The Consumer Financial Protection Bureau: Savior or Menace?

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A centerpiece of the Dodd-Frank financial reform legislation was the creation of a new Federal Consumer Financial Protection Bureau ("CFPB") within the Federal Reserve. Few bureaucratic agencies in American history, if any, have combined the vast power and lack of public accountability of the CFPB. It is an independent agency inside another independent agency, presided over by a single director who is insulated from presidential removal. Additionally, the Board is outside of the congressional appropriations process. Finally, its actions are unreviewable by the Federal Reserve—they can be checked bureaucratically only by a supermajority vote of the Financial Stability Oversight Council finding that the Board's actions imperil the safety and soundness of the American financial services industry.

Proponents of the CFPB argue that extreme independence is justified to insulate it from political pressures. But the history of regulation teaches that insulation can be isolation, resulting in inefficient regulation. Scholars over the past several decades have identified common pathologies associated with bureaucratic behavior. The CFPB's structure virtually guarantees the manifestation of those pathologies in practice: excessive risk aversion, agency imperialism, and tunnel vision. Indeed, it is as if the CFPB were an agency frozen in amber during the Nixon Administration and thawed out today, completely unaware of the past several decades' lessons on how to structure an effective regulatory strategy.

In the end, by manifesting these bureaucratic pathologies, the CFPB is likely to raise the price of and reduce access to credit, thereby harming the very consumers it was founded to protect.

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Introduction

A centerpiece of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")[1] was the creation of the new Consumer Financial Protection Bureau ("CFPB") within the Federal Reserve.[2] Indeed, so high profile was the agency that it catapulted its founding mother, Elizabeth Warren, into the United States Senate.[3]

To be sure, the system of consumer financial protection needed streamlining and reform even before the onset of the financial crisis. A patchwork of agencies covered different aspects of the financial system and all of them tended to focus on safety and soundness issues

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1 Dodd-Frank Wall Street Reform and Consumer Protection ("Dodd-Frank") Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

2 *Id.* §§ 1001–1100H, 124 Stat. at 1955–2113.

3 *See* Danielle Douglas, *Warren Fights for CFPB Again, but this Time as a Senator*, Wash. Post (Feb. 14, 2013), http://articles.washingtonpost.com/2013-02-14/business/37098356_1_richard-cordray-cfpb-director-senate-republicans.

rather than consumer protection. The most obvious federal regulator, the Federal Trade Commission ("FTC"), was prohibited from exercising authority over most of the industry, having jurisdiction over only nonbank lenders.[4] Into this regulatory gap poured politically ambitious state attorneys general and state legislators, suing and legislating with an eye toward buying in-state votes with the money of out-of-state banks while also balkanizing the consumer banking system. These activities subsequently triggered a reprisal by the federal government using its preemption power.[5] On the federal level, decades of class action lawsuits and regulatory sedimentation had eroded the simplicity and coherence of the original Truth in Lending Act[6] by rendering the system increasingly unworkable and incoherent.[7] The original model of disclosure-based regulation had become confused and modified by meddling as the federal government increasingly gravitated toward mandating what it thought consumers should care about rather than regulating what consumers *do* care about.[8] Thus, the need for reform was urgent and the opportunity ripe.

Alas, the creation of the CFPB squandered this historical opportunity for innovative and effective consumer protection reform. Although touted as a great leap forward for consumer protection, the institutional design of the CFPB is in fact a great leap backward into not only the principles that animated agency design in the New Deal and post-New Deal era, but into an even more archaic model of consumer financial protection.[9] In short, the CFPB's institutional design can be seen as the revenge of Richard Nixon: the return of a discredited view of agency design that, like a creature from *Jurassic Park*,[10] has emerged as if it were frozen in amber during the Nixon administration and thawed out today without recognizing why a bipartisan consensus emerged to move beyond the Nixon-era model of regulation and agency design that the CFPB resuscitates.[11]

Indeed, if one were to sit down and design a policymaking agency that embodied all of the pathologies scholars of regulation have iden-

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4 *See* 15 U.S.C. § 45(a)(2) (2006); *id.* § 1607(a), (b).

5 *See* Johnathan Mathiesen, Note, *Dr. Spitzlove or: How I Learned to Stop Worrying and Love "Balkaninzation"*, 2006 COLUM. BUS. L. REV. 311, 313 (describing this phenomenon); *see also infra* Part V.

6 Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968).

7 *See infra* note 264 and accompanying text.

8 *See infra* Part IV (describing the assumptions underlying the CFPB's regulatory authority).

9 *See infra* Part III.

10 JURASSIC PARK (Universal Pictures 1993).

11 *See infra* Part II.B.

tified over the past several decades, one could hardly do better than the CFPB: an unaccountable body, headed by a single director, insulated from both removal by the President and budgetary oversight by Congress, and charged with a tunnel vision mission to pursue one narrow goal that carries the potential for substantial harm to the economy and consumers.[12] So flawed is the CFPB's design, and so similar is it to the regulatory agencies of an earlier era, that the problems it will manifest and the harm it will impose on the economy are entirely predictable. In fact, based on its early efforts, the Bureau is causing such harm already.[13] Most tragically, unless reformed, the likely result of the CFPB in operation will be a result completely contrary to that intended by its founders: an increase in fraud against consumers, an increase in foreclosures in the event of a future housing market downturn, and an increase in cost and reduction in access to high-quality credit products for consumers.[14] This Article is an effort to avert those harms by pointing out the CFPB's structural defects in the hope that the agency will be reformed before those harms materialize.

This Article thus begins by briefly reviewing the evolution of the CFPB, placing the story in the historical context of both consumer credit regulation and the study of the theory of regulation in the twentieth century. The Article then describes some of the novel structural features of the CFPB, drawing on the literature of agency design to illustrate why these features are undesirable. The Article will then turn to the incredibly broad and ill-defined grant of powers given to the CFPB, focusing in particular on its power to attack "abusive" loan products and terms. Next, the Article will discuss the incoherence of the statutory scheme that Congress created regarding preemption of contrary state laws. Finally, this Article will address an unexamined proposition that lies at the root of Dodd-Frank generally, and the Act's consumer protection provisions specifically: the now commonly accepted but troubling assumption that it is appropriate for the government to pick and choose market winners and losers with no coherent justification, rather than creating a level playing field of equally applicable and neutral rules that structure the market process. The Article will conclude by briefly discussing some possible reforms to the CFPB that would mitigate some of the Bureau's most undesirable features.

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12 *See infra* Part III.B.

13 *See, e.g.*, *infra* notes 275–77 and accompanying text.

14 *See infra* Part III.C.2.

I. THE SHORT HISTORY OF THE CFPB

The origins of the CFPB lie in a short article authored by then-Professor Elizabeth Warren in 2007, in which she proposed a new consumer financial protection agency modeled on the Consumer Products Safety Commission ("CPSC"), which regulates the safety of consumer products.[15] Setting aside the absurd analogy between consumer appliances and consumer credit,[16] the article seeded the ground for the opportunity created a few years later when Barack Obama was elected President in the midst of the financial crisis. At that point, the new financial consumer protection agency was touted as a centerpiece of the Obama Administration's reform efforts in the wake of the financial crisis.[17]

In 2009, the Obama Administration published a white paper that laid out a framework which later became the basis for the Dodd-Frank financial reform legislation, and which included a proposal for a new consumer financial protection agency.[18] Under this initial proposal, the new agency was modeled on the federal CPSC as a multimember commission funded in part by congressional appropriations.[19] As originally introduced by Congressman Barney Frank in the House of Representatives in July 2009, the agency retained a multimember commission structure but also added an independent revenue stream.[20] The proposal for a new agency, however, drew widespread criticism, especially from Republicans.[21] In response to this criticism, the proposal was made to instead turn the agency into a bureau of the

15 *See* Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY J., Summer 2007, at 8, 16–17.

16 *See* Todd J. Zywicki & Stefanie Haeffele-Balch, *Loans Are Not Toasters: The Problems with a Consumer Financial Protection Agency*, MERCATUS ON POL'Y (Mercatus Center, George Mason U., Fairfax, Va.), Oct. 2009, at 1 (noting that unlike unsafe consumer products such as toasters, almost all consumer credit products are useful for some consumers in some contexts).

17 *See* Andrew Martin & Louise Story, *Banks Brace for Fight over an Agency Meant to Bolster Consumer Protection*, N.Y. TIMES, June 18, 2009, at B1.

18 *See* DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 55–75 (2009), [hereinafter TREASURY DEP'T WHITE PAPER], *available at* http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf (proposing the "Consumer Financial Protection Agency").

19 *See id.* at 58 (suggesting the proposed Consumer Financial Protection Agency's basic structure, which included a Director and a Board, and arguing that the Agency should have a "stable funding stream, which could come in part from fees assessed on entities," but not suggesting that the agency be completely self-funded).

20 H.R. 4173, 111th Cong. § 4103 (2009) (as proposed in the House) (providing for a multimember structure); *id.* § 4109 (adopting an independent funding source).

21 Carl Hulse, *House Approves Tougher Rules on Wall Street*, N.Y. TIMES, Dec. 12, 2009, at A1 (noting that "Republicans strongly criticized the Democratic legislation").

Federal Reserve (the "Fed").[22] Therefore, when Senator Chris Dodd introduced the legislation in the Senate in April 2010, the new consumer protection agency had been converted into a bureau of the Fed with a single director and an independent revenue stream.[23] Eventually the Dodd-Frank financial reform legislation passed Congress and was signed into law in July 2010.[24]

The concept of a new dedicated consumer financial protection agency was one of the centerpieces of the Obama financial regulatory reform program.[25] To a large extent, the critique of the existing federal consumer financial protection system was well founded: consumer financial protection was balkanized among many disparate bank regulatory agencies, many of which had any particular expertise in consumer protection regulation (as opposed to prudential regulation).[26] Issuance of new rules regarding consumer protection often resembled a United Nations meeting: a fractious, multi-agency negotiation process animated as much by bureaucratic turf battles and warring agency cultures as by a desire to promote a rational and efficient consumer protection policy. Moreover, the need for reform of consumer protection laws at the national level predated and was independent from the financial crisis that finally provided the impetus for reform.[27] That there is absolutely no evidence that failures in consumer protection actually contributed in a major way to the crisis—indeed, many of the financial service providers swept under the CFPB's umbrella, such as payday lenders and providers of cash remittances, had nothing at all to do with the financial crisis—does not detract from the fact that

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22 *See* Rich Danker, *How the CFPB Got the Fed's Lunch Money*, CQ ROLL CALL (July 23, 2012, 1:56 PM), http://www.rollcall.com/news/Danker-How-the-CFPB-Got-the-Feds-Lunch-Money-216345-1.html.

23 *See* S. 3217, 111th Cong. § 1011(a) (2010) (as introduced in the Senate) (establishing the agency as a Bureau within the Fed); *id.* § 1011(b)(1) (establishing a single Director for the Bureau); *id.* § 1017 (establishing the Bureau's funding source).

24 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); Helene Cooper, *Obama Signs Contentious Overhaul of the Financial System*, N.Y. TIMES, July 22, 2010, at B3.

25 *See* TREASURY DEP'T WHITE PAPER, *supra* note 18, at 3; *see also* Robert G. Kaiser, *How a Crusade to Protect Consumers Lost Its Steam*, WASH. POST, Jan. 31, 2010, at G1 (noting that President Obama called consumer protection a priority of the administration and urged the approval a new consumer financial protection agency).

26 *See* TREASURY DEP'T WHITE PAPER, *supra* note 18. at 55 (describing this decentralized, conflicting approach).

27 *See, e.g.*, Laurie A. Burlingame, *A Pro-Consumer Approach to Predatory Lending: Enhanced Protection Through Federal Legislation and New Approaches to Education*, 60 CONSUMER FIN. L. Q. REP. 460, 460, 482–84 (2006) (advocating before the 2008 financial crisis for, inter alia, "federal legislation aimed at curbing predatory practices and terms").

greater coherence and rationalization was needed.[28] To concentrate consumer financial protection in one body was a reasonable reform to this system, though the responsibilities given to the CFPB could have been allocated to the already-extant FTC, which had developed deep expertise in consumer protection issues, including certain elements of consumer financial products.[29] The fact that it was not *necessary* to create a new superagency (the CFPB) to perform the task of consumer financial regulation should not, however, be read as suggesting that institutional reform of the consumer financial system was unnecessary.

Nonetheless, almost from the beginning the new Bureau proved to be politically controversial. It was conventionally believed that the Bureau's first Director would be its intellectual godmother, Elizabeth Warren.[30] Warren, however, was too controversial a figure to be confirmed by the Senate.[31] As a result, rather than nominating her to head the Bureau, President Obama instead named her an Assistant to the President and Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau.[32] In this position, Warren was tasked with setting up the Bureau and preparing it to begin its duties upon the designated transfer date one year after the passage of Dodd-Frank.[33] At the end of that one-year period, however, it remained clear that Warren could not be confirmed.[34] Moreover, Warren herself had apparently decided that she would run as the Democratic nominee for United States Senator from Massachusetts in the meantime, challenging incumbent Scott Brown.[35] She was, therefore, never nominated by the President to head the Bureau.[36]

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28 For debate on this question, see *Did a Lack of Consumer Protection Cause the Financial Crisis?*, CATO INST., (Mar. 16, 2010, 12:00 PM), http://ne.edgecastcdn.net/000873/archive-2010/cpf-03-16-10.m4v.

29 *See, e.g.*, Burlingame, *supra* note 27, at 469 (noting that the FTC had been the most active agency in taking action against predatory lenders).

30 *See* Kaiser, *supra* note 25, at G1 (noting that "[f]riends and allies say Warren would love to be the first director of a CFPA" and that Rep. Barney Frank, then-Chairman of the House Financial Services Committee, quickly endorsed Warren).

31 *See* Brady Dennis, *Warren Expected to Be Adviser*, WASH. POST, Sept. 16, 2010, at A18 (discussing how Warren's nomination would have caused "a confirmation battle").

32 *See id.*

33 *See id; see also* Designated Transfer Date, 75 Fed. Reg. 57,252, 57,252 (Sept. 20, 2010) (setting the transfer date as July 21, 2011, exactly one year after the passage of Dodd-Frank).

34 David Nakamura & Felicia Sonmez, *Obama Defies Senate, Puts Cordray in Consumer Post*, WASH. POST, Jan. 5, 2012, at A1 ("[T]he White House opted not to nominate Warren" at the same time "as the agency was preparing to open its doors in July [2011].").

35 *See id.*

36 *Id.*

Instead, on July 18, 2011 President Obama nominated former Ohio Democratic Attorney General Richard Cordray to serve as CFPB Director.[37] Senate Republicans immediately announced that they would filibuster any confirmation vote of Cordray's nomination until certain structural reforms were made to the CFPB.[38] The conditions insisted on by the Republicans included reforming the CFPB into a multimember, bipartisan agency (rather than one with a single director), bringing the CFPB under Congress's appropriations authority, and reducing the required level of consensus for the Financial Stability Oversight Council ("FSOC") to overrule actions by the CFPB from a two-thirds consensus (as required by Dodd-Frank) to a simple majority.[39] The Obama Administration refused to acquiesce in this request, and the position therefore remained vacant.

Then on January 4, 2012, in a surprise move, President Obama took the unprecedented step of naming Cordray as the Director of the Bureau, claiming that the President could do so using his constitutional power to make recess appointments, even though Congress was not actually in recess.[40] The legality of Cordray's status remains unclear and has been contested in a lawsuit that also challenges a number of provisions of Dodd-Frank generally, as well as those related to the CFPB specifically.[41] Moreover, the issue is important not just because of the constitutional questions implicated, but also because the statute itself makes the transfer of certain new powers granted to the CFPB under Dodd-Frank—namely, the power to regulate nonbank lenders such as payday lenders, as well as credit reporting agencies—subject to the presence of a confirmed director.[42] In addition, and the

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37 *See* Richard Shelby, Op-Ed., *The Danger of an Unaccountable 'Consumer-Protection' Czar*, WALL ST. J., July 21, 2011, at A17.

38 *See id.* (explaining the Republicans' proposed changes); *see also* John H. Cushman Jr., *Senate Stops Consumer Nominee*, N.Y. TIMES, Dec. 9, 2011, at B1 (relating these changes to Senate Republicans' eventual filibuster of Cordray).

39 *See* Shelby, *supra* note 37; Edward Wyatt, *Nominee to Head Consumer Bureau Says He Will Streamline Regulations*, N.Y. TIMES, Sept. 7, 2011, at B3 (noting that Senate Republicans tied their opposition to Cordray's confirmation in part to the FSOC's supermajority vote requirement); *see also, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1023, 124 Stat. 1376, 1985 (2010) (requiring two-thirds majority vote for FSOC to set aside a CFPB-issued regulation).

40 *See* Nakamura & Sonmez, *supra* note 34.

41 *See* C. Boyden Gray & Jim R. Purcell, *Why Dodd-Frank Is Unconstitutional*, WALL ST. J., June 22, 2012, at A17. The D.C. Circuit recently issued an opinion that puts Cordray's recess appointment in serious constitutional doubt. *See* Noel Canning v. NLRB, No. 12-1115, slip-op at 13–44 (D.C. Cir. Jan. 25, 2013).

42 *See* Dodd-Frank Act § 12 U.S.C. § 5586(a) (Supp. IV. 2011); *see also* Joint Response by Inspectors Gen. of Dep't of the Treas. & Bd. of Governors of the Fed. Reserve Sys. to Spencer

statute requires the Director to be nominated by the President and confirmed subject to the advice and consent of the Senate.[43] Thus, even if Cordray's appointment is constitutionally valid (despite the apparent lack of a congressional recess that would justify a recess appointment), it remains an open question whether a recess appointment without formal confirmation satisfies the *statutory* requirement that the CFPB Director be confirmed by the Senate for it to acquire the full scope of its powers under the law.

II. Consumer Credit Regulation and Regulatory Theory in American History

The modern regulatory framework for the regulation of consumer credit—until the 2008 financial crisis and the rise of the Obama-Warren regulatory counterrevolution—was forged by the experience of the economic crisis of the 1970s and an academic backlash against the regulatory framework constructed during the New Deal. The lessons learned had two mutually reinforcing elements. First, decades of learning taught scholars and policymakers about the unintended consequences of poorly conceived regulation of consumer credit.[44] Second, scholars and policymakers gained an improved understanding of the pathologies and tendencies inherent in bureaucratic decisionmaking and the need for institutions that could counterbalance those tendencies.[45] A full accounting of both of these historical lessons is beyond the scope of this Article, but a brief understanding of these twin historical phenomena—and why they produced particular schools of regulatory theory and consumer credit regulation—is necessary to understand the radical intellectual counterrevolution embodied in CFPB.

A. *Consumer Credit Regulation: The Lessons of History*

As I have discussed elsewhere, the early history of consumer credit regulation can be traced to the pre-Civil War era.[46]

Bachus, Chairman, H. Comm. on Fin. Servs. & Judy Biggert, Chairman, Subcomm. on Ins., Hous. & Cmty. Opportunity of the H. Comm. Fin. on Servs. 4–7 (Jan. 10, 2011), *available at* http://www.federalreserve.gov/oig/files/Treasury_OIG_Posted_PDF_-_Response_CFPB.pdf.

43 Dodd-Frank Act § 1011(b)(2), 124 Stat. at 1964 ("[T]he Director shall be appointed by the President, by and with the advice and consent of the Senate.").

44 *See infra* Part II.A.

45 *See infra* Part II.B.

46 The following quoted passage is drawn from the author's working paper entitled "Credit Cards and Bankruptcy. Todd J. Zywicki, Credit Cards and Bankruptcy 6-7 (March 2008) (unpublished manuscript), *available at* http://works.bepress.com/cgi/viewcontent.cgi?article=1002&context=todd_zywicki. Internal citations have been retained for the benefit of the reader.

In pre-Civil War America, most Americans were farmers, living outside major population centers. Gold and silver coins were scarce.[47] Personal credit, however, was not, and farmers relied on credit to smooth investment and consumption across the crop harvesting season.[48] Credit was as important as the Conestoga Wagon in conquering the west.[49]

In the decades following the Civil War, a tide of immigrants swept into America, building the great cities.[50] Most urban dwellers were unskilled blue-collar workers with unpredictable employment and income; thus the consumer credit industry emerged to cope with seasonal fluctuations in employment.[51] This need for unsecured, small-loan seasonal borrowing placed new pressures on the consumer credit system and regulation.[52] In post-Civil War New York City, for instance, two-thirds of the city's total consumer lending came from small-loan agencies, including loan sharks and the forerunners to today's "payday" or "wage assignment" lenders.[53] Pawnshops proliferated; in some neighborhoods virtually the entire population had a pawn ticket at all times and as many as twelve in the winter when factories typically closed down.[54] These various unlicensed lenders charged interest rates that approached 300% annually and resorted to embarrassing and aggressive collection practices to enforce repayment of these illegal debts.[55] Counterproductive usury regulations made operations unprofitable for legitimate lenders, thereby driving many urban consumers into the hands of illegal lenders.[56] It was estimated that in 1911,

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47 LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 75 (1999).

48 *See id.* at 160–61 (discussing how the extension of credit allowed mid-nineteenth century farmers to purchase new farming technology that would otherwise "cost too much to be paid off in full after one harvest").

49 *See* LEWIS MANDELL, THE CREDIT CARD INDUSTRY: A HISTORY, at xii (1990).

50 *See* CALDER, *supra* note at 47, at 166–67.

51 *See id.* at 169–70.

52 *See id*. at 116–17.

53 *See id.* at 49–50.

54 *See id.* at 44, 48.

55 *See id.* at 48–54. Interest rates on these loans were comparable to those of modern payday lenders. *See Hearing Your Stories on Payday Lending*, CONSUMER FIN. PROT. BUREAU (Jan. 19, 2012), http://www.consumerfinance.gov/blog/hearing-your-stories-on-payday-lending/ (noting that the annual percentage rate on some payday loans can exceed 400%). Of course, collection practices by illegal loan sharks were much more severe.

56 Alan Greenspan, Chairman, Fed. Reserve Bd. of Governors, Remarks at the Economic Development Conference of the Greenlining Institute (Oct. 11, 1997), [hereinafter Greenspan, Greenlining Remarks] (transcript available at http://www.federalreserve.gov/BoardDocs/

> thirty-five percent of New York City's employees owed money to illegal loan sharks.[57] Reviewing the credit market of this era, former Federal Reserve Chairman Alan Greenspan described the plight of lower-income wage earners subject to aggressive and overreaching creditors as "virtual serfdom."[58]

Confronted with these dual problems of an increased need for consumer credit by an urbanized wage-earner economy and an outmoded moralistic and paternalistic system of consumer credit regulation, reformers began to search for progressive solutions, especially to the recurrent problem of illegal loan sharks arising to serve the needs of wage earners who were unable to obtain credit elsewhere.[59] Beginning in the early twentieth century, far-sighted reformers and consumer advocates affiliated with the nonprofit Russell Sage Foundation began to push for reforms of consumer credit laws, sponsoring pathbreaking economic research on consumer credit that highlighted the negative unintended consequences associated with overly strict and outmoded consumer credit laws.[60] Its efforts culminated in the first Uniform Small Loan Law in 1916, which recognized the need for consumer credit and sought to bring it out of the hands of loan sharks and into competitive markets.[61] In subsequent decades, access to consumer credit grew rapidly—especially access to consumer installment lending and early automobile installment credit.[62]

These beneficial regulatory developments, however, came to a crashing halt in the wake of the Great Depression. A common explanation of the Great Depression was that it was caused in part by an excess of consumer credit—especially installment lending to purchase consumer durables such as appliances and automobiles.[63] The re-

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Speeches/1997/19971011.htm) (noting that "usury laws . . . limited interest rates to levels that were uncompetitive, making profitable consumer lending difficult for more legitimate, licensed lenders. Consequently, unlicensed, illegal, high-rate lenders continued operation in response to the persistent demands of the marketplace of the day").

57 See CALDER, *supra* note 47, at 118.

58 *See also* Greenspan, Greenlining Remarks, *supra* note 56.

59 *See* CALDER, *supra* note 47, at 124.

60 *See id.* at 124–27.

61 THOMAS DURKIN ET AL., CONSUMER CREDIT AND THE AMERICAN ECONOMY (forthcoming 2013) (manuscript at 642) (on file with the George Washington Law Review). By 1932, half the states had used the Uniform Small Loan Law as the basis for their own legislation, and by 1960, nearly every state had done so. *Id.*

62 *Id.* at 642–644.

63 *See* CALDER, *supra* note 47, at 151–52 (describing the expansion of consumer credit for installment purchases in the 1920s); Barry Eichengreen & Kris Mitchener, *The Great Depression as a Credit Boom Gone Wrong* 3–6 (Bank for Int'l Settlements, BIS Working Paper No. 137,

sponse was a backlash in the form of tight restrictions on access to consumer credit—interest rate ceilings were ratcheted downward and new regulatory barriers to the entry of personal finance companies and small-loan lenders were erected.[64] Consumer credit markets were balkanized by a complex web of regulations that treated functionally similar credit products disparately based on loan size, interest rates, and other characteristics, which stifled competition and resulted in higher prices for consumers.[65] Moreover, this regulatory web also had the effect of generating market winners and losers, intentionally or unintentionally favoring some types of lenders over others (such as favoring retailers over nonretailers, larger retailers over smaller ones, and pawnshops over unsecured lenders) and certain types of consumers over others (such as middle class and wealthy consumers over lower-income consumers).[66] Most notably, up until the 1970s, illegal loan sharks remained in business even in the face of deregulation of the consumer credit market. Indeed, in 1969, famed economist Paul Samuelson went before the Massachusetts State Legislature to argue for relaxing the usury ceilings on the grounds that a primary beneficiary of usury ceilings were "illegal loan sharks," not consumers.[67]

The increasing bipartisan consensus regarding the harmful effects of misguided regulation of the terms and conditions of consumer credit led to a new approach to consumer credit regulation, similar to that adopted earlier in the century. In particular, rather than using regulation to dictate substantive terms of consumer credit— i.e., attempts to displace market terms such as interest rates and loan size—economically sophisticated reformers came to see that it would be more productive to instead accept the necessity of market forces and

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2003), *available at* http://www.bis.org/publ/work137.pdf (describing claims that easy access to credit helped cause the Depression and "find[ing] that the credit boom view provides a useful perspective on both the boom of the 1920s and the subsequent slump," while emphasizing that they "are not necessarily advocating a 'credit-centric' interpretation of the Great Depression").

64 *See* DURKIN ET AL., *supra* note 61, at 644 (noting that "[s]tates eventually applied interest rate ceilings to sales finance companies and merchants beginning in 1935").

65 *See id.* at 645–47, 654–60 (noting the balkanization of consumer credit and suggestions by two federal commissions in the early 1970s to "relax[ ] . . . regulations that restricted competition within and across institutional classes of lenders" as a means of "reduc[ing] prices and increas[ing] availability of financial services, including consumer credit").

66 *See id.* at 645–46 (describing the varying maximum rates allowed for different types of lenders); *id.* at 649–56 (discussing the effects of rate caps on different classes of borrowers as well as the segmentation of the consumer finance industry).

67 Paul A. Samuelson, Statement Before the Committee of the Judiciary of the General Court of Massachusetts in Support of the Uniform Consumer Credit Code (Jan. 29, 1969), *in* STATEMENTS OF FORMER SENATOR PAUL DOUGLAS AND PROFESSOR PAUL SAMUELSON ON THE UNIFORM CREDIT CODE 7 (1969).

seek to make them work better for the benefit of consumers.[68] The response was a move away from command-and-control substantive regulation of the type adopted in the post-Depression era, and toward a new regulatory approach focused on promoting competition and consumer choice in markets through disclosure-based regulation.[69]

The result was important regulation of the era such as the Truth in Lending Act ("TILA"),[70] which abandoned old-style imposition of terms and instead sought to construct standardized disclosure formats. This, in turn, would enable consumers to more easily compare the terms and conditions of competing offers.[71] This revolution reflected more than just a change in economic thinking, however—the change was philosophical as well, reflecting an abandonment of the paternalistic philosophy of political elitists who felt that most consumers could not be trusted with access to credit. These regulatory elitists were especially vigilant in their efforts to protect groups that they saw as vulnerable: the poor, immigrants, and perhaps most of all women, whom paternalists viewed as especially needing protection because of their purportedly poor math skills.[72] The deregulatory reforms that began in the 1970s, by contrast, were grounded on the dual premises of treating borrowers like adults (even the supposedly "math-impaired" females) and the demonstrated inability of governmental regulators to improve matters by substantive regulation of consumer credit markets.[73]

The second major regulatory transformation during this period was the Supreme Court's 1978 decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*,[74] which held that to determine the correct choice of law for consumer interest rates, the relevant state would be the state of the issuing bank rather than the state of the consumer's residence.[75] The effect of this decision was

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68 *See* DURKIN ET AL., *supra* note 61, at 645–47.

69 *See id.* at 774 (noting that, traditionally, state consumer finance regulation has generally relied on substantive prohibitions, while relatively newer federal regulation has focused more on disclosure).

70 Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (1968).

71 *See generally* THOMAS A. DURKIN & GREGORY ELLIEHAUSEN, TRUTH IN LENDING: THEORY, HISTORY, AND A WAY FORWARD (2011) (giving a thorough overview of the TILA).

72 *See* CALDER, *supra* note 47, at 166.

73 *See* DURKIN ET AL., *supra* note 61, at 646–47.

74 Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978).

75 *Id.* at 313 ("Since Omaha Bank and its BankAmericard program are 'located' in Nebraska, the plain language of [the National Banking Act] provides that the bank may charge 'on any loan' the rate 'allowed' by the State of Nebraska.").

profound; by allowing the "exportation" of interest rates on credit cards, *Marquette* prompted the growth of a fully nationalized consumer lending market, bringing efficiencies to consumers.[76] More concretely, *Marquette* enabled the rapid growth of the credit card industry, setting in motion a robust competitive structure that resulted in the spread of credit cards throughout the economy, and the displacement of many traditional types of credit that were more expensive, less flexible, and otherwise inferior to credit cards, such as layaway, retail store credit, and many types of personal finance companies and other high-cost lenders.[77]

This hard-won intellectual consensus over the benefits of access to high-quality consumer credit and the unintended consequences of bad regulation, which had built up over several decades, was smashed by the 2008 financial crisis. Ironically—and to a large extent, predictably—the intellectual response to the financial crisis has been to repeat the same arguments heard in prior eras regarding consumer credit and its link to macroeconomic instability, along with a call for new paternalistic regulation under the guise of "behavioral economics," which is seen as providing a new justification for paternalistic intervention into consumer credit markets.[78] These current approaches, however, not only ignore the lessons of history, but actually appear to be based on a fundamental misunderstanding of the lessons of history, as they incorrectly imagine a golden age of consumer credit. As will be explained below, the cost of this historical amnesia is likely to be high: a repeat of the destructive regulatory philosophies of the past, with disastrous results for both the economy and consumers, especially those low-income and other vulnerable consumers who have the fewest credit choices.

B. Bureaucratic Agency Design: The Lessons of History

There is a second strand of history that is ignored by the architects of the CFPB, a strand that follows much of the same historical trajectory as the repudiation of the consumer credit regulatory apparatus constructed in the post-Depression era. This second strand re-

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76 *See* Joshua D. Wright & Todd J. Zywicki, *Three Problematic Truths About the Consumer Financial Protection Agency Act of 2009*, LOMBARD STREET, at 1, 15 (Sept. 14, 2009), http://www.law.gmu.edu/assets/files/publications/working_papers/0948ThreeProblematicTruths.pdf [hereinafter Wright & Zywicki, *Three Problematic Truths*].

77 *See* Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79, 164–65 (2000).

78 *See* Wright & Zywicki, *Three Problematic Truths*, *supra* note 76, at 8–13.

lates to the history of the theory of regulation and the design of regulatory agencies and regulatory processes.

Beginning in the Progressive Era and reaching its apotheosis during the New Deal, a new type of regulatory approach came into vogue.[79] Impressed by the increasing complexity of society and frustrated by the supposedly dysfunctional nature of electoral politics, the New Deal created an armada of expert regulatory agencies staffed by expert decisionmakers and tasked with the responsibility of bringing expertise to bear on the design of regulatory policies.[80] These experts were, by design, meant to be insulated from market and political pressures so that they could be free to pursue the "public interest" as they understood it; thus, their decisionmaking would be uncorrupted by venal self-interested influences.[81]

By the 1970s, however, this model of governmental decisionmaking was falling into deep disrepute. The increasing economic burden imposed by bureaucratic regulation was seen as reducing economic growth, stifling innovation, increasing inflation, and undermining America's global competitiveness.[82] Much of the blame came to rest on the philosophy that had animated the New Deal support for administrative agencies: the naïve view that unelected bureaucrats insulated from political oversight and other feedback mechanisms would produce ideal policies.[83]

Instead, scholars of regulation came to observe that responsive public oversight of bureaucratic action could provide a salutary check on bureaucratic decisionmaking by providing information about the social and economic consequences of their policy choices.[84] While insulation from oversight provided independence, it also created isola-

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79 *See* Cass R. Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 422–23 (1987) ("In the New Deal period, reformers believed that administrative officials would serve as independent, self-starting, technically expert, and apolitical agents of change. This basic understanding wedded the original constitutional belief in the need for an energetic national government to the desire, associated with the Progressive movement, to insulate public officials from partisan pressures in the service of a long-term public interest." (footnotes omitted)).

80 *See id.* at 423 ("The New Dealers believed that institutional changes were necessary to allow the federal government to deal with the multiple social and economic issues that arose in the wake of the Depression.").

81 *See* MAXWELL L. STEARNS & TODD J. ZYWICKI, PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW 44–46 (2009) (discussing the "public interest" theory of regulation); Sunstein, *supra* note 79, at 422–23.

82 James C. Cooper, Paula A. Pautler & Todd J. Zywicki, *Theory and Practice of Competition Advocacy at the FTC*, 72 ANTITRUST L.J. 1091, 1094 (2005).

83 *See* Sunstein, *supra* note 79, at 426 (describing some of these criticisms).

84 *See id.* at 427–28 (discussing the arguments for and against political control over regulatory agencies).

tion. At best, bureaucratic action is often irrational and dysfunctional.[85] At worst, it is often subject to capture by interest groups and repeat players, whether industry interest groups or non-profit, nongovernmental entities that receive benefits from agencies and provide staffers for them.[86] Reformers also recognized that the decentralized growth of the regulatory state required increased coordination of regulatory policy within the executive branch.[87] Accordingly, one important response was the creation of the Office of Information and Regulatory Affairs ("OIRA"), which was tasked with creating coherence among the conflicting directives of different regulatory agencies and balancing regulations so as to preserve other values such as economic growth and national security.[88] Finally, beginning in the 1970s, analysts began to explore regulatory agencies' internal dynamics to identify the sources of the pathologies that had resulted in the counterproductive and economically destructive regulatory policies in the 1970s.[89]

The outcome of the painful lessons learned during the stagflation and declining American competitiveness of the 1970s led to a bipartisan effort to dramatically restructure governmental agencies to make them more responsive and more resistant to the regulatory pathologies that critics had identified. Several old agencies that were seen as outmoded, hopelessly captured, and beyond reform, such as the Interstate Commerce Commission and Civil Aeronautics Board, were simply abolished.[90] Other dysfunctional agencies, such as the FTC, were

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85 *See* STEPHEN BREYER, BREAKING THE VICIOUS CIRCLE: TOWARD EFFECTIVE RISK REGULATION 10–21 (1993) (discussing the bureaucratic problems of "tunnel vision," "random agenda selection," and inconsistency).

86 *See* Christopher C. DeMuth & Douglas H. Ginsburg, *White House Review of Agency Rulemaking*, 99 HARV. L. REV. 1075, 1081 (1986) (discussing the vulnerability of government agencies to influence by "organized groups with the largest and most immediate stakes in the results").

87 *See id.* at 1076–77.

88 *See* STEARNS & ZYWICKI, *supra* note 81, at 366–67 (discussing OIRA).

89 *See, e.g.*, WILLIAM A. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 5 (1971) ("Any theory of the behavior of bureaus that does not incorporate the personal preferences of bureaucrats . . . will be relevant only in the most rigidly authoritarian environments. In a fundamental sense, our contemporary confusion derives from a failure to bring bureaucracy to terms with representative government and free labor markets."); JAMES Q. WILSON, BUREAUCRACY: WHAT GOVERNMENT AGENCIES DO AND WHY THEY DO IT, at x (1989) (noting that "[e]conomists and political scientists have begun to apply to government agencies the same analytical methods that once were used to explain the behavior of business firms. Just as entrepreneurs are thought to be maximizing their 'utility,' bureaucrats are now thought to be maximizing theirs").

90 *See* ICC Termination Act of 1995, Pub. L. No. 104-88, 109 Stat. 803 (abolishing the Interstate Commerce Commission); Airline Deregulation Act of 1978, Pub. L. No. 95-504,

reformed by a combination of aggressive congressional oversight and conscious efforts to improve their operations.[91] The end result was a more balanced regulatory policy that sought to reimpose checks and balances on the regulatory process by counterbalancing the tendency of bureaucracies to manifest certain predictable pathologies and bringing more collaborative decisionmaking to the regulatory process.

Again, as will be detailed in the next Section, the institutional structure of the CFPB fundamentally ignores these important historical lessons. It creates a single-mission agency insulated from budgetary oversight, OIRA review, and effective oversight of its decisions.[92] As such, it is a virtual poster child for an agency design that eventually will be likely to manifest the bureaucratic pathologies that led to the disastrous regulatory policies that were abandoned in the 1970s. It is as if the agency was frozen in amber during the Nixon Administration and then thawed out in 2008—and as if it were completely unaware of the dramatic improvements in the understanding of regulatory policy in the intervening decades.

III. Structural Defects of the CFPB

Analyzing the historical arch of the twentieth century regulatory state, scholars of regulation have identified a number of bureaucratic pathologies that explain the unresponsive and counterproductive regulation that evolved in the United States and have also provided suggestions on how to construct regulatory agencies that avoid these foreseeable problems.[93] The Dodd-Frank Act, however, erects a regulatory structure that is oblivious to these lessons, laying the foundation for a repeat of the bureaucratic stagnation that culminated in the 1970s and that was swept aside after these lessons were absorbed. Unfortunately, the architects of the CFPB—seemingly oblivious to this history—stand poised to repeat those errors, with potentially disastrous consequences for consumers and the economy.

The CFPB has four features that distinguish it from most other governmental agencies. First, the CFPB is exempted from the Con-

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§ 40(a), 92 Stat. 1705, 1744–45 (terminating the Civil Aeronautics Board and transferring certain responsibilities to other agencies).

91 *See* Richard A. Harris & Sydney M. Milkis, The Politics of Regulatory Change: A Tale Of Two Agencies 140–42 (2d ed. 1996) (noting that beginning in the 1970s and continuing into the 1980s, "the FTC became the target of the Congress, as well as the Reagan administration").

92 *See infra* Part III.

93 *See generally* Stearns & Zywicki, *supra* note 81, at 358–66 (giving an overview of this scholarship).

gressional budgetary and appropriations process. Instead, the CFPB receives from the Fed "the amount determined by the [CFPB] Director to be reasonably necessary" to carry out the CFPB's activities, subject to a ten percent cap of the Fed's total operating expenses in 2011, an eleven percent cap in 2012, and a twelve percent cap in 2013 and each year thereafter.[94] Mandatory 2011 appropriations were $162 million and appeared likely to rise rapidly thereafter: 2012 mandatory appropriations were estimated to climb to $340 million, and 2013 mandatory appropriations are estimated to more than double the 2011 figure, reaching $448 million.[95] In addition, the CFPB is entitled to request further funds from Congress under certain circumstances.[96] Thus, not only does Congress have no real budgetary oversight authority over the CFPB through its appropriations responsibility, the Fed itself essentially has no ongoing budgetary oversight authority either.

Second, the CFPB is headed by a single director who is appointed for a fixed term of five years and who is removable only for "cause," which Dodd-Frank defines as "inefficiency, neglect of duty, or malfeasance in office."[97] Although single individuals head many departments and agencies, most (such as cabinet secretaries) serve at the pleasure of the President and are removable by the same.[98] In contrast, multimember commissions, whose members serve for fixed terms and are removable only for cause, typically head independent agencies.[99] In the rare instances in which a single director, such as the Comptroller of the Currency, serves as the head of an agency with formal de jure protection from removal, it appears that as a de facto matter, such heads serve at the pleasure of the President.[100] Moreo-

94 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1017(a)(1)–(2)(A), 124 Stat. 1376, 1975 (2010) (codified at 12 U.S.C. § 5497(a)(1)–(2)(A) (Supp. IV 2011)).

95 OFFICE OF MGMT. & BUDGET, OTHER INDEPENDENT AGENCIES 1295 (2012), *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/oia.pdf.

96 *See* Dodd-Frank Act § 1017(e)(1)(B)–(2), 124 Stat. at 1979 (codified at 12 U.S.C. § 5497(e)(1)(B)–(2)) (authorizing the CFPB to request up to $200 million in discretionary funds if the Director finds that such funds are necessary and submits a report to Congress stating as much).

97 *Id.* § 1011(c)(3), 124 Stat. at 1964 (codified at 12 U.S.C. § 5491(c)(3)).

98 *See* Kimberly N. Brown, *Presidential Control of the Elite "Non-Agency*,*"* 88 N.C. L. REV. 71, 77 (2009).

99 *See Recent Legislation*, *Dodd-Frank Act Creates the Consumer Financial Protection Bureau, Pub. L. No. 111–203, 124 Stat. 1376 (2010)*, 124 HARV. L. REV. 2123, 2128 (2011) [hereinafter *Dodd-Frank Creates the CFPB*].

100 *Who's Watching the Watchmen? Oversight of the Consumer Financial Protection Bureau: Hearing Before the H. Subcomm. on TARP, Fin. Servs. & Bailouts of Pub. & Private Pro-*

ver, these single-director agencies usually do not hold broad policymaking responsibilities but instead are involved in expertise-based regulation, such as supervising the safety and soundness of banks or the scientific process of the Food and Drug Administration. By contrast, the CFPB director performs an enormous policymaking function by controlling the flow and terms of consumer credit in the American economy.[101] Such policies carry massive implications.

Third, the CFPB's decisions can be overridden only by a two-thirds vote of the FSOC, a new entity created by Dodd-Frank to supervise the safety and soundness of the American financial system.[102] The FSOC can veto actions by the CFPB only if the actions would seriously threaten the "safety and soundness of the United States banking system or [put] the stability of the financial system of the United States at risk."[103]

Finally, Dodd-Frank expressly provides that for purposes of *Chevron* deference,[104] courts must defer to the CFPB "regarding the meaning or interpretation of any provision of a Federal consumer financial law."[105] This provision ensures that the CFPB's interpretation

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grams of the H. Comm. on Oversight & Gov't Reform, 112th Cong. 83–84 (2011) [hereinafter *Who's Watching the Watchman? Hearing*] (statement of Andrew Pincus, on behalf of the U.S. Chamber of Commerce) (noting the President's position that both the Comptroller of the Currency and the Director of the Office of Thrift Supervision serve at the pleasure of the President).

101 *See* Dodd-Frank Act § 1011(a), 124 Stat. at 1964 (codified at 12 U.S.C. § 5491(a)) (charging the CFBP with "regulat[ing] the offering and provision of consumer financial products or services").

102 *See id.* § 1023(c)(3)(A), 124 Stat. at 1985 (codified at 12 U.S.C. § 5513(c)(3)(A)). The FSOC is composed of ten voting members—nine federal financial regulatory agencies and an independent member with insurance expertise—and five nonvoting members. *See id.* § 111(b)(1)–(2), 124 Stat. at 1392–93 (codified at 12 U.S.C. § 5321(b)(1)–(2)).

Voting Members: The Secretary of the Treasury, who serves as the Chairperson of the FSOC, the Chairman of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, the Director of the Consumer Financial Protection Bureau, the Chairman of the Securities and Exchange Commission, the Chairperson of the Federal Deposit Insurance Corporation, the Chairperson of the Commodity Futures Trading Commission, the Director of the Federal Housing Finance Agency, the Chairman of the National Credit Union Administration Board, and an independent member with insurance expertise that is appointed by the President and confirmed by the Senate for a six-year term. *Id.* § 111(b)(1), (c)(1).

Nonvoting Members Who Serve in an Advisory Capacity: The Director of the Office of Financial Research, the Director of the Federal Insurance Office, a state insurance commissioner selected by the state insurance commissioners, a state banking supervisor chosen by the state banking supervisors, and a state securities commissioner designated by the state securities supervisors. *Id.* § 111(b)(2). The state nonvoting members have two-year terms. *Id.* § 111(c)(1).

103 *Id.* § 1023(c)(3)(B), 124 Stat. at 1986 (codified at 12 U.S.C. § 5513(c)(3)(B)).

104 *See* Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).

105 Dodd-Frank Act § 1022(b)(4)(B), 124 Stat. at 1981 (codified at 12 U.S.C. § 5512(b)(4)(B)) ("[T]he deference that a court affords to the Bureau with respect to a determi-

will trump any contrary interpretation from the Fed, or any other entity, by expressly limiting judicial review of the CFPB's interpretation of any consumer financial protection statute.

The effect of these four interlocking provisions has been to make the CFPB one of the most powerful and publicly unaccountable agencies in American history. It is effectively an independent agency housed inside another independent agency—not only largely immune from congressional appropriations, but immune from oversight by the Fed or the President (either directly or via OIRA) as well.[106] No other branch or agency can control the CFPB's budgetary appropriations, regulations, or enforcement decisions.[107] Moreover, there is no multimember commission to counterbalance the Director's policy initiatives.[108] Finally, substantive checks on the CFPB can be triggered only by the cumbersome supermajority rule required for the FSOC to act, and even then, only under the extreme circumstance of a severe threat to the safety and soundness of the American financial system.[109] It is likely that this extreme test will rarely be satisfied in practice.

In practice, therefore, the CFPB is an extremely independent agency—more so, perhaps, than any other prior agency. Led by a single director with authority to engage in both rulemaking and litigation,[110] immune from budgetary oversight, and largely insulated from substantive review, the agency has extreme independence to carry out its functions. Indeed, this extreme independence was originally touted as one of the Bureau's great virtues, as the purported lack of independence of prior financial regulators had been thought to be a source of the allegedly lax oversight that produced the financial crisis.[111]

A. *Characteristics of Agency Behavior*

Scholars of regulation have identified a number of tendencies to which bureaucracies are subject. Several are particularly relevant in understanding the flaws in the CFPB's institutional design: a tunnel

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nation by the Bureau regarding the meaning or interpretation of any provision of a Federal consumer financial law 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.").

106 *See supra* notes 93–100 and accompanying text.

107 *See supra* notes 93–95 and accompanying text.

108 *See supra* notes 96–100 and accompanying text.

109 *See supra* notes 101–02 and accompanying text.

110 *Id.* § 1022(b)(1), 124 Stat. at 1980 (codified at 12 U.S.C. § 5512(b)(1)) (granting the CFPB rulemaking authority); *id.* § 1054(a), 124 Stat. at 2028 (codified at 12 U.S.C. § 5564(a)) (granting the CFPB litigation authority).

111 *See* S. REP. NO. 111-176, at 163 (2010).

vision selection bias and commitment to regulatory mission, systematic risk-averse bias in agency decisionmaking, a tendency toward agency overreach and expansionism, and a heightened risk of regulatory capture by industry participants. Each of these problems is exacerbated in the case of the CFPB by the Bureau's self-proclaimed, narrowly defined, single focus on consumer protection,[112] and each is further worsened by the single-director structure of the CFPB, which makes the Bureau unusually vulnerable to idiosyncratic priorities and decisionmaking by the Agency's head. The problems arising from this single-director structure are exacerbated if that agency head is motivated by political ambition, as seems to be the case with the CFPB's first two leaders, Elizabeth Warren and Richard Cordray, both of whom have pursued (in Warren's case)[113] or expressed interest in pursuing (in the case of Cordray) further political aspirations.[114]

One notable characteristic of agency decisionmaking is a tendency toward a tunnel vision focus on the agency's regulatory mission at the expense of other policy goals.[115] Forty-six years ago, Anthony Downs claimed that bureaucrats' "views are based upon a biased or exaggerated view of the importance of their own positions in the cosmic scheme of things."[116] Because of minimal interagency coordination, independent agencies produce an "uncoordinated stream" of

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112 *See About Us*, CONSUMER FIN. PROT. BUREAU, http://www.consumerfinance.gov/the-bureau/ (last visited Mar. 5, 2013) (stating that the CFPB's "mission is to make markets for consumer financial products and services work for Americans").

113 *See supra* notes 3, 35 and accompanying text.

114 At least before his 2013 renomination, Richard Cordray was mentioned as a potential candidate for governor of Ohio in 2014. *See* Suzy Khimm, *Who Is Richard Cordray, and What Is He Going to Do?*, WASH. POST (Jan. 4, 2012, 2:13 PM), http://www.washingtonpost.com/blogs/wonkblog/post/who-is-richard-cordray-and-what-is-he-going-to-do/2012/01/04/gIQAV4EraP_blog.html ("Cordray had previously expressed interest in running for Ohio governor in 2014, but since his CFPB appointment, he says that he's abandoned these near-term political ambitions."). Of course, there is nothing wrong with partisan politicians or those with political aspirations serving in agency functions. The difference between the CFPB and other agencies, however, is that the CFPB has been billed as nonpolitical, which is the justification for its extreme level of independence from ordinary checks and balances. *See Consumer Protection Is a Non-Partisan Issue: Warren*, CNBC (Nov. 10, 2010, 4:21 PM), http://www.cnbc.com/id/40114195/Consumer_Protection_Is_a_NonPartisan_Issue_Warren (quoting Elizabeth Warren as saying "I just can't believe there is someone who would want to come after this new agency . . . . We're not a partisan agency—we're here for American families.").

115 *See* BREYER, *supra* note 85, at 10–19 (explaining and giving examples of this phenomenon); DeMuth & Ginsburg, *supra* note 86, at 1081 ("An agency succeeds by accomplishing the goals Congress set for it as thoroughly as possible—not by balancing its goals against other, equally worthy goals.").

116 ANTHONY DOWNS, RAND CORP., INSIDE BUREAUCRACY 107 (1967) (internal quotation marks omitted).

regulation, with each agency pursuing its respective goal through the lens of its tunnel vision.[117] For example, increased environmental protection might conflict with other important goals, such as economic growth or national security.[118] Organizations also attract individuals that self-select for high interest in and commitment to the agency's regulatory function (rather than skepticism towards the function), thus producing a natural tendency to place excessive importance on the agency's particular task relative to other policy objectives.[119] This tendency is likely to be especially pronounced with respect to a new agency such as the CFPB, which was created in response to the financial crisis and was initially staffed by Democratic White House and congressional staffers who were not only "true believers" in the agency's mission,[120] but who were hired by the agency's intellectual godmother, Elizabeth Warren—a consumer advocate with an especially strident and idiosyncratic view of the role of consumer protection issues in spawning the financial crisis.[121] A massive influx of "true believers" into a regulatory agency can dramatically alter the trajectory of the agency with respect to regulatory policy, amplifying the policy initiatives of like-minded leaders and dampening future leaders' efforts at course correction.[122]

This tunnel vision focus is heightened when an agency is expressly tasked with a single-mission focus, as the CFPB is rather than a multifunction mission, as is the FTC's. The FTC balances the twin aims of

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117 Angel Manuel Moreno, *Presidential Coordination of the Independent Regulatory Process*, 8 ADMIN. L. REV. AM. U. 461, 464 (1994).

118 *See* Todd J. Zywicki, *Baptists?: The Political Economy of Environmental Interest Groups*, 53 CASE W. RES. L. REV. 315, 327–33 (2002) (discussing an unwillingness of environmentalists to consider tradeoffs between environmental goals and other important goals).

119 David B. Spence & Frank Cross, *A Public Choice Case for the Administrative State*, 89 GEO. L.J. 97, 119–20 (2000) ("That agencies are systematically more loyal to their basic mission seems persuasive, even obvious. People who are sympathetic to that mission are more likely to be attracted to work at the agency.") (emphasis omitted).

120 *See* Press Release, Consumer Fin. Prot. Bureau, Consumer Financial Protection Bureau Announces Senior Leadership Hires (Nov. 15, 2011), *available at* http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-announces-senior-leadership-hires/ (announcing the hiring of three former White House staffers and others who formerly worked for Congress and other agencies).

121 *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 1 (2008) ("These dangerous [consumer financial] products can lead to financial distress, bankruptcy, and foreclosure, and, as evidenced by the recent subprime crisis, they can have devastating effects on communities and on the economy.").

122 *See* Timothy J. Muris, *Regulatory Policymaking at the Federal Trade Commission: The Extent of Congressional Control*, 94 J. POL. ECON. 884, 888 (1986) (noting the influence on the FTC of a wave of "liberal" employees into the Commission in the 1970s and their contribution to the activist policies of the FTC at the time).

consumer protection and increased competition, both of which benefit consumers in different ways.[123] This internal tension in pursuing the end goal of maximizing overall consumer welfare facilitates the reinforcement and counterbalance of each goal against the other.[124] Unlike the FTC, however, the CFPB lacks both a counterbalancing regulatory purpose, as well as a multimember structure to facilitate collegial decisionmaking. Thus, the existence of a single focus, consumer financial protection,[125] and single-director design together create a breeding ground for tunnel vision, favoring one aspect of consumer protection to the detriment of other consumer benefits.

This tunnel vision may be exacerbated by the tendency, observed by William Niskanen, for agencies to be expansionist and imperialistic—not for reasons of mission, but simply because of the agency's leaders' self-interest in expanding the power, influence, and budgets of their agency.[126] Not only will this expansionism be consistent with advancing the bureaucrat's personal interest in increasing power and wealth, but an aggressive and expansionist agency will also tend to increase the bureaucrat's value to the private sector if he or she decides to go through the "revolving door" from government into the private sector.[127] For example, attorneys who participate in regulatory drafting will be in high demand to subsequently advise private clients on compliance, as will those who increase the enforcement activities of the agency.[128] Again, this tendency toward aggressive agency expansionism seems likely to be reinforced where, as appears to be the case with the CFPB, its leaders are using the organization to promote

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123 *About the Federal Trade Commission*, FED. TRADE COMM'N, http://www.ftc.gov/ftc/about.shtm (last visited Mar. 5, 2013) (describing the FTC's mission as "prevent[ing] business practices that are anticompetitive or deceptive or unfair to consumers; . . . enhanc[ing] informed consumer choice and public understanding of the competitive process; and . . . accomplish[ing] this without unduly burdening legitimate business activity").

124 *See Who's Watching the Watchman? Hearing*, *supra* note 100, at 46 (statement of Todd J. Zywicki, Foundation Professor of Law, George Mason University).

125 *See About Us*, *supra* note 112 (describing the CFPB's self-declared mission).

126 *See* NISKANEN JR., *supra* note 89, at 36–42 ("For a positive theory of bureaucracy, though, the beginning of wisdom is the recognition that bureaucrats are people who are, at least, not entirely motivated by the general welfare or the interests of the state."); *see also* Todd J. Zywicki, *Institutional Review Boards as Academic Bureaucracies: An Economic and Experiential Analysis*, 101 NW. U. L. REV. 861, 873 (2007) (discussing Niskanen Jr.'s argument).

127 *See* Zywicki, *supra* note 126, at 873 n.48.

128 *See* PAUL J. QUIRK, INDUSTRY INFLUENCE IN FEDERAL REGULATORY AGENCIES 143–74 (1981); *see also* Robert A. Katzmann, *Federal Trade Commission*, *in* THE POLITICS OF REGULATION 152, 175–79 (James Q. Wilson ed., 1980) (describing the effect of attorney turnover at the FTC); Suzanne Weaver, *Antitrust Division of the Department of Justice*, *in* THE POLITICS OF REGULATION, *supra*, at 124, 134–35 (describing similar effects in the Department of Justice's Antitrust Division).

their political career or personal agenda—as seems to have been the case with Elizabeth Warren.[129] Although such obvious use of an agency position as a launching pad for personal ambition is rare, in such cases bureau heads can be predicted to use their agency as a vehicle for promoting their own ambitions by aggressively expanding the agency's activities so as to garner publicity and news headlines. Finally, the CFPB's tendencies toward agency pathology are exacerbated by the fact that Dodd-Frank did not set forth any specifications or restrictions as to who may serve as director.[130] Although most statutes refrain from requiring specific qualifications for appointees, doing so would create greater independence because "the pool of potential candidates from which the President picks is more limited and he or she cannot select solely on the basis of partisan leanings."[131]

A related bureaucratic bias is one towards risk-averse decision-making. Although efficient regulatory policy would require bureaucracies to weigh offsetting risks symmetrically, in fact, bureaucratic decisionmakers do not personally experience risk symmetrically.[132] For example, when deciding whether to approve a new drug, the Food and Drug Administration ("FDA") should weight equally the expected number of people who might be injured by premature approval of the drug against the number of people who might be injured by unnecessary delay in approval of the drug.[133] In fact, however, leaders of the FDA (as with other bureaucratic agencies) tend to effectively weigh Type II errors (premature approval) more heavily than

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129 Consider, for example, the extraordinary interview with Elizabeth Warren for *Vanity Fair* magazine, a seemingly unique event for a Washington bureaucrat. *See* Suzanna Andrews, *The Woman Who Knew Too Much*, VANITY FAIR, Nov. 2011, at 184.

130 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1011(b)(3), 124 Stat. 1376, 1964 (2010) (codified at 12 U.S.C. § 5491(b)(3) (Supp. IV 2011)) (requiring only that the nominee be a U.S. citizen).

131 Rachel E. Barkow, *Insulating Agencies: Avoiding Capture Through Institutional Design*, 89 TEX. L. REV. 15, 47 (2010). For example, "at least two members of the three-member Surface Transportation Board must have a professional background in transportation," two of the five members of the Public Company Accounting Oversight Board must be certified public accountants, and members of the Defense Nuclear Facilities Safety Board must be "respected experts in the field of nuclear safety." *Id.* at 47–48 (internal quotation marks omitted). Statutes can also impose restrictions on affiliations with non-agency entities. *See id.* at 48. For example, the Consumer Product Safety Act states that a person "cannot hold the office of Commissioner if he or she is 'in the employ of, or holding any official relation to, any person engaged in selling or manufacturing consumer products' or owns 'stock or bonds of substantial value in a person so engaged' or 'is in any other manner pecuniarily interested in such a person.'" *Id.* at 48 (quoting 15 U.S.C. § 2053(c) (2006)).

132 In technical terms this would require so-called Type I and Type II errors to be treated symmetrically. For a discussion, see STEARNS & ZYWICKI, *supra* note 81, at 358–61.

133 *See id.* at 359.

Type I errors (unnecessary delay) because the former is easier to observe and thus easier to criticize than the diffuse and seemingly more speculative second kind of cost.[134] As a result, FDA leaders systematically weigh Type II errors more heavily than Type I, resulting in inefficiently risk-averse decisionmaking.[135]

In the context of the CFPB's operations, this bias can be expected to take the form of undue focus on the Bureau's narrowly defined consumer protection mission while discounting the benefits to consumers of lower prices, greater choice and innovation, and more robust competition.[136] Consumers certainly benefit from heightened consumer protection in financial services, including regulations that would impose enforced standardization and simplification on the products that consumers can purchase. For example, consumer protection issues would certainly be simplified if every mortgage, credit card, and agreement were required to have only one term (say, the interest rate) and to be otherwise identical, just as every computer or cell phone manufacturer could be required to offer a uniform simple computer or cell phone. Regulators also could eliminate the risk of foreclosures by requiring home sales to be in cash, thereby eliminating mortgages. But these overly simplified rules would harm consumers as much, if not more, than they would help consumers. Thus, "perfect" consumer protection must be traded off at the margin with other goals, such as lower prices and greater choice, innovation, and competition. The optimal consumer protection policy will weigh all of these goals. Yet the CFPB—deliberately tasked to pursue consumer protection over everything else—simply is not structured to process these tradeoffs in a rational manner. The end result will likely be harm to consumers.

Consider, for example, the tradeoffs involved in regulating mortgage brokers. It is possible that mortgage brokers contributed to the financial crisis by innovating mortgages that created strong incentives for moral hazard on the part of consumers (as with mortgages requir-

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134 *Id.* at 359–60 (noting that "[e]mpirical studies tend to support the theoretical claim that regulators are unlikely to be risk neutral as between these two kinds of error, and instead that regulation is systematically biased in favor of avoiding the more tangible harm associated with Type II error than the abstract and generally unobservable harm from Type I error").

135 *See* HENRY I. MILLER, TO AMERICA'S HEALTH: A PROPOSAL TO REFORM THE FOOD AND DRUG ADMINISTRATION 42–43 (2000) (making this point and noting that "[t]ype 2 errors in the form of unreasonable governmental requirements and decisions can delay the marketing of a new product, lessen competition to produce it, and inflate its ultimate price").

136 *See Who's Watching the Watchmen? Hearing*, *supra* note 100, at 44 (statement of Todd J. Zywicki, Foundation Professor of Law, George Mason University).

ing no down payment) as well as by contributing to agency cost problems in the origination and securitization of mortgages.[137] Critics of mortgage brokers have pounced on these flaws, resulting in new strict regulation of mortgage brokers.[138]

But mortgage brokers have two distinct incentives:

> First, mortgage brokers have an incentive to maximize the "spread" between the rate at which they can acquire funds to lend to consumers (essentially the wholesale rate) and the rate at which they can lend to borrowers (the retail price). Second, mortgage brokers face competition from other brokers trying to get a borrower to borrow from them. The net result of these two factors—one pushing toward higher rates and one pushing toward lower rates—is ambiguous as an a priori matter.[139]

Empirical studies have found different results, some finding that brokers offer better terms on average than depository lenders and others finding that brokers charge higher prices on at least some elements of the transaction.[140] The explanation for these conflicting findings appears to result from differences in the number of mortgage brokers competing in a given market.[141] Where mortgage brokers are numerous and thus competition and consumer choice is greater, con-

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137 *See infra* Part III.C.2 (discussing the moral hazards created by combinations of state law and various mortgage terms).

138 *See* Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 11,280 (Feb. 15, 2013) (to be codified at 12 C.F.R. pt. 1026).

139 *Condition of Small Business and Commercial Real Estate Lending in Local Markets: Joint Hearing Before the H. Comm. on Small Bus. & the H. Comm. on Fin. Servs.*, 111th Cong. 336 (2010) (statement of Todd J. Zywicki, Foundation Professor of Law, George Mason University).

140 *Compare* Amany El Anshasy, Gregory Elliehausen & Yoshiaki Shimazaki, *The Pricing of Subprime Mortgages by Mortgage Brokers and Lenders* 12 (July 2005) (unpublished manuscript), *available at* http://www.chicagofed.org/digital_assets/others/events/2005/promises_and_pitfalls/paper_pricing.pdf (finding that "broker-originated mortgages are less costly to the borrower than lender-originated mortgages after holding other loan terms and borrower characteristics constant"), *and* Gregory Elliehausen & Min Hwang, The Price of Subprime Mortgages at Mortgage Brokers and Lender (Nov. 29, 2010) (working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1717013 (updated results confirming initial findings *supra*), *with* SUSAN E. WOODWARD, U.S. DEP'T OF HOUS. & URBAN DEV., A STUDY OF CLOSING COSTS FOR FHA MORTGAGES ix (2008), *available at* http://www.huduser.org/Publications/pdf/FHA_closing_cost.pdf (concluding that loans made by mortgage brokers are more expensive than those made by direct lenders by approximately $300 to $425).

141 *See* M. Cary Collins & Keith D. Harvey, *Mortgage Brokers and Mortgage Rate Spreads: Their Pricing Influence Depends on Neighborhood Type*, 19 J. HOUSING RES. 153, 168 (2010) ("Our results support our hypothesis that the mortgage broker is a better informed agent and show that in general as mortgage broker density increases, both the likelihood of a rate spread occurring and the size of a rate spread declines, while the loan approval rate increases.").

sumers generally receive lower interest rates from brokers as the competition effect predominates; however, where there are a smaller number of brokers and less competition, consumers typically pay higher interest rates as the broker interest effect predominates.[142] Empirical studies indicate that overly restrictive broker regulations may also lead to a higher number of overall foreclosures on subprime mortgages.[143]

As this simple example shows, when confronted with the potential contribution of mortgage brokers to the financial crisis, a well-intentioned consumer protection regulator could respond by imposing overly strict licensing regulations on mortgage brokers designed to protect consumers.[144] But onerous restrictions would reduce competition, resulting in both higher prices and worse service, while perversely leading to a higher number of foreclosures overall. Although a well-balanced regulatory policy would take all of these factors into account, the CFPB's focus on "consumer protection," narrowly defined, combined with the inherent tendency of agencies toward risk-averse decisionmaking runs the risk of leading to overzealous regulation that overlooks the benefits of competition and lower prices for consumers. This is precisely the sort of Type I versus Type II error tradeoff that tends to be problematic for single-issue agencies.[145]

Similar tradeoffs can be identified for a whole range of issues that the CFPB might have to consider, from unconventional mortgage products to particular credit card terms. For example, although upward increases in the interest rates on adjustable-rate mortgages were the major catalyst for the foreclosure crisis,[146] consumers unquestionably also benefit when interest rates fall. Moreover, fixed-rate mort-

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142 *See id* at 167–68.

143 *See, e.g.*, Morris M. Kleiner & Richard M. Todd, *Mortgage Broker Regulations That Matter: Analyzing Earnings, Employment, and Outcomes for Consumers* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 13684, 2007), *available at* http://www.nber.org/papers/w13684.pdf?new_window=1 (finding that "the requirement in many states that mortgage brokers maintain a surety bond or maintain a minimum net worth[ ] has a significant and fairly robust statistical association with . . . higher foreclosure rates on subprime mortgages").

144 It should be emphasized that the author of this Article is aware of no evidence to indicate that strict licensing of mortgage brokers actually increases the overall average quality of mortgage brokers or their services for consumers.

145 David Hyman and William Kovacic provide a similar example when it comes to the conflict between economics and purported consumer protection goals in responding to so-called price gouging in the wake of a natural disaster such as a hurricane. *See* David A. Hyman & William E. Kovacic, *Government Organization/Reorganization: Why Who Does What Matters* 53–54 (Univ. of Ill. Program in Law, Behavior & Soc. Sci., Research Paper No. LE12-14, 2012) (on file with the George Washington Law Review).

146 *See* Todd J. Zywicki & Gabriel Okloski, *The Housing Market Crash* 27–28 (Mercatus

gages pose extreme risks for consumers and the economy at large because of the interest rate mismatch problem that they potentially create (i.e., banks must raise lending capital in short-term borrowing markets in order to lend on long-term fixed-rate mortgages or securitize mortgages to pass along the risk), as well as the fact that fixed-rate mortgages interfere with the ability of consumers, if they do not have equity in their homes, to refinance at lower interest rates when rates fall.[147]

For example, as a result of the unique primacy of the thirty-year fixed-rate mortgage in the United States,[148] the housing bust has hit U.S. homeowners much worse than elsewhere.[149] Millions of homeowners have been unable to refinance at record-low mortgage interest rates because they are not only underwater but are not sufficiently liquid to come up with the several thousand dollars needed for closing costs, even if they had sufficient wealth to do so.[150] If more U.S. homeowners had adjustable-rate mortgages, as homeowners do in most other countries, their interest rates and monthly payments would have ratcheted downward automatically, reducing payments for many, staving off foreclosure for some, and spurring a housing market recovery for all.[151] Despite the obvious symmetry of consumer risk posed by adjustable-rate mortgages, however, there is a chance that the CFPB might tend to focus on the risks to consumers from upward movements in mortgage interest rates while discounting the benefits to consumers and the economy from downward adjustments, thereby creating rules that inefficiently favor the thirty-year fixed-rate mortgage.[152] This would effectively force millions of homeowners to pay thousands of dollars over the life of their loan for long-term insurance

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Ctr., Working Paper No. 09-35, 2009), *available at* http://mercatus.org/sites/default/files/publication/WP0935_Housing_Market_Crash.pdf.

147 *See* Todd J. Zywicki, *The Behavioral Law and Economics of Fixed Rate Mortgages (And Other Just-So Stories)*, 21 SUPREME CT. ECON. REV. (forthcoming 2013) (manuscript at 6, 16–17) [hereinafter Zywicki, *The Behavioral Law & Economics of Fixed Rate Mortgages*]; *see also* Michael Lea & Anthony Sanders, *Do We Need the 30-Year Fixed-Rate Mortgage?* 5–9 (Mercatus Ctr., Working Paper No. 11-15, 2011), *available at* http://mercatus.org/sites/default/files/Do-We-Need-30yr-FRM.Sanders.3.14.11.pdf.

148 *See* Zywicki, *supra* note 147, at 18–19 (noting that no other country in the world has standardized on this product).

149 *See infra* note 311 (comparing European and American home foreclosure rates).

150 Zywicki, *The Behavioral Law & Economics of Fixed-Rate Mortgages*, *supra* note 147, at 17.

151 *See id.*

152 Any such additional subsidy would already be on top of existing subsidies for the traditional mortgage, such as the implicit subsidy created by Fannie Mae and Freddie Mac's historic support for the product. *See* Binyamin Appelbaum, *Without Loan Giants, 30-Year Mortgage*

against increasing interest rates twenty-five or thirty years in the future.

In addition to the problems that result from a narrowly focused agency, another bureaucratic predisposition is short-term bias in decisionmaking. Rational political actors (including agency heads) tend to favor policies that produce short-term gains but for which the costs are borne in the long run.[153] Short-term gains permit the political actor to take credit for the policy while subsequent officials are forced to bear the resulting economic and political costs.[154] This will be the case especially with respect to an entity such as the CFPB, which has been headed since its inception by individuals with clear partisan political ambitions (such as Warren and Cordray),[155] and thus can be expected to maximize short-term regulatory activity—such as high-profile lawsuits and regulations—while discounting possible future costs of those activities, such as increased cost and reduced availability of credit. The ambiguous legality of Cordray's appointment adds further short-term bias, revealed by Cordray's writing to his staff that because of "a chance" that his "appointment would be invalidated by a court . . . . [t]his time period should give to each one of us, and not only me, a fierce urgency to accomplish the work we are doing together."[156] The political process may be prone to short-term bias, because the long-term costs of bad regulation generally fall most heavily on less educated, low income individuals who are less likely to perceive the true source of their lack of credit access and less likely to be politically active. For instance, economists have found that, historically, the unintended consequences of heavy-handed governmental regulation of consumer credit have invariably fallen most harshly on low-income consumers, often with a regressive redistributive effect in favor of richer and middle-class consumers.[157]

A final potential problem created by the CFPB's combination of a single-industry mission with a lack of accountability is the risk of

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May Fade Away, NY TIMES, Mar. 4, 2011, at A1 (noting that if Fannie Mae and Freddie Mac were shut down, the thirty-year fixed-rate mortgage would likely disappear from the market).

153 STEARNS & ZYWICKI, *supra* note 81, at 361.

154 Id.

155 *See supra* text accompanying note 114.

156 E-mail from Richard Cordray, Dir., Consumer Fin. Prot. Bureau, to Staff, Consumer Financial Protection Bureau (Feb. 6, 2012), *available at* http://issuu.com/judicialwatch/docs/cordray_weekly_message?mode=window&backgroundColor=%23222222.

157 *See* DURKIN ET AL., *supra* note 61, at 629–78 (surveying political economy and redistributional effects of consumer credit regulation through history).

agency capture.[158] Historically, this problem has referred to the tendency of regulatory agencies to be "captured" by members of the industry that they were established to regulate, such as the Civil Aeronautics Board (captured by the airline industry),[159] the Interstate Commerce Commission (captured by the railroad industry),[160] or the Securities Exchange Commission (captured by the securities industry).[161] With respect to the CFPB, the threat of capture seems to be less likely to come from the industry as a whole than from particular segments within it—namely, the biggest banks. The CFPB promises an unprecedented onslaught of regulatory compliance costs that are likely to proportionally fall much harder on smaller banks and community banks than on the largest banks. It is well established that certain types of regulatory compliance costs, such as many paperwork and other oversight costs, are largely invariant to the size or output of a firm, and thus fall proportionately harder on smaller firms in an industry.[162] It is unsurprising, therefore, that community banks and credit unions have expressed grave concerns about Dodd-Frank's and the CFPB's punishing regulatory compliance costs.[163] In addition, smaller banks compete by providing more personalized services, such

158 *See* STEARNS & ZYWICKI, *supra* note 81, at 376–78 (describing the theory of agency capture and reactions to it).

159 *See* THOMAS K. MCCRAW, PROPHETS OF REGULATION 263–65 (1984).

160 Thomas Frank, Op-Ed., *Obama and 'Regulatory Capture,'* WALL ST. J., June 24, 2009, at A13.

161 Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 922 (1994).

162 B. Peter Pashigian, *A Theory of Prevention and Legal Defense with an Application to the Legal Costs of Companies*, 25 J.L. & ECON. 247, 268–69 (1982) (finding economies of scale in legal costs related to regulatory compliance and observing that "smaller companies . . . are at a cost disadvantage in legal costs incurred," but noting that "[e]xtrapolating [the] results to still smaller companies may be inappropriate if smaller companies are either exempt from or subject to less stringent enforcement by the regulatory authorities").

163 *See, e.g.*, *Rising Regulatory Compliance Costs and Their Impact on the Health of Small Financial Institutions: Hearing Before the H. Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 112th Cong. 72 (2012) (statement of Ed Templeton, President, SRP Fed. Credit Union) ("[A]dditional regulatory requirements mandated in this massive overhaul have added to the overwhelming number of compliance burdens for credit unions. Undoubtedly, an immense amount of time, effort, and resources will be expended at credit unions as they struggle to keep up with new regulation."); Letter from Stephen P. Wilson, Chairman, Am. Bankers Ass'n, to Hon. Sheila Bair, Chairman, Fed. Deposit Ins. Corp. (March 21, 2010), *available at* http://www.aba.com/aba/documents/blogs/DoddFrank/ChairmanBairMar212011.pdf [hereinafter Wilson Letter] (identifying Dodd-Frank regulations which could negatively affect community banks and noting that "even if [the CFPB] does not examine community banks, the Bureau will set the rules for nearly all of community bank business (since community banks depend heavily on providing retail banking services)").

as designing products specifically tailored to individual needs.[164] Dodd-Frank and the CFPB, however, push toward making consumer credit more like a standardized commodity rather than permitting banks to tailor their consumer credit products to the needs of particular borrowers.[165] As noted above, a similar issue arises with respect to mortgage brokers, who can provide an important competitive check on depository institutions.[166]

This one-size-fits-all regulatory approach thus tends to disadvantage those banks that compete on the margins, for instance, by offering superior customer service, while favoring those with the lowest costs, such as big banks that offer economies of scale and lower capital market costs—a result, in part, of the entrenchment of the Too-Big-To-Fail subsidy in Dodd-Frank.[167] Finally, the big banks will have a comparative advantage in being more readily able to make the expenditures needed to hire lobbyists and other Washington resources to influence CFPB decisionmaking than will smaller banks. As a result, the regulatory compliance costs of the CFPB may have the unintended consequences of promoting its capture by the large banks and promoting consolidation of the United States banking industry. For example, as a response to the financial crisis and Dodd-Frank's enactment, industry consolidation has reached an all-time high: as of the first quarter of 2012, the five largest banks held over 39.1% of all deposits, up from 29.2% in 2005.[168] The combination of heavy regulatory costs and the entrenchment of Dodd-Frank's Too-Big-To-Fail funding subsidy is likely to further accelerate this consolidation, thereby ironically increasing the importance of supposedly systemically risky institutions.

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164 *See* Wilson Letter, *supra* note 163 (criticizing elements of Dodd-Frank for preventing "all banks—and community banks in particular—to continue to provide the products and services that our customers want and that our communities need for robust and sustained economic growth and prosperity").

165 The original idea proposed by the Obama Administration of creating a preferred set of "plain vanilla" loan products is an example of a tendency toward commoditization of consumer lending products. The proposal, however, was later rejected. *See* TREASURY DEP'T WHITE PAPER, *supra* note 18, at 15 ("We propose that the [CFPB] be authorized to define standards for 'plain vanilla' products that are simpler and have straightforward pricing.").

166 *See supra* notes 140–43 and accompanying text.

167 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 204, 210, 124 Stat. 1376, 1454, 1460 (2010).

168 Press Release, Indep. Cmty. Bankers of Am., Credit Rating Downgrade Highlights Danger of Banking Concentration: Deposit Concentration Is at All-Time High (June 25, 2012), *available at* http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=128191.

B. *Institutional Devices for Restraining Bureaucratic Tendencies*

Although the aforementioned pathologies are endemic in bureaucratic decisionmaking, a number of countervailing forces can mitigate these problems. These solutions include congressional oversight, heightened executive control, and deliberative decisionmaking by a multimember commission. Yet each of these factors is largely absent in the case of the CFPB.

It should be stressed at the outset that although these systemic checks can improve bureaucratic decisionmaking, the point is not to suggest that these checks are somehow inherently superior to bureaucracies acting autonomously. In fact, many of these checks may be subject to their own peculiar faults, such as congressional oversight that is motivated by political ends rather than by a desire to improve policy outcomes. The point instead is that the value of bureaucratic checks may arise from *combining* them in the regulatory process, just as the justification for the Constitution's checks and balances is that the outcome of the system of interbranch checks is thought to be superior than a system in which all decisions are concentrated in one branch, governed by the same internal dynamics arising from its selection and internal operating procedures.[169] Thus, for example, simply because it is the case that if forced to choose between election or appointment, we might generally prefer to elect the federal government's officers, it does not follow that we are better off if *all* members of the government are elected (including, for example, judges). It is thought instead that we are better off with a system of internal checks and balances, by which the various branches are composed of individuals selected by different constituencies and for different term lengths.[170] Theories of regulatory control rest on the same basic idea: simply because we think that it is wise to vest primary decisionmaking authority in bureaucrats insulated from direct electoral or financial incentives does *not* imply that they should not be subject to supervision by any outside force.

It is striking the extent to which even informal mechanisms of control are absent from CFPB. For example, Justice Breyer's dissenting opinion in *Free Enterprise Fund v. Public Company Accounting Oversight Board*[171] argued that the President's removal power of members of the Public Company Accounting Oversight Board ("PCAOB") was not a necessary condition for adequate executive

169 *See generally* THE FEDERALIST NO. 51 (James Madison).

170 *See id.*

171 Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138 (2010).

control over the agency.[172] He then listed a number of other means of control over the independent PCAOB that, in his view, sufficed to make the body sufficiently accountable, and therefore, constitutional.[173] For example, no PCAOB rule takes effect unless and until the Securities Exchange Commission ("SEC") approves it, and the SEC also has the ability to "abrogat[e], delet[e] or ad[d] to" any rule or any portion of a rule promulgated by the PCAOB.[174] In addition, the SEC has the power to review and modify any sanction imposed by the Board, initiate any investigations within the PCAOB's jurisdiction, remove PCAOB members, or "relieve the [PCAOB] of any responsibility to enforce compliance" any time the SEC believes that doing so would be in "the public interest."[175] As a result, Justice Breyer argued, the SEC has effective power to stop the PCAOB's investigations and other similar actions.[176]

Virtually all of these controls are absent in the case of the CFPB, however.[177] The Fed has no oversight at all over the CFPB's operations, and the FSOC has no formal power to approve a CFPB rule or action. Instead, any rule issued by CFPB automatically becomes effective unless vetoed by the FSOC, which can be done only by supermajority vote and only if the rule or action would imperil the "safety and soundness" of the entire U.S. financial system.[178] Thus, not only are the more obvious formal controls (removal by the President and appropriations by Congress) absent from the CFPB,[179] many of the informal controls typically seen in other agencies are absent as well.

1. *Congressional Oversight*

The CFPB is insulated from the most effective means of Congressional oversight: annual budgetary appropriations.[180] Through the

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172 *See id.* at 3170–71 (Breyer, J., dissenting).

173 *Id.* at 3172.

174 *Id.* (alteration in original) (quoting 15 U.S.C. § 7217(b)(5) (2006)).

175 *Id.* at 3172–73 (quoting 15 U.S.C. § 7217(d)(1) (2006)).

176 *Id.* at 3173 ("The [SEC]'s control over the [PCAOB]'s investigatory and legal functions is virtually absolute.").

177 Special thanks to Jay Wright for pointing this out.

178 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1023(a), 124 Stat. 1376, 1985 (2010) (codified at 12 U.S.C. § 5513(a) (Supp. IV 2011)) (emphasis added) (requiring that the FSOC be allowed only to "set aside a *final regulation prescribed* by the [CFPB]").

179 *See supra* notes 96–100 and accompanying text.

180 *See supra* notes 94–95 and accompanying text (describing how the CFPB funds its operations). Congressional oversight has been recognized as a potentially powerful means of re-

power of the purse, Congress can review agency regulatory and enforcement priorities as well as provide "teeth" to back up other types of oversight, such as public hearings.[181] Active and effective congressional oversight can also help guard against agency capture by opening the claustrophobic and technical process of agency decisionmaking to a broader array of information and constituencies. But Dodd-Frank completely insulates the CFPB from Congress's most potent oversight tool—appropriations authority—by instead guaranteeing its budgetary appropriations from the Fed without having to justify its needs to Congress.[182]

Dodd-Frank does give the Senate the power to confirm the Director of the agency,[183] which in theory gives Congress some modicum of control over the agency. But even this modest degree of congressional oversight was rendered ineffective when President Obama named Richard Cordray via a purported recess appointment to be Acting Director of the agency.[184] Whether Cordray's appointment was a valid recess appointment is open to question and has been subject to legal challenge.[185] However, even if Cordray's appointment was valid as a constitutional matter, there is still the additional statutory question of whether an Acting CFPB Director that has not been confirmed by the Senate can validly exercise the full scope of the CFPB's authority, including the Bureau's power to regulate actors not traditionally regulated by the federal government, such as nonbank lenders and debt collection agencies.[186] Dodd-Frank provides that authority to regulate these entities shifts to the CFPB only upon the "the Director of the Bureau [being] confirmed by the Senate,"[187] which the

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straining bureaucratic agency costs. *See* Barry R. Weingast & Mark J. Moran, *Bureaucratic Discretion or Congressional Control? Regulatory Policymaking by the Federal Trade Commission*, 91 J. POL. ECON. 765, 767–69 (1983) (noting that "[t]he threat of ex post sanctions [resulting from oversight] creates ex ante incentives for the bureau to serve a congressional clientele").

181 *See* Weingast & Moran, *supra* note 180, at 769 ("Several factors make up the congressional incentive system. First, in the budgetary process each agency competes with a host of others for budgetary favors.").

182 *See supra* notes 94–95 and accompanying text.

183 Dodd-Frank Act § 1011(b)(2), 124 Stat. at 1964 (codified at 12 U.S.C. § 5491(b)(2)).

184 *See* Nakamura & Sonmez, *supra* note 34.

185 Gray & Purcell, *supra* note 41, at A17 ("[W]e filed a lawsuit . . . asking a federal court to declare that two parts of Dodd-Frank violate a bedrock rule of law: the Constitution's separation of powers, which the Founders designed specifically to limit the growth of government."); *see also* Noel Canning v. NLRB, No. 12-1115 (D.C. Cir. Jan. 25, 2013) (holding that several other recess nominations made at the same time as Cordray's were unconstitutional).

186 *See supra* note 42 and accompanying text.

187 Dodd-Frank Act § 1066(a), 124 Stat. 2055 (codified at 12 U.S.C. § 5586(a)).

statute defines as requiring the "advice and consent" of the Senate.[188] This suggests that, even if the recess appointment were valid, the vesting of the full scope of the CFPB's powers can occur only upon the actual confirmation of a Director—not merely by naming an Acting Director

In addition, this end run around the Senate's advice and consent power came on the heels of the Obama Administration's earlier decision not to nominate a Director for the entire first year of the agency's existence, but instead to charge Elizabeth Warren with the task of setting up and staffing the agency from within the White House as Assistant to the President and Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau, followed by the nomination of Richard Cordray as Director.[189] This decision immediately belied the stated justification for the extreme level of independence provided to the CFPB, namely that it would be a nonpolitical, expertise-based agency.[190] Finally, it appears that there has been unusually close coordination between the CFPB—a purportedly independent agency[191]—and the White House, undermining the Bureau's supposedly nonpartisan mission.[192] More importantly, by end-running the confirmation process, the White House defeated even the very slight mechanisms of accountability built into Dodd-Frank—which were intended to preserve a congressional hand in overseeing the agency's operations—leaving virtually no congressional control at all.

2. *Executive Branch Oversight*

Checks to encourage the rationality of agency decisionmaking can also be imposed by the Executive Branch through a variety of

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188 *Id.* § 5491(b)(2), 124 Stat. at 1964 (codified at 12 U.S.C. § 5491(b)(2)); *see also* Todd Zywicki, *Legality of Cordray Appointment Under Dodd-Frank*, VOLOKH CONSPIRACY (Jan. 4, 2012, 5:04 PM), http://www.volokh.com/2012/01/04/legality-of-cordray-appointment-under-dodd-frank/ (elaborating on this problem).

189 *See supra* text accompanying notes 30–36 (describing this political back and forth).

190 *See* TREASURY DEP'T WHITE PAPER, *supra* note 18, at 55–63.

191 *See* Dodd-Frank Act § 1011(a), 124 Stat. at 1964 (codified at 12 U.S.C. § 5491(a)) (establishing the CFPB as "an independent bureau" within the Fed).

192 *See* Letter from Patrick McHenry, Chairman, Subcomm. on TARP, Fin. Servs, & Bailouts of Pub. & Private Programs, to Richard Cordray, Dir., Consumer Fin. Prot. Bureau (July 2, 2012), *available at* http://4closurefraud.org/2012/01/05/letter-patrick-mchenry-requests-richard-cordray-to-testify-on-how-he-will-implement-and-enfore-the-unparralleled-powers-of-his-new-office/ (detailing interactions between CFPB leadership and the White House); *see also* Mary Kissel, *Consumer Financial Political Bureau*, WALL ST. J. (July 5, 2012, 2:16 PM), http://online.wsj.com/article/SB10001424052702304299704577503332343808706.html (documenting similar incidents).

mechanisms. But these typical protections are absent in the case of CFPB.

First, the President lacks the authority to remove the Bureau Director except for cause, defined to exclude policy disagreements with the President.[193] The President's ability to remove his appointees is the sine qua non of his ability to control the execution of the law.[194] In the case of the CFPB, however, neither the President nor any other executive branch entity, such as the Office of Management and Budget ("OMB") or OIRA, have control or authority to instruct the CFPB to take any position, including in the Bureau's congressional testimony.[195] Thus, the only effective control held by the President is his ability to initially nominate the Director, and his ability to remove the Director, which is restricted to only the strictest standards of malfeasance.

Second, the President lacks the authority to coordinate the policies of the CFPB with other governmental agencies. Because of agencies' tendencies to expand their power, and their tunnel-vision focus on their own mission—to the exclusion of other policy ends[196]—the executive branch needs to effect coordination and create coherence among different agencies pursuing different objectives. Although a variety of measures have been used through history to bring this centralization about, in recent decades presidents of both parties have come to rely on OIRA to perform this task.[197] Cass Sunstein and

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193 *See* Dodd-Frank Act § 1011(c)(3), 124 Stat. at 1964 (codified at 12 U.S.C. § 5491 (c)(3)) (granting the CFPB Director for-cause removal protection and defining cause as "inefficiency, neglect of duty, or malfeasance in office").

194 *See* Neomi Rao, The Removal Power: Constitutionally Necessary, Constitutionally Sufficient 1 (April 5–6, 2012) (working paper) (arguing that "the ability to remove administrative agency heads is both necessary and sufficient to ensure presidential control").

195 See Dodd-Frank Act § 1012(c)(4), 124 Stat. at 1965 (codified at 12 U.S.C. § 5492(c)(4)), stating:

> No officer or agency of the United States shall have any authority to require the Director or any other officer of the Bureau to submit legislative recommendations, or testimony or comments on legislation, to any officer or agency of the United States for approval, comments, or review prior to the submission of such recommendations, testimony, or comments to the Congress, if such recommendations, testimony, or comments to the Congress include a statement indicating that the views expressed therein are those of the Director or such officer, and do not necessarily reflect the views of the Board of Governors or the President. *Id.*

196 *See supra* Part III.A.

197 *See* Stearns & Zywicki, *supra* note 81, at 366–67 (discussing the role of OIRA in coordinating agency policy); *see also* Nicholas Bagley & Richard L. Revesz, *Centralized Oversight of the Regulatory State*, 106 Colum. L. Rev. 1260, 1264–66 (2006) (describing President Reagan's creation of OIRA and justifications for centralized regulatory oversight); DeMuth & Ginsburg, *supra* note 86, at 1076–80 (discussing the history of centralized White House review).

Richard Pildes have summarized the beneficial role of OIRA as "diminish[ing] some of the characteristic pathologies of modern regulation—myopia, interest-group pressure, draconian responses to sensationalist anecdotes, poor priority setting, and simple confusion."[198] Yet by tradition, independent agencies are excluded from OIRA's reach; that practice has extended to the Fed, and by implication, the CFPB as well.[199]

Leaving aside the legal formalities, as a matter of sound policy, the CFPB's exclusion from OIRA's reach is difficult to justify.[200] It is not clear why independent agencies have been exempted from OIRA's reach (there are, to be sure, unclear constitutional limits on the authority of the President to require independent agencies to submit to OIRA review),[201] but one possible pragmatic or policy justification is that independent agencies have alternative mechanisms for ensuring quality control in the production of rules and other outputs, which Executive Branch departments often do not have. This is likely because Executive Branch agencies instead substitute accountability to the President for internal deliberation. For example, independent agencies are typically headed by a multimember commission, often

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198 Richard H. Pildes & Cass R. Sunstein, *Reinventing the Regulatory State*, 62 U. CHI. L. REV. 1, 4 (1995).

199 *See* Barkow, *supra* note 131, at 31–32 (noting that presidents, by Executive order, have exempted independent agencies that are defined in the Paperwork Reduction Act from having to submit a cost-benefit analysis of their rules to OIRA). The CFPB's exclusion from OIRA review may be implied by the statutory language of Dodd-Frank. See Dodd-Frank Act § 1017(a)(4)(E), 124 Stat. at 1975 (codified at 12 U.S.C. § 5497(a)(4)(E)), stating that the CFPB's organic statute:

> may not be construed as implying any obligation on the part of the [CFPB] Director to consult with or obtain the consent or approval of the Director of the Office of Management and Budget with respect to any report, plan, forecast, or other information . . . or any jurisdiction or oversight over the affairs or operations of the Bureau. *Id.*

200 *See* Risa Gordon, *Rulemakings at the Fed, CFPB Need White House Supervision*, REGBLOG (July 18, 2011) http://www.law.upenn.edu/blogs/regblog/2011/07/rulemakings-at-the-fed-cfpb-need-white-house-supervision.html (explaining that "[s]ubjecting . . . [the] CFPB to OIRA review would likely yield a number of benefits, including increased public trust through greater government transparency, enhanced alignment with democratic ideals, reduced risk that regulated firms will capture the agencies, and better inter-agency coordination"); John Morrall, Richard Williams & Todd Zywicki, *The Next Hot Ticket in Financial Reform*, REUTERS (Oct. 8, 2010, 1:47 PM), http://blogs.reuters.com/great-debate/2010/10/08/the-next-hot-ticket-in-financial-reform/ (arguing that "[i]f [the CFPB] do[es] not perform this essential [cost-benefit] analysis, they will continue to shoot in the dark, either missing their targets by not solving any social problems, or worse, causing unintentional harm to bystanders in the markets they are trying to help").

201 *See* Kirti Datla & Richard L. Revesz, *Deconstructing Independent Agencies (And Executive Agencies)*, 98 CORNELL L. REV. (forthcoming May 2013) (manuscript at 3–4), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2125194.

bipartisan in composition,[202] and the information and debate produced in the resulting deliberative process may provide a partial substitute for OIRA review. However, given the absence of any similar internal checks on the CFPB's activities, its single-director structure and single-mission focus suggest the need for OIRA review of the Bureau's actions.[203] Yet the CFPB remains outside the control of both OIRA and the Fed.

3. *Absence of Judicial Control*

Judicial supervision of the CFPB also is attenuated. In particular, Dodd-Frank expresses Congress's intention that the CFPB's actions shall be inherently subject to *Chevron* deference by the judiciary.[204] This mandated degree of deference reduces the scope for judicial review of the CFPB's actions, thereby further reducing oversight of the CFPB's operations. In addition, Dodd-Frank provides that with respect to matters within the Bureau's scope, if the CFPB's consumer finance rules conflict with those of rival agencies (such as the prudential regulators), the CFPB's rules shall prevail.[205]

4. *Absence of Multimember Structure*

As noted above, the CFPB is unusual in that it is *both* an independent agency and contains a single-director leadership structure instead of a multimember commission. In addition, unlike other

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202 *See Dodd-Frank Creates the CFPB, supra* note 99.

203 *See* Gordon, *supra* note 200 (noting that "Dodd-Frank gives significant leeway in promulgating . . . new regulations to the . . . CFPB. Yet, while these [financial regulatory] agencies are not free from all oversight, the current system of oversight does not sufficiently monitor the . . . CFPB's rulemaking processes"); Morrall, Williams & Zywicki, *supra* note 200 (arguing for OIRA review of the CFPB's rules in part because "[t]he CFPB won't even get [the] modest check of having bipartisan commissioners").

204 Dodd-Frank Act § 1022(b)(4)(B), 124 Stat. at 1981 (codified at 12 U.S.C. § 5512(b)(4)(B)):

> [T]he deference that a court affords to the Bureau with respect to a determination by the Bureau regarding the meaning or interpretation of any provision of a Federal consumer financial law 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. *Id.*

205 *Id.* § 1022(b)(4)(A), 124 Stat. at 1981 (codified at 12 U.S.C. § 5512(b)(4)(A)) ("[T]o the extent that a provision of Federal consumer financial law authorizes the Bureau and another Federal agency to issue regulations under that provision of law for purposes of assuring compliance with Federal consumer financial law and any regulations thereunder, the Bureau shall have the exclusive authority to prescribe rules subject to those provisions of law.")

agencies such as the FTC, the CFPB also lacks internal checks and balances that can encourage efficient regulation.[206]

The institutional structure of the CFPB can be usefully contrasted with that of the FTC. Founded in 1914, the FTC has survived for almost a century and has proved flexible and adaptable enough to regenerate itself over time.[207] Most significantly, until the formation of the CFPB, the FTC was the primary federal consumer protection agency. To be sure, the FTC's jurisdiction with respect to consumer financial services was limited by its inability to reach banks.[208] Nevertheless, the FTC exercised control over debt collectors, mortgage brokers, and credit reporting agencies and continues to exercise authority over a range of consumer protection issues, such as false advertising claims.[209]

Because of its durability, the FTC provides a useful contrast to the CFPB. First, the FTC is subject to the appropriations power of Congress. This congressional oversight authority has proven useful in the past to rein in the FTC when it went astray. For example, the FTC's excesses became so pronounced in the 1970s that by the early 1980s, Congress and the Reagan Administration severely restricted the FTC's appropriations and defunded some programs believed to be "ideologically significant."[210] In addition, as noted above, the FTC is a multimember bipartisan commission with dual missions of consumer protection and promoting competition, which knowledgeable FTC veterans recognize has provided a source of strength in creating effective policies.[211] Indeed, few FTC veterans would be likely to argue that consumers would be well served by spinning off the FTC's Bureau of Consumer Protection and giving it unconstrained regulatory powers, which is essentially what Dodd-Frank does with respect to the CFPB.

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206 *See supra* notes 96-100 and accompanying text.

207 *See* HARRIS & MILKIS, *supra* note 91, at 140–86 (giving a thorough overview of the FTC's origins and changes).

208 *See supra* note 4 and accompanying text.

209 *See generally Legal Resources—Statutes Relating to Consumer Protection Mission*, FED. TRADE COMM'N (June 28, 2012), http://www.ftc.gov/ogc/stat3.shtm (listing and giving an overview of the large number of statutes related to the FTC's "consumer protection mission," and noting Dodd-Frank's changes to the FTC's enforcement responsibility for some of these statutes).

210 *See* HARRIS & MILKIS, *supra* note 91, at 204–05.

211 *See* William E. Kovacic & David A. Hyman, *Competition Agency Design: What's on the Menu?*, 8 EUR. COMPETITION J. 527, 533 (2012) (noting that "multi-purpose agencies can realise synergies and lower the costs associated with coordinating policy between separate institutions with related functions").

In contrast to the FTC, the CFPB is devoid of any of these external or internal checks and balances. Consider in particular the value of an independent agency having a multimember bipartisan governance structure, a feature—along with for-cause removal of agency heads and OIRA exemption—which academic literature often treats as the distinguishing characteristics of independent agencies.[212] Justice Breyer, for instance, has described agency independence as a function of several different factors, one of which is its "composition as a multimember bipartisan board."[213] Indeed, as one commentator has noted, "[m]ost independent agencies have multimember boards, and the conventional wisdom is that boards increase insulation because typical features such as staggered terms and bipartisan requirements limit the impact of individual appointments."[214]

It is thus unsurprising that support for single-director design has often had an ideological motivation as well. As was the case with CFPB, advocacy groups with liberal policy orientations advocated a single-director design, under the assumption that the Bureau's Director would enact a liberal-friendly agenda.[215] Moreover, the design of the agency—a single director with a fixed term, insulated from presidential removal and congressional budgetary appropriations—appears to have been designed to enable the initial director (presumed to be Elizabeth Warren at the time) sufficient time and independence to hire initial staff (drawn predominantly from former Obama administration officials, Democratic congressional staffers, and Democratic activists)[216] and entrench a liberal agenda without interference from Republicans. By the time Dodd-Frank was enacted into law, it was already evident that Republicans were likely to gain a majority in at least one house of Congress during the 2010 midterm elections and that a Republican could even take the White House in the 2012 presidential elections.[217] Thus, the apparent goal of liberal activists in in-

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212 *See* Barkow, *supra* note 131, at 26 (calling these features the "[t]raditional [l]odestars of [i]ndependence").

213 Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138, 3183 (2010) (Breyer, J., dissenting). According to Justice Breyer, other factors include, inter alia, "the use of the word 'independent' in its authorizing statute," for-cause removal, and "a political environment, reflecting tradition and function, that would impose a heavy political cost upon any President who tried to remove a commissioner of the agency without cause." *Id.*

214 *Dodd-Frank Creates the CFPB*, *supra* note 99, at 2128.

215 *See Oppose Attempts to Undermine the New Consumer Bureau*, PUB. CITIZEN, http://www.citizen.org/strong-cfpb (last visited Mar. 22, 2013).

216 *See* Press Release, Bureau Announces New Agency Hires, *supra* note 120.

217 *See* Michael Barone, *House Democrats Head for a Thumping at the Polls*, REAL CLEAR POL. (July 29, 2010), http://www.realclearpolitics.com/articles/2010/07/29/house_democrats_head

vesting the new agency with such a large degree of independence seems to have been to firmly embed their values in the agenda of the new agency, making it resistant to predicted future political shifts.[218]

Collegial decisionmaking can also be a valuable grounding force for an agency that is insulated from effective external oversight and input, as the CFPB is. Collegial processes increase the quality and variety of information considered, and "aggregati[ng]" information through the deliberative process can improve accuracy and output quality.[219] Multimember decisionmaking can also temper idiosyncratic or extreme outlying views that might otherwise be held by a single person.[220] Further, collegial processes can make use of and encourage specialization among commission members, thereby encouraging a division of labor and improving overall decisionmaking. In addition, collegial processes can discipline decisionmaking by forcing proponents of particular actions to articulate a "coherent rationale" to support their decisions, thereby reducing the threat of biased, ill-considered, or politically motivated decisions.[221]

Perhaps the closest analogue to the CFPB's radical degree of independence is that of appellate courts. Scholars who have studied appellate courts have found that comprising multimember appellate panels of judges with different ideological and partisan leanings can improve decisionmaking processes.[222] The collegial process itself can improve judicial rulings by enabling new information to be considered and force articulation of a principled rationale for decisions.[223] Col-

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_for_a_thumping_at_the_polls_106526.html (noting, in the same month that Dodd-Frank was signed into law, that "most signs suggest Democrats will take a thumping this year").

218 *See* Note, *Independence, Congressional Weakness, and the Importance of Appointment: The Impact of Combining Budgetary Autonomy with Removal Protection*, 125 HARV. L. REV. 1822, 1841 (2012) ("[T]he CFPB's congressional supporters likely chose to reduce their own control because they expected future preference divergence and sought to limit the influence of future Congresses."); *cf.* Neal Devins & David E. Lewis, *Not-So Independent Agencies: Party Polarization and the Limits of Institutional Design*, 88 B.U. L. REV. 459, 464–65 (2008) (observing that "the percentage of new agencies with insulating characteristics correlates with periods of divided government").

219 *See Dodd-Frank Creates the CFPB*, *supra* note 99, at 2128.

220 *See id.*

221 *See id.*

222 *See* Harry T. Edwards, *The Effects of Collegiality on Judicial Decision Making*, 151 U. PA. L. REV. 1639, 1645 (2003) (suggesting that the composition of a court can make judges more or less likely to determine legal issues based on their own political ideology).

223 *Id.* at 1645–46 ("In a collegial environment, divergent views are more likely to gain a full airing in the deliberative process—judges go back and forth in their deliberations over disputed and difficult issues until agreement is reached . . . . The mutual aim of the judges is to apply the law and find the right answer.").

legiality can also dampen extreme views and increase consensus-style decisions.[224] In addition, scholars have argued that bipartisan panel composition of appellate panels can serve a "whistleblower" function that constrains partisan and ideological decisionmaking.[225] As with federal judges, in the absence of external political constraints, internal deliberative processes in multimember agencies can improve decisionmaking and constrain politically motivated or ill-informed decisions.

Collegial decisionmaking on corporate boards provides another useful analogue to decisionmaking by multimember agencies.[226] One justification for placing decisionmaking authority in corporate boards, rather than a single CEO, is that collective governance is more effective than vesting power in an individual.[227] To be sure, individual con-

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224 *See* CASS R. SUNSTEIN ET AL., ARE JUDGES POLITICAL? AN EMPIRICAL ANALYSIS OF THE FEDERAL JUDICIARY 8–9 (2006).

225 *See* Frank B. Cross & Emerson H. Tiller, Essay, *Judicial Partisanship and Obedience to Legal Doctrine: Whistleblowing on the Federal Courts of Appeals*, 107 YALE L.J. 2155, 2159 (1998) (suggesting that "the presence of a minority position on the panel . . . creates an opportunity for whistleblowing—a minority member with doctrine on her side and the ability, through a dissent, to expose disobedient decisionmaking by the majority").

226 *See* Daniel P. Forbes & Frances J. Milliken, *Cognition and Corporate Governance: Understanding Boards of Directors as Strategic Decision-Making Groups*, 24 ACAD. MGMT. REV. 489, 490 (1999), (studying corporate board "processes . . . that enable boards to achieve their full potential as strategic decision-making groups" and noting that "the very existence of the board as an institution is rooted in the wise belief that the effective oversight of an organization exceeds the capabilities of any individual and that collective knowledge and deliberation are better suited to this task"). *See generally* Stephen M. Bainbridge, *Why A Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 3 (2002) (arguing that "the [corporate] board's existence follows logically from the evidence on group decisionmaking" and examining legal regimes governing boards to determine whether corporate law is "well-designed to encourage optimal board behavior"). Consider another example of the advantages of group decisionmaking:

> Students with at least one undergraduate course in macroeconomics were presented with a computer-generated model requiring them to make economic policy decisions. Specifically, students were required to set interest rates so as to meet both inflation and unemployment targets . . . . [I]ndividual and group play rounds alternated.
>
> Again, there was no statistically significant difference in the speed with which groups and individuals made decisions. Again, group scores were higher than individual scores. Notably, when subjects acted alone, the "ersatz monetary policymakers moved interest rates in the wrong direction" more often than did groups.
>
> One significant finding is that the average performance of the five individuals making up the group had almost no explanatory power with respect to how well the group performed. Even more striking, the performance of the best member of the group did not predict group performance . . . . [T]hese findings take on considerable importance in evaluating the merits of decisionmaking by interacting groups.
>
> In sum, . . . "two heads—or, in this case, five—are indeed better than one."

Id. at 15–16 (footnotes omitted).

227 *See* Forbes & Milliken, *supra* note 226, at 490.

trol of a corporation promotes swifter and more decisive action. But collective corporate governance permits the board to collect, process, store, discuss, and retrieve information more thoroughly and accurately than one person acting alone. Also, collective governance can constrain overconfidence or cognitive errors by providing critical assessments and viewpoints of proposals.[228] Collective governance can also constrain shirking, self-dealing, and capture by providing multilateral monitoring and raising the number of people who need to be corrupted for improper action to occur.[229]

A bipartisan, multimember commission also can temper extreme policy swings over time. Despite serving only a five-year term,[230] the CFPB's director has a long-term effect due to the institutional and interpretive framework of regulatory law. Under the *Chevron* doctrine[231] the federal judiciary defers to an agency's reasonable interpretation of ambiguous federal statutory language, which already tends to magnify policy swings among administrations.[232] Dodd-Frank further exacerbates this by essentially codifying *Chevron* for purposes of the CFPB's statutory interpretations, thereby excluding the potentially tempering effect of alternative interpretations from other agencies or the judiciary.[233]

An interesting theoretical discussion can be had about the various pros and cons of a single-director design over a multimember agency,[234] assuming that director is accountable to the President. A

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228 *See* Bainbridge, *supra* note 226, at 30 ("The assumption that group decisionmaking constrains overconfident individuals is consistent with the standard account of the board's function.").

229 *See id.* at 32 (noting that "[i]ndividuals shirk, sometimes as a rational response to incentives and sometimes because of biased decisionmaking. In either case, group decisionmaking may help constrain those tendencies").

230 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1011(c), 124 Stat. 1376, 1964 (2010) (codified at 12 U.S.C. § 5491(c) (Supp. IV 2011)).

231 *See* Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984).

232 *See* STEARNS & ZYWICKI, *supra* note 81, at 328, 338–40.

233 *See* Dodd-Frank Act § 1022(b)(4)(A)–(B), 124 Stat. at 1981 (codified at 12 U.S.C. § 5512(b)(4)(A)–(B)). The effect of policy swings may be longstanding, as agency actions have long-term implications due to the friction of the political process. Once an agency acts, interests groups are divided into winners and losers. Because interest groups can block legislation with greater ease than they can pass it, winners block the passage of new legislation to undue agency actions, rendering Congress less able to restore equilibrium and undo an agency action it disfavors. *See Who's Watching the Watchman? Hearing*, *supra* note 100, at 46 (statement of Todd J. Zywicki, Foundation Professor of Law, George Mason University).

234 *See, e.g.*, THE PRESIDENT'S ADVISORY COUNCIL ON EXEC. ORG., A NEW REGULATORY FRAMEWORK: REPORT ON SELECTED INDEPENDENT REGULATORY AGENCIES 31 (1971) [hereinafter Ash Report] (proposing, as part of broad regulatory reform, the replacement of the multimember structures of a number of agencies with a single administrator).

single director lacks the information-gathering, continuity-promoting, and ideology-dampening benefits of the collegial process, but a single director does have benefits in terms of swiftness and accountability. Be that as it may, in the abstract, it does not obviously follow that a single-director agency, largely unaccountable to the President, Congress, or even the multimember Federal Reserve Board, would be seen as an improvement over a bipartisan commission structure. Indeed, the agency structure Congress chose for the CFPB—a single-director structure, devoid of accountability, and with vast, ill-defined powers—appears to be unique in recent American history.

Finally, the combination of a single-director structure, a fixed term for the director, extraordinary powers, and the CFPB's extremely high degree of congressional independence dramatically raises the stakes for nominations to head the Bureau.[235] There is thus little reason to be surprised that Republicans filibustered the nomination of Richard Cordray to head the CFPB. Again, given that Congress or subsequent Presidents have almost no control over the director once he or she is appointed, it is to be expected that any confirmation battle would be highly contentious, similar to a controversial Supreme Court nomination. When combined with the Obama Administration's decision to put Elizabeth Warren in charge of establishing the Bureau and to install Richard Cordray as the Bureau's first Director—both politically controversial figures—heightened conflict should have been expected. Nominations to a multimember commission, by contrast, tend to have lower stakes and greater room to accommodate a variety of skills and ideological views.

C. The CFPB Does Nothing About the Real Causes of the Financial Crisis or the Substantive Failures of Financial Consumer Protection Law and Instead Creates New Problems

The architects of the CFPB were correct in criticizing the hydra-headed consumer financial protection structure that was in place prior to Dodd-Frank. The CFPB's creators were also correct in criticizing the defects in the substantive rules governing consumer credit. The creation of the CFPB does nothing, however, to address the real causes of the crisis, among them, the pre-Dodd-Frank structure of consumer financial protection law and other underlying consumer-re-

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235 *See generally* Note, *Independence, Congressional Weakness, and the Importance of Appointment*, *supra* note 218 (arguing that increased political independence will increase the difficulty of confirming the heads of agencies such as the CFPB).

lated issues. By failing to understand the real problems that plague the consumer financial protection system, the CFPB will not actually provide real solutions (except perhaps by coincidence) and will actually create new problems.

1. *The Causes of Substantive Failures of Federal Consumer Financial Protection Law*

The architects of the CFPB were correct that the substantive consumer financial protection rules were suboptimal. For example, the impenetrable thicket of paperwork surrounding mortgage originations did little to dispel consumer confusion or protect them from fraud. Thus, the mandate in Dodd-Frank to create a single, integrated, simplified mortgage disclosure form[236] was a productive instruction, even if, as noted below, the CFPB's actual proposed disclosure form[237] squanders this invitation. Moreover, it is obvious that disclosures on a variety of consumer credit products, such as credit cards, could be made more transparent and consumer friendly.

The architects of the CFPB, however, largely misdiagnosed the causes of failures in substantive consumer protection policies. Moreover, having failed to address these underlying problems, the CFPB will likely create unintended consequences that will not only prove harmful to consumers in the long run, but will also likely contribute to the next financial crisis. Indeed, had certain provisions of Dodd-Frank been on the books during the most recent crisis, they unquestionably would have worsened the problems that occurred.

The CFPB's approach to these problems raises two perils. First, by focusing on the problem of complexity in consumer credit products as an end in itself, the CFPB significantly increases the risk that it will enact regulations that will artificially simplify product terms in a manner that is inefficient for consumers.[238] Second, the CFPB's approach largely ignores the real causes of unhealthy complexity—namely, excessive regulation and litigation.[239] By misunderstanding the causes of these problems, the CFPB is instead likely to only offer more of the

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236 Dodd-Frank Act § 1032(f), 124 Stat. at 2007 (codified at 12 U.S.C. § 5532(f)) ("[T]he Bureau shall propose . . . rules and model disclosures that combine the disclosures required [in the Truth in Lending Act and Real Estate Settlement Procedures Act] into a single, integrated disclosure for mortgage loan transactions . . . .").

237 *See* Integrated Mortgage Disclosures Under the Real Estate Settlement Procedure Act (Regulation X) and the Truth In Lending Act (Regulation Z), 77 Fed. Reg. 54,843 (Sept. 6, 2012) (to be codified at 12 C.F.R. pt. 1026).

238 *See infra* Part III.C(1)(a).

239 *See infra* Part III.C(1)(b).

same, further undermining the effectiveness of consumer financial protection rules.

a. A Simple-Minded Focus on Simplicity

Consider first the CFPB's simple-minded approach to the complexity of consumer credit products. Elizabeth Warren has pined for a return to a supposed golden age of simple consumer credit products and has argued that the only reason for increased complexity in credit card agreements is to create "tricks and traps" for consumers.[240] Yet nearly everything consumers purchase is too complex for them to understand all of the details, features, and dangers of those purchases—whether the product is a car, computer, or medical service. Yet it would be absurd to argue that the only reason that sellers have replaced typewriters with computers is *because* computers are more complex and bewildering than typewriters, thereby enabling computer sellers to trick and harm consumers more easily by selling them computers when consumers would prefer typewriters. Similarly, a modern Honda Civic is infinitely more complex than a Model T, and while consumers might be able to understand and repair their Model T, the average consumer could not repair their Honda Civic. Yet the fact that a Model T was simpler than a Civic does not mean that we should mandate a return to Model Ts or even urge consumers to buy them. Analogously, simply because credit cards today are more complicated than credit cards were forty years ago, it does not follow that the increased complexity was intended solely to confuse consumers. Thus, while simplification is a useful goal, it cannot be a transcendent goal in itself—at least not without considering functionality and the role of consumer choice.

Consumer credit products are similar. Credit card agreements today are substantially more complex than credit card agreements were forty years ago—the metaphorical typewriters of the consumer credit age. But that is primarily because credit cards today are more com-

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240 See Warren, *supra* note 15, at 8–9, stating:

> Lenders have deliberately built tricks and traps into some credit products so they can ensnare families in a cycle of high-cost debt.
>
> To be sure, creating safer marketplaces is not about protecting consumers from all possible bad decisions. Instead, it is about making certain that the products themselves don't become the source of the trouble. This means that terms hidden in the fine print or obscured with incomprehensible language, unexpected terms, reservation of all power to the seller with nothing left for the buyer, and similar tricks and traps have no place in a well-functioning market. . . .
>
> Part of the problem is that disclosure has become a way to obfuscate rather than to inform. *Id.*

plex than credit cards were three decades ago. And in turn, the reason why credit cards are more complicated today than in they were in the past is because consumers today use credit cards in more complicated and elaborate ways than consumers did in the past.[241] Forty years ago, credit cards were relatively simple products, but they were also exceedingly unattractive for consumers: they carried a high annual fee (often between thirty and fifty dollars), a high fixed interest rate (usually about seventeen percent or more), and offered no ancillary benefits such as frequent flyer miles or car rental insurance.[242] Moreover, crude, inflexible, and simple pricing terms prevented card issuers from effectively pricing risk. As a result, many consumers who wanted credit cards could not obtain them and credit lines were lower because of the inability to price risk accurately; those unable to obtain credit cards were forced to rely instead on personal finance companies, pawnshops, and other high-cost lenders.[243]

Today, by contrast, credit cards have more price points, in large part because of the evolution of more efficient risk-based pricing on credit card terms, and because of consumer demand for increased functionality—and hence, complexity—of cards.[244] Risk-based pricing has enabled extensions of credit cards to a more heterogeneous group of consumers, along with higher credit lines, but such risk-based pricing also requires more sophisticated and nuanced pricing for those more heterogeneous consumers.[245] Consumer demands to use credit cards for a greater variety of purposes, such as a purchase or credit mechanism, for cash back, for small businesses, or for travel around the world, has made it necessary for card issuers to create prices for all of these various functions.[246] Thus, credit card agreements are complicated primarily because credit cards themselves are complicated, and

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241 *See infra* notes 242–47 and accompanying text.

242 *See* Zywicki, *supra* note 77, at 91, 112, 118.

243 *See, e.g.*, *id.* at 96, 162–63 ("[D]uring the late-1970s, Arkansas had very restrictive usury limitations in place that made it almost impossible to make a profit on consumer loans, including credit cards. Predictably, fewer consumer loans were made and more consumer loan applications were rejected, especially for higher-risk customers. It appears that this market niche was filled by pawn shops . . . ."). (footnote omitted).

244 *See* U.S. Gov't Accountability Office, GAO-06-929, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers 13 (2006).

245 *See id.* at What GAO Found ("Issuers explained that these practices [of penalty fees and multiple interest rates] represent risk-based pricing that allows them to offer cards with lower costs to less risky cardholders while providing cards to riskier consumers who might otherwise be unable to obtain such credit.").

246 *See id.* at 29 (linking risk-based pricing to the "many more benefits [that credit cards now offer] to users than they did in the past").

credit cards are complicated because consumers have demanded increasingly complicated functionality for credit cards. This has come about largely through a beneficial process of dynamic competition to meet evolving consumer demand—not as a vehicle for credit card issuers to lay "tricks and traps" for unwitting consumers.[247]

The CFPB's misplaced obsession with simplicity over functionality is best exemplified by the initial proposal to create a preferred menu of "plain vanilla" credit offerings for consumers.[248] The proposal ignores that the proper regulatory goal should not be to minimize complexity of consumer credit products as an end in itself, just as simplicity should not be an end goal for cars, computers, or professional services. The goal should be to reach the *optimal* level of complexity so as to preserve functionality and risk-based pricing, while also enabling consumers to obtain the information that they need to make intelligent decisions and promote competition. For example, although credit cards are complex, a large majority of consumers report that they find it easy to obtain the information that they need about credit cards,[249] and that it is easy to switch to another card if they are dissatisfied or feel mistreated.[250] Indeed, an overwhelming majority of consumers express satisfaction with their credit cards and card issuers[251]—exactly what would be predicted in a market as competitive and with such low switching costs as the credit card market. An undue focus on simplification, therefore, risks sacrificing functionality in order to fit the product's attributes into the straightjacket of the preferred disclosure format, rather than fitting disclosure regulation to the product's substantive attributes. This is especially so in light of the development of specialized websites such as Cardhub.com, which makes it increasingly easy for consumers to identify the products that best meet their individual needs,[252] much as private third-party rating institutions such as Consumer Reports do for other products and services.[253] "Plain

247 *See id.*

248 *See supra* note 165.

249 *See* Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970–2000*, 86 FED. RES. BULL. 623, 631–32 (2000) ("About two-thirds of consumers in the 2000 survey . . . said that obtaining information on credit terms is easy."). Presumably since the growth of the Internet, information about credit card terms is even more accessible than it had previously been.

250 *Id.* at 628 ("Approximately nine in ten holders of bank-type credit cards said that they are satisfied with their dealings with card companies, that their card companies treat them fairly, and that it is easy to get another card if they are not treated fairly.").

251 *Id.* at 628–29.

252 CARD HUB, http://www.cardhub.com/ (last visited Apr. 1, 2013).

253 CONSUMERREPORTS.ORG, http://www.consumerreports.org/cro/index.htm (last visited Apr. 1, 2013).

vanilla" products would be appropriate for "plain vanilla" borrowers, but few if any "plain vanilla" consumers exist.[254]

Moreover, one cannot simply assume that complex loan products provide a vehicle for lenders to exploit hapless borrowers. Economists have found, for example, that during the financial crisis, complex mortgage products (such as negative amortization loans) were used disproportionately by sophisticated, high-income borrowers with prime credit scores.[255] And although they found that complex mortgages did indeed have higher default rates than predicted, this was because they attracted sophisticated borrowers who are "more strategic in their default decisions"—not because unsophisticated borrowers were unwittingly duped into them.[256] Other economists similarly have concluded that "predatory lending" was not a primary cause of the financial crisis.[257]

b. The Real Causes of Complexity: Regulation and Litigation

A second reason for the complexity of consumer credit disclosures is the byproduct of decades of litigation and regulation, which have forced ever-greater burdens onto credit issuers in their efforts to both comply with a thicket of federal regulation and avoid liability for

254 For example, many so-called credit card consumers are not "consumers" at all, but instead are individuals using personal credit cards to start or build a small business. *See* THOMAS A. DURKIN, U.S. CHAMBER OF COMMERCE, THE IMPACT OF THE CONSUMER FINANCIAL PROTECTION AGENCY ON SMALL BUSINESS 2 (2009), http://www.uschamber.com/sites/default/files/reports/090923cfpastudy.pdf ("Most of the 26.7 million businesses in the United States, including the self-employed, rely on credit cards, home equity loans, auto title loans, and other sources of consumer lending to finance their business. . . . Many of these businesses do not have access to a commercial line of credit, often because they are too small or too new.").

255 *See, e.g.*, Gene Amromin et al., Complex Mortgages 31–32 (May 2012) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1714605 (finding that "complex mortgages are the contract of choice for high credit quality and high income households," and concluding that "[o]verall, both the characteristics of complex mortgage borrowers and their default behavior shed doubt on the popular perception that complex mortgages are pushed by predatory lenders to naïve households who do not fully understand the mortgage terms.").

256 *Id.*

257 Sumit Agarwal et al., *Predatory Lending and the Subprime Crisis* 32–33 (Fisher Coll. of Bus., Working Paper No. 2012-03-008, Dice Ctr. Working Paper No. 2012-8, 2012), *available at* http://ssrn.com/abstract=2055889. The authors study anti-predatory legislation in Chicago, concluding that:

> [b]y incurring high counseling costs, removing over a third of the mortgages from the market, and driving about half of the lenders out of the market, 18-month default rates improved by about 12%. The improvement in 36-month default rate was even smaller—7% decline in default rate. This suggests that the effect of predatory lending on mortgage performance may be less onerous than implied in earlier work. *Id.*

technical violations of statutes and regulation. When it was first enacted over forty years ago, the premise of the TILA[258] was simple—to create a standardized format for disclosures on consumer credit that would enable consumers to quickly engage in apples-to-apples comparisons among different lending products in order to find the cheapest and most efficacious product for their needs.[259] When first proposed by Congress in the 1960s, TILA was simple and compact, designed merely to provide a standardized format for disclosing the interest rates (or APR) for consumer loans.[260] But between its enactment in1968 and 2007, TILA was amended twenty-five times, including a major revision in 1980, and by 2008, TILA's statutory language alone filled fifty-five double-column pages.[261]

In addition, the Federal Reserve Board has amended its Regulation Z, which implements TILA, more than fifty times.[262] Federal Reserve economists Thomas A. Durkin and Gregory Elliehausen describe the current state of Regulation Z:

> In the *Code of Federal Regulations* (CFR) for January 1, 2009, the regulation measured almost 300 double-column pages of small type including twelve appendices, a lengthy official interpretation of the regulation by the Federal Reserve Board staff known as the *Commentary* (updated at least yearly), and a four-page *Joint Policy Statement* concerning restitution in cases of inaccurately disclosed annual percentage rates. In all, Regulation Z contains well over 125,000 words of complicated legalese, enough to fill a sizable book. In 1976, the Federal Reserve Board assigned a separate rule to consumer leasing, Regulation M, which by year end 2010 consisted of another fourteen pages in the CFR, plus its own *Commentary* of twelve more pages. The sheer mass of the Truth in Lending Act and its associated regulations, together with its technical nature and frequent changes, has generated an industry of lawyers, consultants, trade associations, and printing and software companies dedicated to aiding creditors in complying with TILA.[263]

258 Truth in Lending Act, Pub. L. No. 90-321, tit. I, 82 Stat. 146 (1968).

259 *See* DURKIN & ELLIEHAUSEN, *supra* note 71, at 8.

260 *Id.* (noting that the original bill "required only two federal disclosures, namely, the total finance charge and the *simple annual interest*" and that "[t]he whole bill, including definitions and penalties, consisted of only three and one-half pages of large type").

261 *See id.* at 9.

262 *Id.*

263 *Id.*

Class action litigation piled still further complications onto TILA. According to Durkin and Elliehausen, by 1979 "more than 13,000 TILA lawsuits had been filed in federal courts"—nearly two percent of the entire federal civil caseload, and "up to fifty percent of the cases in some districts."[264] This stream of litigation in turn "produced a seemingly unending and often inconsistent set of judicial decisions, interpretations, and reinterpretations, each of which could mandate costly new paperwork, procedures, and employee training."[265] In turn, this chaos spawned a growth of Federal Reserve interpretations designed to clarify and bring coherence to these conflicting judicial interpretations, and by 1980 "the [Federal Reserve] and its staff had published more than 1,500 interpretations [of TILA] with varying degrees of legal authority."[266] Despite these good intentions, the Fed's interpretations simply led to further litigation in order to construe the interpretations and to establish their legal authority.[267]

Much of this early chaos was mitigated by a substantial reform in 1980 that simplified TILA to some extent, but which soon spawned its own subsequent onslaught of regulation.[268] For example, in 2008 the Fed undertook to amend Regulation Z solely for open-ended credit.[269] The new text of the rules added 159 pages of regulations and 266 pages of additional official *Commentary* by the Fed staff.[270] Amended Regulation Z also contained sixteen new model forms and 611 pages of "Supplementary Information," intended to elaborate on the foregoing.[271] At the same time, the Fed approved almost 500 pages of amendments to other Regulations that touched on credit cards and other consumer finance issues.[272] Then in 2009, Congress, dissatisfied with the Fed's efforts, passed additional amendments to TILA that provided further direction to the Fed, necessitating even more regulatory revisions.[273] In all, these regulations touched on and required changes to virtually every aspect of credit card operations.[274]

264 *Id.* at 9–10.

265 *Id.* at 10.

266 *Id.*

267 *See id.*

268 *See id.* at 11.

269 *Id.* at 12.

270 *Id.*

271 *Id.*

272 *See id.*

273 *Id.*

274 A similar story could be told about the accumulation of legislation, regulation, and litigation involving home mortgages, which created the need for simplification with which the CFPB is charged.

But the architects of CFPB seem to be largely unaware of the fact that much of the dysfunction in the consumer protection system that they criticize resulted from excessive regulation and litigation. As such, rather than offering an antidote to the cause of complexity in financial disclosures, it instead suggests that the CFPB's answer will be more of the same. For example, the CFPB estimates that the one final rule that has been issued as of the writing of this Article—a rule governing cash remittances—will impose 7,684,000 hours of compliance time for providers of cash remittance services.[275]

According to a recent survey of in-house counsel, compliance officers, and business professionals, "78 percent of respondents expect[ed] that CFPB supervision, examination and regulation w[ould] increase their company's regulatory costs by at least 20 percent."[276] As noted above, this massive increase in the regulatory and supervisory burden will be much easier for large banks to digest than smaller ones, forcing these smaller banks to dramatically increase their expenditures on legal fees while diverting employees from other activities to regulatory compliance efforts.[277]

Dodd-Frank also includes a number of special interest provisions that will increase litigation and primarily benefit class action lawyers. For example, Dodd-Frank bans mandatory arbitration provisions in mortgage and home equity loan contracts[278] and mandates that CFPB conduct a more general study on the use of arbitration clauses in consumer financial products or services.[279] In light of CFPB Director Cordray's ties to the plaintiff's class action bar,[280] there is reason to believe that the CFPB may take a dim view of the value of arbitration

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275 *See* Electronic Fund Transfers (Regulation E), 77 Fed. Reg. 6,194, 6,285 (Feb. 7, 2012) (to be codified at 12 C.F.R. pt. 1005).

276 Jenna Greene, *In-House Lawyers Concerned About Future CFPB Enforcement Efforts, Survey Finds*, BLOG LEGAL TIMES (July 12, 2012, 1:53 PM), http://legaltimes.typepad.com/blt/2012/07/in-house-lawyers-concerned-about-future-cfpb-enforcement-efforts-survey-finds.html.

277 *See On the Record: Community Bankers Speak Out on the Impact of Dodd-Frank Regulations*, COMM. ON FIN. SERV. BLOG (Oct. 17, 2011), http://financialservices.house.gov/Blog/?postid=264807 (presenting statements from community bankers as to the effects that Dodd-Frank compliance will have on their banks); *see also supra* text accompanying notes 162–163.

278 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 1414(a), § 129C(e)(1), 124 Stat. 1376, 2151 (2010) (codified at 15 U.S.C. § 1639c(e)(1) (Supp. IV 2011)).

279 *Id.* § 1028(a), 124 Stat. at 2003 (codified at 12 U.S.C. § 5518(a)).

280 *See* Mark Maremont, Tom McGinty & Nathan Koppel, *Trial Lawyers Contribute, Shareholder Suits Follow*, WALL. ST. J., Feb. 3, 2010, at A1 ("Out-of-state plaintiffs' law firms gave little cash directly to Mr. Cordray's campaign [for Ohio Attorney General], but in 2007 and 2008 they contributed $830,000 to the Ohio Democratic Party candidates' fund, which passed about $2 million to support Mr. Cordray. . . . Six law firms so far have been retained to represent Ohio

clauses to consumers. Indeed, ninety-eight percent of respondents to a recent poll of in-house counsel and executives at financial institutions expect private litigation to increase as a result of the CFPB, with thirty-two percent of respondents expecting a large increase.[281]

Even the one possibly promising reform that could have emerged from the CFPB has already proven itself to be more of the same: the CFPB's rule on mortgage disclosures.[282] As noted above, the call for a simple mortgage disclosure process was a long overdue response to decades of legislation, regulation, and litigation piled upon the mortgage disclosure process that had rendered mortgage documents lengthy and useless to ordinary consumers. Instead, the proposed regulation—which is a total of 342 triple-columned pages[283]—does little to help consumers by simplifying mortgage disclosures. Instead, it imposes new substantive limits on loan terms, such as late fees, balloon payments, and loan-modification fees, while also mandating new obligations by requiring high-risk borrowers in high-risk loan markets to meet with financial counselors before taking out a loan.[284] This entrenchment of continued regulatory complexity combined with new substantive limits on loan terms and a resurgence of paternalistic regulation does not bode well for the CFPB's direction.

2. *Misunderstanding the Real Causes of the Crisis Will Produce Unintended Consequences and Moral Hazard*

A second substantive problem with the CFPB is that it rests on a badly flawed assumption about the causes of the financial crisis, and the crisis' relationship to consumer protection policy. In particular, the animating premise of the CFPB is Elizabeth Warren's assumption that the primary cause of the financial crisis was "dangerous" con-

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pension funds in new lawsuits; five of the firms donated a total of $300,000 to the state Democratic party candidates' fund in 2008.").

See also Daniel Fisher, *Nominee Cordray Had Solid Backing from Securities Lawyers*, FORBES (July 18, 2011, 11:14 AM), http://www.forbes.com/sites/danielfisher/2011/07/18/nominee-cordray-had-solid-backing-from-securities-lawyers/ (documenting contributions from securities class action lawyers to Cordray's campaign for Ohio Attorney General).

281 *See* MAYER BROWN, SURVEY RESULTS: WHAT TO EXPECT FROM THE CFPB: AN IN-HOUSE PERSPECTIVE 7 (2012), *available at* http://www.mayerbrown.com/files/uploads/Mayer_Brown_CFPB_Survey_Results.pdf [hereinafter MAYER BROWN, SURVEY RESULTS].

282 *See* Integrated Mortgage Disclosures Under the Real Estate Settlement Procedure Act (Regulation X) and the Truth In Lending Act (Regulation Z), 77 Fed. Reg. 54,843 (Sept. 6, 2012) (to be codified at 12 C.F.R. pt. 1026).

283 *See id.*

284 *See* Jonathan Macey, Op-Ed., *The Feds' New Mortgage Disclosures Are a Bust*, WALL ST. J., July 18, 2012, at A15 (criticizing each of these provisions in the CFPB's mortgage disclosure rule).

sumer credit products that involuntarily injured consumers by saddling them with overly complex and expensive mortgages (and presumably credit cards, payday loans, and other products) for which consumers did not understand the risks.[285] Then-Professor Warren even went so far as to compare mortgages that resulted in foreclosure to "exploding toasters."[286] As the argument goes, while consumers cannot buy a toaster that has a twenty percent chance of exploding, current federal law permits the existence of subprime mortgages that have a twenty percent likelihood of resulting in foreclosure.[287] Oren Bar-Gill and Elizabeth Warren have argued that consumer credit products can be dangerous in the same way that consumer appliances can be, because consumer credit products are capable of causing substantial injury against which consumers are not equipped to protect themselves adequately. According to Professors Bar-Gill and Warren, "[c]redit products should be thought of as products, like toasters and lawnmowers, and their sale should meet minimum safety standards."[288] The solution proposed by Professors Bar-Gill and Warren was "the creation of a single regulatory body that will be responsible for evaluating the safety of consumer credit products and policing any features that are designed to trick, trap, or otherwise fool the consumers who use them."[289]

This oversimplified analogy completely misses the point. Unlike an exploding toaster, virtually all credit products—whether credit cards, mortgages, or payday loans—are suitable for some consumers in some situations but not for all consumers in all situations. More importantly, borrowers have substantial influence over whether their loans "explode" by the choices they make. If one in five toasters exploded because consumers chose to put them in the bathtub knowing what would happen, then that is hardly the problem of a faulty toaster. In fact, the analogy to the toaster in the bathtub is more apt than Warren's: most foreclosures resulted from consumers' conscious choices in response to incentives—not involuntary harm. For example, recent research indicates that those who took out "complex" mortgages were more financially sophisticated, had higher credit scores, and were more willing to strategically default than average.[290] Subprime lending and subsequent foreclosure rates were highest in

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285 *See* Warren, *supra* note 15, at 9–11.

286 *Id.* at 9; *see also* Bar-Gill & Warren, *supra* note 121, at 6.

287 *See* Warren, *supra* note 15, at 9, 14.

288 Bar-Gill & Warren, *supra* note 121, at 6.

289 *Id.*

290 *See* Amromin et al., *supra* note 255 and accompanying text.

those cities with the highest levels of real estate speculation and house flipping.[291]

Certainly there were incidents of fraud and abuse by lenders during the housing boom, just as there were consumers who misunderstood the lending products they purchased. And certainly there also were incidents of fraud and abuse by borrowers who defrauded lenders. But there is no evidence that consumer protection issues—as opposed to faulty incentives—were a substantial cause of the financial crisis.[292] The consumer side of the financial crisis (i.e., high levels of default on mortgages and credit cards and high levels of foreclosure on mortgages) was caused not by consumer ignorance, but by misaligned incentives and rational consumer responses to those incentives.

Lenders made a huge number of loans that were clearly foolish in retrospect and perhaps should have been recognized as foolish at the time. Those unwise loans presented, and continue to present, major problems for the safety and soundness of the American banking sector. These loans were foolish *not* because consumers did not understand them, however, but because lenders failed to appreciate the incentives that rational, fully informed consumers would have to default on these loans if circumstances changed. Indeed, millions of consumers have acted consistently with these incentives by walking away from their homes when they became bad investments.[293]

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291 *See* STAN J. LIEBOWITZ, INDEP. INST., ANATOMY OF A TRAIN WRECK: CAUSES OF THE MORTGAGE MELTDOWN 24 (2008), *available at* http://www.independent.org/pdf/policy_reports/2008-10-03-trainwreck.pdf ("According to the National Association of Realtors, speculative home purchases amounted to 28 percent of all sales in 2005 and 22 percent in 2006. These numbers are large enough that if only a minority of speculators defaulted when housing prices stopped increasing, it could have explained all or most of the entire increase in foreclosures started. *Id.* (footnote omitted."); William C. Wheaton & Gleb Nechayev, *The 1998–2005 Housing "Bubble" and the Current "Correction": What's Different This Time?*, 30 J. REAL EST. RES. 1, 2, 18 (2008) (noting, between 1998 and 2005, "the emergence of a risk-priced sub-prime mortgage market" as well as "an unusual growth in the demand for second homes or investment homes," and that "[t]hese two factors are highly correlated with the forecast errors in ways that would suggest causality," but cautioning against inferring causality).

292 *See* Agarwal, et al., *supra* note 257. Of course, the housing crisis also implicated other issues, such as the possible effect of governmental policies that forced or encouraged a growth in the number of risky loans through Fannie Mae and Freddie Mac or the influence of the Community Reinvestment Act. *See* Sumit Agarwal et al., Did the Community Reinvestment Act (CRA) Lead to Risky Lending? 24 (Oct. 1, 2012) (unpublished manuscript), *available at* http://ssrn.com/abstract=2172549 ("We find that adherence to the [Community Reinvestment Act] leads to riskier lending by banks: in the six quarters surrounding the CRA exams, lending is elevated on average by about 5 percent [every quarter] and these loans default about 15 percent more often."). This Article expresses no opinion on the possible role of those forces.

293 *See, e.g.*, Tess Vigeland, *They Walked Away, and They're Glad They Did*, N.Y. TIMES,

Consider an extreme, but not unrealistic scenario: a California borrower takes a nothing-down, interest-only, adjustable-rate mortgage to buy a new home in the far-flung exurbs of southern California, planning to live in the house for a few years and then resell it for a profit.[294] Assume further that the borrower could continue to make his mortgage payment if he chose to do so. Instead, the house plunged in value so that it is worth much less than the outstanding mortgage, and with widespread oversupply of housing, there is no reasonable likelihood that it will come regain its original value in the near future. Under California's default-friendly antideficiency laws, the lender is limited to foreclosing on the house and cannot sue the borrower for the difference between the value of the house and the amount owed on the mortgage.[295] As a result, the homeowner crunches the numbers, consults his lawyer, and decides to stop making payments and allow foreclosure. During the pendency of the foreclosure action, however, the borrower can essentially live in the house rent-free, a period that in some places today can take as long two to three years. If a consumer makes this financially savvy and rational choice, does that present a consumer protection issue?

Loans and laws that provide such strong incentives for consumers to rationally default instead of paying their mortgage present serious safety and soundness issues. Sensible regulatory policy should question whether banks should be permitted to make loans that provide such strong incentives for a borrower to default when the loan falls in value, or whether it is even sensible for states to have antideficiency laws. But while this scenario presents safety and soundness concerns, it does *not* present a consumer protection issue—when consumers rationally respond to incentives, there is no consumer protection issue. The end result of foreclosure in this hypothetical stems from the set of incentives confronting the borrower and the borrower's rational response to them. Empirical research indicates that loans with no down payment or which otherwise cause borrowers to have low or no equity in their homes (including interest-only home equity loans and cash-out refinances) have proven to be especially prone to foreclosure in

Nov. 9, 2011, at F9 (collecting anecdotes from homeowners who say that walking away from an underwater mortgage "turned out to be the best financial decision they made").

294 The most important kindling that started the housing crisis was the development of no-equity products, such as low down payment mortgages. *See generally* Kristopher Gerardi et al., *Making Sense of the Subprime Crisis*, BROOKINGS PAPERS ON ECON. ACTIVITY, Fall 2008, at 69–70.

295 CAL. CIV. PROC. CODE § 580b (West 2011).

the recent crisis,[296] because stripping the equity out of one's house makes it more likely that a price drop will push the house into negative equity territory, thereby providing incentives to default on the loan.

Economists model the homeowner's decision to default on an underwater mortgage as a financial "option," which consumers exercise consistent with the prediction of standard economic models.[297] In addition, economists find that when the value of exercising the foreclosure option rises (such as when the value of the underlying asset falls in value) or when the cost of exercising the option falls (such as by the presence of an anti-deficiency law that reduces the cost of default to homeowners, especially high-income and high-wealth homeowners),[298] homeowners respond by exercising the option more readily.[299]

However, rather than recognizing that the financial crisis resulted at least partly from misaligned incentives, which created major safety and soundness issues, the operative premise of the CFPB is that the

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296 *See, e.g.*, Stan Liebowitz, Op-Ed., *New Evidence on the Foreclosure Crisis*, WALL. ST. J., July 3–5, 2009, at A13 (analyzing loan-level data to conclude that "the most important factor related to foreclosures is the extent to which the homeowner now has or ever had positive equity in a home" and that low down payment mortgages accounted for the fourth largest number of foreclosures, after negative equity, high unemployment, or a subprime FICO score).

297 *See generally* Todd J. Zywicki & Joseph D. Adamson, *The Law and Economics of Subprime Lending*, 80 U. COLO. L. REV. 1 (2009) (examining the "distress" and "option" models of home foreclosures).

298 *See* Lawrence D. Jones, *Deficiency Judgments and the Exercise of the Default Option in Home Mortgage Loans*, 36 J.L. & ECON. 115, 135 (1993); Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States* 28 (Fed. Reserve Bank of Richmond, Working Paper No. 09-10R, 2011), *available at* http://www.richmondfed.org/publications/research/working_papers/2009/pdf/wp09-10r.pdf ("We find that, in a sample of loans originated between August 1997 and December 2008, at the mean value of the default option at the time of default, the probability of default is 32% higher in non-recourse states than in recourse states.").

299 Lenders, of course, are well aware that debtor-friendly default laws raise the risk of lending and thus charge higher interest rates while lending less in states such laws. *See* WOODWARD *supra* note 140, at 50 (finding that nonrecourse laws "raise costs to borrowers by $550 per $100,000 of loan amount"); Brent W. Ambrose & Anthony B. Sanders, *Legal Restrictions in Personal Loan Markets*, 30 J. REAL EST. FIN. & ECON. 133, 148 (2005) (finding lower interest rate spreads in states that permit deficiency judgments and do not require judicial foreclosure procedures); Jones, *supra* note 298, at 125–26 (in a study of Canadian provinces, finding higher down payments in provinces with antideficiency laws); Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 146 (1982) (estimating a 13.87 basis point increase in interest rates for new homes as a result of antideficiency laws); Karen M. Pence, *Foreclosing on Opportunity: State Laws and Mortgage Credit*, 88 REV. ECON. & STAT. 177, 177, 180 (2006) (finding that average loan size is smaller in states with "defaulter-friendly" foreclosure laws). *But see* Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 514 (1991) (finding that the "magnitude of the increase in credit costs is likely to be modest" and critiquing Meador's findings as not "statistically significant").

financial crisis was produced by hapless consumer victims being exploited and defrauded by unscrupulous lenders.[300] Regulatory decisions based on a flawed understanding of the underlying phenomenon will undoubtedly have unintended consequences for consumers and, in fact, will likely exacerbate similar problems in the future.

Yet, astonishingly, the CFPB makes no acknowledgement of the reality that consumers respond to incentives and can create moral hazard problems of their own. In fact, in its major rulemakings on "Ability-to-Repay and Qualified Mortgages,"[301] issued in January 2013, the CFPB made no provision for requiring higher down payments, restricting cash-out refinancing, or acknowledging the incentive effect of state antideficiency laws on foreclosures. This blind spot is consistent with Dodd-Frank, which imposes new rules specially designed to protect antideficiency laws and ensure that homeowners retain the benefit of those laws—i.e., the ability to walk away from underwater mortgages with no penalty. For example, Dodd-Frank requires that consumers be made expressly aware that, by refinancing their homes, they may be losing the benefit of an antideficiency law.[302] This sort of special protection for antideficiency laws may or may not be wise as a matter of general policy—as noted above, empirical studies find that the presence of an antideficiency law raises the risk of lending, resulting in higher interest rates, higher costs, and reduced credit access for borrowers.[303] One point, however, is exceedingly clear: antideficiency laws tend to increase the total number of foreclosures when home prices fall.[304] Thus, if the goal of the CFPB is to reduce the number of mortgages that end in foreclosure, providing special protection for antideficiency laws will squarely contradict that goal, by increasing the number of foreclosures when home prices fall.

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300 *See* Elizabeth Warren, *Building the New Consumer Bureau*, CONSUMER FIN. PROT. BUREAU (Mar. 16, 2011), http://www.consumerfinance.gov/opeds/building-the-new-consumer-bureau/ ("The consumer bureau's mission is to make sure consumers have the information they need—upfront, not buried in fine print—to make the best choices about mortgages, credit cards and other financial products and services. Consumers' personal responsibility is, of course, critical. But prices and risks must be straightforward, consumers should be able to make apples-to-apples comparisons among two or three products.")

301 *See* Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 6,408 (Jan. 30, 2013) (to be codified at 12 C.F.R. pt. 1026).

302 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 1414(a), § 129C(g)(3), 124 Stat. 1376, 2152 (2010) (codified at 15 U.S.C. § 1639c(g)(3) (Supp. IV 2011)).

303 *See supra* note 298 and accompanying text.

304 *See supra* notes 298–99 and accompanying text.

Similarly, consider the role of prepayment penalties. Dodd-Frank bans prepayment penalties in most mortgages, on the presumption that they are harmful to consumers and contributed to the foreclosure crisis for subprime mortgages, which often contained prepayment penalties (unlike prime mortgages).[305] But there is no evidence that prepayment penalties were excessively risky for consumers or that they systematically increased the risk of borrower default. In fact, evidence suggests that homeowners who took out a subprime loan that contained a prepayment penalty clause were less likely to default than those who took out loans without such clauses, perhaps because of the lower interest rate on loans with prepayment penalties or because the acceptance of a prepayment penalty provides a valuable and accurate signal of the borrower's intentions.[306] Borrowers pay a premium of approximately twenty to fifty basis points (or 0.2 to 0.5 percentage points) for the unlimited right to prepay, and subprime borrowers generally paid a higher premium for the right to prepay than prime borrowers did because of the increased risk and more idiosyncratic nature of subprime borrower prepayment, which makes it more difficult to predict which borrowers will prepay.[307] Because mortgage lending has an asymmetric information problem—i.e., borrowers know better than lenders their likelihood of prepaying—a prepayment penalty may also provide a credible signal by the borrower of

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305 *See* Dodd-Frank Act sec. 1414(a), § 129C(c), 124 Stat. at 2149 (codified at 15 U.S.C. § 1639(c)); *see also* O. Emre Ergungor, Fed. Reserve Bank of Cleveland, Prepayment Penalties on Subprime Mortgages 1 (2007), *available at* http://www.clevelandfed.org/research/Commentary/2007/0901.pdf (noting that "[p]repayment penalties were a contract feature of a significant percentage of the loan defaults in the subprime mortgage market").

306 *See* Chris Mayer et al., The Inefficiency of Refinancing: Why Prepayment Penalties Are Good for Risky Borrowers 36–37 (Nov. 28, 2010) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1108528 (finding that "refinancing penalties can be welfare improving and that they can be particularly beneficial to riskier borrowers in the form of lower mortgage rates, reduced defaults, and increased availability of credit"). Sherlund also finds that the presence of prepayment penalties does not raise the propensity for default. Shane M. Sherlund, *The Past, Present, and Future of Subprime Mortgages* 17 (Fed. Reserve Bd. Fin. & Econ. Discussion Series, Working Paper No. 2008-63, 2008), *available at* http://www.federalreserve.gov/pubs/feds/2008/200863/200863pap.pdf.

307 *See* Gregory Elliehausen, Michael E. Staten & Jevgenijs Steinbuks, *The Effect of Prepayment Penalties on the Pricing of Subprime Mortgages*, 60 J. Econ. & Bus. 33, 34, 44–45 (2008) (reviewing conflicting studies to find that "[r]econciling these studies is difficult" but ultimately determining that the data "suggest that a prepayment penalty reduces risk premiums" by thirteen to thirty-eight basis points, depending on the type of loan); Mayer et al., *supra* note 306, at 7–8 (reviewing studies); Zywicki & Adamson, *supra* note 297, at 18–20 (summarizing studies). Term sheets offered to mortgage brokers similarly quoted interest rate increases of approximately twenty to fifty basis points in those states that prohibited prepayment penalties. *Id.* at 19.

his intent not to prepay the loan, thus overcoming an adverse selection in the marketplace and permitting a reduction in interest rates.

In addition, the ability of American consumers to freely prepay and refinance their mortgages clearly exacerbated the current mortgage crisis and banning prepayment penalties might thus exacerbate a similar situation in the future. When home prices were rising, many consumers refinanced their mortgages to withdraw equity from their homes. These "cash-out" refinancings became increasingly common during the duration of the housing boom: from 2003 to 2006, the percentage of cash-out refinancings doubled from slightly less than forty percent to over eighty percent,[308] and among subprime refinanced loans in 2005, around ninety percent involved some cash out, even though mortgage interest rates were rising during that period.[309] In fact, although there was a documented rise in loan-to-value ("LTV") ratios between 2003 and 2005, even that fact may underestimate the true increase in the LTV ratio if refinancing appraisals were inflated (either intentionally or unintentionally), as appraisals are a less accurate measure of value than are actual sales.[310] This withdrawal of equity reduced borrowers' equity cushion. As such, when home prices fell, these borrowers were much more likely to fall into a negative equity position, thereby making it economically rational to exercise the default option. This unique ability of American consumers to remove their home equity through refinancing is a major reason why the foreclosure rate in the United States has been so much higher than it is in Europe,[311] where prepayment (and hence, cash-out refinancing) is

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308 Luci Ellis, *The Housing Meltdown: Why Did it Happen in the United States* 22 (Bank for Int'l Settlements, BIS Working Paper No. 259, 2008), *available at* http://www.bis.org/publ/work259.pdf.

309 Chris Mayer & Karen Pence, *Subprime Mortgages: What, Where, and to Whom?* 16–17 (Fed. Reserve Bd., Fin. & Econ. Discussion Series Working Paper No. 2008-29, 2007), *available at* http://www.federalreserve.gov/pubs/feds/2008/200829/200829pap.pdf.

310 *See* Ellis, *supra* note 308, at 22 (noting that "[f]requent refinancing also means that more mortgages are originated based on appraisals rather than market prices"); Christopher J. Mayer, Karen M. Pence & Shane M. Sherlund, *The Rise in Mortgage Defaults* 6 (Fed. Reserve Bd., Fin & Econ. Discussion Series Working Paper No. 2008-59, 2008), *available at* http://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf ("The combined loan-to-value ratios of subprime refinances remained around 80 percent [from 2003-2005], although these estimates may have become artificially low over time if house price appraisals were biased upwards.").

311 *Compare* European Comm'n, *National Measures and Practices to Avoid Foreclosure Procedures for Residential Mortgage Loans* 13 (European Comm'n, Staff Working Paper No. SEC(2011)357, 2011), *available at* http://ec.europa.eu/internal_market/finservices-retail/docs/credit/mortgage/sec_2011_357_en.pdf (reporting that in 2009, default rates in Europe ranged from a low of 0.44% (France), to a high of 7.83% (Bulgaria), excluding the outlier of 15.95% (Latvia)), *with* James E. Hagerty & Sara Murray, *Fear of Double Dip in Housing*, WALL ST. J.,

generally prohibited.[312] Thus, even though many countries in Europe (notably England) experienced a housing price bubble virtually identical to the bubble in the United States', their foreclosure rate has been a fraction of ours, in part because restrictions on refinancing forced homeowners to retain the equity in their homes at the height of the boom, thereby providing an equity cushion when prices later fell.[313] As a result, a much smaller number of European homeowners had an incentive to walk away from their homes than did American homeowners.[314]

Thus, there is no evidence that the *presence* of prepayment penalties systematically increases foreclosures, primarily because consumers' acceptance of prepayment penalty clauses results in more affordable loans and addresses adverse selection problems. On the other hand, the *absence* of prepayment penalties can increase foreclosures by providing opportunities for consumers to refinance and strip equity out of their homes. Thus, it is highly possible that the overall effect of banning prepayment penalties in mortgages will be to increase foreclosures and exacerbate a financial crisis similar to the last one. Nevertheless, Dodd-Frank expressly bans prepayment penalties[315] without any apparent recognition of this possible unintended consequence—a decision that makes sense only by ignoring the reality

Nov. 19, 2009, at A3 (reporting that "about 12.4% of American households with mortgages in October [2009] were 30 days or more overdue or in the foreclosure process").

312 *See* Zywicki, *The Behavioral Law and Economics of Fixed Rate Mortgages*, *supra* note 147, at 1 (noting that the "unlimited right of the borrower to prepay" a mortgage is a "distinctive [American] attribute").

313 *Id.*

314 Of course, this is not the only difference that explains why the foreclosure crisis has been so much more severe in the United States. Foreclosure laws are much tougher in Europe than in the United States. Antideficiency laws are unheard of in Europe and foreclosure is often more rapid and aggressive than in the United States, which in many states now takes two or three years, during which consumers can live for free after they stop making payments. Also extremely important is that most mortgages in Europe are adjustable rate mortgages, unlike in the United States, which is saddled with a disproportionate number of fixed rate mortgages. In Europe, when the central bank cuts interest rates, this automatically reduces the interest rate for borrowers, making payment obligations more affordable and solidifying home values. However, borrowers in the United States with fixed rate mortgages can benefit from lower interest rates only by refinancing. Nonetheless, those consumers with negative equity in their homes will be unable to refinance without first coming up with a cash payment to make up the windfall. As a result, many hard-hit homeowners have been unable to refinance because of an inability to cover the closing costs and equity shortfall that would be necessary to do so. *See generally* Zywicki, *The Behavioral Law & Economics of Fixed Rate Mortgages*, *supra* note 147 (comparing European and American mortgages and the incentives that different loan provisions have).

315 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, sec. 1414(a), § 129C(c), 124 Stat. 1376, 2149 (2010) (codified at 15 U.S.C. § 1639(c) (Supp. IV 2011)).

that consumers respond to incentives and that failing to recognize this reality can create a moral hazard problem.

D. *Summary*

The logic of the CFPB is flawed throughout. First, it creates a regulatory structure that ignores decades' worth of lessons with respect to creating an effective regulatory body.[316] Second, instead of imposing structural checks that could mitigate these problems, Dodd-Frank instead creates a structure that virtually guarantees the full manifestation of standard bureaucratic pathologies.[317] Third, it fails to account for the real driving force behind the breakdown of consumer finance—a runaway expansion of litigation and regulation—and instead promises more of the same.[318] Finally, the logic behind the CFPB fails to appreciate the underlying causes of the financial crisis itself, namely that defective loans were problematic because of misaligned incentives that caused safety and soundness concerns—not consumer protection issues.[319] By ignoring the reality that consumers respond to incentives, the proposed consumer protection reforms designed, for example, to reduce foreclosures, instead will likely have the effect of *increasing* foreclosures in the future.[320] It is an open question whether it would be optimal policy to adopt rules that can be predicted to increase foreclosures. In discussing whether such a policy is wise, however, it does not make sense to believe that these policies are justified because they somehow will decrease foreclosures, when in fact the opposite result is more likely.

IV. The CFPB's Substantive Powers

A third major area of concern with the CFPB is the vast, ill-defined nature of the powers Dodd-Frank grants the Bureau. The CFPB has broad authority to engage in rulemaking, litigation, and to use other tools to further its mission. It also has the power to regulate virtually every credit provider in America—including the most local pawnshops and payday lenders—and to enforce its mandates by imposing massive penalties.

Among the CFPB's substantive powers, perhaps the most threatening is its power to regulate "unfair, deceptive, or abusive act[s] or

316 *See supra* Part II.
317 *See supra* Part III.A–B.
318 *See supra* Part III.C.1(b)
319 *See supra* Part III.C.1(a).
320 *See supra* Part III.C.2.

product[s]."[321] Although all three terms are vague and potentially expansive, the terms "unfair" and "deceptive" incorporate, at least as an initial matter, the definitions of those terms built up over a long period of time by the FTC.[322] Nevertheless, the CFPB also has the power to redefine those terms as it sees fit going forward.[323] Thus, this initial clarity may not be permanent.

More problematic, however, is the power of the CFPB to regulate "abusive" terms and products. The term "abusive," as used in this context, appears to be an entirely novel term with no forerunners in any prior federal or state statute or regulation. Nor is there any legislative history to suggest what the term might mean.

The term "abusive" is defined by Dodd-Frank in section 5531(d), which states:

> (d) ABUSIVE.—The Bureau shall have no authority under this section to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless the act or practice—
>
> > (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
> >
> > (2) takes unreasonable advantage of—
> >
> > > (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
> > >
> > > (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or

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321 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1036(a)(1)(B), 124 Stat. 1376, 2010 (2010) (codified at 12 U.S.C. § 5536(a)(1)(B) (Supp. IV 2011)).

322 *See* John E. Villafranco & Kristin A. McPartland, *New Agency, New Authority: An Update on the Consumer Financial Protection Bureau*, ANTITRUST SOURCE, Feb. 2012, at 1, 5 (noting that the CFPB will likely interpret the terms "unfair" and "deceptive" in a similar manner as the FTC's).

323 *See* CONSUMER FIN. PROT. BUREAU, SUPERVISION AND EXAMINATION MANUAL UDAAP 3 (2011), http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/supervision_examination_manual_11211.pdf ("Public policy, as established by statute, regulation, judicial decision, or *agency determination*, may be considered with all other evidence to determine whether an act or practice is unfair." (emphasis added)).

> (C) the reasonable reliance by the consumer on a covered person[324] to act in the interests of the consumer.[325]

It is not clear what the term "abusive" might mean, but a few things seem evident. First, it must mean something different from the terms "unfair" and "deceptive," because otherwise the term obviously would be redundant. Second, the definition seems to be a discrete break with the philosophy that has animated the regulation of consumer credit for the past several decades—namely, a disclosure-based system designed to empower rather than displace consumer choice by harnessing the power of markets for consumers.[326] The "abusive" standard, by contrast, appears to be a return to old-fashioned substantive regulation of earlier generations. Some have argued that "abusive" hearkens back to historic standards of unconscionability, which, while once in vogue, have fallen out of favor in recent decades because of the inherent subjectivity of such a standard.[327]

One commentator, for instance, has summarized the abusive standard as empowering the CFPB to do three things:

> First, it seeks to make consumer choices more meaningful by simplifying contractual language. If contracts were clearer, consumers' consent would be more indicative of their actual preferences. Second, the "abusive" standard would give the CFPB some amount of power to regulate products directly and take the most "dangerous" products off the market entirely . . . . Finally, the "abusive" standard attempts to do what market forces alone have not: impose an explicit obligation on lenders to act in consumers' interest.[328]

If this interpretation of the "abusive" standard is correct, then it would give the CFPB power to deem certain products inherently dangerous and remove them from the market—even if they were neither

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324 Dodd-Frank defines a covered person as: "(A) any person that engages in offering or providing a consumer financial product or service; and (B) any affiliate of a person described in subparagraph (A) if such affiliate acts as a service provider to such person." Dodd-Frank Act § 1002(6), 124 Stat. at 1955 (codified at 12 U.S.C. § 5481(6)).

325 *Id.* § 1031(d), 124 Stat. at 2006 (codified at 12 U.S.C. § 5531(d)).

326 *See supra* notes 68–73 and accompanying text.

327 *See* Kate Davidson, *Abuse Standard's Unclear and Banks Clearly Dislike It*, AM. BANKER, Sept. 6, 2011, at 3 (describing the development of "abusive" criteria by stating: "While [unconscionability] criteria would be unlikely to appear in regulations or laws today, [attorney Jeffrey] Taft said, 'It's the same kind of logic.'").

328 Rebecca J. Schonberg, The Meaning of "Abusive" Under Dodd-Frank: Fixing the Broken Market for Consumer Financial Products 5–6 (unpublished manuscript) (on file with the George Washington Law Review).

"unfair" nor "deceptive"—no matter how well the risks were disclosed and no matter how well the consumer understood the risks. Moreover, this interpretation would impose on the lender a duty to both *understand* and act in the "best interest" of the consumer. In this sense, the "abusive" standard could impose a sort of "suitability" standard on lenders, forcing them to determine whether certain products are appropriate for certain consumers or categories of consumers.[329] Thus, for the first time, it appears that under the "abusive" standard, a lender might be required to paternalistically understand what it believed to be in the best interest of the consumer and act accordingly. It is easy to identify the similarities between the traditional paternalistic view of protecting "math-impaired females" who were thought to need special protection,[330] and a new class of borrowers who are believed by regulators and lawyers to be unable to understand and act in their own best interests. Such a broad definition of the "abusive" standard could have substantial implications for consumers and lenders, exposing the latter to potentially massive liability and chilling innovation of new products with the eventual impact being felt by consumers. This massive potential liability makes it critical to determine the word's interpretation.

What might "abusive" mean in light of the fact that it must mean something different from "unfair" and "deceptive"? One interpretation might permit the CFPB to ban contract terms that are justifiable under an efficient risk-based pricing rationale (and thus presumably not "unfair"), but which the regulator believes consumers might find too confusing. How this tradeoff would be determined without the type of analysis contemplated by the unfairness standard is not clear.

A second possible interpretation is potentially more pernicious. The term could be read to create certain classes of consumers who are believed to be systematically less able to protect themselves compared to other classes. This would be the modern-day analogue to the "math-impaired females" of bygone days,[331] but with new "protected" classes of borrowers instead, such as the elderly, service members, or some other group thought to be stereotypically unable to fend for themselves. Lenders could easily find themselves in a catch-22 if they determine that certain products are unsuitable for certain categories of borrowers, such as women, minorities, or the elderly: taking the

329 *See* Davidson, *supra* note 327 (noting that some "observers said the ['abusive'] provision seems to open the door for a so-called suitability requirement").

330 *See supra* note 72 and accompanying text.

331 *See supra* note 72 and accompanying text.

steps required to avoid liability for abusive lending could expose those lenders to potential liability under fair lending laws by withholding loans to certain groups—an especially ironic result given that CFPB also now has authority to enforce fair lending and equal access to credit laws.[332]

A third interpretation might be one that allows the CFPB to ban products if the Bureau determines that, although the products are transparently priced, consumers understand the terms, and the terms are efficient under a cost-benefit analysis, the CFPB nevertheless believes that consumers (or at least some consumers) subjectively do not understand the risk.

Of particular interest here might be the novel use of "behavioral economics" as a justification for regulation.[333] Consider a product such as a payday loan, which among its terms permits borrowers to roll over their loans from one period to the next. Empirical research indicates that the proportion of payday loan customers that benefit from access to payday loans exceeds the proportion of customers that become mired in a 'debt trap' as a consequence of repeated lending.[334] But so-called consumer advocates are often critical of the rollover option, arguing that it can create a "cycle of debt" for some borrowers.[335] The rollover option is plainly not deceptive (all payday loan customers presumably know about it) and is almost certainly not "unfair" (most borrowers seem to have a rollover option and could apply for an unsecured installment loan if they preferred). But the language of Dodd-Frank's "abusive" provision suggests that, if the CFPB decides that consumers systematically underestimate the likelihood of rolling over, it might not matter whether consumers understand and value the option to rollover. In other words, even though consumers say with confidence that they understand the risks and opportunities of the rol-

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332 *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1013(c), 124 Stat. 1376, 1970 (2010) (codified at12 U.S.C. § 5493(c) (Supp. IV 2011)).

333 Because Dodd-Frank expressly bars the CFPB from imposing interest rate regulations on any consumer credit product, see *id.* sec. 1044(a), § 5136C(f), 124 Stat. at 2017 (codified at 12 U.S.C. § 25b(f)), the Bureau could not use such an approach to effectively ban certain products.

334 *See* Todd J. Zywicki, *The Case Against New Restrictions on Payday Lending* 21 (Mercatus Ctr., Working Paper No. 09-28, 2009), *available at* http://mercatus.org/sites/default/files/publication/WP0928_Payday%20Lending.pdf.

335 *See, e.g.*, Rebecca Borné et al., Ctr. for Responsible Lending, Big Bank Payday Loans: High-Interest Loans Through Checking Accounts Keep Customers in Long-Term Debt 2 (2011) ("This 'debt treadmill' is created by the structure of the loan itself. Repayment in full from a single paycheck or benefits check is a tall order for a household already living close to the financial edge. . . . Ultimately, this series of so-called 'emergency, short-term' loans is essentially long-term debt carrying annual interest rates averaging 417 percent . . . .")

lover option, the CFPB may nevertheless determine that it should not be available, because payday lenders might be taking "unreasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service."[336]

One could extend this logic to almost any nontraditional lending product. Auto title pledges, for example, have the obvious risk that the borrower will lose his car; borrowers obviously recognize this. In addition, most title pledge loan customers have more than one car, and a large number of the cars that are subject to repossession are older vehicles with fatal mechanical failures, suggesting that for most borrowers, the adverse consequences of losing the car under the loan are muted.[337] How might the CFPB weigh these factors (of which there are many more) in determining whether consumers rationally default or do so as the result of abusive practices? Moreover, could the CFPB ban title pledges as "abusive" even if they are not deceptive or unfair?

These questions suggest that even though the CFPB cannot regulate interest rates[338] (the traditional vehicle for regulating certain products off the market), it could use the abusive standard to regulate virtually every other provision of consumer credit contracts and essentially abolish many of these products. The ability to deem certain products as inherently unsafe or "abusive" is a dangerous one that will likely chill innovation and the introduction of new products.

Moreover, the uncertainty about the meaning of "abusive" has been heightened by Director Cordray's indication that he will be unlikely to initiate rulemaking to define the term, meaning that the term will instead likely be defined through enforcement actions.[339] Given the ambiguity of the language itself and the novelty of the term, however, it will be very difficult for lenders to accurately anticipate what actions may result in liability later. In addition to increasing predictability, rulemaking also enables impacted parties to participate in the

336 Dodd-Frank Act § 1031(d)(2)(A), 124 Stat. at 2006 (codified at 12 U.S.C. § 5531(d)(2)(A))).

337 *See* Todd J. Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONSUMER L. REV. 425, 435 (2010).

338 Dodd-Frank Act sec. 1044(a), § 5136C(f), 124 Stat. at 2017 (codified at 12 U.S.C. § 25b(f)).

339 *See* Dave Clarke, *US Abusive Lending Bar Likely Set High—Cordray*, THOMSON REUTERS NEWS & INSIGHT (Jan. 24, 2012), http://newsandinsight.thomsonreuters.com/Securities/News/2012/01_-_January/US_abusive_lending_bar_likely_set_high-Cordray/ (noting Director Richard Cordray's statement that the CFPB does not intend to engage in rulemaking to define "abusive," but that "[f]or something to be an abusive practice it would have to be a pretty outrageous practice").

required notice-and-comment procedures for rulemaking. Enforcement actions, on the other hand, expose individual firms to bad publicity and the concentrated financial cost of defending the action, thereby driving them to settle rather than to contest the action. Once a settlement is extracted, this can serve as a de facto rule guiding future behavior—though one that lacks the due process protections of rulemaking.[340] For example, in a series of settled cases in the 1990s, the Department of Justice's prosecution of fair lending actions came to establish a de facto rule of applying "disparate impact" and "disparate treatment" standards to fair lending laws.[341]

In addition, Dodd-Frank requires that if the CFPB does engage in rulemaking, it must consider the rule's costs and benefits to financial service providers and consumers, "including the potential reduction of access by consumers to consumer financial products or services."[342] The CFPB is also required as part of its rulemaking to consult with prudential regulators, and the Bureau's regulations may be set aside by the FSOC in certain circumstances.[343] These limits do not apply to the CFPB's civil investigatory, administrative enforcement, and litigation powers, however, creating an "internal agency bias" toward using enforcement and litigation instead of rulemaking.[344] Given the CFPB's unusual scope of authority to initiate civil litigation on its own, this tendency toward overuse of enforcement is exacerbated.[345]

V. Preemption

A final area of incoherence in the CFPB is the Bureau's preemption scheme established by Dodd-Frank. Indeed, Dodd-Frank creates

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340 *See* Thomas P. Vartanian, *Will CFPB Make Policy via Rules—or Enforcement?*, Am. Banker (Nov. 14, 2011, 6:34 PM), http://www.americanbanker.com/bankthink/will-cfpb-make-policy-via-rules-or-enforcement-1044071-1.html?zkPrintable=1&nopagination=1 (discussing the benefits and problems associated with using either rulemaking or enforcement actions to interpret statutory terms).

341 *Id.* Vartanian indicates that "[a]nti-money laundering and bank secrecy act cases have generally also been settled over the last decade," establishing de facto standards for the industry that are rarely tested in court and which have emerged without the protections of rulemaking procedures. *Id.*

342 Dodd-Frank Act § 1022(b)(2)(A)(i), 124 Stat. at 1980 (codified at 12 U.S.C. § 5512(b)(2)(A)(i)).

343 *See id.* § 1022(b)(2)(B), 124 Stat. at 1981 (codified at 12 U.S.C. § 5512(b)(2)(B)) (requiring consultation with the prudential regulators); *supra* notes 102–03 and accompanying text (describing the operation and structure of the FSOC).

344 Vartanian, *supra* note 340.

345 *See id.* (noting that the CFPB's litigation authority is "unlike [that of] any other federal bank regulatory agency").

a scheme of preemption (and reverse preemption, i.e., enabling state enforcement authorities to enforce federal law) that is an almost Platonic version of incoherence. On one hand, it empowers federal authorities to potentially reach down to regulate the operations of exceedingly local lenders (such as payday lenders), whose operations cannot conceivably have any spillover or externality effect on other states or the national economy. Then on the other hand, Dodd-Frank empowers state attorneys general to attack the operations of national banks by enforcing the CFPB's regulations.[346] Rather than creating a coherent scheme of preemption, the CFPB instead permits redundant enforcement actions by state and local governments with no coherent division of authority. Thus, the CFPB's preemption scheme seemingly has only one purpose: to maximize litigation and enforcement by as many political jurisdictions as possible.

To understand the incoherence of Dodd-Frank's preemption scheme, it is worth considering the initial rationale advanced for restricting preemption of state consumer protection laws. A common claim arising from the financial crisis was that federal bank regulators were "asleep at the switch" during the onset of the financial crisis, turning a blind eye to "predatory lending" by banks under their jurisdiction and preempting the efforts of state consumer protection enforcers to apply their laws.[347] Furthermore, goes the story, the Supreme Court's decision in *Watters v. Wachovia Bank*[348] extended the power of the national bank regulators to preempt state law to subsidiaries and affiliates of nationally-chartered banks, extending still further the number of institutions protected from state enforcement.[349] One conclusion drawn from this history was that in light of

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346 *See* Dodd-Frank Act § 1042(a), 124 Stat. at 2012 (codified at 12 U.S.C. § 5552(a)).

347 *See, e.g.*, Andrew Martin, *Does This Bank Watchdog Have a Bite?*, N.Y. TIMES, Mar. 28, 2010, at BU1 ("For more than a decade, the [Office of the Comptroller of the Currency] has beaten back state attorneys general who have tried to enforce state consumer laws against national banks, arguing that federal laws pre-empt those of the states . . . ."); Richard A. Posner, Op-Ed., *Our Crisis of Regulation*, N.Y. TIMES, June 25, 2009, at A23. In his op-ed, Judge Posner criticizes the Treasury Department's white paper, TREASURY DEP'T WHITE PAPER, *supra* note 18, for "ignor[ing] the elephant in the room: the regulators, including [the Fed and the SEC], were asleep at the switch, oblivious to the housing bubble and the rapid deterioration of the finance industry." *Id.*

348 Watters v. Wachovia Bank, 550 U.S. 1 (2007).

349 *See* Elizabeth R. Schiltz, *Damming* Watters*: Channeling the Power of Federal Preemption of State Consumer Banking Laws*, 35 FLA. ST. U. L. REV. 893, 894, 897 (2008) (calling *Watters* a "dramatic turning point in a persistent struggle between the federal and state authorities for control over consumer protection regulation in the banking industry," and suggesting that "[r]edress of this imbalance would require action by Congress, including a partial reversal of *Watters*").

the lack of aggressive and dedicated federal enforcement of consumer protection laws, it was necessary to withdraw some of the federal government's preemption authority in order to give state attorneys general a greater scope to enforce consumer protection laws.[350]

But even assuming arugendo that the argument for reduced preemption *might* have made sense prior to Dodd-Frank (a question that need not be resolved here), it no longer does, because a centerpiece of Dodd-Frank was the creation of the CFPB: a new federal consumer protection superregulator with massive powers to enforce consumer protection laws.[351] Thus, if the argument for limiting preemption and empowering state attorneys general was predicated on the lack of dedicated federal enforcement, that argument no longer applies after the creation of the CFPB. Rather than allowing state enforcers to fill an arguable hole in the enforcement regime, Dodd-Frank's scaling back of federal preemption piles state enforcement *on top of* vast new federal rulemaking, examination, and enforcement powers. Thus, instead of underenforcing or optimally enforcing, Dodd-Frank adds the potential for overenforcement by state regulators.[352] This concern about overenforcement is especially troubling in the hands of politically ambitious attorneys general who may see an opportunity to promote themselves by redistributing wealth from out-of-state lenders to in-state consumers.

Even leaving these issues aside, the preemption rules and organizational structure of Dodd-Frank are contrary to any reasonable regime. A standard principle of regulation is that regulatory authority should reside in the level of government most suited to dealing with the regulatory problem—i.e., the national government should regulate issues with interstate spillovers and national effects, while the state government should regulate local matters for which the costs and ben-

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350 *See generally* Arthur E. Wilmarth, Jr., *The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893 (2011) (describing the motivations behind and the effects of Dodd-Frank's changes to the preemptive authority of federal banking regulators).

351 *See supra* notes 25-29 and accompanying text (explaining that consumer financial protection was previously balkanized among agencies, but that changed with the creation of the CFPB, which brought all consumer financial protection activities under one roof).

352 An analogous situation arises with respect to so-called "Little FTC Acts" which duplicate the wording of the FTC Act but, in practice, harm consumers and competition by piling redundant enforcement on top of the measured enforcement and action of the FTC. *See generally* Henry N. Butler & Joshua D. Wright, *Are State Consumer Protection Acts Really Little-FTC Acts?*, 63 FLA. L. REV. 163 (2011) (comparing state "little FTC Act" claims with actual FTC standards to find that state standards often prohibit conduct that is not illegal under FTC standards).

efits are concentrated in a given state.[353] Dodd-Frank turns these propositions on their head. On the one hand, Dodd-Frank peels back preemption and authorizes state officials to enforce regulations promulgated under Dodd-Frank, thereby unleashing state regulators to attack national banks.[354] Because consumer finance operates in a national economy today, this will empower state regulators to interfere in interstate commerce and allow them to externalize the costs of a particular state's rules on residents of other states. On the other hand, however, Dodd-Frank also empowers the national government to regulate entirely local lending (such as payday lending), which has no plausible nexus to interstate commerce.[355] It would be hard to imagine a less coherent interaction of state and federal regulation than that established by Dodd-Frank.

As noted, Dodd-Frank reduces the scope of federal preemption of state consumer protection laws. In addition, Dodd-Frank empowers state officials to enforce regulations promulgated by the CFPB.[356] Thus, even if the CFPB itself is conscious of the defects described above that raise concerns about the CFPB's ability to create an efficient regulatory and enforcement policy,[357] there remains the problem that excessive state enforcement could upset any balanced approach adopted by the CFPB. The legislation does require any state seeking to enforce CFPB regulations to notify the CFPB of its plan to do so,[358] and it also permits the CFPB to intervene in any enforcement action by a state attorney general,[359] presumably to explain to a court that the Bureau does not think that a particular action is consistent with the CFPB's position. Dodd-Frank does not, however, empower the CFPB to actually veto CFPB regulatory enforcement actions brought by state officials.[360] Further, any restraint on state efforts to enforce regulations is likely to be fraught with political controversy, especially in light of the pronounced commitment of the CFPB to preserving an active role for state officials. Moreover, state officials can enforce CFPB regulations against any state-chartered entity,[361] essentially ena-

353 *See* STEARNS & ZYWICKI, *supra* note 81, at 534-35.

354 *See supra* note 346 and accompanying text.

355 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1024, 124 Stat. 1376, 1987 (2010) (codified at 12 U.S.C. § 5514 (Supp. IV 2011)).

356 *See supra* note 346 and accompanying text.

357 *See supra* Part II.

358 Dodd-Frank Act § 1042(b)(1), 124 Stat. at 2013 (codified at 12 U.S.C. § 5552(b)(1)).

359 *Id.* § 1042(b)(2), 124 stat. at 2013 (codified at 12. U.S.C. § 5552(b)(2)).

360 *See id.*

361 *Id.* § 1042(a)(1), 124 stat. at 2012 (codified at 12. U.S.C. § 5552(a)(1)).

bling state officials to impose regulations that may be contrary to the policy choices of their state legislatures. Thus, it is unlikely that allowing redundant state enforcement of federal regulations will result in a balanced consumer protection policy.

Conclusion: The Lessons of History Repeated

Washington responded to the financial crisis that began in 2008 with an onslaught of consumer finance regulation that has turned the market on its head. But while the regulation is new, the unintended consequences it has spawned are quite old. Through initiatives such as the Credit Card Accountability Responsibility and Disclosure Act ("Credit CARD Act") of 2009,[362] the Durbin Amendment to Dodd-Frank,[363] and finally and most importantly, the CFPB itself, Washington has systematically imposed punitive and ill-advised regulation and price controls on core consumer financial products: credit cards, debit cards, and mortgages. The results have been both predictable and tragic: systematically driving consumers out of the mainstream financial system, withdrawing high-quality products, and increasingly forcing consumers to resort to inferior substitutes such as payday lending, overdraft protection, and prepaid cards. And while those products play a valuable and necessary role in the consumer credit ecosystem, it is difficult to fathom the wisdom of government policies that systematically deny consumers access to preferred products while encouraging the use of less-preferred alternatives. Still more frightening is the recognition that even as consumers have increasingly turned to these products as a lifeline to make ends meet, the CFPB stands poised to attack these products for doing exactly that.

This myopic vision ignores the lessons of history, with respect to the evolution of both regulatory policy and the regulation of consumer credit. In the end, this regulatory onslaught will end as an economic matter where it has invariably ended in the past: in the recognition that excessive and unresponsive regulation raises the price of, and reduces access to, high-quality credit, while also harming precisely those that the regulations were purportedly intended to help. The most vulnerable consumers will be deprived of credit choices, resulting in those consumers turning ever more desperately to alternatives such as pawnshops and loan sharks. Just as well-intentioned credit regulation in the post-Depression era eventually spawned a thriving

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362 Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (2009).

363 S. Amend. 3989, 111th Cong. (2010) (as proposed by Sen. Durbin).

class of loan sharks, the current regulatory onslaught against credit cards and bank accounts has produced a thriving market for payday loans and pawnshops.[364] Many consumers, especially lower-income consumers, have limited credit options already; a regulatory policy that raises the cost of lending to these consumers or further deprives them of some of their currently limited choices is unlikely to be a strategy that will make their lives better. This is a conclusion shown again and again both by history and sound economics.

Equally tragic is that the creation of the CFPB reflects a squandered opportunity: an opportunity to update, improve, and bring coherence to the nation's consumer financial protection laws. Decades of regulation and litigation had encrusted complexity and stasis on the consumer finance system, rendering the system unfriendly to consumers, competition, and innovation. Yet rather than sweeping away this sedimentary bed and creating a modern, dynamic regulatory scheme suited to a modern, dynamic industry, the CFPB reflects a return to an archaic model of bureaucratic structure and regulation that was already considered outmoded forty years ago. Regrettably then, the CFPB's biggest cost might be a decade or more of lost opportunity as we relearn the lessons that were taught so painfully in the 1970s.

In the hands of an agency with such radical design flaws as the CFPB, this is a recipe for disaster. Sensible reform proposals to the CFPB's structure have been proposed and should be adopted, sooner rather than later. In the meantime we will relearn the tragic lessons of history, both with respect to the institutional design of regulation as well as the dangers of wrong-headed consumer credit regulation.

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364 *See* Lynn Cowan & Isabel Ordóñez, *Short-Term Lenders Seize the Day*, WALL ST. J., Oct. 19, 2011, at C4.