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## Overview: Consumer Financial Protection Agency

*"When you buy a toaster, if it explodes in your face there's a law that says your toasters need to be safe. But when you get a credit card, or you get a mortgage, there's no law on the books that says if that explodes in your face financially, somehow you're going to be protected."*  
- President Barack Obama, 3/19/2009

There are thousands of different credit products. The quality of products varies dramatically, from subprime mortgages and credit cards loaded with tricks and traps to reasonably-priced, sensible products that help borrowers navigate through difficult times or to build wealth. With increased complexity and fine print, however, most customers cannot distinguish between good products and bad, which means that billion-dollar advertising budgets often push customers toward worse products.

It is time to repair this market, both to provide the same basic safety standards for home mortgages, auto loans, and other financial products that are guaranteed for a bar of soap or a tube of lipstick and to permit a level playing field among big-budget and small-budget financial institutions. Such basic standards not only would have prevented the subprime crisis and ensuing global financial meltdown, but they can also prevent similar crises in the future.

### I. The Problem: Bad Products and Weak Regulation

#### **A. The Spread of Dangerous and Misleading Financial Products**

There is overwhelming evidence that many mortgage, credit card, and other financial products are deliberately designed to confuse and trap customers in higher cost products that can cause long-term indebtedness, foreclosure, and bankruptcy. Dangerous and misleading financial products not only put individual consumers at risk, but put the entire economy in danger by increasing risk throughout the financial system.

- **Mortgages** - Fannie Mae estimates that 50% of those who were sold high-cost subprime mortgages would have qualified for much less expensive prime-rate loans. HUD found that consumers spend approximately \$55 billion in closing costs they don't fully understand, concluding that "buying a home is too complicated, confusing, and costly." At the heart of the current crisis is the fact that millions of deceptive mortgages that were sold to homeowners over the last 10 years then got packaged and resold as mortgage backed securities and collateralized debt obligations. Warnings about the danger went unheeded, and the economic crisis began as the mortgages exploded.
- **Credit Cards** - The Federal Reserve found that many consumers did not understand key credit card terms, such as: the ability of the lender to change the "fixed rate" APR; what might trigger the rate to change; what fees were associated with the product; how the balance is calculated; or the cost of

convenience checks. In the early 1980s, the typical credit card contract was one page long; at present, it has grown to more than 30 pages.

- **Tax-Refund-Anticipation Loans** - Approximately 50% of tax-refund-anticipation borrowers were not aware of the fees charged by the lenders. Other types of predatory loans similarly cloud terms and conditions, prevent consumers from comparing products, and create competitive pressures on even those institutions committed to offering clean products.

## **B. The Current Regulatory Structure is Badly Fractured, Creating Inefficiencies and Gaps**

A loose amalgam of common law, statutory prohibitions, and regulatory-agency oversight, the current structure is incapable of providing effective protection for consumers and fair competitions for lenders.

- Among subprime mortgage issuers, 23% were regulated under laws governing thrifts and banks; 25% for holding companies; and 52% had no federal supervision whatsoever.
- Current rule-writing authority for nearly 20 existing laws is spread out among at least seven agencies. Some authority is exclusive, some joint, some concurrent. Regulatory burdens are duplicative, without being effective.
- Many financial institutions can choose their regulators. If one regulatory agency pushes for reform, large financial institutions can simply re-incorporate as a different kind of entity in order to sidestep the new rules.
- The primary charter of regulatory bodies such as the Federal Reserve Board, the OCC, and the OTS is to protect *banks* rather than *consumers*. These regulators have failed to exercise their powers to provide even minimal protection for consumers.
- Regulations are often so complex that financial institutions need multiple compliance officers to manage routine products. Large institutions can spread those costs among millions of borrowers, but smaller institutions cannot and are unfairly disadvantaged.
- Congress moves much more slowly than the financial services industry. The last major financial regulation was enacted in the early 1980s, at a time when most of today's dangerous financial products had not yet been invented. Lenders can change a product with a few keystrokes on a computer, which means a nimble, responsive rulemaking agency is needed.

## **II. The Solution: Consumer Financial Protection Agency**

### **A. What CFPA Would Do**

- CFPA would help our country out of the current crisis and put our economy on the road to financial stability by halting the spread of deceptive and dangerous products.
- CFPA would establish meaningful guidelines for consumer disclosure, collecting and reporting data, reviewing new products for safety, and prohibiting dangerous products.
- CFPA would stop the race to the bottom in the development of financial products that benefits financial institutions with the biggest advertising budgets while leaving smaller institutions to choose between declining revenues and lowering their own lending standards.
- CFPA would support short, plain-vanilla, safe-harbor contracts and products to reduce compliance burdens for lenders that seek to offer straight-forward, customer-friendly loans.
- CFPA would limit the damage caused by bad products not only on families, but also on third parties. With fewer bad products in the marketplace, responsible lenders will suffer less collateral damage resulting from consumer bankruptcy, foreclosures, and defaults.

- CFPA would apply the same rules to the same products, unlike the current system that regulates by the type of lending institution. This approach would eliminate regulatory gaps and contradictions and minimize regulatory arbitrage that benefits “too big to fail” financial institutions while small institutions are shut down.
- CFPA would establish rules to support a fair and safe free marketplace, making it easier for consumers to make informed choices. Ultimately, this would increase consumer confidence, build family stability, and reduce the risks of a future global banking meltdown.

#### **B. What CFPA Would Not Do**

- CFPA would NOT discourage innovation.
  - In fact, CFPA will enhance innovation by preventing the deceptive and dangerous financial products from pushing truly innovative products out of the market. It is the same as product safety: toaster manufacturers cannot undercut competitors by eliminating insulation to prevent fires, and lenders should not be able to boost revenues through tricks and traps.
- CFPA would NOT paternalistically undermine consumer choice.
  - Like the Consumer Products Safety Commission, the CFPA is *not* designed to protect people from themselves and their own bad decisions, but instead to protect the market from deceptive practices and concealed dangers. With better tools to understand financial products, consumers can make their own choices—and be held to them.
- CFPA would NOT fix prices or stamp out products targeted at low-income consumers.
  - Low income consumers are often targeted for the highest-priced, most deceptive products. Because their resources are often constrained, the impact can be devastating. Clear products that explain their costs will permit everyone—especially low-income families—to make better financial choices.
- CFPA would NOT increase total regulatory burdens.
  - By encouraging the development of plain-vanilla, safe harbor contract forms and by reducing duplicative—and ineffective—disclosures, the CFPA can save time and resources for small institutions using traditional, safe products. Under such a system, only those institutions seeking to market deceptive and dangerous products would encounter more burdensome regulation.

#### **III. Safety Commissions are a Proven, Effective Approach.**

- No agency is perfect, but consider how different life would be without a Consumer Product Safety Commission that improved toy safety and infant car seats or a Food and Drug Administration that made sure drugs were safe, effective, and correctly labeled.
  - Safety commissions are also cost effective. Standards for three products alone – cigarette lighters, cribs, and baby walkers – save annually more than \$2 billion, which is more than the Consumer Product Safety Commission’s total *cumulative* budget over the past 35+ years.
- An agency is highly flexible, easily able to adapt quickly to new product innovations in a low cost way, without the need for a cumbersome legislative process.

**CFPA Supporters** include: President Obama; Chairman Dodd; Chairman Frank; Nobel laureate Joseph Stiglitz; economists Robert Shiller and Robert Reich; economic historian David Moss; and economic regulation professor Dan Carpenter.