Consumer Financial Protection Bureau

Taskforce on Federal Consumer Financial Law Public Hearing

July 16, 2020
3:00pm to 5:00pm Eastern

Participants: Professor Mehrsa Baradaran, University of California, Irvine; Professor Vicki Bogan, Cornell University; Dean Marcus Cole, University of Notre Dame; Professor Vernon Smith; Chapman University

Taskforce Participants: Todd Zywicki (Chair), J. Howard Beales III, Thomas Durkin, William Macleod, Jean Noonan

Taskforce Staff Participant: Matt Cameron

Readout: On Thursday, July 16, 2020, the Taskforce on Federal Consumer Financial Law (Taskforce) met with a panel of four academics to hear ideas and perspectives on the consumer protection legal framework, information and education, competition and innovation, inclusion, and modernizing the financial regulatory framework. Highlights from the meeting included:

Opening Statements:

- **Prof. Smith**
  - The fundamental problem we face in asset markets stems from the retrying ability of durable assets.
  - Asset markets can be a problem because they have value in use and value in exchange. These values can become disconnected. Sometimes, for long periods which can lead to price collapse of durable goods (thereby hurting those who have built wealth in the investment of durable goods).
  - When this value disconnects from exchange value, crisis become subject to rational trend based on momentum trading. Disconnected from rationality based on expected fundamental use value, rational expectations are not long, but they are simply trumped by trained volume.
  - Severely sessions like the depression the great recession are balanced sheet recessions because most people's wealth is in their homes.
  - Securities market, collapses yield far less fallout, partly because they are less widely held, but much more importantly because margin loan purchases of securities are against call loan debt.

- **Prof. Baradaran:**
  - Accessing money without significant costs or surcharges is an issue hurting poorer people
  - Currently delays in stimulus funding or tax returns are also costly to the poor. For those who finance tax return preparations through refund anticipation checks, evidence suggests they will turn to payday lenders, title loans, pawnshops because these always fill the void where the banking sector fails to do so.
  - The crisis highlighted communities that these issues affect more dramatically, specifically black and brown communities, low income communities, rural communities. Over the last 10 years, as bank mergers have sped up, over 93% of bank closures were in these communities. Rural America has lost over half of its banks. The higher costs on both lenders and financial transaction providers and filling the void, which means that individuals into spending about 10% of their income on financial transactions.
  - 20-25% of the population is unbanked or underbanked. The U.S. banking system is only available to banks with customers, but the banks don't have a mandate to serve in the community. In recent history banks have simply shut down their lower profit branches, which has hit low income communities especially hard. And, if you are outside of the banking system, you must pay a toll to use it.
  - Some of the solutions that have been offered, visual banking, mobile banking, are essential services and will certainly fill needs, but to truly reach the underbanked, you need a physical location. The ability to deposit your cash or take out cash to pay for goods. Until you have that digital account, you are going to rely on these high-cost ATMs or check cashers.
  - One of the ideas that I promoted in a policy solution I think could work is opening up the payment system that is already there and allowing the physical grants. I've suggested the post office as a possibility, there could be others. The idea would be to have a simple checking account. When a small town loses a bank, the University of Delaware estimates the town loses about 20% of their business income. People are innovative and will find resources at hand to do their financial transactions (example of buying one stamp with large check).
  - To go back to first principles, the Fed payment system, the banking system is federally supported, both through FDIC insurance, through the Fed's mandate to serve the public, the fact that many people are left out and they are left out because either their income, or the place that they live is quite frankly undemocratic. That is a problem I believe that this agency could fix.
- **Prof. Bogan**
  - 3 most important kinds of capital are: Human, Social, and Financial capital
  - Important for households to have access to financial markets to build wealth, but there needs to be safeguards
  - One express area of focus for CFPB is regulation is how consumers can access financial markets
  - The manner and frequency of engagement with markets is evolving with the democratization of stock markets via stock trading on smart phones etc.

- Lots of opportunities create a necessity to regulate fintech and changing interactions with financial markets
- **Dean Cole**
  - In the past, some have suggested within the American economy, consumers are affected by each of the legs of a three-legged school stool: market competition, the common for common property, and consumer protection law.
  - There is a 4th leg: jurisdictional competition. This is the defining characteristic of the American economic advantage that no other country has. Jurisdictional competition presents clear advantages in the realm of regulation because regulators don't need to be perfect in order to take action. You can learn both from their own successes, but also from the successes and the states of other regulators. Several of the greatest regulatory achievements in history have been the product of this pattern of regulatory growth through their continual feedback group afforded by jurisdictional competition. Nowhere are the benefits of jurisdictional competition and regulatory learning more evident than in the financial sector, with jurisdictional competition between states, jurisdictional competition between the state and the federal government, and financial markets, the jurisdictional competition does not stop there. Within the federal government there is jurisdictional competition between financial regulators such as the office of the control of the currency, Federal Reserve, FDIC, treasury department at large, and the CFPB. Each of these regulators has a role to play. In other words, monopoly and regulation is just as bad, perhaps even worse than a monopoly in the private sector because regulatory monopolies crowd out regulatory innovation.
  - Tech advances have strengthened each of these four legs, but if one gets out of balance this can be disastrous for consumers. Tech advances have allowed massive advances for lay consumers to make better decisions than ever before. Tech advances and competition have also solved issues in contract law/torts. People get caught being bad. Tech also reinforces data and disclosure requirements, identifying sources of abuse.

Are there areas in which existing consumer protection laws are inadequate or need to be strengthened to ensure consumers are adequately protected? How can the Bureau use its regulatory tools of rulemaking, enforcement, supervision, and education effectively to maximize consumer welfare?

- **Dean Cole**: In the realm of consumer protection, particularly with regards to financial regulation, is the scaling back of consumer protection regulation. This is particularly in the area with regard to small lending and payday lending, and what we are seeing more frequently referred to as French tech. It is FinTech apply to the fringes in the economy, things like small dollar loans, payday loans, and those types of devices that are used to help fund the day-to-day activities of low income Americans. One of the advantages that are being afforded by technology is that technology is reducing the cost of borrowing and credit (or wage advances more accurately).

- Historically, brick and mortar payday lenders, small dollar loan facilities have required extensive human capital and extensive labor in order to provide these services. FinTech is now dramatically reducing the cost of this. One of the things we need to have more thoughtful approaches to our how we scale back regulation that was originally designed to protect consumers where they did not have access to information, they did not have access to intermediaries, and the cost of accessing these kinds of resources were very high. Now, the reduction in cost and the availability of information, those regular theory--with regulatory bases will impose costs on low income consumers that are unnecessary and were not helpful and not protecting them from anything other than access to capital.
- One of the things that payment FinTech platforms like WeChat and Alipay, have in common is that they serve poor people without any brick and mortar access to banks. They are the largest movements of capital in the world. And they do it all without brick-and-mortar banks. They were a grassroots development from people circumventing the difficulties of life and in sub-Saharan African by people first using top up vouchers to move money around to convert into cash to the cell phone companies recognizing that this was a mechanism for banking as it applies to low income populations of Africa. If this had been regulated at the outset, poor people in Africa would not have had access to money. Today, the governments in Africa recognize that this is an incredible support to their economy. Some studies have shown anywhere from 10 to 15% increases in GDP for sub-Saharan Africa, directly are tied to mobile money transfer platforms. The same thing could be true in the United States, if we give it a chance. In other words, it would suggest that a state-by-state regulatory approach to FinTech, we can actually learn what are the most effective way of promoting money to low income people, rather than taking a top-down approach from federal regulators that impose solutions that may or may not be optimal, and there is no way to find out if it is optimal without the experiment station of the states.

*What actions can the Federal government take to enhance financial mobility? Do you think that providing information for consumers in disclosures are adequate for protec*ting consumers? How should disclosures be updated for the electronic age?

- **Prof Bogan:** There have been several articles in popular press about the 'gameification' of investing. Regular, unsophisticated consumers are playing gamefied sophisticated stock and financial transactions. People are losing tons of money because they don't know what they're doing. One college student killed himself after losing nearly $750,000. It is critical to provide more education and disclosure to consumers who engage in these fintech apps. We also need more responsibility for management these types of accounts. We need more information for consumers about potential risks. These apps can't be promoted or managed like a gambling app. And there should be some restrictions, like based on age. Furthermore, the Federal government should consider something like the 2009 Credit Card Act. Previously, when you went to a broker, you got advice and expertise. Now, on these apps, you get recommendations to trade against your best interest. It is good if these apps promote access, but it is bad if consumers aren't protected from poor decisions or nudges, based on behavioral economics, subtly matching one to certain trades. The thing about these apps, it is good and bad. It is good in that transaction costs are low. People have more access. It is bad if they are not regulated such that consumers are protected from being encouraged to make financial choices that are not in their best interest but the best interest of the firm.

- **Prof Smith:** Economist and traders alike already strongly recommend against trend chasing, but no one pays attention. Not certain new disclosures will help resolve this issue.
- **Prof Baradaran**: Millennials have more debt than other generations, burdened with student loans, exposed to two crises, under more pressure, a lot of people that are taking risks and taking out payday loans are acting rationally. Our focus must be on making bad decisions less catastrophic.

Are there markets where competition is not effective as it could or should be? Are there financial markets where competition does not create beneficial outcomes for consumers? What conditions are limiting competition among financial institutions responding to consumer needs? Are there restrictions, legal barriers, or any other factors that limit financial service organizations providing services to consumers? What trends in FinTech are you seeing today? What studies or regulatory reforms are needed to protect consumers while enhancing competition over the next ten to fifteen years?

- **Prof Smith:** Incentives of individuals have to be compatible with the objective of the institutions/markets. Supply chains in housing markets have incentive incompatibilities. The Bureau should look into incentive misalignment. For example, loan originators paid upfront fee for a loan, rather than quality. Maybe they should be paid as a percentage of principle payments over time? Shouldn't provide tax incentives for specific assets and not others. Want consumers to be able to make their own judgements and find ways for them to protect themselves.
- **Prof Smith (on general thoughts on behavioral economics in consumer protection):** There's been a lot of talk about try to help consumers make better decisions. Trying to protect them from themselves. I prefer to emphasize the development -- I would like to have consumers able to make their own judgments. And be able and find means of protecting themselves. Because if you will always look for ways to protect consumers from themselves, you are not addressing the problem. It must be in the form of better-informed consumers who are better able to make decisions. Okay. I think at least some part of the Bureau's activities should be directed to that, rather than sort of fix ups.

Are there regulatory issues that should be addressed at the federal level to promote greater access to consumer financial products and/or services to underserved or unbanked individuals? What do we know about why consumers are outside the financial system? What do you think are the primary barriers to inclusion, and what public policies would reduce them? How do potential new entrances (e.g. Fintechs or traditionally non-financial companies) play a role to increase inclusion?

- **Prof. Baradaran:** Historically, we've bundled the banks' two services: lending/deposits, and payments. Payments: even FinTech apps use banks on the backend. Deposits: small accounts aren't good for banks or consumers because they lose money or incur fees. Banks focus on higher profits and larger loans.

- **Chair Zywicki:** Is unhooking transactional/payment systems from banking the answer?
- **Prof. Baradaran:** Depends on which non-bank. Need some oversight. Money-laundering laws raise some barriers to entry, but one would need to see data on how those laws work before saying that non-banks should be able to do payments without complying with AML.
- **Prof Bogan:** I'm beginning to do some work on the unbanked and underbanked population, looking at the FDIC survey of them. One of the things that strikes me: it's not just an issue for lower income household. Over 35% of middle-income households are underbanked (meaning they access alternative financial services). Data suggest that fees are a big way that households are discouraged from interacting with the financial markets. CFPB should consider fee regulation.
- **Dean Cole:** I think the term un/underbanked is psychologically restraining as it elevates the status of banks in our economy. They've been historically important, but they're increasingly under pressure and constrained (largely from brick and mortar populations). Most of the world is increasingly cashless (China and much of sub-Saharan Africa). Mobile money transfer is much more secure, less possibility of theft. Fintech puts banks all around the world under tremendous pressure. You also mentioned Walmart. They have effectively become a bank for the poor in America. It's not a depository, but that's where financial services and transactions are offered. Walmart looks an awful lot like a bank now when you walk in the store. Banks are increasingly focusing on segments of the economy where they have less competition in transactional services, and they are ceding territory where there is high competition. We need to think broadly of how to protect consumers in a more global market.

How do we protect consumers from new threats while enabling providers to develop new and better ways to serve their needs? The pandemic highlights the need to ensure the Federal government can quickly adjust and provide regulatory flexibilities. How do we create a system that is responsive to acute market disruptions (i.e. 9/11, the 2008 financial collapse, COVID) while providing a stable regulatory framework for consumers?

- **Prof. Smith:** The Bureau came about addressing endogenous issues. We need to think about addressing exogenous threats. What can CFPB contribute to that beyond a secondary/supplemental role? Though this may require expertise beyond your main function, but you should seek to acquire them.
- **Prof. Bogan:** I agree completely with Prof. Smith. People view CFPB as a resource, which is a good position. The organization must then be nimble enough to respond to disasters. It may be outside the purview to create a system that is responsive to everything catastrophic though. The organization must remain nimble.
- **Prof Baradaran:** You can't predict massive crises, but you can predict events that affect the most vulnerable people. Any major disruption affects those who are vulnerable the hardest. Do not be reactive, create systems that can help the vulnerable before the crisis hits. For example, we did not have a system to send payments to every American before

this, which caused problems when we tried. Pay attention to payments and inclusion issues now, so that the problems can be mitigated in crisis later.

- **Dean Cole:** I agree with all of this. There is something instructive from the COVID crisis for CFPB and all regulators—do we want to be Florida, or do you want to be Illinois? If there were a federal response like the response of Florida, this would be an utter disaster. If we had the federal response like IL, we could look like South Korea right now. We need to use the learning laboratory that is the states and the federalist system. If we try to build a huge system that solves all these issues, we could end up looking like FL rather than IL. We need to learn from federalism.