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PUBLIC INTEREST COMMENT

RESPONSE TO BUREAU OF CONSUMER FINANCIAL PROTECTION REQUEST FOR INFORMATION REGARDING BUREAU EXTERNAL ENGAGEMENTS

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I appreciate the opportunity to respond to the Bureau of Consumer Financial Protection's (Bureau) Request for Information Regarding Bureau External Engagements. This public interest comment represents my views. It does not represent the views of any special interest group, Mississippi State University, the Mercatus Center, or George Mason University.

My aim is to assist the Bureau as it considers changes to external engagements—particularly with respect to the Academic Research Council (Council).

The objective and scope of the activities of the Academic Research Council are outlined in item 3 of the Bureau's Charter for the group:

> The Council will provide the Bureau's Office of Research technical advice and feedback on research methodologies, data collection strategies, and methods of analysis. Additionally, the Council will provide both backward- and forward-looking feedback on the Office of Research's research work and will offer input into its research strategic planning process and research agenda.[1]

Before becoming a senator, Elizabeth Warren (D-Mass.) testified that the Bureau is designed to be "a data-driven agency by making research and market analysis core to all of its work."[2] I applaud the direction Director Mulvaney (Director) gave the Bureau when he stated,

[1] Consumer Financial Protection Bureau, *Charter of the CFPB's Academic Research Council*, February 22, 2017.
[2] *Hearing before the Subcomm. on Fin. Inst. and Consumer Credit of the H. Fin. Serv. Comm.*, 112th Cong. (2011) (statement of Elizabeth Warren, Special Advisor to the Secretary of the Treasury for the Consumer Financial Protection Bureau).

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> Speaking of data, the Dodd-Frank Act, which established the Bureau, requires us to "consider the potential costs and benefits to consumers and covered persons." To me, that means quantitative analysis should drive our decisions. And while qualitative analysis certainly can play a role, it should not be to the exclusion of measurable "costs and benefits." There will be a lot more math in our future.[3]

In my opinion, quantitative, not qualitative, analysis should underpin nearly all the endeavors of the Office of Research.

The Academic Research Council has not fulfilled its original purpose. I base my opinion on a preliminary analysis of the published output of the Bureau's research staff, and on my readings of the minutes of the Council meetings. Moreover, the mission of the Council can and should be expanded to benefit consumers.

Minutes from the inaugural meeting of the Council contain fewer than 100 words.[4] The minutes of subsequent meetings are equally terse, vague, and opaque. Perhaps the Council accomplished more than is reflected in the minutes—if so, the workings of the Council are far from transparent.

This comment raises three main points for consideration:

1. The Bureau's charter for the Academic Research Council should be modified to reflect the importance of this Council.
2. To fulfill its purpose, the Council should increase its impact on research topics investigated by the research staff of the Bureau.
3. The Council should develop a plan to update the 1972 report of the National Commission on Consumer Finance.

SUGGESTED CHANGES TO THE CHARTER OF THE ACADEMIC RESEARCH COUNCIL

The Council is charged with providing advice, feedback, and input to the Office of Research. Yet responsibility for directing the work of the Council has been given to the head of the Office of Research. But how can the Council provide an independent voice when it is under the control of the Office of Research?

Item 8 of the charter for the Council currently reads, in part,

> The Designated Federal Officer ("DFO") is the Assistant Director of the Office of Research, who is a full-time or permanent part time employee. The DFO shall serve as the Council's Chair. The DFO shall ensure that the Council operates in accordance with the requirements under the Federal Advisory Committee Act and the terms of the charter.

This structure makes the Assistant Director both the "supervisor" and "supervisee." To allow for truly independent input into and subsequent review of the Office of Research, the Designated Federal Officer (DFO) for the Council must be someone who is outside the Office of Research and who is appointed by the Director. In addition, while the DFO can still ensure that the Council

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[3] Mick Mulvaney, "The CFPB Has Pushed Its Last Envelope," *Wall Street Journal*, January 23, 2018.
[4] Consumer Financial Protection Bureau, Academic Research Council, *July 27, 2012 Meeting Summary*, July 27, 2012.

operates in accordance with federal law, the Council's chair should be elected by the members of the Council.

Item 12 of the charter for the Council currently reads, in part,

> The Council will be composed of approximately nine members. Council members will be designated as special government employees (SGEs) and will serve four-year terms. Membership can be renewed for additional terms at the option of the Assistant Director of the Office of Research. All members are appointed by the Director and shall serve at the pleasure of the Assistant Director of the Office of Research.

From the minutes, it does not appear that the membership of the Council has been steady at nine members. In fact, currently only five biographies for Council members appear on the Bureau's website. If membership is not fully subscribed, how can the purpose of the Council be fulfilled?

Although the Director appoints Council members, at present Council members serve at the pleasure of the assistant director of research. I think all aspects of membership should be at the option of the Director, not the assistant director of research nor the associate director who oversees the research department as part of a portfolio of responsibilities. The Council was created to provide a supporting role to the Office of Research. My recommendation is that the purpose of the Council be changed, through its charter, to support the Director also.

With this structural change, the Council can function as an outside board, which can benefit the Office of Research because the latter can be briefed on the overall direction of the Bureau by the Director. This structure benefits consumers because the Academic Research Council can help identify new areas of research.

INCREASE THE IMPACT OF THE COUNCIL ON RESEARCH BY THE RESEARCH STAFF OF THE BUREAU

From the Bureau's website, I obtained the names of the 27 researchers in the Bureau's Office of Research.[5] To my understanding, members of the research staff are allowed to spend half their time conducting independent research.

I looked at the number of publications that were listed on the Bureau's website for each researcher. The total number of publications listed is 77. Of the 27 researchers, 10 have zero publications listed; 14 have more than three.

It appears that the Bureau does not list more than five publications for any researcher. Therefore, I also looked at the number of publications that were listed on the Social Science Research Network (SSRN) website—a widely used resource for active researchers. Using this website, I found 86 publications for the current group of Bureau researchers. Twelve researchers had zero papers listed; only nine had more than three papers. Five researchers accounted for 66 percent of the papers listed on SSRN.

[5] Consumer Financial Protection Bureau, "CFPB Researchers," accessed April 30, 2018, https://www.consumerfinance.gov/data-research/cfpb-researchers/.

The fact that 22 researchers account for only one-third of the research papers is puzzling given that each member of the research staff has a terminal academic degree, time to spend on research, and access to data collected by the Bureau.

Topics that should be addressed by the Council include the following:

- What factors explain this level of research productivity?
- Are the research papers that have been produced to date of high quality?
- Have these papers been published in peer-reviewed academic journals?
- Do these articles contain rigorous empirical work on consumer finance issues?
- Has there been an overweighting to behavioral aspects of consumer credit?

I recommend that the Council be reformed and assigned the task of creating empirical research teams to investigate consumer finance issues in a rigorous and scientific way. These research teams could be comprised of researchers with academic appointments, as well as members of the Bureau's research staff.

Research produced by these collaborations should be presented for discussion at well-attended academic conferences. Examples include, but are not limited to, the annual meetings of the American Finance Association, the American Economic Association, the Western Finance Association, and the Western Economic Association. Further, the Bureau should host research conferences where rigorous empirical work is presented and discussed.

The Council should be reformed to focus on regulatory cost-benefit analysis as employed by other agencies of the federal government, such as the Federal Trade Commission. Some historical advice given by the Council seems to focus on a behavioral finance approach to building a welfare model of biased consumer choice. For example, the minutes of the April 2014 meeting state (in part),

> The day's second meeting focused on helping the Office of Research advance its understanding of consumer finance regulations and the benefit-cost analysis of such regulations. . . . During the discussion, Council Members proposed an approach to measuring the welfare impact of regulation. They suggested, given the decision making context that a researcher should begin by identifying two to three main mechanisms by which a consumer's decisions may deviate from optimizing choices. The researcher should then take rational model of consumer choice and build those biases into that model.[6]

I am not saying that the insights from behavioral economics on consumer choice should be ignored in formulating regulation. These insights, however, must not be the primary focus of future research by the Bureau's research staff. Those who craft consumer finance regulations must use accepted research methods in economics and finance. Then proposed regulations must be examined with accepted methods of regulatory cost-benefit analysis.

Before proposing any new regulation, the Bureau should help build and present a mosaic of transparent research results. The Bureau could

- provide downloadable research data for use by outside researchers,

[6] Consumer Financial Protection Bureau, Academic Research Council, *April 25, 2014 Meeting Summary*, April 25, 2014, 4.

- establish its own external publications like the ones published by the various branches of the Federal Reserve banks, or
- serve as the catalyst for a new academic journal on consumer finance. The members of the Council could serve as editors of the journal, and members of the research staff could be part of the pool of people who provide peer reviews.

ENSURE AN UPDATE TO NEEDED POLICY-ORIENTED RESEARCH AS IN THE 1972 REPORT OF THE NATIONAL COMMISSION ON CONSUMER CREDIT

In 1968, Congress passed legislation to form a Presidential Commission on Consumer Credit. Congress could specifically pass legislation to do so again. The Dodd-Frank Act of 2010, however, empowers the Bureau to study the workings of consumer credit markets. The Council is a prime candidate to serve as the catalyst to develop and complete a comprehensive study of current consumer credit markets.

The Consumer Credit Protection Act (Pub. L. No. 90-321, 82 Stat. 146), was enacted May 29, 1968. Title IV of the Act established the National Commission on Consumer Credit.[7]

The commission eventually received presidential backing. In a message to Congress in October of 1969, President Nixon urged the commission to "begin its important work immediately." He cited two important reasons for commencing the study: (1) outstanding consumer credit had grown from $5.7 billion since the end of World War II to $100 billion, and (2) government supervision and regulation of consumer credit had become increasingly complex and difficult.[8]

The commission's tasks were to "report on the adequacy of existing arrangements to provide consumer credit at reasonable rates, the adequacy of existing supervisory and regulatory mechanisms to protect against unfair practices, and ensure the informed use of consumer credit products, and the desirability of Federal chartering or other Federal regulatory measures."[9]

The commission unanimously concluded that a "truly competitive consumer credit market, with adequate disclosure of relevant facts . . . will . . . serve to optimize benefits to the consumer." The commission further found that "free and fair competition is the ultimate and most effective protector of consumers" and recommends "the elimination of restrictive barriers to entry in consumer credit markets by permitting all creditors open access to all areas of consumer credit." The commission urged "that rate ceilings which constrain the development of workably competitive markets be reviewed by those states seeking to increase credit availability at reasonable rates."[10]

More than 45 years have passed since the publication of the commission's comprehensive study of consumer credit. In 1969, President Nixon pointed out two reasons that the commission should promptly begin its work. They are still valid today because (1) outstanding consumer credit continues

[7] Title I (also known as the Truth in Lending Act) is its best-known section.
[8] National Commission on Consumer Credit, *Consumer Credit in the United States*, 1972, vii.
[9] National Commission on Consumer Credit, *Consumer Credit in the United States*, 1.
[10] All quotes are from National Commission on Consumer Credit, *Consumer Credit in the United States*, iii.

to grow (to about $2.8 trillion in 2012),[11] and (2) government supervision and regulation of consumer credit remains complex and difficult. Title X of the Dodd-Frank Act established the Bureau and gave it rulemaking authority over a wide-ranging set of federal consumer protection laws.

The consumer credit landscape has changed significantly in the past 50 years. For example, when the National Commission of Consumer Credit was established, general-purpose credit cards and student loan debt were in their infancy. Also, in 1972, the "subprime" credit market consisted of pawn transactions and installment loans from finance companies regulated by state laws that grew out of the Uniform Small Loan Law of 1916.[12]

Today, there are more mortgage options, more options for auto loans, and a subprime credit market consisting of many products including subprime credit cards, rent-to-own stores, pawn transactions, installment loans from finance companies, lump-sum payday loans, vehicle title pawn transactions, and other consumer credit options such as flex loans available on the internet.

American consumers would be well served with an update to the commission's 1972 report on Consumer Credit. What better way is there to put more math into studying consumer credit markets?

In closing, I note that two strategies to meet objective 1.3 of the Bureau's 2018–2022 strategic plan are to "pursue an efficient, transparent, and inclusive approach to developing or revising regulations" and "carefully evaluate the potential benefits and costs of contemplated regulations."[13] I believe that the recommendations in this comment will support the Bureau's new direction as outlined in its new strategic plan.

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[11] Even accounting for inflation, this growth is remarkable. See Thomas A. Durkin, Gregory Elliehausen, Michael E. Staten, and Todd J. Zywicki, *Consumer Credit and the American Economy* (New York: Oxford University Press, 2014), 6.

[12] For a discussion of the development of the Uniform Small Loan Law, see, for example, Lendol Calder, *Financing the American Dream: A Cultural History of Consumer Credit* (Princeton, NJ: Princeton University Press, 1999); see also the 14 papers published in "Combating the Loan Shark," *Law and Contemporary Problems* 8, no. 1 (Winter 1941): 1–206.

[13] Consumer Financial Protection Bureau, *Bureau of Consumer Financial Protection Strategic Plan, FY 2018 - 2022*, February 2018.