Learning from Financial History: An Academic Never Forgets

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There is a lot of debate in the Senate regarding the appropriate structure and jurisdiction of the Consumer Financial Protection Bureau. But much of the criticism of the CFPB is merely tactical.

Given that it is impossible to kill off the bureau in the current political environment, powerful financial industry interests are seeking to sufficiently hamstring it so as to make it completely ineffective.

Thus, debates over Elizabeth Warren's qualifications and the structure of the leadership of the CFPB were more about this tactical goal than the actual issues themselves.

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It is a truism to say that politicians have short memories, and they share that characteristic with Wall Street. That they have forgotten the rapacious practices of the mortgage industry from the subprime boom of the early 2000s is to be expected. Luckily, academics have longer memories.

One of my most striking memories from the height of the boom involves a particular type of mortgage marketed by a national lender. The mortgage came with a two-year teaser cap on loan payments (not on the interest rate — on the payments!) combined with a three-year prepayment penalty period.

This, of course, can create a perfect storm for a borrower, particularly for an unsophisticated one.

For once the artificially low payments of the two-year teaser period end, the borrower might find it difficult to make her payments covering the smallest details of the smallest transactions.

But it is clear that the CFPB is focusing on big issues, like the servicing of residential mortgages, a secretive sector of the mortgage industry that has been rife with consumer abuse. The bureau has also made it clear that it will seek to reduce the confusion that consumers face with their mortgages by improving mandatory disclosures of the terms of credit.

The CFPB is also taking on the confusing fees that consumers pay to their banks and credit card companies — fees that are very unpopular with just about everybody.

Critics of the agency also seek to define it as anti-business, but its leadership is filled with many people who have worked many years in the finance industry. For example, Raj Date of Deutsche Bank and Capital One and Pat McCoy, a former banking partner at law firm Mayer Brown, are sensitive to the need to balance consumer protection with a healthy business environment for financial institutions.

Consumer Financial Protection Bureau adviser Elizabeth Warren

REUTERS/Kevin Lamarque
Those with short-term memories have been dominating our debate over the future of the Consumer Financial Protection Bureau. They argue that the financial industry has learned its lesson and point to a more rational marketplace today. But the bureau was designed to regulate the subprime mortgage market and other consumer credit markets through the credit cycle.

A strong agency should be built today to deal with the inevitable irrational exuberance of lenders and consumers once the cycle rises from its current depths to the heights of tomorrow.

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