

Alan Kaplinsky: Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean to your business, your customers, and the industry. Well, welcome back professor Todd Zywicki. This is part two of the interview that we began last week, for those of you that listened to our podcast last week. Let me just remind you that we're interviewing professor Todd Zywicki. Todd is the chair of the task force on federal consumer financial law. And this task force chaired by professor Zywicki recently came out with 102 recommendations for changes in the consumer financial services law. And we covered a lot of topics last week and we still have a lot of topics and a lot of ground to cover today. So, let's get right into it. Let me turn to another area that has been alluded to a little bit earlier in your comments, Todd. And that is the recommendation of the task force that the CFPB utilize so-called principles based regulation as distinguished from prescriptive regulations.

Which, prescriptive regulations is basically the system that we have now, largely we have, I guess you could say, except with respect to UDAAP laws that exist in Dodd-Frank and the federal trade commission act and state many consumer protection laws. So, the end as a practitioner in this industry for a long period of time, my clients clamor for certainty. They want to know the answer to the question and they don't like it at all when Chris I talk in generalities or use words like unfair and deceptive. And they want to know what do have to disclose, when do they have to do it and what's going to get them into trouble. So, it strikes me that that recommendation, unless I misunderstand what you're recommending, that's going to be a heavy lift, I think.

Todd Zywicki: I think you're right. And I think everything that you've said is correct, Alan. Which is that, the financial regulatory system is an unusually prescriptive, detailed system. A lot of that is for precisely the reasons you say, which is a clamor by the industry for rules in the like. I think the report indicates to, obviously there's benefits to that, right? In terms of predicting against future liability, you know what the rules are. But there's also two costs to that, that the report identifies, which is first, look, the world is sped up. Financial technology, consumer preferences, all this sort of stuff. It's just changed. And it's accelerating at an accelerating rate. And truth and lending, for example, just keeps getting longer and longer and more and more complex. And the second part is, that doesn't help consumers.

And so we understand, we hear what the industry is saying. But, we think that a system that is focused on disclosing to consumers, for example, the things they need to know in order to make shopping more effective and focusing on that, that's, what's good for consumers. With respect to all the other sorts of things that are disclosed, a lot of that is not helpful to consumers. It overloads consumers. And yes, we understand that the industry likes that certainty, but the way to do it, we think is not by creating these rules, these laws, that freeze things into place, [inaudible] being a good example, right? That [inaudible] basically became obsolete the day after it was written. And so what we say is,

the way to think about this is a more focused use of what we call tools, tool usage, right?

Which is rather than writing these. So, there's a trade-off here, right? We are critical of regulation by enforcement, which is to say basically using enforcement without really any standards to impose what amounts to regulations on the entire industry. But we're also kind of critical of rules that are so detailed, that they don't work for consumers, that they become obsolete, that they require constant updating in the like. And so, what we say is, you should think about how you use your tool CFPB. Which is, what is the optimal combination of rules, enforcement, supervision, consumer education, and research. And so a good example is, CFPB is very unusual in that it's the only consumer protection agency we're aware of that has all five of these tools. The FTC has very limited rulemaking authority and certainly no supervision authority, you can kind of go down the list.

And so, one of the big focuses of the report is, what is the optimal use of these five tools in a way that can provide predictability. While at the same time, dealing with the fact that the world is changing very rapidly, and we want to keep a system that's responsive to new technologies, new opportunities, and new threats. And our view is having reviewed that the greater use of principles based regulation, combined with a proper use of supervision, enforcement, consumer education, and research as a more productive way of accomplishing better regulatory goals that benefit consumers at lower costs.

Chris Willis:

Well, the one principle's based regulation we have now, as you noted, Alan, is UDAAP. And it certainly accomplishes something in the sense of providing an avenue for regulators to hold industry actors accountable for conduct that the regulator believes is harmful to consumers. But it introduces a lot of uncertainty for the industry. And it gives the industry and us as lawyers for the industry, kind of a challenge all the time about trying to figure out, is something going to be viewed as a UDAAP violation by a regulator or not. We ask ourselves that question all the time. We make our best guesses at it. We guess right a lot of the time, because we have seen the history of how it's unfolded. But it takes a lot of knowledge to really accurately assess that. And so it serves as a barrier to anybody who doesn't have that sort of historical knowledge and expertise in what's a UDAAP and what's not.

Because it quickly fails to become intuitive to industry players, whether something is a UDAAP violation or not, when you start looking at examples. And so, given the trouble that's created, the innovation that is suppressed. And sometimes the unfair consequences that are visited on industry players for doing something that they didn't have any reason to believe was wrong, but then a regulator later determines is wrong from a fairness standpoint. Those are all the things that, I think are problems with having more UDAAPs, in other words.

Todd Zywicki: It's a fair point, Chris. And what I'll say about that is first, one particular concern that task force expresses is that the disclosure can certainly do that. But, everybody knows that just like, people don't read disclosures bottom line, all right? One of the things we found was, if you read all the disclosures you receive in a given year, I think it would take 244 hours. You could spend 10 days, 24 hours a day reading disclosures. Everybody knows that people don't read disclosures. And so I understand they create certainty. Does it create consumer protection? I think is an open question. And so what the report comes across is let's focus on the disclosures that really matter, and then focus on potential harms to consumers.

And so, I grant your point. The second thing that we talk about for example is, one of the recommendations we have is that the Bureau should adopt something like its supervision highlights. It should adopt enforcement highlights. And as part of that, don't do case closing memos and things like that, that they do at the FTC, [inaudible] parties. Basically, in a generic, sort of in a way describe. Here's some of the things we saw that we decided were not UDAAP violations. A company did X or Y, right, in some sort of way in order to meet that legitimate need that you have there. So, we are aware that there's cost as well as benefits to a more principles based regulatory system. And that working out those details over time will require some real conscious thought.

Alan Kaplinsky: Okay. So, I've got a couple of other areas I want to explore, and then we're going to have to wrap things up. One of, I thought more controversial recommendations was the recommendation that the CFPB be granted the authority by Congress to issue charters, to FinTech companies, non-banks, to engage in lending, in money transmission, and other things that FinTech companies do, and that they can do it like a national bank can do it. Maybe even with greater preemption powers, because as I understood your recommendation, it said they need only comply with the law of the state where the FinTech company is located, I think is what you said. So, do I understand that... And I know one of the more interesting reactions to that was that Brian Brooks took umbrage with that almost immediately. He didn't like the CFPB infringing on the turf [inaudible].

Todd Zywicki: Yes. Brian disagreed politely with that, didn't he? And let me make it clear, Brian Brooks and what the OCC has done on FinTech, I think over the past few years is unbelievable. And to clarify the recommendation, we say, the CFPB should do it. And in the alternative, it should be clarified that OCC can do it because there's literally ongoing litigation in the like. And so, both are viable and good ways of doing this. And what I think the task force and Brian Brooks agree 100% on are two things, which is first, there are clear absolute benefits to consumers in terms of competition, inclusion and everything else from greater access to FinTech products. That's one thing that we are in agreement with and in the light second, that there are products such as money transmitters where the benefits of state-by-state regulation are very, very small and the costs are very,

very high. When things are inherently interstate transaction requiring 50 state licenses, it's really hard to see what the regulatory benefit is there.

And so I think with respect to these things, we are completely in agreement and this is a very important thing. And, the means of doing it, I think are flexible. We identify two things in the report that suggests why the CFPB might be the right body. And the interesting backdrop to this is, is if you look at the national commission on consumer finance report, one of the things they do is they actually recommend first creating an agency like the CFPB. They call for a National Bureau of Consumer Financial Protection, essentially, as part of that. And one of the authorities that they were going to give to that was the authority to issue national charters to the personal finance companies. So, they actually anticipated this as a way of cutting through this web of consumer protection laws.

There were two things the report identifies as why the CFPB might be relatively better position to deal with this. Which is first, these aren't depository institutions. They just raised different regulatory questions. The regulatory questions they raise are really in the nature of consumer finance. If they're non-depository institutions, you don't have the safety and soundness issues and all those sorts of things. And so while yes, the OCC is very able and capable and knows how to issue bank charters. It's not a perfect fit with them, assuming that they have the authority to do it. It's not a perfect fit to go under their umbrella, as opposed to something that really has the consumer financial, the consumer protection issues, they're the main issues that are raised by this. The second thing is, and I'm not in any way accusing them or suggesting this, but the biggest obstacle to a lot of our proposals is the incumbent financial services industry.

We already see the big banks want to saddle FinTech companies with more onerous capital requirements that are completely inappropriate to non-depository institutions. 10 years ago, they managed to keep Walmart from getting a banking charter. They're still up in arms about things like industrial loan companies. A lot of these things, they're always willing to get rid of alternative financial providers like payday lenders that compete against overdraft protection fees. And so in our view, disentangling FinTech, which is primarily consumer financial product from the incumbent big banks and in industry that could try to use regulatory tricks in capital requirements and things like that to try to squash these competitors, we think might be a better path forward.

Alan Kaplinsky: Yeah. And I take it, I'm going to ask you Chris to react to it, but a matter of clarification, is it correct Todd that if the CFPB were to actually be granted the authority to charter these entities, these entities would not have the authority to issue deposits?

Todd Zywicki: That's the way we thought of it. And, it may be that that's how you draw the line, right? To that. We just sort of propose the idea. And so I think our thought

is that these would be for non-depository institutions, but that, that could be worked out than the details of the process. We were thinking traditional FinTech companies, as well as money transmitters and things like that. Lending companies that are financed in ways other than deposits, for example.

Alan Kaplinsky: Yeah. Chris.

Chris Willis: Yeah. I think this is a recommendation that struggles against the weight of incumbency, as you've noted Todd, both from a regulatory and an industry standpoint, but it makes a lot of intuitive sense. Because first of all, you'll get no argument from me that the piecemeal and inconsistent state regulation of these interstate, money transmission and lending activities is a undesirable relic of bygone years. Just like some of the provisions from the 1970s in the federal consumer protection laws are. And I fully agree with the idea that the benefit of that state regulation is massively outweighed by the cost of it, which is very large. So, like no argument there. And then, as regards to the OCC versus CFPB rule, I think the point is well-made that, the safety and soundness considerations that prompted the creation of the federal banking regulators and then their mission ever since that is to prevent bank failures and runs on banks.

Like what precipitated the great depression in the 1930s are really not present with a money transmitter or a FinTech marketplace lender. You just don't have the same policy reason underlying that. And, what's different about the fact that those entities now are licensed by state regulators who also are not the OCC. Right? The OCC isn't licensing them now. There's someone licensing them, but it's not the OCC. So, the idea that it must be the OCC or no one doesn't make any sense. And in fact, isn't even the case in the status quo.

Alan Kaplinsky: All right. So, let me conclude our podcast today by asking just a general question, Todd. So, here we are on the costs of a new administration. President elect Biden on January 20th will be sworn in as the new president. My guess is that it won't take very long for him to replace Kathy Kraninger, because he's got the right under this US Supreme court opinion and seal a law to do that. And that he'll appoint, either he'll nominate somebody who is more like a Richard Cordray, somebody who's more consumer oriented to be the permanent director. And by permanent, I mean, for a term of five years. Or if that's going to take a while to get through, there will be an acting director selected under the Federal Vacancies Reform Act. So, the question is, you've got, 102 recommendations here. As a practical matter, do you think the newly constituted and governed CFPB is going to pay a lot of attention to what you've done?

Todd Zywicki: Well, we obviously hope so. And I'll say just a couple of things about that. Which is first, as I said earlier, I think everybody can agree on the goals that we were aiming at here. More financial inclusion, a more responsive and modernized regulatory system. And a system that is more efficient in terms of reducing consumer harm at lower cost and greater consumer benefits. So, let me

disagree with some of the specific recommendations, but I hope they wouldn't just rule them out of hand, given that those were our objectives. Second, when we were writing this, we were well aware that we were writing it during an election year. And that wasn't really a consideration, we were writing as the NCCF did, this is a document that looks to 10 or 20 years in the future. It's been 50 years since there was a commission like this.

It was the 10th anniversary, the CFPB. CFPB has gone from a startup phase, which they were unbelievably accomplished it doing to their credit to start up this agency. Well, let's think about, what are the tools of this agency? Why should we do this? In many ways, we've really argued for a pretty robust and muscular CFPB to do a lot of things. Like we were just talking about how to facilitate more inclusion, how to facilitate access, how to facilitate FinTech, things like that. And so we talked a lot during this discussion, ECOA modernization, alternative data for credit reporting. Doing things that can facilitate access for foreign language customers. We also talked about the need, very little is known about the financial inclusion challenges of rural consumers who have very large challenges right now.

And they're getting larger because the impact of the changes in the banking system by industry developments, as well as regulation has been to disproportionately close small rural banks. And if your bank and your town closes, it could be an hour and a half round trip to the next bank. They don't have the same degree of access to the internet and broadband and cell to be able to substitute with FinTech analytics. So, rural consumers, we talk about the challenges of formerly incarcerated consumers. If you're in jail for seven years, you come out, you don't have a credit report. It appears that things like identity theft for those who are incarcerated is a very high thing. Because you can't be checking your credit report all the time. And a lot of times you've got, it might even be family members or friends who are doing it and you come out of prison, we talk about immigrants.

Things like regulatory modernization, dealing with the fact that we've had three major crises in 20 years, nine, 11, 2008 financial crisis. And now most recently, perhaps most the pandemic and the regulatory system did a really good job. I think, the financial regulatory system, we would all agree in adapting and dealing with the unanticipated problems of COVID. But, we say, well, why don't we take a step back and just accept the crisis are going to happen, right? And rather than having to kind of stitch together ad hoc responses to these problems. Let's sit back and think about what kind of authorities do we want to have, rather than having to work around things. We have state laws that require in-person real estate closings, that require you to get an authorized document from somebody in order to conduct certain transactions.

So, there has to be some way in which we build regulatory flexibility to cut through that web of regulation in the like often which, serves no purpose except to benefit some in-state interest group. Right? Going forward. So, creating those

sorts of authorities, faster payment systems so that people can reduce the reliance on things like payday lenders in the like. And just good government things like we've talked about. Better tool usage internally, thinking about what is supervision, how should supervision be used with a lot of these other things? So, I could go on and on and on. But a lot of this I think are things that are just good government regulations, things for the CFPB to think about in sort of its internal organization and operation. We also argue they should reorganize around markets, rather than tools. For example, things that are completely uncontroversial and completely nonideological. And we think a lot of the proposals we have here are in fact, non-partisan prudent.

And even if you don't agree with where we come down on the recommendations, you could follow why we're doing it and at least think about whether there's unintended consequences you want to take into account on some of these things. So, that was a very long answer, Alan.

Alan Kaplinsky: Yeah. No, but they're very, very helpful in making the point, which I came away with after reading the report. And that is, I was surprised, I thought it would be, I have more of an industry slant to it. There were certainly a lot of things in here that the industry likes, but there are a lot of things in here that are very pro-consumer and I can't imagine consumers would argue against such as ECOA covering disability or disabled persons. That's a bi-partisan issue. There are a lot of things I think. And I think there are more things that are what I would call bi-partisan and both good for consumers and good for industry, then there are things that consumer advocates are going to have the hissy over. What do you think, Chris? What was your reaction?

Chris Willis: Yeah. I had the same impression, that this was an effort, as Todd mentioned, to get past the, I'm on one side, you're on the other side and we must always be enemies. And to try to set an example of how regulation can be divorced from politics and sides and done in a rational way. And so, I actually think it's a great example for the government in general to follow. If legislators acted that way, I think we'd get a lot more done in the legislatures, for example. So, I thought it was a very good exercise, an intellectual discipline and an attempt to be fairness to the basic principles of why we have consumer regulation.

Alan Kaplinsky: Yeah. And I think it really, I don't know if this was what Kathy Kraninger had in mind, but when Mick Mulvaney was there as acting director, he issued all these RFIs covering just about everything that the Bureau was doing. And I think you really sifted through all the morass and you distilled out some really basic things that this new CFPB under new leadership ought to seriously consider. And I hope they're not blinded by the reaction of Todd Zywicki is chairing it. He's an industry guy and can't be good for consumers because that would be a horrible mistake either.

Todd Zywicki: Well, thank you guys. I appreciate that. On behalf of the task force, that's what we were really striving for. And I want to recognize and really personally express



my appreciation to director Kraninger. She told us, this is an independent task force. I want you to call, like you see it. I want this to be an academic enterprise, not a political enterprise. And she's made it very clear during her tenure at the Bureau, that her goal is to kind of move the CFPB beyond its startup status, which was sort of very politically fraud and political football. And she basically asked us to engage in this project with that spirit of following the evidence where it lies. And to her credit, she respected our independence throughout the entire process.

And second, Alan, I appreciate you recognizing the hard work that the members and our staff did in trying to get input of going back to the RFIs. The old RFIs and the new RFIs of scouring the websites of people have commented on this, including consumer advocacy groups. Given the short timeframe that we had, the NCCF had for years, we had a year. And related to that is one of my overarching goals as chair and the task force I'd shared in this was, given the challenges of the pandemic, we really, really, really wanted to make sure we reached and gave people an opportunity to participate. And that set us back at first. We had a whole slate of outreach events scheduled for the spring, kind of knocked us off balance but we ended up doing as much as we could to meet with people virtually to hold hearings.

We met with, I think, 12 or 15 other federal agencies, we met with state enforcement officials. We met with the advisory councils. We did as much as we could given the limitations of time and the pandemic. And so, I appreciate the kind words that she said that this reflected in the work, because that was very important to us.

Alan Kaplinsky:

Okay. Well, we've come to the end of our podcast today. It was a little longer than usual, but we had a lot to cover and there is a lot of information in this report. And again, I commended very highly. I think if you're a practitioner in this area or an academic, it's absolutely must reading. So, make sure to visit our website, [ballardspahr.com](http://ballardspahr.com), where you can subscribe to our show, if you're not already a subscriber. You can also subscribe on Apple podcasts, Google Play, Spotify, or essentially any platform where podcasts are available. And of course, don't forget about our blog, [consumerfinancemonitor.com](http://consumerfinancemonitor.com). Our podcasts are released every Thursday, except when Thursday falls on a public holiday. But you can depend on a new podcast show sometime on Thursday of each week. Thank you very much for listening today. And Chris, thank you too. I appreciate your participation today.

Todd Zywicki:

Thank you guys.