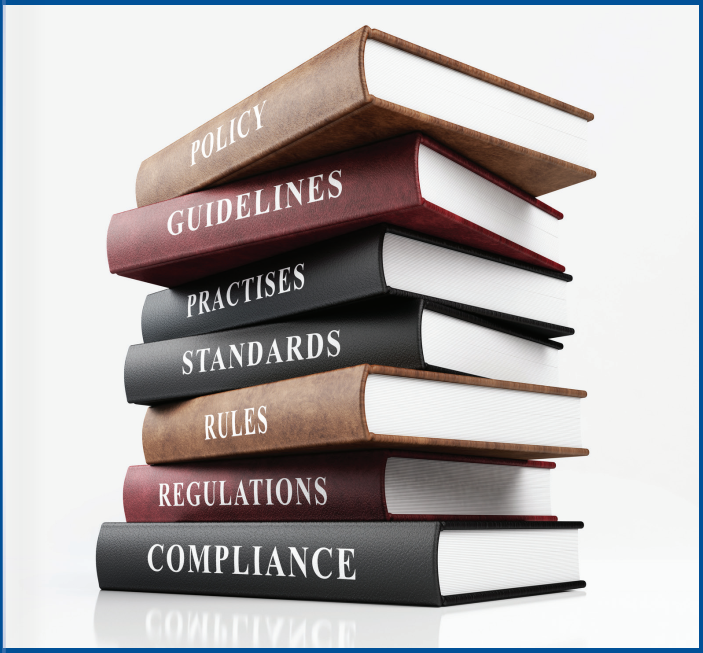
The Case against the Consumer Financial Protection Bureau

Unconstitutionally Structured and Harmful to Consumers

By Iain Murray

September 2017



ISSUE ANALYSIS 2017 NO. 9

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Executive Summary

Who could be against consumer protection? The 2007-2008 financial crisis saw record numbers of mortgage foreclosures, left large numbers of Americans "underwater"—owing more in mortgage principal payments than their homes were worth—and many more carrying more credit card debt than it seemed they could afford. Consumer financial protection was the motivation behind the creation of the Consumer Financial Protection Bureau (CFPB), a new agency designed to protect American consumers from bad actors in the financial services industry.

The CFPB was meant to protect American pocketbooks and property. However, its founders—the drafters of the Dodd-Frank Act of 2010—felt that in order to do so, it had to be protected from political interference. That resulted in the agency being insulated from accountability to the president, Congress, and the courts. Dodd-Frank gave the CFPB three mechanisms for avoiding accountability:

- Its funding comes not from congressional appropriations but from the Federal Reserve, which is to supply whatever the director requests up to a certain amount;
- It is headed by a single director appointed for a fixed term of five years who may not be fired by the president except for "cause," such as dereliction of duty or malfeasance; and
- The courts are required to give extra deference to the CFPB's decisions in some cases.

These provisions violate constitutional norms of checks and balances on executive power and have led the CFPB to abuse its power, including by trying to regulate in areas where its statutory authority is expressly limited.

For example, the CFPB attempted to regulate auto lenders, which are exempt from CFPB oversight under Dodd-Frank. The CFPB alleged that an indirect auto lender's markup and compensation policies may be sufficient to trigger liability under the Equal Credit Opportunity Act (ECOA) if the lender's credit decisions result in discriminatory outcomes. The CFPB then issued guidance on how auto finance firms can avoid being found in breach of the ECOA, indirectly regulating auto dealers by prescribing what kind of financing they may offer. An independent study of the CFPB's methodology concluded that it severely overestimated the number of minority consumers supposedly harmed by the practice. This led to white consumers getting refund checks for supposed racial discrimination against them as African-Americans. Cordray admitted that the CFPB's methodology contained mistakes. An agency subject to adequate constitutional oversight would probably not have been tempted to make these mistakes.

The CFPB has also failed in its core mission of protecting all consumers. For example, while it celebrated the fines it levied on Wells Fargo over its "upselling" scandal—in which bank staffers misled customers into opening new accounts for new services, and in some cases fraudulently opened accounts in their names without their knowledge—it failed to notice the bank's abusive practices until it was alerted to them by *The Los Angeles Times* and California regulators, despite the bank being under Bureau supervision at the time.

Consumers have actually been harmed by CFPB rules. This is because it was set up with a one-size-fits-all mentality at its core. It was empowered to create rules that would apply to financial products in every case, based on the false premise that a government agency can design the appropriate financial products for a large and diverse society. This has denied many consumers access to useful, money-saving products. Consumer protection is ill-served if consumers are "protected" from getting access to products that suit their individual circumstances, or are forced to pay more for a less desirable financial product.

One of the arguments advanced in favor of creating a consumer financial protection agency was that it would fulfill a purpose analogous to the Consumer Product Safety Commission. The argument was that, just as a faulty toaster could lead to your house burning down, so a faulty mortgage could lead to you losing your house. The analogy was faulty from the start. A faulty toaster design is faulty for everyone, but financial products serve different customers with different needs. For example, for someone in the right circumstances, a 30-year, interest-only, adjustable rate mortgage can be a prudent choice, even if it is wrong for someone else who does not plan for possible fluctuations in interest rates. Banning the mortgage would help the latter borrower, but harm the former by forcing her to take out a mortgage that costs more, allocates the costs over time in a more burdensome manner, or fails to take account of other circumstances, such as a plan to move in the near future.

Moreover, because of the complexity of financial products, the CFPB's rules have tended to be extremely long and complicated, imposing a huge compliance burden on financial institutions—which pass on those costs on to consumers in the form of higher fees or reduced product choices.

At the very least, the CFPB needs significant structural reform to alleviate these problems and bring it within constitutional constraints. The CFPB's poor constitutional design insulates it from accountability to Congress, the president, and the courts. That lack of accountability predisposes the CFPB director to abuse the agency's authority.

The CFPB is too problematic to fix by relying on better discretion from its director and other personnel. Even if it were brought under proper constitutional oversight, its one-size-fits-all approach is deeply at odds with the needs and aspirations of millions of individual American consumers.

Current court cases, such as the *PHH* case currently being reheard, could provide some relief to the constitutional problems by, for example, reaffirming the previous decision that the director should be answerable to the president, although that would leave outstanding the constitutional objections in relation to the role of Congress and the courts.

One legislative solution would be to recognize the inherent difference between consumer product protection and financial protection and abolish the agency, transferring consumer protection duties back to the banking supervisors and the Federal Trade Commission.

If Congress is unwilling to take this step, the CFPB at least could be brought back within constitutional constraints and made subject to adequate supervision by the president, Congress, and the judicial branch, while being required to submit adequate justification for its rules to the Office of Management and Budget and to Congress for higher cost rules. This should at least assert some discipline over the agency.

The CFPB represents a drastic change to the way Americans are governed. The remedy for its abuses needs to be equally drastic.

Introduction

Who could be against consumer protection? The 2007-2008 financial crisis saw record numbers of mortgage foreclosures, left large numbers of Americans "underwater"—owing more in mortgage principal payments than their homes were worth—and left many more carrying more credit card debt than it seemed they could afford. Consumer financial protection became the animating thought behind the creation of a new agency designed to protect American consumers from bad actors in the financial services industry.

The Consumer Financial Protection Bureau (CFPB) was meant to protect American pocketbooks and property. However, its founders—the drafters of the Dodd-Frank Act of 2010—felt that in order to do so, it had to be protected from political interference. Dodd-Frank insulated the CFPB from accountability to Congress, the president, and the courts through three mechanisms:

- Its funding comes not from congressional appropriations but from the Federal Reserve, which is to supply whatever the director requests up to a certain amount;
- It is headed by a single director appointed for a fixed term of five years who may not be fired by the president except for causes such as dereliction of duty or malfeasance; and
- The courts are required to give extra deference to the CFPB's decisions in some cases.

These provisions violate constitutional norms of checks and balances on executive power. They have led the CFPB to abuse its powers, as neither the executive nor the legislative branch has meaningful oversight over it.

The CFPB was founded on the false premise that a government agency can design the appropriate financial products for a large and diverse society. One of the arguments advanced in favor of creating a consumer financial protection agency was that it would fulfill a purpose analogous to the Consumer Product Safety Commission. The argument was that, just as a faulty toaster could lead to your house burning down, so a faulty mortgage could lead to you losing your house.[1] The CFPB would prevent that.

The CFPB was founded on the false premise that a government agency can design the appropriate financial products for a large and diverse society.

The analogy was faulty from the start. As George Mason University law professor Todd Zywicki noted, "loans are not toasters."[2] A faulty toaster design is faulty for everyone. But for someone in the right circumstances, a 30-year, interest-only, adjustable rate mortgage can be a prudent choice, even if it is wrong for someone else who does not plan for possible fluctuations in interest rates. Banning the mortgage would help the latter borrower but harm the former by forcing her to take out a mortgage that costs more, allocates the

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costs over time in a more burdensome manner, or fails to take account of other circumstances, such as a plan to move in the near future.

The CFPB was set up with this one-size-fits-all mentality at its core. It was empowered to create rules that would apply to financial products in every case. Because of the complexity of financial products, its rules have tended to be extremely long and complicated, imposing a huge compliance burden on financial institutions—which pass on those costs on to consumers in the form of higher fees or reduced product choices.

This has denied many consumers access to useful, money-saving products. Consumer protection is ill-served if consumers are "protected" from getting access to products that suit their individual circumstances perfectly, or if consumers are forced to pay more for a less desirable financial product.

At the very least, the CFPB needs significant structural reform to alleviate these problems and bring it within constitutional constraints. It may be better to abolish the agency entirely and return the job of consumer protection to market competition overseen by courts of law and other agencies.

Little Oversight from Congress

The appropriations process, whereby elected officials fund federal agencies, is a vital check on executive power. Because of the funding mechanism set up under Dodd-Frank, the CFPB is not subject to Congress' power of the purse. The CFPB's annual budget amounts to approximately $650 million (2017) that Congress cannot touch or regulate.[3] Instead, the CFPB gets its funding from the Federal Reserve, the dollar amount of which Congress can neither review nor deny.[4]

As a result, the CFPB has failed to exercise fiscal discipline. For example, current CFPB Director Richard Cordray authorized the expenditure of $215 million for renovating a new head-quarters in Washington, D.C., on a building valued at just $150 million. The refurbishment appears extravagant, and the House Financial Services Committee found[5] that it cost more than three times per square foot what a typical D.C. luxury renovation would.[6] When questioned by Rep. Ann Wagner (R-Mo.) about this extravagant expenditure in May 2015, Cordray responded, "What does that matter to you?" Wagner responded that it matters to taxpayers.[7] Cordray's lavish redecoration is ultimately being paid for by holders of U.S. debt, to which taxpayers are indirectly exposed. That should matter to lawmakers, but Congress cannot exercise its power of the purse over the CFPB, so there is little officials can do to bring the agency to account.

Little Oversight from the President

The Dodd-Frank Act made it impossible for the president to carry out his constitutional obligation to "take care that the laws be faithfully executed" when it comes to the CFPB. A CFPB director who chooses not to comply with statutory obligations or who abuses his authority cannot be removed by the president except under extremely limited circumstances. Dodd-Frank goes beyond the "for cause" standard for removal from most independent agencies and says the president may only remove the director "for inefficiency, neglect of duty, or malfeasance in office."[8] Although the CFPB is technically labeled a "bureau" within the Federal Reserve and receives its operating funds from the Fed, the Fed has no control over its actions.

This insulates the director from oversight, checks, or balances on his decisions. Traditionally, as the D.C. Circuit Court of Appeals noted in *PHH Corp. v CFPB*, if Congress opted to make an agency independent of presidential authority, it utilized a commission structure, with members from both the president's party and the opposing party to ensure internal deliberation and reasoned decision making.[9]

The Dodd-Frank Act gave the CFPB director complete control of the agency, without any oversight. As the court noted in *PHH*, the CFPB director is the "single most powerful official in the entire U.S. Government, other than the President." It found that this extensive "unilateral power" made the Bureau "structurally unconstitutional."[10] These considerations led the court to rule that the provisions of Dodd-Frank should be amended to cause the director to be "under the ultimate supervision and direction of the president." (The case is being reheard at this writing.)

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Reduced Oversight from the Courts

Dodd-Frank directed the courts to give extra deference to the CFPB should it come into a legal dispute. Section 1022(4)(B) of Dodd-Frank legislates that "the deference that a court affords to the Bureau with respect to a determination by the Bureau … shall be applied as if the Bureau were the only agency authorized to apply, enforce, interpret, or administer the provisions of such Federal consumer financial law."[11] In other words, the court should look to the CFPB itself to understand how the law should be interpreted, with even longstanding interpretations from other financial agencies rendered null and void.

The CFPB's insulation from judicial supervision has had a significant and deleterious effect on precedent and due process. If courts are to defer to agencies' interpretation of the law and regulations, as they are presumed to do

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under the *Chevron* and *Auer* doctrines, then ignoring all interpretations of the law by other agencies that were previously responsible for them will result in situations like the *PHH* case: The CFPB can essentially rewrite a longstanding regulation in order to make legal conduct illegal, and the courts are ordered to accept that.[12] This is, as the court found in *PHH*, a breach of due process.

Moreover, other prudential financial agencies, on which financial institutions rely on prudential matters, have their own interpretations of the law. The Dodd-Frank Act instructs courts to ignore those interpretations. This can easily lead to conflicts, even in situations where the CFPB's interpretation might seem arbitrary in countermanding the other agencies' interpretations.

For instance, in 2014, in its order against PHH, the CFPB relied on this authority to retrospectively modify the Department of Housing and Urban Development's (HUD) longstanding interpretation on whether mortgage lenders could use subsidiary reinsurers to provide mortgage insurance.[13] The court found that such modification deprived PHH of its due process rights.

This authority also compounds the problem of unilateral, unchecked power. In a commission, there is internal debate between commissioners about the rewriting of a rule. In the executive branch, other agencies weigh in with concerns. The CFPB director faces fewer and weaker checks and balances and can rewrite rules practically at whim. Predictably, this unconstitutional structure has led to the CFPB abusing its power, including in ways that threaten constitutional rights.

In effect, there is only one effective check on the CFPB's authority—nullification of a rule by the Financial Stability Oversight Council (FSOC), another regulator created by Dodd-Frank, only if it is determined by FSOC to pose a substantial threat to the safety and soundness of the American financial system. This is a very high hurdle, made even more difficult by the requirement of a supermajority vote of the Council's members, of whom the CFPB director is one.[14] Moreover, the CFPB director serves on the board of the Federal Deposit Insurance Corporation, another voting member of FSOC.

The lack of adequate structural checks and balances on the CFPB has led to poorly designed rules that serve to expand the agency's power instead of protecting consumers. For example, the agency has stifled the free speech rights of those it regulates. It has exceeded its statutory authority to regulate industries and firms that are far outside any reasonable understanding of its jurisdictional powers. And it has put consumer privacy and data at risk due to its voracious quest for consumer financial information.

For all that, there is little evidence the CFPB has done much to protect consumers from fraud—as the agency's slow response to the Wells Fargo scandal discussed below indicates. Meanwhile, it has reduced access to consumer credit, especially for lower income Americans, and adopted policies that have systematically advantaged large banks relative to small banks.

Prior Restraints on Speech

The CFPB's lack of accountability has enabled it to attempt to restrict one of Americans' most precious constitutional rights, the right to free speech. The CFPB's Disclosure of Records and Information Rule is essentially a gag rule for those who receive a request for information from the Bureau.

The rule establishes procedures used by the public to obtain information from the Bureau under the Freedom of Information Act, the Privacy Act of 1974, and in legal proceedings.[15] In 2016, the CFPB proposed amendments to this rule. The amended rule provides that, in the case of a financial institution receiving a criminal investigation demand (CID) or similar requirement, "[R]ecipients of confidential investigative information have the same discretion with respect to disclosing confidential investigative information that they currently have with respect to confidential supervisory information."[16] Translated from legalese, that means the rule imposes prior restraints on speech for those receiving a civil investigative demand.

This means the recipient of an investigative request will have limited power to share it with colleagues and board members, and must seek the permission of a Bureau official to talk about it to others. Arthur B. Spitzer of the American Civil Liberties Union notes that this is "something that courts have time and again said violates the First Amendment."[17] As the Bureau reserves the right to post motions to quash CIDs on its own website, Spitzer further comments:

> It is difficult to imagine the justification for a system where a CID recipient is barred from posting information about a CID it has received on its own website, but the Bureau will post information about the same CID on the Bureau's website if the recipient has the temerity to file a motion to quash the CID—even if the motion to quash is successful.[18]

The CFPB's attempt to do this and its repeated attempts to exceed statutory boundaries demonstrate its proclivity to overreach—which its unconstitutional structure makes possible.

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Exceeding Statutory Authority

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their power to the maximum extent possible.[19] Unsurprisingly, the CFPB, lacking in any meaningful oversight, has done just that. Courts have found that the CFPB has exceeded its statutory authority.

For example, in August 2015 the CFPB issued a criminal investigative demand to the Accrediting Council for Independent Colleges and Schools (ACICS), even though accrediting colleges is not a financial service under the jurisdiction of the CFPB. The CID's stated purpose was "to determine whether any entity or person has engaged or is engaging in unlawful acts and practices in connection with accrediting for-profit colleges."[20]

In April 2016, the D.C. District Circuit found that the CFPB's authority to investigate for-profit schools' lending activities did not entitle it to investigate potential lawbreaking in accreditation. Despite ACICS repeatedly making it clear to the Bureau that it had no connection with student loans, the CFPB refused to remove the CID and went to court to enforce it. It told the court that it was not required to "accept at face value" ACICS' statements of its activities and therefore had the power to assess them independently by investigation. The court's response to this argument: "Please."[21]

The CFPB has even attempted to rule in areas where its statutory authority is expressly limited. For example, the Bureau may not exercise any rulemaking, supervisory, enforcement, or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both. The express instruction from Congress, laid out by Section 1029 of Dodd-Frank specifically excludes auto lenders from CFPB oversight.[22]

Nevertheless, the CFPB attempted to regulate auto lenders by issuing a guidance document to the financial firms that work with auto dealers to provide better rates to their customers.[23] Citing the Equal Credit Opportunity Act (ECOA), the CFPB alleged that an indirect auto lender's markup and compensation policies may be sufficient to trigger liability under the ECOA if the lender's credit decisions result in discriminatory outcomes. The disparities triggering liability could arise either within a particular dealer's transactions or across different dealers within the lender's portfolio. Thus, an indirect auto lender that permits dealer markup and compensates dealers on that basis may be liable for these policies and practices if they result in any lending disparities, even ones beyond the lender's control. The CFPB then issued guidance on how auto finance firms can avoid being found in breach of the ECOA, indirectly regulating auto dealers by prescribing what kind of financing they may offer.

An independent study of the methodology by which the CFPB had found the alleged discrimination concluded that it severely overestimated the number of minority consumers supposedly harmed by the practice.[24] This led to white consumers getting refund checks for supposed racial discrimination against them as African-Americans.[25] Cordray admitted that the CFPB's methodology contained mistakes.[26]

Violating Privacy

The CFPB's tendency to overreach has even threatened Americans' financial privacy. Acting on its own and without any authorization from Congress, it has created massive databases of mortgage and credit card information that may rival those of the National Security Agency in both size and intrusiveness. Every month, the Bureau gathers information on virtually every aspect of Americans' financial affairs.

By claiming it needs this voluminous data to research patterns of behavior in consumer financial transactions, the agency is putting Americans' financial information at risk. The Government Accountability Office (GAO) has criticized the CFPB's security practices in relation to this data because it had not "fully implemented a number of privacy control steps and information security practices."[28] The GAO noted that "CFPB lacks written procedures

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Examples of CFPB Data Gathering Practices

Type of Data Gathered	Number of Records	Frequency
Automobile sales (matching state DMV records with consumer credit data)	700,000 vehicles	Monthly
Consumer credit reports: nationally representative sample	1.7 million individuals	Monthly and Quarterly
Credit cards: individual consumers' account-level data, with links to credit reporting	25-75 million accounts	Monthly
Mortgages: loan-level data from large servicers	29 million active loans; 173 million total loans	Monthly
Online payday loans: loan summaries, matched with consumer credit data	300,000 borrowers	One-time
Overdraft fees: account and transaction-level data randomly sampled from checking accounts	2 million accounts and their transactions	One-time
Private student loans: loan-level data on all education loan originations from 2005-2011	5.5 million loans	One-time

Source: GAO analysis of CFPB information.[27]

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and comprehensive documentation for a number of processes, including data intake and information security risk assessments," and that the Office of Management and Budget had concerns about the Bureau's compliance with Paperwork Reduction Act requirements in relation to the millions of credit card accounts on which it collects data. The GAO concluded these difficulties "could hamper the agency's ability to identify and monitor privacy risks and protect consumer financial data."[29]

Not only does this data collection exercise put individuals' financial privacy at risk, it appears to do so without any discernable benefit. For example, in 2014 the CFPB collected information on 900 million credit card accounts, representing 85 percent of all such accounts in the U.S. The Bureau justified this request simply by saying: "Account-level information provides unique insight into understanding changes in the credit card market. … Such information maintained in a database can be used to create both present-day snapshots and historical trend data and help the CFPB understand the cost of credit and how the costs are realized by consumers."[30] George Mason University Economics Professor Thomas Strattmann noted that statistical sampling techniques would require data from only about 1 percent of accounts to achieve such results.[31]

Arbitrary Decision Making

The *PHH* case provides a good example of how the CFPB's structure leads to arbitrary behavior.[32] In that case, an administrative law judge found mortgage lender PHH Corporation liable for $6.4 million in disgorgement of supposedly illegally gotten profits. On his own discretion, CFPB Director Cordray upped that sum to $109 million, increasing the fines by more than 1,700 percent. The court found that the CFPB reversed longstanding policy from the Department of Housing and Urban Development, which administered the underlying law before the Bureau's creation in the Dodd-Frank Act of 2010. It then proceeded to apply this new interpretation of the law retroactively back to 2008, violating PHH's due process rights, while declaring there was no statute of limitations on its powers. Presumably, the agency trusted that the statutory deference it enjoys under Dodd-Frank would preclude the courts from reining it in.

Another example of the CFPB's arbitrary decision making is its cavalier approach to cost-benefit analysis. The Dodd-Frank Act directs the Bureau to conduct such analyses for its rules, asking it to calculate:

> The potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to

consumer financial products or services resulting from such rule; and the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas.[33]

While the CFPB issues what it calls cost-benefit analyses with each rulemaking, these fall far short of this requirement. Costs and benefits are discussed in a qualitative manner, with little or no attempt to quantify either costs or benefits, and often ignoring potentially large categories of costs. For instance, in a draft rule on the subject of small-dollar loans, the CFPB dismissed the possibility that customers might go to loan sharks if small-dollar loans become too difficult to obtain.[34]

While quantified cost-benefit analysis has its flaws, it is better than what the CFPB has displayed to date. A rule with costs that outweigh its benefits is clearly damaging and should be repealed. By avoiding rigorous quantification, the CFPB has been able to press ahead with rules based on its general sense that the rule would provide some benefit, even if that benefit is likely to be outweighed by costs. This is the very definition of arbitrary behavior.

The U.S. Constitution's framework of checks and balances was put in place to protect Americans from abuses of government power. By failing to follow this framework when it created the CFPB, Congress set the stage for its all-powerful director to act arbitrarily. So it has proved.

However, these constitutional problems are not the only reason why the CFPB needs drastic reform. It is failing to protect consumers, and in many cases is actively harming them, while turning a deaf ear to critics.

CFPB Fails to Protect Consumers

The CFPB touts its protection of consumers by pointing to its enforcement actions, saying, for example, that it has returned $12 billion in funds to 29 million harmed consumers over its six years of operation (which works out to about $70 per harmed consumer per year).[35] The case is not that clear cut, however. While some of the cases were certainly justified, some may have involved overreach by the CFPB. Even in what may be the Bureau's most celebrated victory over a genuine bad actor, the credit actually belongs elsewhere.

The Wells Fargo Case

Many of the CFPB's defenders[36] have pointed to the huge $185 million fine the Bureau's enforcement arm levied on Wells Fargo bank for the "upselling" scandal, in which bank staffers misled customers into opening new accounts for new services, and in some cases fraudulently opened accounts in their

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names without their knowledge.[37] They claim that the case shows the CFPB has been effective in protecting American financial consumers.

This is not the case. The facts show that tension between the CFPB's supervisory and enforcement arms led to a failure to catch Wells Fargo's wrongdoing until after it was revealed in the media. That tension arises because any one company can only be the subject of either a supervisory or enforcement action at any one time. The CFPB's supervision personnel took charge of Wells Fargo in 2011, yet the company's malfeasance escaped its notice until December 2013, when it was made public by a *Los Angeles Times* investigation.[38]

Even after this revelation, the CFPB's supervision division failed to investigate the company's practices with on-site examinations and continued to claim the bank as its territory, fending off the enforcement division's attempts to investigate until the Los Angeles city attorney filed suit against the bank in May 2015.[39] It appears that only after that could the Bureau's enforcement arm take over. The enforcement action that followed used evidence from the investigations of other agencies—the Los Angeles city attorney and the Office of the Comptroller of the Currency—to support its huge fine. The CFPB had missed the malpractice, despite having supervisory powers other agencies lacked. Then it followed the pack in exercising its enforcement powers. The CFPB's large fine will be paid for ultimately by Wells Fargo customers—exactly the people the Bureau was supposed to protect.

CFPB Rules Harm the Middle Class by Chilling Innovation

As noted, the CFPB was founded with the task of protecting American consumers from harm in financial transactions. However, many of the regulations promulgated by the CFPB are working against consumers, and disproportionally against the least fortunate. Even worse, the agency seems bent on protecting consumers from themselves at the expense of their well-being.

One example is the CFPB's rules on prepaid debit cards, which many people use instead of bank-issued cards tied to accounts.[40] Some individuals directly deposit their wages onto such cards. Prepaid cards are more likely to be used by people who are African-American, young, unemployed, disabled, or very low income (under $15,000 a year).[41] These demographics are often referred to as the "underbanked," who find traditional banking services unsuited to their circumstances. Surveys have found that prepaid cards are popular because they allow people to control their finances, avoid overspending, and avoid bank fees.[42]

The CFPB, however, decided that consumers did not know enough about some of the features of their cards, which led to a 1,700-page rule to regulate these features and their disclosures.[43] As can be expected with a 1,700-page rule, the effects will be significant enough to disrupt the prepaid card market, with compliance costs of at least $1 billion, according to an estimate by the American Action Forum.[44] Those costs will be passed on to prepaid consumers in the shape of increased fees—exactly what the consumers were trying to avoid in choosing to use prepaid cards.

While many customers use their cards to avoid overdrafts and would prefer to have transactions declined rather than pay a service fee for an overdrawn prepaid card, a sizeable minority—about 30 percent of users—are happy with paying the fee.[45] These consumers want to make sure that all their small transactions are covered to keep their households running. The rule effectively outlaws overdraft fees on prepaid cards by redefining overdrafts as "credit," to be regulated separately (which is also incompatible with how the Truth in Lending Act has been interpreted over the past 40 years).[46] Of course, the underbanked are much less likely to have access to credit at all, meaning that yet another source of emergency funding for them is to be regulated out of existence by the rule.

Consumers can also expect to lose access to some of these cards' popular features. For instance, the rule requires disclosure of the highest fee payable for bill payment features. Some cards offer free bill payment but charge for emergencies. The disclosure rules will require that the charge for emergency bill payment be made visible, which may deter consumers from using the feature, even for non-emergency payments. That prospect could lead card issuers to stop offering the emergency bill payment feature, or even bill payment features at all.

Everyone who has been in constrained financial circumstances knows the value of quick access to cash.

CFPB Hinders Consumer Access to Short-Term Credit

Everyone who has been in constrained financial circumstances knows the value of quick access to cash. It demonstrates financial responsibility to pay a bill on time even if one has to borrow to do so. Many of the underbanked or other people in constrained circumstances have low credit ratings and may not have a credit card, so they are forced to look for short-term loan financing like payday loans or vehicle title loans. Yet the CFPB is looking to kill off these industries on the basis that they can harm consumers. Its draft rule on small-dollar loans will effectively ban loans that do not meet stringent "ability to repay" criteria. And yet most people who meet such criteria would probably be able to get a credit card or other lower cost loan. The people who will suffer most from the rule are the people who need access to such loans the most.

By seeking to protect all consumers from products that are risky to a few, the CFPB has reduced consumer welfare on net.

Moreover, the Bureau's research that identifies harm from small dollar loans (for instance, to a small number of people who get into a "cycle of debt" and default) is at odds with most published academic research on the subject. The literature on the effects of payday and other small-dollar loans suggests that there are no harmful welfare effects on net, and that there are possibly beneficial effects overall.[47] If you cannot get a short-term loan and fail to pay a bill, the consequences can be devastating. For instance, failure to pay a utility bill could result in service being cut off, with the cost of reinstatement far more expensive in both inconvenience and dollars than the cost of a payday loan—yet the CFPB thinks it is protecting consumers by effectively banning them, despite the lack of compelling evidence to support such action.

Credit unions have objected to the rule because it will make it more difficult for them to offer small-dollar loan products, some of which are intended to help people pay off payday loans and escape from the rare cases of debt cycle the Bureau uses to justify its rule. By seeking to protect all consumers from products that are risky to a few, the CFPB has reduced consumer welfare on net.

CFPB Transfers Wealth from Consumers to Lawyers

The Arbitration Rule is another example of the Bureau's failure to properly analyze costs and benefits. The rule ostensibly seeks to preserve consumers' right to court action by banning mandatory arbitration clauses in financial contracts, thereby encouraging the use of class action lawsuits. The result is a net cost imposed on America's consumers and a windfall for trial lawyers.

Arbitration has long been a feature of the financial system. Throughout history, customers, vendors and other parties seeking to make agreements have bound themselves to decisions from private arbitration services. George Washington even inserted an arbitration clause into his will.[48] Congress recognized the vital role arbitration plays in the Federal Arbitration Act in 1925.[49] Yet the CFPB justified banning arbitration on the basis of a study that found that, in the event of a contractual dispute, the average consumer victor at arbitration was awarded around $5,000, while the average victor as part of a class action settlement received around $32 (and possibly much less, depending on how one looks at the data). Trial lawyers, on the other hand, received on average $1 million per class action settlement.[50] Consumers going to arbitration often had all their costs paid for by the finance company.

The CFPB simply ignored the data it had collected. Instead, it justified the rule by stating that the number of consumer victories at arbitration was small by comparison with those for class action members and that the class-action settlements represented a victory for a much larger number of consumers. It also suggested that the ability to join a class action represented a legal right Americans should not lose when they sign a contract.

Worse, the CFPB simply glossed over several relevant points. It waved away discussion of the arbitration clauses of the Federal Arbitration Act.[51] It failed to examine disputes that do not make it to arbitration or legal proceedings. It also failed to address properly the fact that class actions take much longer than arbitration to reach resolution.[52] Moreover, the CFPB's proposal to ban arbitration clauses is by no means the least onerous way of preserving any right to class action, if that is the true intent of the rule. That could be achieved by allowing an opt-out from arbitration at contract signing for anyone valuing the right.[53]

Accounting for the shift in procedure required by the rule will raise costs for financial firms, and by extension raise costs on middle class consumers, some of whom will no longer be able to afford some financial services as a result. Forced to use the court system and trial lawyers, low- and middle-income consumers will also suffer delays in having their problems addressed. A class action takes on average three years to come to a settlement while arbitration takes just under seven months.[54] These considerations should have factored into a proper cost-benefit analysis of the rule, which the CFPB did not perform.

CFPB Rules Harm Main Street Banks and Consumers

The CFPB's onerous regulations have significantly added to the regulatory burden on regional and local banks and credit unions. The result has been less lending from these institutions and in many cases bank mergers in order to afford the cost of compliance.

Community banks extend the possibility of credit through familiar associations and trust. Many are located in rural and underbanked areas. However, community bankers have testified that they have had to stop offering mortgages to people they know well because they cannot make the individual judgments they once made about creditworthiness due to the Bureau's mortgage rules. As Jim Purcell, Chairman of the Texas Bankers' Association and the State National Bank of Big Spring, told the House Financial Services Committee:

> The problem for us, and I am sure many others, is that our borrowers generally sought relatively small mortgages for their properties which meant that the loan's costs and fees had to be spread across a smaller principal balance. Even though we did not charge any

Community bankers have testified that they have had to stop offering mortgages to people they know well because they cannot make individual judgments about creditworthiness due to the Bureau's mortgage rules.

With rules that reach almost 2,000 pages in length, how the CFPB will enforce them only becomes apparent when enforcement orders are issued.

> application fees, origination fees, or any other type of fee, these were five-year balloon notes which typically meant they would fall into the disfavored "high-cost" definition. In addition, we ran into obstacles arising from the regulation's definition of maximum debt-to-income ratios for borrowers. The end result, at least for us, was that due to the increased regulatory burden and potential liability, State National Bank of Big Spring ceased making what we always deemed very good and certainly very fair mortgage loans for the good of both our customers and the broader community.[55]

Noting that the CFPB's website said that its purpose was to make sure "banks … treat you fairly," Purcell asked: "[H]ow is it 'fairer' to force our customers to go elsewhere for their real estate loans as a consequence of the fact that our mortgage platform did not fit the Dodd-Frank/CFPB profile of a 'Qualified Mortgage?'"[56]

Furthermore, the mortgage rules being implemented are so complex that the CFPB can be credibly accused of regulating by enforcement; regulated entities have to wait to see the outcome of an enforcement action before knowing what is allowed.

One example is the TILA-RESPA Integrated Disclosure rule, a complicated rule related to mortgage disclosures pursuant to both the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA).[57] The rule is 1,888 pages long, yet still vague in places, and, as HousingWire Editor Sarah Wheeler noted, might "actually cause the consumer to have a wrong understanding of some of their costs (especially in title)."[58] This puts companies attempting to interpret and implement the rule in a bind, as they will be subject to enforcement if they fail to implement it, but also if they implement it in a way the CFPB does not like. Wheeler asks:

> Busy with that implementation, companies are also supposed to somehow have the manpower and brain trust to track and understand a pattern of enforcements that may or may not have anything to do with their operations?[59]

The result of too much regulation is a chilling atmosphere for financial services innovation. With rules that reach almost 2,000 pages in length, how the CFPB will enforce them only becomes apparent when enforcement orders are issued. This also represents an end run around the statutory rulemaking process.

There are many dangers associated with such regulation, including the lack of precise definitions of prohibited and allowed activities and the lack of rulemaking safeguards Congress required through the Administrative Procedure Act, the Paperwork Reduction Act, and other rules about rules.

The CFPB's actions have also decimated small and community banks. Many small banks have no in-house counsel to advise on the effects of such regulation and have had to merge with other small banks to reach the economies of scale necessary to employ effective compliance teams. More mergers mean less competition in the long run, and fewer financial options for all. Demanding rules that govern virtually every financial transaction have especially harmed community banks that offered loans based on their personal assessment of creditworthiness through knowledge of the customer and other traditional means of credit assessment.

Small banks facing these new pressures from CFPB Rules have three options:

1) Increase their compliance departments and pass the costs on to their customers.
2) Close.
3) Merge with other banks to be able to afford a large compliance department.

Two thousand community banks and credit unions have closed or merged since 2010, according to a March 2015 Harvard Kennedy School study. The study found that the rate of decline in community banks as a proportion of the U.S. banking system has doubled since 2010, and that "particularly troubling is community banks' declining market share in several key lending markets, their decline in small business lending volume, and the disproportionate losses being realized by particularly small community banks."[60]

Once again, the Bureau took action supposedly to protect consumers but ended up harming them, without a clear analysis of the costs and benefits of its actions, causing poor and underbanked rural consumers to suffer the most.

Conclusion

The CFPB is too problematic to fix by relying on better discretion from its director and other personnel. Its problems are so fundamental that it should probably be abolished. Even if it were brought under proper constitutional oversight, its one-size-fits-all approach is deeply at odds with the needs and aspirations of millions of individual American consumers.

Current court cases, such as the *PHH* case currently being reheard, could provide some relief to the constitutional problems by, for example, reaffirming the previous decision that the director should be answerable to the president, although that would leave outstanding the constitutional objections in relation to the role of Congress and the courts.

The CFPB's one-size-fits-all approach is deeply at odds with the needs and aspirations of millions of individual American consumers.

One legislative solution would be to recognize the inherent difference between consumer product protection and financial protection and abolish the agency, transferring consumer protection duties back to the banking supervisors and the Federal Trade Commission.

If Congress is unwilling to take this step, the CFPB at least could be brought back within constitutional norms and made subject to adequate supervision by the president, Congress, and the judicial branch, while being required to submit adequate justification for its rules to the Office of Management and Budget and to Congress for higher cost rules. This should at least assert some discipline over the agency.[61]

The CFPB represents a drastic change to the way Americans are governed. The remedy for its abuses should be equally drastic.

NOTES

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