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Richard Cordray

FOREWORD: CONSUMER FINANCIAL PROTECTION BUDGET PROPOSAL IN CALIFORNIA

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This Foreword addresses the topic of consumer financial protection in California, which is likely to have considerable bearing on the same topic throughout the country. Presented below is testimony provided to the California Assembly in March 2019.[1] That testimony gave the first push to encourage the State of California to step forward and consciously seek to fill a gap left by the recent retreat of the U.S. Consumer Financial Protection Bureau.

That federal agency, which I headed as the first director, has as its sole mission the responsibility to protect and support consumers in the financial marketplace.[2] During my tenure, which lasted six years, we sought aggressively to fulfill this role and level the playing field for consumers and families who deal with large financial companies, against strenuous opposition from the financial industry and frequent criticism from political opponents. After my departure, however, the new leadership explicitly reversed course, pulling back sharply to use its powers of regulation and enforcement less vigorously. These events are canvassed in my recently published book, *Watchdog*, which provides considerable detail about the need for consumer financial protection in America and how that need can be addressed more effectively.[3]

Against that backdrop, it became more important for the state governments to protect their own people against fraud and abuse in financial markets, without relying on the ebbs and flows of policy made in Washington.[4] California, as the most populous state with the largest economy, seemed a natural candidate for leadership in this regard, and the testimony that follows was designed to advocate such an enlarged role. In the year since, Governor Gavin Newsom has embraced the spirit of this testimony and moved beyond the original legislative proposal. In his proposed budget released on January 10, 2020, he set out to overhaul the existing

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[1] The testimony reproduced below before the California Assembly was presented in response to an invitation issued by Assemblywoman Monique Limón, Chair of the Banking and Finance Committee. The proposal that she had under consideration at the time was aimed broadly at strengthening consumer protection in California, either by creating a new agency described as a "mini-CFPB" or by increasing the budget of the California Department of Business Oversight (DBO) to add more enforcement attorneys. *See* Katie Grzechnik Neill, *California Assemblywomen Explores Creation of State-Level CFPB in Press Conference with Cordray*, INSIDEARM (Apr. 15, 2019), https://www.insidearm.com/news/00044939-press-conference-cordray-california-assem/.

[2] Congress created the new Consumer Bureau when it enacted Title X of the Dodd-Frank Wall Street Reform & Consumer Protection Act in 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. 5301 *et seq.*). The entire law, which is much broader in scope, is known simply as the Dodd-Frank Act, so named after its chief sponsors, Senator Chris Dodd and Representative Barney Frank.

[3] *See* RICHARD CORDRAY, WATCHDOG: HOW PROTECTING CONSUMERS CAN SAVE OUR FAMILIES, OUR ECONOMY, AND OUR DEMOCRACY (2020).

[4] *See, e.g.*, CORDRAY, WATCHDOG, *supra* note 3, at chapter 15; *see also* Mark Totten, *Credit Reform and the States: The Vital Role of Attorneys General After Dodd-Frank*, 99 IOWA L. REV. 115 (2013) (describing and analyzing how the Dodd-Frank Act broadened the role and powers of state officials in securing consumer financial protection).

administrative framework and create a new California Department of Financial Protection and Innovation.[5] The struggle over this new vision remains ongoing so far, but it holds out the promise of a sturdy new federalism that will support and protect consumers who simply deserve to be treated fairly and honestly in the financial marketplace. The original testimony (with reference notations added for purposes of this publication) follows:

TESTIMONY TO CALIFORNIA ASSEMBLY COMMITTEE ON BANKING AND FINANCE

MARCH 27, 2019

Richard Cordray

Thank you for inviting me to testify today. My name is Richard Cordray, and I had the honor to serve as the founding Director of the U.S. Consumer Financial Protection Bureau for its first six years. My testimony concerns how California can take the initiative to protect consumers in the financial marketplace at a time when the Federal government is retreating from this area. It will touch on theories of financial regulation; the purpose, role, and current status of the CFPB; how federalism affects consumer finance; and the rationale for California to step up and enhance its own capability to protect consumers. California has always prided itself on being a leader in looking out for consumers,[6] and it has the chance to do so again here.

Financial regulation is enormously important for consumers, who often feel frustrated and mistreated in the financial marketplace.[7] The problems they face at a personal level are magnified throughout the economy. The last two generations have

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[5] *See, e.g.*, David Lazarus, *Trump Slashed Consumer Protections. So California Is Stepping Up*, L.A. TIMES (Jan. 9, 2020) https://www.latimes.com/business/story/2020-01-09/column-california-consumer-bureau [https://perma.cc/5H8L-JAVD]; Kate Berry, *Can California's Mini-CFPB Pick up Slack Left by Federal Agency?*, AM. BANKER, (Jan. 10, 2020) https://www.americanbanker.com/news/can-californias-mini-cfpb-pick-up-slack-left-by-federal-agency [https://perma.cc/SVK9-JHRE].

[6] For example, the California Supreme Court took a leading role in protecting consumers by establishing strict liability in tort law. *See, e.g.*, Roger J. Traynor, *The Ways and Meanings of Defective Products and Strict Liability*, 32 TENN. L. REV. 363 (1965). In addition, California has long led the nation in protecting the environment by fashioning its own vehicle emissions standards, which has represented a peculiarly strong example of the powers that states can exercise in our system of federalism. *See, e.g.*, S. Allan Adelman, *Control of Motor Vehicle Emissions: State or Federal Responsibility?*, 20 CATH. U. L. REV. 157 (1971). And even as it is stepping forward to take the lead in consumer financial protection, it is also doing so in protecting individual privacy by giving people more control over their personal information. *See, e.g.*, Natasha Singer, *The Week in Tech: Countdown to the California Consumer Privacy Act*, N.Y. TIMES (Dec. 13, 2019), https://www.nytimes.com/2019/12/13/technology/california-consumer-privacy-act-ccpa.html [https://perma.cc/V7UY-TR4L]. In this and other ways, California stands as an example of what Justice Brandeis memorably described as "one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory and try novel social and economic experiments without risk to the rest of the country." New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

[7] For discussion of many ways that consumers are subject to fraud and abuse in the financial marketplace, see, for example, CORDRAY, WATCHDOG, *supra* note 3, at chapter 1; BOB SULLIVAN, GOTCHA CAPITALISM (2007).

seen an explosion of consumer debt, which has risen from about $1000 per person to more than $40,000 per person today.[8] The mass availability of consumer credit has created new opportunities for people but also increases the risks they face, and the risks to our economy. Exotic lending in the mortgage market brought down the entire American economy in 2008, costing millions of jobs, millions of homes, and trillions in lost retirement savings. The regulators lacked the tools to monitor the consumer markets effectively and missed the tell-tale signs. In the end, they were too late to stop the financial crisis from turning into the Great Recession.[9]

In the wake of that catastrophe, which turned out to be worldwide in scope, a chorus of experts called for an overhaul of financial regulation. They converged on the "twin peaks" theory, which has been broadly accepted as the right approach for the 21st century.[10] It imposes a distinct separation between the first peak of financial stability, where prudential regulators assure the stability of the financial companies, and the second peak of financial conduct, where other regulators are responsible for consumer protection. This approach creates efficiency by having the same regulator oversee the conduct of both chartered banks and other financial companies, which often compete with one another in the same markets, such as mortgage and auto lending. The separation of the two main functions is also essential to prevent one of these goals from subordinating the other. In a 20th century model, the missing focus was consumer protection. We neglected our oversight of the conduct of the financial companies, and it cost all of us dearly, including 40 million Californians. The Great Recession also brought on a deep fiscal crisis in California that has only recently been healed.[11]

In the past decade, most large Western economies have adopted the twin peaks model: Australia, New Zealand, the U.S., the U.K., and South Africa. Others are progressing toward the same destination.[12] But right now, California is still operating on the obsolete model with its built-in conflict of interest between promoting the safety and soundness of financial companies versus regulating how they treat consumers. The two goals are sometimes at odds, and the financial regulator depends in part for its funding on dues paid by those companies. That is not the right answer for a state as important as California, which now boasts the fifth

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8 *See Household Debt and Credit Report: Q1 2020,* FED. RES. BANK OF N.Y. CENTER FOR MICROECONOMIC DATA, https://www.newyorkfed.org/microeconomics/hhdc.html [https://perma.cc/N6R4-SJ8Q]. *See generally* A. Ryan, G. Trumbull & P. Tufaro, *A Brief Postwar History of U.S. Consumer Finance*, 85 BUS. HIST. REV. 461, 461-89 (2011).

[9] For more on the startling growth and power of the U.S. financial industry, and how irresponsible mortgage lending helped bring about the Great Recession, see, for example, CORDRAY, WATCHDOG, *supra* note 3, at chapter 2.

[10] *See, e.g.,* Andrew Godwin, Timothy Howse & Ian Ramsay, *A Jurisdictional Comparison of the Twin Peaks Model of Financial Regulation*, 18 J. BANKING REG. 103 (2017) (exploring the design and implementation of this new regulatory model).

[11] *See, e.g., California Faces Budget Crisis*, BBC NEWS (Dec. 2, 2008), http://news.bbc.co.uk/2/hi/americas/7760249.stm [https://perma.cc/T678-PMZ9] (projecting the current California budget shortfall at the time to exceed $11 billion).

[12] *See, e.g.*, Andy Schmulow, *Financial Regulation: Is Australia's 'twin peaks' model a successful export?*, THE INTERPRETER (Mar. 1, 2016), https://www.lowyinstitute.org/the-interpreter/financial-regulation-australias-twin-peaks-model-successful-export [https://perma.cc/EHH5-PMEP] (detailing the approach that separates regulation for financial system stability from regulation of good market conduct and consumer protection).

largest economy in the world.[13] For these reasons, Californians deserve a modernized structure with a more concentrated focus on consumer financial protection.

At the federal level, the CFPB was created to fulfill this role. In less than a decade, it has proved to be a great success. It has amplified the voices of consumers, receiving and handling over 1.6 million complaints since it opened its doors. It has enforced the law vigorously, returning $12 billion to more than 30 million Americans during my tenure, which works out to about a billion dollars for Californians alone.[14] Its reforms to the mortgage and credit card markets have saved consumers billions of dollars per year, putting a halt to the irresponsible and predatory lending that brought on the financial crisis, damaged our economy, and hurt so many Americans. It also has reined in harassing debt collectors, forced improvements to the credit reporting companies, and stopped many sloppy or abusive practices by auto lenders and student loan servicers.[15]

Right now, the CFPB has been retreating from some of its responsibilities under its new leadership. It has backed away from a strong federal rule on payday lending, from actions to prevent violations of the Military Lending Act, and from aggressive oversight of student loan servicers.[16] I am aware that you are going to hear more about these issues from other panelists who are expert in these areas and will discuss them in more detail. But this is the perfect time for California to step forward to shore up consumer financial protection, even as the Trump administration is currently defaulting on some of its obligations under federal law.

The financial reform law that created the CFPB, known as the Dodd-Frank Act, expressly provided for more expansive protections at the state level that can go beyond federal protections. To put it simply, the law says clearly that federal law sets a floor, not a ceiling, on consumer financial protection in this country.[17] Congress thus opened the door for more vigorous protection of consumer rights through state officials who can ensure that these laws are strong and that they are enforced effectively.[18] These efforts not only protect consumers – who simply deserve to be treated fairly by financial companies – but it also levels the playing field by protecting more ethical companies from having to compete against bad actors that are willing to cut corners and violate the law to get an advantage in the

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[13] *See* Jonathan J. Cooper, *California Now World's 5th Largest Economy, Surpassing UK*, USA TODAY (May 5, 2018), https://www.usatoday.com/story/news/nation-now/2018/05/05/california-now-worlds-5th-largest-economy-beating-out-uk/583508002/ [https://perma.cc/RS4N-K5DR].

[14] *See, e.g.*, Kevin Dugan, *CFPB Director Richard Cordray Is Stepping Down*, N.Y. POST (Nov. 15, 2017), https://nypost.com/2017/11/15/cfpb-director-richard-cordray-is-stepping-down/ [https://perma.cc/U478-HZ5D].

[15] *See, e.g.*, CORDRAY, WATCHDOG, *supra* note 3, at chapters 5-12.

[16] *See id.* at chapter 15.

[17] *See* 12 U.S.C. 5551(a) (2018) ("For purposes of this subsection, a statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title.").

[18] This also includes an unusual but not unprecedented provision that allows certain state officials to enforce the federal consumer financial protection law directly, not limiting that authority to federal officials alone. *See* 12 U.S.C. 5552(a) (2018) (authorizing state attorneys general and state regulators to bring civil actions against certain parties as specified to enforce the provisions of the new federal consumer financial law).

market. That is the worst form of unfair competition, and stronger enforcement of consumer laws can help root it out.

We also need to do a better job of educating consumers about the risks and challenges of more complicated credit products.[19] Over the past decade, many consumers have been exposed to the hazards of mortgage instruments with increasingly exotic features; they now have access to revolving credit, often on multiple credit card accounts with different interest rates and vastly different terms; and they may be juggling various other credit obligations as well. Yet nobody would claim that this country is suddenly doing a better job of educating consumers about their obligations – not in the home, not in school, not at work, and nowhere else. That is a task we need to take much more seriously than we now do or have done. By taking the initiative, California can help lead other states forward.

This work matters greatly in our society, which is marked by growing income inequality and huge wealth inequality.[20] The focus on putting more money into people's pockets should be matched by a similar focus on keeping more money in their pockets, rather than having it drain away in nickel-and-dime fees, frauds and scams, or abuses that may be perpetrated by big financial companies. In a simpler time, Benjamin Franklin declared in his *Poor Richard's Almanac* that "a penny saved is a penny earned." In today's world, a penny saved from financial predators is a penny that is very well earned indeed. A single bad financial experience can ruin a person or a family, and a constellation of bad experiences can undermine entire communities, as we saw in the runup to the financial crisis just a decade ago.

In 1962, President Kennedy gave a speech to Congress in which, for the first time, he spoke directly about the role of the consumer in our society. He noted that: "[c]onsumers, by definition, include us all. They are the largest economic group in the economy . . . Two-thirds of all spending in the economy is by consumers. But they are the only important group in the economy who are not effectively organized, whose views are often not heard."[21] His words are just as true today. The push to protect consumers later resulted in bipartisan legislation governing truth in lending,[22] fair lending without discrimination,[23] and debt collection practices,[24] landmark statutes that were enacted under both Republican and Democratic administrations.

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[19] For a fuller account of the shortcomings of financial education in the United States and the justification for more effective efforts in this area, see CORDRAY, WATCHDOG, *supra* note 3, at chapter 8.

[20] *See, e.g.*, ESTELLE SOMMEILLER & MARK PRICE, THE NEW GILDED AGE, ECON. POL'Y INST. (July 19, 2018) (noting that the income gap between top 1% and bottom 99% is now the largest in American history); Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the U.S. Since 1913: Evidence from Capitalized Income Tax Data,* (NBER Working Paper No. 20625, Oct. 2014) (noting that the top 0.1% of wealthiest Americans now own 22% of the wealth, their largest share since 1929; share of wealth held by bottom 90% has been steadily declining for three decades).

[21] John F. Kennedy, Special Message to Congress on Protecting Consumer Interest, (Mar. 15, 1962). The speech was delivered on March 15, 1962, a date that is now celebrated around the globe as "World Consumer Rights Day."

[22] Consumer Credit Protection Act of 1968, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified at 15 U.S.C. § 1601 *et seq.*).

[23] Equal Credit Opportunity Act, Pub. L. No. 93-495, 88 Stat. 1521 (1974) (codified at 15 U.S.C. § 1691 *et seq.*).

[24] Fair Debt Collection Practices Act, Pub. L. No. 95-109, 91 Stat. 874 (1977) (codified at 15 U.S.C. § 1692 *et seq.*).

Thirty years later, these efforts at the federal level had fallen behind the rapid pace of developments in the financial marketplace. The laws needed to be updated, and an outmoded regulatory structure meant that the laws were being systematically under-enforced, with grave consequences for all Americans. The CFPB was an essential and welcome centerpiece of those reforms.[25] As the federal government now again seems to be abdicating its role, it is crucial for this country that the states are taking up the mantle of consumer financial protection. I am encouraged to see that California is prepared to lead the way. Thank you.

[25] An accessible description of these developments can be found in Michael Lewis, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE (W.W. Norton 2010). For a good account of the struggle in Congress to pass the Dodd-Frank Act, see ROBERT G. KAISER, ACT OF CONGRESS (Vintage 2013). The original idea for the U.S. Consumer Financial Protection Bureau was set forth by then-Professor (later Senator) Elizabeth Warren. Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY JOURNAL (Summer 2007) https://democracyjournal.org/magazine/5/unsafe-at-any-rate/ [https://perma.cc/M9DY-GY7Q].