

AMERICANS FOR FAIRNESS IN LENDING

Financial Regulation for Consumer Protection: Ten Principles

1. **Effective consumer protection isn't just to protect consumers.** It also contributes to the safety and soundness of individual firms and to the overall stability of the financial system. In the words of FDIC Chairman Sheila Bair, “consumer protection and safe and sound lending practices are two sides of the same coin.”
2. **More credit isn't always better.** The proper goal is not to maximize credit (borrowing), but to maximize access to fairly-priced loans that are appropriate for the particular circumstances of individual borrowers – and to minimize destructive lending. Lenders must be required to conduct sound underwriting to determine that borrowers have the ability to repay what they borrow.
3. **Disclosure is not enough; substantive protections are essential.** These protections include banning toxic products and unfair practices, establishing maximum interest rates (yes: reimpose usury laws!), and providing consumer-friendly default options that “nudge” people toward safe standard products unless they affirmatively choose something else.
4. **Laws and regulations mean little without vigorous and effective enforcement.** In general, consumer protections should be enforced through all three of the following channels: federal agencies; state agencies and attorneys general; and lawsuits by harmed consumers. Federal laws and regulations should provide a high level of protection for all, but individual states should be able to enact and enforce stronger protections for their own residents.
5. **Gaps in consumer protection must be eliminated.** If companies provide the same products or services, they should be subject to the same laws and regulations. The coexistence of bank and nonbank mortgage lenders is a particularly dramatic example of how failure to follow this principle is unfair and dangerous. By the same principle, consumer protections should extend throughout the full lending cycle, from product marketing through debt collection.
6. **Incentives throughout the financial system must be aligned with consumer interests.** Failures in this regard are particularly evident in the subprime mortgage mess, where actors ranging from front-line personnel to top executives at brokerage firms, lending companies, investment banking companies, and ratings agencies all responded to personal and corporate incentives that encouraged making abusive loans. Instead, all parties should share a common interest in fair, sustainable credit. The incentives facing the leaders and staff of regulatory agencies also need to be realigned to reflect consumer interests rather than those of the lending industry.

7. **Lending practices that are racially or ethnically discriminatory must not be tolerated.** Fair lending laws, already on the books, need to be vigorously enforced to end discrimination on the basis of race, ethnicity, and age. As the financial crisis spreads to every crevice of the economy, it is easy to lose sight of the fact that African Americans and Latinos received a hugely disproportionate share of predatory mortgage loans.
8. **The regulatory system needs to be flexible and proactive.** In a dynamic market system, it is impossible to anticipate the exact nature of future abusive financial products, so it is essential that the system is able to respond to new problems in a timely manner. The present system has long delays and lead times, which means that the damage is often done before the remedy can be put in place.
9. **Consumers victimized by legal violations deserve their day in court.** Access to the legal system is not only a fundamental right, but a powerful mechanism to deter abusive and predatory behavior. Laws and regulations must allow harmed consumers to hold their lenders – or any other party that has purchased their loans from the original lenders – accountable in court. Binding mandatory arbitration in consumer contracts must be prohibited.
10. **Pricing structures in general, and penalty charges and fees in particular, must be reasonably related to costs.** There is no evidence that it costs a credit card company anything close to \$39 when a payment is one day late, or that it costs a bank anything close to \$35 to provide an overdraft loan to cover an approved debit card transaction. A corollary of this principle is that risk-based pricing is only acceptable when the pricing actually bears a close relationship to risk.

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