Financial Services

Will Consumers and the Economy Benefit from the Consumer Financial Protection Bureau?
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JUDGE TYMKOVICH: Let’s go ahead and get started with our luncheon program today. I’m really pleased to have a chance to participate in this year’s Federalist Society annual convention, and I’m looking forward to next year’s 30th anniversary for the Society. I remember attending an early convention at Yale Law School in 1982, so it seems like only yesterday, but the Society has certainly done well and thrived. And the reason it’s done well and thrived is because of its ability to put the other programs like we’ve seen yesterday, today, and tomorrow in general, and in particular, panels like today’s which really go to one of the important policy-legal-political issues of the day, and explore it from various points of view.

The Dodd-Frank Wall Street Reform Act created a new entity in the administrative apparatus. The Consumer Financial Protection Bureau is a new federal agency that regulates financial products from a consumer protection perspective. Supporters argue that the Bureau will provide consumers with much needed protection against fraud and overly complicated financial instruments. Critics, however, are concerned about the Agency’s vast powers and lack of accountability and fear that it may only increase the cost of credit and limit financial options available to ordinary people. As structured, it will be highly independent, with a single director and a new guaranteed funding mechanism. Today, we’re going to explore these various aspects of the new Bureau both from a positive and from a critical perspective. As we sit here today, there’s not a confirmed director of the Bureau; there is a nominee pending, and I hope that we can talk about the politics of that somewhat.

We have a distinguished panel of reporters and researchers today to discuss the advantages and disadvantages of the new agency and to give their thoughts about how it can approach its new task so as to avoid the regulatory pitfalls that plague many agencies. Our first speaker is Todd Zywicki of George Mason University School of Law. Professor Zywicki is the Foundation Professor of Law and has his JD from the University of Virginia, with an MA in economics from Clemson University. He clerked for my colleague Judge Jerry Smith on the U.S. Court of Appeals for the Fifth Circuit from 2003 to 2004. He also served as Director of the Office of Policy Planning at the Federal Trade Commission. Professor Zywicki is the author of more than 70 articles in leading law reviews and peer-reviewed economic journals. He has testified before Congress on issues of consumer bankruptcy law and consumer credit and is a frequent commentator on legal issues. I read him frequently on the Volokh Conspiracy.

Our next speaker is David Berenbaum, who is the Chief Program Officer for the National Community Reinvestment Coalition and a supporter of the Consumer Financial Protection Bureau. The NCRC is an association of more than 600 community-based organizations that promote access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities. Mr. Berenbaum has achieved a national reputation for his fair housing and consumer protection advocacy and his involvement in civil rights issues. He’s appeared as an expert on numerous national news magazine shows and has testified before Congress on foreclosure and subprime mortgage issues.

Our third speaker is another Consumer Financial Protection Bureau skeptic; I guess I would say -- Alex Pollock from the American Enterprise Institute. Mr. Pollock joined AEI in 2004 after 35 years in banking. He was President and Chief Executive Officer of the federal Home Loan Bank of Chicago from 1991 to 2004. He is the author of numerous articles on financial systems and recently published a book on the financial cycle, Boom and Bust.

Lastly, we have the General Counsel of the Implementation team for the new Consumer Financial Protection Bureau, Leonard “Len” Kennedy. Prior to coming into government, Mr. Kennedy served as General Counsel for Sprint Nextel Corporation and handled $35-billion merger. He’s a graduate of the Cornell Law School.

Our last speaker, Tim Muris, the former Chair of the FTC, was unable to participate today; he fell ill.

With that, we’re going to start the program with brief remarks from each of our speakers. We will then have a bit of a roundtable. And finally, I will open up to the audience for questions.

Our first speaker, Professor Zywicki.
PROFESSOR ZYWICKI: Thank you, Judge. We’re going to talk about the CFPB and, to some extent, whether it’s good for consumers. So I’ll talk about what’s good and what’s bad. What’s good will only take me a second.

I think it’s good that we consolidated consumer financial protection into one regulator. I think it’s also obvious that that one regulator should have been the Federal Trade Commission, who knows how to do this, rather than creating a new regulator. But I agree with the idea of creating one regulator for consumer financial protection. The second thing I think is good was the proposal to create an integrated mortgage form that would simplify disclosures for mortgagees. And I think that the impetus, the motivation behind CFPB is good as well, which is, there is a role for government to promote consumer protection competition and consumer choice in the marketplace, and it would be great if this new agency would do that. Unfortunately, it’s not.

As a list of what is bad, the list is pretty much everything else. Everything else in the 450 pages of the CFPB is bad for consumers, bad for the economy, and bad in general; and it’s a real shame because, as I said, we could have simply given all this to the FTC, who knows how to do this, rather than creating this new monster bureau. What I think is a shame about the whole thing is that we did need reform of consumer financial protection. I’ll talk about what I think those reforms should have looked like. Instead, we’ve got the exact opposite, which is, we got more of the same, more of exactly the problems that have interfered with consumer protection, competition, and consumer choice.

So I’m going to talk about a couple of the things primarily focused on the structure and the powers of the CFPB as to why I feel so confident in my prediction that the CFPB is going to end up being a very bad thing for consumers, competition, and the economy. I’ll start off with the structure. If you were to sit down and try to design a government agency that embodied all of the pathologies of bureaucracies identified by scholars of regulation over the past 30 years, it would look exactly like the CFPB. It’s as if they took the cookbook and reversed it. It’s as if this agency was frozen during the Nixon administration, missed the last 30 years, and then was thought out again, and they basically learned nothing about the regulatory experiences of the 1970s and deregulation in the 1980s. Now why do I say this? Well, first, it creates a one-person director, removable only for cause. It’s housed inside the Federal Reserve, but almost completely insulated from Federal Reserve oversight. Perhaps this has existed before; perhaps it’s been held constitutional before. But as far as I can tell, this is by far the most powerful agency in the history of American politics that is an independent agency inside of another independent agency. It is an independent agency that is independent of the agency that is independent, and that supposedly supervises it. Its actions can only be overridden by a two-thirds vote of the Financial Stability Oversight Commission, and only if it would seriously threaten the safety and soundness of the American financial system.

Also, a perfect recipe for a disaster is that it’s set up with a narrowly focused parochial mission purely to take care of consumer protection, which virtually guarantees what most people think of as a glitch, not a feature of sound regulation, which is tunnel-vision focus on the narrow regulatory agenda that’s put before an agency, rather than broader perspective of the impact on the economy. It has a guaranteed budget insulated from any oversight from Congress and basically has almost no oversight from anyone. So it’s almost a perfect model of a dysfunctional bureaucratic structure: a tunnel-vision focus on a narrow parochial regulatory mission, almost perfectly designed for agency overreach without any check from anybody else, and that sort of thing.

So, from that sense, I think what we can expect to see is an agency that is expansionist; an agency that overzealously pursues its own agenda at the expense of other goals. The fundamental question we want to be talking about in consumer protection is, how do we balance consumer protection with other goals that benefit consumers, such as lower prices, greater choice, and greater innovation in the marketplace? And this agency simply is not set up to be able to make those fundamental distinctions and fundamental choices on those margins.

Another problem that has manifested itself, and was, I think, kind of comical from the beginning, was the representation. This is going to be a nonpolitical expert agency, and so that’s the idea why it would be a single director without any oversight. Well, I don’t think anybody seriously believed that to begin with; but then the first thing they did was end-run the appointment of a director by appointing Elizabeth Warren to set up the agency from the White House. The supposedly apolitical Elizabeth Warren is now running, of course, as a Democratic candidate for a Senate from Massachusetts after having used this nonpolitical job to catapult her political career. And now the person they’ve actually appointed or nominated to do this is Richard Cordray, former Attorney General of Ohio, who has clear political aspirations in the future. Now, it’s commonplace to appoint politicians to run agencies in Washington. It is not commonplace to appoint politicians to run agencies and then pretend like they’re nonpolitical agencies.

Now, there have been a lot of arguments that have been made, but if you want to why, I forget, just compare to it the Federal Trade Commission. The Federal Trade Commission does exactly the same thing as CFPB does. It does consumer protection. It is used to doing consumer protection and financial services, among other things. How is the FTC set up? A five-member bipartisan commission, it is subject to internal competition, or checks and balances. It’s got a bureau of competition, a bureau of economics, and a bureau of consumer protection so that these competing policy goals are aired within an Agency of Consumer Protection, but also promoting competition and consumer choice. And basically, what they’re proposing with the CFPB is that you should take the Consumer Protection Bureau out of the FTC and make it a stand-alone agency, allow it to write any regulation it wants, to sue anybody it wants, under broadly delegated powers without any oversight from anybody.

Now I worked at the FTC. I know a lot of work that worked at the FTC. If you propose that to anybody who’s ever worked at the FTC, they would think you had lost your mind because nobody thinks that consumers would be better off if we took the Bureau of Consumer Protection out of the FTC. So what is the lesson? Well, the FTC has been doing it one way for a hundred years, and now we’ve got this new bureau that’s going to do the exact same thing in a completely different way without
any oversight or anything else. There’s a proposition there, which
is either we’ve been doing it wrong for a hundred years and we’ve
finally got it right, in which case we’ve got to abolish the FTC
and start over, or we have an agency that’s done pretty well for
a hundred years and provides a pretty workable and functional
model for how we want to do consumer protection, and we’ve
just basically overlooked that. I think there are good reasons why
we would have these concerns. So that’s my biggest concern is the
structure of the CFPB, which is guaranteed to run off the rails.

Let me spend a couple minutes talking about a couple
other big problems that I think are going to cause a problem for
consumers and the economy. First, among the powers of the
CFPB is to regulate products in terms that are unfair, deceptive,
and abusive. “Unfair” and “deceptive” are broad terms, but
they’ve been defined over decades of FTC rulemaking and the
like. “Abusive” seems to be a completely new standard; nobody
knows what it means. Nobody knows even where it came from.
It doesn’t appear in any other statute in this form on the state,
federal, or local level that I’ve been able to find or that anybody’s
ever identified to me. So it’s a completely broad creation of new
liability for lenders about abuses. We don’t know what it means,
but we do know that lenders are awfully concerned about what
it means, and we know that when we have situations like this,
these kind of terms almost invariably end up hurting the people
they’re supposed to help because it dramatically increases the
risk of innovation, making new loans and that sort of thing. So
it’s going to exacerbate this problem of restricting loans.

A third area that I think is a problem is preemption and
arbitration, which is it dramatically reduces preemption by the
federal government of the states. The logic of that was that the
federal government was asleep at the switch, that we didn’t have
an active enough federal regulator for customer protection, so
we needed to allow the states to do this. Well, now we have that
federal regulator, right? So what’s the justification for a reduced
preemption standard? There isn’t one. The whole justification
was, we didn’t have a federal regulator; we’ve now got that. So
what we’ve got now instead is a federal regulator with the power
of the states to be able to pile on. What does that mean? If
you take “abusive,” for example, it may not even be the CFPB
defines what “abusive” is. It may be the Attorney General of
New York or the Attorney General of California who creates the
de facto definition of “abusive.”

There’s also a lot of provisions that people haven’t
noticed in the CFPB that unleashes the trial lawyers. There’s
a lot of restrictions on arbitration, for instance. Arbitration
clauses are banned in various sorts of things. There’s a lot
of provisions in there that are basically just a sop to the trial
lawyers, for obvious political reasons, who are also going to help
define what this means, and not in a way that’s going to help
consumers.

I’ll say one last word, then, that I think is the biggest
problem, which is that the CFPB does nothing about the real
problems of the financial crisis that supposedly spawned it, and
it will do nothing to prevent that from happening again. Why
is that? Well, when we looked at the loans that the financial
institutions made, they were incredibly stupid loans. But they
weren’t stupid loans because consumers didn’t understand that
if they put nothing down and their house went down in value,
it was a good investment for them to walk away and give their
house back to the bank. They were stupid loans because of the
incentives they were creating. That’s a safety and soundness
issue, and we should think about it as a safety and soundness
issue and not pretend like it’s a consumer protection issue. When
consumers rationally respond to incentives, that is not a consumer
protection issue. Not only does this do nothing about the
incentives, in fact, there are multiple provisions that will actually
create perverse incentives and moral hazards by borrowers.

Thanks.

JUDGE TYMKOVICH: Thank you, Professor. David
Berenbaum.

MR. BERENBAUM: That was a very powerful, powerful
presentation, but I want to deconstruct some of the issues that
you’ve just heard, and I think we’re going to have an extremely
lively luncheon discussion today.

With all due respect, it is extremely easy to define
“abusive,” and we, the entire nation, are feeling the impact
of, frankly, a broad failure of consumer protection issues that
morphed and was a direct result of regulatory failure and a failure
of part of government, industry, and to some extent, consumers
alike to understand the complex changes that were happening in
the financial services marketplace.

Today, over 12 million more foreclosures are expected.
What started as a subprime crisis moved into the middle-class
quickly, as consumers took advantage of option ARMs, home
equity lines of credit, loan-to-value ratios approaching 100, 125
percent loan to value, and no-income-documentation liar loans.
And who was the first to point this out? Was it the federal regulators
who were charged with safety and soundness? In
fact, it was the consumer protection organizations,
legal service attorneys, and consumer advocates
who were working with consumers who were
falling into the trap of unsafe, unsound,
predatory and often
discriminatory loans.

We have a
mortgage crisis, a credit
crisis, in this nation now
that is so perversely because
different people didn’t understand
the connection between meaningful consumer
protection and safety and soundness. They walk
doing hand in hand. Is there
need for a new consumer
protection board? Absol
olutely, there is, and the real issue today is, how do we move
ahead in the marketplace. Twelve million-plus more foreclosures
around the corner -- for every 100 jobs lost 40 more foreclosures
take place. There’s been $5.6 trillion lost by families who have
been foreclosed upon, impacting the tax base, our schools, all of
our investment in our homes. Five hundred and two billion dol
ars has been lost overall in homes that are adjacent to foreclo
sure. And if we all look at our own 401(k)s, in 2007 the na
tion’s value was $8.7 trillion. At the end of Fiscal Year 2009, it
had dropped to $5.9 trillion, and we expect lower numbers from
economists moving ahead.

This is a complex environment. The Supreme Court
just approved cert. regarding a disparate impact case, an area very
close to home for NCRC, because we are fighting to ensure access
to responsible credit. In the Magna v. Gallagher case, I’m sure
the amicus briefs are going to be flying in the very near future.
To have an entity created to conduct rulemaking, to supervise,
and to enforce federal consumer protection laws is extremely reasonable when we look at the failures over the past decade. To take consumer complaints which have not been reasonably acted upon because, frankly, states don’t have adequate resources to do that, to promote financial education so that the next generation of homeowners, credit card users, folks looking for student loans, folks who unfortunately may need payday loans, will have better information on how to make appropriate choices, and to monitor the financial markets for new consumer risks, is all very, very important.

And don’t think for a moment, because the market has changed, oh, there’s no more subprime lending, option ARMs are a thing of the past, that in fact there are not emerging issues. The National Community Reinvestment Coalition is challenging lenders who are not lending to the FHA loan program standards. A GNMA-guarantee program, and yet consumers who desperately need to refinance, particularly African-American and Latino consumers, are not being given access to credit. The CFPB is charged to look at that data, to address the issues, to work with prudential regulators.

Older Americans across the country are literally landlocked in their homes right now. Many of them could benefit from the reverse mortgage program. Many of you know program, home equity conversion mortgage from HUD. But there’s a growing trend of predatory lending because these are equity-rich seniors in our society, and in fact, we see a new breed of mortgage bankers and brokers targeting these consumers with high-cost loans. None of the prudential regulators are looking at this. The CFPB just announced they are closely looking at this issue.

We are in a very complex society right now, and it’s a shame that the CFPB has gotten into an issue of politics between Republicans and Democrats. I’m very nonpartisan; the National Community Reinvestment Coalition is nonpartisan. Frankly, we’ve seen mistakes on the part of both the Republicans and the Democrats. We’ve seen successes on both parties’ parts as well. But this entire fight over whether it should be your director versus commission -- the bottom line is, Congress voted, this Bureau is being implemented, and in fact, many in industry as well as consumer groups alike are looking for standards, are celebrating transparency. And though there is a lot of rulemaking coming, and I understand that is a concern to many in this room, they have been inviting groups in so that it will be intelligent and transparent. And whether it’s an appraisal, whether it’s the disclosure documentation -- frankly, no other agency in years has been able to really address TILA and RESPA revision. They are the first. We have an opportunity for a new coordinated level of prudential oversight by the existing regulators, who hopefully will do a better job with the new regulator in town.

I’d like to close with a final thought, and that is, you know, we all operate from various perceptions or views of how the marketplace should be. In an ideal world, freedom of choice, a competitive marketplace, is a wonderful thing. Our organization celebrates access to credit and wants to see responsible credit, and in fact, equal access to qualified consumers. The reality is that a market without constraints created where we are today. Those option ARMs, 90 percent of the files I’ve personally reviewed for consumers facing foreclosure, never should have been originated. The idea of a product, a no-income verification loan for professionals such as you in this room is probably a very good product. But the way it was originated across this country and ultimately incentivized and securitized -- to Wall Street -- was one of the downsides of the mortgage process not only here but around the globe.

So, to have extra checks and balances, consumer protections, coupled with more attention to the rating agencies -- not really the subject of today -- but the rating agencies knew. The reports were clear. Irresponsible lending, reported all over the place, continuing to give AAA credit ratings to Ameriquest, New Century, Countrywide Loans, as they were defaulting, as they were being criticized. The system is broken, and the time has come for a fresh look.

Thank you.

JUDGE TYMKOVICH: Thank you. Alex Pollock.

MR. POLLOCK: The Dodd-Frank Act in general, and the Consumer Financial Protection Bureau in particular, are a highly interesting case of clashing political philosophies, as we’ve heard today. It remains my opinion that the Dodd-Frank Act is best characterized as the Faith in Bureaucracy Act. It’s also my opinion that, given human nature, we shouldn’t have unadulterated faith in anyone or anything. Now, the Faith in Bureaucracy Act is a typical product in the aftermath of a financial crisis. These acts, which go back through history just as financial crises do, typically are accompanied by the assertion that we’re going to set up these new rules and these bureaucracies, and this will assure that our problems “never happen again.” But of course, they always do happen again, we get into trouble anyway, and in addition, the reaction, the political and regulatory reactions to the crisis are typically pro-cyclical. That is to say, they come in and clamp down at the bottom and they make it harder to recover from the bust, which is also what’s happening now.

Each time we have a boom and bust, a political imperative is for politicians to do something. Well, what can you do if you’re a politician? Well, you can always set up a new bureaucratic agency or expand the rules and the authorities of existing ones. The Consumer Financial Protection Bureau is a result of this political imperative. It’s an extreme example of faith in bureaucracy because it is consciously designed to be completely independent, as we say, that is, free of all checks and balances, as Todd also very pointedly discussed.

Indeed, the political tactic of turning the CFPB into a bureau of the Federal Reserve, as we all know, in fact completely freed it from that most basic democratic control, which is the power of the purse of the elected representatives of the people. Excess profits of the Federal Reserve, which is the funding source -- by excess profits, we mean profits in addition to statutory dividend paid by the Fed -- are simply and completely taxpayers’ money. The funding of the CFPB, by diverting these profits,
is transparent and, so far, successful attempt or to create a permanent appropriation of the taxpayers’ money and to take away the ability of future congresses to control the bureaucracy through the power of the purse.

The Dodd-Frank Act was enacted in July 2010, and by July 2010, the party of Senator Dodd and Congressman Frank could see that they were going to suffer very large losses in the next election. The funding device of the CFPB passed while they still had large majorities and made sure that the will of the people in the next election couldn’t take away this funding, which the people are providing through their taxes, remembering that the Fed’s profits are simply taxpayers’ money.

Now, setting up bureaucracies free of the nuisance of checks and balances and congressional appropriations is a philosophical position. It is a Platonic claim that rests on the assertion of the existence of experts, in other words, of people with superior knowledge and superior virtue in the Platonic fashion. And the people who have this superior knowledge and virtue are the employees of the bureaucratic agency. The opposite position, that of the believers in democracy as opposed to Platonists, sees no evidence of such superior knowledge or superior virtue on the part of government employees or anybody else, for that matter. Instead, it observes that all men are sinners, all have fallen short, all make mistakes, and all are hungry for power. Therefore, in a democracy, no one should be completely independent. No one. And all should be subject to checks and balances.

In my view, for the CFPB, these checks and balances should include appropriations by Congress in the normal democratic fashion, the need to have the CFPB’s agenda balanced by safety and soundness considerations in the rulemakings, and by explicit cost-benefit analysis which takes account of economic, competitive, and market efficiency aspects, as Todd also said.

Let me come, speaking of philosophy, to a Hegelian conclusion. Thesis: Backers of the CFPB are prone to worry about so-called unfettered markets. Antithesis: Believers in democracy worry about the unfettered state, and in particular, unfettered bureaucracies. Synthesis: Everybody should be subject to checks and balances, and this obviously includes the CFPB.

JUDGE TYMKOVICH: Thank you. Our last speaker for the first round, Len Kennedy.

MR. KENNEDY: Thank you. This has been quite interesting. The views I express are my own, and I’d like to start with something that I wrote before I joined the CFPB in 2010. “The financial crisis of 2008 was a catastrophic failure of business judgment, corporate governance and regulatory oversight.” Now CFPB was created to address some of the causes, with supervision of financial institutions, regulations of the products and services, enforcement matters to be taken when rules were broken, and, I think most significantly perhaps, robust services to be provided on behalf of consumers so that they are in fact better consumers of financial services. The question on the floor is, will the economy and consumers benefit from the existence of the Bureau? I think we should look back, as well as forward, as we think of what we all, industry, consumers, and regulators, should do differently.

Alexander Hamilton, Federalist, lawyer, financier, and political philosopher, was once asked why government existed at all. He responded that it was because “the passions of man will not conform to the dictates of reason and justice without constraint.” What Hamilton said over 200 years ago remains true today. As former Federal Reserve Board Chairman Paul Volker recently put it, “It should be clear that among the causes of the recent financial crisis was an unjustified faith in rational expectations, market efficiencies, and the techniques of modern finance. That faith was stoked in part by the huge financial rewards that enabled the extremes of borrowing, the economic imbalances, and the pretenses and assurances of the credit rating agencies to persist so long. A relaxed approach by regulators and legislators reflected the new financial zeitgeist.”

Over the past few years, these excesses caused boom and a subsequent bust that Warren Buffett’s partner Charlie Munger characterized as dangerous and whose recurrence Munger no longer thought should be prevented. We came close to the collapse of the financial and economic system. If you were a keen observer of the scene, as I was, in the private sector at the time, it was not difficult to imagine a world where ATMs ceased working, checks stopped clearing, credit cards were refused, and commerce ground slowly to a halt. And it is surely too soon to say that we have put all our troubles behind us. The very recent collapse of MF Global Holdings and a tottering Euro zone demonstrate that the powerful undertow of the forces at work in 2008 are still with us.

Given the close call we had, it should be no surprise that the voters, acting through their representatives, decided that the animal spirits needed taming. That’s what led to the Dodd-Frank Act and the creation of the Consumer Financial Protection Bureau. In many ways, though, there is nothing new under the sun, for Hamilton faced similar issues. Remember, it was Hamilton who, more than 200 years ago, brought stability to the chaotic financial affairs of the new federal government. He persuaded Congress to have the new federal government assume the debt of the states, combine it with pre-existing debt of the national government, and issue bonds which had to be repaid. Hamilton triumphed over Jefferson and Madison by wheeling and dealing on a grand scale and agreeing to support the establishment of the new capital on the Potomac in exchange for the support of Hamilton’s assumption plan.

In order to generate the revenue needed to pay the bondholders, Hamilton persuaded Congress to adopt a national excise tax on the sale of distilled products (whiskey), which was the first tax imposed on the new national government on a domestic product. Western Pennsylvania farmers resented the new tax and vigorously resisted it, occasionally tarring and feathering the tax collectors. Hamilton, for his part, published essays in the newspaper under a pseudonym, urging military action against the tax protesters, and also accompanied President Washington when the latter led a large federal militia to put down the insurrection. It was Hamilton who, as the first Secretary of Treasury, enabled the establishment of the First National Bank who had earlier founded the Bank of New York, which only ceased independent existence in 2007 when it merged with Mellon Financial Corp. It was Hamilton who established the US Mint, who established an extensive system of tariffs, who founded the Revenue Cutter Service, the predecessor to the US Coast Guard, and from whence the term “Coast Guard Cutter” originated.

As we will see, a financial infrastructure of the federal government as we know it probably owes more to Hamilton than to any other individual. He was an enthusiastic supporter of what must surely have seemed then like big government because that’s what he thought the times demanded. Hamilton’s handiwork was not perfect, and if he were alive today, I’m sure he would be amazed at the complexity, size, breadth, and imperfections of the federal government.

Yet, I also believe that with his sure eye and keen feel for finance, he would see problems that warranted close oversight and possibly strong action. Hamilton would, I suspect, be wary of large financial institutions that cross many borders, that employ a high degree of leverage, that total assets exceeding the gross domestic product of many countries, that are not subject to...
overall control by any entity, and that can move capital around the world with the click of a button so that the problems in one country can quickly become the problems in another. He would likely be troubled by financial institutions that are too big to fail and that, therefore, have the public as their implicit partner. He would probably wonder how an insurance company managed to take on so much exposure that its failure risked tanking the entire financial system, requiring a bailout by the federal government.

In short, Hamilton would probably conclude that the size, complexity, and opacity of our modern-day financial institutions require vigilance, attention, and competence on the part of the national government, the operators of those businesses, and as well, the consumers who take advantage of their products and services. On the consumer side, I believe that Hamilton would find that modern-day institutions of many stripes are difficult or almost impossible for even savvy consumers to navigate. During the housing bubble, for example, the fastest growing mortgage products were some of the most complicated: hybrid adjustable-rate mortgages, interest-only loans, and payment option ARMs. To calculate the costs and risks, borrowers needed sophisticated knowledge of things like rate caps and rate spreads.

The potential costs and risks of these mortgages were unclear to many consumers, and the lack of transparency saddled too many people with mortgages they couldn’t afford. And as well, apparently, many of these products were not understood by their issuers. For those who purchased real estate requiring a mortgage recently, you may recall you received a set of materials in the process of your closing. In my own experience, those documents were, shall we say, difficult if not impenetrable, and that’s even if you have a law school degree and you’re working at it pretty hard.

In short, I think that Hamilton would acknowledge that our modern-day financial industry needs oversight in a number of areas to curb its inclination to profit from market failures, like a lack of transparency, misaligned incentives, and an unlevel playing field, as well as its propensity to blow up from time to time, often causing extensive collateral damage to innocent bystanders. And he would readily agree that leadership and policy competence by the putative overseers is very important.

That said, I also think Hamilton would be skeptical of the government the only solution to these problems and would be willing to hold people accountable for their actions when they had the ability to make choices but then chose unwisely. For example, when home prices were levitating unnaturally in many communities in the last decade, many saw this as an opportunity to get rich quick by flipping houses, at least until the music stopped. No one forced these speculators to do what they did. Attempts at regulation must be carefully weighed and considered, for the law of unintended consequences applies particularly strongly in this area. A rush to regulate a particular type of undesirable activity engaged in by an entity that has a certain name (think of the word “bank”) can easily result in regulatory arbitrage when the same activity is conducted by entities not subject to such regulation.

I think Hamilton would agree that a would-be regulator should be humble and pragmatic about what they can hope to accomplish, aware of what hasn’t worked before and mindful of the importance of credit in a modern economy. Lenders generally don’t have to extend credit, and making it too difficult or costly to do so will simply result in the withdrawal of credit to those who need it and can afford it. After all, most people in modern America need loans to buy cars, buy homes, and educate their children. Regulation should therefore be no more intrusive than necessary, yet strong enough to get the job done.

There undoubtedly will be bumps in the road and errors along the way, and the task is likely to be nerve-wracking, but I take heart from Hamilton, who was well aware that we humans are imperfect. He also said, “A well-adjusted person is one who makes the same mistake twice without getting nervous.”

Thank you very much.

JUDGE TYMKOVICH: Thank you, Mr. Kennedy.

I think the panel can stay seated for the next round, and we’d very much appreciate your preliminary remarks.

Let’s go back to Todd. You’ve heard some pros and cons of this new entity, which I think is fascinating because we’re really seeing the creation of some of a new type of administrative structure that is somewhat unique. What are your comments on what you’ve heard from its supporters?

PROFESSOR ZYWICKI: I’ll just say two things real quick so that we can get to questions and that sort of things. The first thing I want to say is that I do want to stress that I agree with the central proposition that David and Leonard both said, which is that there was a need for a unified, streamlined, coherent consumer protection system on the federal level. To try to get TILA reform and that sort of thing was like the United Nations, with all the different regulators who had to come together around a table and that sort of thing. So I don’t disagree with that.

I also don’t disagree with David’s proposition that many of these loans should not have been made. I disagree with the proposition that, say, a nothing-down loan is a consumer protection problem. It’s a safety and soundness problem of because the incentives they set when the house goes down in value because then the people don’t have skin in the game. I agree, the loans shouldn’t have been made, but we’ve misdiagnosed the problem if we think of that as a consumer protection problem.

Now don’t get me wrong; I’m an economist, so I’m not going to criticize consumers for responding to incentives. But that’s what consumers are doing is responding to incentives, and the whole rationale of CFPB seems to be set up on this idea that consumers are these hapless victims, and they’re not. That was certainly part of the problem. There was consumer fraud. But that’s not that’s not the main problem here. There was a huge safety and soundness problem. Having said all that, agreeing with all that, we don’t need a new agency. We don’t need a new super-bureaucracy. We could have solved that.

The second thing I just want to say is I think that my biggest concern, taken away from this consumer issue, the sad irony of all this is that, if you look at the history of consumer credit regulation, most likely, an unfortunate result of the CFPB is, if it does its job the way it thinks it’s going to, it’s probably going to be to increase consumer fraud and increase abuse of consumers in the American economy. Now why is that? Well, I’ve not heard any supporters of the CFPB say that they think the CFPB is going to increase access to credit or decrease the cost of credit. We’ve seen this story before when we’ve regulated consumer credit, and this is why we deregulated consumer credit beginning in the 1980s.

What happens is, if you reduce the ability of people to

Attempts at regulation must be carefully weighed and considered, for the law of unintended consequences applies particularly strongly in this area.
get credit, you don’t reduce the need for credit. If you still need $500 to fix your transmission to get to work on Monday, you still need $500 regardless of whether you can get a credit card because the government has said, we don’t believe you should be allowed to have a credit card. We’ve seen this since the onset of financial crisis, with things like the Card Act, which make it more difficult to price risk on credit cards and reduced access to credit cards. Well, yeah, people are getting fewer credit cards, but payday lenders have been experiencing double-digit growth since the onset of financial crisis because people still need credit. And I think that’s the sad irony of not learning the lessons of history.

We’ve been down this road before. We know how the story ends, and we know why we abandoned the regulatory models during the Nixon administration that the CFPB stands for, which is that once you get into this one to see the impact is it’s going to reduce access to credit and increase the cost of good credit; what you’re doing is you’re taking the most vulnerable people, pushing them down the ladder from credit cards to payday loans to Internet payday loans to pawn shops. You’re pushing those vulnerable people down the ladder to precisely the forms of credit that we’re most concerned about. The most likely effect of all this is going to be, I suspect, that a lot more people are going to be victims of fraud. That’s unfortunate, but I think that’s how this story ends.

JUDGE TYMKOVICH: David, in a previous life, I was in a state Attorney General’s office. I was the Solicitor General in Colorado. And my boss Gale Norton, who I think I saw in the audience, was the Attorney General. And her office had a very strong and committed consumer protection division. But she was an elected official, and although she had a lot of power to exercise the consumer protection statute, she was subject to election. This structure doesn’t have the traditional pieces of accountability. What would be your response to those concerns?

MR. BERENBAUM: I think you’re raising a good point about accountability. I actually believe there is accountability to the Financial Oversight Council on critical issues. It’s not that hard to get consensus among prudential regulators, and in fact, we were trying to really foster independence. We felt that those, in fact, being regulated by this institution should, through fees, through the Fed, be supporting the institution, not the taxpayers.

I think there’s a tension at work here, though. It’s very easy to say that the new CFPB or other Dodd-Frank provisions are going to inhibit credit or promote the cost of it in this country. And there’s a real rub there because, frankly, it’s the failures of our financial system that have brought the entire marketplace to a freeze. The point about low-income consumers, consumers who have less resources, frankly, all of middle-class America is struggling to gain access to credit today; small businesses are struggling. But for the role of the government -- Freddie, Fannie, FHA, and VA -- there would be no lending right now. Ninety percent of the loans being originated are not in the private sector, folks. It is the government. That’s how serious our market failure was.

I wanted to make another point relative to what was said earlier as well, and that is, there is some accountability at the Bar, and we have approached the American Bar Association. We’re also very concerned about the role of service, and you know what I’m about to say. In the robo-signature issue, there is accountability at the Bar, and we have to face that fact. The CFPB is looking at these issues. We’ve asked the Bar to voluntarily look at these issues, and I believe a subcommittee is being created to do so. But it raises very serious ethical as well as practice performance issues for attorneys as a group. Again, who has the strength to call out these issues? Our hope is a new era of protecting consumer issues, as well as your own associations. Maybe that’s a role for the Federalist Society, for the private sector to engage on these issues as well.

Back to the question, though, which I think is a very fair question, ultimately, while we want to see the CFPB up and running, we support the appointment of the director of the CFPB immediately. We think it works against the government as a whole, regardless of appointments, to have any administrative appointments held up. I speak with attorneys; I speak with compliance officers from finance and real estate all the time. And in this particular case, the entire industry wants clarity, they want to understand the rules, and they want to be able to lend again. We have to get beyond the smoke and mirrors.

JUDGE TYMKOVICH: Alex, the political processes is in some state of limbo. Maybe Len can comment on this also. But I’d be curious on your take of where the next 12 to 14 months will lead. There is some debate about the funding mechanism and the lack of an oversight commission and the like. What’s your take on the politics of the day and where that’s going to go as we enter into an election cycle?

MR. POLLOCK: Well, Judge, needless to say, election cycles tend to make politics in Washington move toward stalemate, and I don’t think this is any different. It makes one remember that the democracy, with all its faults, is still the best thing we’ve got.

If I could make a couple more comments with your permission?

JUDGE TYMKOVICH: Please.

MR. POLLOCK: I was very interested to hear Len tell us how the Western Pennsylvania farmers tarred and feathered the tax collectors.

JUDGE TYMKOVICH: After judicial process.

MR. POLLOCK: All of my colleagues on the panel mentioned simplified and clear and straightforward mortgage information for borrowers, or financial information generally. That’s something I think everybody agrees on. That’s an omni-partisan perspective and it’s one that I’ve worked on, I guess now, for four and a half years. I proposed a one-page mortgage form the spring of 2007.

It’s surprising how hard it is to actually do it, even though everybody agrees on it. One of the things, in my view, that’s most important in such a key information form is to repeat to the borrower what we say their household income is, and then to express the debt service as a percent of that income for people to really think about.

I bet you agree with that, David.

MR. BERENBAUM: You know I do.

MR. POLLOCK: That item, which was in my form, tends to have been left out in all of the official proposals, which I think is a huge mistake.

Finally, both David and Len mentioned credit rating agencies. There is no question that they are an important part of the story of the last boom and bust and crisis. But it is to be remembered that the rating agencies had so much power because they were given it by government regulation, which made them into a government-sponsored oligopoly, which required the use of their ratings. In my judgment, one of the two good things in the Dodd-Frank Act is the mandate, to American regulators at least, to take reliance on credit ratings out of their regulations. I
think it’s a really good idea. Such reliance is unfortunately still in the international standards, promulgated at Basel, and we need to move the point up to the Basel standards. It ought to be easy because the Germans in particular always looked at credit rating agencies as a part of American financial imperialism in these international standards. They’re in there, and they need to be taken out.

Thank you.

JUDGE TYMKOVICH: Thank you.

Len, you’re the General Counsel to a brand-new entity in the federal government. It’s a rare opportunity for a lawyer to come in and have that chance to develop both the policy and the administrative structure from the ground up.

I’m curious about how the agency has put itself together over the last year or so, how you have recruited and employed people, and whether you are engaging in rulemaking even though the director has yet to be confirmed, and given that fact, whether it has slowed down the process or will it continue to go forward.

MR. KENNEDY: Thank you, Judge. There are a whole host of questions that, for obvious reason, I will not answer or discuss. But some of the things that have been touched on, I’d like to address. As the General Counsel of this Agency, I consider it my job to make sure that everything we do is totally consonant with the rule of law and how we engage in regulation in this country. I’ve spent something like 35 years of my life as a professional working in one part or another, either in industry, in a law firm, or in a regulatory body. I spent most of my time in college and law school very interested in regulated industries, and actually deregulation, having been influenced by Dean Kahn, Alfred Kahn, of Cornell, who passed away recently. I’m a huge believer in markets and I’m a huge believer in the law.

So, to my mind, the notion that we are somehow unaccountable, you know, I have a hard time squaring it because we start our conversations about everything we’ve done, what does the statute say? What do other laws say? What has the Supreme Court said? And I recognize that this law has embedded in it a huge number of policy questions. But I think when you take the oath of office to represent your country, it’s your duty and your responsibility to have loyalty to what others have created and what we have inherited. And the notion that anyone would think that I or my colleagues would take that lightly I find abhorrent.

Now, with respect to this agency, I came to this role and this job because I thought it would be an opportunity for me personally to give something back to a country that’s given me more than I deserve, probably: the opportunity to fulfill whatever promise and talent I had, and it’s been quite an interesting experience. People have come from all directions and all corners and all sectors of our economy, financial services industry, law firms, academia, you name it. They’ve given up lots of prestigious titles and lots of money. Happy to do it. Happy to be able to contribute in some way.

Taking as the mission how to create an institution that cannot just be better than the institutions that existed prior to the time the Bureau was created, let’s think about it. Let’s think about this industry, the financial services industry, with which we deal with only one small piece, people. If this industry doesn’t work well for our country, we’re going to have a very challenging time here, not just like we have now. It could be worse. So, as we’ve tackled the job, we’ve looked for people who understand various parts of the industry, who understand regulation, who understand the law, and who are committed to doing our best to make wise decisions, pragmatic decisions, decisions that will affect people’s lives, their investments, and their well-being.

I take the point that Alex made: I haven’t met anyone at the bureau or any other place I’ve been up to this point in life who’s perfect. So there is a need for a certain amount of skepticism and there’s a huge need to be an informed regulator. So that’s kind of what I dedicated myself to, and we have an agency -- how to find the people, how to create the processes, how to build the systems to make things a little bit better and more stable. To me, it’s a particularly difficult challenge because of the nature of the financial services industry. A professor said to me in the course of the last two years, well, one problem with the financial services industry is that the business you’re in is the business of risk, and when you take the risk and you lever it up, you’re exploding the risk, and things turn again to the consequences, obviously, the consequences obviously can be quite devastating. So we’ve talked to people in other agencies and governments for their best ideas, the things that have worked for them and the things that haven’t.

We’ve talked to people in the financial services industries, large banks, small banks, non-regulated entities as well. What are the problems they’ve encountered, including the problems of regulation? TILA and RESPA -- you know, a form that people literally have been trying to improve for 15 years, and we can’t get there somehow. So that’s a huge mission. We have a statutory deadline to get it done. We’ll see. So part of what we’ve worked with, a little bit unusual -- and I’ll stop here; I feel like I’m filibustering or something -- but we created a form, we’ve done some testing, we’ve had lots of people in the industry, we’ve put it on our website. ‘Can you understand this form?’ We’ve had 24,000 comments from the public on it. That’s a lot, and that doesn’t mean it’s perfect by any means, but it’s two pages, three pages. That’s a start. So we’ll see where we go from there.

But I guess I would simply say we start not believing that we are the inheritors of some received wisdom about how all this should work and will work. We’re in the process of working with the public and the regulated entities to do our best job.

Thank you.

JUDGE TYMKOVICH: We’re in a room of mostly lawyers. And not a few of you will likely be concerned about litigating in the future over some of these issues, representing clients on these issues.

I want to go back to Todd and really ask your take on the current political context -- where we are, and also perhaps some of the legal or constitutional issues that may be lurking out there as the agency comes up and running.

PROFESSOR ZYWICKI: Great. Thanks. First, I thought it might be helpful just for those who haven’t followed the nuts and
bolts of the details to give you a sense of what the current political posture is because we’ve all alluded to this.

Basically, what has happened is, as you know, Elizabeth Warren was originally appointed. She set up and staffed the agency as a special assistant to the White House or Treasury or something like that. They were supposed to nominate a director within a year or something like that. In the end, they nominated Richard Cordray, who I mentioned earlier. As things stand right now, the Republicans in the Senate filibustered his nomination until they say they get certain structural forms which they want, which are along the lines that I described. They want a commission rather than a single director. They want to budget oversight by Congress rather than it just being -- basically, what they get now is a guaranteed budget from the Federal Reserve; no questions asked. The Federal Reserve has to give them 12 percent of its revenues, and they can do anything they want to with it. And they want to change the veto by the Federal Stability Oversight Council from two-thirds to one-half.

The Republicans so far have hung together on that. The 44 Senate Republicans have all said they’re in alignment to filibuster any nominee until that actually happens. If you believe that at the end of the day Republicans are to hold together, then you’ve got more faith in the Republican Party than I do as we go into an election year. But they seem to be confident that they could be able to hold onto this. So that’s where things stand right now. [Ed. Note: On January 4, 2012, Barack Obama issued a recess appointment to install Cordray as director through the end of 2013.]

The legal status of the Bureau, then, the way it’s set up is that immediately -- I think it was after a year -- everything that was done by the other federal agencies on consumer protection went over to the Bureau. So they basically took all the things that the Fed and the FTC and the OTS and FDIC and these guys were doing. New authority was given to the Bureau, such as the ability to regulate payday lenders in state-based entities. That authority doesn’t go to the Bureau until a director is confirmed. So what you have right now is that all those who used to be regulated by the federal government are now regulated by the CFPB. Those who will eventually be regulated by the CFPB, like payday lenders and that sort of thing, are not currently under the CFPB’s oversight, and some people have complained about that. There is one ad hoc exception, which is the auto dealers for car loans. They’re not subject to the CFPB at all basically because they already have their lobbyists in town fighting over Chrysler and GM, so they said, why don’t you give this to us too? There’s no reason why they shouldn’t be under the boot of the CFPB, but they managed to wiggle out. They’re regulated by FTC. So that’s the politics of it.

I’ll just say one or two words about the legality. One, seeing what happens with “abusive” is the big question. What does “abusive” mean? My guess is that’s going to be defined by litigation over time. As I said, it’s going to be defined by litigation by the CFPB and the state AGs. I don’t know what that’s going to do, but it’s very broad. It’s really a very capacious grant of power, which we can talk about.

The second thing is there’s a peek-a-boo issue if you’re familiar with that. There’s a certain issue in the CFPB involving the Deputy Director that is blatantly unconstitutional under the PCAOB case from the Supreme Court, which is the Deputy Director is appointed by the Director and has the authority to act as the Director when the Director can’t act. That’s a clear PCAOB violation, so I’m sure there’s going to be litigation on this. That seems clearly unconstitutional and at least provides a jumping-off point for the litigation.

JUDGE TYMKOVICH: David, a comment? And also, if you have a question for another panelist, go for it.

MR. BERENBAUM: Sure. Well, just a quick reaction. I mean, there is a lot of rulemaking going on. One of the other areas, though, with regard to defining what is responsible versus an abusive loan that is going on right now is rulemaking in what’s called qualified mortgage (QM) space right now by the CFPB, and that is an ongoing process. But literally, “QM”, just to go back a few years ago, is how the various Republican or Democratic proposals in Congress with regard to predatory lending ultimately were incorporated into the responsibilities of the CFPB. Legally, there is a very big debate going on right now with regard to QM about whether, if a lender originates a loan to the standards of these QM provisions, you will have a safe harbor, which of course industry is seeking, or there will be a rebuttable presumption that it was an appropriate loan. Many of the QM parameters deal with what is a reasonable responsible loan -- prepayment penalty issues, down-payment, and other issues.

There’s also a broader issue that all the regulators are involved in that actually has prompted a universal industry civil rights and consumer protection consensus, and that’s called “qualified residential mortgage.” That is a rule, as issued by the prudential regulators, not the CFPB, that would require 20 percent down from all consumers. Now, regardless of your beliefs about skin in the game, one of Todd’s colleagues from Moody’s.com has actually done a wonderful study that shows, whether a loan is five percent, 10 percent, or even 20 percent down, they all perform pretty closely to each other. It’s the quality of the origination that really counts; is it a fixed rate, a 30-year loan or more? These are the issues that matter. And this is another issue for us to be looking at regardless of our persuasion.

As to a question, since there’s been a lot of good debate, you know, part of our panel discussion was the future of credit and financial markets. The White House, in their recent Treasury paper, has recommended the elimination of Fannie Mae and Freddie Mac. As I noted earlier, the reality is the nation is dependent upon those GSEs right now -- FHA as well as VA. So we need to jumpstart the private sector. We need to ensure that product of choice, in fact, that celebrates entrepreneurial, responsible lending, a good economy.

So, Todd, what would you recommend to the White House today to get through this log-jam that we’re facing right now? I mean, what in the financial sector markets will get us to a point where lending will occur?

PROFESSOR ZYWICKI: Well, I think what we have seen is completely counterproductive. I mean, the Credit Card Act is a good example in a microcosm. Basically, what the Credit Card
Act did make it more difficult to adjust interest rates when a person’s risk profile changes. When that happens, lenders have two options. Either they can do what they did, which is raise interest rates ahead of time, you know, because they can’t adjust them after the fact, so they can try to price the risk effectively. Or they can try to reduce their risk exposure; and the way they do that is to lend less and to lend to fewer people. Everything we’ve seen over the past couple of years have had that same effect, which is that they increase the risk and cost of lending, and therefore, people lend less. The Durbin Amendment is going to have the same sort of effect. The Durbin Amendment, by putting price controls on the debit card interchange fees, they’re going to drive consumers out of the mainstream banking system.

So the obvious thing is to stop doing all the dumb stuff that we’ve been doing in response to the crisis. And so the question is, then, what’s left after you take out the chilling effect of direct regulations on credit, after you layer on all the other regulations you’ve seen in the past few years, from health care to all the regulations being generated out of different agencies. I mean, how do you price the risk of lending to a small business that might be affected by greenhouse gas regulation? How do you do that? How do you price the risk of somebody who might be -- what happens with new regulations on this, that, and the other thing? If you can’t price the risk, you can’t make the loan. And so this concern about greater instability and that sort of thing, that’s the whole game. That’s why the rule of law has always been the essence of lending. And what we’ve seen is basically the opposite of the rule of law.

So it still seems to me that we’ve got to get the fundamentals right first, and then it takes care of itself. So that’s my impression of it.

JUDGE TYMKOVICH: Alex, do you want to take that one on also?

MR. POLLOCK: When you look backwards at a financial boom and bust and then panic and crisis, you can find plenty of mistakes made by everybody you can think of. I think about my own career, and I can think of all these amazing mistakes that I made. And then I try to take myself back to the state I was when I made the mistake. The only thing I can come up with an explanation was, it seemed like a good idea at the time. That characterizes what happens in financial markets and regulation and legislation.

Kierkegaard says someplace, “Life can only be understood backwards, but it must be moved forwards.” And what we’re always doing is taking the experience, especially recent experience, drawing the lessons from it and trying to control the future. But of course, as we all know, we often get surprised when that happens. Arnold Kling wrote a wonderful paper a year or so ago, I guess, on how the regulators who dealt with the mortgage market drew three really important lessons from careful and intelligent study of the collapse of the 1980s. May I just remind us, because memories fade, we had an incredible crisis or series of simultaneous crises in the 1980s, which, among other things, saw the failure of more than 2,000 highly regulated financial institutions? They drew, as in Kling’s story, three lessons from the 1980s. You have to promote securitization, you have to have mark-to-market accounting, and you have to have risk-based capital. Those were all applied and were all promoted, and all of them were major contributors to the collapse 20 years later.

I was really glad to hear Len talk about skepticism. We need to have a lot of skepticism, including about our own ideas. Even things that seem very simple -- this will be the last point I make, Judge -- things that seem very simple like, in America, we surround the 30-year fixed-rate loan with a religious aura, like a saint in a Byzantine painting, the 30-year fixed-rate mortgage. And even in the original versions of the Treasury proposals, when they were talking about plain-vanilla, “We’re only going to let you do plain-vanilla mortgages,” what is plain vanilla? A 30-year fixed-rate. What is one of the most important reasons that the American real estate and mortgage situation is so bad right now? Answer: The 30-year fixed-rate mortgage.

The 30-year fixed-rate mortgage is a mortgage built for inflation. I’ll use some economic jargon here. In an unexpected inflation, the entire inflationary gain goes to the borrowers. But in a housing deflation, if you are stuck with your 30-year fixed-rate mortgage, as millions of Americans are now, that’s one of their biggest problems, that they have a 30-year fixed-rate mortgage. In a housing deflation, the entire inflationary loss is imposed on the fixed-rate borrower. So even things that seem really easy, like, oh, well, we know what’s the best kind of mortgage, turn out not to be the case, at least not to be universally the case.

PROFESSOR ZYWICKI: Could I just add, and to flesh out what Alex was saying, the problem is housing prices fall, the Federal Reserve drives down interest rates, but the only way you can get a lower interest rate is if you can refinance. If your house is under water, you can’t refinance; you can’t take advantage of the lower interest rates. So people are trapped in 30-year fixed-rate mortgages for higher interest rates than they would be if they were able to refinance. Whereas, in countries that have adjustable-rate mortgages, when their central banks decrease their interest rates, everybody’s mortgage payments automatically fell, people here can only do it if they can refinance, and they can’t refinance if they’re under water.

JUDGE TYMKOVICH: David?

MR. BERENBAUM: Well, I’m going to respond to that because I understand, in recent congressional testimony, the 30-year fixed-rate mortgage has been coming under question. The data overall, the performance of a 30-year fixed, is very strong. The real issue today is how, in fact, the refinance marketplace was operating. My organization funds about 80 groups, HUD-certified counseling groups around the nation as a national housing counseling intermediary. The consumers who we are seeing right now who are facing foreclosure either have reduced income or they’ve lost their jobs or, almost universally, they have an 80/20 percent situation or higher, where they have a prime loan with the HELOC or they’ve been refinanced into an adjustable-rate product or an option ARM. And of course, those payments are going up, the so-called toxic loans, and values, as noted, have been dropping, and they are trapped.

The administration has, in an overdue way, just proposed changes to the HARP program, the refinance program, at Fannie and Freddie. As taxpayers, we should support this because if we can get people into a lower interest rate who are facing foreclosure, rather than seeing a total loss, we will only see a partial loss in long-term profits for Fannie and Freddie. But this is a very complex equation. Again, the numbers that are out there support the use of responsible 30-year or even 40-year fixed-rate loans. Now, that said, do we need to be doing more to sustain affordable tenancy for Americans? You bet. There’s been an overemphasis on homeownership at the expense of providing quality tenancy as well.

AT THIS POINT THE PANEL ANSWERED QUESTIONS FROM THE AUDIENCE