable financial options if abusive, back-to-back lending is restricted

A strong rule would not unduly reduce access to safe and sustainable credit options. Instead it would ensure that all lenders, including storefront and online lenders, are only issuing loans that a borrower can repay in full and on time without re-borrowing or financial hardship.

In 2012, the Pew Charitable Trusts issued a report examining how borrowers would manage their financial options if high-cost payday lending was unavailable. The report found that 81 percent of borrowers that used payday loans would cut back on expenses. Borrowers also indicated that they would borrow from family or friends or sell or pawn possessions instead of taking out a high-cost payday loan. Likewise, 44 percent indicated that they would take a loan from a bank or credit union, 37 percent would use a credit card and 17 percent would borrow from an employer.[11]

A strong rule based on an ability to repay standard that applies to the entire payday and auto title market would serve the dual purpose of preventing widespread, well-documented abuses and giving borrowers the option of turning to lower-cost and more sustainable credit options as they already do in states that do not allow payday and auto title lending. While the proposal as currently structured may ultimately limit the number of back-to-back loans, this should be viewed as a dramatic improvement in a marketplace where over 80 percent of all loans are followed by another loan just days or weeks later.

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[10] Ibid. Note that Cash America has since spun off its online lending operation, Enova Financial.

[11] *Payday Lending in America: Who Borrows, Where They Borrow, and Why*. Washington, DC: The Pew Charitable Trusts, July 2012. http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf.

Conclusion

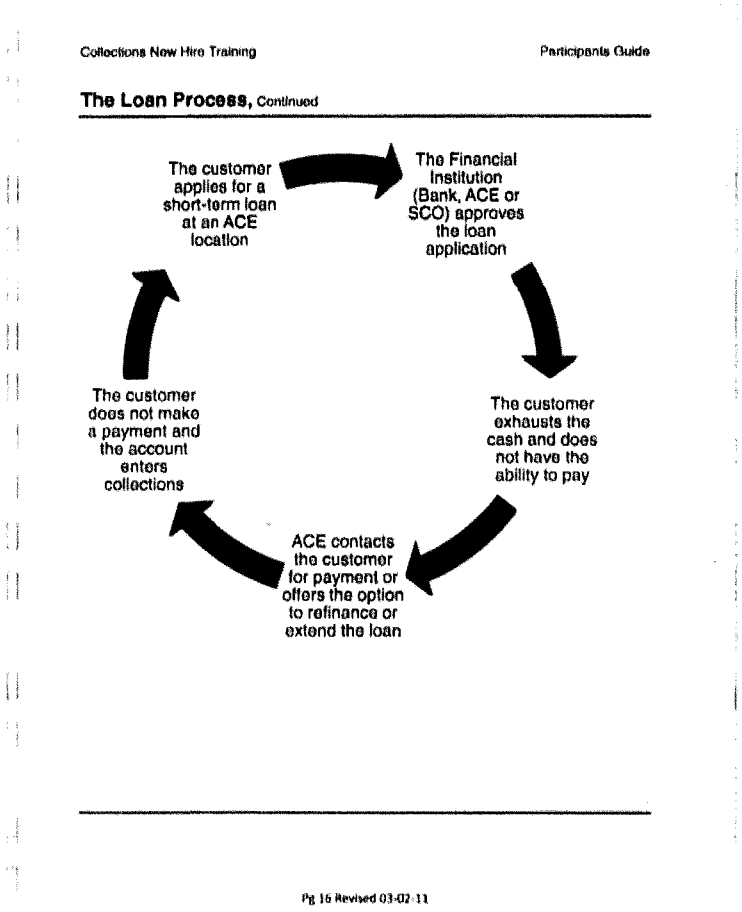
Effective regulation of the lenders that offer high-cost payday, auto title and other loans is critical to protecting consumers from abusive practices and the financial insecurity that results from the sustained use of high-cost debt. The proposal under consideration by the CFPB is the result of a comprehensive analysis of the high-cost credit marketplace and is supported by robust CFPB research and information collected as part of its ongoing supervision and enforcement activities. It represents a targeted response that will prevent bad practices so that good practices can flourish. We urge you to fully consider the profound harm suffered by consumers trapped in a long-term cycle of debt caused by payday and auto title loans and support the Bureau's work to ensure that consumers are treated fairly.

If you have any additional questions or concerns, please contact Tom Feltner, director of financial services at Consumer Federation of America at 202-618-0310 or tfeltner@consumerfed.org.

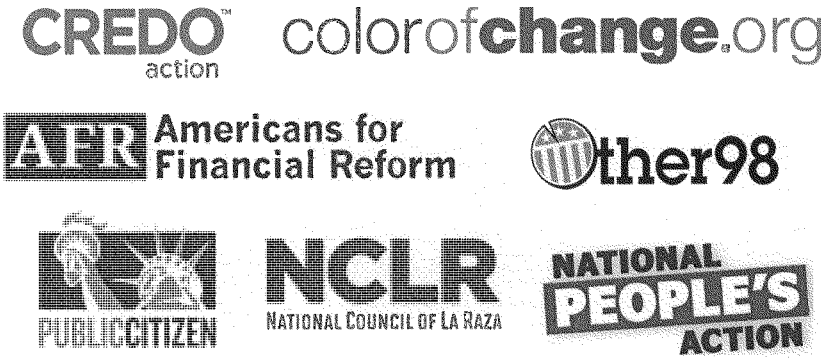
Respectfully submitted,

Tom Feltner
Director of Financial Services
Consumer Federation of America

Figure 1. Graphic from ACE's 2011 Training Manual illustrating the cycle of debt business model



Source: Consumer Financial Protection Bureau press release available at: http://1.usa.gov/1N6WFp7



Senator Richard Shelby, Chairman
Senator Sherrod Brown, Ranking Member
Committee on Banking, Housing and Urban Development

April 7, 2016

Dear Senators Shelby and Brown,

We are writing to express our strong support for the work of the Consumer Financial Protection Bureau (CFPB). Our organizations speak for countless millions of Americans who are glad such an agency exists, grateful for what it has done to bring basic standards of fair play to the financial marketplace, and committed to its continued ability to carry out its crucially important mission.

Many lawmakers, including members of your committee, have attacked the Consumer Bureau and called for the enactment of bills and amendments that would gravely weaken it. In doing so, they ignore the will of the vast majority of voters, across party lines. To underscore that fact, we are delivering a flash drive containing petitions in which hundreds of thousands of Americans urge Congress to stand up for the CFPB and oppose efforts to weaken its authority and effectiveness by, for example, turning it from a director-led agency into a commission. These petitions were initiated by CREDO Action, ColorOfChange, Americans for Financial Reform, Other 98, Public Citizen, National Council of LaRaza, and National People's Action.

(The petition files on the flash drive contain 462,000 signatures. We can't give a precise figure on the total number of signers, because we have not attempted to account for people who signed more than one petition.)

In addition to the petitions contained on the flash drive, more than 200,000 people have signed petitions urging Congress not to try to undermine the CFPB through riders to spending bills or other "must-pass" legislation; and tens of thousands of people have signed petitions appealing

to lawmakers to back the Consumer Bureau in its specific efforts to rein in the abuses of triple-digit interest, debt-trap consumer lenders; combat auto-lending practices that systematically lead to the overcharging of black and Hispanic borrowers; and end the used of forced arbitration clauses to strip consumers of their ability to take companies to court.

Thank you for your consideration.

Sincerely,

Americans for Financial Reform
ColorOfChange
CREDO Action
National Council of LaRaza
National People's Action
Other 98
Public Citizen

April 5, 2016

Dear Senator,

Americans for Financial Reform (AFR)[1] appreciates the opportunity to provide this statement for the record of the Senate Committee on Banking, Housing on Urban Affairs regarding the Effects of Consumer Finance Regulations. It is less than five years since the Consumer Financial Protection Bureau (CFPB) was established. Since then, the CFPB has fulfilled Congress's vision of a federal agency with "the authority and accountability to ensure that existing consumer protection laws and regulations are comprehensive, fair, and vigorously enforced."[2] Through its rulemaking, supervision, enforcement, and consumer education and complaint system, the CFPB has made enormous strides in ensuring that the financial marketplace is fair to consumers. Its rules and supervision have already begun to reform the industry's conduct, making banks and other financial services companies more attentive to consumers' rights.

In this statement, AFR focuses in particular the CFPB's enforcement successes, the need to retain its statutory structure, and some of the CFPB's priorities in the coming years. AFR members are submitting statements for the record on issues we did not address in this short statement, and we ask the Committee to give those statements full consideration.

Enforcement

Director Cordray has been straightforward in stating that "the Consumer Bureau fully intends to be the 'cop on the beat' that was envisioned when the financial reform law was enacted."[3] Through its enforcement actions, the CFPB has lived up to those words, resolving more than 80 cases and securing $11.2 billion in relief for consumers - more than four times what the Bureau has spent on all functions over the course of its existence. These settlements have also yielded more than $375 million in fines.

A few examples illustrate the breadth of the CFPB's successes:

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[1] AFR is a coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups. A list of AFR member groups is attached to this letter.

[2] Joint Explanatory Statement of the [Dodd-Frank] Committee of Conference, at 874 (June 29, 2010), http://www.llsdc.org/assets/DoddFrankdocs/dodd-frank-act-jt-expl-statement.pdf

[3] Richard Cordray, *Prepared Remarks of CFPB Director Richard Cordray at the National Association of Attorneys General* (Feb. 23, 2015), http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-national-association-of-attorneys-general-2/.

- Securing $1.8 billion in refunds for the credit card customers of Citibank,[4] Bank of America,[5] and JP Morgan Chase[6] for worthless add-on products like fraud monitoring services and deceptively-marketed insurance.
- Entering into a $2.1 billion settlement with Ocwen for systematically overcharging homeowners by misapplying their payments and adding unauthorized fees, and by misleading homeowners and courts in the foreclosure process.[7]
- Securing a $530 million default judgment against Corinthian,[8] a for-profit school that swindled students into paying for worthless degrees and then engaged in illegal debt collection in its private student loan program, as well as $480 million in debt relief for affected students.[9]
- Putting an end to the unfair practices of dozens of other companies in other cases. To take one example, in December 2015, the CFPB stopped CarHop from continuing to convey inaccurate information to credit reporting agencies; CarHop also agreed to pay a $6,465,000 civil penalty in recognition of the 84,000 customers already been harmed by its false reports.[10]

In the face of these law enforcement successes and their tangible results for consumers, the CFPB's critics assert that the Bureau is engaging in "rulemaking by enforcement." This is simply a pejorative label for routine agency practice. For more than a century, Congress has recognized the necessity of having agencies make judgments on a case-by-case basis, particularly in stopping unfairness in the marketplace. As the legislators who passed the Federal Trade Commission Act in 1914 wrote, "[i]t is impossible to frame definitions which embrace all unfair practices. There is no limit to human inventiveness in this field. Even if all known unfair practices were specifically defined and prohibited, it would be at once necessary to begin over again."[11]

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[4] http://www.consumerfinance.gov/newsroom/cfpb-orders-citibank-to-pay-700-million-in-consumer-relief-for-illegal-credit-card-practices/

[5] http://www.consumerfinance.gov/newsroom/cfpb-orders-bank-of-america-to-pay-727-million-in-consumer-relief-for-illegal-credit-card-practices/

[6] http://www.consumerfinance.gov/newsroom/cfpb-orders-chase-and-jpmorgan-chase-to-pay-309-million-refund-for-illegal-credit-card-practices/

[7] http://www.consumerfinance.gov/newsroom/cfpb-state-authorities-order-ocwen-to-provide-2-billion-in-relief-to-homeowners-for-servicing-wrongs/

[8] http://www.consumerfinance.gov/newsroom/cfpb-wins-default-judgment-against-corinthian-colleges-for-engaging-in-a-predatory-lending-scheme/

[9] http://www.consumerfinance.gov/newsroom/cfpb-secures-480-million-in-debt-relief-for-current-and-former-corinthian-students/

[10] http://www.consumerfinance.gov/newsroom/cfpb-orders-carhop-to-pay-6-4-million-penalty-for-jeopardizing-consumers-credit/

[11] House Report No. 1142, 63d Congress, 2d Sess., at 19 (Sept. 4, 1914) *cited with approval FTC v. R. F. Keppel & Bro., Inc.*, 291 U.S. 304, 312 n.2 (1934).

Similarly, the Supreme Court has long recognized that case-by-case adjudication is entirely appropriate and necessary for an administrative agency:

> Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular, unforeseeable situations. In performing its important functions in these respects, therefore, an administrative agency must be equipped to act either by general rule or by individual order. To insist upon one form of action to the exclusion of the other is to exalt form over necessity.
>
> In other words, problems may arise in a case which the administrative agency could not reasonably foresee, problems which must be solved despite the absence of a relevant general rule. Or the agency may not have had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule. Or the problem may be so specialized and varying in nature as to be impossible of capture within the boundaries of a general rule. In those situations, the agency must retain power to deal with the problems on a case-to-case basis if the administrative process is to be effective. There is thus a very definite place for the case-by-case evolution of statutory standards.[12]

At bottom, objection to case-by-case development of the law is an objection to the entire common law system that forms the foundation of Anglo-American law. The feigned outrage at this ordinary and longstanding practice is simply a pretext to complain about the CFPB's success in fulfilling its mission to enforce consumer finance laws.

Structure

The CFPB's success has confirmed the wisdom of creating an agency accountable to a single Director with the independent funding to shield financial regulation from undue politicization.

Vesting a single director with responsibility for the Bureau's functioning facilitates effective decision-making and ensures a clear point of responsibility for the CFPB's performance. A single-director structure for a financial regulator is nothing new: the Office of the Comptroller of the Currency, the regulator of national banks, has been headed by a single official since it was

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[12] *SEC v. Chenery Corp.*, 332 US 194, 201-202 (1947); *accord NLRB v. Bell Aerospace Co.*, 416 US 267 (1974); *Conference Group, LLC v. FCC*, 720 F. 3d 957 (D.C. Cir. 2013) (Rogers, J.) ("The Commission's decision involved a statutory interpretation that could be rendered in the form of an adjudication, not only in a rulemaking. . . . Although the Commission stated its decision would apply to 'similarly situated' providers, that is true of all precedents.").

established in 1863.[13] Since Congress established the Federal Housing Finance Agency in 2008, that agency has also been headed by a single director who can be removed only for cause.[14]

The CFPB nevertheless faces many structural checks on its authority. Its rulemakings are subject to notice-and-comment procedures that provide opportunity for input by the affected industries, the public, and elected officials, and its rules may be challenged in court under the Administrative Procedures Act. Similarly, enforcement actions may be appealed to the courts. Unlike other bank regulators, the CFPB's decisions are also subject to veto by the members of the Financial Stability Oversight Council,[15] and CFPB rulemakings that impact small businesses are initially reviewed by a panel of affected small businesses.[16] The CFPB is also subject to extensive oversight through semi-annual testimony before each house of Congress's committee of jurisdiction, annual Government Accountability Office audits, and frequent reports by the Inspector General.

Independent funding is also a common characteristic of the federal bank regulatory agencies. Like the other federal bank regulators – the OCC, the FDIC, and the Federal Reserve – the CFPB does not receive appropriations. None of these agencies have ever been appropriated agencies. While other bank regulators have mechanisms to increase their own independent funding, only the CFPB's budget is capped by Congress. The CFPB has proven itself prudent in the use of this funding. In FY2015, the CFPB spent $524.4 million, 17% less than its Congressionally-authorized cap of $631.7 million and 49% less than the $1.04 billion spent by the OCC.

Future Policy Priorities

The CFPB must continue to move forward on many pressing priorities. Despite the enormously successful initiatives of the past four-and-a-half years, consumers continue to face unfair, deceptive, and abusive practices when accessing financial services. To that end, AFR continues to urge the CFPB to move forward on each of the nine priorities it has identified for the next two years[17] as well as in a number of other areas. We discuss several, but not all, of these priorities below.

Payday lending. AFR hopes and expects that the CFPB will soon propose a strong rule requiring all high-cost lenders, including payday, car title and installment lenders to confirm a borrower's ability to repay in light of their income and expenses without defaulting on other bills and without taking out a new loan. This work is vital to stopping the worst abuses in predatory small dollar lending and the debt trap that has ensnared millions of Americans.

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[13] 12 U.S.C. § 1(b)(1).

[14] 12 U.S.C. § 5491(b).

[15] 12 U.S.C. § 5513(a).

[16] 5 U.S.C. § 601 *et seq.*

[17] CFPB Fact Sheet, Policy priorities over the next two years (Feb. 25, 2016), http://files.consumerfinance.gov/f/201602_cfpb_policy-priorities-over-the-next-two-years.pdf.

Arbitration. AFR urges the CFPB to propose a strong rule banning or restricting forced arbitration. Lenders and financial servicers use mandatory arbitration clauses to block consumers from joining together to seek compensation; these clauses typically force wronged consumers to individually bring their claims against large companies in a private arbitration system that is shaped by companies to favor their own interests. The empirical findings in the CFPB's comprehensive report on the use of arbitration clauses unequivocally demonstrate that forced arbitration leaves consumers effectively powerless to hold companies accountable.

Debt collection. AFR is encouraged that the CFPB has announced its intention to initiate a rulemaking process on debt collection. The CFPB receives more complaints about debt collection than any other issue, and it is vital that continued abuses be addressed by the Bureau.

Student lending. AFR welcomes the CFPB's attention to the student loan servicing market, including its ongoing collection of debt collection and private student loans. The CFPB recently solicited feedback from students on their student loan-related problems in the form of a Request for Information (RFI) on servicing,[18] which received more than 30,000 comments. The information collected through this RFI was analyzed in a September report that found student loans are more distressed than other types of consumer debt, with more than 1-in-4 student loan borrowers now delinquent or in default on a student loan.[19] We urge the CFPB to use the lessons it learned from its September servicing report to inform future action to address ongoing failures in student loan servicing.

Mortgage servicing. AFR looks forward to a final CFPB rule revising its mortgage servicing standards to address ongoing problems faced by homeowners. These problems include unnecessary delays in the processing of mortgage modification requests, family members being left unable to seek mortgage modifications after inheriting a home, and homeowners negatively impacted by the transfer of a mortgage from one servicer to another. Even after these rules are instituted, the CFPB will need to address mortgage servicing issues involving the needs of borrowers with limited English proficiency and to take additional steps to maximize the number of borrowers able to access sustainable loan modifications as the housing market and policy environment change.

Collection of data on lending to small businesses. AFR is very pleased to see the CFPB identify meeting its responsibility to collect data on lending to small businesses and women- and minority-owned businesses as a top priority.[20] Small businesses are critical to job creation, and the founding of a successful small business is one of the ways for people to build wealth and get ahead. Unfortunately, small businesses – especially women- and minority-owned businesses –

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[18] CFPB, *Tell us about your student debt stress* (May 14, 2015), http://www.consumerfinance.gov/blog/tell-us-about-your-student-debt-stress/.

[19] CFPB, *Student Loan Servicing* (Sept. 29, 2015), http://www.consumerfinance.gov/reports/student-loan-servicing/.

[20] *See* 15 U.S.C. § 1691c–2.

have trouble attracting needed capital.[21] The CFPB's data collection will provided a valuable tool to address this problem, and we hope that the CFPB will move quickly to establish this statutorily-required system.

Data availability. AFR has been impressed by the success of the CFPB's complaint database. In particular, AFR appreciates that consumer complaints are now available for public review with personally identifiable information redacted. We hope that the CFPB will also take steps to ensure the public disclosure of the maximum amount of information from both the Home Mortgage Disclosure Act database and the forthcoming small business lending database. We believe that it is possible to combine expansive disclosure with protecting borrowers' legitimate privacy interests.

* * *

Thank you for the opportunity to express AFR's views on the success of the CFPB. If you have additional questions on these issues, please contact Brian Simmonds Marshall, AFR's Policy Counsel, at brian@ourfinancialsecurity.org or 202-684-2974.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future

[21] Karen Gordon Mills & Brayden McCarthy, *The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game*, HARVARD BUSINESS SCHOOL WORKING PAPER 15-004, at 58 (July 22, 2014), http://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf.

- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America

- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction

- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY

- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Phoenix AZ
- UNET

April 4, 2016

The Honorable Senator Richard Shelby, Chairman
The Honorable Senator Sherrod Brown, Ranking Member
U.S. Senate Committee on Banking, Housing, & Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Shelby and Ranking Member Brown,

On behalf of the Alliance for a Just Society, I am writing to submit this statement for the record of the Committee's April 5 hearing titled "Assessing the Effects of Consumer Finance Regulations."

The Alliance is a network of state-based community organizations that work with people in low-income communities across the country to advance economic opportunity and racial equity. Many of our affiliates' members are affected by the escalating crisis of family debt (including medical debt, mortgage debt, student loan debt, municipal fines/fees, and more). Because of this, we are highly concerned with the prevalence of unfair, deceptive, and abusive practices in the debt collection industry, and we believe the Consumer Financial Protection Bureau should act promptly to establish new rules to protect consumers from collection-related abuses.

The Alliance recently conducted a study of debt collection-related complaints published in the CFPB complaint database. In the two-year sample we examined, covering July 2013 to August 2015, there were nearly 75,000 published debt collection complaints. This study highlighted consumers' experiences of hardship and harassment at the hands of debt collectors, and underscored the need to develop new rules not only for third-party collectors and debt buyers, but also for creditors collecting debts. Please see the attached summary fact sheet and full report for more details on our research findings and recommendations for reforms to protect consumers from debt collection abuses.

While we know some industry interests are intent on undermining the ability of the CFPB to protect consumers, we hope the committee's proceedings will explore the continuing threats of unfair and deceptive financial industry practices facing consumers, both in debt collection and in other areas, and the important role of the CFPB in curbing abusive practices that harm families, communities, and our economy.

Sincerely,

LeeAnn Hall
Alliance Executive Director

CONTINUING ABUSES BY DEBT COLLECTORS

We recently conducted an analysis of debt collection-related complaints published in the CFPB complaint database. In the two-year sample we examined, covering July 2013 to August 2015, there were nearly 75,000 published debt collection complaints.

The breakdown of collection-related complaints by primary issue was as follows:

- 42 percent were about continued attempts to collect debts consumers said they didn't owe;
- 19 percent were about collectors' communication tactics;
- 17 percent were about disclosures and verification of debts;
- 8 percent were about false statements or representations;
- 8 percent were about improper contact or sharing of information; and
- 7 percent were about a collector taking or threatening an illegal action.

The stories captured in the consumer complaint narratives are compelling. The following excerpts speak to the hardships consumers have suffered:

- A consumer wrote about PRA Group: "A company called Portfolio Recovery has done all of these things: contacted family in other states, contacted employer, threatened me, calls multiple times a day from different numbers, won't tell me what this is for, etc. ... FOR SEVERAL YEARS!!!! Please stop them."
- A consumer from Florida wrote about Encore Capital Group: "I have been receiving numerous calls from [Encore subsidiary] Midland Credit. They are looking for someone else, not me, for over a month. Sometimes it is automated and they just ring the phone; I called them back XXXX times and asked them to take off my number – calls keep coming. Today I spoke to a person that said he would remove it from the automated calls and now the manual calls have begun."
- A consumer from Florida wrote about Navient: "I am writing on behalf of my XXXX year old XXXX. She is paying on her grandson's XXXX XXXX XXXX loan, however they call her day and night requesting that she pay it off in full or they demand a very large payment. They threaten her with foreclosure and lawsuits. She pays monthly and they still call, they even call her on holidays. She asks them to stop calling and has put it in writing and the harassing calls continue. They've told her they'll call whenever they want and will continue until she pays off the loan. These calls are making her XXXX and I need to know what we can do to stop this harassment?"
- A consumer from Colorado wrote about Dynamic Recovery Solutions: "Dynamic Recovery Solutions is contacting myself and my husband daily, with very threatening attitudes. I have received a letter in the mail also. This is not my debt, I do not owe this money and they will not leave us alone."

For more information, see full report at: http://allianceforajustsociety.org/2016/01/debt-collectors-report/

SIGNIFICANT ABUSES BY CREDITORS COLLECTING DEBTS

In our analysis of collection-related complaints in the CFPB database, we looked at the 15 companies that received the most complaints related to debt collection activities. While debt buyers took the top two slots, it's important to note that six out of the 15 companies receiving the most collection-related complaints were original creditors (the list included many of the biggest banks). *The high incidence of creditors on this list underscores the need to develop new rules for creditors collecting debts.*

Examining the breakdown of complaints by type for creditors, looking at Citigroup as an example, we found in a sample of more than 1,500 complaints:

- 34% were about continued attempts to collect debts consumers said they didn't owe;
- another 31% were about communication tactics;
- 13% were about disclosure and verification issues; 9% about improper contact or sharing of information; 7% about false statements; and 6% about taking or threatening illegal actions.

The consumer complaint narratives underscore that consumers' experiences with creditors can be just as harrowing as with third-party collectors. For example:

- A consumer from South Dakota wrote about Capital One: "This company calls me repeatedly throughout the day, every day of the week. From morning until night. They have never left a message. They use multiple numbers to call me from. It interrupts me at work. It interrupts me at home while I care for my young son... They call XXXX times a day for months now."
- A consumer from Texas wrote about Citigroup: "Letter sent to me pertaining to my DEAD husband's account. My husband died on XXXX XXXX, 1991 (almost XXXX years ago). I believe the account was paid off, but I might be wrong. But I do believe there is a statute of limitations with debt collections. I would consider XXXX years within that limit..."
- A consumer from Washington wrote about Wells Fargo: "My wife and I have been getting harassing phone calls on our cell phones and at work about a debt we know nothing about. (They called her XXXX in the last five days at work and told her manager she would be served papers at work when she returned.) They are claiming we owe a debt to Wells Fargo from 2005 (well past the six-year statute of limitations in Washington state). They say we are going to be sued and that her wages will be garnished."
- A consumer from Washington wrote about Bank of America: "An automatic call placed many times from XXXX states that there is fraudulent activity associated with my name and Social Security number. To avoid XXXX charges being filed against me, they then give me a case number of XXXX and a contact number XXXX. When calling the XXXX number, the operator tells me that I will be sued if I don't come to an agreement even though it is a time-barred debt. They continue to call even after I tell them the debt is not valid."

For more informatian, see full report at: http://allianceforajustsociety.org/2016/01/debt-collectors-report/

PROFILES OF COMPANIES WITH THE MOST DEBT COLLECTION COMPLAINTS IN THE CFPB CONSUMER COMPLAINT DATABASE

ALLIANCE FOR A JUST SOCIETY

JANUARY 2016

The Alliance for a Just Society's mission is to execute local, state and national campaigns and build strong affiliate organizations and partnerships that address economic, racial, and social inequities.

► www.allianceforajustsociety.org

COVER ART

The text used to create the word cloud were taken directly from complaints filed with the Consumer Financial Protection Bureau.

CONTRIBUTORS

Sam Blair, Ben Henry, Jill Reese and Kristofer Bitney, Alliance for a Just Society.

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UNFAIR DECEPTIVE & ABUSIVE

Debt Collectors Profit from Aggressive Tactics

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Introduction

In November 2013, the Consumer Financial Protection Bureau (CFPB) released an advance notice of proposed rulemaking signaling that it would consider whether new rules are warranted to protect consumers from unfair, deceptive and abusive debt collection practices.[1] The Bureau received over 23,000 comments in response.[2]

As part of this process, the Bureau is also conducting a survey of thousands of consumers to gather input on their experiences with debt collectors as part of its pre-rulemaking process. Pre-rule activities, including the expected convening of a Small Business Advocacy Review panel meeting under the Small Business Regulatory Enforcement Fairness Act (SBREFA), are anticipated to continue at least through February 2016.[3]

Meanwhile, the CFPB also has been accepting consumer complaints about debt collection practices since July 2013 and began making details of many of these complaints publicly available through its consumer complaint database starting in November 2013.[4,5] As of August 11, 2015, the database contained records for 74,376 debt collection-related complaints. (This number does not reflect the total number of complaints submitted, as the CFPB excludes many complaints in adherence to its privacy policy.)

This report examines the share of Americans affected by debt collection issues, trends in the debt collection industry, and patterns in the collections-related complaints in the CFPB complaint database. The report contains detailed profiles of the 15 companies with the most debt collection-related complaints filed against them in the CFPB complaint database (these companies include a mix of debt buyers, third-party collection agencies, and original creditors). The report concludes with a series of recommendations for the debt collection rulemaking.

Background

PREVALENCE OF DEBTS IN COLLECTIONS ACROSS U.S. AND IN STATES

Practices in the debt collection industry have implications for a surprisingly large share of the U.S. population. According to the Urban Institute's 2014 study *Delinquent Debt in America*, roughly 77 million Americans, or 35 percent of adults with a credit file, have a report of debt in collections. The average amount in collections is $5,178 — more than four months' wages for a full-time worker earning the federal minimum wage.[6]

The share of people with debts reported in collections is even higher in some states, the Urban Institute study found. In Alabama, Arkansas, the District of Columbia, Florida, Georgia, Kentucky, Louisiana, Mississippi, Nevada, New Mexico, North Carolina, South Carolina, Texas, and West Virginia, the share of adults with debt in collections tops 40 percent.[7]

Of the 100 largest Metropolitan Statistical Areas (MSAs) in the U.S., more than a quarter have shares

CATEGORIES OF DEBT COLLECTORS

There are generally three types of entities that collect payments on debts:

- Original creditors. These companies make loans and extend credit direct to consumers (for example, a bank or credit card company). Original creditors typically have internal debt collection departments that work to collect payments on the debt they issue.
- Third-party debt collectors. Companies and original creditors contract with third-party debt collectors to collect payments from consumers. Third-party debt collectors typically charge fees as a percentage of the debt they collect.
- Debt buyers. Original creditors sometimes sell portfolios of unsecured debts to debt buyers. Debt buyers purchase debts that were from original creditors or acquired from other debt buyers. These companies then use their own internal collections and legal teams to seek payments from consumers.

Note: These categories are not mutually exclusive — original creditors sometimes buy debts and collect on them, and debt buyers sometimes hire third-party debt collectors. And the categories are useful for understanding consumer privacy concerns.

of their adult populations with debt in collections exceeding 40 percent. McAllen, Texas, has the highest share at 52 percent.[8]

While debt collection practices impact a broad swath of Americans, evidence suggests increases in aggressive collection practices — in particular, the rise in debt collection lawsuits and resulting court judgments against consumers — disproportionately impact communities of color. A recent exposé by *Pro Publica* found: "Our analysis of five years of court judgments from three metropolitan areas — St. Louis, Chicago and Newark — showed that even accounting for income, the rate of judgments was twice as high in mostly black neighborhoods as it was in mostly white ones."[9]

ABOUT THE U.S. DEBT COLLECTION INDUSTRY

INDUSTRY GROWTH AND SCALE

Debt collection is a $13 billion industry in the U.S.[10] More than 50 percent of industry revenues comes from third-party collections agencies, while close to one-third come from debt buyers.[11]

The debt buying industry, in particular, has grown rapidly since its inception during the Savings & Loan crisis of the late 1980s and early 1990s. Today, two of the three largest debt collectors are primarily debt buyers, and these companies have experienced explosive growth:

- Encore Capital Group increased its revenues from $381 million in 2010 to nearly $1.1 billion in 2014. Over that period, Encore doubled its profits from $49 million to $104 million.[12]
- PRA Group increased its revenues from $373 million in 2010 to $881 million in 2014. Over that time, PRA more than doubled its profits from $73 million to $177 million (with a profit margin of 20 percent in 2014).[13]

LEGAL AND ENFORCEMENT FRAMEWORKS

Third-party debt collectors and debt buyers are governed under federal law by the Fair Debt Collection Practices Act (FDCPA). This law was enacted in 1977 to "eliminate abusive debt collection practices by debt collectors, to [ensure] that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses."[14]

MARKET SHARE, DEBT COLLECTIONS INDUSTRY, 2014

Rank	Company	Percentage of Total Market Revenue
1	Expert Global Solutions, Inc.	8.8%
2	Encore Capital Group, Inc.	7.5%
3	PRA Group, Inc.	6.9%

Source: IBISWorld Debt Collection Agencies in the U.S. Industry Report, April 2015

The FDCPA prohibits debt collectors from engaging in "unfair, deceptive, and abusive acts and practices" in collecting debts. Its definition of "debt collectors" encompasses third-party debt collectors and debt buyers, but it does not include original creditors.[15] The Consumer Financial Protection Bureau (CFPB), created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and the Federal Trade Commission (FTC) are responsible for enforcement of the FDCPA.

In addition, Section 1031 of the Dodd-Frank Act gives the CFPB direct rulemaking and enforcement authority to protect consumers from unfair, deceptive, or abusive acts or practices (or "UDAAP" authority) in connection with consumer financial products and services. Debt collection activities fall within the CFPB's UDAAP authority, and the CFPB has already taken a number of enforcement actions against companies it determined were engaging in unfair, deceptive or abusive debt collection activities.

According to the CFPB's March 2015 annual report on debt collection issues, in 2014, "the CFPB and the FTC provided almost $700 million in relief to consumers who were subject to illegal collections practices; the CFPB collected $13 million in fines, and took seven enforcement actions involving egregious debt collection violations; the FTC's enforcement actions resulted in 47 businesses and individuals being banned from the debt collection business."[16]

Both the CFPB and the FTC log consumer complaints about debt collectors who may have violated the FDCPA or other laws. The CFPB began accepting complaints in the second half of 2013. In 2014, the CFPB reported receiving 88,300 complaints related to debt collection, more than any other industry under the CFPB's purview, including a variety of financial

industries.[17] Additionally, the FTC, which also receives complaints from consumers, noted that it receives more complaints about debt collection than any other industry.[18]

In November 2015, the FTC announced an unprecedented partnership with state and local law enforcement across the country as part of a "crackdown" resulting in 30 new actions taken against "rogue collectors." Offenses include attempts to collect on debts that are not actually owed and improper threats of arrest and wage garnishment.[19]

Around the time the CFPB began accepting debt collections complaints, it also announced its intention to create new rules for debt collectors. The CFPB cited several reasons for the proposal, including the need for increased information accuracy, more informed consumers and fair communication tactics.[20] The CFPB collected tens of thousands of public comments, hosted roundtable discussions, and conducted consumer and business surveys to gather input from a wide range of stakeholders. Currently the rulemaking remains in a "pre-rule" status, meaning the CFPB is still collecting information.[21]

PREVIOUSLY DOCUMENTED ISSUES

Identified patterns of problematic practices in the debt collection industry include:

- *Consumer harassment:* Debt collectors have been criticized for aggressive and harassing collection tactics. In 2013, the FTC secured a $3.2 million penalty against Expert Global Solutions, the largest debt collector in the world, for "employing harassing collection calls, disclosing consumers' debts to third parties, and continuing collection efforts without verifying debts even after consumers said they did not owe those debts."[21] A 2013 study by the FTC found that, in a sample of accounts purchased by debt buyers, only 51 percent of disputed debts were verified by the debt buyers.[22]
- *Pursuit of time-barred debt:* Debt portfolios purchased by debt buyers often include accounts for debts that are too old to show up on credit reports or to be pursued through the legal system. (The statutory limitations defining the age at which debt can no longer be pursued vary by state.) But debt buyers seeking to collect payments on time-barred debts may still threaten to sue or employ other aggressive and deceptive tactics to induce consumers to make a payment, which can "restart the clock" on the statute of limitations.[23]
- *Incomplete documentation:* When a debt buyer purchases a portfolio of accounts, information is often incomplete and documentation lacking. The FTC's 2013 study examining over 5 million accounts purchased by the largest debt buyers found that only 11 percent of reviewed accounts included the principal amount owed and only 46 percent specified the name of the original creditor. An examination of documentation at the time of purchase for 3.9 million accounts found only 12 percent of accounts included any account documents (such as account statements, terms and conditions documents, or application documents).[24]
- *Mass litigation:* One estimate claims the third largest debt collector, PRA Group Inc., was pursuing up to 1.5 million individual accounts in court at once in 2013. At that time, legal actions represented an estimated 47 percent of PRA Group's collection activities outside of bankruptcy.[25] In 2011, debt buyers filed more than 200,000 cases in New York state alone. In 2014, there were 130,000 lawsuits in Cook County, Illinois.[26] A study of 4,400 lawsuits filed in Maryland by debt collectors in 2009 and 2010 found that more than 99 percent of

The 15 companies with the most debt collection-related complaints lodged against them in the CFPB's consumer complaint database, together with individuals associated with those companies, have collectively spent hundreds of millions of dollars on federal lobbying and political contributions since 2001, according to an analysis of data from the Center for Responsive Politics.

judgments against defendants were obtained without trial and less than 2 percent of defendants had lawyers.[27]

- *Robo-signing:* Some large debt collectors have been penalized for using "robo-signing" tactics, wherein individuals sign huge numbers of court case affidavits — too many for the signers to know the details of each case — in order to increase the number of lawsuits the companies can file without hiring more people.[28]

INDUSTRY INFLUENCE

The CFPB's role in establishing rules and initiating enforcement actions to protect consumers from unfair, deceptive and abusive debt collection practices is particularly important because of the significant investments companies engaging in collection activities have made to gain influence in Congress.

The 15 companies with the most debt collection-related complaints lodged against them in the CFPB's consumer complaint database, together with individuals associated with those companies, have collectively spent hundreds of millions of dollars on federal lobbying and political contributions since 2001, according to an analysis of data from the Center for Responsive Politics.

Of the 15 companies, eight companies and/or individuals associated with those companies — which include Encore Capital Group, PRA Group, Citigroup, Capital One, JPMorgan Chase, Bank of America, Navient and Wells Fargo — have made material contributions to federal candidates and political parties since 2001, totaling a combined $94.9 million.[29]

Meanwhile, six of the 15 companies — including Encore Capital Group, Citigroup, Capital One, JPMorgan Chase, Bank of America and Wells Fargo — have reported material spending levels on federal lobbying, totaling $284.9 million since 2001.[30]

These figures constitute total political contributions and lobbying spending by these entities and associated individuals. While these sums of money were not spent entirely to further specific interests around debt collection, the figures speak to the overall influence these entities hold in Congress. As such, the aggregate figures underscore the important role of independent, agency-level rulemaking to ensure meaningful protection for consumers.

COMPLAINTS ABOUT DEBT COLLECTION PRACTICES FROM THE CFPB CONSUMER COMPLAINT DATABASE

Consumer complaints filed with the Consumer Financial Protection Bureau suggest that unfair, deceptive and abusive tactics are prevalent in the debt collection industry. This report analyzes a sample of 74,376 consumer complaints received by the Consumer Financial Protection Bureau between July 10, 2013, when the CFPB first began accepting complaints about debt collections, and August 7, 2015. The sample excludes complaints in which the complainant did not specify debt collections as the primary "product." The sample contains only those complaints made publicly available by the CFPB. (Tens of thousands of debt collections complaints are not publicly available due to requests for privacy, limited data quality and other reasons.)[31]

CONSUMER COMPLAINTS BY ISSUE AND SUB-ISSUE

The breakdown of complaints by issue and sub-issue within the database provides an illustrative picture of consumers' self-reported experiences of different types of unfair, deceptive and abusive practices. (See table, Page 5.)

Consumers' most common complaint is that they are repeatedly being requested to pay a debt they do not believe they owe: 30,905 complaints (42 percent) specify this issue. Of the complaints with "continued attempts to collect debt not owed" as their specified issue, 63 percent indicate "debt is not mine" as the sub-issue of their complaint, 27 percent state the debt was paid, 6 percent state the debt resulted from identity theft, and 4 percent state the debt was discharged in bankruptcy.

The second most common complaint relates to the communication tactics used by debt collectors: 13,966 complaints (19 percent) cite this issue. Of those, 62 percent specify "frequent or repeated calls," 19 percent state the collector threatened legal action, 8 percent relate to companies calling after being sent written notices to cease communication, 7 percent relate to companies using obscene, profane or abusive language, and 4 percent relate to collectors calling outside the hours of 8 a.m. to 9 p.m.

Third, 12,992 complaints (17 percent) relate to debt disclosures and verification of debts. Of those, 69 percent of those consumers report that debt collectors did not provide documentation believed by the consumer to be necessary for verification of the debt. Another

DEBT COLLECTION-RELATED COMPLAINTS BY COMPLAINT TYPE

Types of products identified by consumers who submitted complaints on debt collections to the CFPB between July 7, 2013 and Aug. 7, 2015.

Issue Identified	Number of Complaints	% of Total Complaints
Continued attempts collect debt not owed	30,905	42%
Communication tactics	13,966	19%
Disclosure verification of debt	12,992	17%
False statements or representation	6,077	8%
Improper contact or sharing of info	5,600	8%
Taking/threatening an illegal action	4,836	7%
Total	74,376	100%

Sub-issue Identified	Number of Complaints	% of Total Complaints
Debt is not mine	19,375	26%
Not given enough info to verify debt	8,920	12%
Frequent or repeated calls	8,625	12%
Debt was paid	8,310	11%
Attempted to collect wrong amount	4,626	6%
Right to dispute notice not received	3,255	4%
Threatened to take legal action	2,653	4%
Talked to a third party about my debt	2,620	4%
Debt resulted from identity theft	1,950	3%
Contacted me after I asked not to	1,525	2%
Threatened to sue on too old debt	1,449	2%
Threatened arrest/jail if do not pay	1,433	2%
Contacted employer after asked not to	1,318	2%
Debt was discharged in bankruptcy	1,270	2%
Called after sent written cease of communications	1,140	2%
Used obscene/profane/abusive language	999	1%
Not disclosed as an attempt to collect	817	1%
Impersonated an attorney or official	721	1%
Sued w/o proper notification of suit	712	1%
Seized/Attempted to seize property	556	1%
Called outside of 8 a.m.-9 p.m.	549	1%
Indicated committed crime not paying	546	1%
Attempted to/collected exempt funds	488	1%
Sued where didn't live/sign for debt	198	0.3%
Indicated shouldn't respond to lawsuit	184	0.2%
Contacted me instead of my attorney	137	0.2%
Total	74,376	

Source: CFPB Consumer Complaint Database

25 percent report they did not receive a "right to dispute" notice, which is required by the FDCPA. The remaining 6 percent state the company did not disclose that the communication was an attempt to collect a debt (also required by the FDCPA).

False statements or representations are cited in 6,077 complaints (8 percent). Of these, 76 percent report attempts to collect the wrong amount of debt. Another 12 percent report collectors impersonated an attorney, law enforcement or government official. In 9 percent of these complaints, consumers report the collector indicated the consumer had committed a crime. And in 3 percent, consumers report they were told they should not respond to a lawsuit.

Consumers cite improper contact or sharing of information as the primary reason for 5,600 complaints (8 percent). Of those, 47 percent report the collector talked to a third-party about the debt. Another 27 percent indicate the collector contacted the consumer after being asked not to do so, 24 percent report the collector contacted an employer after being asked not to do so, and 2 percent report the collector contacted the consumer instead of her/his attorney.

Finally, 4,836 complaints (7 percent) relate to debt collectors taking or threatening an illegal action. Of those, 30 percent report threats to sue on time-barred debt, 30 percent report they were told they would be arrested or sent to jail if they did not pay, 15 percent report being sued without proper notification, 11 percent cite seizures or attempts to seize property, 10 percent cite collection or attempts to collect from exempt funds, and 4 percent cite attempts to sue where the consumer didn't live or sign for the debt.

The table at left summarizes the public complaint data by type of complaint.

Type of Debt	Number of Complaints	Percentage of Named Complaints
Credit card	15,524	42%
Medical	9,081	25%
Payday loan	4,542	12%
Student loan	2,978	8%
Mortgage	2,551	7%
Auto	1,941	5%
Other (phone, health club, etc.)	21,471	
Unidentified	16,288	

Source: CFPB Consumer Complaint Database

CONSUMER COMPLAINTS BY DEBT TYPE

The complaint database also includes information about the type of debt to which each complaint relates. Among the complaints identified with a single specific debt source, credit card debt is by far the most common type of debt connected to collection-related complaints. Medical debt is the second most common debt type. (See table, Page 5.)

EXCERPTS FROM COMPLAINT NARRATIVES

While the tallies of complaints by issue area and debt type are instructive, the numbers tell only part of the story. A significant share of complaints in the public database also include complaint narratives, and these narratives speak to the level of frustration consumers experience as a result of their contact with debt collection agencies.

A sampling of quotes, with identifying information redacted with "XXXX," from these narratives include:

- *"A company called Portfolio Recovery has done all of these things: contacted family in other states, contacted employer, threatened me, calls multiple times a day from different numbers, won't tell me what this is for, etc. ... FOR SEVERAL YEARS!!!! Please stop them."*
- *"They call every day XXXX times a day and I tell every single XXXX of them says they will take me off the list and they do not!!!! This is unacceptable! They are looking for XXXX and he doesn't live at this number because this number is a XXXX, which I've also said before. This disrupts the flow of my office and it must stop. XXXX of them accused me of lying and said they were going to take this XXXX guy to court if he doesn't come to the phone ... What?!"*
- *"This company calls me repeatedly throughout the day, every day of the week. From morning until night. They have never left a message. They use multiple numbers to call me from. It interrupts me at work. It interrupts me at home while I care for my young son. I have answered XXXX in the past but nobody communicated on the other line. They call XXXX times a day for months now."*
- *"Received a robocall from XXXX, saying he was going to deliver a summons in the next 24 hours and to be available with XXXX forms of ID, etc., and to call XXXX. I called. Spoke to XXXX, from XXXX XXXX XXXX, told him I dispute the debt, that it is time-barred, and that the kind of robocall they are doing is illegal. He said, 'Hey, let's resolve this now; I will make it go away for $1,900.' I told him, 'I don't have any money and they are not allowed to call that phone number any more (it's not mine).' He hung up on me. I called back asking for the company address and summons and court case number. He said it would be delivered. I told him I didn't want to wait, that I wanted the information so I could turn it over to a lawyer ASAP. He said it would be delivered by summons and hung up. The summons never came and they hang up on me when I call to ask for their info and the info on the court case they claimed they have filed ..."*
- *"I made a payment agreement around XXXX, 2014, with Allied Interstate about a non-federal private student loan that I am in default. Last month, due to hardship, I requested a month off payments. After that period they started attempting to call me. I requested not to be called since they always interrupt me while working. They debited my bank account already, thus resuming payments, yet they continue to call non-stop demanding to give me an update. Now they are harassing my domestic partner by phone XXXX XXXX, asking her personal questions about our relationship. They have no reason to call, since payments are being currently made. I do not wish to talk to them."*
- *"Letter sent to me pertaining to my DEAD husband's account. My husband died on XXXX XXXX, 1991 (almost XXXX years ago). I believe the account was paid off, but I might be wrong. But I do believe there is a statute of limitations with debt collections. I would consider XXXX years within that limit. Also, it was sent to my current address that has never been associated with my dead husband at all. I am not listed on this account at all."*

- *"I am writing on behalf of my XXXX year old XXXX. She is paying on her grandson's XXXX XXXX XXXX loan, however they call her day and night requesting that she pay it off in full or they demand a very large payment. They threaten her with foreclosure and lawsuits. She pays monthly and they still call, they even call her on holidays. She asks them to stop calling and has put it in writing and the harassing calls continue. They've told her they'll call whenever they want and will continue until she pays off the loan. These calls are making her XXXX and I need to know what we can do to stop this harassment?"*
- *"An automatic call placed many times from XXXX states that there is fraudulent activity associated with my name and Social Security number. To avoid XXXX charges being filed against me, they then give me a case number of XXXX and a contact number XXXX. When calling the XXXX number, the operator tells me that I will be sued if I don't come to an agreement even though it is a time-barred debt. They continue to call even after I tell them the debt is not valid."*
- *"My wife and I have been getting harassing phone calls on our cell phones and at work about a debt we know nothing about. (They called her XXXX in the last five days at work and told her manager she would be served papers at work when she returned.) They are claiming we owe a debt to Wells Fargo from 2005 (well past the six-year statute of limitations in Washington state). They say we are going to be sued and that her wages will be garnished."*

These excerpts from complaint narratives indicate a high level of stress. According to the psychological research literature, being in significant debt is itself a major stressor (in one study, "getting into debt beyond means of repayment" ranks as the fifth most stressful life event, next behind "immediate family member attempts suicide" and ahead of "period of homelessness," "immediate family member seriously ill," "unemployment," and "divorce"; see table, below).[32] Unfair, deceptive and abusive collection practices can only be expected to compound the stress involved.

LIFE EVENTS INVENTORY

Weightings of life event items by Cochrane and Robertson (2001), ranked in order of severity of weights.

Rank	Life event	All	16–25	26–35	36–45	46–55	Male	Female
1	Death of spouse	93.77	98	94	93	94	95	93
2	Jail sentence	90.17	93	88	91	91	92	89
3	Death of immediate family member	88.44	96	87	86	91	88	89
4	Immediate family member attempts suicide	87.45	85	86	88	89	86	89
5	**Getting into debt beyond means of repayment**	**83.86**	**82**	**79**	**86**	**87**	**82**	**86**
6	Period of homelessness (hostel or sleeping rough)	82.48	90	73	86	87	81	84
7	Immediate family member seriously ill	81.38	87	80	78	86	83	80
8	Unemployment (head of household)	81.02	77	79	76	90	82	80
9	Divorce	80.78	82	79	78	86	81	81
10	Break-up of family	80.60	86	75	79	88	81	81
11	Immediate family member sent to prison	79.52	78	77	77	86	76	83
12	Sudden and serious impairment of vision or hearing	79.38	82	73	80	85	80	79
13	Death of close friend	79.23	92	77	77	81	78	80
14	Infidelity of spouse/partner	79.23	50	78	80	79	77	81
15	Marital separation	78.25	82	75	76	84	80	77

Source: Spurgeon, A., C.A. Jackson, and J.R. Beach. "The Life Events Inventory: Re-Scaling Based on an Occupational Sample." Institute of Occupational Health, University of Birmingham. 31 Jan. 2001. Available at: http://occmed.oxfordjournals.org/content/51/4/287.full.pdf

COMPLAINTS BY COMPANY

The 15 companies most commonly mentioned in the CFPB complaint database account for a combined total of 21,464 consumer complaints. Encore Capital Group leads the complaint tally with 4,684 filed complaints. PRA Group places second with 2,216 complaints, and Enhanced Recovery Company places third with 2,016 complaints. The next five companies in the list each have more than 1,000 filed complaints, and the remainder in the top 15 each have at least 700. All 15 have at least 1 percent of total complaints.

The table on Page 9 lists the companies with the most debt collection-related complaints logged in the CFPB complaint database.

COMPLAINT CATEGORIZATION

Complaints are categorized by issues and sub-issues, as follows:

EXAMPLES OF ISSUES IDENTIFIED BY CONSUMERS IN COMPLAINTS

Communication Tactics

- Called after sent written cease of communication
- Called outside of 8 a.m.-9 p.m.
- Frequent or repeated calls
- Threatened to take legal action
- Used obscene/profane/abusive language

Continued Attempts to Collect Debt Not Owed

- Debt is not mine
- Debt resulted from identity theft
- Debt was discharged in bankruptcy
- Debt was paid

Disclosure Verification of Debt

- Not disclosed as an attempt to collect
- Not given enough info to verify debt
- Right to dispute notice not received

False Statements or Representation

- Attempted to collect wrong amount
- Impersonated an attorney or official
- Indicated committed crime not paying
- Indicated shouldn't respond to lawsuit

Improper Contact or Sharing of Info

- Contacted employer after asked not to
- Contacted me after I asked not to
- Contacted me instead of my attorney
- Talked to a third party about my debt

Taking/Threatening an Illegal Action

- Attempted to/collected exempt funds
- Seized/Attempted to seize property
- Sued without proper notification of suit
- Sued where didn't live/sign for debt
- Threatened arrest/jail if do not pay
- Threatened to sue on too old debt

NOTE ON DEBT COLLECTION COMPLAINTS

The CFPB collects thousands of consumer complaints and sends them to companies for a response. The CFPB publishes [illegible] of many of these complaints in its database for public review. Complaint filings also help inform CFPB rulemaking.[illegible]

For the purposes of this report, the CFPB complaint database was accessed on August 11, 2015 and records for all publicly available complaints relating to debt collection were downloaded. The dataset includes all publicly available debt collection complaints received between July 10, 2013, and August 7, 2015, which totaled 94,776. The database goes as far back as December 1, 2011, but did not accept debt collection complaints until July 2013.[illegible]

In the following profile, samples of complaint narratives submitted to the CFPB by the most frequently complained about companies are extracted from the complaint database. The CFPB has redacted these complaints of identifying information to protect individual identities, with redacted information presented as "XXXX". Complaints are selected only for basic grammar. When possible, we include the CFPB's accounts of how these complaints were resolved. The report authors, the Alliance for a Just Society and its affiliates, provide no personal or legal opinion as to the accuracy of the complaints included by the CFPB and republished in this report.

Profiles of Companies with Most Consumer Complaints about Debt Collection Practices in the CFPB Complaint Database

COMPANIES WITH MOST DEBT COLLECTION COMPLAINTS IN CFPB DATABASE

CFPB debt collection complaints, accessed Aug. 11, 2015; sample includes all publicly available debt collection complaints accrued between July 10, 2013, and Aug. 7, 2015 (n = 74,376); companies listed are those with one percent or more of total complaints.

Rank	Company	Number of Complaints	Core Business
1	Encore Capital Group, Inc.	4,684	Debt Buyer
2	PRA Group, Inc.	2,216	Debt Buyer
3	Enhanced Recovery Company, LLC	2,016	Contractor
4	Citibank (subsidiary of Citigroup, Inc.)	1,553	Original Creditor
5	Expert Global Solutions, Inc.	1,463	Contractor
6	Resurgent Capital Services L.P.	1,161	Debt Buyer
7	Capital One Financial Corp.	1,145	Original Creditor
8	GE Capital Retail (now Synchrony Financial)	1,140	Original Creditor
9	Convergent Resources, Inc.	985	Contractor
10	JPMorgan Chase & Co.	952	Original Creditor
11	Allied Interstate LLC	919	Contractor
12	Bank of America Corp.	908	Original Creditor
13	Navient Corp.	842	Contractor
14	Dynamic Recovery Solutions, LLC	764	Contractor
15	Wells Fargo & Co.	716	Original Creditor

Source: CFPB Consumer Complaint Database

CONSUMER COMPLAINTS PROFILE

#1 ENCORE CAPITAL GROUP, INC.

Encore Capital Group is the nation's second-largest debt collector,[34] controlling about 7.5 percent of the debt collections market in the U.S.[35] Encore has experienced rapid growth over the past five years: between 2010 and 2014, Encore nearly tripled its annual revenues and more than doubled its profits.[36]

The CFPB has received more than twice as many debt collection-related complaints about Encore Capital Group as it has about any other company, with Encore alone responsible for more than 6 percent of all debt collections complaints in the complaint database.

PROFILE[37]

- Business type: Specialty finance company providing debt collections services for consumers and property owners across a broad range of financial assets. Portfolio purchasing and recovery.
- Headquarters: San Diego, California
- Employees: 5,400
- Subsidiaries: 108 worldwide, including in tax havens like the Cayman Islands (two companies) and Delaware (27 companies)[38]
- Stock: ECPG, NASDAQ

Total number of debt collection complaints filed with the CFPB

4,684

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	$49M	$61M	$69M	$75M	$104M
REVENUE	$381M	$467M	$556M	$773M	$1.073B
PROFIT MARGIN	13%	13%	12%	10%	10%

Source: Morningstar.com

EXECUTIVE COMPENSATION

Kenneth A. Vecchione, President and Chief Executive Officer

2010	2011	2012	2013	2014
-	-	-	$7,156,327	$5,190,334

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	1,958	42%
Disclosure verification of debt	1,009	22%
Communication tactics	770	16%
False statements or representation	433	9%
Taking/threatening an illegal action	292	6%
Improper contact or sharing of info	222	5%
Total	4,684	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"I have been receiving numerous calls from [Encore subsidiary] Midland Credit. They are looking for someone else, not me, for over a month. Sometimes it is automated and they just ring the phone; I called them back XXXX times and asked them to take off my number — calls keep coming. Today I spoke to a person that said he would remove it from the automated calls and now the manual calls have begun."

State: Florida
Date: Submitted to CFPB on March 21, 2015
Issue: Communication tactics; frequent or repeated calls
Company response to consumer: Closed with explanation

COMPANY ANALYSIS

In 2011, the state of Minnesota sued Encore Capital Group subsidiaries Midland Funding and Midland Credit Management "for allegedly using fraudulent 'robo-signed' affidavits in collection cases."[39] Minnesota Attorney General Lori Swanson stated: "Midland has perverted the justice system by filing robo-signed affidavits in court and hounding citizens for debt they don't owe."[40] In 2012, Midland settled with the state, agreeing to adjust its business practices and provide consumers with proof of debt.[41]

Similarly, the state of West Virginia sued the same two units of Encore Capital Group in March 2012, claiming "the firms used false affidavits in lawsuits and took part in fraudulent debt-collection practices."[42]

In 2012, Encore Capital Group acquired Propel Financial Services LLC, a leading purchaser of tax debt. At the time, Encore CEO Brandon Black said the acquisition would "put Encore in position to build a significant tax lien acquisition business."[43]

Encore Capital Group is known to collect on time-barred "zombie" debt — debt that is too old to show up on credit reports or to be collected through legal judgment. According to the company's 2013 SEC filings, that year Encore collected payments on debt accounts it had purchased in the 1990s.[44]

In 2013, Encore acquired Asset Acceptance Capital Corporation, which paid a $2.5 million civil penalty in 2012 to settle Federal Trade Commission charges alleging it "made a range of misrepresentations when trying to collect old debts."[45]

Also in 2013, an appeals court overturned a $5.2 million settlement in a class action lawsuit against Encore (wherein the plaintiffs alleged Encore subsidiaries used "robo-signing" tactics to file large numbers of collections lawsuits against consumers), ruling the settlement was unfair to unnamed class members.[46] The deal would have paid just $17.38 in restitution to each unnamed class member.[47]

More recently, in January 2015 Encore Capital Group settled a lawsuit initiated by New York state for "bringing improper debt collection actions against thousands of New York consumers." Encore had allegedly sued those thousands of New York consumers in order to gain default judgments for time-barred debt. As part of the settlement, Encore paid a $675,000 penalty to the state and was made to vacate 4,500 improperly obtained judgments totaling close to $18 million.[48]

In September 2015, the CFPB announced a new enforcement action after finding Encore and another debt collector "bought debts that were potentially inaccurate, lacking in documentation, or unenforceable." The CFPB further found that Encore, "without verifying the debt, ... collected payments by pressuring consumers with false statements and churning out lawsuits using robo-signed court documents."[49] Furthermore, according to the CFPB, Encore told consumers the burden of proof was on them to disprove the debt. The CFPB levied a $10 million penalty on Encore and ordered the company to pay up to $42 million in consumer refunds and stop collection on over $125 million worth of debts. The action further required Encore to overhaul its debt collection and litigation practices.[50]

CONSUMER COMPLAINTS PROFILE

#2 PRA GROUP, INC.

PRA Group, Inc. (PRA), formerly known as Portfolio Recovery Associates, is the nation's third largest debt collector, with 6.9 percent market share. PRA Group's size can be attributed in part to its rapid growth in recent years, outpacing the growth of other entities in the expanding debt buying industry. Between 2010 and 2014, PRA Group's annual revenues increased by 236 percent and its annual profits grew by 242 percent.

PROFILE[51]

- Business type: The purchase, collection and management of portfolios of defaulted consumer receivables. Purchases delinquent debt accounts and collects on those debts.
- Headquarters: Norfolk, Virginia
- Employees: 3,900
- Subsidiaries: 63, from Delaware to Norway[52]
- Stock: PRAA, NASDAQ

Total number of debt collection complaints filed with the CFPB

2,216

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	$73M	$101M	$127M	$175M	$177M
REVENUE	$373M	$459M	$593M	$735M	$881M
PROFIT MARGIN	20%	22%	21%	24%	20%

Source: Morningstar.com

EXECUTIVE COMPENSATION

Steven D. Fredrickson, Chairman of the Board, President and Chief Executive Officer

2010	2011	2012	2013	2014
$2,508,546	$3,010,050	$3,534,981	$3,960,210	$5,606,441

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	920	42%
Communication tactics	525	24%
Disclosure verification of debt	369	17%
Improper contact or sharing of info	170	8%
False statements or representation	134	6%
Taking/threatening an illegal action	98	4%
Total	2,216	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"My XXXX died owing a credit card debt. The debt collectors say I now owe the debt. My name is not on the application for credit nor have I benefited from the credit card. The debt collectors reported it to the credit reporting corps. And it appears on my credit report as a debt I failed to pay and fraud. I am applying to refinance my home and I am being denied because of the report. I have no other blemishes on my credit report. I can't sleep with the fear of losing my home."

State: California
Date: Submitted to CFPB on May 19, 2015
Issue: Continued attempts collect debt not owed; debt is not mine
Company response to consumer: Closed with explanation

COMPANY ANALYSIS

PRA Group has obtained revenue through default judgments in lawsuits filed against consumers in the pursuit of time-barred "zombie" debt. SEC filings from 2013 reveal payments received on debt the company purchased as long ago as 1996.[53] In 2014, PRA was made to pay $300,000 in civil penalties to the state of New York as part of a settlement for its violations concerning the pursuit of time-barred debt through default court judgments. In addition, the company was made to vacate thousands of judgments that the New York Attorney General's Office called "improper."[54]

According to an estimate by the Virginian-Pilot, PRA group is pursuing legal action on 1.5 million of its accounts, and nearly half of PRA Group's collections came from legal action in late 2013.[55]

PRA Group has also been subject to legal action. A Missouri jury awarded one woman, who alleged long-term harassment, $250,000 for violations of the Fair Debt Collection Practices Act and almost $83 million in punitive damages.[56]

In September 2015, the CFPB announced a new enforcement action after finding that PRA Group, along with Encore Capital, "bought debts that were potentially inaccurate, lacking in documentation, or unenforceable." The CFPB further found that PRA Group, "without verifying the debt, ... collected payments by pressuring consumers with false statements and churning out lawsuits using robo-signed court documents."

Likewise, PRA Group was found to have "falsely claimed an attorney had reviewed the file and a lawsuit was imminent," when, in fact, attorneys allegedly had not reviewed files and the company had not decided whether to file suit. The CFPB enforcement action required PRA Group to pay an $8 million penalty, pay up to $19 million in consumer refunds, and stop collection on over $3 million worth of debts. The action further required PRA Group to overhaul its debt collection and litigation practices.[57]

CONSUMER COMPLAINTS PROFILE

#3 ENHANCED RECOVERY COMPANY, LLC

This privately held company manages tens of millions of debtor accounts every year. According to the company, it made more than 150 million calls and sent more than 2 million letters in the first quarter of 2012 — a ratio of 75 calls for every letter sent to a customer.[58]

Enhanced Recovery Company (ERC) is the subject of 2.7 percent of all debt collections complaints logged in the CFPB complaint database, placing it third on the list of companies with the most debt collection-related complaints. More than 60 percent of complaints about ERC were for continued attempts to collect debt that consumers stated they did not owe.

PROFILE

- Business type: One of the largest third-party debt collectors in the industry. Also known as Enhanced Resource Centers.
- Headquarters: Jacksonville, Florida
- Employees: 1,000-5,000[59]
- Subsidiaries: Not publicly available
- Stock: Privately held

Total number of debt collection complaints filed with the CFPB

2,016

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

Not publicly available.

EXECUTIVE COMPENSATION

Kirk Moquin, Co-Founder & Chief Executive Officer. Compensation not publicly available.

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	1,227	61%
Disclosure verification of debt	489	24%
False statements or representation	115	6%
Communication tactics	114	6%
Improper contact or sharing of info	59	3%
Taking/threatening an illegal action	12	1%
Total	2,016	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"I received many calls from a debt collector, to the point where I had to change my phone number. This is a debt that is from 6+ years ago, which I don't have proof that I paid but in fact did pay. They have gone ahead and reported it in my credit reports. I tried calling XXXX last time in an effort to solve this issue and was threatened that if I did not pay they would contact my XXXX and contact my employer (which they repeatedly called and that's how we found out it was a false collection agency)."

State: Maryland
Date: Submitted to CFPB on March 20, 2015
Issue: False statements or representation; indicated committed crime not paying
Company response to consumer: Closed with non-monetary relief

CONSUMER COMPLAINTS PROFILE

#4 CITIGROUP, INC.

PROFILE[60]

- Business type: Diversified financial services holding company, including consumer banking and credit, corporate and investment banking, securities brokerage, trade and securities services and wealth management.
- Headquarters: New York, New York
- Employees: 241,000
- Subsidiaries: 279 worldwide, including Citibank,[61] in tax havens such as the Cayman Islands (six companies) and Delaware (95 companies)[62]
- Stock: C, NYSE

Total number of debt collection complaints filed with the CFPB

1,553

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	$10.6B	$11.1B	$7.5B	$13.7B	$7.3B
REVENUE	$86.6B	$78.4B	$70.2B	$76.4B	$76.9B
PROFIT MARGIN	12%	14%	11%	18%	10%

Source: Morningstar.com

EXECUTIVE COMPENSATION

James A. Forese, Co-President, Citi; Chief Executive Officer, Institutional Clients Group; Michael L. Corbat, Chief Executive Officer; Manuel Medina-Mora, Co-President, CEO, Global Consumer Banking and Chairman, Mexico

	2010	2011	2012	2013	2014
Forese	-	-	-	$17,536,298	$15,892,220
Corbat	$8,022,760	$10,658,652	$12,377,508	$17,558,119	$14,457,199
Medina-Mora	$10,116,895	$11,446,900	$15,131,874	$14,012,550	$10,161,014

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	527	34%
Communication tactics	489	31%
Disclosure verification of debt	195	13%
Improper contact or sharing of info	146	9%
False statements or representation	110	7%
Taking/threatening an illegal action	86	6%
Total	1,553	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"Letter sent to me pertaining to my DEAD husband's account. My husband died on XXXX XXXX, 1991 (almost XXXX years ago). I believe the account was paid off, but I might be wrong. But I do believe there is a statute of limitations with debt collections. I would consider XXXX years within that limit. Also, it was sent to my current address that has never been associated with my dead husband at all. I am not listed on this account at all."

State: Texas
Date: Submitted to CFPB on June 8, 2015
Issue: Communication tactics; threatened to take legal action
Company response to consumer: Closed with explanation

CONSUMER COMPLAINTS PROFILE

#5 EXPERT GLOBAL SOLUTIONS, INC.

The largest third-party debt collector in the world, Expert Global Solutions (EGS) holds an 8.8 percent market share in the U.S. debt collection industry. This private company was formed in 2012, when NCO Group merged with APAC Customer Services. EGS provides services to more than 200 of the Fortune 500 companies.[63]

FINANCIALS

	2010	2011	2012	2013	2014
REVENUE	$1.2B	$1.1B	$1.2B	$1.2B	$1.2B

Source: "IBISWorld Debt Collection Agencies in the U.S. Industry Report," IBISWorld, April 2015, p. 25.

Other information not publicly available.

EXECUTIVE COMPENSATION

Bob Segert, President and Chief Executive Officer.[67] Compensation not publicly available.

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	724	49%
Communication tactics	251	17%
Disclosure verification of debt	239	16%
False statements or representation	126	9%
Improper contact or sharing of info	82	6%
Taking/threatening an illegal action	41	3%
Total	1,463	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

PROFILE[64]

- Business type: Third-party debt collector.
- Headquarters: Plano, Texas
- Employees: More than 40,000
- Parents: EGS is a subsidiary of One Equity Partners (OEP), the private investment arm of JP Morgan Chase & Co.[65,66]
- Stock: Privately held

Total number of debt collection complaints filed with the CFPB

1,463

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"They call every day XXXX times a day and I tell every single XXXX of them says they will take me off the list and they do not!!!! This is unacceptable! They are looking for XXXX and he doesn't live at this number because this number is a XXXX, which I've also said before. This disrupts the flow of my office and it must stop. XXXX of them accused me of lying and said they were going to take this XXXX guy to court if he doesn't come to the phone ... What?!"

State: Virginia
Date: Submitted to CFPB on June 10, 2015
Issue: Continued attempts collect debt not owed; debt is not mine
Company response to consumer: Closed with explanation

COMPANY ANALYSIS

In 2013, the Federal Trade Commission secured a $3.2 million civil penalty for unlawful collection practices conducted by EGS. These practices included "harassing collection calls, disclosing consumers' debts to third parties, and continuing collection efforts without verifying debts even after consumers said they did not owe those debts."[68]

This was the largest penalty the FTC had ever levied against a third-party debt collector.[69,70] Other major regulatory enforcements against EGS include a $1.5 million settlement with the FTC in 2004 for alleged violations of the Fair Credit Reporting Act involving the reporting of account delinquency dates that were later than the actual delinquency dates;[71] a $300,000 Assurance of Voluntary Compliance agreement with the Commonwealth of Pennsylvania in 2006 for alleged unlawful business practices;[72] and a similar $575,000 Assurance of Voluntary Compliance agreement with multiple states in 2012.[73]

CONSUMER COMPLAINTS PROFILE

#6 RESURGENT CAPITAL SERVICES L.P.

FINANCIALS

Not publicly available.

EXECUTIVE COMPENSATION

Sherman Financial Group founder and Chief Executive Officer is Benjamin W. Navarro.[76] Compensation not publicly available.

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	511	44%
Disclosure verification of debt	376	32%
False statements or representation	110	9%
Taking/threatening an illegal action	78	7%
Communication tactics	51	4%
Improper contact or sharing of info	35	3%
Total	1,161	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

PROFILE[74]

- Business type: Manager and servicer of domestic and international consumer debt portfolios for credit grantors and debt buyers.
- Headquarters: Greenville, South Carolina
- Employees: Not publicly available
- Parent: Resurgent Capital Services (Resurgent) is an affiliate of Sherman Financial Group.[75]
- Stock: Privately held

Total number of debt collection complaints filed with the CFPB

1,161

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"I continue to get phone calls from a company XXXX XXXX, XXXX. They claim I have a debt from a XXXX credit card from 1998, which is in my maiden name. The debt totals $1,400. I called XXXX and this debt does not exist."

State: Pennsylvania
Date: Submitted to CFPB on April 22, 2015
Issue: Continued attempts collect debt not owed; debt is not mine
Company response to consumer: Closed with non-monetary relief

COMPANY ANALYSIS

In 2012, Resurgent and subsidiary LVNV Funding reached an agreement with the Maryland State Collection Agency Licensing Board for various alleged violations of state and federal laws, including the Fair Debt Collection Practices Act. Seeking to generate default judgments, Resurgent filed more than 27,000 cases in Maryland over the course of six years.[77] Alleged violations included filing false or misleading complaints, misrepresenting the amounts of claims and engaging in collections activities without being properly licensed. The settlement included $12.5 million in costs to Resurgent.[78]

Similarly, in 2014, Resurgent agreed to a settlement with the state of New York — part of a combined agreement costing Resurgent and another major debt buyer a combined $16 million — for allegedly seeking default court judgments on time-barred debt.[79]

CONSUMER COMPLAINTS PROFILE

#7 CAPITAL ONE FINANCIAL CORP.

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	$2.7B	$3.1B	$3.5B	$4.2B	$4.4B
REVENUE	$16.2B	$16.3B	$21.4B	$22.4B	$22.3B
PROFIT MARGIN	17%	19%	16%	19%	20%

Source: Morningstar.com

EXECUTIVE COMPENSATION

Richard D. Fairbank, Board Chair, Chief Executive Officer & President

2010	2011	2012	2013	2014
$14,859,688	$18,668,058	$22,605,374	$18,294,525	$19,606,474

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	404	35%
Communication tactics	260	23%
Disclosure verification of debt	208	18%
Taking/threatening an illegal action	111	10%
False statements or representation	84	7%
Improper contact or sharing of info	78	7%
Total	1,145	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"This company calls me repeatedly throughout the day, every day of the week. From morning until night. They have never left a message. They use multiple numbers to call me from. It interrupts me at work. It interrupts me at home while I care for my young son. I have answered XXXX in the past but nobody communicated on the other line. They call XXXX times a day for months now."

State: South Dakota
Date: Submitted to CFPB on June 10, 2015
Issue: Communication tactics; frequent or repeated calls
Company response to consumer: Closed with explanation

PROFILE[80]

- Business type: American bank holding company specializing in credit cards, home loans, auto loans, banking and savings products.
- Headquarters: McLean, Virginia
- Employees: 46,000
- Subsidiaries: Capital One Bank, National Association, and Capital One N.A.[81]
- Stock: COF, NYSE

Total number of debt collection complaints filed with the CFPB

1,145

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

#8 SYNCHRONY FINANCIAL

FINANCIALS

	2011	2012	2013	2014
NET INCOME (PROFIT)	$1.9B	$2.1B	$2.0B	$2.1B
REVENUE	$8.7B	$10.0B	$11.1B	$11.8B
PROFIT MARGIN	22%	21%	18%	18%

Source: Morningstar.com

EXECUTIVE COMPENSATION

Margaret M. Keane, President and Chief Executive Officer

2010	2011	2012	2013	2014
-	-	-	-	$14,783,661

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	407	36%
Communication tactics	343	30%
Disclosure verification of debt	156	14%
False statements or representation	91	8%
Improper contact or sharing of info	81	7%
Taking/threatening an illegal action	62	5%
Total	1,140	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

PROFILE[82]

- Business type: Consumer financial services, providing a range of credit products. Formerly GE Capital Retail Finance.
- Headquarters: Stamford, Connecticut
- Employees: 1,000
- Subsidiaries: 20 worldwide, including 13 in the tax haven state of Delaware[83]
- Stock: SYF, NYSE

Total number of debt collection complaints filed with the CFPB

1,140

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"I [am] getting almost daily calls from this agency, threatened and tried to garnish my unemployment benefit, I am still unemployed."

State: California
Date: Submitted to CFPB on April 30, 2015
Issue: Taking/threatening an illegal action; attempted to/collected exempt funds
Company response to consumer: Closed with explanation

COMPANY ANALYSIS

In 1998, GE Capital (Synchrony Financial's predecessor) agreed to settle a $100 million class action lawsuit over its debt collections practices. The settlement involved the Federal Trade Commission and attorneys general in all 50 states.[84]

CONSUMER COMPLAINTS PROFILE

#9 CONVERGENT RESOURCES, INC.

PROFILE[85]

- Business type: Third-party debt collector.
- Headquarters: Atlanta, Georgia
- Employees: 2,300
- Subsidiaries: Not publicly available
- Stock: Privately held

Total number of debt collection complaints filed with the CFPB

985

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

Not publicly available.

EXECUTIVE COMPENSATION

Not publicly available.

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	645	65%
Disclosure verification of debt	153	16%
Communication tactics	82	8%
False statements or representation	55	6%
Improper contact or sharing of info	33	3%
Taking/threatening an illegal action	17	2%
Total	985	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"Sending emails, threat[en]ing to sue and add additional charges resulting in jail time, calling non-stop after XXXX."

State: Rhode Island
Date: Submitted to CFPB on June 3, 2015
Issue: Continued attempts collect debt not owed; debt is not mine
Company response to consumer: Closed with explanation

CONSUMER COMPLAINTS PROFILE

#10 JPMORGAN CHASE & CO. (JPM)

PROFILE[86]

- Business type: Financial holding company specializing in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing and asset management.
- Headquarters: New York, New York
- Employees: 241,359
- Subsidiaries: 49 worldwide[87]
- Stock: JPM, NYSE

Total number of debt collection complaints filed with the CFPB

952

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	$17.4B	$19.0B	$21.3B	$17.9B	$21.8B
REVENUE	$102.7B	$97.2B	$97.0B	$96.6B	$94.2B
PROFIT MARGIN	17%	20%	22%	19%	23%

Source: Morningstar.com

EXECUTIVE COMPENSATION

James S. Dimon, Chairman of the Board and Chief Executive Officer

2010	2011	2012	2013	2014
$20,816,289	$23,105,415	$18,717,013	$11,791,833	$27,701,709

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	368	39%
Communication tactics	172	18%
Disclosure verification of debt	143	15%
Taking/threatening an illegal action	111	12%
False statements or representation	106	11%
Improper contact or sharing of info	52	5%
Total	952	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"Received a robocall from XXXX, saying he was going to deliver a summons in the next 24 hours and to be available with XXXX forms of ID, etc., and to call XXXX. I called. Spoke to XXXX, from XXXX XXXX XXXX, told him I dispute the debt, that it is time-barred, and that the kind of robocall they are doing is illegal. He said, 'Hey, let's resolve this now; I will make it go away for $1,900.' I told him, 'I don't have any money and they are not allowed to call that phone number any more (it's not mine).' He hung up on me. I called back asking for the company address and summons and court case number. He said it would be delivered. I told him I didn't want to wait, that I wanted the information so I could turn it over to a lawyer ASAP. He said it would be delivered by summons and hung up. The summons never came and they hang up on me when I call to ask for their info and the info on the court case they claimed they have filed and which I cannot find ..."

State: California
Date: Submitted to CFPB on June 8, 2015
Issue: Taking/threatening an illegal action; threatened to sue on too old debt
Company response to consumer: Closed with explanation

COMPANY ANALYSIS

In March 2013, the state of California sued JPMorgan Chase, alleging the company's in-house attorneys illegally robo-signed thousands of court documents in debt collection lawsuits. The suit also alleged JPMorgan engaged in other deceptive and abusive practices, such as claiming it had served customers with required notices of debt collection suits without actually doing so, failing to redact personal information from court filings, and asserting that people it was suing were not on active military duty without checking the validity of that assertion.

In November 2015, the California Attorney General's Office announced a proposed deal to settle this lawsuit. Under the terms of the proposal, JPMorgan will be required to pay $50 million in restitution to customers across the country, and another $50 million in penalties to the state.[88]

Meanwhile, in July 2015 JPMorgan Chase agreed to pay at least $216 million as part of a settlement with the Consumer Financial Protection Bureau, the Office of the Comptroller of the Currency and 47 states. This settlement also requires JPMorgan Chase to reform its credit card debt collection operations to prevent the recurrence of problems, including inaccurate information in customer files and the sale of inaccurate information to collection agencies.[89]

CONSUMER COMPLAINTS PROFILE

#11 ALLIED INTERSTATE LLC

PROFILE[90]

- Business type: Third-party debt collector.
- Headquarters: Minneapolis, Minnesota
- Employees: Not publicly available
- Parent: Allied Interstate is a subsidiary of iQor, Inc., a New York-based private company that operates internationally.
- Stock: Privately held

Total number of debt collection complaints filed with the CFPB

919

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

Not publicly available.

EXECUTIVE COMPENSATION

Douglas J. Lewis, Chief Executive Officer and Jeff Swedberg, President. Compensation not publicly available.[91]

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	445	48%
Communication tactics	237	26%
Disclosure verification of debt	99	11%
False statements or representation	62	7%
Improper contact or sharing of info	52	6%
Taking/threatening an illegal action	24	3%
Total	919	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"I made a payment agreement around XXXX, 2014, with Allied Interstate about a non-federal private student loan that I am in default. Last month, due to hardship, I requested a month off payments. After that period they started attempting to call me. I requested not to be called since they always interrupt me while working. They debited my bank account already, thus resuming payments, yet they continue to call non-stop demanding to give me an update. Now they are harassing my domestic partner by phone XXXX XXXX, asking her personal questions about our relationship. They have no reason to call, since payments are being currently made. I do not wish to talk to them."

State: Florida
Date: Submitted to CFPB on July 24, 2015
Issue: Improper contact or sharing of info; talked to a third party about my debt
Company response to consumer: Closed with non-monetary relief

COMPANY ANALYSIS

The Federal Trade Commission penalized Allied Interstate in 2010 for allegedly attempting to collect debts from the wrong consumers and in wrong amounts, harassing consumers with repeated calls and abusive language, and revealing private information to third parties it had called when searching for debtors. These alleged practices, conducted over a multi-year period, would be in violation of the FDCPA. At the time, the $1.75 million penalty paid by Allied Interstate to resolve this complaint was the second largest civil penalty the FTC had ever obtained from a third-party debt collector.[92]

A Canadian Broadcasting Corporation investigation in 2012 found that iQor Canada had been fined in two Canadian provinces for its debt collection practices.[93]

CONSUMER COMPLAINTS PROFILE

#12 BANK OF AMERICA CORP.

PROFILE[94]

- Business type: A bank holding company and a financial holding company. Banking, investing, asset management and other financial and risk management products and services.
- Headquarters: Charlotte, North Carolina
- Employees: 224,000
- Subsidiaries: 103 worldwide[95]
- Stock: BAC, NYSE

Total number of debt collection complaints filed with the CFPB

908

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	-$2.2B	$1.4B	$4.2B	$11.4B	$4.8B
REVENUE	$110.2B	$93.5B	$83.3B	$88.9B	$84.2B
PROFIT MARGIN	-2%	2%	5%	13%	6%

Source: Morningstar.com

EXECUTIVE COMPENSATION

Brian T. Moynihan, Chairman of the Board and Chief Executive Officer

2010	2011	2012	2013	2014
$1,940,069	$8,097,181	$8,321,300	$13,139,357	$15,342,399

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	341	38%
Disclosure verification of debt	213	23%
Communication tactics	150	17%
False statements or representation	69	8%
Taking/threatening an illegal action	68	7%
Improper contact or sharing of info	67	7%
Total	908	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"An automatic call placed many times from XXXX states that there is fraudulent activity associated with my name and Social Security number. To avoid XXXX charges being filed against me, they then give me a case number of XXXX and a contact number XXXX. When calling the XXXX number, the operator tells me that I will be sued if I don't come to an agreement even though it is a time-barred debt. They continue to call even after I tell them the debt is not valid."

State: Washington
Date: Submitted to CFPB on April 2, 2015
Issue: Taking/threatening an illegal action; threatened to sue on too old debt
Company response to consumer: Company chooses not to provide a public response; closed with explanation

COMPANY ANALYSIS

Bank of America has settled numerous large class-action lawsuits, including suits headed by state attorneys general and federal regulators.

In relation to debt collections, in 2013 Bank of America agreed to a $32 million settlement resulting from a class-action lawsuit that alleged the bank made harassing collections calls to customers' cell phones at all hours of the day, using an automatic dialing system (aka "robocalls").[96]

Bank of America, like some other original creditors, has allegedly sold millions of dollars in credit card debt to collectors without guaranteeing the accuracy or reliability of debt information. Bank of America has allegedly sold some debt without guaranteeing the account balances were correct or that the debt had not already been paid back in full.[97]

CONSUMER COMPLAINTS PROFILE

#13 NAVIENT CORP.

Navient is a publicly traded corporation and one of the nation's largest loan management companies, with more than 12 million customers. Navient is a spinoff of Sallie Mae that became an independent company in May 2014 and is the nation's largest student loan servicing company. Navient employs about 6,000 people and services about $300 billion in student loans.[98, 99]

PROFILE[100]

- Business type: Loan management, servicing and asset recovery, servicing student loans.
- Headquarters: Wilmington, Delaware
- Employees: 6,200
- Subsidiaries: HICA Holding, Inc.; Navient Solutions, Inc.; Navient Credit Finance Corporation; Navient Credit Funding, LLC; Blue Ridge Funding, LLC; Navient Investment Corporation; Southwest Student Services Corporation[101]
- Stock: NAVI, NASDAQ

Total number of debt collection complaints filed with the CFPB

842

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	-	-	$940M	$1.4B	$1.1B
REVENUE	-	-	$3.5B	$4.1B	$3.6B
PROFIT MARGIN	-	-	27%	35%	32%

Source: Morningstar.com

EXECUTIVE COMPENSATION

John F. Remondi, President and Chief Executive Officer

2010	2011	2012	2013	2014
-	$4,394,918	$4,466,200	$5,462,776	$6,613,724

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Communication tactics	297	35%
Continued attempts to collect debt not owed	252	30%
Improper contact or sharing of info	137	16%
Disclosure verification of debt	76	9%
False statements or representation	51	6%
Taking/threatening an illegal action	29	3%
Total	842	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"I am writing on behalf of my XXXX year old XXXX. She is paying on her grandson's XXXX XXXX XXXX loan, however they call her day and night requesting that she pay it off in full or they demand a very large payment. They threaten her with foreclosure and lawsuits. She pays monthly and they still call, they even call her on holidays. She asks them to stop calling and has put it in writing and the harassing calls continue. They've told her they'll call whenever they want and will continue until she pays off the loan. These calls are making her XXXX and I need to know what we can do to stop this harassment?"

State: Florida
Date: Submitted to CFPB on March 20, 2015
Issue: Taking/threatening an illegal action; threatened arrest/jail if do not pay
Company response to consumer: Closed with explanation

COMPANY ANALYSIS

Navient has earned tens of millions of dollars through federal contracts since its formation in 2014. However, the U.S. Department of Education announced in March 2015 that it would end contracts with Navient when it found the company had misled struggling borrowers with inaccurate information.[102] The company has been under investigation by federal regulators for more than two years, in part for its debt collections practices. A group of state attorneys general and the New York Department of Financial Services have also launched investigations.[103]

#14 DYNAMIC RECOVERY SOLUTIONS, LLC

PROFILE

- Business type: Third-party debt collections.
- Headquarters: Greenville, South Carolina
- Employees: Between 51 and 200[104]
- Subsidiaries: Not publicly available
- Stock: Privately held

Total number of debt collection complaints filed with the CFPB

764

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

Not publicly available.

EXECUTIVE COMPENSATION

Not publicly available.

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	462	60%
Disclosure verification of debt	101	13%
Communication tactics	87	11%
False statements or representation	43	6%
Taking/threatening an illegal action	39	5%
Improper contact or sharing of info	32	4%
Total	764	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"Dynamic Recovery Solutions is contacting myself and my husband daily, with very threatening attitudes. I have received a letter in the mail also. This is not my debt, I do not owe this money and they will not leave us alone."

State: Colorado
Date: Submitted to CFPB on April 23, 2015
Issue: Continued attempts collect debt not owed; debt is not mine
Company response to consumer: Closed with non-monetary relief

CONSUMER COMPLAINTS PROFILE

#15 WELLS FARGO & CO.

PROFILE[105]

- Business type: Provides retail, commercial and corporate banking services. Provides other financial services through subsidiaries engaged in various businesses, principally: wholesale banking, mortgage banking, consumer finance, equipment leasing, agricultural finance, commercial finance, securities brokerage and investment banking, insurance agency and brokerage services, computer and data processing services, trust services, investment advisory services, mortgage-backed securities servicing and venture capital investment.
- Headquarters: San Francisco
- Employees: 264,500
- Subsidiaries: 1,427 worldwide, including in tax havens such as the Cayman Islands (34 companies) and Delaware (1,086 companies)[106]
- Stock: WFC, NYSE

Total number of debt collection complaints filed with the CFPB

716

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

FINANCIALS

	2010	2011	2012	2013	2014
NET INCOME (PROFIT)	$12.4B	$15.9B	$18.9B	$21.9B	$23.1B
REVENUE	$85.2B	$80.9B	$86.1B	$83.8B	$84.3B
PROFIT MARGIN	15%	20%	22%	26%	27%

Source: Morningstar.com

EXECUTIVE COMPENSATION

John G. Stumpf, Board Chairman, President & Chief Executive Officer

2010	2011	2012	2013	2014
$18,973,722	$19,847,921	$22,878,085	$19,320,409	$21,426,391

Source: Morningstar.com

DEBT COLLECTIONS

Issues Raised By Consumers to CFPB	Frequency	Percent
Continued attempts to collect debt not owed	202	28%
Communication tactics	185	26%
Disclosure verification of debt	130	18%
Taking/threatening an illegal action	82	11%
False statements or representation	62	9%
Improper contact or sharing of info	55	8%
Total	716	

Source: CFPB Consumer Complaint Database, between July 7, 2013 and Aug. 7, 2015

EXAMPLE OF CONSUMER COMPLAINT

"My wife and I have been getting harassing phone calls on our cell phones and at work about a debt we know nothing about. (They called her XXXX in the last five days at work and told her manager she would be served papers at work when she returned.) They are claiming we owe a debt to Wells Fargo from 2005 (well past the six-year statute of limitations in Washington state). They say we are going to be sued and that her wages will be garnished. They won't give us any more info without disclosing sensitive information with them."

State: Washington
Date: Submitted to CFPB on July 6, 2015
Issue: Taking/threatening an illegal action; threatened to sue on too old debt
Company response to consumer: Company chooses not to provide a public response; closed with explanation

Recommendations

RECOMMENDATIONS FOR CFPB RULEMAKING

In light of consumers' experiences as evidenced in the complaint database records, the CFPB should adopt rules that strengthen protections for consumers against unfair, deceptive, and abusive debt collection practices. Recommendations for CFPB rulemaking include:

Apply new debt collection rules to original creditors — which include payday lenders, credit card companies, and banks — along with third-party collectors and debt buyers.

Currently, the provisions of the Fair Debt Collection Practices Act, for which the CFPB has primary enforcement responsibility, apply only to third-party debt collectors and debt buyers (not to original creditors). Yet, six of the top 15 entities with the most debt collection-related complaints in the CFPB consumer complaint database operate primarily as original creditors. Applying fair debt collection rules to original creditors is necessary to correct this double standard and protect consumers from unfair, deceptive and abusive collection practices, regardless of the primary line of business of the entity seeking to collect payment on a debt.

Strengthen remedies and increase penalties to enable consumers to stop abusive debt collection practices.

The CFPB should clarify that consumers have the right to injunctive relief to stop unfair debt collection practices, and that multiple statutory damages may be awarded for multiple statutory violations of fair debt collection rules. The CFPB should also clarify that the law allows courts to award separate statutory penalties of $1,000 for each violation of the FDCPA. In addition, the CFPB should clarify that all amounts collected by a collector in connection with these violations should be treated as actual damages and returned to consumers.

Require debt collectors to have complete documentation (including information about the consumer, the debt itself, previous communications, and proof of the collector's legal right to collect the debt) prior to initiating collection actions, and require debt sellers to furnish full documentation to future collectors of the debt.

The top consumer complaint in the CFPB database — with 42 percent of all complaints — is that collectors are asking for payments on a debt that is not owed. Currently, collectors have little incentive to conduct due diligence and verify that the debts they are attempting to collect are legitimate, and consumers pay the price. The CFPB should require debt collectors to have the following information before initiating collection actions:

- Information about the consumer (including identifying information, primary language, receipt of exempt funds, disability status, conditions of financial hardship, military status, and whether or not the consumer is represented by an attorney);
- Information about the debt itself (including original creditor; type of debt; account number; date of origination; terms and conditions; principal due; an itemization of fees, charges and interest; documentation of consumer responsibility; any settlement agreements or payment plans previously established; and information about the applicable statute of limitations);
- A record of previous communications (including all previous communications and attempts to collect payments on the debt, cease contact demands, previous disputes about the debt, and details about inconvenient times/places to contact the consumer); and,
- Proof of the collector's legal right to collect the debt.

The CFPB should make clear that the collector will be held responsible for having this information

(failure of a prior collector or debt seller to furnish this information will not release the collector from responsibility and the possibility of enforcement action by the CFPB). The CFPB should also require debt-sellers to convey this information to debt buyers and make clear that sellers will be held liable for failure to do so.

Set specific limits on phone calls from debt collectors to prevent harassment of consumers and ensure that consumer requests to cease communication are honored.

Nearly one in five complaints to the CFPB cite communication tactics employed by collectors. Nearly two-thirds of those complaints involve "frequent or repeated calls." The CFPB should limit the number of times a debt collector can call a consumer to no more than three times per week and no more than one conversation per week. Calls or text messages to cell phones should be prohibited without consumer opt-in. The CFPB should prohibit calls to consumers in their place of work if consumers request not to be contacted at work. In addition, the CFPB should require debt collectors to notify consumers of their right to request a cease of communications during each contact, and it should require collectors to accept cease communication requests in forms including verbal request, written letter, online form submission, and email. The CFPB should strongly enforce the requirement that collectors abide by cease communication requests once made.

Strengthen enforcement of the prohibition against debt collectors contacting third parties (such as employers and family members).

Complaint records implicate debt collectors engage in improper contact with third parties (sometimes used as a tactic to embarrass and put pressure on consumers), despite the fact that such third-party contact is illegal. The CFPB should strengthen enforcement of this prohibition.

Prohibit the sale, purchase, and collection of time-barred debt.

When collectors seek to collect time-barred debts, which cannot be pursued through the legal system, the danger of deceptive collection tactics is great. To address this, the CFPB should prohibit the sale, purchase, and collection of time-barred debt.

Stop deceptive and abusive credit reporting practices by debt collectors.

The CFPB should require debt collectors to report any disputes over allegedly owed debts to credit reporting agencies. It should also require collectors to notify consumers that paying a debt that is already reported on a credit report will not eliminate information about previous non-payment from that credit report.

Stop unfair and abusive practices in the collection of medical debt.

The CFPB should clarify that reporting a debt to a credit reporting agency before attempting to collect the debt from the consumer constitutes an unfair practice in violation of the FDCPA. It should establish a 120-day waiting period after first billing before health care entities or third-party collectors can report an unpaid debt to a credit reporting agency. It should also establish that errors in billing and disputes with health insurers constitute disputes for the purposes of the FDCPA. In cases where consumers qualify based on income for financial assistance, the CFPB should prohibit collectors from attempting to collect "gross" or "chargemaster" prices.

Protect student loan holders from abusive collection practices.

The CFPB should require debt collection communications relating to private student loans to include clear information that consequences associated with federal loans (such as garnishment of federal benefits) do not apply. The Bureau should require debt collection communications relating to federal student loans to include clear information about circumstances where debt discharge is an option, such as closed schools, permanent disability, false certification, and unpaid refund discharges.

In enforcement actions, levy penalties on a scale to serve as meaningful deterrents to prevent companies from engaging in unfair, deceptive and abusive debt collection practices.

For companies with annual profits in the hundreds of millions or even billions of dollars, penalties of a few million dollars for violating the rules fail to serve

as a meaningful deterrent. Instead, companies can simply budget for and absorb these small penalties as a "cost of doing business." The CFPB should levy penalties against violators that are sufficient to act as a meaningful deterrent against future violations.

RECOMMENDATIONS FOR LEGISLATIVE ACTION

In addition to new rules from the CFPB, action from Congress is needed to ensure full protection for consumers against unfair debt collection practices. Congress should:

Close loopholes in existing law that leave consumers vulnerable to unfair, deceptive or abusive debt collection activities associated with consumer debts not directly related to a financial product or service.

Under current laws, collection activities of original creditors on consumer debts not related to a financial product or service — such as municipal debts and medical debts — fall into a grey area where regulatory authority is unclear. This leaves consumers vulnerable to abuse. Congress should enact legislation that clarifies that all collection activities relating to consumer debts (including municipal and medical debts), whether initiated by an original creditor or a third-party collector, fall within the rulemaking and enforcement authority of the CFPB.

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Statement for the Record
Hearing of the Senate Committee on Banking, Housing, and Urban Affairs on
"Assessing the Effects of Consumer Finance Regulations"

Chairman Richard Shelby
Ranking Member Sherrod Brown
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

April 4, 2016

Dear Chairman Shelby and Ranking Member Brown:

As the Consumer Financial Protection Bureau reaches the five-year mark, it has achieved a remarkable track record for American families. It has handled over 830,000 public complaints[1], its enforcement actions have provided more than $11 billion in relief to more than 25 million wronged consumers,[2] and, it has uncovered consumer financial challenges in segments of the market—such as credit reporting—that had previously not been addressed.[3] In short, consumer finance regulations post-crisis are working.

All too often, debates over consumer financial regulation are perceived as a tug of war between greater protection and greater access. This is a false choice. Enabling faulty products to thrive by failing to regulate or enforce consumer protection laws does not ultimately expand access—it only expands consumer harm, leaving other actors to pick up the tab whether they are family and friends, community nonprofits and houses of worship, social service agencies, or the public at large. For example, in a healthy economy, a homeowner may not be concerned about the state of his or her neighbor's mortgage. But if that neighbor is ultimately unable to pay and the home falls into foreclosure—as we witnessed on a massive scale—that community, and ultimately the taxpayers, end up paying the price.

As millions of Americans painfully learned during the financial crisis, conflicting incentives are at the heart of financial products that fail consumers and the broader economy. As the Center for American Progress noted in a 2015 report, "Lending for Success," historically, an economically rational lender would be unlikely to make a loan that would not be paid back.[4] The interests of the lender and borrower would naturally be aligned. Yet, in a number of credit markets—most dramatically, the pre-crisis mortgage market—this rational outcome became less and less prevalent. Instead of assessing the borrower's ability to repay, lenders increasingly focused on loans that were either immediately unaffordable or that were likely to fail in the future.

Consumer finance regulations exist to foster a lending market in which these incentives are realigned. Ultimately, they should incorporate safeguards to ensure not just that loans are originated with the customer in mind, but that the customer is not harmed throughout the life of a loan. For example, prior

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[1] Consumer Financial Protection Bureau, "Monthly Complaint Report, Volume 9: March 2016," available at http://files.consumerfinance.gov/f/201603_cfpb_monthly-complaint-report-vol-9.pdf.
[2] Consumer Financial Protection Bureau, "Financial report of the Consumer Financial Protection Bureau: Fiscal year 2015," available at http://files.consumerfinance.gov/f/201511_cfpb_report_fiscal-year-2015.pdf.
[3] For example, the three main credit bureaus have been among the most complained-about firms to the CFPB. Credit reporting oversight was limited prior to the CFPB's inception.
[4] Joe Valenti, Sarah Edelman, and Julia Gordon, "Lending for Success" (Washington: Center for American Progress, 2015), available at https://www.americanprogress.org/issues/economy/report/2015/07/13/117020/lending-for-success/.

to the 2009 CARD Act, credit card users faced sudden interest rate changes through no fault of their own.[5] Ending these and other practices has saved consumers $16 billion in fees.[6]

Present and future rulemaking is intended to address segments of the market where loopholes or uneven regulations present confusion and potential harm to consumers. One key example is the harm posed by unaffordable small-dollar lending. When four out of five loans cannot be paid back on time as intended, the lending model is clearly inappropriate and unsustainable.[7] Many states' efforts, while well-intentioned, have been inadequate to deal with loans at triple-digit interest rates that trap vulnerable consumers in a cycle of debt. Faith groups have joined low-income advocates, civil rights groups, and others in recognizing the harm caused by these loans[AP1].[8]

Attempts to take away the CFPB's independent funding or turn it into a commission are short-sighted and would harm both the agency's effectiveness and broader public trust.[9] The single-director structure of the CFPB makes it a more effective agency than commissions that may be mired in partisan gridlock. And the financial independence of the CFPB—a key component of financial regulation—ensures that it acts in favor of the consumer's interest. In an environment where only about one in four Americans expresses "a great deal" or "quite a lot" of confidence in banks,[10] the Consumer Financial Protection Bureau plays a critical role in improving both trust in government and trust in the financial system.

Thank you for providing me with the opportunity to discuss this matter. Please do not hesitate to contact me if you have any questions or would like any additional information.

Sincerely,

Joe Valenti
Director of Consumer Finance
Center for American Progress

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[5] Joe Valenti, "Protecting Consumers Five Years After Credit Card Reform" (Washington: Center for American Progress, 2014), available at https://www.americanprogress.org/issues/economy/report/2014/05/22/90198/protecting-consumers-five-years-after-credit-card-reform/.

[6] Consumer Financial Protection Bureau, "The Consumer Credit Card Market," December 2015, available at http://files.consumerfinance.gov/f/201512_cfpb_report-the-consumer-credit-card-market.pdf.

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[9] Joe Valenti and David Sanchez, "The Consumer Financial Protection Bureau is working. So why is Congress trying to cripple it?" *Morning Consult*, July 20, 2015, available at https://morningconsult.com/opinions/the-consumer-financial-protection-bureau-is-working-so-why-is-congress-trying-to-cripple-it/.

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Statement for the Record

Hearing of the Senate Committee on Banking, Housing, and Urban Affairs: Assessing the Effects of Consumer Finance Regulations

Submitted by: Center for Responsible Lending (CRL)

April 05, 2016

Thank you for the opportunity to submit a statement for the record for this hearing. We write to express our support for post-crisis lending rules that have made the financial system safer by eliminating abusive financial products, reining in reckless behavior, and encouraging more effective oversight. We support statements prepared by other members of various consumer and civil rights organizations who are generally in support of the Consumer Financial Protection Bureau (CFPB) as a key achievement of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). However, CRL focuses our statement on the positive impacts of Dodd-Frank and CFPB's regulations on mortgage lending.

Abusive loan terms, rather than "risky" borrowers, bear the greatest responsibility for the foreclosure crisis and the Great Recession of 2008. During the subprime boom, misaligned incentives and deregulation allowed mortgage brokers, lenders, and investors to profit greatly from reckless and predatory lending, and toxic financial products. As a result, approximately 8.2 million families have lost their homes to foreclosure since 2004[1]. As of January 2016, about 1.2 million families are seriously behind with their mortgage payments, and just under half a million are in some stage of foreclosure.[2] Recently released Home Mortgage Disclosure Act (HMDA) data also shows that the American dream of homeownership and wealth building remains out of reach for too many creditworthy lower-wealth households.

The CFPB's Qualified Mortgage (QM) rule addresses the frontline abuses that caused the crisis. The QM rule, along with the Ability-to-Repay standard, defines bright line standards to move the market away from high-risk, unsustainable loans and ensure borrowers have an ability to repay the loans they receive. In fact, recent studies conducted prior to the enactment of the QM rule have shown that, comparing borrowers of similar risk characteristics, loans with sensible QM-like terms had significantly lower foreclosure rates than subprime loans with toxic and unpredictable features.[3] As stated above, irresponsible mortgage lending that ignored borrowers' ability to repay their loans resulted in a foreclosure tsunami that disproportionately impacted communities of color—eviscerating a generation of wealth building. QM and Ability-to-Repay

[1] CORELOGIC, CORELOGIC, CORELOGIC REPORTS 38,000 COMPLETED FORECLOSURES IN JANUARY 2016 YEAR, PRESS RELEASE (2016) *available at* http://www.corelogic.com/about-us/news/corelogic-reports-38,000-completed-foreclosures-in-january-2016.aspx.

[2] *Id.* See also CORELOGIC, NATIONAL FORECLOSURE REPORT: JANUARY 2016 4-5 (2016) *available at* http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-january-2016.pdf.

[3] CENTER FOR COMMUNITY CAPITAL, BALANCING RISK AND ACCESS, UNDERWRITING STANDARDS AND QUALIFIED RESIDENTIAL MORTGAGES 15 (2012) *available at* http://www.responsiblelending.org/mortgage-lending/research-analysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf.

promote underwriting and product features that will help reorient the housing market back toward safe, sustainable lending for all borrowers.

The mortgage rules also offer stability to the mortgage market. The QM rule, with its consumer-friendly product requirements, is designed to facilitate the flow of mortgage credit, as lenders will have the confidence in knowing the suitability of loans for borrowers at the time of origination. This in turn reduces the overall likelihood of borrower default. This certainty will benefit consumers, lenders, and investors alike, leading to a more sustained housing recovery.

Contrary to some predictions, the reforms of Dodd-Frank, including QM and Ability-to-Repay, have not hurt mortgage lending or access to credit. Instead, these reforms support sustainable homeownership and wealth building opportunities for lower-wealth households. While it has been just over two years since the QM rule was implemented, early and current reports confirm that QM has not negatively impacted mortgage lending or access to credit. In fact, the 2014 HMDA data does not show that federal mortgage underwriting rules (Ability-to-Repay and QM) have had a "cooling effect" on mortgage lending.[4] The data is very much consistent with market trends immediately preceding the implementation of the rule. The Federal Reserve's seasonally adjusted origination numbers show a slow increase in monthly originations from 2011 through 2014 with no discernable decrease when the rules were fully implemented in January 2014. After considering the data the Federal Reserve concluded "The HMDA data provide little indication that the new ATR and QM rules significantly curtailed mortgage credit availability."[5] Reports by Federal Reserve's Senior Loan Officer Survey also show that the majority of respondent loan officers did not note a change in their business post-QM rule.[6] Analysis of previous Federal Reserve Studies and current mortgage lending data from the Urban Institute, a nonpartisan policy research organization, also notes that lending has not decreased due to the QM rule.[7] The Urban Institute attributes continued access to credit problems to overcorrections in the post-crises market that results in constrained lending. This environment is most harmful to lower-wealth households with lower FICO scores and lower down payment needs.[8]

The QM rule also allows for flexibility by loan size and lender type. The CFPB carefully considered and continues to consider and act upon the impacts of the rule on various types of loans and lending institutions. The result allows for differences to accommodate small and rural

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[4] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE 2014 HOME MORTGAGE DISCLOSURE ACT DATA (2015), *available at* http://www.federalreserve.gov/pubs/bulletin/2015/pdf/2014_HMDA.pdf.
[5] *Id.*, at 3.
[6] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JANUARY 2016 SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES 35-41. (2016), *available at* https://www.federalreserve.gov/boarddocs/snloansurvey/201602/fullreport.pdf.
[7] BING BAI ET. AL, HAS THE QM RULE MADE IT HARDER TO GET A MORTGAGE? 7, URBAN INSTITUTE (2016) *available at* http://www.urban.org/sites/default/files/alfresco/publication-pdfs/2000640-Has-the-QM-Rule-Made-It-Harder-to-Get-a-Mortgage.pdf. SEE ALSO JIM PARROT ET. AL., DATA SHOW SURPRISINGLY LITTLE IMPACT OF NEW MORTGAGE RULES, URBAN INSTITUTE, (2014) *citing* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, JULY 2014 SENIOR LOAN OFFICER OPINION SURVEY ON BANK LENDING PRACTICES (2014), *available at* http://blog.metrotrends.org/2014/08/data-show-surprisingly-impact-mortgage-rules.
[8] Jim Parrot and Mark Zandi, Opening up the Credit Box 5 (2013), *available at* http://www.urban.org/UploadedPDF/412910-Opening-the-Credit-Box.pdf.

lenders and smaller loans.[9] While the QM rule is just over two years old, the data suggest that the market is slowly improving and access to credit for creditworthy borrowers has slightly improved, as well. There is little, if anything, to suggest a rollback of consumer protections will help borrowers.

In addition to its implementation of the Dodd-Frank mortgage protections through thoughtful deliberation and rulemaking, the CFPB has played an important role in improving consumer protections in other areas as well. Its research has improved understanding of issues like overdraft fees on bank accounts, issues in student lending, and the high-cost of abuses in the small dollar loan market. Enforcement actions have returned billions to consumers who have been harmed by unfair and deceptive financial services practices across the board. The CFPB is considering rulemaking in several areas, including strong and safe regulation of payday loans, arbitration clauses, debt collection, prepaid accounts, and overdraft fees. The CFPB also continues to include consumer groups, civil rights organizations, and industry into a collaborative discussion process in addition to its own data collection and research. These are finance areas where increased oversight and protections are much needed, and we support their efforts to do more on behalf of consumers and on behalf of creating a more stable financial market.

We should remember lessons from the immediate past – Congress should not roll back the protections that will prevent the onslaught of defaults and foreclosures that caused the crisis. We can increase access to credit by providing well-underwritten loan products to creditworthy borrowers from lower- and moderate-income households. Borrowers from lower-wealth households have succeeded and can succeed with appropriate underwriting and safe mortgage loans. Instead of focusing on false causes of the crisis, Congress needs to give its full attention to the economic recovery—which will remain out of reach for too many Americans as long as creditworthy borrowers struggle to keep or purchase a home. We must move forward, not backward, on the reforms that protect borrowers and promote sustainable homeownership. The reforms of Dodd-Frank and the CFPB help consumers, lenders, and the economy by the promotion of responsible loan products.

[9] ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE, SMALL ENTITY COMPLIANCE GUIDE, CONSUMER FINANCIAL PROTECTION BUREAU (2014), *available at* http://files.consumerfinance.gov/f/201411_cfpb_atr-qm_small-entity-compliance-guide.pdf.

DON'T "SCREW JOE THE PLUMMER": THE SAUSAGE-MAKING OF FINANCIAL REFORM

Kimberly D. Krawiec*

This Article examines agency-level activity during the preproposal rulemaking phase—a time period about which little is known despite its importance to policy outcomes—through an analysis of federal agency activity in connection with section 619 of the Dodd–Frank Act, popularly known as the Volcker Rule. By capitalizing on transparency efforts specific to Dodd–Frank, I am able to access information on agency contacts whose disclosure is not required by the Administrative Procedure Act and, therefore, not typically available to researchers.

I analyze the roughly 8,000 public comment letters received by the Financial Stability Oversight Council in advance of its study regarding Volcker Rule implementation and the meeting logs of the Treasury Department, Federal Reserve, Commodity Futures Trading Commission, Securities and Exchange Commission, and Federal Deposit Insurance Corporation prior to the Notice of Proposed Rulemaking. This analysis reveals significant public activity, but also a stark difference in investment by financial institutions versus other actors in influencing Volcker Rule implementation. It further reveals a greater unity of interest among financial market participants than suggested by press reports and the provision's legislative history. Finally, the data shed light on the efficacy of the notice and comment process as a means for federal agencies to engage the general public and solicit relevant information in advance of rulemaking.

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* Kathrine Robinson Everett Professor of Law, Duke University. I thank Matt Adler, Lawrence Baxter, Stuart Benjamin, Joseph Blocher, Curt Bradley, Rachel Brewster, Guy-Uriel Charles, John De Figueiredo, Erik Gerding, Mitu Gulati, Larry Helfer, Marin Levy, Brett McDonnell, Saule Omarova, Richard Pierce, Arti Rai, Roberta Romano, Dan Schwarcz, David Skeel, Jennifer Taub, Mark Weidemaier, Jonathan Wiener, Susan Yackee; audiences at the University of Colorado, UC Berkeley, Duke, George Washington, Saint Louis, Reykjavik, and Florida International Universities; and helpful (but confidential) congressional staffers and public interest group representatives for insights on this project. I am also grateful to Guangya Liu for empirical support and to Robert Blaney, Nilesh Khatri, and Daniel Luna for research assistance.

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> *in regards to the Volker Rule, just how stupid do you think the working class is? we just passed the two bills of financial reform and here, not even 3 months later, you big banks are at it again to screw joe the plummer.*
>
> – Comment from Ronnie Endre to the Financial Stability Oversight Council, November 6, 2010[1]

INTRODUCTION

On July 21, 2010, President Obama signed into law the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank"),[2] to fanfare and criticism. At 848 pages, the mammoth statute amends dozens of existing laws and creates major new federal agencies, including the Financial Stability Oversight Council ("FSOC") and the Consumer Financial Protection Bureau, with potentially broad powers over systemically important firms and consumer protection, respectively. It also eliminates the Office of Thrift Supervision, by merging it into the Office of the Comptroller of the Currency ("OCC"), and significantly reshapes the derivatives markets, by requiring many over-the-counter derivatives to be

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1. *Comment from Ronnie Endre*, REGULATIONS.GOV (Nov. 6, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1096 (spelling, grammar, capitalization, and punctuation are all retained from the original source).

2. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of the U.S. Code).

cleared and traded through exchanges.[3] Dodd–Frank will have major regulatory and legal consequences for banks and many other financial institutions for years to come. It is thus little wonder that both congressional Democrats and the Obama administration claimed credit for passing historic legislation that is the toughest financial reform since the Great Depression.[4]

Many commentators and press members agreed, labeling the legislation "sweeping" and the "most ambitious overhaul of financial regulation in generations."[5] The reactions of Wall Street interest groups, which promptly and vociferously criticized the legislation, confirm this interpretation.[6]

Of particular note is section 619 of the Dodd–Frank Act, popularly known as the "Volcker Rule," which restricts certain risky activities by banking entities and systemically important firms, including proprietary trading and fund investment.[7] Hailed by President Obama as a "simple and common sense reform" in the face of "an army of industry lobbyists from Wall Street,"[8] the Volcker Rule had the potential to seriously undermine profits at many of America's largest and most profitable financial institutions. Had the big banks finally been brought to heel? Not yet.

One of the most persistent criticisms of Dodd–Frank, and of the Volcker Rule in particular, is its many gaps and ambiguities, which leave a host of meaningful issues to subsequent interpretation and implementation by federal agencies. Many worry that, largely freed from public scrutiny, special interests can capture the Dodd–Frank rulemaking process and generate favorable interpretations of the statute's numerous incomplete and contested provisions.[9] Others, in contrast, point to impediments to special interest capture at the agency level,

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3. *Id.* § 723, 124 Stat. at 1675–82 (codified at 7 U.S.C. § 2 (2012)).

4. *See, e.g.*, Senator Jeff Merkley & Senator Carl Levin, *The Dodd–Frank Act Restrictions on Proprietary Trading and Conflicts of Interest: New Tools to Address Evolving Threats*, 48 HARV. J. ON LEGIS. 515, 515 (2011) (labeling Dodd–Frank "the broadest financial reforms since the 1930s"); Press Release, White House, Remarks by the President at Signing of Dodd–Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-signing-Dodd–Frank-wall-street-reform-and-consumer-protection-act (referring to Dodd–Frank as "the strongest consumer financial protections in history").

5. Brady Dennis, *Financial Regulation Moves into New Era*, WASH. POST, July 16, 2010, at A1; *see also* Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES, July 22, 2010, at B3 (calling Dodd–Frank "a sweeping expansion of federal financial regulation" and a "major" Democratic legislative victory).

6. Cooper, *supra* note 5 (reporting that "within minutes" of the presidential signing, Wall Street representatives, including the Business Roundtable and U.S. Chamber of Commerce, "were leveling criticism at the new legislation").

7. 12 U.S.C. § 1854 (2012).

8. Press Release, White House, Remarks by the President on Financial Reform (Jan. 21, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-financial-reform.

9. *See infra* notes 80–84 and accompanying text (discussing these concerns).

including the policy preferences of regulators, judicial review, and procedural checks designed to enhance transparency and accountability.[10]

This debate raises the question: What happened to major Dodd–Frank provisions once lawmaking power shifted from Congress to federal agencies? More specifically, are industry groups attempting to influence outcomes? Is there a meaningful counterbalance to influential industry voices? What is the public salience of the reform? Are relevant public interest groups engaged in the issue? And finally, what mode of analysis might yield insight into these questions?

One mode of analysis is substantive: examine the sausage. This sausage approach examines *output*, usually by measuring Dodd–Frank against an idealized version of financial reform—the reform that would have emerged under a perfect political system. This comparison might then yield inferences about the lawmaking process. For example, a provision that appears overly favorable to particular industry segments might lend itself to an inference that the policy outcome is the result of special interest influence. In contrast, one that appears to impose costs in excess of its benefits might be attributed to pandering by elected officials. Dodd–Frank analyses have, to date, been of the sausage variety.

The substantive method has a serious drawback, however: There is little agreement on what the ideal response to the financial crisis should have been. Moreover, the Dodd–Frank sausage is not yet finished and will not be for many years to come. Given that so much of the substantive effect of Dodd–Frank depends on still-pending administrative rulemaking, the sausage method is especially unsatisfying at this early stage of Dodd–Frank's existence.

Alternatively, the procedural, or sausage-making, approach analyzes *inputs* by examining the financial reform sausage as it is being made to see what goes into it. What is the level and type of interest group activity? Do lawmakers appear receptive to interest group overtures? Is there a counterbalance to influential industry voices? What is the public salience of the reform? Are relevant public interest groups ("PIGs") engaged in the issue?

While the sausage-making approach, alone, inevitably leaves unanswered the important question of *actual* (as opposed to *attempted*) interest group influence, its focus on process provides advantages that the substance-oriented sausage approach does not. First, the informal notice and comment process seeks a pluralist goal of facilitating engagement opportunities for broad segments of society, including individuals and firms, as well as public and private interest groups.[11] Though technically open to all, administrative law scholars forcefully debate the extent to which this ideal is met in practice.[12] Second, this spirit of openness is in some tension with administrative efficiency, causing many to question whether attempts to expand transparency and access in administrative

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10. *See generally* STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT (2008).

11. *Id.* at 123–25.

12. *Id.* at 125–33.

rulemaking, particularly to the general public, lead to inefficiency.[13] Finally, the sausage-making procedural approach, when applied after the enactment of final rules or rule re-proposals, could capture some of the benefits of the sausage approach by systematically examining inputs (for example, in the form of comment letters and agency contacts) against changes in output (that is, changes from the proposed rule to the final or re-proposed rule).

This Article, because of the time period studied, adopts the pure sausage-making approach, using the Volcker Rule as a case study to examine the process of Dodd–Frank financial reform from inception through rule proposal, with a particular focus on agency-level activity prior to the Notice of Proposed Rulemaking ("NPRM"). This Article thus systematically examines a less-studied time period about which little is known, despite its acknowledged importance to final policy outcomes.[14] Later articles will address subsequent stages of Volcker Rule activity using a mixed approach that systematically examines both inputs and outputs.

To be clear, this is not a comment on the merits of the Volcker Rule. Numerous objections have been raised to the Volcker Rule, some of which I recount.[15] The Volcker Rule makes for an interesting financial reform case study, not because it is wise—that may or may not be the case. Rather, the congressional maneuvering that accompanied the Volcker Rule's passage and the importance of proprietary and fund activities to banks' bottom line signaled that the provision had the potential to illuminate questions about which voices get heard on a major issue of financial reform as the sausage is really being made.

Part I of this Article reviews the political and economic events leading to Dodd–Frank's passage, setting the stage for the agency-level activity that followed. That review reveals substantial Wall Street lobbying, but also substantial public interest in the legislative process surrounding the Volcker Rule, including the various accommodations and concessions necessary to gain the votes for Dodd–Frank passage. Both the public and the press followed these developments closely and expressed frequent concern, even outrage, at signs that the financial industry might escape the consequences of its role in precipitating the financial crisis.

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13. *See, e.g.*, Mark Seidenfeld, *Demystifying Deossification: Rethinking Recent Proposals to Modify Judicial Review of Notice and Comment Rulemaking*, 75 TEX. L. REV. 483, 483–84 (1997) (arguing that attempts by courts to ensure public participation and influence in the administrative process have led to inefficiencies and potential ossification).

14. David J. Barron & Elena Kagan, *Chevron's Nondelegation Doctrine*, 2001 SUP. CT. REV. 201, 231–32 (arguing that agencies complete the bulk of their work prior to the rule proposal stage and are less responsive to the concerns of affected parties during the notice and comment period); Wendy Wagner, Katherine Barnes & Lisa Peters, *Rulemaking in the Shade: An Empirical Study of EPA's Air Toxic Emission Standards*, 63 ADMIN. L. REV. 99, 110–13 (2011) (discussing the dearth of research on the preproposal stage, despite its importance).

15. *See infra* notes 36–46 and accompanying text (discussing alternatives to the Volcker Rule, including capital requirements, other systemic risk regulations, bank downsizing, and a return to Glass–Steagall).

Part II digs into Volcker Rule activity from Dodd–Frank passage to rule proposal. Sections A and B set the stage by discussing reactions to the Volcker Rule's gaps and ambiguities, and the resulting importance of the preproposal rulemaking phase. Section C analyzes the roughly 8,000 public comment letters received by FSOC during the 30-day public comment period in advance of its statutorily required Volcker Rule study, placing these data within the context of prior comment letter research. Though scholars may debate the extent to which comment letters can—and should—reveal information to agencies,[16] comments can reveal a great deal of information to the interested researcher, in this case exposing both public sentiment and the involvement of relevant PIGs on this issue.

This analysis shows that a consortium of PIGs—Americans for Financial Reform, Public Citizen, and U.S. PIRG—managed to generate a surprising level of Volcker Rule interest among private citizens, who sent in letters by the thousands. But, 7,316 (or 91%) of those comments are a virtually identical form letter. The comment letters from private citizens that were not a form letter (515 comments) confirm that people are angry about the economy; about the plight of working Americans; and about the politicians who allowed the financial crisis to develop. The banks are "fools," "hogs," and "criminals" out to "screw joe the plummer" and should be "put in jail," receiving no more "bailouts with citizens' money."[17] Political officials and regulators fare little better.

But at the same time, the contrast with the meticulously drafted, argued, and researched—though far less numerous—letters from the financial industry and its representatives is stark. In comparison, the citizen letters are short and provide little evidence that citizen commenters even understand, or care, what proprietary or fund investment is, much less the ways in which agency interpretation of the Volcker Rule's complex and ambiguous provisions might govern such activities.

Part II.D analyzes meeting logs of the Federal Reserve, United States Treasury Department ("Treasury Department"), Commodity Futures Trading Commission ("CFTC"), Securities and Exchange Commission ("SEC"), and Federal Deposit Insurance Corporation ("FDIC"), which, as part of the new transparency efforts associated with Dodd–Frank implementation, were made publicly available for the first time shortly after Dodd–Frank was signed into law on July 21, 2010.[18] It is here that the differential investment by financial

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16. *Compare* Stuart Minor Benjamin, *Evaluating E-Rulemaking: Public Participation and Political Institutions*, 55 DUKE L.J. 893, 912 (2006) (arguing that comment letters—particularly those from the general public—are unlikely to provide meaningful information to agencies), *and* E. Donald Elliott, *Re-Inventing Rulemaking*, 41 DUKE L.J. 1490, 1492 (1992) (referring to notice-and-comment rulemaking as Kabuki theater), *with* Susan Webb Yackee, *Sweet-Talking the Fourth Branch: The Influence of Interest Group Comments on Federal Agency Rulemaking*, 16 J. PUB. ADMIN. RES. & THEORY 103, 103–19 (2005) (finding that interest group comments can, and often do, affect the content of final government regulations).

17. *See infra* Part II.C.2 (discussing these and other comment letters in detail).

18. CURTIS W. COPELAND, CONG. RESEARCH SERV., R41472, RULEMAKING REQUIREMENTS AND AUTHORITIES IN THE DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 11 (2010), *available at* http://www.llsdc.org/attachments/

institutions in influencing this early stage of Volcker Rule implementation is most evident. Financial institutions, financial industry trade groups, and law firms representing such institutions and trade groups collectively accounted for roughly 93% of all federal agency contacts on the Volcker Rule during the time period studied. In contrast, public interest, labor, advocacy, and research groups, and other persons and organizations accounted for only about 7%. Moreover, the quality of federal agency contacts with financial industry representatives exceeds that of other contacts on several measures. Finally, the meeting logs, particularly when combined with the comment letters, reveal a level of industry cohesion that would not be predicted based on either press reports or the legislative history.

This Article concludes that, as feared by many Dodd–Frank critics, the powerful interest groups most affected by Dodd–Frank did not waste the opportunities provided by the Volcker Rule's gaps and ambiguities. Instead, as evidenced by both public comment letters and meeting logs, they actively lobbied agencies to adopt favorable definitions, interpretations, and exemptions prior to the NPRM. Countervailing voices were not wholly absent during this early stage of Volcker Rule implementation. Angry citizens sent in letters by the thousands, potentially shading FSOC's view of the public salience of the Volcker Rule and of the relative power of active PIGs. Conclusions regarding the ultimate impact of this activity are left for another day. Nonetheless, these results challenge the efficiency of current administrative processes and suggest that the pluralist ideal of administrative law has not been fully realized, at least in the case of the Volcker Rule.

I. FROM INCEPTION TO PASSAGE

A. Crisis and Reform

Dodd–Frank emerged in the wake of the worst U.S. financial crisis since the Great Depression.[19] U.S. financial firms suffered heavy losses in 2007 and 2008, largely from sharp declines in the value of mortgage-related assets. Several firms failed. Others were saved only through taxpayer bailouts. Fannie Mae and Freddie Mac were placed in government conservatorship; Merrill Lynch was sold to Bank of America in a deal backed by the Federal Reserve and the Treasury Department; Lehman Brothers filed for bankruptcy; and AIG, facing catastrophic losses on credit default swaps, averted default only through an $85 billion loan

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files/255/CRS-R41472.pdf (discussing voluntary transparency efforts by the federal agencies charged with implementing Dodd–Frank, including logging interest group meetings and making such logs publicly available through agency websites).

19. The general facts of the financial crisis have by now been retold many times in numerous sources. The details in this paragraph are drawn from FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf; *The Financial Crisis: A Timeline of Events and Policy Actions*, FED. RES. BANK ST. LOUIS, http://timeline.stlouisfed.org/index.cfm?p=timeline (last visited Feb. 11, 2013) (providing detailed timeline of these events).

from the Federal Reserve. In the wake of general financial panic, Congress intervened with the $700 billion Troubled Asset Relief Program ("TARP"), and the Federal Reserve stepped in to provide liquidity through several lending facilities. Despite these interventions, the crisis exacerbated already weakening economic conditions: asset prices fell; unemployment rose; business investment stalled; and consumers suffered losses in housing values, retirement, and investment funds. Against this background, Congress and the Obama administration launched a financial reform effort.

The legislation that became Dodd–Frank got its start when the Obama administration announced on June 17, 2009, an "extraordinary response to a historic economic crisis," and outlined the basic framework it intended to pursue for financial reform.[20] This was followed by a more extensive proposal from the Treasury Department."[21]

Although President Obama later claimed that Dodd–Frank contained 90% of his initial framework,[22] early reactions to the proposed reforms were negative.[23] Throughout the second half of 2009, reform advocates from the Obama camp (and, in particular, Treasury Secretary Tim Geithner) defended the administration's financial reform proposal against critics on both the right and the left. Conservative Republicans, for example, portrayed the President's proposed financial reforms as a formalization of the "too big to fail" policies from 2008 and as more of the same Big Government outlook that gave us health care reform.[24] The Left, meanwhile, complained that the proposal overly favored Wall Street and failed to account for consumer concerns.[25] As a consequence, the administration was forced to alter certain portions of the proposal that critics contended invited bailouts, and to make other concessions.[26]

One important concession was the addition of a provision that would limit banks' ability to engage in proprietary trading and to invest in or sponsor hedge or private equity funds.[27] That provision, known as the Volcker Rule, was highly

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20. Press Release, White House, Remarks by the President on 21st Century Financial Regulatory Reform (June 17, 2009), *available at* http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform.

21. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION (2009), *available at* http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

22. Press Release, White House, Remarks by the President on Wall Street Reform (June 25, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-wall-street-reform-1.

23. DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD–FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES 3 (2011).

24. *Id.*

25. *Id.*

26. *Id.*

27. Only a single sentence in the Treasury Department's initial 89-page proposal references proprietary trading and hedge funds. DEP'T OF THE TREASURY, *supra* note 21, at 32 ("Finally, the Federal Reserve and the federal banking agencies should tighten the

contested, both because of philosophical objections and because it had the potential to seriously impact the profitability of banks' operations.[28] The full depth of that impact will ultimately depend on interpretation and enforcement, as discussed below.

B. The Volcker Rule: Politics and History

The Volcker Rule originated in January 2009, when the Group of Thirty, an international group of 30 leading finance professionals and academics (including Paul Volcker, chair of the financial reform working group, former Chairman of the Trustees, and now Chairman Emeritus), released a report containing 18 recommendations for global financial reform.[29] The first of those recommendations proposed that:

> Large, systemically important banking institutions should be restricted in undertaking proprietary activities that present particularly high risks and serious conflicts of interest. Sponsorship and management of commingled private pools of capital (that is, hedge and private equity funds in which the banking institutions own capital is commingled with client funds) should ordinarily be prohibited and large proprietary trading should be limited by strict capital and liquidity requirements.[30]

But the idea was not initially embraced, either by the Obama administration or by House and Senate Democratic leaders.

The initial House version of Dodd–Frank, introduced by Barney Frank on December 2, 2009, did not ban proprietary trading nor did it limit fund investment.[31] It did, however, grant power to the Board of Governors of the Federal Reserve System to prohibit proprietary trading if the Board determined that it posed "an existing or foreseeable threat to the safety and soundness of such

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supervision and regulation of potential conflicts of interest generated by the affiliation of banks and other financial firms, such as proprietary trading units and hedge funds.").

28. Christine Harper, *Goldman Special Situation Profit Seen at Risk with Volcker Rule*, BLOOMBERG (Mar. 27, 2011, 6:08 PM), http://www.bloomberg.com/news/2011-03-28/goldman-special-situation-profit-at-risk-with-volcker-correct-.html (discussing the importance of certain proprietary investment activity to Goldman Sachs' profits); Cyrus Sanati, *Wall St. Tries to Put a Price on Volcker Rule*, DEALBOOK (Jan. 28, 2010, 6:33 PM), http://dealbook.nytimes.com/2010/01/28/wall-st-tries-to-put-a-price-on-the-volcker-rule/ (estimating the effects of the Volcker Rule proprietary trading ban on various banking institutions).

29. GROUP OF THIRTY, FINANCIAL REFORM: A FRAMEWORK FOR REGULATORY STABILITY (2009), *available at* http://fic.wharton.upenn.edu/fic/Policy%20page/G30 Report.pdf.

30. *Id.* at 28.

31. Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (as introduced in House of Representatives, Dec. 2, 2009). For a more detailed legislative history of the Volcker Rule, see Merkley & Levin, *supra* note 4, at 531–38.

company or to the financial stability of the United States."[32] This portion of the bill was passed by the House unchanged.[33]

The Senate version, originally introduced by Christopher Dodd on April 15, 2010, directed the appropriate federal banking agencies to develop rules prohibiting both proprietary trading and fund investment and sponsorship.[34] These prohibitions were subject to the recommendations and modifications of FSOC, which was directed to conduct a study regarding the risks and conflicts associated with proprietary trading by the entities covered in the bill.[35] Both the House and Senate versions contained exceptions to these restrictions, many of which were retained in the final Dodd–Frank legislation, the details of which are discussed below in Part I.C.

As already noted, the Obama administration's reform proposal did not contain restrictions on proprietary trading or fund investment. Indeed, the administration explicitly resisted such limits,[36] believing that size and interconnectedness—rather than organization as a banking entity—were what made an institution too important to fail.[37] Many economists agreed.[38]

In the wake of the crisis and the bailouts that accompanied it, some reform advocates wanted to break up the largest financial institutions so that no entity could again be too big to fail.[39] Several economists actively involved in reform debates, such as Simon Johnson, Joseph Stiglitz, and Nouriel Roubini publicly advocated this approach, which gained some adherents in the Senate.[40]

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32. H.R. 4173, § 1116.

33. *Id.* § 1117 (as engrossed in House of Representatives, Dec. 11, 2009).

34. Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. §§ 619, 989 (as introduced in Senate, Apr. 15, 2010).

35. *Id.* § 989.

36. SKEEL, *supra* note 23, at 54–57. Though Tim Geithner is often depicted as the public face of such resistance, other sources paint Larry Summers as the primary roadblock to the Volcker Rule within the Obama camp. *See* RICHARD WOLFFE, REVIVAL: THE STRUGGLE FOR SURVIVAL IN THE OBAMA WHITE HOUSE 170–71 (2011) (discussing Larry Summers's opposition to the Volcker Rule, which he considered "unrealistic and unworkable").

37. John Cassidy, *The Volcker Rule: Obama's Economic Adviser and His Battles over the Financial-Reform Bill*, NEW YORKER, July 26, 2010, at 25, 27.

38. *Id.* ("[T]he crisis would have unfolded precisely as it did" even if the Volcker Rule had been in effect (quoting Benn Steil, economist at the Council on Foreign Relations)); *Id.* at 30 (arguing that banks were likely to find other ways to take risks and that the Volcker Rule could create a false sense of safety (quoting Raghuram Rajan, University of Chicago economist)).

39. SKEEL, *supra* note 23, at 49–50.

40. *See generally Debt Financing in the Domestic Financial Sector: Hearing on S. 270 Before the Subcomm. on Fin. Insts. & Consumer Prot. of the S. Comm. on Banking, Hous. & Urban Affairs*, 112th Cong. 10 (2011) (testimony of Dr. Joseph Stiglitz) ("We should not allow any bank to grow to a size that it poses a systemic risk to the economy."); SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 208–13 (2010) (discussing the risk to the financial system posed by large, concentrated financial power and urging a breakup of big banks); Nouriel Roubini &

The Brown-Kaufman SAFE Banking Amendment, introduced in the Senate on April 21, 2010, would have prohibited bank holding companies from holding more than 10% of total U.S. insured deposits and more than 2% of gross domestic product ("GDP") in liabilities and would have imposed other capital requirements and leverage restrictions.[41] The rule reportedly would have required downsizing by some of the largest U.S. banks, including Citigroup and Goldman Sachs.[42] It was defeated 33–61 on May 6, 2010, with 27 Democrats voting against the amendment.[43]

Other reformers looked back with nostalgia at Glass–Steagall, which since the 1930s had separated commercial and investment banking.[44] Since its repeal in 1999, the lines between commercial and investment banking had become increasingly blurred and proprietary trading had come to represent an ever-larger share of the profits of financial institutions, including commercial banks and bank holding companies.[45] As a result, many—including Paul Volcker himself—believed that the Volcker Rule would at least partially restore Glass–Steagall's legal divide between commercial and investment banking.[46]

Needless to say, affected financial institutions lobbied hard against these efforts.[47] Just as importantly, the Obama administration also resisted these reforms, arguing that Dodd–Frank's increased oversight of systemically important institutions was sufficient to protect against future bailouts.[48] However, intervening events between introduction and passage of Dodd–Frank continued to stoke the American public's fears of another financial crisis and their anger over perceived Wall Street excesses, which necessitated further action from the Obama administration if Dodd–Frank was to become a reality.

Stephen Mihm, *Bust up the Banks*, DAILY BEAST (May 6, 2010, 8:00 PM), http://www.thedailybeast.com/newsweek/2010/05/07/bust-up-the-banks.html (arguing that the Obama reform proposals do not go far enough and that "drastic changes . . . including breaking up big banks and imposing new firewalls in the financial system" are needed).

41. Safe, Accountable, Fair, and Efficient Banking Act of 2010, S. 3241, 111th Cong. §§ 3–4 (Apr. 21, 2010) (as introduced by Sen. Brown, on behalf of himself and Sens. Kaufman, Casey, Merkley, Whitehouse, & Harkin).

42. David M. Herszenhorn, *Senate Liberals Move to Toughen Bill Regulating Wall Street*, N.Y. TIMES, May 6, 2010, at B3.

43. David M. Herszenhorn, *Bid to Shrink Big Banks Falls Short*, N.Y. TIMES May 7, 2010, at B1.

44. SKEEL, *supra* note 23, at 86–87.

45. Harper, *supra* note 28 (discussing the economic impact of the Volcker Rule on many financial institutions); Sanati, *supra* note 28 (same).

46. Cassidy, *supra* note 37, at 25 (reporting that Volcker believed the rule would "go a long way toward restoring" the commercial banking/investment banking distinction).

47. Ctr. for Responsive Politics, *Lobbying Spending Database*, OPENSECRETS, http://www.opensecrets.org/lobby/lookup.php?type=i&q=dodd+frank (last visited Feb. 11, 2013) (posting lobbying disclosures on Dodd–Frank).

48. SKEEL, *supra* note 23, at 44–52 (discussing the key players in Dodd–Frank debates and their various positions); Cassidy, *supra* note 37, at 27 (discussing the belief by Geithner and Summers that capital requirements were a better mechanism for protecting against bailouts than either the Volcker Rule or Glass–Steagall).

The public detested the 2008 bailouts and, as economic and employment fears lingered into 2010, popular backlash increased, reaching a crescendo as news of lavish bonuses and compensation packages at bailed-out financial firms hit the press.[49] Alarmed by the growing public discontent, senior White House officials reportedly began to reevaluate Volcker's reform proposals.[50] The final straw came on January 19, 2010, when Republican Scott Brown was elected to fill Ted Kennedy's Senate seat in Massachusetts. Two days later, on January 21, 2010, President Obama appeared with Paul Volcker and publicly announced his support for the Volcker Rule.[51] Most observers concluded that the two events were not independent.[52]

Ironically, however, Scott Brown's election also prompted some of the Volcker Rule's exemptions and ambiguities. As noted, a strict ban on proprietary trading and fund investment had the potential to seriously compromise existing banking entity operations. Those financial institutions affected by the rule forcefully lobbied key congressional members to weaken it.[53] As it became clear that Scott Brown's vote was necessary for Dodd–Frank passage, he wielded substantial clout, which he reportedly used to protect Massachusetts firms such as State Street, Fidelity, and MassMutual.[54] Only after Brown secured a definition of "systemically significant" firms that looked to activities, rather than to size (reportedly a carve-out for Fidelity), and a de minimis exemption for fund investment that would allow banks to invest up to 3% of Tier 1 capital (reportedly, a carve-out for State Street), did he provide the last vote needed for Dodd–Frank passage.[55]

C. The Volcker Rule: Statutory Text

Subject to important exceptions, the Volcker Rule prohibits banking entities from "engag[ing] in proprietary trading" and from "acquir[ing] or retain[ing] any equity, partnership, or other ownership interest in or sponsor[ing] a hedge fund or a private equity fund."[56] Systemically important nonbank financial

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49. SKEEL, *supra* note 23, at 55; Cassidy, *supra* note 37, at 28.

50. Cassidy, *supra* note 37, at 28–29.

51. Press Release, White House, *supra* note 8.

52. SKEEL, *supra* note 23, at 55; Editorial, *The Volcker Rule Could Clarify Roles and Risks in the Financial System*, WASH. POST (Jan. 23, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/01/22/AR2010012204348.html.

53. Cassidy, *supra* note 37, at 29; Jia Lynn Yang, *A Key Republican Vote Keeps Banking Curbs in Play*, WASH. POST, June 23, 2010, at A12.

54. Yang, *supra* note 53; Silla Brush, *Wall Street Bill Tests Scott Brown's Clout*, HILL (June 22, 2010, 5:00 AM), http://thehill.com/homenews/senate/104631-wall-street-bill-tests-scott-browns-clout.

55. *Fidelity and State Street Win in Brown Deal*, DEALBOOK (July 14, 2010, 12:02 PM), http://dealbook.nytimes.com/2010/07/14/fidelity-and-state-street-win-in-brown-deal/.

56. 12 U.S.C. § 1851(a)(1) (2012). "Banking entity" is broadly defined, with some exceptions, to include FDIC-insured depository institutions, entities that control such an institution (such as bank holding companies), and the affiliates—i.e., under 25% common control—of both of these entities (including non-U.S. affiliates). *Id.* § 1851(h)(1).

institutions are not banned from trading and fund activity, though they must carry additional capital and comply with other restrictions on such dealings.[57]

The Volcker rule became effective on July 21, 2011, two years after Dodd–Frank enactment, despite the lack of implementing rules. However, covered entities were granted the full two-year period provided by the statute (that is, until July 21, 2014) to comply with the Volcker Rule, with the possibility of extensions.[58] Both parts of the rule—the ban on proprietary trading and the restrictions on fund investment and sponsorship—are subject to substantial ambiguities that require agency definition and rulemaking.

1. Proprietary Trading

The term "proprietary trading" is defined as "engaging as a principal for the trading account of [a] banking entity."[59] "Trading account," in turn, is defined as any account used for acquiring or taking positions:

> principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule as provided in subsection (b)(2), determine.[60]

Much turns on the interpretation of the phrase "trading account," which is unclear and appears to depend on the trader's intent when purchasing.[61] Thus, a purchase made with long-term investment intent may be permitted, even if ultimately quickly sold.[62] Similarly, speculative trades may be permitted under the rule, provided they are held beyond the "near term," however that phrase is ultimately defined by regulators.[63]

More ambiguity is added by the nine exceptions to the ban on proprietary trading explicitly contained in Dodd–Frank, as well as the power granted to the federal banking agencies, SEC, and CFTC to draft exceptions to the exceptions in order to "promote and protect the safety and soundness of the banking entity and the financial stability of the United States."[64] Of particular importance are the exceptions for transactions in connection with underwriting or market-making activities, risk-mitigating hedging activities, and transactions on behalf of customers. Each of these is a potentially vast exception, with the potential to

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57. *Id.* § 1851(a)(2).
58. *Id.* § 1851(c).
59. *Id.* § 1851(h)(4).
60. *Id.* § 1851(h)(6).
61. Memorandum from Cadwalader, Widkersham & Taft LLP to Clients and Friends, An Analysis of the Dodd–Frank Act's Volcker Rule 5 (2010), *available at* http://www.cadwalader.com/assets/client_friend/101510VolckerRuleAnalysis.pdf.
62. *Id.*
63. *Id.* at 5–6.
64. 12 U.S.C. § 1851(d)(1)(J).

permit much trading activity previously undertaken under the rubric of proprietary trading.

2. Hedge and Private Equity Funds

Subject to essentially the same exceptions that apply to the ban on proprietary trading, the Volcker Rule prohibits banking entities from "acquir[ing] or retain[ing] any equity, partnership, or other ownership interest in or sponsor[ing] a hedge fund or a private equity fund."[65] Hedge fund and private equity fund are collectively defined as:

> an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule, as provided in subsection (b)(2), determine.[66]

Section 619 provides a "de minimis" exception to the restrictions on fund activity,[67] with the goal of facilitating customer-focused advisory services.[68] This amount must not exceed 3% of the total ownership interests of the fund one year after its inception and must be immaterial to the covered banking entity as defined by regulation.[69] In addition, the aggregate investments of each regulated banking entity in all such funds may not exceed 3% of its Tier 1 capital.[70]

As is the case with the restrictions on proprietary trading, the restrictions on fund investment require substantial agency definition and clarification. For example, the 3(c)(1) and 3(c)(7) exemptions are relied on by a variety of legal entities other than hedge and private equity funds. Employee pension funds and traditional parent-subsidiary investments thus could be impacted by a strict interpretation of section 619, even though these activities do not appear to have been within Congress's intended restrictions.[71] At the same time, a strict interpretation would exempt certain commodity pools and other risky activities from the Volcker Rule's reach, even though these investments pose similar risks to the activities Congress sought to restrict.[72]

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65. *Id.* § 1851(a)(1)(B).
66. *Id.* § 1851(h)(2).
67. *Id.* § 1851(d)(4).
68. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-529, PROPRIETARY TRADING: REGULATORS WILL NEED MORE COMPREHENSIVE INFORMATION TO FULLY MONITOR COMPLIANCE WITH NEW RESTRICTIONS WHEN IMPLEMENTED 4 (2011), *available at* http://www.gao.gov/new.items/d11529.pdf.
69. 12 U.S.C. § 1851(d)(4)(b)(ii)(I).
70. *Id.* § 1851(d)(4)(b)(ii)(II).
71. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 68, at 40.
72. *Id.*

D. Section Summary

In sum, the Volcker Rule originated as a political concession. Dismissed by the Obama administration and many economists as unnecessary and unworkable, it nonetheless became a necessary element in the campaign to quell complaints that Dodd–Frank did not do enough to reign in large, risky financial institutions. But for reasons both practical and political, the Volcker Rule that emerged from the legislature and was signed into law contained broad gaps and ambiguities on key definitional issues.

An examination of the problems in defining and identifying proprietary trading will help illustrate these points. In anticipation of the Volcker Rule, a number of affected banking entities shut down or announced an intention to shut down their stand-alone proprietary trading desks.[73] But, even before Volcker Rule passage, stand-alone proprietary trading activity accounted for a relatively small amount of banking entity revenues, probably around 3%.[74] To avoid an easy end-run around the Volcker Rule's restrictions, federal regulators will have to police proprietary trading that takes place outside of designated proprietary trading desks.

This is no easy task. Much of the trading activity explicitly permitted by the Volcker Rule—in particular, market making, hedging, underwriting, and transactions on behalf of customers—displays objective characteristics very similar to proprietary trading, with the distinguishing trait being primarily the trader's motive.[75] Many firms, for example, take proprietary positions in the course of servicing customer orders or market making, and their trades are argued to provide liquidity, especially in thin markets.[76] Affected industry members contend that zealous enforcement of the proprietary trading ban, which could restrict other bank principal positions, would impair customer service, market liquidity, and other beneficial functions performed by many banking entities.[77] Many banking entity customers and other market participants agree.[78] Balancing these competing concerns and implementing workable and enforceable definitions of permitted and

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73. FIN. STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS 2 (2011), *available at* http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf. The same is true of much impermissible fund activity. *Id.*

74. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 68, at 16.

75. FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 73, at 1.

76. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 68, at 28–29.

77. *Id.* at 28.

78. *See, e.g.*, Letter from Investment Company Institute to Financial Stability Oversight Council 1–2 (Nov. 5, 2010), *available at* http://www.ici.org/pdf/24696.pdf (urging that the FSOC study clarify that the exceptions to the proprietary trading ban permit the provision of liquidity and execution services on investment fund trades); Letter from Private Equity Growth Capital Council to Financial Stability Oversight Council 2–3 (Nov. 5, 2010), *available at* http://www.pegcc.org/wordpress/wp-content/uploads/PEGCC-FSOC-Volcker-Rule-Comment-Letter.pdf (arguing that Congress did not intend the Volcker Rule to prohibit the ability of banks to provide intermediary services to the private equity industry).

prohibited activity falls to the five federal agencies charged with Volcker Rule implementation.

II. MAKING THE SAUSAGE: FROM PASSAGE TO PROPOSAL

A. Setting the Stage: Gaps and Ambiguities

The preceding Part detailed the substantial definitional ambiguities surrounding important Volcker Rule provisions, including the definitions of "proprietary trading" and its nine exceptions, as well as the definitions of "hedge" and "private equity" fund. Other Dodd–Frank sections are similarly indefinite, prompting numerous requests for the clarification of definitions, prohibitions, and exemptions.[79]

Dodd–Frank is conspicuously lacking in particulars, a fact recognized by nearly every commentator—popular, academic, and practitioner—to address the issue. As *The New York Times* stated shortly before Dodd–Frank's passage: "[Dodd–Frank] is basically a 2,000-page missive to federal agencies, instructing regulators to address subjects ranging from derivatives trading to document retention. But it is notably short on specifics, giving regulators significant power to determine its impact—and giving partisans on both sides a second chance to influence the outcome."[80]

A widely circulated memo by the law firm Davis Polk opined that "the legislation is complicated and contains substantial ambiguities, many of which will not be resolved until regulations are adopted, and even then, many questions are likely to persist" and predicted a "dynamic" regulatory process between market participants and regulators.[81] Academic commentary similarly has noted the degree

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79. Peter Madigan, *Goldman Sachs Tops List of Firms That Met CFTC*, RISK.NET (July 1, 2011), http://www.risk.net/risk-magazine/analysis/2080403/goldman-sachs-tops-list-firms-met-cftc (discussing the numerous industry meetings with the CFTC regarding Dodd–Frank implementation and noting that most meeting participants request clarification of various definitions, especially those involving swap dealers and major swap participants).

80. Binyamin Appelbaum, *On Finance Bill, Lobbying Shifts to Regulations*, N.Y. TIMES, June 27, 2010, at A1.

81. Memorandum from Davis Polk & Wardwell LLP to Clients and Friends, Summary of the Dodd–Frank Wall Street Reform and Consumer Protection Act, Passed by the House of Representatives on June 30, 2010, at i (2010), *available at* http://www.davispolk.com/files/Publication/7084f9fe-6580-413b-b870-b7c025ed2ecf/Presentation/PublicationAttachment/1d4495c7-0be0-4e9a-ba77-f786fb90464a/070910_Financial_Reform_Summary.pdf. A memo from the law firm Arnold & Porter similarly advises:

> We believe the ultimate impact of the Act on the financial industry will be shaped largely by the outcome of these rulemakings. . . . In addition, entities affected by the Act will have an opportunity to comment on the new regulations as they are drafted and finalized by the regulators, making participation in the process critical.

Memorandum from Arnold & Porter LLP to Clients and Friends, Are You Prepared? A Compendium of Advisories on the Dodd–Frank Act 109 (2010), *available at*

to which Dodd–Frank delegates authority and leaves the resolution of serious issues to regulators.[82] Even the Congressional Research Service acknowledges that "many of the changes are likely to be implemented through regulations that are to be developed and issued by regulatory agencies."[83]

Many of the statute's critics worry that this filling-in takes place outside of the public glare that accompanied the congressional deliberations on Dodd–Frank and provides the large Wall Street firms with another opportunity to shape the final law in their favor.[84] Some fear this potential is heightened as memories of the financial crisis fade and the general public—temporarily galvanized by financial-institution bailouts into an interest in credit derivatives and systemic risk—turns its attention to other political issues.

These Dodd–Frank gaps and ambiguities assumed new political importance as a Republican majority entered the House during the interim period between Dodd–Frank's passage and implementation. Some Republicans, nearly all of whom voted against Dodd–Frank, explicitly warned regulators to tread lightly in implementing the statute and particularly in implementing the Volcker Rule.[85] Alabama Republican Representative Spencer Bachus, for example, urged FSOC to implement the Volcker Rule "in such a way as to minimize its substantial and very real costs, given that the gains are likely to be illusory."[86] A group of congressional representatives led by Michele Bachmann went further, introducing House Bill 87, a one-sentence bill that would repeal Dodd–Frank.[87] Finally, budget battles for both the SEC and CFTC, each of which require additional resources to fulfill the

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http://www.arnoldandporter.com/resources/documents/Dodd%20Frank%20Act%20Compendium%20%28eBook%29.pdf.

82. *See, e.g.*, Edward J. Kane, *Missing Elements in U.S. Financial Reform: A Kubler-Ross Interpretation of the Inadequacy of the Dodd–Frank Act*, 36 J. BANKING & FIN. 654, 659–60 (2012). "[D]uring and after what will be an extended post-Act rulemaking process, decision-makers will be energetically lobbied to scale back taxpayer and consumer protections to sustain opportunities for extracting safety-net subsidies." *Id.* at 656.

83. COPELAND, *supra* note 18, at 1. A total of 330 Dodd–Frank provisions expressly require (148, or 44.8%) or permit (182, or 55.2%) rulemaking. *Id.* at 4. But this does not fully capture the extent of likely agency rulemaking under Dodd–Frank as numerous provisions that do not expressly mention rulemaking will nonetheless require agency action. *Id.*

84. *See supra* notes 80–83 and accompanying text.

85. Deborah Solomon, *Bachus Urges Regulators Not to Rigidly Implement Volcker Rule*, WALL ST. J. (Nov. 4, 2010, 2:56 PM), http://online.wsj.com/article/SB10001424052748703805704575594473849188154.html. The post-conference vote breakdown is available at http://www.govtrack.us/congress/vote.xpd?vote=s2010-208 (Senate vote) and http://www.govtrack.us/congress/vote.xpd?vote=h2010-413 (House vote).

86. Letter from Spencer Bachus, Ranking Member, H. Comm. on Fin. Servs., to Members of the Financial Services Oversight Council 1 (Nov. 3, 2010), *available at* http://www.ft.com/intl/cms/d983eaa6-e793-11df-8ade-00144feab49a.pdf.

87. H.R. 87, 112th Cong. (2011).

requirements of Dodd–Frank, have prominently featured critiques of the agencies' lack of attention to the economic impact of their respective regulations.[88]

In sum, the Volcker Rule, like many Dodd–Frank provisions, entered the administrative process both highly incomplete and highly contested. The federal agencies charged with rulemaking under the statute would play a substantial role in shaping the final policy outcomes and would likely do so under the continued watchful eye of affected industry members and potentially other interested parties. The remainder of this Part confirms these intuitions.

B. The Preproposal Period

Dodd–Frank required FSOC to study and make recommendations to relevant federal agencies regarding Volcker Rule implementation within six months of the statute's enactment.[89] Those agencies were then statutorily required, within nine months of the completion of the FSOC study, to adopt rules implementing the Volcker Rule, based on a consideration of FSOC's recommendations.[90] On October 11, 2011, the OCC, Federal Reserve, FDIC, and SEC issued an NPRM (hereinafter the "Joint Rule"), requesting comments prior to January 13, 2012, on proposed rules to implement the Volcker legislation.[91] That deadline was later extended to February 13, 2012.[92] The CFTC, by a vote of 3–2, adopted the entire text of the Joint Rule in an NPRM dated February 14, 2012, requesting comments prior to April 16, 2012.[93]

The following Subsection analyzes relevant agency activity during the period from presidential signing on July 21, 2010 to the NPRM on October 11, 2011. This Article is one of the few studies to systematically analyze the preproposal period, a time period about which little is known, despite its

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88. Jessica Holzer, *SEC, CFTC Ask US Congress for Budget Increases*, COMPENDIUM (May 6, 2011), http://commoditymkts.wordpress.com/2011/05/06/sec-cftc-ask-us-congress-for-budget-increases/.

89. 12 U.S.C. § 1851(b)(1) (2012). Those agencies are the OCC, FDIC, Federal Reserve, SEC, and CFTC. FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 73, at 1 n.6.

90. FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 73, at 8. The agencies are required by the statute to consult on Volcker implementation, under the coordination of the FSOC chairperson (the Treasury Secretary). *Id.*

91. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (proposed Oct. 11, 2011) (to be codified at 12 C.F.R. pts. 44, 248, 351, and 17 C.F.R. pt. 255); *see also* Press Release, Office of the Comptroller of the Currency, The OCC Issues Volcker Rule Proposal for Public Comment (Oct. 11, 2011), *available at* http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-126.html.

92. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 77 Fed. Reg. 23 (Jan. 3, 2012) (to be codified at 12 C.F.R. pts. 44, 248, 351, and 17 C.F.R. pt. 255).

93. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Covered Funds, 77 Fed. Reg. 8332, 8332 (Feb. 14, 2012) (to be codified at 17 C.F.R. pt. 75).

importance to policy outcomes.[94] Subsequent articles will analyze the period from the October 11, 2011 NPRM to final rule issuance.[95]

As Wagner, Barnes, and Peters discuss in detail, the need to produce a proposed rule that is ready for comment pushes much regulatory work to this early stage of the rule development process.[96] As a result, preproposal collaborations between agencies and regulated industry members, who are likely to have technical and other expertise necessary to produce a rule that withstands judicial review, become practical necessities.[97]

If much of the real work of final rule creation takes place during the preproposal period, then one might predict both substantial preproposal lobbying activity and limited changes between rule proposal and final rule. Both predictions are generally borne out by existing research.[98] However, research on the preproposal stage of the rule development process has traditionally been impeded by a lack of information; Administrative Procedure Act docketing and other transparency requirements are generally limited to the period after publication of the proposed rule.[99] Dodd–Frank's transparency innovations thus provide a wealth of information previously unavailable to researchers. This Article is the first to systematically analyze that information.

C. FSOC Comment Letters

1. The Numbers

The newly formed FSOC's first action was to request public input on Volcker Rule implementation—a request that resulted in more than 8,000 comments.[100] To put this number into context, studies repeatedly show limited comment activity in connection with most rulemakings, with the exception of a relatively small number of high-salience issues that generate thousands (in a few cases, hundreds of thousands) of comments.[101] Far more typical, however, are

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94. *See supra* note 14 and accompanying text.

95. Kimberly D. Krawiec & Guangya Liu, Influencing the Volcker Rule (Jan. 1, 2013) (unpublished manuscript) (on file with authors).

96. Wagner, Barnes & Peters, *supra* note 14, at 110 ("[T]he courts have made it painfully clear that if a rule is to survive judicial review, it must be essentially in final form at the proposed rule stage.").

97. *Id.* at 110–11.

98. *See* CROLEY, *supra* note 10 (summarizing these studies); *see also supra* notes 14, 96–97 and accompanying text (summarizing the limited research on preproposal activity).

99. Wagner, Barnes & Peters, *supra* note 14, at 112.

100. Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds, 75 Fed. Reg. 61,758 (Oct. 6, 2010) (soliciting public comments in advance of a Volcker Rule study); FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 73, at 10.

101. Cary Coglianese, *Citizen Participation in Rulemaking: Past, Present, and Future*, 55 DUKE L.J. 943, 950–59 (2006) (summarizing empirical studies of rulemaking activity).

dockets that receive a handful of comments.[102] By this standard (and as suggested by the legislative analysis in Part I), the Volcker Rule is a relatively high-salience issue, particularly for a technical piece of financial reform legislation not yet at the rule proposal stage.[103]

FSOC concluded that, of these 8,000 comment letters, roughly 6,550 "were substantially the same letter arguing for strong implementation of the Volcker Rule."[104] FSOC gave no further information about these letters and did not make them publicly available. But an analysis of the remaining comment letters (confirmed by conversations with PIG representatives) reveals that the 6,550 identical letters are the result of an action campaign by a PIG consortium—Citizens for Financial Reform, Public Citizen, and U.S. PIRG. Members of these groups were provided a form letter (the "PIG form"), included as an Appendix to this Article, urging the prompt implementation of the Volcker Rule and the closing of any loopholes.

With the help of three research assistants, I analyzed and hand-coded the remaining, roughly 1,450, comment letters.[105] FSOC concluded that these "remaining 1450 comments each set forth individual perspectives from financial services market participants, Congress, and the public."[106] However, this is not the case.

Table 1 provides summary statistics on these comments. Figure 1 displays this same information graphically. First, the exclusion of duplicate comment postings left a total of 1,374 comments. Of these, as detailed in Table 1, 1,281, or 93%, were submitted by private individuals. The remainder were submitted by financial industry members, trade groups, public interest groups, think tanks, academics, and congressional members. At first blush, these numbers seem to

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102. *Id.* at 956; John M. DeFigueiredo, *E-Rulemaking: Bringing Data to Theory at the Federal Communications Commission*, 55 DUKE L.J. 969, 992–93 (2006) (finding limited comment activity on the FCC docket, outside of a few outlier events).

103. Bruce Bueno de Mesquita defines salience as:

> how focused a stakeholder is on the issue. Its value is best thought of in terms of how prepared the stakeholder is to work on the issue when it comes up rather than some other issue on his or her plate. Would the stakeholder drop everything else to deal with the issue? Would the player work on it on a weekend day, come back from vacation, etc.? The more confidently it can be said that this issue takes priority over other matters in the stakeholder's professional life (or personal life if the issue is about a personal or family matter), the higher the salience value.

Bruce Bueno de Mesquita, *Game*, PREDICTIONER'S GAME, http://www.predictioneersgame.com/game (last visited Feb. 11, 2013).

104. FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 73, at 10.

105. We collected these comments from Regulations.gov, Docket ID: FSOC-2010-0002, as of June 2011. *See Docket Browser: Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds*, REGULATIONS.GOV, http://www.regulations.gov/#!searchResults;rpp=25;po=0;s=FSOC-2010-0002;fp=true;ns=true (last visited Feb. 11, 2013).

106. FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 73, at 10.

confirm an extraordinary public interest in the Volcker Rule—the raw number of comment letters from private individuals dwarfs the number submitted by all other categories of actors combined, including industry actors.

Pausing yet again to put these data into context, recall that—leaving aside a comparatively small number of high-salience issues—most rulemakings receive only a limited number of comments, very few of which emanate from individual citizens. Instead, the lion's share of commentary is typically submitted by industry members, trade groups, law firms, and political consultants.[107] The comment letter data thus confirm some level of Volcker Rule salience, including to members of the general public.

Yet, a breakdown of the 1,281 letters submitted by private individuals reveals several interesting patterns. Contrary to setting forth an individual perspective, over half (nearly 56%) of these comments from private individuals use the same form letter, with some slight variations, as the other 6,550 identical letters received by FSOC. These letters often add a sentence or two outlining a personal hardship arising from the financial crisis or use only a portion of the form (typically, the demands). Therefore, these comments were not *exactly* identical and escaped whatever recognition software or rough exclusion methods FSOC employed. Yet, they are the same—*nearly* identical—substantive letter. Thus, of the 8,000 letters received by FSOC on the Volcker Rule, 7,316 (or 91%) are a form letter. This is roughly consistent with prior findings on individual citizen comment activity.[108]

Though scholars may debate the extent to which comment letters, particularly letters from the general public, can—and should—reveal useful information to agencies, such comment letters contain a wealth of information for researchers.[109] On one hand, the Volcker Rule does have some public salience—individuals sent in letters by the thousands. Even if that salience is largely a PIG creation, the fact that PIGs were able to rally public interest in the issue may suggest both something about the issue and about those PIGs' power. Moreover, as detailed in Table 1, other nonindustry participants—including academics, public intellectuals, and members of Congress—submitted comments. Though these were fewer in number, they contained significantly more substance than the public citizen comments, as would be expected.

At the same time, however, the implications to be drawn from this comment activity are probably quite different from the conclusions one might draw about the public's dedication to an issue about which a regulatory body had

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107. DeFigueiredo, *supra* note 102, at 987 (documenting scant individual participation in FCC rulemaking, outside of a few high-salience issues); Thomas C. Beierle, *Discussing the Rules: Electronic Rulemaking and Democratic Deliberation* 10–11 (Resources for the Future, Discussion Paper No. 03-22, 2003), *available at* http://ageconsearch.umn.edu/bitstream/10681/1/dp030022.pdf (same with respect to Department of Transportation rulemakings).

108. *See* Coglienese, *supra* note 101, at 953–54; Mariano-Florentino Cuéllar, *Rethinking Regulatory Democracy*, 57 ADMIN. L. REV. 411, 449 (2005).

109. *See supra* note 16 and accompanying text.

received 8,000 individuated comments expressing both concern about and, importantly, knowledge regarding the terms of a particular legislative enactment. Certainly, submitting a form letter does not require the same level of investment as the detailed comments submitted by financial institutions and trade groups.[110] As we shall see in Part II.C, Volcker Rule interpretation is also a high-salience issue to financial firms, particularly the large banks most affected by it, and they are willing to expend large resources toward influencing that interpretation.

2. The Content

The remaining 515 comments submitted by private individuals that were not traceable to the PIG form letter yield a useful comparison to letters from other groups. Table 2 breaks down the comments by group and word count. Figure 2 displays this information graphically, showing the distribution of word count by private individuals not using the PIG form (in light gray), private individuals using the form (in dark gray), and all others (in black).

There are three spikes in the data, at less than 50 words, at 200–249 words, and at 250–299 words (note the larger sizes of the two far right bins, representing comments with 350–799 words and those with 800 words or more). The spikes at 200–249 words and 250–299 words represent the PIG form letter and its slight variations, discussed above (in its original form the letter is 244 words). The spike at comments of less than 50 words represents only letters from private individuals.

The shortest comment—only a single word, "regulate"—was submitted by a private individual.[111] The longest comment, received from the Securities Industry and Financial Markets Association ("SIFMA"), measures 19,500 words.[112] The industry and trade group comments are, as a general rule, lengthy and contain cogent arguments in support of a generally narrow interpretation of the Volcker Rule's scope of prohibited activity. Overall, they advance detailed legal arguments relying on numerous statutes and cases, reference the Dodd–Frank legislative history, and often contain thorough empirical data. Most are meticulously argued and carefully drafted.

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110. At a minimum, we might conclude that the Volcker Rule is not an issue of the highest salience to the public, meaning: "This is my most important issue. I would drop whatever I am doing and turn to this issue whenever asked." Mesquita, *supra* note 103. The same is likely not true for financial institutions affected by the Volcker Rule. *See infra* Part II.D (discussing the financial industry's investment in influencing Volcker Rule implementation); *see also* Shabnam Mousavi & Hersh Shefrin, *Prediction Tools: Financial Market Regulation, Politics and Psychology*, 3 J. RISK MGMT. FIN. INSTITUTIONS 318, 325–26 (2010) (assigning a Dodd–Frank salience measure of 99 out of 100 to financial firms).

111. *Comment from Val Laurent, Activist*, REGULATIONS.GOV (Nov. 6, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1094. Punctuation, spelling, and typographical errors in this and the following comments are all retained from the original sources.

112. *Comment from Randolph Snook, SIFMA*, REGULATIONS.GOV (Nov. 5, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0908.

This does not mean, however, that industry and trade group letters necessarily contain unique information and arguments. In fact, a close substantive read of these comments suggests that, within each industry subgroup, the arguments and evidence are quite similar. As Stuart Benjamin and Art Rai conclude in an analysis of industry and trade group comment letters to the Federal Communications Commission, "the words differed, but the arguments did not."[113]

In contrast, comments from the general public tend to be short—the average word count, excluding the PIG form letters, is only 86, and roughly half of the comments, again excluding those using the PIG form letter, are less than 50 words. In addition, these public comments by and large lack specific suggestions or recommendations for interpreting and implementing the Volcker Rule; generally urge that the rule be "enforced" or "adopted"; contain many grammatical, punctuation, and typographical errors; and express extreme anger at the banks and, often, at the political system as well.

One letter, from which this Article's title is drawn, aptly illustrates these points. Note the writer's anger and his "working class versus the big banks" mentality:

> in regards to the Volker Rule, just how stupid do you think the working class is? we just passed the two bills of financial reform and here, not even 3 months later, you big banks are at it again to screw joe the plummer. aren't you wondering why everyone is preferring to do business at a credit union over a bank? how about all of us that have canceled all of our credit cards? whatch it or we all might just pull all of our money out of the banks and make you go under! and lose your home![114]

Another commenter, echoing a common refrain, considers banks criminals and wonders why they are not yet jailed: "Please pass the Volker Law!. I am disgusted that banks were deregulated over the last 8 yrs which caused this economic disaster and now they want to weaken the laws that were just passed! They should be jailed. Where are the arrests!! They are all criminals!"[115]

Another, like many of the private individual letter writers, echoes the working class versus rich banks theme exemplified by the "joe the plummer" commenter. Her family, unlike the "unscrupulous" bank CEOs and shareholders, works for its money:

> The Volker Rule is critical to preventing banks from unscrupulous banking activities. At the expense of American citizens, their dependants, and their posterity banks have made trillions of dollars for their CEO's and shareholders. It is time to stop their inner-circle deals and demand justice for every American. I will not allow some

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113. Stuart Minor Benjamin & Arti K. Rai, *Fixing Innovation Policy: A Structural Perspective*, 77 GEO. WASH. L. REV. 1, 74 (2008).

114. *Comment from Ronnie Endre*, *supra* note 1.

115. *Comment from Katherine Myskowski, Public Citizen*, REGULATIONS.GOV (Nov. 4, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0528.

> bank to rob me and my familiy of everything that we work for with our blood, sweat, and tears.[116]

This raw anger at the banks pervades the public comments. They are "fools . . . [and] hogs"[117] that should be "put . . . in jail," and receive "no more passes"[118] or "bailouts with citizens' money."[119] Wall Street caused "a HUGE amount of destruction and are busily going Who? Me? now."[120] Regulators, for their part, must impose "control" lest the banks "continue to screw up,"[121] and must "[s]top the fraud."[122] Indeed, the entire country is on the wrong track. We need to get "back to industry" so that our country "produces and exports things," rather than finance, which "export[s] jobs and produc[es] poverty for people who actually work."[123]

Many commenters express dissatisfaction with the political system that enabled Wall Street to accumulate so much power. One commenter sees "no reason to waste my time voting" unless "we replace the regulations we had on Wall Street."[124] Urges another: "Don't let Big Banks write the rules!"[125] One writer finds it "craven" that elected officials are accountable to big business, rather than to the citizens:

> Obviously we need to do as much as we can to control the banks which ruin this country. They have already heisted most of the money—to allow them to continue unimpeded would be sheer lunacy. We understand the relationship between the money big business gives elected officials and the laws that are written and we are sick and tired of laws being written by and for big business at the expense of human beings. this is craven—there is no other word for it—and it much stop. the volker rule and any others that are

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116. *Comment from Amy Margolis, Lebanon Property Management*, REGULATIONS.GOV (Nov. 4, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0523.

117. *Comment from Dan Guerena, Change.org*, REGULATIONS.GOV (Nov. 4, 2011), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0555.

118. *Comment from Katherine Myskowski, Public Citizen*, REGULATIONS.GOV (Nov. 4, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0530.

119. *Comment from Abigail Winston*, REGULATIONS.GOV (Nov. 3, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0285.

120. *Comment from Bill Jaynes, Swan River Software*, REGULATIONS.GOV (Oct. 28 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0294.

121. *Comment from Ann McGill, Public Citizen*, REGULATIONS.GOV (Nov. 4, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0430.

122. *Comment from Abigail Winston, supra* note 119.

123. *Comment from Dan Guerena, supra* note 117.

124. *Comment from Mary Lou Czupek, Public Citizen Member*, REGULATIONS.GOV (Oct. 28, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0240.

125. *Comment from Victor Escobar, Member of Americans for Financial Reform*, REGULATIONS.GOV (Nov. 03, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1058.

> meant to regulate the banks and keep more people's money from disappearing in the maw of corporate america the better.[126]

Though some consider regulators, like the banks they regulate, "crooks [who] will ignore this,"[127] others urge regulators to stand firm against the "rapacious financial institutions":

> Surely you understand the necessity of standing firm for the subject prohibitions as promoted by the distinguished Paul Volcker. You will be facing gale force threats, bribes, and deceptions from financial institutions who have amply proved they care not one whit for the economic health of the country, for the strategic national interest, or even the longevity of their own institutions; subordinating all of this to their greed for bonuses that can lock in generations of family wealth in just a few years of gambling with other people's money. Without the full strength of this prohibition, the nation is doomed to be blackmailed again to rescue a kidnapped economy. You can't allow this, if you have one shred of integrity. You must ignore the promises and prospects for lucrative employment by the rapacious financial institutions anf do what is right.[128]

These letters are notable for several reasons and confirm many of the intuitions gleaned from the review of the Dodd–Frank legislative process in Part I, and the analysis of form letters in the prior Subsection. The individual citizen letters reveal disgust and anger over perceived Wall Street excesses and expose a "Wall Street versus Main Street" mentality. People are angry about the economy, about the plight of working people, and about the politicians who they hold responsible for these outcomes. But importantly, the citizen letters provide no substantive guidance to FSOC on how to interpret and enforce the Volcker Rule's complex and ambiguous provisions. Indeed, the letters provide little evidence that commenters even understand, or care, what proprietary trading or fund investment is, much less the ways in which the Volcker Rule might govern such activities.[129]

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126. *Comment from Rachel Kaplan, the Village Way*, REGULATIONS.GOV (Nov. 5, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0966.

127. *Comment from Leo Stack*, REGULATIONS.GOV (Nov. 5, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-0990.

128. *Comment from Critz George*, REGULATIONS.GOV (Nov. 6, 2010), http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1202.

129. DeFigueiredo and Cuéllar each find similar results. DeFigueiredo's examination of FCC filings from 1999 to 2004 reveals that the media ownership rules received more filings than any other issue but were largely identical texts, mass electronic mailings, and simple click-throughs that failed to demonstrate an individual understanding of the complex issues. DeFigueiredo, *supra* note 102. Cuéllar's analysis of three rules issued by the Treasury Department, the Federal Election Committee ("FEC"), and the Nuclear Regulatory Commission ("NRC") concluded that "[i]ndividual commenters often came across as being angry and exasperated," failed to understand "the distinction between the regulation and the statute," and rarely offered "anything remotely resembling a concrete proposal." Cuéllar, *supra* note 108, at 443.

The contrast with the meticulously drafted, argued, and researched—though far less numerous—letters from financial industry members and trade groups is stark.

D. The Meeting Logs

1. Introduction

As part of the new transparency efforts associated with Dodd–Frank implementation, the Treasury Department, Federal Reserve, CFTC, SEC, and FDIC began disclosing their contacts regarding Dodd–Frank shortly after the bill was signed into law in July 2010. These logs give some insight into the work of Dodd–Frank statutory interpretation and implementation that goes on behind closed doors: Who is meeting with the regulators that will ultimately determine the scope of the Volcker Rule? What interests do they represent? What are the topics on which they are meeting? What questions are being asked and answered, and what sort of information is being conveyed? These logs are especially noteworthy given the previously discussed importance of the preproposal period to final policy outcomes, combined with the traditional inaccessibility of this data.

There is wide variation in the amount and quality of information provided by the federal agency meeting logs concerning the Volcker Rule, both across agencies and across meetings for any given agency. As a general rule, the Federal Reserve's logs were the most detailed, while the CFTC's contained the least information. Although all agency logs disclose the date, starting time, and format of the meeting (for example, a conference call versus a live meeting), as well as the names and affiliations of the parties in attendance, there are large differences in the level of detail surrounding the subject matter of the meeting. Some meeting logs disclose only that the parties met to discuss the Volcker Rule,[130] while others provide detail on the specific topics discussed, as well as the parties' positions on those topics. For example, according to Federal Reserve meeting logs, at a January 20, 2012 meeting American Bankers Association representatives raised concerns about the application of the Volcker Rule to small banks, argued that some small banks were surprised to learn that the Volcker Rule may apply to their activities, and expressed concerns that some banks could not comply with the Volcker Rule by the July 21, 2012 effective date.[131]

Despite these differences, it is possible to form educated guesses about the general content of the meetings, even when detailed meeting logs are absent. Often, parties that met with federal agencies on the Volcker Rule also submitted comment letters. These comment letters provide some insight into the likely concerns and positions raised during agency meetings. This mechanism—

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130. *See, e.g.*, *External Meetings: Americans for Financial Reform*, U.S. COMMODITY FUTURES TRADING COMM., http://www.cftc.gov/LawRegulation/DoddFrankAct/ExternalMeetings/dfmeeting_031212_1433 (last visited Feb. 11, 2013).

131. FED. RESERVE, MEETING BETWEEN FEDERAL RESERVE BOARD STAFF AND REPRESENTATIVES OF THE AMERICAN BANKERS ASSOCIATION JANUARY 20, 2012 (2012), *available at* http://www.federalreserve.gov/newsevents/rr-commpublic/aba-meeting-20120120.pdf.

extrapolating information regarding informal participation from formal participation records—has been used by other researchers for similar purposes, for example, to estimate *ex parte* contacts.[132]

In addition, one can sometimes divine the likely content (or, at least, eliminate certain content) of meetings based on the combination of participants. A participant at a meeting that includes representatives of Goldman Sachs, J.P. Morgan Chase, and Morgan Stanley, for example, is unlikely to be meeting for the purpose of urging the relevant agency to apply the Volcker Rule in a manner that severely restricts banking entity activity.

2. The Numbers

Table 3 shows the federal agency meetings with financial institutions in which the Volcker Rule was discussed. These meetings occurred between July 21, 2010, the date of presidential signing, and October 11, 2011, the date of the NRPM. J.P., Morgan Chase, Goldman Sachs, and Morgan Stanley met with federal agencies most frequently on the Volcker Rule, with 27, 22, and 19 meetings, respectively. This accounts for nearly 20% of financial institution meetings with federal agencies on the Volcker Rule.[133] In total, there were 351 financial institution meetings with federal regulators regarding the Volcker Rule during this time period, which accounts for more than 78% of all such meetings during the relevant time period, as shown by Table 8 and Figure 3.

Table 4 shows federal agency meetings with law firms in which the Volcker Rule was discussed. Each of these law firms represents financial institutions or financial industry trade groups, and representatives of those institutions or trade groups were typically also in attendance at each meeting. In total, these law firms met with the federal agencies charged with Volcker Rule implementation 35 times during the relevant time period. Sullivan & Cromwell, Davis Polk, and Debevoise met most frequently with federal regulators, with 11, 9, and 8 meetings each.

Table 5 shows federal agency meetings with financial industry trade associations, lobbyists, and policy advisors to discuss the Volcker Rule—a total of 32 meetings. SIFMA and the Financial Services Roundtable met most frequently with federal agencies—eight and five times, respectively.

Table 6 shows federal agency meetings with public interest, labor, research, and advocacy groups to discuss the Volcker Rule—a total of 19 meetings, nearly 40% of which are with labor union representatives.[134] Finally,

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132. *See, e.g.*, Susan Webb Yackee, *The Politics of Ex Parte Lobbying: Pre-Proposal Agenda Building and Blocking During Agency Rulemaking*, 22 J. PUB. ADMIN. RES. & THEORY 373, 381–82 (2012) (using this technique and citing similar uses).

133. "Financial institution" is defined broadly in this Subsection to include not only commercial and investment banks, but also asset managers, investment advisors, and insurance companies.

134. Labor unions are included in Table 6 because of their advocacy on behalf of a strong Volcker Rule.

Table 7 shows a total of 12 meetings by other persons and organizations: namely, Senators Merkley and Levin and their staffs and Paul Volcker and his staff.

In sum, whereas financial industry representatives met with federal agencies on the Volcker Rule a total of 351 times, there were only 31 meetings with entities or groups that might reasonably be expected to act as a counterweight to industry representatives in terms of the information provided and the types of interpretations pressed (those listed in Tables 6 and 7). This is nearly the same number of times that a single financial institution—J.P. Morgan Chase—met with federal agencies on Volcker Rule interpretation and implementation. As shown by Table 8 and Figure 3, financial institutions, financial industry trade groups, and law firms representing such institutions and trade groups collectively accounted for 93.1% of all federal agency Volcker Rule meetings, whereas public interest, research, advocacy, and labor groups, and other persons and organizations, accounted for only 6.9%.

This is not meant to suggest that these very different types of financial industry members raised identical concerns at every meeting. To the contrary, the exact subject matter of the meetings appeared to differ according to the particular regulatory concern faced by each group. The important point for these purposes, however, is that nearly all of the industry representatives that met with federal agencies on the Volcker Rule were seeking clarifications on the rule's application to their activities—most often, a clarification that the Volcker Rule would not prohibit the activities in question.

This latter observation is an important point, as dissension among important industry actors ensures that agencies will receive competing views and information on the Volcker Rule, even in the absence of effective participation by public interest groups and other potential watchdogs. For example, one might have predicted that some industry segments—perhaps, hedge funds—would view banks' proprietary trading activities as competing with their own operations and would advocate on behalf of the Volcker Rule in order to advance their own competitive positions. But this is not the case. Instead, the meeting logs, when combined with the comment letters, suggest that hedge and private equity fund Volcker Rule activity has largely centered on the rule's impact on their own activities. Specifically, hedge and private equity fund comment letters and meeting logs reveal concerns that restrictions on banks' fund investments will economically harm the hedge and private equity fund business, request delays in implementation and effective dates, and argue that the Volcker Rule should be interpreted narrowly to permit certain fund investment activity by banks.[135]

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135. *See, e.g.*, FED. RESERVE, MEETING BETWEEN FEDERAL RESERVE BOARD STAFF AND REPRESENTATIVES OF BLACKROCK, INC. ("BLACKROCK") JUNE 30, 2011 (2011), *available at* http://www.federalreserve.gov/newsevents/rr-commpublic/black_rock_meeting_20110630.pdf (discussing the Volcker Rule's impact on BlackRock's business model); Letter from Alternative Investment Management Association to Financial Stability Oversight Council (Nov. 5, 2010), *available at* http://www.aima.org/objects_store/aima_-_comments_to_fsoc_on_nbfcs_-_5_nov_10.pdf (noting the potential adverse impact of the Volcker Rule's restrictions on the hedge and private equity fund industry); Letter from

Similarly, Senators Merkley and Levin (the Volcker Rule's sponsors), among others, promoted the Volcker Rule as a means to reduce conflicts of interest between banking entities and their customers caused by proprietary trading operations.[136] One might, therefore, predict that large institutional investors would be highly involved in Volcker rulemaking, to ensure that this purported benefit of the legislation is not undercut. However, large institutional investors are notably absent from Volcker Rule administrative activity, at least in the preproposal phase. Although the Council of Institutional Investors submitted a comment letter supporting the Volcker Rule, it is short (under 300 words) and nonsubstantive.[137] The Council did not meet with agencies in person on the Volcker Rule, though it did meet in connection with other Dodd–Frank provisions.[138] On the rare occasions when institutional investors met with federal agencies on the Volcker Rule, the topic appears to concern the Volcker Rule's application to their own activities, rather than to the proprietary trading or fund activities of banking entities.[139]

Moreover, not all agency meetings are created equal. Many of the meetings in Table 3 are group meetings, often part of an industry trade association meeting. For example, 27 separate financial institution representatives were listed in attendance at an April 7, 2011 SIFMA–SEC meeting with Chairman Schapiro.

Perhaps more telling, nearly all of the Table 6 contacts are group meetings of this type. For example, representatives of AFL-CIO, Laborer's International Union of America, AFSCME, and SEIU are logged for an October 13, 2010 SEC meeting with Kayla J. Gillan and Jim Burns. These are four of the five meetings by public interest, labor, and advocacy groups with the SEC (Americans for Financial Reform met separately with the SEC on April 13, 2011). And all of the CFTC meetings with public interest, labor, and advocacy groups on the Volcker Rule took place together, on March 16, 2011.

In addition, the identity (or number) of agency representatives at certain meetings may signal something about the importance of the event. For example,

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Private Equity Growth Capital Council to Financial Stability Oversight Council, *supra* note 78 (expressing concern about the impact of the Volcker Rule on private equity funds).

136. *See* Merkley & Levin, *supra* note 4, at 549 ("The Merkley–Levin provisions' broad restrictions on proprietary trading should significantly reduce the opportunities for conflicts of interest in trading.").

137. E-mail from Jeff Mahoney, Gen. Counsel, Council of Institutional Investors, to Timothy Franz Geithner, Chairman, Fin. Stability Oversight Council (Oct. 28, 2010), *available at* http://s3.documentcloud.org/documents/12382/councilinstitutionalinvestors-letter-to-fsoc.txt (supporting the Volcker Rule due to the conflicts of interest created by proprietary trading at depository institutions and their holding companies).

138. FED. RESERVE, MEETING BETWEEN FEDERAL RESERVE BOARD STAFF AND REPRESENTATIVES OF INVESTORS IN MORTGAGE PRODUCTS APRIL 6, 2011 (2011), *available at* http://www.federalreserve.gov/newsevents/rr-commpublic/investors_mortgage_20110406.pdf (discussing section 941 of the Dodd–Frank Act).

139. *See, e.g.*, FED. RESERVE, MEETING BETWEEN FEDERAL RESERVE BOARD STAFF AND REPRESENTATIVES OF TIAA-CREF OCT. 19, 2010 (2010), *available at* http://www.federalreserve.gov/newsevents/rr-commpublic/TIAA_CREF_Meeting_20101019.pdf (discussing the application of the Volcker Rule's restrictions to insurance companies).

the log for an August 3, 2010 CFTC meeting with SIFMA and ISDA at which the Volcker Rule was discussed (along with other Dodd–Frank provisions) lists 53 SEC and CFTC staff members in attendance. But Goldman Sachs' CEO, Lloyd Blankfein, is logged as meeting alone with SEC Chairman Mary Schapiro; Chief of Staff Didem Nisanci; and Robert Cook, Director of Trading & Markets, on March 9, 2011. Mr. Blankfein met with Chairman Schapiro again on October 8, 2010 at an SEC–Financial Services Roundtable meeting, at which Jamie Dimon of J.P. Morgan, Robert H. Benmosche (President and CEO of AIG), Richard K. Davis (President and CEO of U.S. Bancorp), and other major financial institution CEOs are logged as being in attendance.

3. Section Summary

The meeting log data reaffirm the impression gained from the analysis in prior Subsections: The Volcker Rule contained substantial gaps and ambiguities on key issues, generating an intense interest in the rule's implementation that began as soon as the legislation was signed. Notably, federal agency contacts with industry representatives significantly outpace those of any other group in terms of both quantity and quality. This finding is consistent with the limited number of other studies examining the preproposal period.[140]

Moreover, financial industry interests appear, at least from these data, more unified in their interests than press reports and the legislative history would predict, reducing the probability that conflict among powerful interest groups will diminish the influence of any single position. This is an important finding, and one that can be discerned only by an examination of agency-level data. Prior research has documented a measurable influence of preproposal interest group activity on final agency rules when there is a high level of consensus among those groups.[141]

Finally, the data demonstrate continuing interest in, and oversight of, the Volcker Rule by Senators Merkley and Levin (the provision's sponsors) and by Paul Volcker (the provision's original architect).[142] While it is true that other members of Congress hostile to the Volcker Rule have also remained involved in the rulemaking process, those contacts appear, at least based on documented evidence, limited to comment letter activity.[143] No other congressional members or elected officials have committed the human capital that Merkley, Levin, and Volcker have. Is this attention sufficient to offset any superior influence enjoyed by a unified regulated industry? It is impossible to determine from these data at this stage of the rulemaking process. However, Susan Webb Yackee finds that the

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140. *See* Wagner, Barnes & Peters, *supra* note 14, at 125 ("[The] pre-NPRM period was almost completely monopolized by regulated parties.").

141. David Nelson & Susan Webb Yackee, *Lobbying Coalitions and Government Policy Change: An Analysis of Federal Agency Rulemaking*, 74 J. POL. 339, 340 (2012).

142. *See infra* Table 7.

143. *See supra* notes 85–86 and accompanying text.

more congressional attention a rule enjoys, the less interest group influence the final rule exhibits.[144]

CONCLUSION

Statutes, like contracts, can be more or less complete, but will inevitably have some gaps and ambiguities that courts or agencies must fill. In neither setting—contract or statute—is this outcome necessarily bad.[145] To the contrary, lawmakers may delegate such discretionary authority to other governmental branches for a variety of salutary reasons. For example, statutory incompleteness may allow lawmakers to harness the expertise of courts and agencies, provide the flexibility to adapt the statute to changing circumstances, or reduce the transaction costs associated with lawmaking.[146]

Proprietary trading and fund investment are technical questions of financial regulation about which federal agencies have substantial expertise and experience. Understandably, Congress relied on that experience and expertise for much of the definitional work of the Volcker Rule. But the Volcker Rule is not by any means the type of low-salience rule that characterizes the bulk of daily administrative work. Instead, the political conditions surrounding Dodd–Frank's passage suggest unusual populist pressure to address the perceived power and problems posed by large financial institutions, which the public blamed for the financial crisis, the bailouts that followed it, and the continuing economic woes of the average working American. This populist pressure was met with intense lobbying by affected financial institutions in an effort to, if not stave off regulation entirely, at least minimize the damage that financial reform would cause. As evidenced by the data, that populist pressure and industry interest continued into the rulemaking phase.

Against this economic and political background, Dodd–Frank arose, purportedly to stop "'too big to fail' [and] to protect the American taxpayer by ending bailouts."[147] But the Volcker Rule—largely an afterthought by the Obama administration, which considered the rule unworkable and unnecessary—was an essential concession to gain political support from Dodd–Frank critics who argued that the law did too little to restrict risky banks. As a result, the Volcker Rule—like many other Dodd–Frank provisions—entered the rulemaking process both highly incomplete and highly contested, thus ensuring the importance of the rulemaking process and of interest group attempts to influence that process.

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144. Susan Webb Yackee, *Assessing Inter-Institutional Attention to and Influence on Government Regulations*, 36 BRIT. J. POL. SCI. 723, 725 (2006).

145. Parties may leave contractual gaps and ambiguities for a variety of innocuous reasons, including bounded rationality and the high transaction costs of specifying precisely all future contingencies. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 93 (1989). Such gaps may also be strategic. *Id.* at 94.

146. *See generally* Scott Baker & Kimberly D. Krawiec, *The Penalty Default Canon*, 72. GEO. WASH. L. REV. 663 (2004).

147. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, pmbl., 124 Stat. 1376 (2010).

Thanks to the Obama administration's new transparency efforts under Dodd–Frank, scholars are able to view that agency-level activity from the moment after presidential signing—well before the NPRM phase that triggers most of the Administrative Procedure Act's docketing and transparency requirements. This information, seldom available to researchers up to this point, confirms what, with the exception of a handful of studies, has been largely an intuition: The preproposal phase is a battleground for agenda setting and that battleground is dominated by regulated industry. Though this Article ends with the NPRM and thus cannot document the effectiveness of these attempts, other researchers have found such preproposal activity critical to final rule development.[148]

Countervailing voices were not entirely absent on the Volcker Rule. Angry citizens sent in letters by the thousands, potentially shading FSOC's view of the public salience of the Volcker Rule and of the relative power of relevant PIGs. But the comment letter findings are consistent with much prior research on public comment letters—they are short, angry, duplicative, and provide little, if any, useful substantive information. It is precisely this type of data that has prompted some researchers to question the efficiency and utility of informal notice and comment as a means of generating public input.[149]

Other countervailing voices include PIGs, academics, and three individuals involved in crafting the original legislation—Senators Merkley and Levin and Paul Volcker. This latter group, as suggested by prior research, may be a particularly effective counterweight to regulated industry.

Finally, there is a notable lack of countervailing voices within the financial industry itself. Industry segments, such as institutional investors, that might (based on press reports and the legislative history) be expected to fight any weakening of Volcker Rule protections that supposedly accrue to their benefit are almost entirely absent from the preproposal stage. Whether this is because the benefits of the legislation to those parties was overstated, or because, for whatever reason, they have found it unnecessary to join in Volcker Rule administrative activity during the preproposal phase is unclear, though research on later rulemaking stages should shed light on this question.

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148. *See, e.g.*, Keith Naughton et al., *Understanding Commenter Influence During Agency Rule Development*, 28 J. POL'Y ANALYSIS & MGMT. 258 (2009).

149. Benjamin & Rai, *supra* note 113, at 74–75; DeFigueiredo, *supra* note 102, at 992–93.

Table 1: Number of Comments by Submitter		
Private Individuals	1,281	93.2%
Private Individuals Using Public Citizen Form	766	55.7%
Private Individuals Not Using Public Citizen Form	515	37.5%
Industry Trade Groups	26	1.9%
Asset Management	16	1.2%
Public Interest, Research, Advocacy, and Labor Groups	14	1.0%
Academics/Public Intellectuals	12	0.9%
Insurance Companies/Employee Benefits	10	0.7%
Financial Institutions	8	0.6%
Congress	7	0.5%
Total	**1,374**	**100%**

Table 2: Word Count Statistics

	Average Comment Length (Words per Comment)	Total Words
Longest Comment		19,500
Shortest Comment		1
All Private Individuals	187	239,547
Private Individuals Not Using PIG Form	86	44,290
Academics/Public Intellectuals	1,522	18,264
Asset Management	2,055	32,880
Congress	2,651	18,557
Insurance Companies/Employee Benefits	2,761	27,610
Public Interest, Research, Advocacy, and Labor Groups	3,465	48,508
Financial Institutions	3,852	30,816
Industry Trade Groups	4,027	104,702
All	379	520,884

Table 3: Financial Institution Meetings with Federal Agencies to Discuss the Volcker Rule, July 26, 2010 to October 11, 2011

Organization	Treasury	CFTC	SEC	Federal Reserve	FDIC	Total	%
J.P. Morgan Chase	8	2	6	11		27	7.7
Goldman Sachs	7	2	7	6		22	6.3
Morgan Stanley	2	2	7	6	2	19	5.4
Bank of America	2	2	5	6		15	4.3
Barclays	2	2	4	6		14	4
Credit Suisse	2	1	6	5		14	4
Citigroup	2	1	4	6		13	3.7
BNY Mellon	4	1	4	2		11	3.1
RBC	1		5	4	1	11	3.1
State Street	2	1	4	4		11	3.1
Deutsche Bank	1	2	3	3		9	2.6
GE Capital	3		3	3		9	2.6
BlackRock	3		3	2		8	2.3
Wells Fargo	2	1	3	1		7	2
BB&T	2		1	2	1	6	1.7
BNP Paribas		3	1	1		5	1.4
Prudential	1		2	2		5	1.4
MetLife	1		2	1		4	1.1

RBS	2		1	1	4	1.1
UBS	1		1	2	4	1.1
HSBC	1			2	3	0.9
Northern Trust	1		1	1	3	0.9
PNC Financial	1		1	1	3	0.9
Principal Financial Group	1		1	1	3	0.9
Silicon Valley Bank Financial Group			1	2	3	0.9
Sun Trust	1		1	1	3	0.9
U.S. Bancorp	1		2		3	0.9
Allstate			2		2	0.6
Ameriprise Financial	1		1		2	0.6
Brown Brothers Harriman	1			1	2	0.6
Edward Jones			2		2	0.6
Harris Bank	1		1		2	0.6
ING			1	1	2	0.6
Lincoln Financial	1			1	2	0.6
Millennium Partners	1	1			2	0.6
Nationwide	1			1	2	0.6
Nomura	1			1	2	0.6
Pyramis Global Advisors	1	1			2	0.6

Societe Generale		1	1		2	0.6
T. Rowe Price	2				2	0.6
The Hartford	1			1	2	0.6
TIAA-CREF	1			1	2	0.6
Zions Bank	1		1		2	0.6
AIG			1		1	0.3
Alexandra & James LLC			1		1	0.3
Alliance Bernstein Special Opportunities and Advisory Services	1				1	0.3
Allianz	1				1	0.3
Arab Bank Plc				1	1	0.3
Atlanta Capital Management		1			1	0.3
AXA Financial			1		1	0.3
Banco Itau BBA				1	1	0.3
BancWest Corp			1		1	0.3
Bank of Montreal				1	1	0.3
BankcorpSouth			1		1	0.3
Brevan Howard	1				1	0.3
BTM UFJ				1	1	0.3
Cantor Fitzgerald			1		1	0.3

Capital Research and Management	1			1	0.3
Capstone	1			1	0.3
Carlyle	1			1	0.3
Charles Schwab & Co.	1			1	0.3
CIBC World Markets Corp.			1	1	0.3
City National Bank		1		1	0.3
Comerica Inc.	1			1	0.3
Commerzbank AG			1	1	0.3
Credit Agricole			1	1	0.3
Crossroads Strategies LLC	1			1	0.3
Davidson Companies		1		1	0.3
Discovery Capital Management	1			1	0.3
Dodge & Cox	1			1	0.3
Estrada Hinojosa		1		1	0.3
Fidelity		1		1	0.3
Fifth Third Bancorp	1			1	0.3
Glenview Capital	1			1	0.3
Highfields Capital	1			1	0.3
Hovde Capital	1			1	0.3
Huntington Bancshares Incorporated	1			1	0.3

ICAP			1	1	0.3
Janney Montgomery Scott		1		1	0.3
Jefferies		1		1	0.3
John Hancock	1			1	0.3
KeyBank National Association	1			1	0.3
Knight Capital Group		1		1	0.3
Loomis, Sayles & Company		1		1	0.3
Lord Abbett & Co.		1		1	0.3
LPL Financial		1		1	0.3
M.R. Beal & Company		1		1	0.3
MasterCard		1		1	0.3
Mitsubishi UFJ Financial Group, Inc.			1	1	0.3
Mizuho Corporate Bank, Ltd.			1	1	0.3
Moore Capital Management	1			1	0.3
National Australia Bank			1	1	0.3
National Bank of Pakistan			1	1	0.3
Natixis Global Asset Management			1	1	0.3
New York Life			1	1	0.3
Nomura Holding America		1		1	0.3

Pershing LLC (BNY Mellon subsidiary)			1		1	0.3
PIMCO	1				1	0.3
PioneerPath Capital	1				1	0.3
Protective Life Corp.			1		1	0.3
Putnam Investments	1				1	0.3
Raymond James Financial			1		1	0.3
Round Table IMC	1				1	0.3
Scott & Stringfellow LLC (BB&T Affiliate)			1		1	0.3
Soros Fund Management LLC	1				1	0.3
Standard Chartered Bank				1	1	0.3
Stephens Inc.			1		1	0.3
Stifel, Nicolaus & Company			1		1	0.3
SVB Financial Group		1			1	0.3
Swiss Re			1		1	0.3
TD Bank	1				1	0.3
Thomson Reuters				1	1	0.3
Thrivent	1				1	0.3
Tolleson Wealth Management				1	1	0.3
Toyota			1		1	0.3

Tudor Investment Corporation	1			1	0.3
UnionBanCal Corp			1	1	0.3
Unum			1	1	0.3
USAA	1			1	0.3
Webster Bank			1	1	0.3
Wellington Asset Management		1		1	0.3
Western Asset Management Co.	1			1	0.3
Wiley Bros.			1	1	0.3
Total				**351**	**100%**

Table 4: Federal Agency Meetings with Law Firms to Discuss the Volcker Rule, July 26, 2010 to October 11, 2011

Organization	Treasury	CFTC	SEC	Federal Reserve	FDIC	Total	%
Sullivan & Cromwell	2	2	2	4	1	11	31.4
Davis Polk		3	3	3		9	25.7
Debevoise & Plimpton	3		2	3		8	22.9
WilmerHale	1			1		2	5.7
Barnett, Sivon & Natter			1			1	2.9
Cleary Gottlieb Steen & Hamilton				1		1	2.9
Haynes & Boone, LLP				1		1	2.9
Schiff Hardin			1			1	2.9
Skadden Arps				1		1	2.9
Total						**35**	**100%**

Table 5: Federal Agency Meetings with Trade Associations, Lobbyists, or Policy Advisors to Discuss the Volcker Rule, July 26, 2010 to October 11, 2011

Organization	Treasury	CFTC	SEC	Federal Reserve	FDIC	Total	%
SIFMA		4	3	1		8	24.2
Financial Services Roundtable			2	2	1	5	15.2
American Council of Life Insurers	1		1	1		3	9.1
ABA Securities Association	1			1		2	6.1
AIMA (Alternative Investment Management Association)	1		1			2	6.1
Clearinghouse Association	1			1		2	6.1
Institute of International Bankers				2		2	6.1
Managed Funds Association					2	2	6.1
Foreign Exchange Committee Chief Dealers Working Group				1		1	3.0
Greg Wilson Consulting			1			1	3.0
ISDA		1				1	3.0
Private Equity Growth Capital Council	1					1	3.0
The Financial Services Forum			1			1	3.0
Washington Analysis		1				1	3.0
Woodbine Associates			1			1	3.0
Total						**33**	**100%**

Table 6: Federal Agency Meetings with Public Interest, Labor, Research, and Advocacy Groups to Discuss the Volcker Rule, July 26, 2010 to October 11, 2011

Organization	Treasury	CFTC	SEC	Federal Reserve	FDIC	Total	%
Americans For Financial Reform	2	1	1	1		5	26.3
AFL-CIO	1	1	1			3	15.8
AFSCME	1		1			2	10.5
Demos	1	1				2	10.5
Public Citizen	1	1				2	10.5
Better Markets	1					1	5.3
Laborer's International Union of America			1			1	5.3
SEIU			1			1	5.3
Third Way Capital Markets Initiative Advisory Group (TWCMIG)	1					1	5.3
University of Massachusetts	1					1	5.3
Total						**19**	**100%**

Table 7: Federal Agency Meetings with Other Persons and Organizations to Discuss the Volcker Rule, July 26, 2010 to October 11, 2011

Organization	Treasury	CFTC	SEC	Federal Reserve	FDIC	Total	%
Senator Carl Levin and/or Staff		1	3	1		5	41.7
Senator Jeff Merkley and/or Staff		1	3	1		5	41.7
Paul Volcker and/or Staff		1		1		2	16.7
Total						**12**	**100%**

Table 8: Federal Agency Meetings to Discuss the Volcker Rule: July 26, 2010 to October 11, 2011

Financial Institutions		Law Firms Representing Financial Institutions		Financial Industry Trade Associations, Lobbyists, or Policy Advisors		Public Interest, Research, Advocacy, and Labor Groups		Other Persons and Organizations	
J.P. Morgan Chase	27	Sullivan & Cromwell	11	SIFMA	8	Americans For Financial Reform	5	Senator Carl Levin and/or Staff	5
Goldman Sachs	22	Davis Polk	9	Financial Services Roundtable	5	AFL-CIO	3	Senator Jeff Merkley and/or Staff	5
Morgan Stanley	19	Debevoise & Plimpton	8	American Council of Life Insurers	3	AFSCME	2	Paul Volcker and/or Staff	2
Bank of America	15	WilmerHale	2	ABA Securities Association	2	Demos	2		
Barclays	14	Barnett, Sivon & Natter	1	Alternative Investment Management Association	2	Public Citizen	2		
Credit Suisse	14	Cleary Gottlieb Steen & Hamilton	1	Clearinghouse Association	2	Better Markets	1		
Citigroup	13	Haynes & Boones, LLP	1	Institute of International Bankers	2	Laborer's International Union of America	1		
BNY Mellon	11	Schiff Hardin	1	Managed Funds Association	2	SEIU	1		
RBC	11	Skadden Arps	1	Foreign Exchange Committee Chief Dealers Working Group	1	Third Way Capital Markets Initiative Advisory Group	1		
State Street	11			Greg Wilson Consulting	1	University of Massachusetts	1		
Deutsche Bank	9			ISDA	1				
GE Capital	9			Private Equity Growth Capital Council	1				
BlackRock	8			The Financial Services Forum	1				
Wells Fargo	7			Washington Analysis	1				
BB&T	6			Woodbine Associates	1				
Other Financial Institutions	155								
Total	**351**		**35**		**33**		**19**		**12**
%	**78**		**7.8**		**7.3**		**4.2**		**2.7**

Figure 1. Number of Comments by Submitter

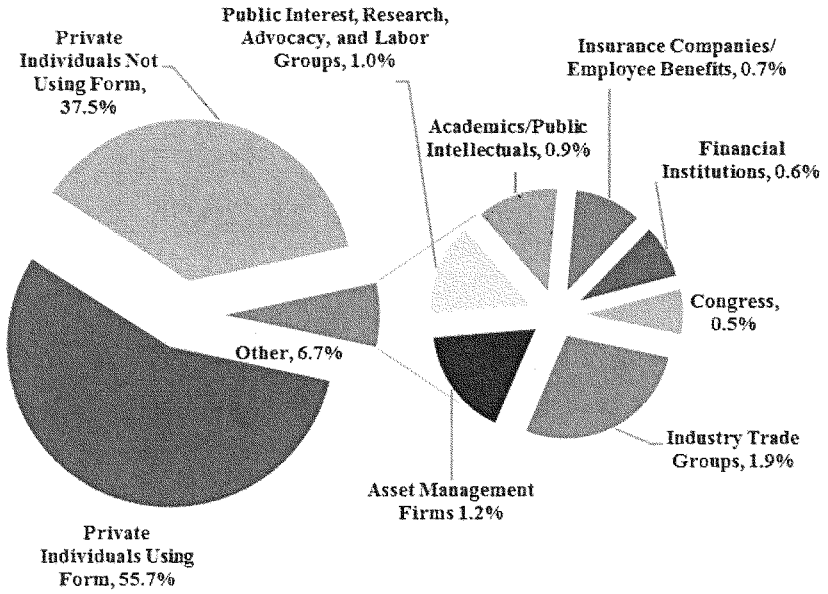


Figure 2. Word Counts By Submitter

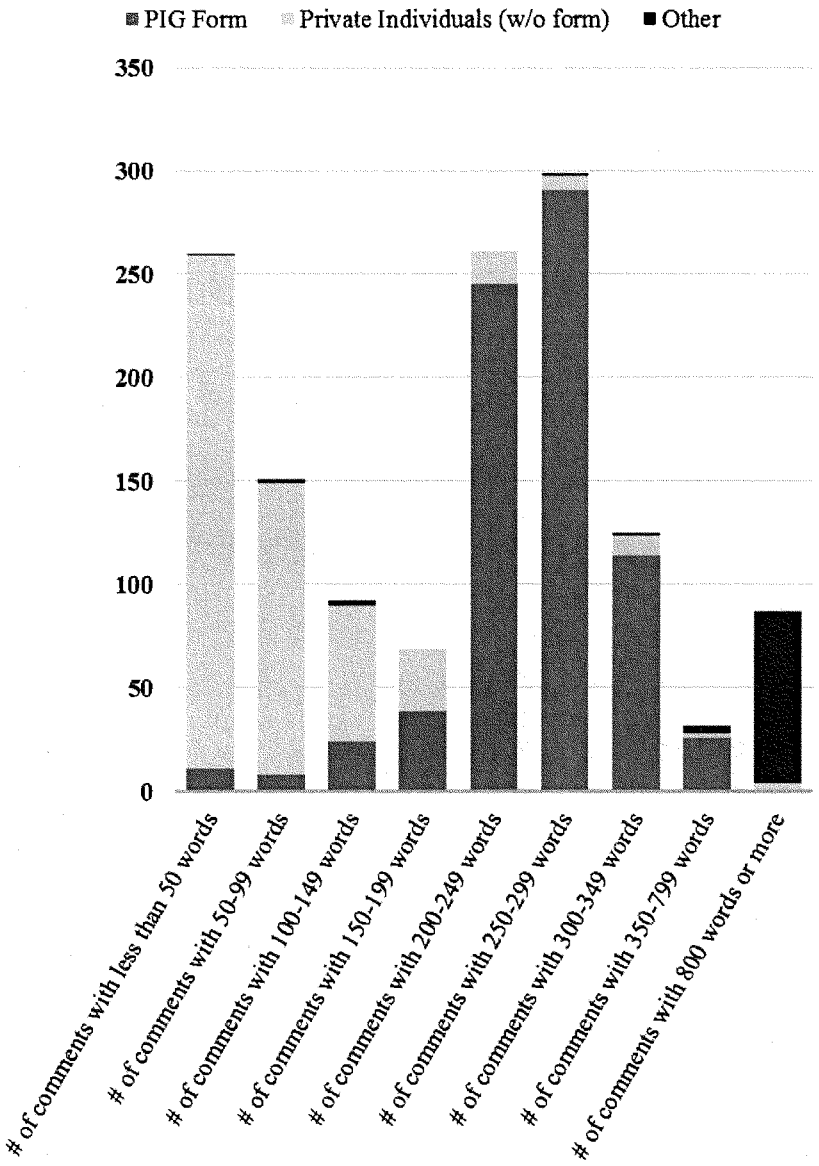
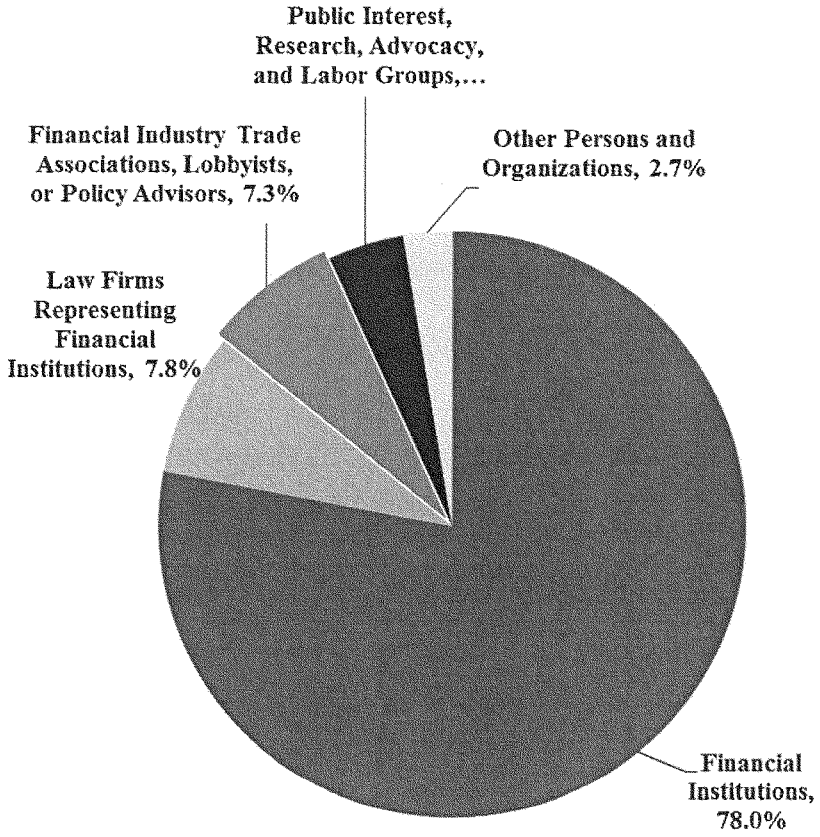


Figure 3. Federal Agency Meetings To Discuss The Volcker Rule: July 26, 2010–October 11, 2011



Appendix: Public Interest Group Form Letter

Just two years after the Wall Street banks were bailed out and just three months after we passed a tough new law to rein them in, the Wall Street bankers want weak regulations so they can keep making risky bets with your money.

Because of the upcoming election, the banks thought nobody would notice that they redeployed their army of more than 1,500 lobbyists to try to weaken the new rules as they're being written.

They were wrong. We noticed. And we need your help to fight back.

Regulators are accepting public comments on the new law's important "Volcker rule." The rule is named for a vocal White House official who called on Congress to stop banks from making risky bets for their own profit while relying on taxpayer bailouts if the bets go bad.

Here's how you can help:

1. Follow this link, and you'll get to the page where you can submit a comment about the Volcker rule.

2. Next, cut and paste the SAMPLE COMMENT that follows this message into the comment box. Fill out all the required information.

3. In the required field that asks for your "Organization Name" write "PUBLIC CITIZEN MEMBER."

4. Click "Submit."

The banks have already submitted their regulatory comments. Now it's our turn!

The Volcker rule will prevent banks from trying to make a quick buck by betting—and possibly losing—trillions of dollars and leaving you with the tab.

It's your money that the regulators should be protecting, not the big banks' risky practices.

Follow this link to submit your comment.

Please copy and paste the SAMPLE COMMENT below. Feel free to edit it and add your perspective on the economic crisis:

RE: Docket ID: FSOC-2010-0002—Public Input for the Study Regarding the Implementation of the Prohibition on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds.

Dear Members of the Financial Stability Oversight Council:

I am writing as a concerned citizen affected by the financial meltdown and bailouts caused by Wall Street banks' high-risk trading. I am submitting this comment pursuant to the Financial Stability Oversight Council's (FSOC) request for comment on Sections 619–621 of the Wall Street Reform and Consumer Protection Act.

Banks should be in the business of lending to America's small businesses and families, not using our money to run a private casino where the House always wins. We never again want to be left on the hook for bad bets by Wall Street.

I urge regulators to implement a strong Volcker Rule:

1) Don't let the exceptions swallow the rule. If banks are profiting from swings in prices, that's prohibited proprietary trading, plain and simple.

2) The rule cannot allow hedge fund bailouts. Bear Stearns ended up spending $3 billion bailing out a hedge fund in which it had invested just $35 million.

3) Regulators must ban any activity that allows banks to bet against their customers, or for that matter creates any material conflict of interest between banks and their customers. Regulators should investigate the full range of ways that Wall Street insiders are profiting at the expense of the rest of us, collect all the trading data needed to monitor the system and protect taxpayers, and then use their new powers to crack down on abuses.

Thank you for your consideration of my views.

April 11, 2016

Chairman Richard Shelby
Senate Committee on Banking
304 Russell Senate Office Building
Washington, DC 20510

Ranking Member Sherrod Brown
Senate Committee on Banking
713 Hart Senate Office Building
Washington, DC 20510

Dear Chairman Shelby and Ranking Member Brown,

The Food Marketing Institute[1] respectfully requests to have this letter submitted into the record for the Senate Banking Committee's hearing entitled, "Assessing the Effects of Consumer Finance Regulations." During the hearing there were several statements made regarding the effectiveness of debit reforms included in the *2010 Dodd-Frank Wall Street Reform and Consumer Protection Act* that we believe merited a response and clarification of the facts. The debit reforms, also referred to as the "Durbin Amendment," have certainly benefitted American consumers, merchants, financial institutions with less than $10 billion in assets, and the economy as a whole. FMI and our member companies strongly support the reforms and will oppose any effort to weaken or repeal the debit reforms included in the law.

American consumers and merchants earned a hard fought victory over escalating, uncontrollable fees with the inclusion of the debit reform measures in the *Dodd-Frank law*. The debit reforms brought a level of transparency (for the first time small businesses can see and know exactly how much they will be charged for a debit transaction from one of the covered institutions) and a level of competition for the first time into a market that was traditionally set behind closed doors, without regard to the costs imposed on American consumers and retailers. This was an essential first step to try to push America's electronic payments system toward a true and open free market with the innovations that allows.

To better understand the origins of the reforms, it is important to understand the history of the U.S. debit market. Banks originally began issuing debit cards as a less expensive and faster alternative to

[1] Food Marketing Institute proudly advocates on behalf of the food retail industry. FMI's U.S. members operate nearly 40,000 retail food stores and 25,000 pharmacies, representing a combined annual sales volume of almost $770 billion. Through programs in public affairs, food safety, research, education and industry relations, FMI offers resources and provides valuable benefits to more than 1,225 food retail and wholesale member companies in the United States and around the world. FMI membership covers the spectrum of diverse venues where food is sold, including single owner grocery stores, large multi-store supermarket chains and mixed retail stores. For more information, visit www.fmi.org and for information regarding the FMI foundation, visit www.fmifoundation.org.

2345 Crystal Drive, Suite 600, Arlington, VA 22202-4801 T 202.452.8444 F 202.429.4519 www.fmi.org

the traditional paper check, and initially there were no "swipe fees" associated with these cards - similar to checks, which under federal law must clear at par. In time, the credit card networks saw debit cards as a tool to deliver additional revenue to their banks by imposing swipe fees on the transactions. These fees were centrally set by the card networks, not the issuing banks, and merchants and their customers were required to pay these fees if they wanted to accept debit or credit cards issued by the card networks without the ability to negotiate or even know the cost of acceptance.

The debit reforms included in the *Dodd-Frank law* directed the Federal Reserve to establish parameters on the allowable centrally-set fees that could be imposed on each of these check-replacement debit transactions by those banks with over $10 billion in assets. It is important to note that any bank with under $10 billion in assets is exempt from the cap, and any bank above the threshold would be exempt if they simply choose to set their own fees as opposed to having them centrally set. These reforms took a balanced approach trying to achieve some level of transparency, predictability and competition with regard to the extreme growth in swipe fees, particularly among the very largest banks, realizing that over 98% of U.S. banks are exempt from the cap.

While the reforms were being debated in the Congress in 2010, opponents raised several concerns that history has proven not to be substantiated. First, opponents of reforms claimed that small banks would be harmed and the exemption of 98% of the banks in the U.S. would not work. In fact, studies from the Federal Reserve Board[2] and the Government Accountability Office[3] have disproven this concern. Just this spring, the Philadelphia Federal Reserve released a report that concluded small banks have not been harmed by the reforms, and in fact have benefitted. The report states "...after the ceiling was imposed, the volume of transactions conducted with cards issued by exempt banks grew faster than it did for large banks."[4] The report further found that interchange revenue for exempt banks continued to rise for small banks.[5]

Opponents of debit reforms also argued that merchants would not pass along any savings achieved from capping interchange fees along to the consumer. History has also disproven this concern as well. The grocery industry functions on razor thin profit margins and our members compete for customers on price every day. If a grocery can realize any savings in the system, it will use it to hold down prices or increase value for its customers. This principle was proven in a study by prominent economist Robert Shapiro who found that consumers have saved nearly $30 billion since the reforms have been in place and merchants have saved more than $10 billion. These savings have permitted merchants, including grocers, hold down price increases, and to reinvest savings into

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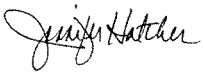
[2] http://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm
[3] http://www.gao.gov/assets/650/648210.pdf
[4] file:///C:/Users/hvlw/Downloads/bt-how_dodd_frank_affects_small_bank_costs.pdf
[5] file:///C:/Users/hvlw/Downloads/bt-how_dodd_frank_affects_small_bank_costs.pdf

their associates, which has supported tens-of-thousand more jobs and significant economic activity.[6] Unfortunately, opponents of reforms simply look at the shelf price of goods from one year to the next without consideration of outside pricing fluctuations not tied to swipe fees. Grocers must consider numerous factors including drought, product recalls, gasoline/energy costs, labor and health care expenses, and others when establishing a shelf price for goods. What is clear since the implementation of the reforms, grocers' profit margins have remained low, and instead, savings have been passed to customers due to intense competition in the food retail marketplace.

The facts are clear; debit reforms are working, and if anything, Congress should act to strengthen them or address the excessive and hidden credit card fees American consumers and merchants pay every year. Bank self-reported data has shown that the cost of accepting debit has actually decreased 44% since the reforms were implemented. By becoming more efficient, the largest issuers are now collecting a profit of almost 500% on a debit transaction currently under the cap.[7] This is even further evidence that the reforms are working and that competition and transparency are indeed a good thing.

FMI appreciates your consideration of our perspective on the debit reforms, and we look forward to working with the Committee and its members moving forward.

Sincerely,



Jennifer Hatcher
Chief Public Policy Officer &
Senior Vice President, Government Relations

CC: Members of The Senate Committee on Banking

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[6] See generally Robert J. Shapiro, The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees (Oct. 1, 2013).

[7] "Volume and Cost Trends in the Debit Card Industry", Merchants Advisory Group White Paper: https://files.ctctcdn.com/26db5c23201/8b43b2a5-993d-4c1a-ac9b-07c8acc488ea.pdf

STATEMENT FOR THE RECORD

OF THE

NATIONAL ASSOCIATION OF CONVENIENCE STORES

AND THE

SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA

FOR THE

HEARING OF THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

APRIL 5, 2016

"ASSESSING THE EFFECTS OF CONSUMER FINANCE REGULATIONS"

This statement is submitted on behalf of the National Association of Convenience Stores ("NACS") and the Society of Independent Gasoline Marketers of America ("SIGMA"). We appreciate the opportunity to offer our views regarding the impact of consumer finance regulations on the retail fuels market.

NACS is an international trade association representing the convenience store industry with more than 2,200 retail and 1,600 supplier companies as members. NACS member companies do business in nearly 50 countries worldwide, with the majority based in the United States. The convenience store industry as a whole operates approximately 153,000 stores across the United States.

SIGMA represents a diverse membership of approximately 260 independent chain retailers and marketers of motor fuel that sell more than 50 percent of motor fuel sold in the United States. Most SIGMA members are involved in gasoline retailing, approximately two-thirds are involved in wholesaling, 36 percent transport product, 25 percent have bulk plant operations, and 15 percent operate terminals.

In 2014, the convenience store and fuel retail industry posted almost $700 billion in total sales, representing approximately 4% of United States GDP. Despite the fact that our members' channel of trade serves about 160 million people per day – around half of the U.S. population – we are an industry of small businesses. More than 70 percent of retail motor fuel and/or convenience stores companies operate ten stores or less—and approximately 63 percent of convenience store owners operate just one store.

In light of the number of fuel and other transactions that our industry engages in, we handle approximately one of every 25 dollars spent in the United States. Our industry is also one of the most competitive in the United States. NACS' and SIGMA's members operate on tiny margins (around 2% or less) and are unable to absorb incremental cost increases without passing them on to consumers. In 2014, for example, the industry paid $11.4 billion in card fees compared to $10.4 billion in pre-tax profits.[1] There is very little space for our retailers to maneuver and cut costs given the exorbitant expenses associated with payment cards. In fact, swipe fees associated with payment card transactions are the second highest operating expense for convenience stores – second only to labor.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), required the Federal Reserve Board ("the Fed") to set standards for assessing whether debit card swipe fees are reasonable and proportional to the costs incurred by the debit card issuer with respect to the transaction.[2] On July 20, 2011, the Fed finalized the Debit Card Interchange Fees and Routing regulations, also known as "Regulation II".[3] The debit reform provision, which was implemented as the Fed's Regulation II, is arguably the single most important federal legislation

[1] NACS, State of the Industry, Annual Report 2014.

[2] Pub.L. 111–203 (July 21, 2010). *See generally*, Section 1075 of Dodd-Frank (15 USC 1693p, 1693q; 15 USC 1693o–2)(requiring the Fed to set reasonable fees and rules for debit transactions).

[3] *See* 12 C.F.R. Part 235 [Reg. II], *available at* https://www.gpo.gov/fdsys/pkg/FR-2011-07-20/pdf/2011-16861.pdf.

affecting our industry as it provides a method of addressing the market failure which exists with respect to debit card swipe fees.

While debit fees should have been reduced even further than they have been to date under Regulation II, overall, the impact of reform on the payment system, retailers, consumers, and the vast majority of financial institutions has been a net positive. By requiring the Fed to lower retailers' costs of accepting debit transactions, debit reform made it possible for small businesses to pass on savings to consumers in the form of lower prices which, in turn, led to increased economic activity. By making debit swipe fees resemble something slightly closer to a competitive market, the law made it possible for small banks to flourish. Overall, debit reform has benefited financial institutions and many other sectors of the American economy.

I. By injecting competition into the payments card market – a non-competitive market riddled with inefficiencies – debit reform has widely benefited consumers and businesses.

Payment card costs, which include swipe fees as the largest component, represent the single largest operating expense in our industry behind payroll expenses. By requiring the Fed to regulate debit card swipe fees, which represent only one part of the $11.4 billion in card fees that our industry paid in 2014, debit reform is widely regarded by retailers as one of the most important laws implemented by Congress. Debit reform has not only benefited our industry, it benefits consumers. This is because the cost of debit and the escalating cost of credit card transactions, which are borne directly by retailers, are paid by consumers through higher prices.[4] The debit card market is characterized by centralized price-fixing among competing banks. Basically, the card networks and the major banks centrally set prices—and the banks, which should be competing against one another, agree to charge the same fees. This results in dramatically inflated fee levels. Because of these fees, American consumers pay inflated prices for virtually everything they buy. Swipe fees are effectively a regressive national sales "tax" levied on all consumers through price fixing. The Fed's debit swipe fee regulations have benefitted consumers and businesses and have not negatively impacted financial institutions.

Prior to the enactment of Dodd-Frank, debit card swipe fees increased rapidly – and costs increased along with them because they were not disciplined by competitive market forces. After reform, however, a study by the Merchant Advisory Group found that between 2009 and 2013, issuers' self-reported average cost of handling debit transactions had decreased by 42%, from 7.6 cents to 4.4 cents.[5] While NACS and SIGMA have maintained that the Fed should have reduced debit fees even further, the impact of banks reducing costs when faced with a somewhat

[4] A report by the Hispanic Institute found that over 97% of the cost of payment cards is passed on to consumers – whether they pay with cards or cash - translating into over 3 cents per every gallon of fuel sold in the United States as of 2009. *See* Effraim Berkovich, PhD, "Cross-subsidization of Consumers in the Payment Card Market," Hispanic Institute, November 2009. This number may have increased over time as consumers use payment cards on increasing percentages of their transactions.

[5] Merchant Advisory Group, Volume and Cost Trends in the Debit Card Industry (2015), *available at* https://files.ctctcdn.com/26db5c23201/8b43b2a5-993d-4c1a-ac9b-07c8acc488ea.pdf.

more competitive fee structure is striking and demonstrates the benefits of Fed Regulation II. Financial institutions, like other businesses, need pricing pressures to create incentives to discipline their costs.

II. Debit reform has protected small businesses and consumers from the anti-competitive debit card market and has resulted in an overall improvement in the payments marketplace and the economy.

When the Fed was first considering how to implement debit reform, some falsely assumed that payment card issuers would compete down the price of interchange fees below any standard amount set by the Fed and that market pressures would force issuers who were exempt from the regulation to reduce their prices to compete with regulated institutions. Neither of those things has happened. Swipe fees have been raised across the board to the limits set by the Fed and exempt institutions have continued to charge the same rates they did before Regulation II – even though those rates are, on the whole, higher than regulated rates. These responses show that swipe fees are not set in a competitive market and that regulation is necessary.

A. Debit Reform has benefitted American consumers.

According to noted economist Robert Shapiro,[6] in the first year after the Fed implemented debit reform (2012), the reduction in debit swipe fees under the Federal Reserve's regulation generated almost $6 billion in lower prices for consumers and $2.6 billion in merchant savings, which supported 37,501 new jobs. Those numbers were just the initial net benefits of debit swipe fee reform in its first year of implementation.

B. Today, most American consumers have access to free checking.

Although critics of debit reform continue to spin yarns about a loss of free checking since the Fed's regulation of debit swipe fees, those statements misrepresent what is actually happening on the ground. According to the American Bankers Association, today, most Americans "pay nothing at all" for bank services, including checking account maintenance.[7] In fact, the number of Americans reporting that they pay nothing for their checking accounts has **increased** since 2010 – precisely the opposite of what critics pretend.[8]

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[6] Robert J. Shapiro, Chairman, Sonecon, LLC, *The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees* (Oct.1, 2013).

[7] American Bankers Association, *Survey: Most Americans Pay Nothing for Bank Services* (Aug. 18, 2015), *available at* http://www.aba.com/Press/Pages/081815SurveyonBankCosts.aspx.

[8] *See* Adam Levitin, *The Myth of the Disappearing Free Checking Account*, Credit Slips (Oct. 22, 2015), *available at http://www.creditslips.org/creditslips/2015/10/the-myth-of-the-disappearing-free-checking-account.html.*

In addition, smaller banking institutions, such as credit unions, are better able to compete with larger banks by offering free checking to consumers. In fact, 76 percent of credit unions now offer free checking, a 4 percent increase from 2015.[9]

Critics of debit reform have used misleading data to try to blame changes in bank offerings on debit reform. For example, they use figures relating to free checking offerings in 2009 – two years before debit reforms took effect – to set a false high-water mark for free checking. Those critics also completely ignore the market forces, such as the financial crisis and historically low interest rates, that have led banks to change their checking offerings since 2008-9. Finally, those critics fail to note that many of the largest financial institutions that have received reduced swipe fee revenue due to reforms have reported increased earnings in many of the years that reform has been in place.

In short, none of the critics' arguments about free checking pass muster. The best evidence available leads to precisely the opposite conclusion than the one critics assert. As measured from the time debit reform went into effect, if anything there is now more free checking available to consumers.

C. Debit reform has allowed regional banks and other smaller, insured depository institutions to thrive as they are able to compete against larger institutions.

Over the past few years, many large, medium-size, and small banks that have assets below $10 billion and are exempt from debit reform have complained that debit reform is still harmful to their industry. According to those banks, the competition between large and small banks would reduce debit swipe fees at all banks even though most are exempt. This simply has not happened. In fact, the Economic Research Department at the Philadelphia Federal Reserve Bank has recently published an article disproving these claims.[10] Specifically, the authors found that "evidence does not support the claim that competitive forces have effectively imposed the interchange fee ceiling on small banks."[11] Rather,

> There is substantial evidence that the ceiling did lower interchange fees collected by banks with assets above $10 billion, from around 44 cents to about 22 cents per transaction. But there was no such decline for small banks. Furthermore, after the ceiling was imposed, the volume of transactions conducted with cards issued by exempt banks grew faster than it did for large banks… interchange revenue fell

[9] *Credit unions: Where free checking still reigns* (Mar. 8, 2016), *available at* http://www.bankrate.com/finance/checking/want-free-checking-check-out-credit-unions-1.aspx.

[10] James DiSalvo and Ryan Johnston, Federal Reserve Bank of Philadelphia, Research Department, *Banking Trends: How Dodd-Frank Affects Small Bank Costs. Do Stricter Regulations Imposed After the Financial Crisis Pose a Significant Burden?* (First Quarter 2016).

[11] *Id.* at 17.

substantially at large banks after the fee ceiling was imposed but continued rising for small banks.[12]

The bottom line is that debit reform has benefitted banks with less than $10 billion in assets and helped them increase their debit swipe fee revenues. Only the largest 100-plus institutions have seen a reduction in swipe fee revenue – and for many of them that reduction was tiny because debit cards are a tiny part of their business.

Debit swipe fee reform has increased, not decreased, revenues for smaller financial institutions. Reform has benefitted small banks so that they can better compete for market share and grow their profits.

III. Conclusion

Debit swipe fee reform has protected small businesses, including convenience stores, and created savings for consumers. The reason for this is simple: the statute has limited the ability of the card networks to price-fix anticompetitive fee levels for the largest banks. This has led to greater efficiency by those banks, crated opportunities for small banks to compete more effectively, led to consumer savings and helped small businesses. These reforms have had a positive impact and critics who say otherwise can only cite to studies funded by the credit card and banking industry to try to deny that reality.

[12] *Id.*

Small business owners. Small business values.

April 5, 2016

The Honorable Richard Shelby
304 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Sherrod Brown
713 Hart Senate Office Building
Washington, D.C., 20510

Dear Chairman Shelby and Ranking Member Brown:

On behalf of the Main Street Alliance, a national network of state-based small business coalitions, I am writing to express enthusiastic support for the Consumer Financial Protection Bureau (CFPB) and to oppose any attempt to weaken the Bureau's ability to protect consumers and enact critical financial reforms.

As you are well aware, the 2008 crash caused the worst economy since the Great Depression, decimating the labor market. While all businesses suffered from the crisis, the economic wreckage caused by the financial industry disproportionately hurt small businesses. At the peak of the recession, the job loss rate for businesses with fewer than 50 employees doubled that of businesses with 500 or more employees.[1] And between 2007 and 2012, an astonishing 60 percent of the total net job losses were in the small business sector. To this date, the job creation rate of small businesses lags well behind the pre-recession levels, and small businesses widely struggle to obtain sufficient financing.[2]

Lawmakers passed the Dodd-Frank bill and created the CFPB to ensure that such a crisis never again happens. Less than five years in, the CFPB has already proven itself an able and effective agency. Highlights of its accomplishment include:

- Returning more than $11 billion to individuals cheated by financial companies;
- Crafting new rules outlawing unaffordable, predatory mortgages that instigated the financial collapse;
- Securing $1.8 billion in refunds from credit card customers of the largest banks for worthless add-on products like fraud monitoring services and deceptively-marketed insurance products;
- Securing $530 million from a for-profit school that swindled students and then engaged in illegal debt collection in its private student loan program; and

[1] Mills, Karen Gordon and Brayden McCarthy. "The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game." Harvard Business School, July, 2014.
[2] Mills, Karen. Ibid.

The Main Street Alliance - 6827 4th St. NW, Suite 1220, Washington, DC 20036
(202) 263-4529 - www.mainstreetalliance.org

- Creating a complaint system to help consumers, small businesses, and the Bureau spot worrisome practices.

Beyond these accomplishments, the CFPB has an ambitious agenda ahead. It is working on rules to safeguard economically vulnerable people and communities against the abuses of triple-digit-interest debt-trap lenders; to rein in the use of take-it-or-leave-it forced arbitration clauses to bar wronged consumers from taking companies to court; and to stop illegal debt collection activities. And, of particular interest to small business owners, the CFPB will soon be collecting publicly available small business loan data—information that has been difficult to come by, but is essential to increase access to capital for small businesses, particularly female-owned and minority-owned.

CFPB opponents often invoke small businesses in their opposition, claiming that its regulatory and enforcement actions are burdensome or job-killing. However, the Main Street Alliance firmly believes that these protections are the necessary safeguards to enable businesses and entrepreneurs to take the financial risks to start or expand their business. For instance, 63 percent of small business owners used their personal assets, such as their homes or personal savings, as collateral to secure financing, and over half used personal savings to finance their business.[3] As such, protecting these "consumer investments" is critical to small business success. Likewise, removing forced arbitration clauses that disempower consumers is beneficial to small businesses, who are subject to the same clauses whenever they seek to set up internet or phone service, open a credit card account, or rent a car.

Furthermore, when consumers' financial lives are held hostage to predatory payday loans or student loans that lock them in a cycle of debt, businesses suffer. Under the weight of this debt, customer dollars are siphoned away from the local economy, consumer demand for goods and services slackens, and Main Street businesses lose revenue. Strong, local businesses depend upon robust enforcement by the CFPB.

The CFPB has made enormous strides in creating a fairer marketplace in which small businesses, consumers, and local economies can thrive. The Main Street Alliance urges the CFPB to continue this work ahead and promptly move forward on each of the nine priorities it has identified for the next two years.[4] We are particularly eager to see the issuance of a robust small business lending data collection regulation that includes accessible and comprehensive data broken down by, among other fields, race, economic status, census tract, loan type, and action taken on the application.

Thank you again for the opportunity to express Main Street Alliance's views. If you have any questions, please contact Michelle Sternthal, Deputy Director of Policy and Government Affairs, at 202-263-4529 or michelle@mainstreetalliance.org.

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[3] "2015 Small Business Credit Survey: Report on Employer Firms." Federal Reserve Bank of Atlanta. https://www.frbatlanta.org/-/media/Documents/research/small-business/survey/2015/report-on-employer-firms/2015-report-on-employer-firms.pdf?la=en.

[4] CFPB Fact Sheet, Policy priorities over the next two years (Feb. 25, 2016), http://files.consumerfinance.gov/f/201602_cfpb_policy-priorities-over-the-next-two-years.pdf

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Sincerely,

Amanda Ballantyne
National Director
Main Street Alliance

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Written Statement of

Christine Hines
Legislative Director, National Association of Consumer Advocates

Before the
U.S. Senate Committee on Banking, Housing, and Urban Affairs

"Assessing the Effects of Consumer Finance Regulations"

April 5, 2016

Chairman Shelby, Ranking Member Brown, and Members of the Committee:

The National Association of Consumer Advocates (NACA) is a nonprofit association whose members are private and public sector attorneys, legal services attorneys, law professors, and law students committed to representing consumers' interests. NACA is actively engaged in promoting a fair and open marketplace that forcefully protects the rights of consumers, particularly those of modest means. Supporting reasonable safeguards against unfair and deceptive business practices, and ensuring that corporations comply with state and federal consumer protection laws are continuing priorities.

For the hearing titled, "Assessing the Effects of Consumer Finance Regulations," we write to commend the ongoing efforts of the Consumer Financial Protection Bureau to curb predatory practices in the financial sector, as a general matter, and specifically, the Bureau's announced intention to promulgate rulemaking to address corporations' use of pre-dispute binding mandatory (or "forced") arbitration against American consumers.

Over the last six years, the Bureau has engaged in multiple pursuits to monitor the financial marketplace and enforce laws under its jurisdiction. These activities include its rigorous collection and analysis of data; its supervision and examination of financial services providers and their systemic practices and conduct; and its enforcement actions against financial institutions that violate critical consumer financial protection laws. The CFPB's work has resulted in billions of dollars returned to consumers and consequential changes to predatory industry practices. Through these and other actions the Bureau has identified and addressed some of the worst unfair, abusive and deceptive practices in debt collection, credit reporting, student loans, payday loans, back accounts, and other products and services.

For example, for debt collection alone, which recently surpassed mortgages as the most complained-about product on the Bureau's complaint database,[1] CFPB's law enforcement actions in 2015 involving debt collection practices have resulted in over $360 million in consumer relief.[2] The enforcement actions and examinations also have spurred some changes in industry conduct that will help to alleviate consumer harm from abusive debt collection.

We also support the Bureau's rulemaking agenda and its work to set appropriate standards and practices in lending and other financial products. We expect to review upcoming proposed rulemaking for payday loans, debt collection practices, and prepaid cards. We are especially looking forward to the Bureau's exercise of its explicit authority to regulate the use of forced arbitration terms in corporate-written financial contracts that require consumers to resolve disputes in private, individual arbitration proceedings instead of in open court. We have long condemned these provisions as a serious

[1] CFPB, Monthly Complaint Report, Vol. 9, March 2016, http://1.usa.gov/1S41VeB.
[2] Fair Debt Collection Practices Act CFPB Annual Report 2016, at 27, http://1.usa.gov/25GtXXQ.
[2] Fair Debt Collection Practices Act CFPB Annual Report 2016, at 27, http://1.usa.gov/25GtXXQ.

imposition on consumers' rights and freedom, and a damaging tool that corporate entities use to avoid responsibility for harmful conduct.

A Comprehensive Data-Driven Study on the Use of Forced Arbitration

The Dodd-Frank Wall Street Reform and Consumer Protection Act[3] required the CFPB to study the use of predispute arbitration clauses in consumer financial products or services, and to provide a report to Congress. It also authorized the CFPB to write a rule consistent with the study to prohibit or limit the use of forced arbitration clauses in consumer financial products or services if it is in the public interest and for the protection of consumers.

In 2012, the CFPB launched a study on arbitration and spent the next three years compiling and analyzing data and collecting stakeholder feedback. The study presented data on the prevalence of the practice, including the use of terms that prohibit consumers' participation in class actions, litigation outcomes, and arbitration outcomes. The effort resulted in the most comprehensive and evidence-based examination ever of forced arbitration in consumer contracts.

(A) *The Study Process.* The Bureau's multi-year study process included the following:

The CFPB officially launched its study with a public request for information. It received comments from public interest organizations, industry trade associations, law firms and individuals. Afterward, the CFPB scheduled meetings with stakeholders.[4] In June 2013, the CFPB launched a telephone survey to study consumer awareness and perception of arbitration clauses with a Federal Register notice and invited public comment.[5]

The CFPB released preliminary results from the study in December 2013.[6] The Bureau held a public field hearing to discuss the findings, inviting participation from industry and consumer interests. It also announced that it would hold stakeholder meetings.[7]

The CFPB issued a second Federal Register notice on its proposed telephone survey on consumer awareness, inviting public comment.[8] The Office of Management and Budget approved the CFPB's request to proceed with the consumer awareness survey.

The CFPB released the final arbitration report in March 2015. It held a second field

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[3] 12 U.S. Code § 5518 (a).
[4] *Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, CFPB-2012-0017-0001, April 27, 2012, http://1.usa.gov/1N59nVB.
[5] *Agency Information Collection Activities; Proposals, Submissions, and Approvals*, CFPB-2013-0016-0001, June 7, 2013, http://1.usa.gov/23bhxVx.
[6] *CFPB Arbitration Study Preliminary Results*, Dec. 2013, http://1.usa.gov/18WUWEy.
[7] CFPB, *Live From Dallas!*, Dec. 12, 2013, http://1.usa.gov/1XcG0X1,
[8] *Agency Information Collection Activities; Proposals, Submissions, and Approvals*, CFPB-2014-0011-0002, May 29, 2014, http://1.usa.gov/1W6dlEy.

hearing and announced that it would hold roundtables with stakeholders.[9] In October 2015, the CFPB released an initial proposal for its arbitration rulemaking prepared for a Small Business Regulatory Enforcement Fairness Act (SBREFA) panel review.[10] The Bureau held a third public field hearing on arbitration, inviting public feedback from business and consumer interests.[11]

(B) Key Study Findings. Forced arbitration clauses are unfair and everywhere:

The Bureau found that tens of millions of consumers that use financial services and products are subject to forced arbitration clauses and class action bans, including in their credit cards, bank accounts, prepaid cards, credit reporting services, and student loans. For example, almost all [98.5%] of licensed payday loan storefronts that the CFPB studied in California and Texas used contract terms with forced arbitration clauses, while only 1.5% did not use forced arbitration clauses.

• Almost all forced arbitration clauses in financial services and products also prohibit consumer participation in class actions: 93.9% of credit card arbitration clauses; 88.5% of checking account arbitration clauses; 97.9% of prepaid card arbitration clauses; 88.7% of storefront payday loan arbitration clauses; 100% of private student loan arbitration clauses; and 85.7% of mobile wireless arbitration clauses.

• The Bureau's data revealed that very few consumers can vindicate their rights in arbitration on an individual basis, especially for small-dollar losses. In its study, the Bureau identified only on average about 8 cases per year involving a debt dispute of $1,000 or less, and only about 25 cases per year involving an affirmative consumer claim of $1,000 or less.

• Its examination of class action in financial services makes clear that consumers receive remedies in class actions for harm in financial services: Across consumer finance markets, at least 160 million class members were eligible for relief over a five-year period. The settlements totaled $2.7 billion in cash, in-kind relief, and attorney's fees and expenses – [roughly 18 percent went to expenses and attorneys' fees].

• Based on data from its consumer telephone survey, the Bureau concluded that consumers are not aware of and do not understand the impact of arbitration clauses. Consumers are unaware of whether their credit card contracts include arbitration clauses. Consumers' beliefs about dispute resolution rights bears little to no relation to the actual contract terms. Despite provisions that restrict their rights, most believe that they can sue in court for wrongdoing and participate in class actions. Fewer than 7 percent recognized that they could not sue their credit card company in court.

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[9] CFPB, *Arbitration Study: Report to Congress 2015*, http://1.usa.gov/1EPG8nT and Live From Newark!, http://1.usa.gov/18xSGDQ.
[10] CFPB, *Small Business Advisory Review Panel For Potential Rulemaking On Arbitration Agreements; Outline Of Proposals Under Consideration And Alternatives Considered*, Oct. 7, 2015, http://1.usa.gov/1MpolPr.
[11] CFPB, *Live From Denver!*, http://1.usa.gov/226ymhW.

• The CFPB also found no evidence that arbitration clauses led to lower prices for consumers, as corporate representatives often claim. The CFPB compared companies that use arbitration clauses and prohibit class actions with companies that had eliminated forced arbitration from their consumer contracts. It found no statistically significant evidence that the companies that removed the arbitration clauses increased their prices or reduced access to credit.

Restoring Consumer Choice in the Marketplace

Based on its study findings, the Bureau announced that it would undertake a rulemaking to regulate the use of forced arbitration in financial services. Specifically, the Bureau has initially proposed to bar the use of class action bans in financial services contracts and to require reporting of individual arbitration claims and awards, which it would consider releasing to the public.

Although we have long called for the outright elimination of forced arbitration clauses in consumer contracts, we strongly support this step that the Bureau is proposing to take to restrict the use of class action bans, the worst aspect of arbitration clauses. We have been aware and have studied the consequences of forced arbitration on consumers and the markets, but now that the CFPB has collected and examined an unprecedented amount of data, the conclusion is irrefutable: forced arbitration and class action bans unfairly deny consumers' right to seek recourse for financial injuries caused by corporate misconduct.

The data makes clear that class actions bans are an unreasonable burden on consumer rights. Small-dollar claims prevalent in financial services, such as illegal charges and fees and abusive interest rates, are not heard in arbitration or court because most people cannot practically seek remedies for those losses individually. These claims simply are better pursued on a class basis. The Bureau's decision to eliminate class action bans would restore a critical right for consumers in the marketplace. It is in the public interest for consumers to have the freedom to band together to seek remedies and accountability for wrongdoing.

We also agree with the Bureau's findings in its initial proposal that state and federal governments with their limited resources, cannot sufficiently monitor and enforce laws for the entire financial services marketplace on their own. The marketplace benefits from consumers' ability to privately enforce rights and remedies granted to them in consumer protection laws. In 2014, state attorneys general submitted a letter to the Bureau confirming a similar view that private enforcement of laws supplements the work of state officials.[12]

Finally, the Bureau's decision to limit the use of arbitration clause is consistent with recent decisions by Congress and other federal agencies to seek to provide adequate avenues of redress for harmed consumers. For example: (a) the Dodd-Frank Act barred forced arbitration in residential mortgages and lines of credit, and prohibited forced

[12] *Letter from State Attorneys General to Director Richard Cordray*, Nov. 19, 2014, http://1.usa.gov/1xGl6WS.

arbitration of whistleblower claims under the Sarbanes-Oxley Act of 2002; (b) Congress has protected auto dealers from forced arbitration in their transactions with auto manufacturers; (c) employees of government defense contractors with Title VII and sexual assault tort claims are shielded from forced arbitration (the federal government is finalizing an executive order to similarly protect employees of all federal contractors); (d) Military members and their dependents cannot be forced into arbitration for a wide range of high- cost loans (payday, etc.).[13] Currently, the Centers for Medicare and Medicaid Services is considering protections from forced arbitration for nursing home residents,[14] and the Department of Education[15] similarly is reviewing protections for students of colleges and universities.

These actions demonstrate that there is acute concern about the practice and its impact on individuals who participate in the respective sectors and markets. The CFPB's anticipated action for consumer financial services, supported by its evidence-based report, is consistent with the activities of other areas of government that similarly seek to protect the public interest by restoring ordinary Americans' access to remedies.

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[13] Pub. L. 107-273, 15 U.S. Code § 1226); 48 CFR 252.222-7006; 10 U.S.C. 987(e)(3) and (f)(4) and 79 Fed. Reg. 58602.

[14] *Medicare and Medicaid Programs: Reform of Requirements for Long-Term Care Facilities*, CMS-2015-0083-0001, July 16, 2015, http://1.usa.gov/1V4XpD4.

[15] *U.S. Department of Education Takes Further Steps to Protect Students from Predatory Higher Education Institutions*, March 11, 2016, http://1.usa.gov/1WfKxYc.

CFPB Must End Abusive Forced Arbitration and Class Action Bans in Consumer Financial Services

A top priority of the Consumer Financial Protection Bureau (CFPB) is to protect American consumers from unfair, deceptive and abusive financial products. Few practices are as abusive, unfair and deceptive as the widespread use of forced arbitration clauses written into millions of contracts for financial goods and services. These terms strip consumers of their right to go to court and to participate in class actions when companies cheat or rip them off. Instead, they are forced into a private system set up by an industry that favors big banks, payday lenders, debt settlement and auto financing companies and other financial institutions at the expense of consumers.

The CFPB is authorized to write a rule on the use of forced arbitration under the Dodd-Frank Wall Street Reform and Consumer Protection Act. In July 2015, it announced its intention to begin rulemaking, and has completed a small business review of its proposal. The CFPB can look to its own compelling data as it decides on the details of a rule that protects consumers from forced arbitration.

CFPB study is roadmap for rule to restore consumer access to the court system.

In March 2015, the CFPB released a comprehensive, 728-page, three-year study on the widespread use of forced arbitration that demonstrated a fundamental lack of access to justice for millions of consumers and the potential for harm to the financial markets. The CFPB found that:

Forced arbitration clauses are unfair and everywhere in the consumer financial services market: Tens of millions of consumers that use financial services and products are subject to forced arbitration clauses and class action bans, including credit cards, checking accounts, prepaid cards and student loans.

Forced arbitration prohibits consumer participation in class actions: Almost all of the arbitration clauses CFPB studied forbid consumers from participating in class actions.

Few consumers can go to arbitration, especially for small-dollar claims. The CFPB data showed very few small-dollar claims – such as for illegal charges and fees – are brought in individual arbitration. There were only on average about 8 cases per year involving a debt dispute of $1,000 or less and only about 25 cases per year involving an affirmative consumer claim of $1,000 or less.

Eliminating arbitration clauses & restoring access to courts do not raise prices for consumers. Industry players argue that restricting access to court lowers consumer prices. The CFPB found no evidence to support their claim. In a comparison of companies that use arbitration clauses and prohibit class actions with companies that had eliminated forced arbitration from their consumer contracts, the CFPB found no statistically significant evidence that the companies that removed the arbitration clauses increased their prices or reduced access to credit.

Systemic, widespread misconduct is better addressed in class actions. The data showed that common complaints, such as wrongful overdraft fee charges on bank statements, that would typically motivate customers to contact their banks, were not adequately resolved. Instead, consumer remedies for the widespread predatory charges affecting millions were recovered in class action settlements. Meanwhile, banks that enforced arbitration clauses and class action bans in their contracts evaded accountability for the illicit charges because the terms denied their customers adequate access to remedies.

Consumers are not aware of and do not understand the impact of arbitration clauses: Data showed that consumers are unaware of whether their credit card contracts include arbitration clauses. Despite provisions that restrict their rights, most consumers believe that they can sue in court for wrongdoing and participate in class actions. Fewer than 7 percent recognized that they could not sue their credit card company in court.

The CFPB should use its full authority to restore consumers' choice to go to court.

No consumer financial contract should block consumers' ability to go to court as an individual or as part of a class action.

The study showed that even bolded and underlined language describing forced arbitration terms does not adequately inform consumers about the meaning and consequences of forced arbitration. Similarly, disclosures and other cosmetic changes to arbitration clauses will fail to restore consumer choice in the market. The data makes clear that only voluntary arbitration, chosen by both parties after the dispute arises, sufficiently restores consumer access to remedies.

The rampant use of forced arbitration and the demonstrated harm to consumers were unmistakable before the CFPB conducted its study. However, the CFPB's data-driven and evidence-based examination of the practice shed considerable light on the issue. The CFPB spent three years, 2012 to 2015, examining the use of forced arbitration in financial services. The study presented comprehensive data on the prevalence of forced arbitration, litigation outcomes and arbitration outcomes. Despite the evidence, bank lobbyists suggest that the CFPB should take even more time to gather additional evidence.

It would be a huge step backwards for the public interest and a tremendous gift to the worst actors on Wall Street and others in the financial sector if rulemaking was delayed any further. Based on the ample proof it has presented, it is time for the CFPB to exercise its authority to write a rule to protect consumers from forced arbitration and class action bans.

Support the CFPB's Authority to Restore Consumer Rights in the Financial Marketplace

After the well-documented abuses that led up to the 2008 financial crisis, Congress authorized the Consumer Financial Protection Bureau to restore consumers' legal rights by regulating the use of forced arbitration clauses in financial services contracts. These are terms inserted in contracts that bar consumers from going to court to seek remedies for harm, and instead force consumers to resolve disputes in private arbitration on an individual basis.

After a three-year examination of the issue, the CFPB released a comprehensive, data-driven study on the use of forced arbitration and class action bans in consumer financial contracts. The study confirmed that forced arbitration is a rigged system that favors corporations over ordinary American consumers. The CFPB can act now to restore consumers' ability to join together to seek remedies for harm. However, despite the strong evidence supporting action, corporate interests are lobbying against this much-needed protection. Here are a few myths that corporate lobbyists are circulating, and the facts to refute those myths:

Myth: Forced arbitration benefits consumers and gives them a fair place to resolve disputes.

FACT: Forced arbitration simply eliminates consumer claims. It provides almost no relief to consumers harmed by illegal or abusive practices in the financial services sector. Many forced arbitration clauses prohibit consumers with similar small claims (such as wrongful charges and fees, and illegal interest rates) from banding together in class actions even when class actions are the only economically feasible way for the consumers to resolve those claims. The CFPB has found that few consumers go to individual arbitration, while millions more recover in class actions.[1] According to the CFPB data, there were only on average about 8 individual cases per year involving $1,000 or less, and only about 25 cases per year involving a claim of $1,000 or less. Permitting forced arbitration clauses with class action bans under most circumstances has now become "a foolproof way of killing off valid claims," as Justice Kagan warned in her dissent in *Am. Exp. v. Italian Colors Restaurant* (2013).

Myth: Class actions do not compensate consumers.

FACT: In financial services, consumers are often cheated by small-dollar rip-offs, such as predatory and illegal charges and fees, and usurious interest rates, where a consumer cannot practically seek remedies on his or her own. A company that charges small-dollar illegal fees of hundreds or thousands of its customers reaps huge illicit profits. Consumers need the ability to join together in class actions to hold entities accountable for misconduct. The CFPB study reported extensively on the value of class action settlements (Section 8) and the prevalence of class action bans in arbitration clauses (Section 2). Across consumer finance markets, at least 160 million class members were eligible for relief over a five-year period. The settlements totaled $2.7 billion in cash, in-kind relief, and fees and expenses.

Myth: Forced arbitration, that is, corporate terms requiring consumers to resolve disputes in individual arbitration instead of court, is a favored public policy.

FACT: Congressional actions and public sentiment show significant opposition to forced arbitration. Congress has protected numerous sectors from forced arbitration, recognizing the harm of the practice to consumers and small businesses. The Federal Arbitration Act is a 1925 law that was originally passed by Congress to facilitate *business-to-business* arbitration, where two sophisticated entities

[1] CFPB Arbitration Study, Section 5.

negotiated contract terms. It was not meant to force individuals into arbitration with businesses in one-sided, non-negotiable contracts. While the Supreme Court has expanded the reach of the FAA to allow the use of forced arbitration clauses and class action bans against consumers, Congress has acted many times to restrict the FAA and protect individuals in numerous sectors:
(1) The Dodd-Frank Act barred forced arbitration in residential mortgages and lines of credit, and prohibited forced arbitration of whistleblower claims under the Sarbanes-Oxley Act of 2002;
(2) Congress has protected auto dealers from forced arbitration in their transactions with auto manufacturers (Pub. L. 107-273, 15 U.S. Code § 1226);
(3) Livestock and poultry growers are shielded from forced arbitration with big agribusiness (7 U.S. Code § 197c);
(4) Employees of government defense contractors with Title VII and sexual assault tort claims are shielded from forced arbitration (the federal government is finalizing an executive order to similarly protect employees of all federal contractors)(48 CFR 252.222-7006);
(5) Military members and their dependents cannot be forced into arbitration for a wide range of high-cost loans (payday, etc.)(10 U.S.C. 987(e)(3) and (f)(4) and 79 Fed. Reg. 58602).

These are great steps forward for American consumers and workers. Congress should pass legislation that will restore the rights of consumers and workers in *all* areas of the marketplace.

Myth: Public enforcement by state and federal governments is sufficient.

FACT: Public agencies cannot, as a practical matter, police the activities of the financial services industry by themselves. The limited number of enforcement actions that these agencies bring each year is not enough by itself to protect consumers adequately. Private actions complement the work of state and federal officials.[2] As private enforcement actions have become more unlikely because of forced arbitration, abusive industry actors have greater incentives to flagrantly violate consumer protection laws. State attorneys general,[3] the CFPB,[4] and other agencies[5] have acknowledged the limitations of public enforcement, and the need for consumers to be able to enforce laws in court. Congress also has reinforced private rights and remedies in numerous consumer protection laws, which often cannot be used due to forced arbitration.[6]

Myth: The CFPB study does not provide sufficient information on forced arbitration.

FACT: The rampant use of forced arbitration and the demonstrated harm to consumers were unmistakable before the CFPB conducted its study. However, the Bureau's data-driven and evidence-based examination of the practice is the most comprehensive analysis of the issue ever. The CFPB spent three years, 2012 to 2015, examining the use of forced arbitration in financial services. The study presented data on the prevalence of forced arbitration, litigation outcomes and arbitration outcomes. When it launched the study, the Bureau sought information from the public, to help identify the appropriate scope, methods, and sources of data for the Study. Industry groups, including the American Bankers Association, U.S. Chamber of Commerce and bank lawyers submitted their views to the CFPB on multiple occasions during the three-year process. The CFPB has conducted numerous public

[2] Letter from State Attorneys General to CFPB Director Richard Cordray, Nov. 19, 2014, http://1.usa.gov/1xGl6WS.
[3] Id.
[4] CFPB, Small Business Advisory Review Panel For Potential Rulemaking On Arbitration Agreements; Outline Of Proposals Under Consideration And Alternatives Considered, at 4, (Oct. 2015), http://1.usa.gov/1MpolPr.
[5] FTC Joins Amicus Brief Opposing Federal Court Finding On Consumers' Rights Under the Fair Debt Collection Practices Act, (2012), http://1.usa.gov/1MytiBf.
[6] E.g. Fair Credit Reporting Act, Truth in Lending Act, and Fair Debt Collection Practices Act.

hearings on the arbitration study, permitting further public comment and discourse. Despite the evidence presented in the CFPB's study, bank lobbyists seek to delay CFPB action by suggesting that the CFPB should repeat its study.

Myth: Companies' customer service departments (informal) adequately solve complaints.

FACT: The CFPB refutes this claim: "Companies' informal systems are voluntary and are primarily designed to benefit those consumers who pursue them. *Many more consumers* may be harmed by the same wrongful practice without realizing it or without filing their own disputes ... Also...companies can choose not to resolve disputes raised by customers who complain or can resolve disputes with those customers while maintaining practices that violate the law or harm consumers who never complain."[7]

Banks' recent abusive overdraft fee practices are a telling example. In a class action against one bank, the court noted that individual consumers complained to the bank about the order in which the bank would clear account expenditures. The bank built "a trap...(and) then exploited that trap with a vengeance, racking up hundreds of millions off the backs of the working poor, students, and others without the luxury of ample account balances..." The bank helped relatively few consumers who complained to customer service about its conduct, but it continued the practice on many others. In a class action, the court ordered the bank to return $203 million to consumers. Clearly, the class action worked better, than individual customer service, for consumers and the market.

Myth: Disclosures and other changes to arbitration clauses will help consumers.

FACT: Hollow proposals, such as disclosures, opt outs and other meaningless changes fail to address the basic problems of forced arbitration: consumers' lack of choice and lack of access to remedies. Section 3 of the study showed that bolded and underlined language describing forced arbitration does not adequately inform consumers about the meaning and consequences of this industry practice. Disclosures and other cosmetic changes to arbitration clauses will fail to restore consumer choice in the market. The data makes clear that only voluntary arbitration, chosen by both parties after the dispute arises, sufficiently restores consumer access to remedies. What consumers need is the freedom to say NO to forced arbitration after the dispute arises.

Myth: Forced arbitration lowers consumer transaction costs.

FACT: Section 10 of the study presents data on the cost and availability of credit when forced arbitration is restricted. The CFPB found no evidence that arbitration clauses led to lower prices for consumers. The CFPB compared companies that use arbitration clauses and prohibit class actions with companies that had eliminated forced arbitration from their consumer contracts. The CFPB found no statistically significant evidence that the companies that removed the arbitration clauses increased their prices or reduced access to credit.

Based on the ample proof it has presented, it is time for the CFPB to exercise its authority to write a rule to protect consumers from forced arbitration and class action bans.

Contact Christine Hines at Christine@consumeradvocates.org with any questions.

[7] SBREFA Outline, at 14, http://1.usa.gov/1MpolPr.

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April 5, 2016

Chairman Richard Shelby
Ranking Member Sherrod Brown
Committee on Banking, Housing and Urban Affairs
U.S. Senate
Washington, DC 20510

Re: April 5, 2016 hearing on the Effects of Consumer Finance Regulations and April 7, 2016 hearing on The Consumer Financial Protection Bureau's Semi-Annual Report to Congress

Dear Chairman Shelby, Ranking Member Brown, and Members of the Committee:

The National Consumer Law Center, on behalf of its low income clients, would like to submit the following statement for the record for the U.S. Senate Committee on Banking, Housing and Urban Affairs' April 7, 2016 hearing on the Consumer Financial Protection Bureau's Semi-Annual Report to Congress.

This statement focuses on several areas where the CFPB is doing critical work to protect consumers: debt collection, credit cards, credit reporting, access to bank accounts and prepaid cards. In each of these areas, we provide only a very brief summary of the problems and the CFPB's efforts. We invite you to visit our website, including the comments on our Rulemaking page, for more in-depth information about the problems facing consumers and the CFPB's role in making the financial marketplace safer for consumers. We also support the work of the CFPB and the need for more consumer protection in other areas addressed in statements prepared by members of Americans for Financial Reform. Although we may not have a position on every consumer regulatory issue discussed by other AFR groups, we strongly associate ourselves with other remarks defending the CFPB's work and structure.

Credit Cards

The Credit Card Accountability, Responsibility and Disclosures (CARD) Act of 2009 addressed some of the worst abuses in the credit card market. The credit card industry claimed that the CARD Act and implementing regulations would drive up prices and unduly restrict access to credit. But the CFPB has produced two in-depth reports using rich data sources and rigorous analysis that refute the naysayers. The all-in cost of using credit cards has declined across credit score ranges; the Credit CARD Act increased price transparency and saved consumers $16 billion in back-end fees; an credit is increasingly available, except where Congress explicitly intended it to be more restricted (i.e., consumers under 21 years old and others who did not have

the ability to repay the credit).[1] Consumer satisfaction with credit cards is also much higher, and most in the credit card industry would also likely agree that the regulations improved a dysfunctional market.

The disparity between the industry's Chicken Little claims in 2009 and the reality shows the importance of discounting gloom and doom predictions about consumer protection regulations and the CFPB's value as a data-driven regulator. The CFPB's insightful, groundbreaking credit card research adds facts to the discussion about the impact of regulation, and has also highlighted areas of continuing concern, especially deferred interest offers, laying the groundwork for potential future reforms.

The Credit CARD Act did not, and could not, address every single abuse developed by credit card lenders to extract profits from consumers. Part of the very reason for the CFPB's existence is to have a strong and nimble agency to address abuses in a timely fashion so as to minimize consumer harm. The CFPB has successfully fulfilled this purpose by taking aggressive action against abuses in the credit card sector, recovering billions for injured consumers.

After the Credit CARD Act, two of the worst abuses left in the credit card market were (1) deceptive sales of often useless add-on products, such as debt suspension products and credit monitoring; and (2) deferred interest promotions, which promise "no interest" but are a trap that can result in the imposition of hundreds or thousands of dollars in retroactive interest. The CFPB has brought actions regarding add-on products against almost all of the major credit card lenders (American Express, Bank of America, Capital One, Citibank, Discover, JPMorgan Chase, Synchrony, and US Bank), resulting in over $2.2 billion being returned to injured consumers. Furthermore, these actions have resulted in a dramatic reduction in the marketing for these products, which are overpriced and of limited use at best.

The CFPB has also taken aggressive action against Synchrony, one of the major purveyors of deferred interest promotions, over the use of these promotions with its healthcare credit card product CareCredit. This action resulted in major reforms in the marketing of CareCredit cards to vulnerable, economically stressed patients while returning $34 million to them.

Credit Reporting

Prior to the CFPB, there was no regulator with authority to supervise the credit reporting industry. The Big Three nationwide credit reporting agencies - Experian, Equifax and TransUnion – operated with oligopolistic impunity, allowing errors to infect the credit reports of millions of consumers, making a mockery of the federally-mandated dispute process, and deceptively promoting expensive credit monitoring subscription products. The FTC was outgunned and under-resourced, without the legal tools necessary to bring about significant reform. The Big Three credit bureaus consistently resisted any reforms, and could do so because they were immune to normal market forces such as competition. Unresponsive to the complaints of consumers, without a strong regulator to rein them it, the Big Three wreaked havoc on the lives of those consumers with errors in their credit reports– 20% of consumers with credit reports or 40 million Americans.

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[1] *See* CFPB, The Consumer Credit Card Market (Dec. 2015), http://files.consumerfinance.gov/f/201512_cfpb_report-the-consumer-credit-card-market.pdf.

The CFPB has wrought a sea change in the realm of credit reporting. The Bureau's supervisory and enforcement activities have already made significant improvements to this historically intransigent sector, including:

- Getting the credit bureaus to finally agree, after years of complaints and litigation, to take the simple step of providing the consumer's actual dispute and supporting documentation to the creditor or debt collector ("the furnisher") that provided the information. The credit bureaus have also finally provided the ability for consumers to upload supporting documents when they file disputes online.

- Taking enforcement actions against creditors and debt collectors in their role as furnishers of information for failing to properly investigate disputes, providing inaccurate information, and making deceptive statements about credit reporting when engaged in debt collection. In addition, the CFPB has taken enforcement action against at least one background check credit reporting agency.

- Examining the practices of lenders and debt collectors under its supervision in their role as furnishers of information.

Finally, the CFPB has conducted groundbreaking research on consumer credit reporting. For example, the Bureau issued a landmark report on the enormous role of medical debt in damaging the credit reports of tens of millions of consumers, finding that 1 in 5 consumers with a credit report has a medical debt collection item and over half of collection items on credit reports are for medical debt. The CFPB's report on *Key Dimensions and Processes in the U.S. Credit Reporting System* is considered a standard reference document.

However, there is still much more to be done. The Big Three credit bureaus still continue to abuse consumers, which is dramatically reflected in the fact that they are consistently among the top four or five companies for which the CFPB receives the most complaints, and in some months have been ***the*** top three most complained-about companies. Consumers need a strong CFPB to ensure that the credit reporting industry treats them fairly and with respect.

Debt Collection

In 2015, the CFPB resolved critical, targeted enforcement actions to curb abusive debt collection practices, such as:

- Encore Capital and Portfolio Recovery Associates – the two largest debt buyers in the country – were engaged in practices such as attempting to collect unsubstantiated or inaccurate debt, robo-signing documents, and suing consumers past the statute of limitations;

- JPMorgan Chase – one of the largest banking institutions in the United States – was selling credit card accounts that already been paid or discharged in bankruptcy and robo-signing documents used in litigation against its former customers; and

- Frederick J. Hanna & Associates – a Georgia-based law firm and debt collection lawsuit mill – was filing lawsuits without meaningful review or involvement by attorneys and introducing faulty or unsubstantiated evidence.

In each of these cases, the defendants were clearly violating existing law and harming consumers. The CFPB's negotiated consent orders remedied these violations and prevented future harm by preventing collection of debts that were in the wrong amount, against the wrong person, or not legally collectible. The CFPB's enforcement actions also have had a helpful deterrent impact against wrongdoing by the industry as a whole and serve as a roadmap to industry compliance going forward.

In addition to these important enforcement actions, the CFPB continues to work toward comprehensive debt collection regulations for debt collectors, debt buyers, and creditors collecting debts in their own name. The need for debt collection regulations is underscored by the 82,500 debt collection complaints received by the CFPB – the highest of any industry – and the 897,655 debt collection complaints received by the FTC in 2015. Problems are widespread, including continued collection of debts not owed, in the wrong amount or against the wrong person; telephone harassment; deceptive and abusive collection of ancient, zombie debt; harmful practices involving medical debt and student loans, and inaccurate information impacting consumer credit reports. The CFPB's debt collection rulemaking will allow the agency to update and strengthen the provisions of the nearly 40-year old Fair Debt Collection Practices Act to address old problems that remain and new issues posed by communication technology and debt collection practices that did not exist in 1977, such as the sale of charged-off debt to debt buyers. Regulations will provide clarity to both consumers and the collection industry.

Access to Bank Accounts

Access to a safe and affordable bank account is a cornerstone of financial empowerment. However, almost 17 million Americans do not have bank accounts. One of the obstacles that prevents many consumers from opening an account is a negative history at a bank account screening consumer reporting agency (CRA), such as ChexSystems or Early Warning Services. Account screening CRAs operate databases that receive and report information, mostly negative, about a consumer's banking history and are used by banks to determine whether to allow a consumer to open an account.

Originally intended to warn financial institutions about potential fraud, the vast majority of negative information at account screening CRAs actually involves accounts closed due to overdrafts. Yet many consumers end up overdrawing their accounts due to unfair banking practices that permit or exacerbate overdrafts, such as allowing overdrafts on debit cards where they are almost completely avoidable and unnecessary or re-ordering transactions to create the maximum number of overdrafts in order to charge more fees. In addition to costing consumers billions in overdraft fees, these practices result in shutting out millions of consumers from the mainstream banking system.

The CFPB has taken a number of steps to address the problems with account screening CRAs and access to bank accounts in general. The CFPB took the first step in October 2014 by holding a Forum on Access to Checking Accounts. The CFPB followed up by examining, in its supervisory role, practices at both the account screening CRAs and the financial institutions that furnish and use their information. Discovering insufficient procedures and policies to ensure accuracy at both, the CFPB has directed both to institute reforms.

In February of this year, the CFPB took a number of additional steps to improve access to bank accounts. First, Director Cordray sent a letter to the 25 largest banks encouraging them to offer and promote "safe" accounts that help consumers avoid overdrafting. The CFPB also issued a

bulletin reminding financial institutions of their obligations under the Fair Credit Reporting Act to have reasonable policies and procedures regarding the accuracy and integrity of information that they furnish to account screening CRAs.

Ultimately, ensuring fair access to bank accounts involves reform of bank overdraft abuses. The CFPB is considering a rulemaking process on this critical issue. The Bureau has conducted several in-depth research studies and issued a notice and request for information regarding the topic. There is much work that remains to reform bank overdraft practices, and we urge Congress to let the CFPB do its job.

Prepaid and Payroll Cards

The prepaid card market (including payroll and government prepaid cards) has been growing exponentially in the last several years. Prepaid cards fill an important gap left by banks' failure to adequately and safely serve low and moderate income consumers. But antiquated regulations have left most prepaid cards out of key consumer protection statutes that protect the safety of bank debit cards and bank accounts. In addition, while the vast majority of the prepaid cards on the market are true to their name and their promise – a safe account for vulnerable consumers that does not risk overdraft fees or the risks of credit – a few cards are designed to exploit consumer struggles, encouraging overdraft fees and enabling payday loans that undermine the safety and prepaid nature of the account.

The CFPB has proposed rules that would close the gaps in consumer protections for prepaid cards, improve those protections, and preserve the vital role prepaid cards play for families who struggle paycheck to paycheck. The proposal would extend Regulation E to prepaid cards, ensuring that prepaid cardholders have protection against unauthorized charges and a mechanism to address errors and disputes. The CFPB has proposed vastly improved fee disclosures that would give consumers clear information about the cost of the card, making comparison shopping easier. The proposed rule would also limit – but unfortunately not completely prohibit – overdraft fees and credit features on prepaid cards, helping to preserve prepaid cards as a safe refuge for consumers who have been denied access to or have trouble managing checking accounts.

The proposed rule is long and detailed, reflecting the careful thought, nuance, and care to avoid evasions and unintended consequences that the CFPB has brought to designing a rule that will encompass a variety of different types of cards and a variety of different consumer protection issues. The detailed specifics also make it easier for companies to comply, knowing exactly what is required. Ironically, a long and detailed regulation addressing a variety of situations actually results in a more straightforward product for consumers and simpler compliance for the industry – a hallmark of the CFPB's rulemaking approach.

Conclusion

The Consumer Financial Protection Bureau has been doing exactly what Congress created it to do: addressing a long backlog of consumer protection issues that have been sorely neglected. The Bureau has been listening carefully to consumers, industry and other interested parties and gathering critical research in order to make financial markets work better for all concerned. Congress should applaud the CFPB for the tremendous progress it has already made in a short period of time and provide strong support to the agency to continue its vital work in protecting the American public.

If you have any questions, please contact Lauren Saunders, Associate Director, National Consumer Law Center, lsaunders@nclc.org, (202) 595-7845.

Respectfully submitted,

National Consumer Law Center
(on behalf of its low income clients)
Start here

Statement for the Record From John Taylor, President and CEO, National Community Reinvestment Coalition

Senate Committee on Banking, Housing, and Urban Affairs Hearing

"Assessing the Effects of Consumer Finance Regulations"

April 5, 2016

Chairman Shelby, Ranking Member Brown, and Distinguished Members of the Committee:

The National Community Reinvestment Coalition (NCRC) appreciates the opportunity to provide this written statement for the record of the April 5, 2016 hearing on "Assessing the Effects of Consumer Finance Regulations." NCRC applauds the Consumer Financial Protection Bureau's (CFPB) final rule expanding the data collected around the Home Mortgage Disclosure Act (HMDA).

The expansion of HMDA data is an important step for all consumers. Had we had this expanded data before, it would have provided an early warning system that would have helped to prevent the housing crisis by alerting regulatory agencies to a rapid increase in abusive lending. The expanded data includes information that could help to identify potential discriminatory lending practices, such as property value, term of the loan, total points and fees, information on teaser or introductory rates, and the applicant's age and credit score. Teaser rates, usurious loan fees, and points are commonly used tools to prey on vulnerable consumers with lower credit scores. The expanded data sets also include information on underwriting and pricing, such as debt-to-income ratios and interest rates. This information will be used to determine disparities across communities in the way home loans are written and priced.

The data will serve to increase the fairness of mortgage markets for all Americans. Existing HMDA data has been central to recent investigations and enforcement actions by the CFPB and the U.S. Department of Justice (DOJ), exposing on-going redlining. The CFPB and DOJ ordered Hudson City Savings Bank to pay $27 million for discriminatory redlining practices. Evans Bancorp agreed to a $825,000 settlement in response to a mortgage redlining lawsuit brought by the New York State Attorney General. The expanded HMDA data will increase the effectiveness of enforcement by boosting the ability of agencies to identify price discrimination in addition to redlining cases.

We are particularly pleased that the CFPB has followed the recommendation of NCRC and other advocacy groups to disaggregate the data on race and ethnicity. The CFPB has also shown careful consideration of potential privacy issues in this process, which should assuage any concerns surrounding the collection of the data.

The next step for the CFPB is to ensure that all of the data elements collected that pose no privacy concerns are released to the public. Detailed public disclosure gives increased transparency to the market and allows members of the public to detect lending discrimination and abuse. We urge the CFPB to commence this process as soon as possible. We anticipate that the dissemination of the new data elements will present minimal privacy risk to consumers; therefore, the CFPB should opt for comprehensive disclosure of the new data elements. There are several arguments that support a full public dissemination of the data:

- The personally identifying information (Social Security numbers and account numbers) that is most sought after by identity thieves will not be reported to the CFPB under the HMDA rule expansion.[1]
- Loans will be identified using a Universal Loan Identifier that must not include any information that could be used to directly identify an applicant. Prohibited information includes but is not limited to the applicant's name, date of birth, Social Security number, driver's license number, or employment/ tax identification number.[2]
- The CFPB interprets HMDA to call for the use of a balancing test to determine whether and how HMDA data should be modified prior to public release in order to protect privacy while also fulfilling the public disclosure requirements of the statute.[3]
- The CFPB has taken steps to remove information that directly identifies consumers in its current data collections. The CFPB can apply similar procedures as it relates to sensitive HMDA data (age, credit score, LTV ratio) if it chooses to make any part of such data public.[4]
- If made publicly available, credit scores and ages could be reported in ranges or percentiles which are valuable for analysis but do not identify specific consumers.[5]
- Under the current rule, sensitive, potentially personally identifying data are not made available. The application/loan number, the date an application was received, and the date action was taken on an application are not made available to the public.[6] Similar procedures will be applied to the new data.

1 HMDA Disclosure Requirements http://www.occ.gov/static/community-afairs/community-developments-newsletter/summer05/cd/hmdadisclosure.htm

2 Ibid.

3 CFPB Proposed Rule on Home Mortgage Disclosure http://files.consumerfinance.gov/f/201407_cfpb_proposed-rule_ home-mortgage-disclosure_regulation-c.pdf

4 Ibid.

5 Ibid.

6 Ibid.

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Statement for the Record

Hearing of the Senate Committee on Banking, Housing, and Urban Affairs: Assessing the Effects of Consumer Finance Regulations

Submitted by: National Fair Housing Alliance

April 5, 2016

The National Fair Housing Alliance (NFHA) appreciates the opportunity to submit this statement for the record for the hearing of the Senate Committee on Banking, Housing and Urban Affairs on the effects of regulations as it relates to consumer finance. In the lead up to the foreclosure and financial crises, NFHA, along with many of our allies in the civil rights community, strongly urged the Congress and federal regulatory agencies to increase oversight of the financial industry by passing stronger legislation to stamp out abusive practices, step up regulation of the industry using then existing authority, and increase enforcement actions against bad actors. Thus, we are very supportive of current lending rules, implemented as a result of the Wall Street Reform and Consumer Protection Act (Dodd-Frank) to eliminate discriminatory and abusive lending practices, create safer products, improve consumers' understanding of financial products and services and implement sound rules to help the industry operate in a profitable and safe manner. We believe the CFPB has done an extraordinary job in accomplishing all of these goals but will focus our comments on the Bureau's fair lending work. NFHA also supports the remarks that have been submitted by our colleagues who are members of Americans for Financial Reform.

The foreclosure and financial crises and their impact on the global economy have been at the forefront of the country's domestic and foreign policy issues for years and for good reason. Moody's Chief Economist, Mark Zandi, estimates that over 7 million consumers will have lost their homes to foreclosure by the end of the crisis[1]. Reports vary on the cost to the American people of the foreclosure and financial crises but estimates range from $13 trillion to $20 trillion[2]. What has been greatly overlooked is how rooted the crises are in the historical discriminatory housing and lending practices in our nation. Bias in our housing and lending markets created a segregated society which has made it easy for unscrupulous

[1] Garrison, Trey, "Moody's Analytics: Single-family rental growth will accelerate", HousingWire, July 1, 2015; available at: http://www.housingwire.com/articles/34369-moodys-analytics-single-family-rental-growth-will-accelerate

[2] One study conducted by Better Markets puts the estimate at $12.8 trillion. Another study by the GAO states that the crises, as of 2013, cost the American economy $22 trillion.

actors to exploit under-served communities and indeed was the catalyst for the explosive growth in the subprime lending market. From segregated banks and lending institutions who closed their doors to newly emancipated Black citizens, to federally created redlining maps to the perpetuation of a bifurcated lending system, borrowers of color have never been fully served by the financial mainstream. Indeed, subprime and fringe market lenders have always been the primary source of credit for consumers of color. This is why PayDay and fringe lenders are and always have been disproportionately located in communities of color.

Moreover, we have more proof than ever that subprime lenders, in large part due to a lack of regulation and misaligned incentives, preyed upon highly qualified consumers to provide them with high-cost lending products – not because the borrowers were risky but, rather because lenders sought ways to enhance their earnings. African-American and Latino borrowers were targeted by lenders for subprime lending products. Numerous fair lending cases have been brought by the Department of Justice, Department of Housing and Urban Development, the CFPB or a combination of these agencies addressing discriminatory lending practices. These cases reveal that borrowers of color who were in all pertinent points equal to their White counterparts were charged more for loans and/or were unduly placed in subprime loans. Some cases also demonstrated redlining practices by mainstream financial institutions[3]. In fact, the Wall Street Journal commissioned an analysis of several subprime loan vintages and found that most people who got subprime loans qualified for prime-rate, fully amortizing, fixed rate conventional loans. In one portfolio, 61% of the borrowers qualified for prime credit.[4]

Communities of color are still bearing a disproportionate burden of the financial crisis and are the slowest to recover making it all the more imperative for the CFPB to use all of the

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[3] For some examples see CFPB and United States of America v. Hudson City Savings Bank, F.S.B. https://www.justice.gov/crt/file/791046/download; CFPB and United States of America v. National City Bank https://www.justice.gov/sites/default/files/crt/legacy/2014/04/08/nationalcitybanksettle.pdf ; United States of America v. Countrywide Financial Corporation, et al https://www.justice.gov/sites/default/files/crt/legacy/2012/01/27/countrywidesettle.pdf ; United States of America v. First Lowndes Bank, Inc. https://www.justice.gov/sites/default/files/crt/legacy/2010/12/15/lowndessettlefinal.pdf ; United States and CFPB v. Provident Funding Associates https://www.justice.gov/sites/default/files/crt/legacy/2015/05/29/providentcomp.pdf ; United States of America v. Wells Fargo Bank, NA https://www.justice.gov/iso/opa/resources/9512012712113719995136.pdf ; United States of America v. Suntrust Mortgage, Inc. https://www.justice.gov/iso/opa/resources/3132012531162538304 20.pdf

[4] Brooks, Rick and Simon, Ruth, "Subprime Debacle Traps Even Very Creditworthy," *Wall Street Journal*, December 3, 2007 available at: http://www.wsj.com/articles/SB119662974358911035

tools within its bailiwick to provide relief for consumers still struggling to work, live in safe and stable housing and provide for their families.

The CFPB has taken great steps to create a more fair and balanced marketplace and improve the ability of consumers to operate in a safe environment and the Bureau's efforts in this regard have been critically important. The CFPB has been addressing issues that too long have been ignored and, thanks to the Dodd-Frank legislation, the Bureau has the authority it needs to regulate financial transactions in sectors of the market that have been too long left un-monitored.

Fair Lending Regulation and Enforcement

The CFPB issued its Supervision and Examination Manual which provides guidance to banks and financial institutions on how the Bureau provides oversight on fair lending and consumer protection laws. The manual provides not only the legislative backdrop for the Bureau's regulatory and examination activities but includes descriptions of the type of discriminatory conduct that is prohibited by fair lending statutes. The guidance walks lenders through the process of ensuring that institutions have the appropriate policies, product offerings, fair lending compliance programs, board and management oversight, training, consumer complaint and response systems, vendor management oversight, marketing and advertising protocols, application and underwriting processing systems, pricing protocols, servicing procedures, and ability to monitor and correct problems. The manual outlines the CFPB's examination process, which is thorough and helps ensure that all consumers have fair access to quality credit.

The CFPB has also issued a bulletin entitled Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act, which provides extremely critical guidance to lenders to reduce the level of discrimination experienced by borrowers of color who procure auto loans. Discrimination in this sector has been long documented and was the subject of much public furor when PrimeTime aired its groundbreaking investigation called **True Colors**[5], which featured two testers from a Chicago fair housing group. The African-American tester encountered discrimination on multiple occasions when trying to purchase a car, secure

[5] See video clip showing differences in treatment at: https://www.bing.com/videos/search?q=abc+nightline+discrimination+segment+testing&view=detail&mid=E611CB52E8E8E6AC9349E611CB52E8E8E6AC9349&FORM=VIRE

housing and purchase everyday goods and services. When trying to purchase a car, the White and Black testers received completely different information over and over about financing requirements and the cost of the cars for which they were shopping. When PrimeTime reporter Diane Sawyer asked why there was a difference in pricing, the auto salesman only responded "They're all different." When pressed to explain the difference, the auto sales person walked away from her. National studies have borne out the differences that Blacks and Latinos pay for car loans as compared to their White counterparts, even when Latinos and Blacks make the same attempt as Whites to negotiate on car dealer loans[6]. Discrimination in this sector has been revealed by the number of fair lending enforcement cases brought by both the DOJ and the CFPB as well as civil rights organizations[7].

Prior to the establishment of the CFPB there was an obvious void in federal oversight of financial institutions operating to bring a panoply of financial products and services to consumers. This is evidenced by the sheer number of fair lending issues the Bureau is now able to address using its authority under Dodd-Frank. The millions of consumers who have received relief from discriminatory practices are a testament to the Bureau's necessity. NFHA fully supports the fair lending regulatory and enforcement work the CFPB has undertaken and urges the Committee to do everything within its power to ensure that the agency is fully equipped to continue its work to make our financial markets fair for America's consumers.

We are happy to answer any questions Committee members might have about our comments. Please feel free to contact Lisa Rice, Executive Vice President at lrice@nationalfairhousing.org or 202-898-1661.

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[6] Davis, Delvin, "Non-Negotiable: Negotiation Doesn't Help African-Americans and Latinos on Dealer-Financed Car Loans", Center for Responsible Lending, January, 2014.

[7] For some examples see United States of America v. Fifth Third Bank https://www.justice.gov/crt/file/783561/download ; United States of America v. Evergreen Bank Group https://www.justice.gov/sites/default/files/crt/legacy/2015/05/07/evergreencomp.pdf ; United States of America v. Toyota Motor Credit Corporation https://www.justice.gov/opa/file/818481/download

Statement of the
National Retail Federation

submitted to the
U.S. Senate Committee on
Banking, Housing and Urban Affairs
for its hearing on
"Assessing the Effects of Consumer Finance Regnlations"
held on

April 5, 2016

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Introduction

Chairman Shelby, Ranking Member Brown, and Members of the Senate Committee on Banking, Housing and Urban Affairs, on behalf of the National Retail Federation (NRF), I appreciate the opportunity to submit this written statement to the Committee in connection with its hearing entitled, "Assessing the Effects of Consumer Finance Regulations," held on April 5, 2016.

NRF is the world's largest retail trade association, representing discount and department stores; home goods and specialty stores; Main Street merchants; grocers; wholesalers; chain restaurants; and Internet retailers from the United States and more than 45 countries. Retail is the nation's largest private sector employer, supporting one in four U.S. jobs and 42 million working Americans. Retail contributes $2.6 trillion to annual GDP and is a daily barometer for the nation's economy. Retailers create opportunities for life-long careers, strengthen communities, and play a critical role in driving innovation. Overwhelmingly, our members must accept debit and credit cards from customers in payment for products and services. However, the hidden high costs of card acceptance affects what our customers ultimately pay. This is bad for them and for us, and, as is typical of monopoly pricing, stifles innovation.

Background

The prospect of increased competition, both with respect to debit card interchange fees and routing options were important parts of the Dodd-Frank Wall Street Reform and Consumer Protection Act. There is a ("swipe") fee for ultimately approving the transaction and an additional ("routing") fee to telecommunicate transaction information to the banks. Prior to the law's enactment, debit interchange fees, or swipe fees, were increasing constantly. For years, debit card transactions essentially passed on par with checks, while simultaneously saving banks millions of dollars in processing costs. Over time two monopoly-like networks entered the market and swipe fees were first added and then greatly increased so as to rival credit card fees. Shortly before Dodd-Frank, the average swipe fee added 45 cents to the cost of every such transaction. In many cases merchants were blind as to what they would be charged. The "Durbin Amendment," as part of Dodd-Frank, sought to bring transparency and competition to this broken market.

Congress mandated the rule's adoption in part because there was little evidence of meaningful competition by issuers in the delivery of debit card services. For decades issuers' prices for credit and debit services largely had been collectively established within issuer-member trade associations. The high "default" price to merchants of plastic payment products was reflective of the issuers' collective market power.

In the second half of the 2000s the issuer trade associations were officially "spun off" from their issuer members, but the practice of default pricing continued. In short, the issuers' prices for most debit card services were effectively fixed for them by the two dominant networks, and other opportunities for cost savings for merchants (and their customers) via competitive routing were undermined by the same two dominant networks' cartel-like behavior. Issuers simply "took" and charged the default price regardless of their actual costs. The result was escalating increases in

debit pricing within various sectors of the merchant community and decreasing opportunities for other potentially competitive network services.

The law sought to address this in two ways. With respect to network services, it did so by ensuring that merchants would have at least two alternatives for routing each transaction as it was finally presented at the point of sale. With respect to debit card pricing, it did so by:

a) providing an incentive for larger issuers to independently compete outside the cartels for merchant acceptance of their cards; or

b) in the event large issuers chose not to compete, by having the Federal Reserve Board establish standards essentially ensuring that the price for their services was reasonable and proportional to their incremental cost.

In the latter case, the lower the price cap set by the Board's standards above actual cost for basic debit card services, the greater the likelihood that individual issuers would exit the cartel and compete to offer sufficiently innovative products or services outside the cap as to potentially allow them to earn greater revenue. Of course, true competition among such unrestrained debit card services would act as an upper bound on how much extra revenue could be earned. The combination of prices constrained by a truly competitive market and those constrained in the non-competitive standards-set market would both foster some innovation while keeping overall costs at a more reasonable and proportionate level.

Reasonable and Proportional Standards

Regulation ii (Reg. ii) has worked moderately well. On average, the established cost of providing debit card services among affected issuers is less than five cents per transaction. As was mentioned, prior to the regulation's adoption, the cost to merchants (and ultimately in part to their customers) for an average transaction was 45 cents per transaction. The regulation reduced this figure to 24 cents. Most merchants and consumers have realized the benefits of these savings. One prominent study estimated that approximately two-thirds of the savings is passed on to the shopping public and one-third is retained by merchants for investment and return to shareholders.[i] In most cases, 24 cents per transaction represents a significant savings over the prior non-competitive pricing. However, it is still *substantially* higher than issuers' incremental costs.

The higher cap has had three effects. First, savings more proportionate to those of a truly competitive market have not been realized under the Reg. ii standards with respect to issuers who remain under the cartel's collective pricing umbrella. The margins afforded such issuers are much too high. By way of comparison, due to more restrictive margins in the retail industry and elsewhere, the average net profit for retail varies from slightly over one percent for the grocery sector to slightly under four percent for high-end specialty luxury stores.

Second, by establishing so high a ceiling and so great a profit potential for those operating within the cartel, the regulation undermines the incentive for issuers to abandon it in order to engage in the risks and rewards associated with the innovative products and services envisioned by the law.

The extremely comfortable return provided issuers under current Reg. ii standards makes risk-taking less rewarding.

And third, the high 21 cent-and-up ceiling has become a *de facto* floor in virtually every instance. There have been serious real world consequences.

Once tens of millions of consumers have been trained to expect to use a particular form of payment, it is extraordinarily difficult (if not impossible) to subsequently remove that form of payment from merchant establishments. Many retail transactions, especially small ticket price transactions, are quick in-and-out affairs. Checkout time spent on payment, or on tender type discussions, that upset consumers' expectations seriously impedes the profitability of the enterprise. (As a hypothetical, imagine entering a quick serve hamburger restaurant with cash and being told at checkout that the establishment no longer accepts bills; that it only accepts coins. The conversation time and disruption would be enormous. The same would be true for credit and debit cards.)

For many years, small ticket merchants did not accept credit or debit cards. That was understood by consumers. They were not accepted because the total transaction time was slightly longer than that for cash. More important, the cost of the transaction was far more than most small ticket merchants could afford in light of their narrow margins. Consequently, consumers expected to, and did, pay with cash.

In order to overcome merchant objections, the cartel payment networks offered merchants who specialized in small ticket products a special default issuer price. It was significantly lower than the standard debit card pricing in recognition of the deleterious effects of plastic transactions on small ticket product pricing and merchant profitability. Given the actual cost of transactions, as demonstrated by the Board's own research, the high single digit amounts then charged to merchants was reasonable and proportional to the issuers' costs, and it was not so high as to have the negative effects mentioned above. Consequently, the transactions came to be accepted at such merchants and consumers were trained to expect the ability to use another form of tender, debit, at point of sale.

Commentary surrounding the adoption of Reg. ii, and the activity of one major debit card network in the immediate aftermath, suggested that such differential pricing would continue to the mutual benefit of issuers, merchants, networks, and consumers. However, shortly thereafter in response to inverse competition among the networks (i.e. the major card networks compete to maximize the amount of revenue they can extract from merchants and consumers to deliver to the issuing banks), the commentary and expectations were confounded. The Reg. ii ceiling was converted by both the major networks into a default issuer floor for small ticket purchases. In light of the one-third versus two-thirds pass-through discussed above, ***all*** consumers of small ticket goods and services were injured.

For the reasons set forth, despite some successes achieved by Reg. ii, the standards caps merit review and likely downward adjustment.

Network Services
As to network services, the law allows merchants and the buying parties who (along with their processors) have the greatest knowledge of the costs and benefits among competing network options to route transactions over those networks that provide the greatest overall benefit when completing their transactions. Variables could include speed, cost, security, downtime, volume, cleanliness of transactions, and responsiveness, among other factors. Allowing this choice provides the opportunity for regional and other networks to outcompete the majors by investing in services that enhance these sometimes extremely technical variables.

There recently has been an effort to subvert this provision of the law and transfer the choice of routing to a party who is not familiar with all of the factors involved in making an informed competitive choice. This subversion is of concern to merchants who have seen savings through routing choice and passed along those savings to our customers.

Fraud Costs
Finally, there has been a significant liability shift in conjunction with the multiyear transition to chip card transactions. The issuer fraud costs shifted onto merchants has been enormous. It appears that costs far beyond the claimed costs of counterfeit cards are being shifted by issuers onto merchants despite initial assurances by the major networks that such would not happen. Some mid-sized merchants already have seen issuer asserted counterfeit card costs rise from tens of thousands of dollars to over one million dollars, per month. If fraud costs anywhere near these amounts are being transferred from issuers to merchants, then the five basis point fraud allowance in the current standard may no longer have a legitimate basis.

Due to serious backlogs of hardware, network mandated certification resources, and scheduling (service station fuel pumps, for example, are not scheduled to be compliant until fall of 2017) these costs are likely to be shifted onto merchants for years to come. Indeed, the Canadian transition, involving a population of merchants a fraction the size of that in the U.S., took nearly ten years and included a delay. In light of this change, the current fraud allowance is ripe for revisiting by the Federal Reserve Board of Governors under the law.

Conclusion
The goal of debit card interchange reform was to bring transparency and competition to the market, which would lower costs for merchants. Debit reform has helped consumers, merchants, and the U.S. economy. In fact, the Philadelphia Federal Reserve released a study in 2016 that reports that revenue for small banks and credit unions has risen since debit reform.[ii] Merchants have seen some savings and have passed those savings on to our customers. Retail is highly competitive, and as other business costs such as goods, labor, and transportation rise, merchants use the savings from debit reform to protect our customers from the other rising costs.[iii] While retailers would like to see the Fed revisit the rule's cap to better reflect a reasonable and proportional fee to the banks' costs, Congress' intent is clear. The limits on price-fixing promote competition. It is also critical that merchants' network routing options are preserved, especially as we shift to EMV card acceptance, and competition continues to exist in processing transactions.

Debit card reform brought greater transparency to debit card acceptance for merchants, and the savings retailers do see is passed onto our customers. We appreciate the Committee's interest in this issue.

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[i] Shapiro, Robert J. "The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees," October 1, 2013.

[ii] DiSalvo, James and Ryan Johnston. "How Dodd-Frank Affects Small Bank Costs," First Quarter, 2016.

[iii] Sohn, Stephen and Curt Beaudouin, Moody's Investor Services. "New Debit Rules Hurt Banks and Reshape the Processor Market," January 2012.

U.S. PIRG Statement for the Record
Hearing on Assessing the Effects of Consumer Finance Regulations, 5 April 2016
U.S. Senate Committee on Banking, Housing and Urban Affairs
by Edmund Mierzwinski, Consumer Program Director

Chairman Shelby, Senator Brown and Members of the Committee:

On behalf of state PIRG consumer members around the nation, thank you for the opportunity to present this brief statement for the record for Tuesday's hearing "On Assessing the Effects of Consumer Finance Regulations" and in advance of "The Consumer Financial Protection Bureau's Semi-Annual Report to Congress" hearing on Thursday.

SUMMARY:

Defend the CFPB, It Works: U.S. PIRG stands in strong support of the Consumer Financial Protection Bureau (CFPB), including support for its single-director structure, its independent funding insulating it from special interest chicanery and its broad authority and tools to make all financial markets work. Without any doubt, establishment of the CFPB is the most important consumer financial protection action by the Congress since the establishment of deposit insurance in the 1930s. And, independent funding is neither a controversial nor new idea; it's been the law since 1864 for all bank regulators.

The Public Complaint Database Works For All of Us: While we associate our remarks today with those of other Americans for Financial Reform coalition (AFR) members whose statements will focus on defending the CFPB and on mortgage lending, credit card markets, credit reporting, CFPB enforcement actions, current rulemakings on predatory payday and auto title lending and arbitration reform and other aspects of the CFPB's work, we will emphasize the importance of the CFPB's public Consumer Complaint Database as a mechanism to both aid its enforcement and selecting its rulemaking priorities but also to help it avoid the calcification of, or worse, regulatory capture of, its predecessor consumer regulators.

The "Durbin Amendment" Works to Improve a Broken Payment Card Marketplace While Benefiting Small Banks and Credit Unions: All consumers pay more at the store and more at the pump due to "market power" exerted by the Visa/Mastercard card network duopoly, which allows banks to impose excessive "swipe fees" on merchants. The "Durbin amendment" limiting the duopoly's power to allow big banks to collect these excess rents has worked. Contrary to testimony that may be provided to the committee, there is strong evidence that the Durbin amendment has helped small banks and credit unions, which continue to offer both free checking and debit rewards programs. Further, perhaps less-discussed but also important provisions of the amendment have encouraged merchants to give consumers "price signals," resulting in more competition from fraud-resistant "PIN" networks against the riskier and fraud-prone but lucrative-to-banks "signature" network transactions preferred by Visa and Mastercard.

1. THE CFPB WORKS AND SHOULD NOT BE WEAKENED

In less than five years of existence (its fifth birthday will be July 21) the success of the CFPB has demonstrated the wisdom of Congress both in establishing it and in insulating it from special interest chicanery. Its independent funding is neither a controversial nor new idea; it's been the law since 1864 for all bank regulators. Further, despite allegations by special interests, the CFPB is neither rogue nor immunized from Congressional oversight. The director's appearance before Congress Thursday will be approximately the 59th by him or another senior CFPB official.

The CFPB has already provided over $11 billion in refunds, restitution and other relief to consumers harmed by unfair financial practices of banks, credit card companies, mortgage companies, for-profit student lenders, debt collectors, payday lenders and other wrongdoers. Its work has protected all of us but placed an emphasis on protecting servicemembers and veterans, older Americans, young Americans (students) and consumers at greater risk of discrimination. We would urge the committee and the full Senate to reject the self-serving demands of powerful special interests to weaken the bureau's independent funding or gut its single-director structure (there is no evidence that commissions are better than single-directors, nor is the claim that all financial regulators are run by commissions even close to true). Further, a variety of other special-interest proposals would subject the CFPB to a death by a thousand cuts, for example, by eliminating its authority over auto financing or to issue predatory lending rules or to tie it in regulatory knots or even to weaken its highly-successful public consumer complaint database.

2. THE CFPB'S PUBLIC CONSUMER COMPLAINT DATABASE WORKS FOR ALL OF US

In just four and one-half years, the CFPB now has the largest public consumer complaint database of any federal agency, with over 834,000 complaints collected as of 1 March 2016. Over 540,000 of the 834,000 complaints to the CFPB have been posted in the Public Consumer Complaint Database (others are still being processed or have been referred to other agencies).

It is important to point out, however, that transparent public consumer complaint databases are now the rule, not the exception. Other examples include the Consumer Product Safety Commission (saferproducts.gov) and National Highway Traffic Safety Administration (safercar.gov). U.S. PIRG maintains an appendix of these and several other searchable government consumer complaint databases in each of its six (so far) reports on CFPB Consumer Complaint Database. We drill down into the CFPB database on issues from credit reporting to mortgages.[1]

We commend the CFPB for its efforts, first to stand up the database while ensuring both that consumers had legitimate account relationships and that businesses had ample opportunity to comment on, respond to and dispute consumer claims, but not to censor complaints, as they routinely demand to do. Further, the CFPB should be commended for making the work of government more transparent and open while also protecting customer privacy.

[1] See our page "Reports: The CFPB Gets Results for Consumers," linking to reports on bank accounts, credit cards, credit reports, debt collection, mortgages and student lending here at http://www.uspirgedfund.org/page/usp/reports-cfpb-gets-results-consumers Open any report and scroll to the Appendix B, "Searchable Public Databases of Government Consumer Agencies."

By publishing consumer complaints, the CFPB has improved its own ability to police the marketplace and prioritize use of its own scare resources while simultaneously enabling independent and academic researchers, other consumers and other firms to better analyze consumer complaints and concerns.

- Researchers, from PIRG to academics to industry consultants, are identifying trends and developing more insights about good and bad marketplace practices;
- Consumers are making better marketplace choices after searching the database. They more wisely choosing institutions based on a more robust understanding of a firm's behavior toward its other customers, accountholders or – in the case of "dead-end markets" such as debt collection and credit reporting – the consumers it maintains files on. Those potential customers will also be able to see if a problem that they are having is the same the problem other consumers are having;
- Other firms are better able to identify patterns and practices that they might change, or affirmatively choose to avoid, and then be able to market their firm as more consumer-friendly, making it easier for good actors to gain market share and stimulating competition positively, by better aligning the interests of firms with those of their customers and potential customers. Firms without "tricks and traps" should do better in a more transparent marketplace. (In fact, news stories have pointed out that industry consultants are recommending improvements to customer service as a best practice;[2] so are consultant reports, such as one from Deloitte[3]);
- Researchers, armed with more robust data, will be better able to build models to provide early warnings of the kinds of unsafe consumer practices that could otherwise lead to a systemic collapse such as occurred in 2008.

Narratives Are a Very Important Improvement to the Database: Last year, as of June, following a public comment period, the CFPB made consumer narrative or "story" fields public, but only with the consumer's informed opt-in consent. Approximately half of all new complaints come with narrative fields. The narratives make the database more accessible and understandable and provide a more robust picture of marketplace practices than mere coded "issue" (problem) fields were able to do. Stories should also encourage more consumers to use the database. This positive feedback loop or "network effect" will increase its value to everyone as the financial services marketplace becomes more transparent.

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[2] See e.g., this 11 September 2013 American Banker story, "Customers Are Now Banks' Greatest Regulatory Threat" by Rachel Witkowski: "You want to reduce the number of complaints to the CFPB and a way you can do that is to cut them off at the pass," said Alan Kaplinsky, who heads the consumer financial services group at Ballard Spahr. Banks should "have a very good system in place from the get go to resolve a complaint quickly." http://www.americanbanker.com/issues/178_176/customers-are-now-banks-greatest-regulatory-threat-1061975-1.html

[3] See page 9, "CFPB's consumer complaint database analysis reveals valuable insights," Deloitte, September 2013, available at http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/FSI/US_FSI_CFPBConsumerComplaintDatabaseFINAL2_091913.pdf

Of course, the bureau already had access to the narrative information and was already using these data points in its supervision, enforcement, rulemaking and public education. But the bureau itself now will benefit from more eyes aimed at potential marketplace problems. In addition, the public, including outside academics, "civic hackers" and other researchers are expected to develop new crowd-sourcing and other analytic tools using the new data points.

Monthly Snapshots Are Also an Important Improvement to the Database: Last year, the CFPB also took another of our recommendations when it began publishing its own detailed monthly complaint summaries.[4] Since July, the monthly snapshots produced by CFPB Consumer Response have added an important new window into the financial marketplace. Each snapshot examines a particular financial sector in depth, profiles complaints in a different geographical area and ranks complaints by company and product category, with trend analysis.

The Database Works To Prevent Regulatory Capture: The CFPB is a transparent, data-driven agency which publishes vast amounts of information for public examination and review. It devotes substantial resources to rulemaking, examination, enforcement and public education. Yet, the database may be among its most important tools against the complacency that has led to calcification and regulatory capture among other government agencies. The database provides an important way for the CFPB to hear from consumers, not just from the typical insider lobbyists and lawyers for regulated firms. As CFPB Director Richard Cordray told AFR members on the occasion of the CFPB's fourth birthday last July:

> Each complaint that people take time to submit to the Consumer Bureau can provide invaluable information and insight. Consumer complaint data is part of our DNA and these complaints play an important role in our supervision of companies, our enforcement actions, our rulemakings, and our engagement with servicemembers, students, the economically vulnerable, and older Americans. Each complaint is a chance for us to evaluate a perceived problem and see if it can be addressed successfully. But more importantly, complaints make all the difference by informing our work and helping us identify and prioritize problems. We know that if we hear about the same problem from fifty consumers, it likely looms larger than if we hear about it only from one or two. All of these complaints have real people behind them. Each tells us a story about how consumers view their experiences with financial institutions, as they struggle to manage the ways and means of their economic lives. Often consumers ask simply to be treated with fairness, dignity, and respect. And we all know in our hearts that this is exactly what each of us deserves.[5]

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[4] The most recent CFPB complaint snapshot, released at the end of March and drilling down into debt collection complaints and complaints from the Florida region, is here http://www.consumerfinance.gov/newsroom/cfpb-monthly-complaint-snapshot-examines-debt-collection-complaints/

[5] See "Prepared Remarks of CFPB Director Richard Cordray At the Americans for Financial Reform Event on the CFPB's Fourth Anniversary (16 July 2015):"http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-americans-for-financial-reform-event-on-cfpb-anniversary/

3. THE DURBIN AMENDMENT LOWERING DEBIT CARD SWIPE FEES WORKS, DESPITE CLAIMS TO THE CONTRARY

We also want to take this opportunity to offer U.S. PIRG's continued strong support for another benefit of the Dodd-Frank Act, its "Durbin Amendment," which reduced allowable "swipe fees" imposed on merchants accepting debit cards from banks over $10 billion. A lesser known impact is that the amendment also prevents banks from imposing unfair limits on the ability of merchants to give "price signals" to their customers by explaining that certain payment methods – such as rewards cards, especially credit and debit card rewards cards – cost the merchant more and force it to raise everyone's, including cash customers, prices.

Everyone pays more at the store and more at the pump due to anti-competitive swipe (interchange) fees, which have declined in nearly every country, but continue to rise in U.S. markets due to market power of the primary card networks. Although the Visa and Mastercard networks are now publicly traded, they remain controlled by the big banks. High swipe fees also impose a regressive tax on lower-income cash customers, who are forced to subsidize the rewards cards of more affluent credit card customers.

We have seen numerous unfounded claims that the Durbin amendment's price caps on debit cards offered by the largest banks are somehow responsible for a decline in fee revenue which allegedly harms small banks and credit unions and has supposedly ended free checking and debit card rewards everywhere.

These claims are not backed up by any sort of evidence. In fact, there is much statistical and survey evidence to the contrary. The most recent issue of the Philadelphia Federal Reserve Bank's Banking Trends[6] explains that the Durbin amendment reduced interchange fee revenue at big banks, as intended, it did not harm and even helped small bank fee revenue:

> "There is substantial evidence that the ceiling did lower interchange fees collected by banks with assets above $10 billion, from around 44 cents to about 22 cents per transaction. But there was no such decline for small banks. Furthermore, after the ceiling was imposed, the volume of transactions conducted with cards issued by exempt banks grew faster than it did for large banks. Finally, Zhu Wang shows that interchange revenue fell substantially at large banks after the fee ceiling was imposed but continued rising for small banks." [citations omitted]

Nor has the Durbin amendment been shown to harm free checking programs at large or small banks. The ABA itself finds that "61% of consumers" pay no fees at all for "checking account maintenance

[6] See James DiSalvo and Ryan Johnston, "How Dodd-Frank Affects Small Bank Costs: Do Stricter Regulations Enacted Since The Financial Crisis Pose A Significant Burden?", In "Banking Trends," First Quarter 2016, page 14, Federal Reserve Bank of Philadelphia, available at https://www.philadelphiafed.org/-/media/research-and-data/publications/banking-trends/2016/bt-how_dodd_frank_affects_small_bank_costs.pdf

or ATM access.[7]" There are no independent data showing any link to any decline in the availability of so-called free checking to the Durbin amendment at large banks; if so, 61% of consumers could not be paying zero fees.

Bankrate.com's most recent survey finds that more large and small (76%) credit unions are now offering free checking, up from 72% last year.[8] Finally, nor has the Durbin amendment restricted the ability of large or small banks or credit unions to offer their own debit card rewards programs to members. In January, Credit Union Times reported:

> "Debit rewards programs at big institutions may be few and far between, but industry experts said they're rapidly becoming the new secret weapon for credit unions interested in snagging market share. The trigger was the Durbin Amendment, which is part of the Dodd-Frank Act."[9]

CONCLUSION:

Thank you for the opportunity to present these brief comments to the committee. Strong consumer regulations, and a strong CFPB, are critical to making financial markets work. They better align the interests of buyers and sellers so sellers don't depend on "gotcha" practices and buyers (consumers) gain more trust and confidence in the regulated financial system. Strong consumer rules also reduce the amount of risk placed in the system by unsafe, unsustainable products, further reducing the threat of future financial crises.

The idea of the CFPB needs no defense, only more defenders.

Respectfully submitted,

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[7] See "Survey: Most Americans Pay Nothing for Bank Services," 15 August 2016, available at http://www.aba.com/Press/Pages/081815SurveyonBankCosts.aspx

[8] See Claes Bell, "Credit unions: Where free checking still reigns," undated article based on 2016 Bankrate.com 2016 Checking Account Survey, both available at http://www.bankrate.com/finance/checking/want-free-checking-check-out-credit-unions-1.aspx

[9] Tina Orem, "Credit Unions Pile Into Debit Card Rewards," Credit Union Times, 21 January 2016, available at http://www.cutimes.com/2016/01/20/credit-unions-pile-into-debit-rewards Also, re large bank rewards programs, see CU Today's "Despite Durbin, Debit Card Reward Programs Remain Vibrant," 29 March 2016, available at http://www.cutoday.info/Fresh-Today/Despite-Durbin-Debit-Card-Reward-Programs-Remain-Vibrant

Statement for the Record

Hearing of the Senate Committee on Banking, Housing, and Urban Affairs: Assessing the Effects of Consumer Finance Regulations

Submitted by: Public Citizen

April 5, 2016

As the Senate Banking Committee meets with the Consumer Financial Protection Bureau (CFPB), Public Citizen applauds the CFPB for what it's done—returning more than $11 billion from predatory Wall Street firms to victims. We urge the agency to continue to fulfill its mandate by moving forward a strong rule banning or restricting forced arbitration—a pernicious practice which blocks consumers from joining together to seek justice and forces ripped-off consumers to take on large corporations alone in a secretive system set up to favor corporations, giving them an effective license to steal. We also urge the CFPB to propose strong rules protecting consumers from abusive small-dollar lending that exploits the most vulnerable among us. Public Citizen stands strongly behind the CFPB as a key achievement of Dodd-Frank and a tried and true defender of American consumers. We also agree and support other statements made by members of our coalition, Americans for Financial Reform.

Washington MONTHLY

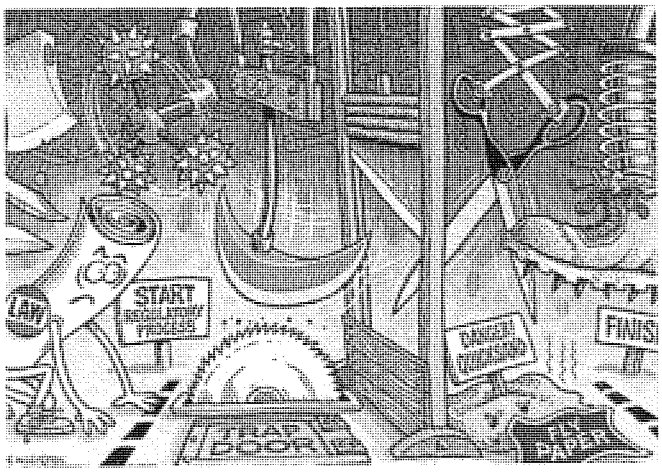
Features

March/ April 2013

He Who Makes the Rules

Barack Obama's biggest second-term challenge isn't guns or immigration. It's saving his biggest first-term achievements, like the Dodd-Frank law, from being dismembered by lobbyists and conservative jurists in the shadowy, Byzantine "rule-making" process.

By Haley Sweetland Edwards



In late 2010, Bart Chilton, one of three Democratic commissioners at the U.S. Commodity Futures Trading Commission (CFTC), walked into an upper-floor suite of an executive office building to meet with four top muckety-mucks at one of the biggest financial institutions in the world.
There were a handful of staff members present, but it was a pretty small gathering—one, it turns out, that Chilton would never forget.

The main topic Chilton hoped to discuss that day was the CFTC's pending rule on what are known as "position limits." If implemented properly, position limits would put a leash on speculation in the commodities market by making it harder for heavyweight traders at places like Goldman Sachs and JPMorgan Chase to corner a market, make a killing for themselves, and screw up prices for the rest of us.

Position limits are also one of many ways to tamp down the amount of risk big institutions can take on, which keeps them from going belly up and minimizes the chance taxpayers will have to bail them out.

The financial institution Chilton was meeting with that day was a big commodities exchange, which is like a stock exchange except that instead of trading stocks they trade derivatives based on the value of actual products, like oil and gas. Chilton wouldn't say which major commodities exchange he was meeting with that day, but suffice it to say two of the biggest—the Chicago Mercantile Exchange and Intercontinental Exchange—have a lot to lose from federally administered position limits. To them, the more derivatives traded, the better. They've been fighting the CFTC's attempts to establish position limits for years.

The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010 seemed to promise meaningful reform on this front. The law includes Section 737, which explicitly directs the CFTC to establish position limits and lays out detailed guidelines on how they should do so. "The Commission shall by rule, regulation or order establish limits on the amount of positions, as appropriate," it reads.

Still, even with the strength of the law behind him, Chilton waited until the end of the meeting to broach what he knew would be a tense subject. He began diplomatically. Now that the CFTC was required by law to establish position limits, his commission wanted to do so "in a fashion that made sense—one that was sensitive to, but not necessarily reflective of, the views of the exchange," he told the executives.

Chilton's gracious overture fell flat. His hosts, who had been openly discussing other topics moments before, were suddenly silent. They deferred instead to their top lawyer, who explained that the exchange's interpretation of Section 737 was that the CFTC was not required to establish position limits at all.

Chilton was blindsided. While other parts of Dodd-Frank were, admittedly, vague and ambiguous and otherwise frustrating to those, like him, who were tasked with writing the hundreds of rules associated with the act, Section 737 didn't exactly pull any punches. *The Commission shall establish limits on the amount of positions, as appropriate.*

"You gotta be kidding," Chilton told the executives. "The law is very clear here. The congressional intent is clear."

But the executives stood their ground. Their lawyer quietly referred Chilton to the end of the sentence in question: *as appropriate.* Those two little words, the lawyer said, clearly modify the verb "shall." Therefore, the statute can be interpreted as saying that the commission *shall*—but only if appropriate—establish position limits, he explained.

Anyone with a passable command of the English language should, faced with that argument, feel both dismay and a grudging sort of admiration. After all, given the context in which that sentence appears, the sheer brazenness of such a linguistic sleight of hand is, in a way, inspired. It's the kind of thing that would make Dick Cheney and John Yoo proud. Joseph Heller has written books on less.

But it's still, rather obviously, just that: a linguistic sleight of hand. The words "as appropriate" have appeared in statutes governing the CFTC's authority to implement position limits for at least forty years without challenge. In fact, the CFTC used the authority of that exact line, complete with its "as appropriate," to establish position limits on grain commodities decades ago. Even those who drafted Dodd-Frank later weighed in, saying they had intended for the language to explicitly instruct the CFTC to establish position limits *at levels that were appropriate*. The summary of Dodd-Frank, drafted by the Congressional Research Service, doesn't quibble either: "Sec. 737 Directs the CFTC to establish position limits," it reads. No ifs, ands, or "as appropriate"s.

"But this kind of thing"—manipulating the minutiae—"is how the game is played," said Bartlett Naylor, a financial policy advocate at Public Citizen, one of a handful of public interest groups tracking the rule-making process for Dodd-Frank. Since the law passed, the financial industry has been spending billions of dollars on lawyers and lobbyists, all of whom have been charged with one task: weaken the thing. One strategy has been to carve loopholes into the language of the law, Naylor said. A verb. An imprecise noun. A single sentence in an 876-page statute. "With a thousand lawyers on your payroll, that's nothing."

In the meeting that day, Chilton couldn't believe what he was hearing. He pointed out to the executives that, in Dodd-Frank, Congress had not only directed the CFTC to establish position limits, it had also imposed a deadline asking the commission to do so months before almost any other rule. It was obvious, he argued, that it was a matter of *when* position limits would be in place. Not *if*.

But the executives refused to discuss the matter further. The meeting ended abruptly, and Chilton wandered out into the hallway, dazed and reeling. One of the muckety-mucks from the meeting walked with him to the elevator. While they waited, away from the rest of the group, Chilton turned to his host. "You guys have got to be kidding about this 'as appropriate' stuff, right?" he said.

"I know," the muckety-muck replied, admitting it was a stretch. He let out a little chuckle—"but that's what we're going with."

"He *laughed*," Chilton told me recently, remembering that day. "He was laughing about how ludicrous it was."

A couple of months after that inauspicious meeting, the CFTC released a proposed rule establishing position limits on oil, gas, coffee, and twenty-five other commodities markets. They received about 15,000 letters during the public comment period and spent the next six months reading through all of them, incorporating the suggestions into the draft, meeting with industry and consumer groups, and revising the rule. Fearful of being sued, the CFTC held off voting on the rule several times and agreed to delay its implementation for a year to help financial institutions comply. Finally, in October 2011, the CFTC issued a final rule. It was a victory, but a short-lived one.

Two months later, two powerful industry groups, who together represent the biggest speculators in the world, hired Eugene Scalia, the son of Supreme Court Justice Antonin Scalia, as their lead counsel, and

launched a lawsuit against the CFTC. The Securities Industry and Financial Markets Association and the International Swaps and Derivatives Association were suing on the same grounds that the exchange executives' lawyer had cited in that meeting with Chilton a year earlier: the CFTC had not demonstrated that establishing position limits was necessary and appropriate, they claimed. They also argued that the commission had not sufficiently studied the economic impact of the rule.

House Democrats and nineteen senators, some of whom had drafted Dodd-Frank, petitioned the court to rule in favor of the CFTC, a handful of op-eds beseeched judges to do the right thing, and financial reform advocates called foul.

None of it made a difference. In September 2012, the U.S. Court for the District of Columbia Circuit overturned the CFTC's rule. In the decision, the conrt wrote that the commission lacked a "clear and unambiguous mandate" to set position limits without first demonstrating that they were necessary and appropriate. And with that, more than two years after the passage of Dodd-Frank, there were still no federally administered position limits for any commodities except grain, and the CFTC was back to square one. The muckety-mucks at the exchanges rejoiced, as appropriate.

Welcome, dear readers, to the seventh circle of bureaucratic hell.

As Obama begins his second term, all the talk in Washington is about whether ongoing congressional gridlock and soul-crushing partisanship will block the administration from achieving significant legislative victories, be they immigration reform, a big fiscal deal, or an infrastructure bank. But at least as important to the future of the country and to the president's own legacy is whether that potentially game-changing legislation he signed in his first term—like the Affordable Care Act and Dodd-Frank, as well as a slew of other landmark bills—is actually implemented at all.
It may seem counterintuitive, but those big hunks of legislation, despite being technically the law of the land, filed away in the federal code, don't mean anything yet. They are, in the words of one CFTC official, "nothing but words on paper" until they're broken down into effective rules, implemented, and enforced by an agency. Rules are where the rubber of our legislation hits the road of real life. To put that another way, if a rule emerges from a regulatory agency weak or riddled with loopholes, or if it's killed entirely—like the CFTC's rule on position limits—it is, in effect, almost as if that part of the law had not passed to begin with.

As of now, there's no guarantee that either Obamacare or Dodd-Frank will be made into rules that actually do what lawmakers intended. That's partly because the rule-making process is a dangerous place for a law to go. We might imagine it as a fairly boring assembly line—a series of gray-faced bureaucrats diligently stamping laws into rules—but in reality, it's more of a treacherous, whirling-hatchet-lined gauntlet. There are three main areas on this gauntlet where a rule can be sliced, diced, gouged, or otherwise weakened beyond recognition.

The first is in the agency itself, where industry lobbyists enjoy outsized influence in meetings and comment letters, on rule makers' access to vital information, and on the interpretation of the law itself.

The second is in court, where industry groups can sue an agency and have a rule killed on a variety of grounds, some of which make sense and some of which most definitely do not.

The third is in Congress, where an entire law can be retroactively gutted or poked through with loopholes, or where an agency can be quietly starved to death through appropriations bills.

And here's the really alarming part: rules run this gauntlet largely behind closed doors, supervised by people we don't elect, whose names we don't know, while neither the media nor great swaths of the otherwise informed public are paying any attention at all. That's not because we don't care what happens; we do. After all, millions of us spent the better part of a year closely monitoring the battles to pass Obamacare and Dodd-Frank. Remember? It was high drama! Every detail was faithfully chronicled in front-page headlines and long disquisitions on *The Rachel Maddow Show*; in countless posts by wonky bloggers, who dissected every in and out, every committee hearing, every new study about the pnblic option or the Volcker Rule.

That kind of stuff is the Washington journalist's bread and butter: the artful, insidious process by which a bill becomes a law. And since reporters know how the process works, how influcnce gets wielded and where the pressure points arc, the rest of us were able to follow along closely. We knew what to root for, what to keep our eye on, and which decision makers in Washington we could remind to do the right thing.

But fast-forward a couple of years, and as the fate of those very same laws is being determined in the rule-making process we've found ourselves distracted by new shiny objects, like women in combat and how Pennsylvania will allocate its electoral votes in 2016. Part of the reason for that, no doubt, is that many Washington journalists, underpaid, overworked, and required to write a dozen blog posts a day, don't have time to dedicate to following the rule-making process. Others simply don't understand it.

Regardless, the result is that the rest of us haven't followed the progress of these landmark laws in anywhere near the same way that we followed it during the legislative process. And in our inattention we've made it infinitely easier for industry lobbyists and members of Congress who voted against the laws to begin with to destroy them by subtle, nuanced, backdoor means. By quibbling over "as appropriate"s and misplaced verbs. By crafting crafty legal arguments and drowning understaffed rule makers in industry-funded hogwash. This is the way a law ends: not with a bang but with a whimper.

For purposes of illustrating the problem, this article will focus on just one of these landmark laws, Dodd-Frank. It passed more than two and a half years ago, in July 2010, but most of its rules have yet to make it through the rule-making gauntlet. While many liberals have already written it off as a total failure—some were, in fact, writing its eulogy the day it passed—it's time we had some perspective. It's true that it's not as strong as many experts on financial markets had called for. It's true that it doesn't break up the big banks, nor fundamentally change the structure of our financial system. We may have been hoping for, say, a bulletproof SUV with state-of-the-art airbags; what we got instead are a few seat belts that need to be

welded into our old rig. But as of now, those jury-rigged seat belts are the only thing we've got, and given the gridlock on the Hill they're all we're likely to get. And the truth is that they're strong enough that the financial industry is willing to spend billions of dollars to keep them from being installed.

As of now, roughly two-thirds of the 400-odd rules expected to come from Dodd-Frank have yet to be finalized. That includes big, potentially game-changing rules governing inappropriate risk taking and international subsidiaries of American banks, and how exactly we'll go about regulating derivatives. In the next year or so, the vast majority of these rules will be launched down the rule-making gauntlet. The necessary first step in assuring that they come out the other end as strong as they should be—or that they come out the other end at all—is to understand the challenges they'll face along the way.

The basic rules of rule making

The rule-making process is governed by the Administrative Procedure Act, which became law in 1946, in response to the New Deal-era expansion of the federal bureaucracy. In the late 1930s and early '40s, all the new agencies were dancing to their own beat; the APA established a system-wide metronome. Since then, a handful of other laws have been passed, including the Regulatory Flexibility Act, Paperwork Reduction Act, Government in the Sunshine Act, and Congressional Review Act, which also govern parts of the process; but for the most part the APA is the foundation.

Every stage in the rule-making process is guided by the APA. It begins the moment a law is passed and shunted off to the regulatory agency that will oversee its implementation. Once it's in the agency, the APA governs the activities of a team of rule makers—researchers, analysts, economists, and lawyers—who do a bunch of fact gathering, perform studies, and hold a ton of informational meetings in an attempt to get a handle on how best to abide by the intention of the law and how to apply that intention to real life. Since big laws like Obamacare and Dodd-Frank deal with complex issues, Congress often makes the statutes deliberately vague, deferring to rule makers' technical expertise and policy decisions, and giving them a significant amount of authority on how to interpret a law. All of that interpretation generally happens in the very beginning of the rule-making process, which is called the Notice of Proposed Rulemaking, or, in the acronymic parlance of the federal bureaucracy, NPRM.

After spending months and months in the NPRM process, the agency eventually publishes a proposed rule, on which, the APA stipulates, the public gets an "adequate" amount of time to comment. Usually, that's about sixty days, but it can be shorter or longer, depending on how complex or controversial a rule is. After that, the rule makers revise the rule again, taking into account concerns raised by regulated industries and the public's comment letters.

From there, executive branch agencies like the Food and Drug Administration and the Environmental Protection Agency send their rules to the White House Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA), which reviews the projected costs and benefits of those agencies' major new rules, as well as the suggestions of other agencies, before the final rule is published and implemented. At independent agencies like the Securities and Exchange Commission (SEC) and the

CFTC, a bipartisan panel of commissioners publicly debates and votes on the rule—a process that often results in further revisions and compromises.

Like the rest of us, rule makers use the Track Changes feature in Microsoft Word, which assigns a different color font to each contributor. By the time a complex rule has made it through this whole process, it is "lit up like a Christmas tree," said Leland Beck, who worked for various agencies for thirty years and practiced administrative law. "A rule becomes a decision on all the comments and revisions and compromises between agencies and all the individuals who got their hands on it." Eventually the agency publishes a final rule, which is implemented and enforced. *Voilá* .

Or that's how it's supposed to work. But like many things in Washington, that's just half the story. The rule-making process is actually a much messier, much more cacophonous affair, dictated to a large degree by lawmakers who voted against the law to begin with, and by industry groups who would often prefer that no rules be implemented at all. In the last decade, conservative members of Congress have built ever-higher hurdles that agencies mnst clear, and done so while cutting their staff and budgets.

Meanwhile, since the passage of Dodd-Frank, financial industry groups have also sabotaged parts of the APA's carefully plodding process, overwhelming rule makers with biased information and fear tactics and threatening to sue the agencies over every perceived infraction. That's a big reason why agencies have missed so many of their deadlines for implementing Dodd-Frank—a subtlety reporters frequently miss. (See "Why Agencies Are Always Missing Their Deadlines.")
"It's just this constant, never-ending onslaught," a former SEC staffer told me. "You're doing battle every day."

The Gauntlet, Stage 1: Asymmetric warfare in rule making

Public interest and consumer advocates tend to describe the fight over the rules of Dodd-Frank in martial terms. "It's like World War II," said Dennis Kelleher, the president and CEO of the nonprofit Better Markets. "There's the Pacific theater, the Atlantic, the European, the African theater—we're fighting on all fronts." Former Senator Ted Kaufman, an outspoken advocate for financial reform, says it's "more like guerrilla warfare." The reformers are trying "to make it at the margins, but they're totally outgunned," he said.

The financial industry certainly has a spectacularly enormous arsenal. Since the passage of Dodd-Frank, the industry has spent an estimated $1.5 billion on registered lobbyists alone—a number that most dismiss as comically low, as it doesn't take into account the industry's much more influential allies and proxies, including a battalion of powerful trade groups, like the U.S. Chamber of Commerce, Business Roundtable, and American Bankers Association. It also doesn't take into account the public relations firms and think tanks, or the silos of campaign cash the industry has dumped into lawmakers' reelection campaigns.

"The amount of money and resources they're willing to deploy to protect the status quo is unlimited," said Kelleher. His company, Better Markets—one of the slickest and most vocal financial reform shops in

town—has a $2 million annual budget, Kelleher said, which is about how much the financial industry spends on its lobbying team every day and a half.

While there's no record of the total amount the industry has spent, it's clear that there's no shortage of money in its war chest. In the last quarter of 2010, just a few months after Dodd-Frank passed, the financial industry raked in nearly $58 billion in profits alone—about 30 percent of all U.S. profits that quarter. With that sort of bottom line, spending a hundred million or so to kill a single rule that could "cost" them a couple billion in profits is a pretty good return on investment.

In 2009, researchers at the University of Kansas and Washington and Lee University studied the return on corporations' investment in lobbying for the American Jobs Creation Act, which included a one-time corporate tax break, and found that it was a staggering 22,000 percent. That means that for every dollar the corporations spent lobbying, they got $220 in tax benefits. Based on the billions Wall Street has spent to weaken Dodd-Frank, it seems that they have done similar math.

One thing all that industry money buys is a well-disciplined army. According to public records, representatives from the financial industry have met with the chosen or an agencies that regulate them thousands of times in the past two and a half years. According to the Sunlight Foundation, the top twenty banks and banking associations met with just three agencies—the Treasury, the Federal Reserve, and the CFTC—an average of 16.5 times per week, for a total of 1,268 meetings over the two-year period from July 2010 to July 2012. JPMorgan Chase and Goldman Sachs alone met with those agencies 326 times. That's 114 more times than all the financial reform groups combined.

"For every one hundred meetings I have, only one of them is with a consumer group or citizens' organization," said Chilton. While it's good that regulated industries have a chance to express their opinions and concerns to those who regulate them, he said, "the deck is just stacked so heavily against average people."

It's not just the quantity of meetings, it's the quality, too. Kimberly Krawiec, a professor at Duke Law School, published a study last year analyzing the role of external influence during the NPRM period of Dodd-Frank's Volcker Rule. (The Volcker Rule would ban proprietary trading, which is when banks trade for their own profits, and not on behalf of their customers, making them more likely to fail.) In her study, Krawiec found that while public interest organizations met with agencies in giant group meetings on the same day, head honchos from the industry often met with the agencies' top staff alone. Former Goldman Sachs CEO Lloyd Blankfein, for instance, was not expected to share the floor.

That's not an insignificant advantage, considering that the NPRM period is when "the majority of the actual agenda setting and rule making happens," Krawiec said. Because APA stipulations require that the public get a fair shake at commenting on a rule before it is implemented, a proposed rule can't be too different from the final rule or an agency can get sued, she explained. That has the effect of pushing most of the rule making to the very beginning of the process, which is also the least transparent, since agencies don't have to publish what they're up to or who their staff is meeting with during this time. Because of

increased transparency efforts surrounding Dodd-Frank, agencies have been encouraged to publish all of the meetings that occur during the NPRM period—hence Krawiec's study.

Krawiec has also found that after the Volcker Rule was proposed the vast majority of substantive public comment letters were from the financial industry, trade groups, and their various proxies—lawyers, lobbyists, and under-written think tanks—all of whom have the time and money to present extensive, if wildly biased, legal and economic arguments. Often, industry lawyers will simply rewrite entire paragraphs of the proposed rule, fashioning loopholes or limiting an agency's scope with a single, well-placed adjective or an ambiguous verb. Whether a rule survives that change, whether it then can be effectively implemented and enforced, really does come down to such trivialities. In the rule-making process, the minutiae aren't incidental to the rule; they *are* the rule. (Don't believe me? The U.S. Supreme Court recently heard a case on a 1934 SEC rule on fraud that centered entirely on different definitions of the verb "to make.")

Industry lobbyists are well aware that they don't need to outright kill a rule; they need only to maim it, and it's as good as dead. In fact, it's better than that: it's on the books, the newspapers cover it—it looks like a success for financial reform—but industry remains as unfettered as it was before. "That happens all the time," said a former rule maker at the CFTC, who spoke on the condition of anonymity. "The public interest groups get the headline, but if you look at the details, the industry group has actually won. There's an order of magnitude between the public interest groups' and the industry groups' attention to detail." When I spoke to an industry lobbyist in mid-January, he put that another way. "We can't kill it, but we can try to keep it from doing any damage," he said.

Jeff Connaughton, a lobbyist turned crusader for financial reform, said that the "ubiquitous presence of Wall Street" goes beyond meetings and legalese in comment letters. In his book *The Payoff: Why Wall Street Always Wins*, he describes the tight-knit relationships between industry lobbyists and proxies and government officials as the "Blob," which, in his experience, "oozed through the halls of government and immobilized the legislative and regulatory apparatus, thereby preserving the status quo." Many in the Blob are married to one another and move fluidly from industry to government and back again, he told me. For example, CFTC Commissioner Jill Sommers, who recently announced her resignation, is married to Speaker of the House John Boehner's top aide. She used to work at the Chicago Mercantile Exchange, one of the biggest exchanges in the world, which is overseen by the CFTC; she also worked at the International Swaps and Derivatives Association, the organization that later sued the CFTC to overturn the rule on position limits.

In this light, the traditional notion of "regulatory capture" doesn't go far enough. Instead, we should think of it as "cultural capture," writes the political scientist James Kwak. There may be no bags of cash exchanging hands, but that doesn't matter when regulators, like many of the rest of us, have been steeped for so long in the idea that Wall Street produces the best and brightest our society has to offer. Regulators often look up to industry representatives, or know them personally, which begets "the familiar effect of relationships," Kwak wrote in *Preventing Regulatory Capture*, a compilation of essays that will be published this year by Cambridge University Press in collaboration with the Tobin Project, a nonprofit

research center. "You are more favorably disposed toward someone you have shared cookies with, or at least it is harder for you to take some action that harms her interests."

Like many reformers, Connaughton points a finger at the so-called "revolving door," which sends former bureaucrats into the private sector and vice versa, blurring the line between the regulators and the regulated. From 2006 to 2010, 219 former SEC employees filed 789 statements saying that they would be representing a lobbyist or industry group in front of the SEC, according to the Project on Government Oversight. A complex law like Dodd-Frank accelerates that cycle, Connaughton said, as industry has even more incentive to hire people directly from the agencies to help them navigate the new regulations. "Put your time in at one of these regulatory agencies while they're doing the Dodd-Frank rule making and it's a license to print money when you come out," he told me.

Of course, the revolving door doesn't explain everything. A lot of the agencies are packed with ten-, fifteen-, and twenty-year veteran rule makers, who are motivated by the esprit de corps and have no interest in leaving for industry. "Money isn't everything. If you leave, there's the feeling that you're in the audience, and no longer on the public policy stage," the former CFTC rule maker told me. "That, and at the agency you're actually performing a public service. People recognize that. It's a factor."

Also, the revolving door revolves both ways. Industry leaders who are later appointed as commissioners sometimes provide a valuable asset to rule makers. In agency parlance, "they know where the bodies are buried." In many iustances, these former industry officials head agencies at the end of their careers and have no intention of returning to the private sector. CFTC Chairman Gary Gensler, for example, spent eighteen years at Goldman Sachs, eventually rising to partner, before becoming one of the most outspoken advocates in recent years for better regulation. (In 1934, President Franklin Delano Roosevelt appointed Joseph Kennedy to head the brand-new SEC for this exact reason.)

Another swiuging mace in this stage of the rule-making gauntlet is what Kelleher, the head of Better Markets, calls the "Wall Street Fog Machine." "They come at you with this jargon," he said. "They want to make you feel like it's too complicated for you to understand. You're stupid, and they're the only ones who get it—that's the end game." This is particularly true when it comes to financial products, like customized swaps, which traders on Wall Street have spent the last decade designing precisely in order to swindle their clients.

"That's how you make money. You make it so complicated the clients don't understand what it is they're buying and selling, or how much risk they're taking on," said Alexis Goldstein, who worked in cash equity and equity derivatives on Wall Street for several years, first at Merrill Lynch and then at Deutsche Bank, before joining the reform movement. The more complex the product, the higher the commission you can charge, and the less likely it is that there will be copycats driving down your profit margins with increased competition, she explained. In other words, complexity "isn't a side effect of the system—it's how the system was designed."

Partly as a result of that business model, the system really is complicated—extraordinarily so. But that doesn't mean it can't *also* be regulated in the right ways, reformers say. How exactly that should be done is often a bone of contention. Take those customized swaps, for example. Right now, they're traded in the private "over the counter" market, which means that they're contracted bilaterally, often between a single bank and a counterparty during a phone call, and they aren't transparent. Dodd-Frank gives the CFTC the power to regulate them, and many suggest that all trades should be conducted in clearinghouses, where customers can easily compare prices and are therefore less likely to be fleeced. Banks claim they're too complex to be traded in that way.

Kelleher says that's "just plain false." A customized swap is nothing more than a bundle of so-called "two-legged" swaps, he said. If you unbundle them, which the banks themselves do, for lots of reasons, like hedging, there's no reason we can't regulate them, he said. Just as Wall Street used the excuse of complexity to hoodwink their clients, they're now using the excuse of complexity to hoodwiuk their regulators—"it's the greatest coup they've managed to pull off," Kelleher said.

Others argue that customized swaps should be regulated but clearinghouses aren't the answer. They worry that if all such trading is moved to clearinghouses, then those institutions will balloon, leaving them vulnerable to collapse, said Peter J. Ryan, a fellow at the University of California Washington Center whose research focuses on financial services policymaking. In other words, the clearinghouses themselves could become too big to fail.

The real problem here is not that rule makers can't understand Wall Street's complex financial products. It's that they often don't have enough information about those products or the systems that govern them to see the whole picture, and therefore to choose the best possible way to regulate. As it stands, rule makers, as well as the teams of agency researchers who help them, rely to a large degree on industry to provide data about things like banks' internal trading. For proprietary reasons, only the banks have access to much of that information, and they have no incentive to share it. When regulators request data in public comment letters, industry rarely provides it; when they do, it's often incomplete, one-sided, or missing crucial variables. "If there's a datum that supports their argument, they produce it. If not, they don't—why would they?" said Naylor of Public Citizen.

This is one of the main reasons the Volcker Rule has been such a mess. It requires that regulators determine what's proprietary trading (when banks trade with their capital base for their own profit) and what's market making (the backbone of a bank's basic business model). A Credit Suisse lobbyist claimed recently that the metrics in the Volcker Rule were flawed since, in a test run, the bank found that proprietary trading and market making were indistinguishable. Credit Suisse's claim will go into the rule makers' record, which, in turn, can be used as evidence in court, should implementing agencies be sued. In that situation, rule makers and reformers are left without a card to play. "We can't dispute [their claim], because Credit Suisse owns the data and won't share it publicly," Naylor said.

While Dodd-Frank provides rule makers with access to a variety of new information sources—the new Office of Financial Research, the SEC's Consolidated Audit Trail, the CFTC's Swaps Report—none of these tools do enough yet to keep them ahead of the financial industry's constantly morphing business model,

which changes every time an analyst invents a new product or a new way to trade it. "The regulators need to be able to pool all of this disparate information together into a complete picture of the financial system, which I'm not sure if they have the funding and coordination to do," said Marcus Stanley, the policy director at Americans for Financial Reform, a coalition of consumer, labor, small business, and public interest groups. If a shape shifter shows up as a mouse, building a mouse trap will only get you so far.

It is in some ways a Sisyphean task. Here you have a group of rule makers—lawyers, economists, analysts, and specialists—sitting around a table. On one side, they've got the language of Dodd-Frank, which requires them, by congressional mandate, to effectively regulate new, never-before-regulated products in never-before-regulated markets that change by the month. On the other side, they've got a pile of reports, nine out of ten of which were provided by the same industry they're trying to rein in. Meanwhile, industry lobbyists and lawyers are crowding into their conference rooms on a nearly daily basis, flooding their in-boxes with comment letters, and telling them that if they do something wrong, they'll be personally responsible for squelching financial innovation and destroying the economy. "They're scared to death," said Naylor of Public Citizen, who compares the effect the financial industry has on rule makers to Stockholm syndrome. "No one wants to be the one who writes the rule that screws up the entire financial system."

Wall Street is well aware of rule makers' human vulnerabilities. Last year, when the SEC was writing rules governing money markets, the U.S. Chamber of Commerce, one of the financial industry's staunchest allies, launched a public relations campaign in D.C.'s Union Station, which abuts the SEC building. They papered the place with dozens of bright purple and orange posters, billboards, and backlit dioramas on the train platforms and above the fare machines, asserting that money markets are strong: "Why risk changing them now?" It is not coincidental that a good number of rule makers began and ended their daily commute beneath those very banners. "We certainly want to get the attention of those who are capable of giving us the answers," David Hirschmann, a Chamber of Commerce official, told Bloomberg at the time. One imagines him stifling a smirk.

Given the many whirling hatchets in this stage in the regulatory gauntlet, it's a miracle any rules have emerged in the last couple years reasonably unscathed. But they have. When that happens, industry can appeal to the second stage in the gauntlet: litigation.

The Gauntlet, Stage 2: Cost-benefit analysis and a conservative court

On a sweltering summer day in 2011, the U.S. Court of Appeals for the D.C. Circuit—the de facto second most powerful court in the land, and the body that oversees the agencies—sent shockwaves through the regulatory apparatus.

In a now-infamous case, *Business Roundtable vs. SEC*, a three-judge panel decided in favor of two of the financial industry's biggest backers and overturned the SEC's so-called "proxy access" rule. The rule would have made it easier for shareholders to elect their own candidates to corporate boards, allowing investors to put the brakes on out-of-control CEO pay. In the past decade, it has attempted to establish a proxy access rule on three separate occasions, but each time it was cowed into submission by industry

lobbyists claiming that the rule would destroy corporate growth. In 2011, emboldened by the language of Dodd-Frank, which explicitly authorizes the SEC to establish a proxy access rule, the agency tried once again.

Almost immediately after the final rule was published, the Business Roundtable and the U.S. Chamber of Commerce sued the SEC on the grounds that the agency's cost-benefit analysis was inadequate. The judges agreed, marking the first time that the court had overturned a rule explicitly authorized by Dodd-Frank. But that's not the part that sent shockwaves through the regulatory apparatus. The D.C. Circuit has overturned dozens of regulations over the years, including six SEC rules in the previous seven years, for lots of reasons, including inadequate cost-benefit analyses.

What sent the shockwaves was that this case didn't seem to have anything to do with cost-benefit analysis at all. In the vitriolic decision, the panel of judges, all of whom were appointed by Republican presidents, lamented that due to "unutterably mindless" reasoning, the SEC had "failed once again" in its cost-benefit analysis. But the court never cited how exactly the agency's twenty-three-page economic impact report could have done better. It simply appeared to *disagree* with the agency's policy choice—and that, apparently, was grounds enough to overturn the rule.

"It was a shot across the bow," said Michael Greenberger, a former regulator and professor at the University of Maryland Carey School of Law. The decision set a radical new precedent that would affect not only the SEC but all the independent agencies tasked with implementing Dodd-Frank, he said. It would also raise a powerful question: Should specific policy judgments be made by the agencies or the courts? "It upset the balance of the power," Greenberger said.

Part of the issue here is that the D.C. Circuit is packed high with conservative judges. Eight out of eleven on that bench were appointed by Republicans; despite four vacancies, Obama's nominations have been stymied consistently by Republicans in Congress. The three-judge panel that decided *Business Roundtable*included two Reagan appointees, Judge Douglas Ginsburg and Chief Judge David Sentelle, a Jesse Helms protégé. (That's the same Sentelle, by the way, who headed the panel that fired Whitewater independent counsel Robert Fiske, a moderate Republican, and replaced him with Kenneth Starr.) The third judge was George W. Bush appointee and consummate Ayn Randian Janice Rogers Brown. All three have made a bit of a name for themselves over the years as conservative activists, unafraid to mold precedent to fit their ideological ends. Their decision in *Business Roundtable* didn't break that mold.

In one section, for instance, the judges ask why the SEC would have dismissed public comments suggesting that proxy access could exact a significant economic cost to corporations. Judge Ginsburg writes, "One commenter, for example, submitted an empirical study showing that 'when dissident directors win board seats, those firms underperform peers by 19 to 40% over the two years following the proxy contest.' " But hold the phone. Or, better yet: WTF? Ginsburg fails to note here that the "one commenter" in question *is one of the plaintiffs*, the Business Roundtable. And as for that "empirical study"? It was conducted by an economic consulting group hired *by that same plaintiff*. In the rest of the decision, Ginsburg appears to ignore the precedent set by the foundational 1984 *Chevron* case, which,

among other things, stressed that judges must afford "deference" to an agency's interpretation of a statute, especially when it's "evaluating scientific data within its technical expertise."

Questionable judicial behavior aside, the *Business Roundtable* decision marked "the culmination of a trend empowering regulated entities to strike down regulations almost at will," wrote Bruce Kraus, a former counsel at the SEC, in a subsequent report. For one, it established an inherent bias—reformers cannot, after all, challenge a rule in court to make it *stronger*. For another, it opened up the floodgates for future suits. If two of the industry's most powerful organizations could sue the SEC and overturn a rule on such grounds, it was suddenly feasible for industry groups to sue *any* agency and overturn *any* new Dodd-Frank rule using the same arguments.

It was a point that did not go unnoticed by industry. "I would hope the agencies are taking to heart the potential consequences for Dodd-Frank rules," said lead counsel Eugene Scalia, after the case was decided. (Scalia was also lead counsel on the case that overturned the CFTC's rule on position limits a year later.) Industry groups have since brought a half-dozen more cases against agencies on practically identical grounds.

The *Business Roundtable* decision had the immediate effect of adding a whole new lethal section to the regulatory gauntlet, this time complete with flypaper and trapdoors. In the months following, the SEC's progress through the Dodd-Frank rule making is estimated to have slowed by half as they struggled to "bulletproof" their rules from future lawsuits. ("They have to be *more* than bulletproof," Chilton told me, when I asked him if that was a factor for the CFTC, too. "They have to be layered in Kevlar. We go way beyond the requirements of the law.")
The decision also had the effect of tipping the balance of power at independent agencies. By making an agency's cost-benefit analysis the centerpiece of the litigation, economic models now hold disproportionate weight. If a single economist at an agency produces a report, based on a single model, and "demonstrates" that a rule would exact steep costs from a given industry, it acts like a trump card, according to former staffers at the SEC and the CFTC. Even if the majority of that economist's colleagues disagree with him, his report will enter the public record, where it can be cited in a subsequent lawsuit and end up determining if a rule is implemented or not. And economic models are like statistics; you can always find one that supports your position.

Along those same lines, in the wake of *Business Roundtable* a single commissioner—one of five on a bipartisan panel—now has the de facto power to torpedo a rule simply by questioning its economic impact in a public forum. For example, if a Republican commissioner disagrees with a rule, he will, under normal circumstances, be required to compromise with his fellow commissioners, or risk being simply outvoted. If at least three of his colleagues disagree with him, the rule will pass. The *Business Roundtable* decision seemed to suggest that a single commissioner's verbal expression of disapproval could be used later as grounds for litigation and as evidence in court. Indeed, a year after the *Business Roundtable*decision, in the CFTC's position limits case, part of Scalia's argument rested on the fact that former CFTC Commissioner Michael Dunn has expressed misgivings about the rule.

"When a commissioner says publicly, 'I'm concerned about the economic impact of this rule,' that's enough to lay the groundwork for a future case," said Chilton. Several former rule makers and staffers at the CFTC and the SEC told me they would "not be surprised," given the wording of these public expressions of disapproval, if these commissions were getting their language directly from industry lawyers.

The most profound weapon the *Business Roundtable* decision introduced into the regulatory gauntlet is stupefying uncertainty. "It has been paralyzing for the agencies," the former CFTC rule maker told me. How extensive must their cost-benefit analyses be? What kind of costs must be measured? And costs to *whom*—the industry or the investors? What were the criteria? "It's like going into a class and not having any idea how your professor grades," he said. "Everyone is trying to figure out how to move forward without getting sued."

In the past, when an agency has been sued over a rule, that litigation has often marked the end of the rule altogether. Most are never re-proposed, and those that are often emerge pitifully weak. It also has the effect of sending an agency back to the starting line, where it must run the gauntlet yet again, only this time with more attention from Congress—which is often the most lethal weapon of all.

The Gauntlet, Stage 3: Congress's retroactive attacks

Many of us think of Congress as passing a law, shunting it off to the agencies, then wiping its hands of the matter. Not the case. Lawmakers, and particularly those who voted against Dodd-Frank to begin with, have a number of tools up their sleeves, which they've been using consistently since 2010 in an attempt to retroactively weaken the act.

One way has been to go after the regulators personally, lambasting them publically, smearing their reputations, and wasting their time. In the wake of the *Business Roundtable* decision, for example, the House Financial Services Committee summoned former SEC Chairwoman Mary Schapiro to testify before Congress about why the SEC had failed in its cost-benefit analysis. The Senate Banking Committee, obliquely questioning her competency as a leader, also requested a series of investigations into why her agency's cost-benefit analyses were falling short. While lawmakers have a legitimate right to ask the heads of regulatory agencies to testify, in the past few years Congress has seemed to blur the line between inquiries and something more akin to the Inquisition. All told, since 2009 Schapiro has been called to testify before Congress forty-two times.

"On one hand, those attempts to create a scandal don't mean anything," said Lisa Donner, the executive director of Americans for Financial Reform, referring to Congress's harassment of Schapiro late last year. "But on the other hand, those performances waste an enormous amount of time. It plays a role. It's intimidating."

Also in the wake of *Business Roundtable,* Alabama Republican Senator Richard Shelby, as if on cue, wielded another of Congress's favorite weapons to kill a law in the regulatory process. He introduced a bill

suspending all the independent agencies' major rules until they could be subjected to OIRA, the Office of Management and Budget's subsidiary, which vets the cost-benefit aualyses for new executive branch rules. Had that bill passed, it would have had the effect of stopping all Dodd-Frank rule making in its tracks indefinitely. It didn't pass, but last summer a similar bill—this one bipartisan—the Independent Agency Regulatory Analysis Act, was introduced and passed in the House, before failing, in the nick of time, in the Senate.

In the two and a half years since Dodd-Frank passed, lawmakers have introduced dozens of other such bills, so-called "technical amendments," that purport to change or clarify certain sections of Dodd-Frank but would actually gut, defang, or kill the act entirely. Because the bills are presented as mere tweaks to an existing law, and because industry cash is the only way many of these congressmen will get reelected, the bills are often voted on quickly, sometimes even coming up for a voice vote—a procedure usually reserved for uncontroversial issues.

Take the Swap Jurisdiction Certainty Act, for example. That bipartisan bill would have prevented the CFTC and the SEC from regulating derivatives trades conducted by American companies' subsidiaries overseas. That's insanity. First, if any of those subsidiaries—much less hundreds of them at once—were to fail, they would threaten and potentially take down the U.S. market. (Indeed, during the 2008 crash, U.S. taxpayer money was used to bail out those foreign-based subsidiaries too, for precisely that reason.) And second, if you only regulate the derivatives traded by American institutions on U.S. soil, American traders will simply scoot their business over to the thousands of subsidiaries abroad, making those unregulated markets even larger and more dangerous. In other words, had this bipartisan, innocent-looking bill passed, it would have undermined all the provisions in Dodd-Frank that attempt to regulate the derivatives market at all.

While the efforts of public interest groups and financial reform advocates, like Americans for Financial Reform, have succeeded thus far in keeping any of these bills from passing, they still have an effect behind the scenes. "There are instances where regulators say, 'I know what we want to do with this, but if we go too far, Congress is just going to wipe out the whole thing, and I want what we're doing to last,' " said Stanley, the policy director at Americans for Financial Reform. "That's a calculation."

A much more common weapon congressional opponents can wield after a law has been passed is a little less dramatic. By attaching riders to appropriations bills, Congress can simply forbid an agency from using its money to enforce oue specific rule or another—and, of course, an unenforced rule is a dead rule. Lawmakers can do that even if Congress has passed another law that pointedly mandates that an agency take the action in question. In 2011, for instance, the House Appropriations Committee, which is dominated by Republicans, attached a rider to its funding bill preventing the U.S. Department of Agriculture from using its funds to finalize and implement a series of specific rules helping small farmers fight back against big livestock and poultry corporations. Despite the Obama administration's attempts to get those exact rules implemented, the rider passed, tying the USDA's hands and sending small farmers adrift. (For more on this, see Lina Khan, "Obama's Game of Chicken.")

Using the same mechanism, Congress also has the power to defund or severely underfund any agency that relies on congressional appropriations, including the CFTC and the SEC—a guillotine it has successfully used for decades. Just last year, for instance, the House Appropriations Committee cut the CFTC's annual budget by $25 million, leaving it with an anemic $180 million. (For a sense of how little money this is, consider that San Bernardino, a county of about two million people in California, spends more than $180 million just on its public works department.) In 2011, congressional opponents of financial regulation blocked any increase in the SEC's budget, despite or perhaps because of the agency's massive new workload with Dodd-Frank. The Republicans' argument against funding the independent agencies is delightfully absurd: since the agencies have not written and enforced rules fast enough, Congress should "punish" them, rather thau "reward" them with adequate funding.

Yet another weapon Congress uses to retroactively kill bills in the rule-making process is to block presidential appointments. In January, another three-judge panel at the D.C. Circuit, led by the same conservative crusader who voted to overturn the SEC's proxy access rule, Judge Sentelle, ruled that Obama's recess appointments were unconstitutional. It was a radical decision that has the potential to invalidate rules and guidelines promulgated by the National Labor Relations Board and the Consumer Financial Protection Bureau for the previous year. The decision may be reconsidered (and, heaven help us, affirmed) by the Supreme Court, but in the meantime it brings the independent agencies further into Congress's orbit.

Congressional Republicans are already using the decision to strong-arm Congress into weakening the CFPB's independence. The only way Congress will allow Obama to reappoint CFPB Director Richard Cordray, or to install another head, Republican lawmakers say, is if the agency's funding is brought under congressional appropriations controls. It's an underhanded move that would eliminate the CFPB's strongest asset—that it's *not* subject to Congress's manipulative purse strings—and may have the effect of gutting the entire agency, one of the strongest things that's come out of Dodd-Frank thus far.

Gunning for the finish line

It's true that Dodd-Frank started out as a compromise. "It was compromise on top of a compromise—a pile of compromises," said Kelleher of Better Markets. And that's what we can expect from the rule-making process too, he said. As it stands, how the law has fared in its journey down the regulatory gauntlet has been mixed.

Some rules have been spectacularly hacked to death. Take, for example, a joint rule by the SEC and the CFTC, which was intended to force swaps dealers into maintaining more capital and to prevent horrible scenarios, like the collapse of AIG, from ever happening again. When it was first proposed, the rule required that every dealer trading more than $100 million in swaps should be subject to regulatory oversight. A bill proposed by Illinois Republican Representative Randy Hultgren raised that threshold to $3 billion, but the agencies, intimidated by lobbyists' doomsday scenarios and under the constant threat of litigation, raised it again: to $8 billion. The rule that eventually emerged now exempts about two-thirds of all swaps dealers from new capital requirements.

Scenarios like that can be deflating for reformers, but there have been wins, too. The CFPB remains a major success for consumer and investor advocates, and the SEC's rule on whistleblowers appears to have emerged fairly intact. The CFTC's brand-new Swap Data Repositories, which were designed to collect data about over-the-counter derivatives transactions, are also up and running, with the potential to shed some much-needed light on that shady industry. Whether the new repositories will be useful to regulators, or whether they will be undermined by a future lawsuit or lack of funding, is still unclear.

In some arenas, most notably the D.C. Circuit's activist bench, reformers have faced crushing defeats. Yet all is not lost. In a case this past December, the U.S. District Court for D.C., a notch below the D.C. Circuit, handed the industry its first loss in years, deciding in favor of the CFTC's rule requiring registration of mutual funds that engage in derivatives trading. It also marked the eud of a five-case winning streak in lead counsel Eugene Scalia's battle against agency rules. Judge Beryl A. Howell, an Obama appointee, decided against the U.S. Chamber of Commerce and the Investment Company Institute. (Both are now appealing that case to the D.C. Circuit.)

The Dodd-Frank rules that, against all odds, have emerged relatively intact underscore an important point: those who favor strong regulations are not without shields to protect rules against the many whirling weapons along the regulatory gauntlet. But in order to be effective, of course, those shields have to be used.

First and foremost, the White House has to get more involved in defending its own legislative achievements from being gutted in the rule-making process. In addition to appointing more judges to the D.C. Circuit (and that's no guarantee of success; the judge who decided against the CFTC's position limits rule was a Democratic appointee), the administration should deploy its best Justice Department lawyers to defend against the industry's court attacks on Dodd-Frank rules. It should aggressively push to fill vacancies at the agencies with pro-regulation commissioners and other agency heads, and fight harder for bigger agency budgets. And the president himself should shine a spotlight on the process, and support the work rule makers do by paying personal visits to the agencies.

Second, the administration and its allies in Congress must address as quickly as possible the asymmetry of information in the agencies. In order to do their jobs, regulators must be armed with objective information to offset the biased or incomplete reports they receive from industry. This is particularly important for a small, underfunded agency like the CFTC, which doesn't have the stable of researchers and economists employed by some of its brethren, including the Fed, the CFPB, and the FDIC.

The good news is that Dodd-Frank mandated the creation of a new office whose mission, in part, is to correct this imbalance of information. Housed in the Treasury and funded by bank fees, the new Office of Financial Research was conceived as a kind of giant weather station monitoring the financial industry in order to detect potential "storms" before they arrive. To that end, it's statutorily authorized to gather, with subpoena power if necessary, grannlar-level data from financial institntions, including information about banks' trading partners, positions, and transactions, and to make that data available to other regulatory agencies. The only question is whether the OFC will have the political backing it needs to fulfill those ends.

As of now, it has a very small budget and an advisory board heavily weighted with industry insiders. It's also facing extraordinary political opposition, mostly from congressional Republicans, who have called for nothing less than its immediate abolishment, arguing that it compromises data security and encroaches on the private sector. Making sure that the OFC survives and overcomes any legal challenges to its ability to share key information with regulators should be a top agenda item for congressional Democrats and the new treasury secretary, Jacob Lew.

Third, reformers and reform-minded analysts, lawyers, and academics need to do a better job of making their voices heard in the agencies. The Administrative Procedure Act, which governs the rule-making process, painstakingly enshrines public commentary, but as of now the vast majority of the substantive comments are coming from industry groups and their proxies, including bought-and-paid-for think tanks, trade groups, and consulting firms, which have the time and legal expertise to dedicate to such things. Launching a counterinsurgency in kind will obviously require a pretty chunk of change. Perhaps it's a place where foundations can make a real difference. If more individuals and groups weighed in with smart ideas and substantive research to counter industry, it could help strengthen the rule makers' hands.

Rule makers read and make note of every comment letter, and those letters have a cumulative effect of pushing policy, staff members at the SEC and the CFTC told me. That's particularly true in instances where a rule-making team believes the best public policy differs from what indnstry is advocating. "To the extent that there was already an argument for a given position, a public letter will give a team support. There's a sense of 'See? Other people think this too,' " a former SEC staffer told me.

Reform groups like Americans for Financial Reform, Better Markets, and Public Citizen have thus far done a heroic job writing substantive, evidence-based letters of concern and organizing public letter-writing campaigns. Groups like Occupy the SEC, which is run by people with direct experience in the financial industry, have also submitted long, well-informed reports to the agencies and engaged with rule makers personally. Those voices make a big difference. But they go only part of the way toward countering the overwhelming influence that industry has enjoyed.

Fourth, what's needed is the vigilance of the wider public. That may seem unreasonable to expect—who has the time or inclination to follow the grammatical arcana of rule making as it moves through the process? But in an age of Wikipedia, when millions of people write and edit tomes on obscure and complex issues on a daily basis, there's no reason in theory why more Americans couldn't weigh in on regulations that most of them clearly favor. Nearly 75 percent of voters, Republicans and Democrats alike, support "tougher" rules and enforcement for Wall Street financial institutions, according to a 2012 poll commissioned by a coalition of consumer, reform, and public interest groups.

Those same citizens should also prod their members of Congress. The political scientist Susan Webb Yackee has found that the attention of lawmakers is one of the primary factors that can help curb industry influence in the regulatory process. In the stew of congressional power struggles, and with the financial industry furiously underwriting lawmakers' reelection campaigns, members of Congress have a variety of reasons *not* to stick their necks out. Their constituents should insist that they do.

Finally, there's no mystery about how to stir up public attention: the press needs to do a better job of covering the regulatory process. Again, that may seem unreasonable, especially in an age when for-profit news has lost its business model. But it needs to be done. Those same editors, reporters, bloggers, and wonky producers at *The Rachel Maddow Show* who followed the passage of Dodd-Frank so closely two and a half years ago should tune in again.

As of early February, fewer than 150 of the estimated 400 rules from Dodd-Frank had been finalized, according to Davis Polk & Wardwell, a law firm that keeps track of such things. Nearly the same number had not even been *proposed* yet. All together, almost 65 percent of the law, including potentially significant hunks, like rules on extraterritoriality and systemic risk, have yet to be finalized.

In the next year or so, the vast majority of these new rules will enter the regulatory gauntlet, while agencies and industry will watch carefully as those that have already been finalized are implemented and enforced. Industry and its allies in Congress will scream bloody murder and claim that Dodd-Frank rules are imposing an insurmountable burden on industry, the economy, and the American people. Meanwhile, the agencies either will attempt to hold the line or, without the glaring light of public scrutiny, they will allow industry to take the lead again. What happens in the next year or two will have a profound effect not only on Dodd-Frank, but on the future of our financial industry. "We're in the fifth inning," said Kelleher. "The only way to guarantee you'll lose is if you walk ont before the end of the game."

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