COMPETITIVE ENTERPRISE INSTITUTE

*Overcoming Regulatory Barriers to Serving the Underserved*
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*Policy keynote delivered at the Financial Service Centers of America Annual Conference and Exposition, Las Vegas, October 5 2017*

As you might guess from my accent, I'm an immigrant – which is my excuse for any funny pronunciations you might hear tonight.

When I first arrived in this country over twenty years ago, despite having a Masters from Oxford University and an MBA from the University of London and (after a year-long struggle with a dysfunctional immigration service) a good job, I had no credit history and hence no credit rating. For years I was reliant on my wife's family for sources of emergency funding.

Today, I could go to a Financial Service Center for those needs. That is one of many reasons why I am so happy to be addressing this conference today on the subject of overcoming regulatory barriers to serving the underserved. I was one of those underserved.

My name is Iain Murray; I am a Vice President at the Competitive Enterprise Institute in Washington, DC. CEI, as we like to be known, is a think tank dedicated to reducing the burdens of regulation on the economy. We are not part of the federal government. We try to educate the administration and the Hill on the burdensome effects of regulation. If necessary, we sue the federal government to try to get overreaching regulations lifted.

Our research tells us that the overall burden of regulation on the American economy now reaches $1.9 trillion annually. That's almost $15,000 per household, and a quarter of the average household expenditure budget of $56,000. We spend more per household on regulation that we do on health care, food, transportation, and entertainment.

Those costs translate into real problems. Households face hardship. Jobs are not created. Businesses are not started.

Worse, jobs can be eliminated, services closed off, and businesses shuttered when regulation increases – leading to yet more hardship for the people affected. You know this, because you are all under threat from the regulation the Consumer Financial Protection Bureau finalized yesterday.

It's all the more ridiculous when we consider the good work you do. As I mentioned before, I used to find it hard to get cash when I needed it. For a variety of reasons, the number of people underserved by traditional banking arrangements has increased since then – about 80 million people, as Joanne noted.

One important factor besides immigration and unemployment was the Dodd-Frank Act of 2010. According to work by Todd Zywicki and colleagues at George Mason University, up to a million people may have been pushed to the fringes of the banking system by regulations introduced

by Dodd-Frank. The law increased fees and reduced eligibility for services. Banks drove away marginal customers. Such simple features as checks and overdrafts became too expensive for them.

It was entrepreneurs like you who filled the void. Financial Service Centers have become the go-to places for the underbanked to handle their financial needs. Nor is it just the presence of ready cash – I am sure you all know about Lisa Servon, a professor of city planning at the University of Pennsylvania, who wrote in her book "The Unbanking of America," about how financial service centers fill a vital community and human need.

People who use your businesses like them because they get a sympathetic ear and find a willingness to work with them to meet their individual needs. She discovered this after working for four months as a teller at a center in the South Bronx. It surprised her because she had the typical impression that your businesses are predatory.

Of course, the academic literature also shows this is completely untrue. As a study my organization published last year shows, academics who have researched the effects of payday loans and other similar services have found that their effects on consumer welfare are at worst neutral and probably positive overall. You are doing good work, and you are helping people. We *know* this – anecdotal and empirical evidence supports it.

And yet, as you know, your very existence is under regulatory threat. The CFPB itself admits that its new rule could wipe out 75% of loan value.

The CFPB's new rule will do more to *stop* people from getting urgently needed funds than it will to *help* consumers avoid prolonged debt. Imposing a new 'ability to repay' standard is wholly inappropriate for small-dollar loans, because if borrowers truly had an immediate 'ability to repay,' they would most likely use a credit card instead of getting a loan.

The CFPB is simply attempting to circumvent Congress. Dodd-Frank bars the CFPB from capping interest rates on loans. Lawmakers of both parties viewed that as a state rather than federal decision.

And as you know, Consumers have said in multiple surveys that they were satisfied with their loan products, and they reported repayment difficulties only in a small minority of cases. For those minority of cases, the CFPB could simply have issued rules improving disclosure, rather than limiting options for lower-income consumers and those who need cash in emergency circumstances.

How could this happen? How can the CFPB issue such a rule, so harmful to low-income men and women?

To understand how that has happened, and to consider what to do about it, I will need to explain how our regulatory system is supposed to work, and what has gone wrong here.

The Constitution says that all legislative powers are vested in Congress. Yet over the years, Congress has developed a system of delegating law-making power to the Executive Branch, a system that has been ratified by the Judicial Branch. This system is what we know as regulation.

What happens is that Congress writes a law that empowers an Executive Officer – normally a Cabinet Secretary – to flesh out rules based on general principles laid down in the law. In practice, the rules are written by bureaucrats employed in the Secretaries' agencies.

The rationale for this system is that cabinet agencies have greater expertise in the ins-and-outs of issues than does Congress, and that is why courts have upheld the system, as providing more expert legislation.

When this system began with the New Deal, however, the rules were generally developed by enforcement. The agency would issue general guidelines and then sue people they felt were breaking those guidelines. Representative Sinema indicated that the CFPB still does this, by the way. This led to such an air of uncertainty and confusion over due process that Congress moved to change the system.

In 1946, it passed the Administrative Procedure Act, which imposed due process on adjudicative enforcement actions, and introduced further requirements for rulemaking that included public participation in crafting new rules through a process known as notice and comment.

Agencies considering new rules have to set out their thinking in a public notice and invite public comment from stakeholders and the general public. In theory, the comment process should improve the rule by incorporating suggestions or removing objectionable elements.

Yet the excellent aims of the Administrative Procedure Act have been subverted by agencies in a variety of ways. Let me give you some unhappy examples of how it works in practice.

Most of you here will have heard of Operation Choke Point.

Many of you will have been harmed by it.

Some of you will have been driven to the brink of going out of business.

Operation Choke Point was clearly an attempt to hurt the payday lending business – the clue is in the name. Internal documents obtained by the House Committee on Financial Services showed that the initiative was so named in order to "choke off" the financial oxygen of abusive payday lenders by denying them access to banking services. Of course, it wasn't just the abusive lenders who were hurt. It was people like you.

Yet Congress never authorized such an initiative.

There was no formal rulemaking, no notice and comment.

The Department of Justice simply started issuing subpoenas to banks engaged with payday lenders.

They did this on the basis that a Federal Deposit Insurance Corporation guidance document warned banks to be wary of "reputational risk" associated with providing banking services to a variety of businesses, including not just payday lenders, but also firearms sales and pornography.

Banks reacted by cutting ties with any business that could be covered by the list. They wanted to avoid the risk of a subpoena or even the heightened supervisory scrutiny that reputational risk might trigger. It was a rational reaction by the banks, yet one that the Department of Justice dismissed as a mere inconvenience.

Of course, the effect of the initiative was more than mere inconvenience. Thousands of businesses, including many of yours I am sure, had to move to systems of cash or shoebox accounting.

In many cases, businesses that courts had repeatedly reaffirmed had a constitutional right to exist, like firearms sales, were put in jeopardy. Both the First and Second Amendment were rendered meaningless to a degree by a simple administrative initiative.

Before I give an answer as to how this was allowed to happen, let's look at another example of a rule that overreaches. In this case one that supposedly adhered to the principles of the Administrative Procedure Act – the rule covering arbitration clauses in financial contracts issued by the CFPB. I use this as an example rather than the small dollar rule not only because it affects many of you, but because I haven't yet had time to go through hundreds of pages of the full rule issued yesterday.

The arbitration rulemaking was based not on an explicit instruction in the Dodd-Frank law, which only called for a study of mandatory arbitration clauses. It was issued after that study concluded under the Bureau's broad power to issue regulations supposedly in the public interest and consistent with the study.

The 724 page study in fact provided information both for and against regulation of arbitration clauses. One piece of academic literature included in the study found that the likely effect of banning arbitration clauses would be to raise the cost of credit on average by 3.5 percentage points - a huge effect. Yet the Bureau ignored this direct evidence of consumer harm -- a finding the Office of the Comptroller of the Currency has recently affirmed in its own study.

Thousands of commenters pointed out this and similar deficiencies in the study. They pointed out that the study showed that consumers with complaints generally fared better under arbitration than in class action lawsuits.

Yet the CFPB went through each one of these thousands of objections and hand-waved them away. There is no sign in the Bureau's response to the comments that it ever had any intention of changing its mind in response to the comments it received. In many cases it seems that the CFPB took the objections as evidence it was doing something right.

The spirit of the Administrative Procedure Act – that comments should improve the rule – seems entirely absent. The Bureau is going forward as if the notice and comment period was merely a box to check in issuance of the rule, not a chance to think it might be mistaken.

As I say, we are still analyzing the new small dollar rule, but it looks as if exactly the same thing has happened there. In particular, the weight of the million plus comments that were submitted criticizing the rule seems to have counted for naught.

For example, the comments my organization submitted included evidence of substantial loan shark activity in certain communities and suggested that the Bureau really should study the question empirically. The Bureau ignored this suggestion, and hand-waved away other evidence that loan-sharking might increase from other groups. It simply repeated its assertion that it was unaware of any evidence that restricting payday loans would lead to increased activity by loan sharks.

The Bureau did drop several parts of its rule, but by its admission some of this was because it would take too much time to evaluate the comments on those parts of the rule, which is completely against the spirit of the APA and suggests another timetable may be in play.

As for the rules supposedly exempting small dollar lending by community banks, our sources in that industry tell us that they are still evaluating whether the exemptions will work for them. In any event, it was clear from the start that this rule was aimed at people like you. The Bureau has what it always wanted – a rule aimed at killing off parts of your industry.

So we need to answer these questions - how has it come to this? And what can we do about it?

At CEI, we have identified a number of maladies that have crept into administrative procedure over the years. One of them we call "regulatory dark matter," and it is this problem that was at the heart of Operation Choke Point.

All agencies issue hundreds of guidance notes, legal interpretations, and even blog posts about regulation each year. Over the years, many of these have come to have the force of law. It was the FDIC guidance on reputational risk, for instance, that scared banks into cutting off banking services once reference was made to it in association with heightened supervision.

Although the document itself had no formal legal role, it had the effect of law in that the agencies used it to justify heightened supervision and banks realized the note itself posed a risk

they were not prepared to bear. Yet that note had not gone through notice and comment or any other procedure mandated by the administrative procedure act.

We see similar issues with agency interpretations of the law.

These are issued by agencies routinely, but can have the effect of changing the law. An example was the Department of Labor last year issuing an administrator's interpretation that overturned 40 years of precedence in deciding what qualifies a firm as a "joint employer" of a worker with another firm. This may sound arcane, but it in fact formed an existential threat to the operation of franchise businesses, which faced the threat of becoming actual subsidiaries in all but name of their franchisor.

Challenging such an interpretation in court would prove very difficult owing to a judicial doctrine called Chevron Deference, which states that the courts should agree with an agency interpretation of a law on the grounds that the agency has more expertise than the courts. While Chevron does not apply in every interpretation, it makes challenging interpretations an uphill battle.

The previous administration was even happy to use blog posts to change the law. Another example from the Department of Labor in 2015 was a blog post that explained that henceforth it would change the tests of whether someone was an independent contractor or an employee – and the effect of the change would be to make many more people employees, with a series of attendant benefits the employer would be required to offer.

Once again, there was no notice and comment attached to this change – it was simply announced. It is the closest I have seen to ruling by decree in America. That is the effect of regulatory dark matter. As long as it is allowed to have the effect it has had in increasing regulation, initiatives like Operation Choke Point remain possible.

The example of the CFPB rules, meanwhile, shows us the special effect of one malady in particular – the unconstitutional walling off of new agencies from accountability to the three branches of government.

A series of new agencies were created after 2008 that had what we consider unconstitutional features that isolate them from consequences of regulatory overreach. The most prominent among these is the Consumer Financial Protection Bureau.

How is the CFPB unconstitutional? Well, the Constitution vests the duty to ensure faithful execution of the laws in the President. Until the 1930s all federal officials answered to him. In the New Deal, however, a new form of agency – the independent agency – was created. These took the form of commissions, with members from each party, nominated by the President but

able to take decisions without his approval. The courts approved these agencies on the grounds that they had internal checks and balances from the commission structure.

Moreover, these agencies all depended for their financing on Congress, which exercises the power of the purse through the appropriations process. Congress can cut off the financing of an overreaching agency, as it has done many times, such as the reforms to the Federal Trade Commission when it tried to become what the Washington Post called "the national nanny" in the 1980s.

Finally, the agencies are subject to the courts, which can find that they have overreached on their powers, even with the doctrine of Chevron deference.

The creation of the CFPB tossed these checks and balances out the window. It was created with a single director, not a commission structure (which even Elizabeth Warren wanted when she floated the idea of the agency). Moreover, the President cannot fire this single director except "for cause" – meaning that the Director has to engage in malfeasance or something similar.

Congress cannot exercise the power of the purse over the agency, because it draws its funding from the Federal Reserve, not the appropriations process (nor can the Fed exercise control, because it is mandated to provide whatever the Director asks for up to a certain limit).

Finally, the courts are instructed by the law to give extra deference to the CFPB – in the event of another financial regulator having a different interpretation of the law, the courts are instructed to ignore that and take the Bureau's interpretation as the only one. Add Chevron deference to that and you have a recipe for practical absence of judicial review.

In other words, with no accountability, this unconstitutionally structured agency can do what it likes, just about.

Director Cordray has no worries about being overruled, fired, or losing his funding. The courts themselves are constrained as to what they can do. And of course the judicial system is notoriously slow these days, meaning that anyone harmed by a CFPB rule has a good chance of being out of business by the time the court hears their objections – and the CFPB knows this.

So what can be done? How can we overcome these regulatory barriers? Well, I can bring <u>some</u> good news.

The one good thing about regulatory dark matter is that, because it has no formal legal status, it can be changed or withdrawn quite easily. We saw this in Choke Point – the FDIC Chairman realized that things had gone awry when Rep. Blaine Luetkemeyer and others confronted him with evidence of harm. He withdrew the guidance. Although Choke Point continued through the bloody-mindedness of the Justice Department, its basis had disappeared. Of course, the CFPB took up the baton in its rulemaking, but all executive agencies involved in Choke Point

have now repudiated the initiative. We've seen similar changes in other departments – the Labor Department has rescinded the dark matter I talked about there.

Yet the threat remains that future administrations might use dark matter to circumvent the law again. That's why we at CEI are pressing Congress to take action and subject anything more that the most innocent guidance to the notice and comment requirements of the APA.

As for the CFPB, there is hope on three counts.

First, the courts have finally taken an interest in the CFPB's structure. Indeed, last year the DC Circuit Court of Appeals, found in the case of PHH, a mortgage processor, against the CFPB, that the Bureau's structure is indeed unconstitutional because of its unaccountability. We believe the court was inspired by CEI's amicus brief in support of the plaintiff.

The court struck down the clause in Dodd-Frank that said that the Director could not be fired except for cause, meaning that the Director would then serve at the pleasure of the President. Unfortunately, the Court agreed to rehear the case on appeal from the CFPB, and we are still waiting to find out if the full Court will continue to find the Bureau's structure unconstitutional – a stance, by the way, the Department of Justice agreed with in its submission to the court. If not, we expect to see the case appealed to the Supreme Court, where we believe the current court will take a dim view of the Bureau's structure.

There are other cases pending – CEI itself has joined with a small bank in Texas that has been badly harmed by the Bureau to argue not only that the Director is too powerful but that Congress must be able to exercise the power of the purse. That case is on hold pending resolution of the PHH case, but we plan to push it hard whatever happens there. So the courts allow for one measure of redress, even if it has to be at the high level of constitutionality.

The Congress can also do things. There is a procedure known as the Congressional Review Act that allows Congress to disapprove of a regulation. This has to be done within 60 legislative days of the regulation being finalized, but it requires only simple majorities in both Houses, meaning the Senate cannot filibuster a resolution of disapproval. The CFPB's arbitration rule was disapproved of by the House, and we expect a vote in the Senate the week after next. If a rule is disapproved of, not only is the rule struck down, but the agency is forbidden from making any substantially similar rule in the future.

Thus, a CRA may be the best hope for killing the payday rule. The vote in the Senate on arbitration will be a good signal as to whether that can succeed. Letters to Senators are generally the best way to influence them one way or the other, so if you would like to educate them about the effect the CFPB rules have on you and your customers, you might want to consider letting them know where you stand.

Congress can also do something significantly stronger on the CFPB. The Financial CHOICE Act passed the House earlier this year. One of its sections restructured the CFPB into the Consumer

Law Enforcement Agency, stripping the new bureau of the CFPB's rulemaking and supervisory powers, and solving all the constitutional problems. While the full act shows no sign of being able to get 60 votes in the Senate, the CFPB section has direct effect on the budget, as it brings the agency within the appropriations process. That means that the Senate could include it in the budget reconciliation resolution that is being debated right now. Again, if you were to contact your Senators for any reason, you might perhaps want to express your views on that. Budget reconciliation may be our best bet for meaningful, long-lasting CFPB reform.

Finally, there is one thing the President could do, and it's what he's perhaps best known for. He could tell Richard Cordray, "You're Fired!"

There is ample cause for him to do so. He could announce that he considers the Dodd-Frank Act an unconstitutional restriction on his duty to see that the laws are faithfully executed and say he's firing Cordray as he believes he has the power to do so. That would lead to a pretty swift decision from the courts.

But he also has ample evidence to say he has cause to fire Cordray. The facts of the PHH case alone, where Cordray appealed to himself and upped the company's fine from $6 million to over $100 million, violating the company's due process rights, are evidence of abuse of power. The President needs to hear that Cordray deserves to be fired and replaced with a Director much more friendly to underserved consumers and the businesses that serve them.

So there are ways to overcome these barriers. The small dollar lending rule can be challenged in court, it can be challenged in Congress, and the President can expunge dark matter and take control of rogue agencies.

You need to be part of this process. As Representative Sinema said, You need to educate your Senators and Representatives about the effects of regulation on your employees and your customers. You can talk to us at CEI, and we can help tell your story in Washington. You need to challenge harmful rules with cogent comments and, when they ignore those comments, lawsuits.

And above all, you need to stand up to the CFPB on the grounds that it is unresponsive, unfair, and unconstitutional. With the new rule issued yesterday, the time to have your voice heard is now. Speak up, ask your customers to speak up, and help bring this rogue, unconstitutional agency to justice.

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