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A New Approach to the Regulation of Consumer Credit

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Thank you, Richard, for that kind introduction, and thank you, Steve and the members of the Financial Services Roundtable, for inviting me to join you this evening.

When Steve generously invited me to speak, it didn't take me long to accept. But both of us, I think, knew we were taking a gamble--Steve, because he didn't know what I would say and me, because I didn't know which hat I'd would be wearing when I gave this address. There were possibilities: I could have given a technical analysis of the TARP program as the Chair of the Congressional Oversight Panel or a dusty lecture on the concept of anticipatory repudiation as a contract law professor.

The gamble I took in accepting this invitation turned out all right. I'm no longer the Chair of the Congressional Oversight Panel nor am I teaching at Harvard Law School.

But Steve--he's still not so sure about the gamble he took. He still doesn't know what I'm going to say. So here goes.

The past two years have been a time of rapid change. The financial crisis that nearly brought our economy to its knees has been averted. TARP and other government support played a significant role in ending the panic and helping stabilize the markets. But there was little time to pause and absorb the impact of this country's close encounter with economic collapse. The economy took new turns, rescue efforts quickly evolved, and new regulatory responses emerged.

Over the past year, the President fought for a reform bill that, among other things, created a new agency to provide a voice in Washington for middle class families. In July, he signed that bill into law. Less than two weeks ago, the President asked me to serve as his assistant and Secretary Geithner asked me to serve as his Special Advisor for standing up the new agency.

My first public meeting after that appointment was with bankers—bankers from Oklahoma, where I grew up, where my grandmother drove a wagon in the land rush, and where I learned to sing Boomer Sooner before I learned Old MacDonald. In the few days since the President's announcement, I've spoken with dozens of CEOs of financial institutions, trade associations, members of Congress, and consumer groups.

I've heard a great deal in these meetings about the significant time and resources that financial services providers have spent implementing regulatory changes already, including substantial changes to credit card practices, implementation of the new Good Faith Estimate forms, and upcoming changes on mortgage broker compensation. I want to acknowledge your hard work in making these changes and note that they are already making meaningful differences in the credit experiences of your customers.

With only ten days on the job, it's too soon to make many promises. But, if only to set Steve's mind at ease, I'm going to start with two. When you hear them, I hope you'll understand why I didn't hesitate to be here tonight.

First, in the weeks and months ahead, I'm going to listen more than I'm going to talk, and I'm going to keep my door open.

And, second, I am committed to helping build a consumer credit structure that works—works for families, works for the financial services industry, and works for the American economy.

For 30 years, my research has focused on the difficulties facing the middle class—some of which are related to consumer credit. For the last two years, my work has shifted to TARP, where I tried to help provide strong, independent oversight on behalf of those same families. I'm not going to change. I will be a strong and independent advocate for hard-working, play-by-the-rules, middle class families. But the best way, in my view, to strengthen those middle class families is to find solutions that are deep and lasting, that strengthen the markets, and that will create a robust, competitive consumer credit industry that works **for** families, not against them.

As we enter this new world, it's critically important to start by having a conversation – together – about the principle of free and reliable markets and about the best approach to regulation.

I'd like to start that conversation by looking back 76 years to the launch of a new agency in another time of economic turmoil. When President Roosevelt appointed Joseph P. Kennedy to the brand new Securities and Exchange Commission, his selection of a businessman was seen as an outrage to reformers. One New Deal liberal said the appointment was like "setting a wolf to guard a flock of sheep."

I don't need to tell you that my appointment didn't cause outrage to reformers. But I want to share with you a few words from Joe Kennedy's speech just after his appointment. He said:

> Everybody says that what business needs is confidence. I agree. Confidence that if business does the right thing it will be protected and given a chance to live, make profits and grow, helping itself and helping the country...
>
> We of the S.E.C. do not regard ourselves as coroners sitting on the corpse of financial enterprise… We are not working on the theory that all the men and all the women connected with finance, either as workers or investors, are to be regarded as guilty of some undefined crime. On the contrary, we hold that business based on good will should be encouraged.

Joe Kennedy had it right. Good regulations can create an opportunity for good businesses to thrive.

Thanks to the new law, for the first time ever, we will have a single federal agency charged with writing the rules for all mortgages and all credit cards, regardless of whether they are issued by a federally chartered bank, a state chartered credit union, or a group of unlicensed investors. Thanks to this new law, for the first time ever, both banks AND non-bank lenders will be subject to federal examination to ensure that they are all playing by the same rules. Thanks to this new law, for the first time ever, critical consumer financial protection activities performed by seven different agencies will be consolidated into

one agency, closing gaps in oversight. Thanks to this new law, for the first time ever, a new agency will be born not simply to create new regulations but also to get rid of old regulations that are dated, expensive or just plain don't work.

Those innovations would be a headline in themselves—and they alone would provide significant opportunities for you and significant relief for American families. But we can do more. Before this agency decides to cut regulations in some areas and add in others, we have a chance to take a step back to ask: What vision should drive this agency? What test should be used to determine when the agency should act, when it should not, and which tools it should use when it does take action? What is the central aim of financial services regulation?

Some of you may have noticed that I have not kept my opinions to myself about where I think the financial industry has gone wrong. And I notice that some of you have not kept your opinions to yourself about me. But there is something you may want to know: I come to Washington as a genuine believer in markets and a genuine believer that the purpose of regulating the consumer credit market is to make that market work for buyers and sellers alike: a level playing field where the best products at the best prices win. When it works, the market is an ally to consumers. And, when it works, the market rewards those lenders who offer the best value to their customers.

Good regulation is not about impeding market forces; it is about unleashing those forces to work better. Good regulation is not about retribution designed to make an industry suffer; it is about rooting out deception so that straight up competition actually works. Good regulation is about applying a range of tools in order to help markets do what they do best. Good regulation supports strong markets, and, because it supports strong markets, it is more likely to persist over time, more likely to avoid capture or the conceit that the regulator has become omniscient.

Let me be clear. When I talk about functioning markets, I'm not using the word "market" as coded language for a return to the Wild West where companies use deception to pick off every consumer they can get in their sites. A free market is one where consumers have the ability to make well-informed choices, where the choices are visible and the terms are clear, and where there are cops on the beat to make sure that everyone plays by the same rules.

American families aren't looking for a free ride. They expect to be held responsible for the purchases they make. If they don't keep up with payments on their credit cards, car loans and mortgages, they expect to face the consequences. They also expect to pay for the services they receive. They know that businesses need to make a profit, and "free" usually means that the real costs will eventually show up somewhere.

They aren't look for a free ride, but they are looking for an honest marketplace. They want to know the costs up front, before something gets added that they never knew was coming. They want a level playing field, one where they can get the deal in full and up front.

But credit agreements have gotten long and complicated. In fact, there's a new epithet: fine print. I understand that some of you call it "mice type." Where I come from, nobody calls fine print, hidden fees and surprise penalties "negotiated contract terms" or "innovations." On a polite day, my brothers in Oklahoma call that kind of stuff "garbage." They don't care if it is there because regulators required it,

because the companies' lawyers were trying to ward off lawsuits, or because it was a good place to hide another new fee.

They simply see a world in which the financial institutions they do business with are not on their side. Every surprise hidden in the fine print is a bad surprise. Instead of seeing banks as their friends—as I did when I put my babysitting money in a savings account at Penn Square National Bank so my brothers didn't *borrow* it out of my sock drawer—too many Americans see dealing with banks like handling snakes—do it long enough and you'll get bit.

You can argue with my brothers—Lord knows I argue with my brothers—but, on the question of fine print, they have it right. An AARP poll earlier this year showed that 96 percent of Americans over 50 surveyed want to put an end to the fine print in their credit agreements. Just in case you missed the point, 91 percent felt strongly about that. 96 percent? These are your customers.

So how does a regulatory approach fit into this? Regulation can take two obvious forms: Regulators can make more pronouncements from on high, identifying suspicious practices in the various markets and banning them. Or regulators can layer on more disclosure requirements. But neither restores customer trust. In one case, it becomes the job of the agency to highlight industry shortcomings and pile on more and more "thou shalt not" rules, and, in the other case, consumers are hit with even more paperwork—and a growing suspicion that the game is rigged against them.

Now look, sometimes it is necessary to prohibit unfair practices that have become so pervasive that there is no meaningful choice in the market. And sometimes disclosures can help ensure that families have the information they need to choose financial products that best meet their needs. This is something that I, and many people in this room, have acknowledged in lots of places, including in testimony before Congress.

But I'm here tonight to talk about an alternative recommended by the Financial Services Roundtable three and a half years ago: a principles-based approach.

Instead of creating a regulatory thicket of "thou shalt nots," and instead of using ever more complex disclosures that drive up costs for lenders and provide little help for consumers, let's measure our success with simple questions. Your first principle is "Fair treatment for consumers." I'll paraphrase your explanation of how to tell if that principle has been met: Can customers understand the product, figure out the costs and risks, and compare products in the marketplace? Regulators should be aiming toward the goals you laid out.

Instead of layering on regulations that don't fully protect consumers, a better approach would focus on how to give consumers the power to make the right choices for their families—and, at the same time, to ease the regulatory burden for the lenders. Best of all, if we do this right, perhaps together we can reassure families that the people in this room have met their own goal of fair treatment and that they should be treated as trusted friends.

So let's start with an example that hits home for the vast majority of Americans: a credit card.

The principle is easy: Just as you said, customers should be able to understand the deal, assess the costs and risks, and compare one card to another.

What should we drive toward? Short agreements that can be read in very little time with very high levels of understanding. Certain basic information would have to be made available and each lender would set the terms of its deal: the interest rate, the penalty terms, the free gifts or rewards that come with the card, and any other terms.

For consumers, this would mean products that are easy to understand and easy to compare. For lenders, this means regulatory compliance costs could be reduced. Competition would flourish, but in ways that consumers can see—better customer service, lower prices or cool new iPhone apps.

Of course, lenders could continue to develop their credit agreements and work up new features, but the concept would remain the same: a credit card agreement that can be read and understood in a short time.

The early feedback I've received from credit card issuers suggests that industry is eager for simplification too. Some bankers have told me that a simple contract is exactly what they want too. I believe there are people in this room who are ready to run with this idea.

At its core, this is a pretty simple idea that builds on the basic principles your industry laid down through this group. So I'm here with all of you tonight because I want to be part of a discussion about how we can make the idea of a short, easy-to-read agreement a reality.

It has been a long time since Congress established an agency from scratch. To build the consumer agency, we will be drawing on the proven experience and competence of the staff at many federal agencies. But if all we do is bring together those staffs to continue writing "thou shalt not" regulations and layering on more disclosures, then we will have missed a real opportunity. And if all those resources are used just to force an entire industry, begrudgingly or worse, to accept marginal changes in a few forms, we will have missed a real opportunity. On the other hand, if we use this moment to rethink our approach to regulating financial services, then we can seize the opportunity to do something unexpected—and exceptional.

It is now, right here at the beginning, that we have a remarkable chance to put aside misconceptions and preconceptions--whether they are yours or mine. We have a chance to build something better, to pour over the research and data together, and to identify problems and solutions, with or without regulation.

The new agency's voice will be independent and strong. I hope its goal will be to advance a robust market for consumer credit, one that produces real competition that benefits millions of American families by making it easy for them to know the terms of the deal with their lenders and to shop around for the best products. In the long run, this will be good for families. And, like Joe Kennedy said, it will be good for the lenders who want to build thriving businesses serving their customers. And it will be good for America, for my children and grandchildren and yours, creating more economic stability throughout the system, from families to Wall Street—and back again.

That's what I want to see. I'm here tonight to ask if we can work together, and I'm here to ask you to work with me.

Thank you.