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ASSESSING THE EFFECTS OF CONSUMER FINANCE REGULATIONS

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Committee on Banking, Housing, and Urban Affairs

Thank you chairman Shelby, ranking member Brown, and members of the committee. It is my pleasure to testify this morning on the crucially important topic of "Assessing the Effects of Consumer Finance Regulations."

Enacted into law in July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was animated in large part by the belief that a primary source of financial instability was an inadequate consumer financial protection regime at the federal level. Dodd-Frank sought to address those perceived deficiencies both by substantive legislation (for example, by banning binding arbitration provisions in mortgages) and by creating the Bureau of Consumer Financial Protection (CFPB) within the Federal Reserve and vesting that new super-bureaucracy with vast rule-making, litigation, and supervisory powers over all consumer credit products and services.

Let me stress at the outset that at the time of Dodd-Frank I supported the need to unify consumer financial protection policy under a single agency. Based on my long study of consumer finance and its regulation as well as my hands-on experience as the Director of the Federal Trade Commission's Office of Policy Planning I believe that the regulatory framework that existed prior to Dodd-Frank was too fragmented and too cumbersome to effectively regulate the full range of consumer financial protection products at the federal level. Competition and consumer choice in consumer financial products doesn't follow arbitrary product and geographic lines—for example, many consumers view payday loans and overdraft protection as close substitutes even though overdraft protection is provided by billion-dollar banks and payday loans are offered by street-corner storefronts. Strong, consistent, economically-informed consumer protection policy is essential to a thriving consumer credit system that allows consumers to access credit, build wealth, and climb the ladder of opportunity, through access to credit cards, bank accounts, and mortgages.

The tragedy of Dodd-Frank and the CFPB is that it squandered this unprecedented opportunity to modernize the consumer credit system to promote competition, consumer choice, and innovation. Instead, the post-crisis regulatory framework has resulted in higher prices and reduced choice for consumers and little improvement in consumer financial protection. Indeed, by stifling competition and driving millions of Americans out of the mainstream financial system, it may actually result in more consumer protection problems.

Although this sorry result for American consumers is tragic, it is hardly surprising. The failure of Dodd-Frank's regulatory agenda to promote the interests of consumers was built in from the beginning.[1] The CFPB is vested with extraordinarily broad powers to regulate virtually every consumer credit product in America under the vague charge to prevent "unfair, deceptive, and abusive" acts and practices. At the same time, this vast power is vested in an agency with an unprecedented lack of democratic accountability. Under the statute, the president can nominate the director, but once confirmed the director can be removed only "for cause."[2] Furthermore, the CFPB is outside Congress's appropriations power, and is authorized to spend hundreds of millions of taxpayer dollars every year with no accountability to the American people.

Given this extreme lack of democratic accountability, the CFPB has done what all bureaucracies tend to do: it has constantly expanded its power, promoted its own bureaucratic interests at the expense of the public and American families, and trampled under foot other public policies, such as consumer choice and financial innovation.

The impact on American families and the economy from the actions of this unaccountable super-regulator has been disastrous:

- By imposing a regulatory regime that substitutes the judgment of bureaucrats for consumer decisions, Dodd-Frank has raised prices and cut off access to mortgages, credit cards, and bank accounts, harming millions of American families that use credit to improve their lives and depressing economic growth.[3]
- By stripping consumers of mainstream financial products such as mortgages, credit cards, and bank accounts, Dodd-Frank has driven the most vulnerable

[1] Todd J. Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEORGE WASHINGTON L. REV. 856 (2013).
[2] *But see* Statement of Barney Frank, "Hearing Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, U.S. House of Representatives, (Feb. 15, 2012) at p. 8 ("Just a couple of points—first of all, this notion that the director cannot be removed is fanciful. It says in the statute that, yes, the director is appointed for a 5-year term, but can be removed by the president for insufficiency, neglect of duty, or malfeasance. No one doubts that if a change in administration comes, and the new president disagrees with the existing director, he or she can be removed. And proving that you were not inefficient, the burden of proof being on you, would be overwhelming.").
[3] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL E. STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (Oxford, 2014).

Americans into the arms of check cashers, pawn shops, and payday lenders, increasing their reliance on those products for which sharp practices are most feared. Those products meet an urgent need for many consumers, yet there are few who believe that consumers are made better off when they are driven to use these products involuntarily because of their loss of mainstream products.

- The crushing regulatory compliance cost burden and destruction of community banks' traditional relationship lending model has accelerated consolidation of the retail banking system, making big banks even bigger and further eliminating competition and choices for consumers.
- The CFPB has launched a massive data-mining program that collects data on hundreds of millions of consumer credit cards, mortgages, bank accounts, and other products, an appetite for consumer information that far exceeds any reasonable regulatory purpose. Not only do these data-mining operations impose costs on banks and their customers, the scale of the data-collection efforts creates unprecedented threats to privacy and risks to personal information security.
- The CFPB has announced plans to effectively prohibit consumers and financial institutions from agreeing to have disputes under the contract resolved through arbitration by prohibiting bans on class action litigation. Yet the agency's proposed action is based on a terribly flawed study that fails to demonstrate the CFPB's premise that consumers are harmed by agreeing to arbitration or that they will be benefited by unleashing class action lawyers. Moreover, the findings of the study actually rebut much conventional wisdom regarding arbitration.
- The CFPB has announced plans to regulate payday loans and other small dollar lending products in a fashion that dramatically reduce access to their use yet has provided no workable plan for addressing the lack of financial inclusion for which many small dollar loans are the response.
- Because many small, independent, kitchen-table businesses use products such as personal credit cards, home equity loans, and auto title loans in financing their businesses, the CFPB's powers reach into all of these small businesses as well.

After five years, have Dodd-Frank and the CFPB made American families better off? No. Instead, the overall impact of Dodd-Frank has been to slow our economic recovery, raise prices, reduce choice, and eliminate access to the financial mainstream for American families. And low-income Americans have been hit the hardest.

Bank Accounts and The End of Free Checking for Millions of Americans

The years 2001 to 2009 saw one of the most important pro-consumer innovations in the history of retail consumer financial services: the rapid spread of near-universal consumer access to free checking.[4] It is estimated that during that period, consumer access to free checking accounts increased from under 10 percent of all bank accounts to 76 percent. In the years since Dodd-Frank, however, the number has collapsed to half of that amount—38 percent, as shown in figure 1.[5]

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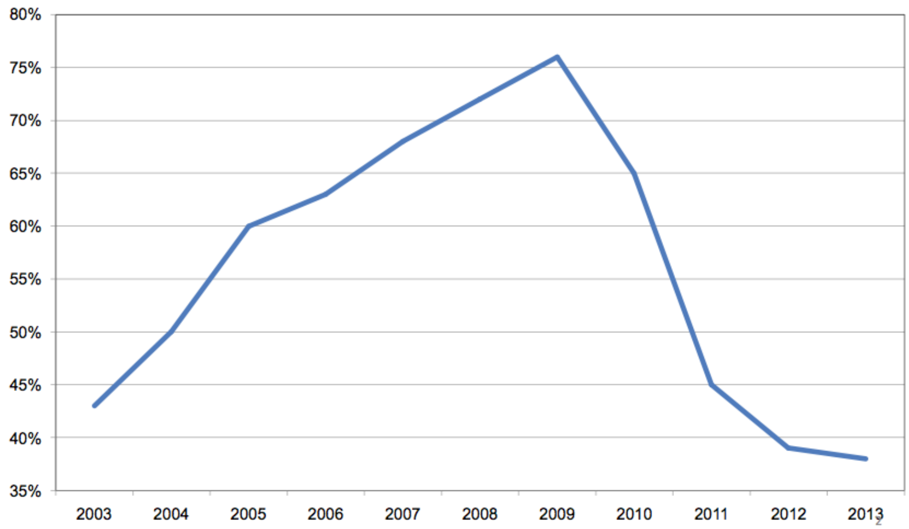
[4] Todd J. Zywicki, Geoffrey A. Manne, and Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (June 4, 2014), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.
[5] *Id.* at 6, figure 1.

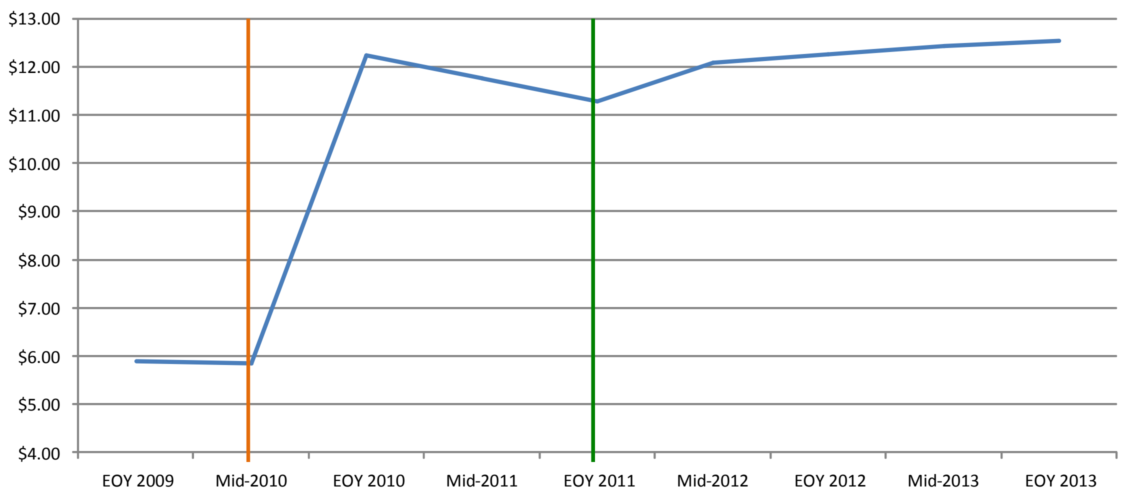
Figure 1. Banks Offering Free Checking from 2003 to 2013



Source: Bankrate.com.

Not only are more consumers forced to pay fees to maintain their checking accounts, those (and other) fees have soared. Fees are twice as high on average as before Dodd-Frank was enacted, as shown in figure 2.[6]

Figure 2. Monthly Maintenance Fee (Non-Free Checking)



[6] *Id.* at 8, figure 4. Mid-2010, of course, is when Dodd-Frank was passed into law. EOY 2011 marks the period at which regulations from the Federal Reserve System (Federal Reserve) regulations implementing the "Durbin Amendment" to Dodd-Frank became effective.

Source: MoneyRates.com.

Figure 2 shows trends in the amounts of monthly maintenance fees for non-free checking accounts since 2009. The first bar (marked mid-2010) marks the date on which Dodd-Frank was signed into law in July 2010, including the Durbin Amendment. Moreover, the passage of the Durbin Amendment with its "hard cap" price controls on permissible interchange fees was completely unexpected. The Durbin Amendment was a last-minute floor amendment to Dodd-Frank and had never been seriously considered previously in any committee prior to being proposed and adopted on the floor. As a result, there was not anticipatory increase in bank fees prior to July 2010, as would have been the case had the enactment of the Durbin Amendment been expected.

The second bar (marked EOY 2011) captures the date at which the Federal Reserve's rule-making went into effect (October 2011). As can be seen, there was a second jump in average bank fees around the period that the Durbin Amendment went into effect.

Moreover, this decline in access to free checking and increase in bank fees has taken place *only* at those banks subject to the Durbin Amendment, larger banks with over $10 billion in assets.[7] In contrast to the dramatic reduction in free checking at large banks, there is no sign of a reduction in access to free checking or increased fees at banks that are not subject to the Durbin Amendment's price controls. In fact, there is some evidence that free checking might have actually increased slightly at exempt banks. This suggests that the loss of access to free checking and higher bank fees is the result of the Durbin Amendment, a factor unique to larger banks, and not general economic conditions or heightened regulation generally.

Most troubling, however, is that low-income and other vulnerable populations have been most adversely impacted by Dodd-Frank's destruction of access to free checking: according to the FDIC, the number of unbanked consumers increased by 1 million between 2009 and 2011 and the number of underbanked consumers increased still faster.[8] While economic recovery has reversed some of those losses for lower-income consumers, the impact of Dodd-Frank has put bank accounts—once the first rung on the ladder of financial inclusion—out of the reach of millions of young and lower-income Americans, forcing them to rely on alternative financial services such as check cashers and pawn shops.

And while the Durbin Amendment has saved big box retailers billions of dollars per year in interchange fees, there is no evidence to date that those cost savings have been passed on to retail consumers. In short, consumers are paying higher fees for bank accounts and receiving no rebates from retailers.[9] Indeed, unlike big box retailers that have received

[7] *Id.* at 10-13.
[8] FEDERAL DEPOSIT INSURANCE CORPORATION, 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf;
[9] Zhu Wang, Scarlett Schwartz, and Neil Mitchell, *The Impact of the Durbin Amendment on Merchants: A Survey Study*, 100(3) RICHMOND FEDERAL RESERVE ECONOMIC QUARTERLY 183 (3Q 2014).

multi-billion dollar windfalls, many small retailers are actually paying *higher* merchant discount rates than before the Durbin Amendment's enactment.[10]

Credit Cards

Consumers have also suffered a loss of access to credit cards in the post-crisis era, not only because of Dodd-Frank but also the impact of the Credit Card Accountability Responsibility and Disclosure Act—and once again, low-income consumers have suffered the most. According to the CFPB's own estimates, the period between July 2008 and December 2012 saw the closure of 275 million credit card accounts and elimination of $1.7 trillion in credit card line of credit.[11] Overall, the CFPB found a significant decline in the percentage of households that had cards, from 76 percent to 71 percent. But even this figure understates the disproportionate impact on low-income consumers. According to Federal Reserve Board economists Glenn Canner and Gregory Elliehausen, the percentage of households in the lowest quintile of credit scores with credit cards fell from 65 percent in 2008 to 54 percent in 2010.[12] Loss of access to credit cards has forced those consumers into great reliance on higher-cost products such as payday loans and overdraft protection.[13]

Mortgages

The CFPB's "qualified mortgage" (QM) and "ability to repay" rules have dramatically slowed the recovery of the housing market, and fears of government liability have caused even large lenders to reduce lending substantially, especially to riskier borrowers. As Janet Yellen has noted, "banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores."[14] Despite the heavy regulatory burden imposed by the CFPB's mortgage rules, however, the rules are silent with respect to one of the most important risk factors for mortgage foreclosures—the reduction or elimination of minimum down payment requirements.[15] Nor do the rules address state antideficiency laws or cash-out

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[10] *See* Zywicki, *et al.*, *supra* note 4.

[11] CONSUMER FINANCIAL PROTECTION BUREAU, CARD ACT REPORT: A REVIEW OF THE IMPACT OF THE CARD ACT ON THE CONSUMER CREDIT MARKET 56 (Oct. 1, 2013).

[12] Glenn B. Canner and Gregory Elliehausen, *Consumer Experiences with Credit Cards* at 10 Table 2, FEDERAL RESERVE BULLETIN (Dec 2013), online at http://www.federalreserve.gov/pubs/bulletin/2013/pdf/consumer-experiences-with-credit-cards-201312.pdf. By contrast, for highest-quintile households, card holding fell only one percentage point (from 91 percent to 90 percent of households).

[13] *See* Robert L. Clarke and Todd J. Zywicki, *Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau*, 33 REVIEW OF BANKING AND FINANCIAL LAW 235 (2013-14).

[14] *See* Federal Reserve Board, *Transcript of Chairman Yellen's Press Conference* at p. 12 (June 18, 2014):

> Banks, at this point, are reluctant to lend to borrowers with lower FICO [credit] scores. They mention in meetings with us consistently their concerns about put-back risk, and I think they are—it is difficult for any homeowner who doesn't have pristine credit these days to get a mortgage. I think that is one of the factors that is causing the housing recovery to be slow. And of course, you know, there were a lot of practices in connection with mortgage lending that really needed to be changed, we don't want to go back to those days, but it is important to clarify—for us to work to clarify the rules around mortgage lending to create an environment of greater certainty for lenders to be willing to extend mortgage credit.

[15] *See* Zywicki, *supra* note 1, at 913.

refinancing by homeowners, both of which have been shown to have materially contributed to the foreclosure crisis.[16]

As a result of the regulations imposed by Dodd-Frank and the CFPB many smaller banks have simply chosen to exit the market rather than to bear the regulatory cost and risk. According to a survey of small banks conducted by the Mercatus Center at George Mason University, 64% of small banks reported that they were making changes to their mortgage offerings because of Dodd-Frank and 15 percent said that they had either exited or were considering exiting residential mortgage markets entirely.[17] Nearly 60 percent of small banks reported that the CFPB or the qualified mortgage rule had a "significant negative impact" on their mortgage operations. Nearly 60 percent said that the CFPB has had a significant negative effect on bank earnings and more than 60 percent said that changes in mortgage regulations had had a significant negative effect on bank earnings.

Moreover, by imposing a one-size-fits-all mechanical underwriting system for mortgages, the Qualified Mortgage rule has deprived community banks of a significant competitive advantage over megabanks: their intimate familiarity with their customers and their ability to engage in relationship lending with their customers. One illustration of the value of the traditional relationship-lending model for residential mortgages is that the default rate for residential mortgages made by community banks (with less than $1 billion in assets) was 3.47 percent in 2013 compared to a default rate of 10.42 percent for banks with more than $1 billion in assets.[18] Thus, this regulatory-induced decline in the market share of small banks is not only hurting consumers, it is making the banking system less stable and less effective. Consumers face a market with fewer choices, less innovation, and less competition than before.

As many banks have exited the mortgage market,[19] non-bank lenders (typically less-regulated than banks) have filled the market demand, increasing their share of mortgage lending from 10 percent in 2009 to 43 percent in 2015.[20] Ironically, one consequence of

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[16] *See* Todd J. Zywicki and Joseph Adamson, *The Law and Economics of Subprime Lending*, 80 UNIVERSITY OF COLORADO L. REV. 1 (2009) (summarizing studies). In fact, Section 1414(g) of Dodd-Frank Dodd-Frank actually mandates new disclosures before a consumer loses his or her anti-deficiency law protection, a provision that will increase defaults and foreclosures in the event of a future downturn in housing prices. Other provisions of Dodd-Frank, including new regulations on mortgage servicing companies and new substantive regulations on foreclosure processes under Dodd-Frank Section 1413, will also increase the cost and length of the mortgage foreclosure process, which also has been shown to lead to increased defaults and foreclosures.

[17] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Fairing Under Dodd-Frank?* Mercatus Center Working Paper No. 14-05 (Feb. 2014).

[18] *See* FDIC Statistics on Depository Institutions, accessed July 16, 2013, http://www2.fdic.gov/sdi/main.asp. Loans in default are defined as nonaccrual loans or loans past due 30 or more days. These data include one to four family residential properties.

[19] *See supra* note 14.

[20] *See* Diana Olick, *How Dodd-Frank Changed Housing, for Good and Bad*, CNBC.COM (Jul. 16, 2015), *available in* http://www.cnbc.com/2015/07/16/how-dodd-frank-changed-housing-for-good-and-bad.html.

Dodd-Frank and the CFPB's aggressive regulation and litigation against banks has been to drive consumers toward a variety of lenders with less regulatory scrutiny.[21]

At the same time, because the Qualified Mortgages rule and other elements of Dodd-Frank fail to address the underlying structure of incentives for consumers when housing prices fall, there is little evidence that Dodd-Frank and the regulations promulgated pursuant to it will actually accomplish their goal of reducing foreclosures in a future downturn. Peter Wallison, former general counsel of the Department of the Treasury, estimated that had the QM rules applied in the period leading up the financial crisis, the default rate on QM–conforming mortgages would have still been 23 percent.[22] Summarizing the assembled conclusions of several studies, economist Mark Calabria concluded that the proposed restrictions on debt to income ratios in the QM and QRM (Qualified Residential Mortgages) rules "appear to have very modest impacts on projected defaults."[23] Requiring lower loan-to-value ratios (such as by requiring larger down payments or restricting cash-out refinancing), by contrast, would have substantially reduced defaults and foreclosures during the financial crisis[24]; however, the final mortgage rules eliminated any minimum down payment requirements for QM and QRM mortgages, thus eliminating one of the reforms that would have had the most significant effect on foreclosures.

Although the new mortgage rules are expected to have very little impact on reducing defaults, they have had a large impact on reducing mortgage lending, especially in the subprime market.[25] In substantial part, the imposition of reams of bureaucratic red-tape and paperwork has made it more of a hassle for consumers to apply for and receive a mortgage.[26] For example, the "average large bank underwriter could process about 165 loans per month in 2005 but can only do about 33 today."[27] According to industry analyst

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[21] Let me emphasize that I am *not* implying that just because non-bank lenders are less lightly regulated and supervised that one should infer that they are engaging in malfeasance. But for the architects of Dodd-Frank it is hard to see how this would be considered a desirable effect of the law and regulation.
[22] PETER WALLISON, HIDDEN IN PLAIN SIGHT: WHAT REALLY CAUSED THE WORLD'S WORST FINANCIAL CRISIS AND WHY IT COULD HAPPEN AGAIN (2015).
[23] Testimony of Mark A. Calabria, Ph.D. Director, Financial Regulation Studies, Cato Institute Before the Committee on Financial Services United States House of Representatives Hearing entitled "The Dodd-Frank Act Five Years Later: Are We More Stable?" (July 9, 2015) at 13; *see also id.* at 13 n.16 ("The presence of a DTI in excess of 41 percent increases the probability of default by 0.25, 0.08, and 0.59 for fixed rate, long-term ARM and Hybrid ARM, respectively. Accordingly to GAO's analysis, reducing the prevalence of mortgages with a DTI in excess of 41 will have barely notice effects (although statistically significant in all cases)" (citing UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE. 2010. NONPRIME MORTGAGES: ANALYSIS OF LOAN PERFORMANCE, FACTORS ASSOCIATED WITH DEFAULTS, AND DATA SOURCES. Report to Congress, GAO-10-805 (Aug. 2010).
[24] Calabria Testimony, *supra* note 23, at 13-14 ("For fixed rate non-prime purchase loans, moving from a LTV of 100 to under 80 percent reduces projected default probabilities by over 3 percentage points. For hybrid non-prime ARMs, the reduction in projected default probabilities is just over 6 percentage points. Coupled with full documentation and a LTV under 80 percent, one could eliminate over 70 percent of the standardized default risk among hybrid non-prime ARMs. Academic studies have arrived at similar conclusions when examining the drivers of default among subprime mortgages.").
[25] *Id.*
[26] *See* Olick, *supra* note 20.
[27] *Id.*

Realtytrac, by 2013 the U.S. Mortgage market had recovered to the extent that mortgage originations had increased to over 2.5 million per quarter, exceeding $600 billion in mortgages originated. Following the roll out of the QM proposal in 2013, however, mortgage originations collapsed to under1.5 million per quarter (and less than $400 billion in amount) and have remained below the pre-QM levels since.[28] Although the high costs imposed by the implementation of the CFPB's new TRID integrated mortgage disclosure forms may be temporary to some extent, it has imposed still further regulatory cost and complexity that has continued to drag down recovery in the mortgage market.[29]

Disappearing Small Banks

The regulatory costs imposed by CFPB and Dodd-Frank have fallen particularly heavily on smaller community banks and credit unions. Although consolidation in the banking industry was occurring prior to Dodd-Frank, Dodd-Frank has accelerated these trends by driving out smaller community banks that comparatively lack the resources to comply with Dodd-Frank's crushing and ham-fisted regulatory burden. For example, a recent study by scholars at the Kennedy School of Government found that in the period since Dodd-Frank was enacted, the asset bases of smaller banks have shrunk twice as fast after Dodd-Frank's enactment compared to before, a result that they attribute to the high regulatory costs imposed by Dodd-Frank.[30] In addition, the Mercatus Center study of the impact of Dodd-Frank on smaller banks found that the law has imposed huge compliance costs on small banks and that they have been less able to bear those costs than large banks.[31] Overall, according to the Mercatus Center study, 71 percent of small banks stated that the CFPB has affected their business activities.[32]

The ripple effects of the displacement of smaller banks by large banks are not limited to the direct impact on the consumer banking system but carry over to other markets as well, including agricultural and small business loans. Community banks traditionally have provided a disproportionate share of small-business lending in the economy.[33] According to the summary of one report by Goldman Sachs:

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[28] Realtytrac, U.S. Residential Loan Originations Increase 17 percent in Q1 From a Year Ago Depsite 6 Percent Drop From Previous Quarter (May 14, 2015), *available in* http://www.realtytrac.com/news/realtytrac-reports/q1-2015-u-s-residential-loan-origination-report/.

[29] *See* RealtyTrac, *U.S. Residential Loan Originations Decrease14 Percent in Fourth Quarter Driven by 24 Percent Drop in Purchase Loans*, REALTYTRAC.COM (Feb. 16, 2016), *available in* http://www.realtytrac.com/news/mortgage-and-finance/q4-2015-u-s-residential-property-loan-origination-report/; *see also* Brena Swanson, *It's Official: TRID Kills Mortgage Profits*, HOUSINGWIRE.COM (March 17, 2016), http://www.housingwire.com/articles/36541-trid-slashes-independent-mortgage-banks-profits-by-60.

[30] Marshall Lux and Robert Greene, *The State and Fate of Community Banking*, M-RCBG Associate Working Paper No.37 (February 2015) online at http://www.valuewalk.com/wp-content/uploads/2015/02/Final_State_and_Fate_Lux_Greene.pdf.

[31] Hester Pierce, Ian Robinson and Thomas Stratmann, *How Are Small Banks Fairing under Dodd-Frank?*, George Mason University Mercatus Center Working Paper No. 14-05 (February 2014), online at http://mercatus.org/publication/how-are-small-banks-faring-under-dodd-frank; *see also*

[32] Hester Peirce, Ian Robinson, and Thomas Stratmann, *How Are Small Banks Fairing Under Dodd-Frank?* Mercatus Center Working Paper No. 14-05 (Feb. 2014).

[33] GOLDMAN SACHS, THE TWO-SPEED ECONOMY (Apr. 2015), *available in* http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/2-speed-economy-report.pdf;

> While there is some added subtlety to the results of our analysis, we find in general that low-income consumers and small businesses – which generally have fewer or less effective alternatives to bank credit – have paid the largest price for increased bank regulation. For example, for a near-minimum wage worker who has maintained some access to bank credit (and it is important to note that many have not in the wake of the financial crisis), the added annual interest expenses associated with a typical level of debt would be roughly equivalent to one week's wages. For small and mid-sized businesses the damage from increased bank regulation is even greater: their funding costs have increased 175 basis points more than those of their larger peers, when measured against the pre-crisis period. That funding cost differential is enough to seriously damage the ability of smaller firms to compete with their larger competitors. This fact has become all too evident in the economic statistics and is already changing the shape of American business, as small and mid-sized firms, the historic engines of US job creation, shrink and sometimes disappear, displaced by large corporations.[34]

As community banks have been driven out of the market by regulatory costs, small business credit has contracted as well, dampening entrepreneurship and economic growth. As noted by one analysis, large firms have performed well since the financial crisis and subsequent recovery, but small firms have suffered low rates of formation, employment growth, and wage growth.[35] Indeed, the number of small firms in the economy actually declined over the period since the crisis, as more small firms disappeared than were created, the first time that this has happened since data became available in the 1970s.[36]

A primary explanation for this drop in small business formation and growth is Dodd-Frank and increased financial regulation since the financial crisis, which has fallen especially hard on smaller banks relative to larger banks.[37] Overall, a recent analysis of FDIC data found that while bank loans to small businesses had declined by 16% since 2008, loans to large businesses had increased by 37% over that same period.[38] As one commenter described the situation, large banks "have effectively abandoned the small business market."[39] Another analysis concluded that small business loans are down about 20 percent since the financial crisis while loans to larger businesses have increased by

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Lux & Greene, *supra* note, at 1 (noting that community banks provide 77 percent of agricultural and over half of small business loans).

[34] GOLDMAN SACHS, WHO PAYS FOR BANK REGULATION? 2-3 (June 2014); http://www.goldmansachs.com/our-thinking/public-policy/regulatory-reform/who-pays-for-bank-regulation-pdf.pdf.

[35] Goldman Sachs, *The Two-Speed Economy* 2 (April 2015).

[36] *Id.*

[37] Goldman Sachs, *Who Pays for Bank Regulation*, *supra* note.

[38] Ruth Simon, *Big Banks Cut Back on Loans to Small Business*, WALL ST. J. (Nov. 26, 2015).

[39] *Id.*

about 4 percent over the same period.[40] It appears that some of the unmet demand from the reduction in community bank lending is being served by non-bank lenders that charge higher rates than traditional small business bank loans and which, ironically, are much less-regulated that the traditional banks that they have replaced.[41]

According to Wells Fargo Quarterly survey of small business owners, in the 3rd Quarter of 2015, just 33% of small business owners surveyed stated that it would be "very easy" to obtain credit if they needed it and 22% said that it would be "somewhat difficult" or "very difficult."[42] By contrast, during the period from the 1Q2004-4Q2007, an average 51% of small business owners said that it was "very easy" or "somewhat easy" to obtain credit if they needed it, and about 12% said it would be difficult. In addition, among those who said that it was easy to obtain credit in the 2004-07 period, 2/3 of those reported it was "very easy" compared to "somewhat easy," whereas only about half of those who said that it would be easy in the 2015 pool reported that it would be "very easy."

As smaller banks have been disappearing and exiting certain markets, large banks have grown still larger and Dodd-Frank has increased their insulation from competitive pressures. In fact, large banks have admitted as much. For example, JP Morgan Chase CEO Jamie Dimon observed that the aggregate costs of complying with all of the rules, regulations, and capital costs associated with Dodd-Frank has built a "bigger moat" to protect his bank from competition from smaller rivals.[43] Similarly, Goldman Sachs CEO Lloyd Blankfein announced in 2010 that the bank would be "among the biggest beneficiaries" of Dodd-Frank as its regulatory costs and regulatory-created profit opportunities would be particularly advantageous to large banks that could bear those costs more easily than smaller competitors.[44]

Moreover, because many of Dodd-Frank's most expensive rules kick-in once a bank reaches $10 billion in assets, that figure acts as a sort of tripwire—either banks try to remain below that threshold, or if they do cross it, then they accelerate their merger activities to try to gain the size and economies of scale necessary to cope with heightened regulatory costs. Thus, the market is becoming increasingly bifurcated between large

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[40] *See* Karen Gordon Mills & Brayden McCarthy, *The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game*, Harvard Business School Working Paper 15-004 (July 22, 2014).
[41] *Id.*
[42] Gallup/Wells Fargo Small Business Survey 24-25, https://wellsfargoworks.com/File/Index/btDsu4gv9UqK07hpFKVbgw (Oct. 3, 2015) (responses to Question 11).
[43] Rick Rouan, *Dimon says Dodd-Frank puts 'bigger moat' around JPMorgan Chase*, COLUMBUS BUSINESS FIRST (Feb. 5, 2013), *available in* http://www.bizjournals.com/ columbus/blog/2013/02/dimon-says-dodd-frank-puts-bigger.html.
[44] Timothy P. Carney, *Goldman and JPMorgan sit safely behind the walls of Dodd-Frank*, WASHINGTON EXAMINER (Feb. 12, 2015), *available in* http://www.washingtonexaminer .com/goldman-and-jpmorgan-sit-safely-behind-the-walls-of-dodd-frank/article/ 2560179.

banks and very small banks, as medium-sized banks grow larger.[45] On the other hand, only one new bank has been formed since the financial crisis and small banks continue to merge or otherwise disappear as a result of their own regulatory costs. This phenomenon of the disappearance of small banks and the lack of creation of new ones led economists from the Dallas Federal Reserve bank to ask whether small banks are "too small to succeed" in light of the huge growth in regulatory cost and complexity imposed in the period since the financial crisis.[46] They too note the important role played by community banks in small business lending and agricultural markets and the adverse effects on small-business formation and growth as a result of this trend toward the disappearance of small banks.

Perhaps most remarkable, despite the thousands of pages of the Dodd-Frank statute and hundreds of regulations promulgated under it, there is broad agreement that the problem of so-called "Too-Big-To-Fail" institutions persists. Thus, although there is some evidence that the "subsidy" for large banks from implicit government guarantees may have narrowed in the wake of Dodd-Frank, few believe it has been eliminated completely. A report by the Government Accountability Office concluded that while Dodd-Frank may have reduced the size of the so-called "TBTF subsidy" for large banks it did not eliminate it, indicating that large banks still retain an implicit government guarantee.[47] A study by the International Monetary Fund concluded that the subsidy to TBTF banks in the United States amounts to some $70 billion per year in lower capital costs and that in turn the existence of an implicit government guarantee promotes the moral hazard problem of greater risk-taking by large banks.[48]

In short, Dodd-Frank appears to have entrenched the dominance of large banks in the market while simultaneously crushing small banks.

The CFPB's Data Mining Operations

Government power unconstrained by the rule of law also has direct implications for consumers by cultivating an environment of bureaucratic hubris at the expense of the rest of us. Consider the CFPB's extraordinary data mining program of American families' financial accounts. According to a report by the Government Accountability Office, the CFPB collects information on 10.7 million individual consumer credit reports on a monthly and quarterly basis, more than 500 million credit card accounts on a monthly basis, and 29 million active mortgages and 173 million total mortgages on a monthly

[45] Leslie Picker and Matthew Monks, *Small Banks Feel the Urge to Merge*, BLOOMBERG BUSINESS (Oct. 3, 2013); http://www.bloomberg.com/bw/articles/2013-10-03/dodd-frank-fills-small-banks-with-the-urge-to-merge.

[46] *See* Preston Ash, Chistoffer Koch, and Thomas F. Siems, *Too Small to Succeed?—Community Banks in a New Regulatory Environment*, DALLAS FED FINANCIAL INSIGHTS, Vol. 4, Issue 4 (Dec. 31, 2015).

[47] GOVERNMENT ACCOUNTABILITY OFFICE, LARGE BANK HOLDING COMPANIES: EXPECTATIONS OF GOVERNMENT SUPPORT (July 2014).

[48] International Monetary Fund, *Big Banks Benefit from Government Subsidies*, Global Financial Stability Report (2014) online at http://www.imf.org/external/pubs/ft/survey/so/2014/POL033114A.htm. Other studies reach different conclusions on the continued existence of the TBTF subsidy. For a summary of the literature as well as a caveat on the conclusions that can be drawn, *see* Todd J. Zywicki, *The Rule of Law During Times of Economic Crisis* (Aug. 26, 2015), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2651893.

basis.[49] Moreover, because this data-mining program was not initiated according to any sort of formal notice and comment rulemaking procedure, it is not subject to cost-benefit analysis or any other evaluation as to whether such extensive snooping is necessary to further any legitimate regulatory purpose. In fact, George Mason University economist Thomas Stratmann has estimated that the number of credit card accounts for which the CFPB wants to collect consumer information is some 70,000 times greater than is necessary for the agency to execute its regulatory mission.[50] Indeed, the Bureau itself has refused to permit consumers an opportunity to opt-out of the program, admitting that if consumers were permitted to withdraw consent to the program the government would be unable to obtain the data.[51]

But the costs of CFPB's demand for information do not fall solely on the banks that must provide it. While the CFPB claims that this data is anonymous, every bit of information increases the risk to consumers of identity theft and other misuse of their information. In fact, testifying before this committee last year, CFPB director Richard Cordray admitted that the information the CFPB collects is not 100 percent secure and could be hacked.[52] Moreover, according to a recent article in *Science*, using only three months of anonymous credit card data, the researchers were able to reidentify 90 percent of individuals, with women being more readily reidentifiable than men.[53]

While the unnecessary acquisition and retention of troves of Americans' information is troubling enough in itself, it is especially worrisome in light of repeated rebukes of the CFPB's faulty data security systems.[54] Following massive data security breaches and compromising of personal information by the Internal Revenue Service and Office of Personnel Management, it is inexplicable that the CFPB continues to insist on vacuuming up excessive amounts of consumer data without considering the privacy threat to consumers. Leaving aside the risk of creating a massive trove of financial data for private hackers to target, Americans also have a fundamental interest in not having their purchases tracked by the federal government and an expectation that the government should not demand any more personal financial data than is necessary to advance its legitimate regulatory purposes.

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[49] GOVERNMENT ACCOUNTABILITY OFFICE, CONSUMER FINANCIAL PROTECTION BUREAU: SOME PRIVACY AND SECURITY PROCEDURES FOR DATA COLLECTIONS SHOULD CONTINUE BEING ENHANCED (2014).
[50] *See* Letter of Professor Thomas Stratmann to Congressman Scott Garrett (Jan. 23, 2014), *available in* http://mercatus.org/sites/default/files/StratmannCFPBStatisticMethods.pdf.
[51] *See* Richard Pollock, *Federal Consumer Bureau Data-Mining Hundreds of Millions of Consumer Credit Card Accounts, Mortgages*, WASHINGTON EXAMINER (Jan. 29, 2014), *available in* http://www.washingtonexaminer.com/consumer-bureau-data-mining-hundreds-of-millions-of-consumer-credit-card-accounts-mortgages/article/2543039.
[52] *Id.*
[53] Yves-Alexandre de Montjoye, Laura Radaelli, Vivek Kumar Singh, and Alex "Sandy" Pentland, *Unique in the Shopping Mall: On the Reidentifiability of Credit Card Metadata*, 347 SCIENCE No. 6221 536-39 (Jan. 30, 2015).
[54] *See* Government Accountability Office, *Consumer Financial Protection Bureau: Some Privacy and Security Procedures for Data Collections Should Continue Being Enhanced* (Sept. 2014); Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Office of Inspector General, *Security Control Review of the CFPB's Cloud Computing–Based General Support System*, 2014-IT-C-010 (Washington, D.C.: July 17, 2014).

Remaking the Auto Finance Market Through Regulatory Overreach
A particularly striking example of the CFPB's tendency toward jurisdictional overreach and lawless behavior is its efforts to remake the auto finance market by indirectly regulating loans made by auto dealers. Fair lending laws that prohibit discrimination in making loans apply to auto dealers. It is clear, however, that Dodd-Frank prohibits the CFPB from exercising jurisdiction over loans made by auto dealers, leaving that responsibility by implication to other federal agencies such as the Federal Trade Commission and DOJ.[55]

Lacking the authority to reach the auto dealers, the CFPB came up with a creative solution—it decided to hold the financial institutions (the indirect lenders) responsible for any alleged discriminatory lending patterns by the auto dealers themselves. Under the CFPB's new regime, indirect lenders bear this responsibility even though they have no interaction with the borrower, information about the borrower's race, or any reason to believe that the dealers is engaged in discriminatory lending patterns. Moreover, the indirect lenders would be held responsible according to the theory of "disparate impact," making the indirect lenders responsible for any statistical anomalies that seemed to exist, regardless of the lack of any evidence of intentional discrimination.

A prime illustration of the CFPB's regulatory approach was its decision to target Ally Financial for its first high-profile settlement for alleged discrimination in auto dealer markups.[56] According to internal documents examined by the House Financial Services Committee, the CFPB identified Ally as its first target not because Ally had acted in a particularly improper fashion, but because Ally was particularly vulnerable to being strong-armed into a settlement. This was for three reasons. First, as a result of the continued legacy of the auto bailouts, the federal government still held a 73.8% stake in Ally at that time (and still held 63.4% at the time the case was actually settled). Second, Ally had an application pending in front of the Federal Reserve to become a financial holding company, approval of which was necessary to continue its insurance and used-car remarketing operations. Third, the FDIC was conducting a Community Reinvestment Act review of Ally and settlement of the CFPB investigation was a precondition to receive a satisfactory CRA rating, which in turn was necessary for approval of Ally's status change to become a financial holding company. Notably, the CFPB's Director is one of five members of the FDIC's board of directors.[57] Faced with these obstacles, Ally eventually capitulated and finally paid $98 million for restitution and civil penalties. More than one observer has analogized the CFPB's behavior in the matter to a "shakedown" or "extortion" racket.

On the other hand, because the CFPB never identified particular victims of discrimination but relied on statistical aggregates, it had no way of identifying the race of the supposed

[55] Dodd-Frank Wall Street Reform and Consumer Protection Act § 1029(a), Pub.L 111-203, H.R. 4173 (2010).
[56] Report of Republican Staff of the Committee on Financial Services, U.S. House of Representatives, *Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending* (Nov. 24, 2015).
[57] *See* Ronald L. Rubin, *The Rogue Regulator*, THE WEEKLY STANDARD (Feb. 15, 2016).

victims or to identify those to whom restitution should be paid. Instead, the CFPB relied on a statistical technique known as Bayesian Improved Surname Geocoding, which has been demonstrated to be statistically invalid for these purposes.[58] Indeed, according to documents secured by the House of Representatives Financial Services Committee, the CFPB itself was aware of the flaws in the methodology and the CFPB's proposed use, yet nevertheless persevered, using it as a basis to establish liability. The result has been to issue "restitution" checks to many people who have provided no evidence that they were the subject of racial discrimination—including at least one identified beneficiary who is not even a minority.[59] Ally's former CEO Michael Carpenter estimates that up to 20% of the checks being sent out by the government as a result of the settlement are being sent to non-minorities and Ally itself has decided to randomly cut refund checks to some of its customers outside of the settlement as a preemptive strike to try to avoid future risk of liability.[60] And while the settlement has delivered millions of dollars of "recourse" to consumers who may have suffered no harm, even possibly including many non-minorities, according to a report in the *Wall Street Journal*, by narrowing the range over which dealers and consumers can bargain, the overall effect of the CFPB's micro-managing of the auto finance market has resulted in higher interest rates on car loans for consumers.[61]

Notably, the CFPB's attack on indirect auto lenders was issued through a five page "Guidance" document that provided no information about the basis for the CFPB's claim of widespread discrimination or, originally, any methodology for determining liability, no opportunity for public comment or other due process protections, and no assessment of

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[58] *See* Arthur P. Baines and Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, American Financial Services Association (November 19, 2014), *available in* http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf.

[59] *See Do Two Half Victims Make a Whole Case?*, WALL ST. J. (Apr. 13, 2015), *available in* http://www.wsj.com/articles/do-two-half-victims-make-a-whole-case-1428966741.

[60] Paul Sperry, *Bank CEO Reveals How Obama Administration Shook Him Down*, NY POST (Feb. 21, 2016). According to a second report by the House Financial Services Committee, the CFPB never even examined many of these relevant factors. *See* REPORT PREPARED BY REPUBLICAN STAFF OF THE COMMITTEE ON FINANCIAL SERVICES, U.S. HOUSE OF REPRESENTATIVES, HON. JEB HENSARLING, CHAIRMAN, UNSAFE AT ANY BUREAUCRACY, PART II: HOW THE BUREAU OF CONSUMER FINANCIAL PROTECTION REMOVED ANTI-FRAUD SAFEGUARDS TO ACHIEVE POLITICAL GOALS at 8 (Jan. 20, 2016) ("The fact that a particular consumer paid more or less than average says nothing about whether that consumer was treated unfairly. Only by comparing that consumer to other similarly situated consumers – those with a similar creditworthiness, financing a similar amount at the same dealer at around the same time, etc. – can the Bureau draw a meaningful conclusion about whether a particular consumer was 'overcharged.').

[61] *See* Annamaria Andriotis & Gautham Nagesh, *Crackdown on Racial Bias Could Boost Drivers' Costs for Auto Loans*, WALL ST. J. (Aug. 31, 2015), http://www.wsj.com/articles/crackdown-on-racial-bias-could-boost-drivers-costs-for-auto-loans-1441038864. The CFPB ignores other important elements of the inquiry especially that, unlike many other credit transactions, a car loan from an auto dealer is not a stand-alone transaction but is linked to the purchase of a car. For example, auto dealers offer promotional financing deals on particular car models in order to move inventory (rather than cutting the sticker price), which can result in spurious implications of differential pricing overall.

the impact on consumers.[62] According to Ally's Carpenter, the CFPB "tried to hide" the methodology it used to determine that discrimination had occurred and when Ally finally obtained the underlying data and analysis, it concluded that "non-discriminatory factors," such as "credit differences, vehicle type purchased, trade-ins, and down payments" accounted for "virtually all of the disparities in the loan data."[63]

This practice of regulating consumer credit through informal means such as regulatory guidance, letters, and other informal means of what the Competitive Enterprise Institute's Wayne Crews has dubbed "regulatory dark matter,"[64] seems to have become commonplace with respect to the making of consumer credit policy. A similar example is a recent letter from CFPB Director Richard Cordray that reportedly "asks" the nation's 25 largest banks to "voluntarily" make low cost, no overdraft accounts available to consumers, presumably at a loss to the bank and subsidized by other bank customers.[65] The request, of course, has no legal significance, yet the decision by the CFPB to make the request in public is clearly intended to nudge certain banks toward taking this step. Indeed, most banks have interpreted this "request" as functionally equivalent to a regulatory mandate. Common sense and compliance with the principles of the rule of law suggest that an agency action that could impose millions of dollars of costs on certain banks within the industry should be undertaken with proper procedural regularities, not through a "letter" from the CFPB Director to the targeted banks. This tendency to make consumer protection policy through such "regulatory dark matter" processes should be scrutinized closely and the use of abusive tools that circumvent proper regulatory processes should be stopped.

Arbitration

The CFPB's latest regulatory target is to effectively prohibit consumers and retail financial services providers from contracting voluntarily to agree to have any disputes that arise from being subjected to arbitration instead of retaining the right to engage in class action litigation.[66] In so doing, the CFPB would be rejecting decades of federal policy that supports the use of arbitration and other forms of alternative dispute resolution processes as opposed to litigation as less-expensive, faster, less contentious, and less taxing on the public court system.[67] Before undertaking such an aggressive rejection of longstanding federal policy, one would expect the CFPB to have an especially sound

[62] Consumer Financial Protection Bureau, *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act*, CFPB Bulletin 2013-02 (March 21, 2013), *available in* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

[63] Sperry, *supra* note 60.

[64] *See* CLYDE WAYNE CREWS, JR., MAPPING WASHINGTON'S LAWLESSNESS 2016: A PRELIMINARY INVENTORY OF "REGULATORY DARK MATTER," Competitive Enterprise Institute Issue Analysis 2015 NO. 6 (Dec. 2015).

[65] *See* Yuka Hayashi, *CFPB Asks Banks to Make Low-Cost Accounts Available to Consumers*, WSJ.COM (Feb. 3, 2016).

[66] *See* Joe Adler, *CFPB Plan would all but Ban Arbitration Clauses*, AM. BANKER (Oct. 7, 2015) ("It may not be an outright ban on arbitration clauses, but the Consumer Financial Protection Bureau's impending proposal to enable more class action lawsuits comes close.").

[67] *See, e.g.*, *AT&T Mobility v. Concepcion*, 563 U.S. 321 (2011).

basis for its action. Yet the CFPB's proposal is based almost completely on a single report, one that is plagued by junk social science and flawed methodology.[68]

In fact, many of the findings in the CFPB's Report actually undermine the agency's conclusion that arbitration is unfair to consumers.[69] First, contrary to the claims of many critics of arbitration, the report finds that consumers generally have great choice in whether to enter into a contract that contains an agreement to arbitrate. For example—*according to the CFPB's own findings*—many financial services providers do not include arbitration clauses in their contracts. For example, only 8% of banks include arbitration providions in their checking account contracts and only 16% of credit card issuers do the same. In other words, if a consumer prefers a checking account or credit card agreement that does not have an arbitration clause, he or she can choose among hundreds or thousands of providers. Although arbitration clauses are more common in contracts in other industries (such as prepaid cards and payday loans) the variety among issuers and industries suggests that choice is plentiful and consumers are not required to enter into such contracts on a "take it or leave it" basis.

The CFPB further finds, however, that very few consumers know whether they have an arbitration clause in their contracts with financial services providers and do not generally shop for providers based on the ability to enter a class action suit if things go wrong. According to the CFPB, this failure to shop suggests a market failure—that consumers are unaware that they are waiving their right to sue in the event that they have a disagreement with their provider.

A more plausible explanation readily presents itself: Consumers recognize that although class action lawsuits benefit the lawyers that bring them, those lawsuits rarely provide much benefit to consumers beyond their other options of redress that remains available, including arbitration. It is important to recognize that consumer arbitration is not completely unregulated: courts rigorously scrutinize arbitration processes to ensure that they are fair and efficacious for consumers. Moreover, as the CFPB Report demonstrates, almost 2/3 of consumers are represented by counsel in arbitration proceedings, a figure that exceeds 90% for disputes involving student and payday loans. Most arbitration disputes are resolved in less than 5 months—far faster than litigation—and 57% end in a settlement and 6% in an award in the consumer's favor, comparable to 48% and 6% in individual litigation. Indeed, research by othe scholars finds that consumers generally win *more frequently* in arbitration of some types of disputes than in litigation, in part because of the cosumer-friendly features of arbitration, such as reduced expense and complexity.[70] Moreover, the development of arbitration proceedings by Skype and telephone makes such proceedings even faster and less expensive. Indeed, only 1% of consumers in the CFPB's study even said that they would consider suing if they had a

[68] CONSUMER FINANCIAL PROTECTION BUREAU (CFPB), ARBITRATION STUDY: REPORT TO CONGRESS 2015 (March 2015).
[69] The following discussion relies on JASON SCOTT JOHNSON & TODD ZYWICKI, THE CONSUMER FINANCIAL PROTECTION BUREAU'S ARBITRATION STUDY: A SUMMARY AND CRITIQUE (Mercatus Working Paper, Aug. 2015).
[70] Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77 (2011).

dispute with their financial services provider. Consumers don't value the right to join class action lawsuits against their financial services provider because they recognize that while class aciton litigation benefits the lawyers that bring the cases they rarely provide much in redress to consumers compared to the alternative measures available to resolve their disputes.

More important, the CFPB ignored the most common method by which consumers resolve disputes—through an internal complaint and dispute resolution process. Indeed, most consumers in the CFPB's survey said that if they were dissatisfied, they would simply cancel their credit card or bank account and walk across the street to another provider. And banks, like other businesses, take this threat seriously.[71] data provided to Professor Jason Johnston and me by a mid-size bank in Texas, 68% of complaints about bank fees and the like were resolved in the customer's favor with a refund and the average size of the refund was $58, compared to an average recovery of $32 in the average class action recovery in the CFPB's Report. In short, most consumers seem to implicity recognize that the availability of powerful competitive market checks backed up by the potential to arbitrate if necessary, are much more potent methods of redress than a class action suit, with its accompanying delay and expense.

Yet the CFPB contends that arbitration is an ineffective tool for consumers, pointing to the relatively small number of small-dollar arbitration cases it found in its database of cases. Yet even if accurate, the finding of a relatively small number of small-dollar arbitration cases does not necessarily imply the conclusion that arbitration is an ineffective tool for consumers. This is for several reasons.

First, as noted, a large number of consumer disputes are resolved through internal complaint-resolution processes and without resorting to litigation or arbitration. Indeed, according to the data that Johnston and I reviewed, that one mid-sized bank alone provided over $2 million in refunds to consumers last year. Across the banking system as a whole, consumers likley receive hundreds of millions of dollars or even billions in voluntary refunds every year, without ever resorting to litigation or arbitration or even threatening to do so. Yet in the CFPB's upside-down worldview, arbitration could be thought to be effective only if banks refused to issue refunds and forced consumers to arbitrate to get redress. Thus, the absence of small-dollar arbitration proceedings might simply reflect the effectivenss of informal complaint resolution processes rather than a failure of the efficacy of arbitration. Moreover, as noted above, the average refund given in response to a complaint was substantially higher than the average redress provided to consumers through class action lawsuits. Before banning arbitration clauses on the basis that arbitration is ineffective for consumers, the CFPB *must* first consider alternative explanations for the apparently small number of small-dollar arbitrations—such as the use of internal dispute resolutions processes.

[71] The logic is straightforward: It is estimated that it costs as much as several hundred dollars for banks to acquire one new account. Given that reality, few banks are going to alienate good customers over a $3 ATM fee or $29 overdraft fee, even if the fee was assessed appropriately.

But the failure to account for internal complaint resolution processes is just one of the methodological flaws in the CFPB's analysis on this point. For example, available data (although spotty) suggests that small-dollar aribtrations are quite common in other industries, such as cellphone contracts, which suggests that their absence in financial services may be attributable to reasons other than the lack of cost-effective arbitration processes. Finally, the CFPB fails to recognize that although small-dollar arbitration cases are infreqent for financial service providers, there are also very few small-dollar *litigation* cases as well. Yet this finding may have little to do with the cost-effectiveness of the processes—instead, it may reflect that many consumer financial protection statutes provide for minimum "statutory damages" for a violation of the statute, regardless of the actual harm to consumers. Thus, for example, many statutes provide for a minimum of $1,000 or $1,500 per violation, regardless of consumer harm. As a result, consumers tend to bring actions for the minimum statutory damage amount, which results in n apparent absence of small-dollar arbitrations.

The CFPB Report also grossly overstates the apparent benefits to consumers from class action litigation. The CFPB finds that in its study of class action cases, the average claim rate was 21% and that lawyers fees represented only 21% of the total recovery to consumers.

Yet the CFPB's methodology was highly flawed—it lumped all class action cases together and came up with an overall average for the entire data base based on the total average recovery for consumers and total average attorneys' fee.[72] In particular, just 6 class action cases in the CFPB's database accounted for 83% of the cash payouts to consumers from 241 total settlements. Yet by lumping these 6 very large settlements with 235 other smaller settlements, the CFPB obscured the reality of the typical class action case that produces minimal benefit for consumers and an outsized benefit for lawyers. For example, in large class actions where the recovery was over $100 million, lawyers' fees accounted for only 9% of the costs on average. Yet for cases of less than $100,000 in consumer recoveries, attorneys' fees were 57% of the recoveries on average.

Finally, it is important to put to rest one final claim about the superiority of class action cases over arbitration—the claim that somehow access to class action cases furthers the cause of "justice" by ensuring tha consumers get their "day in court." Yet in the period covered by the CFPB's Report, *not a single class action case went to court*. Whatever is happening with class action cases involving consumer financial products, the idea that consumers are being provided with a "day in court" is little more than a myth.

There is still one final point I would like to make about the CFPB's arbitration study that represents a larger problem: The repeated practice of the CFPB of issuing studies that make dubious factual claims and use questionable methodological techniques, while

[72] In addition, the CFPB arbitrarily excluded some cases that seemingly should have been included, such as a series of cases involving violations of the Electronic Funds Transfer Act for the failure to display physical signs on ATMs, cases where the harm so non-existent that Congress eventually amended the law to eliminate the requirement.

refusing to make the underlying data available to independent researchers for analysis.[73] This lack of transparency is particularly ironic for an agency that persists in describing itself as a "data-driven agency" that basis its policies on sound social science.

Payday Lending, Small Loans, and Financial Inclusion

Sometime this spring the CFPB is expected to release its proposed rule on payday loans and other small loan products. The CFPB has indicated that the rule would impose "ability-to-pay" requirements on providers of small loans, such as payday loans, auto title loans, and certain installment loans. An analysis by economists at Charles River Associates estimates that approximately 80% of payday lenders in America will be driven out of business if the rule goes into effect.[74]

Yet there is little reason to believe that the already-difficult plight of those who rely on short-term loan products will be made better off by banning access to these products. Surveys of payday loan customers, for example, routinely find that a majority of payday loan customers rely on payday loans to pay for food, rent, and other necessities.[75] Choking off access to payday loans, auto title loans, and other similar products without ensuring the availability of reasonable alternatives could impose substantial harm on many consumers, resulting in bounced checks, eviction, termination of utilities, or even reliance on illegal loan sharks.[76]

Even more important, concentrating on consumer use of payday loans and other small loan products focuses on the symptoms without addressing the underlying disease of financial exclusion. As noted at the outset, the tragedy of the Dodd-Frank era has been the systematic reduction of access to mainstream financial services such as credit cards and bank accounts for millions of consumers. Consumers suffering from regulatory-induced exclusion from mainstream financial services increasingly have turned to alternative products such as payday loans, overdraft protection, as a financial life raft. Yet along comes the CFPB threatening to shoot holes in the life raft to which they have tried to cling for support.

The CFPB has also announced plans to dramatically reduce access to overdraft proection for many consumers who use the service frequently, such as by limiting their total number of overdrafts per year. Again, this is a regulatory policy that could prove extremely harmful for consumers who rely on overdraft protection to make important

[73] *See* G. Michael Flores and Todd J. Zywicki, *Commentary on CFPB Report: Data Point: Checking Account Overdraft* (Sept. 22, 2014), *available in* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2499716 (noting that CFPB Data Report on overdraft protection made available only median values and failed to disclose many other descriptive features, such as mean values, standard deviations, and the like).

[74] Arthur Baines, Marsha Courchane, and Steli Stoianovici, Economic Impact on Small Lenders of the Payday Lending Rules under Consideration by the CFPB Prepared for: Community Financial Services Association of America (Charles River Associates, May 12, 2015).

[75] *See* discussion in Clarke & Zywicki, *supra* note 13.

[76] *See* U.S. Senate, Committee on Government Operations, Subcommittee on Legal and Monetary Affairs, Federal Effort Against Organized Crime: Report of Agency Operations (June 1968) (reporting that illegal loan-sharking operations were the second-largest revenue source of the mafia at that time).

payments. Michael Flores and I analyzed the MCC codes for point-of-sale debit card usage for one bank's overdraft usage and found that a majority of purchases that triggered overdraft usage were for products that were arguably necessities, such as groceries, gasoline, insurance, utilities, and financial services.[77] Moreover, research indicates that those who use overdraft protection tend to have poor credit and a lack of access to alternative credit options, such as credit cards or bank lines of credit.[78] In fact, many of those who rely on overdraft protection most heavily report that if they were to lose access they would be forced to turn to payday lending as a substitute.[79] At the same time, when combined with the Durbin Amendment's price controls on interchange fees, restricting access to overdraft protection has exacerbated the loss of access to free checking, especially for lower-income Americans that cannot bear the higher costs of bank accounts.

This onslaught of regulation is driving a growth in financial exclusion, especially for low-income and younger consumers. For example, as a result of the Durbin Amendment and other regulations, Bank of America's CEO stated that the bank would focus on the top 20 per cent of its most profitable customers and get rid of the unprofitable ones.[80] J.P. Morgan Chase estimated that new regulations on overdraft programs and price controls on debit card interchange fees made unprofitable 70 per cent of customers with less than $100,000 in deposits, which required the bank to raise fees, reduce costs and services, or shed unprofitable customers.[81] One industry analyst estimated that approximately 40% of bank customers would become unprofitable as a result of various regulations, including most of those with incomes under $40,000 per year.[82] Thus, the effect of these various regulations has been highly regressive, an ironic consequence of reforms that supposedly were intended to benefit consumers.

A better strategy for financial inclusion would be to start by examining the causes of financial exclusion and eliminating the regulatory barriers that prevent banks and other financial service providers from treating low-income and non-traditional consumers as valuable customers and innovating new products to meet their needs. For example, although aimed at traditional debit cards, the Durbin Amendment also extends its price

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[77] *See* Flores & Zywicki, *supra* note 73.
[78] For a review of various new regulations on overdraft protection in the United States, see Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 68 WASH. & LEE L. REV. 1141, 1155-62 (2012).
[79] *See* Clarke & Zywicki, *supra* note 13.
[80] *See* Claes Bell, *Prepaid Debit: Oasis for Unbanked?*, BANKRATE (Jan. 11, 2012), http://www.bankrate.com/financing/banking/prepaid-debit-oasis-for-unbanked/.
[81] *See* Dan Fitzpatrick & David Enrich, *Big Bank Weighs Fee Revamp*, WALL ST. J. (Mar. 1, 2012), http://online.wsj.com/article/SB10001424052970204571404577253742237347180.html.
[82] *See* Theodore Iacobuzio, *Innovative Strategies for Dealing with No-Longer-Profitable Customers*, MASTERCARD ADVISORS U.S. INSIGHTS (2010), *available at* http://insights.mastercard.com/position-papers/innovative-strategies-for-dealing-with-no-longer-profitable-consumers-us/. Although Iacobuzio's estimate of a 50% drop in debit card revenues as a result of the Durbin Amendment appears to be largely accurate, overdraft revenues have not dropped by 30%. From a high of $37 billion in 2009, overdraft revenue fell to under $32 billion in 2011 but rose in 2012. *See* Kevin Wack, *Overdraft Revenue Makes First Climb in Three Years: Report*, AM. BANKER (Mar. 18, 2013), *available at* http://www.moebs.com/Portals/0/pdf/Articles/31_Moebs.American%20Banker.3.18.13.Overdraft%20Revenue%20Makes%20First%20Climb%20in%20Three%20Years_Report.pdf.

controls to prepaid cards that offer consumers more than a rudimentary degree of services.[83] In so doing, the presence of the Durbin Amendment presents one of the leading obstacles to the development of a low-cost, highly-functional mobile banking platform that could provide not only essential financial services for millions of low-income and young consumers, but also their first step toward full financial inclusion.

Consumer Complaint Database

Another problematic activity of the CFPB is its decision to post "consumer narratives" on its webpage as part of a consumer complaint database.[84] The collection of consumer complaints can provide a crucially important role in promoting consumer protection regulatory and enforcement policy by providing early-warning signals of emerging problems in various regions of the country or products and practices. Collecting complaints and analyzing them in a statistically-rigorous fashion in the aggregate thus is an important element of a responsive and aggressive consumer protection policy.

On the other hand, it is hard to see how the CFPB's practice of permitting consumers to post isolated, unverified complaints on the agency's website furthers any coherent consumer protection purpose. Indeed, the CFPB's complaint database appears to be little more than a government-sponsored version of Yelp, where disgruntled consumers can vent their anecdotal complaints about providers of financial services. There is no doubt, of course, that consumers often have legitimate complaints with providers of financial services, just as with any other businesses. But it is doubtful that providing a forum for anecdotal, unverified complaints—as opposed to collecting and analyzing complaints by the agency—furthers any coherent regulatory purpose.

Conclusion

It is disappointing that Dodd-Frank squandered the historic opportunity presented by the financial crisis to create a modern and coherent consumer protection regime—one that would not only protect consumers from sharp practices but promote competition, innovation, and consumer choice. Even worse, Dodd-Frank imposed a regime that instead has led to higher prices, less innovation, and less choice in consumer credit products, while doing little to improve consumer protection. By taking away preferred choices for consumers, such as mortgages, bank accounts, and credit cards, Dodd-Frank and other laws have increased consumer dependence on less preferred products like payday loans, pawn shops, and check cashers. Most tragic of all, low-income and younger consumers—who already had the fewest choices—are those who have suffered the most from Dodd-Frank's regulatory onslaught.

Thank you.

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[83] Todd J. Zywicki, *The Economics and Regulation of Network Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013).

[84] *See* "Consumer Complaints with Consumer Complaint Narratives," *available in* https://data.consumerfinance.gov/dataset/Consumer-Complaints-with-Consumer-Complaint-Narrat/nsyy-je5y.