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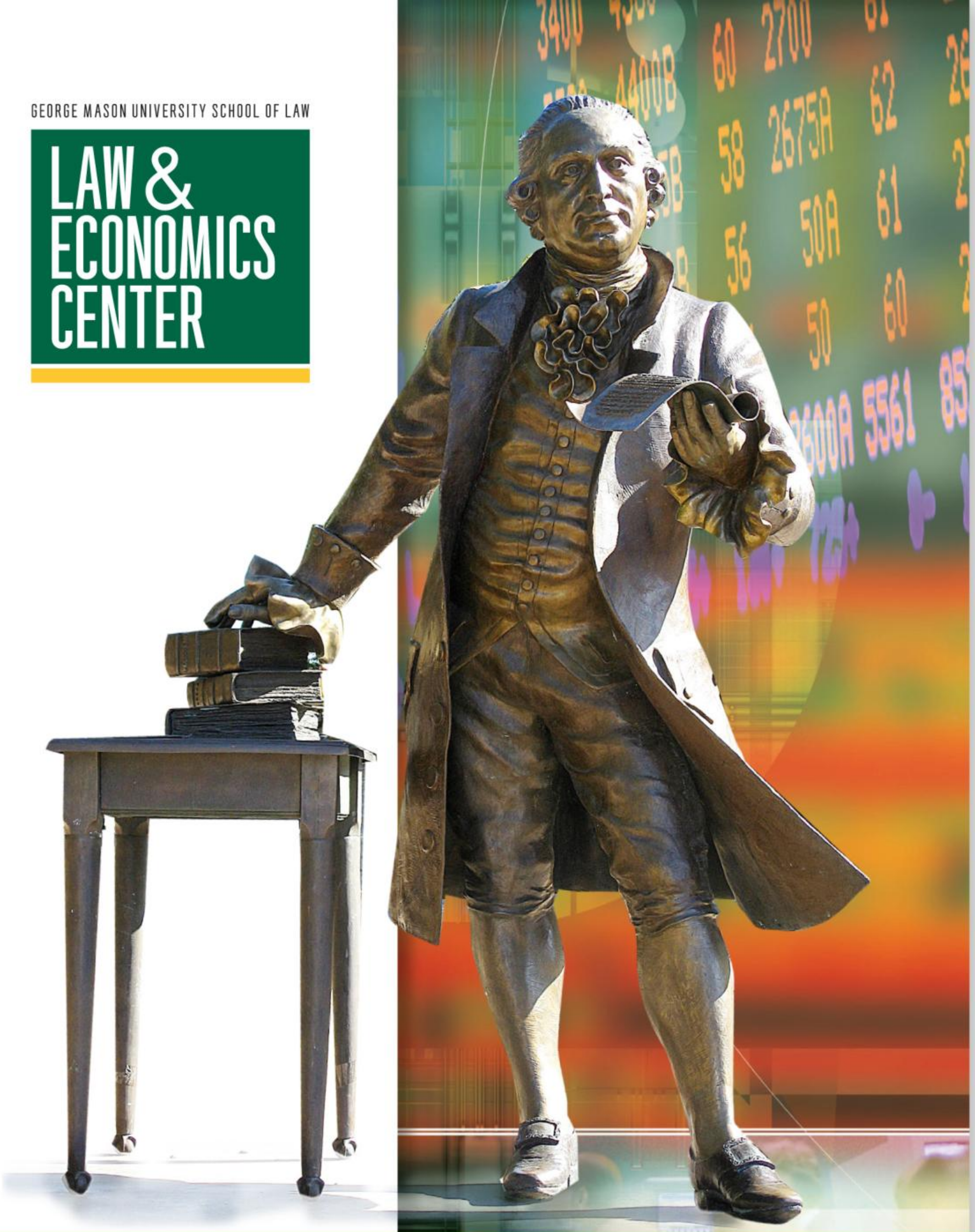

Workshop on Administrative Law and the States:

Case Study: Dodd-Frank

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LEGAL & ECONOMIC ANALYSIS. PUBLIC POLICY IMPACT.

Introduction

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- Need for a single agency
- The Revenge of Richard Nixon
- Learned in the 1970s why we don't design agencies like this anymore
- Scholars of Bureaucratic Behavior
  - Tunnel vision
  - Imperialism
  - Highly Political

Traditional Agency Design

- Need for single agency (but note preemption)
- Executive Agencies: Accountability
- Independent Commissions: Deliberation and Congressional Oversight
- Federal Trade Commission
- CFPB is neither:
  - An Independent Agency Inside Another Independent Agency
  - Single Director: Five-Year Term Removable Only for Cause
  - Guaranteed Budget
  - No OIRA Control
  - Limited Safety and Soundness Control
  - Statutory-Based *Chevron* Deference

Is CFPB “Different”?

- Says it is different because of “Evidence-Based Policy-Making”
- Thus, doesn’t need accountability (i.e., “politics”) or deliberation (because decisions are “facts” not “opinions”)
- But politics is everywhere
- Policy-Based Evidence Making
- No reason to treat it different from FTC or others

Chicago Fed Study

- "**We find that complex mortgages are used by households with high income levels and prime credit scores, in contrast to the low income population targeted by sub-prime mortgages.** Complex mortgage borrowers have significantly higher delinquency rates than traditional mortgage borrowers even after controlling for leverage, payment resets, and other household and loan characteristics. Our analysis of dynamic default patterns, bankruptcy filings, and household characteristics **suggests that complex mortgage contracts attract sophisticated borrowers who are more strategic in their default decisions**."

CFPB Rule

- **"In their later incarnations, interest-only and negatively amortizing loans (along with loans with terms greater than 30 years) were often sold on the basis of the consumer's ability to afford the initial payments and without regard to the consumer's ability to afford subsequent payments once the rate was recast…. The lower payment possibility for these loans allows borrowers to qualify for loans that they otherwise may not have been able to afford; but this comes with the same risks just described. The performance of many of these loans was also very poor, and worse than expected, with the onset of the downturn.** [Footnote 196 in rulemaking reference to "Complex Mortgages" study.] The final rule does not ban such products outright, but rather requires that lenders that make such loans have a "reasonable and good faith" belief in the borrower's ability to repay and that in formulating such a belief the lender must calculate the monthly payment based on the fully indexed rate and fully amortizing payments, and does not allow these loans to enjoy the presumption of compliance associated with qualified mortgage status. **The new underwriting requirements, coupled with the liability for violating these rules, should deter improper loans and ensure proper underwriting and diligence when making such loans; again limiting cases of personal or social harm."**

“Teaser” Rates

- Economists: No Evidence
- CFPB: “The evidence is mixed on whether payment shock at the initial interest rate adjustment causes default”
- Yet teaser rates essentially banned by QM

Moral Hazard and Incentives

- What QM doesn't do
- Equity Retention
- Downpayments
- Anti-Deficiency Laws

Implications

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- Plain Vanilla through the back door
- Banks exiting low-income mortgage lending
- Not a safe harbor from ECOA so still too risky for many

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Auto Dealers under Dodd-Frank

- **SEC. 1029. EXCLUSION FOR AUTO DEALERS.**

  (a) SALE, SERVICING, AND LEASING OF MOTOR VEHICLES EXCLUDED.—Except as permitted in subsection (b), the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both.

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CFPB Bulletin 2013-02 (March 21, 2013)

- "The supervisory experience of the CFPB confirms that some indirect auto lenders have policies that allow auto dealers to mark up lender-established buy rates and that compensate dealers for those markups in the form of reserve (collectively, 'markup and compensation policies'). **Because of the incentives these policies create, and the discretion they permit, there is a significant risk that they will result in pricing disparities on the basis of race, national origin, and potentially other prohibited bases**."

Implications

- End run around congressional preferences
- No indication of methodology, thresholds, statistical methods
- End-run around rulemaking: No cost-benefit analysis, notice and comment
- No discussion of possible unintended consequences to consumers of cars and car loans of remaking entire industry under flat-fee arrangement
- No understanding of industry: especially captive lenders (promotional financing deals, etc.)
- Could dampen competition and result in higher prices for many consumers
- Regulation by bullying: Turn the financing providers into the enforcers

Data Mining Operations

- 85% of Credit Card Accounts (991 Million)
- 90% of Mortgages
- Risk of breach and harm to consumers
- Privacy concerns
- Expense to banks
- Only want to collect as much as necessary to further regulatory purposes
- Do they need that much data?

Data Mining

- No They Don't
- Thomas Stratman (http://mercatus.org/sites/default/files/StratmannCFPBStatisticMethods.pdf): Only need 1.4 million accounts to get statistical significance at 99th Percentile
- CFPB requesting 70,000% more accounts than necessary for any regulatory purpose

Payday Lending

- Payday Lending White Paper: Found average number of loans and days of loans outstanding to be very high
- But blatant methodological flaw: Just took loans outstanding on a given date instead of just new loans
- CFPB Data Point: White Paper “approach includes more borrowers who are in long sequences, and therefore the median number of loans, 11, is higher than for the other two approaches.” By including *all* borrowers or new borrowers, the median number of loans is 6

Overdraft Protection

- CFPB White Paper
- Most banks have eliminated direct-deposit advance products
- Supposed to determine what “alternatives consumers have for meeting short-term shortfalls.”
- Flores and Zywicki (Mercatus Commentary):
- White Paper states that approximately 90% of banks that offer overdraft protection also offer some sort of “linked credit line for overdraft protection.”
  - But those who use it can’t get credit lines
- Opt-In: Heaviest users more likely to opt-in

Preemption and Federalism

- Preemption turned on its head
  - Federal government regulating local level
  - State governments enforcing federal law
  - Worst of all worlds
- Remember why we limited preemption in the first place
- Opportunity for coordination

Case Study Of Cooperation: Overdraft and Payday Lending

- Overdraft traditionally federal: bank regulators and supervision
- Payday traditionally state: enforcement and consumer protection
- Consumers use both and compete against each other
- Consumer protection concerns are similar
- Optimal policy for each depends in part on the other
- Opportunity for pro-consumer, pro-competition policy

Why Agency Design Matters

- Congressional Oversight: Sticks Matter
- Bipartisan Commission Structure:
  - Deliberation
  - Expertise:
    - Consumer Protection
    - Safety & Soundness
    - Policy
    - Rule-Making
    - Enforcement