Prepared Remarks of CFPB Director Richard Cordray at the Consumer Advisory Board Meeting

Washington, D.C.

By Richard Cordray – JUN 08, 2017

Welcome to this meeting of the Consumer Advisory Board. Once again, I thank our members for sharing your expertise and perspectives on the concerns of consumers and the issues we face at the Consumer Financial Protection Bureau. You help us maintain our focus, prioritize our work, and fulfill our responsibilities more effectively. We share a belief that consumers deserve fair treatment in a more transparent and competitive financial marketplace.

Usually in these remarks, I highlight the work we are doing in a particular area and describe it in some detail. Today, I will do something different. My remarks will touch on several different issues to show more of the breadth of the work we are doing in various areas simultaneously. For each, I will identify our goals and describe the progress we are making to achieve them.

In particular, I will discuss four topics. First, I will address our latest efforts to encourage more transparency in the credit card market to reduce risks to consumers, especially those who are the most vulnerable. Second, I will update our groundbreaking research into the phenomenon we have described as "credit invisibility," by discussing a new report on how consumers become "credit visible." Third, I will say more about our recent Request for Information to help us fulfill our mandate to develop data collection for small business financing. Fourth, I will describe how we intend to proceed in formulating new rules to govern the debt collection market. Each of these topics reflects our efforts to understand better how to support and protect consumers.

On the first topic, we are announcing today that the Consumer Bureau has sent letters to the top retail credit card companies, encouraging them to consider adopting more transparent credit practices. Many retail credit cards offer consumers promotions with deferred interest as a financing option for certain purchases. They promise consumers that they will incur no interest charges for a set period if the promotional balance is paid in full at the end of the period. Our research has led to concern that these promotions may surprise consumers with high retroactive interest charges after the promotional period ends. The Bureau is suggesting instead that companies consider a zero-percent-interest promotion that is more transparent and that carries less risk for consumers.

Deferred-interest financing is commonly offered on store-brand credit cards. They may be marketed as an attractive way to buy big-ticket items such as appliances, furniture, or even medical or dental services, while avoiding interest charges. But they can be confusing for many consumers. Under these plans, customers are generally not charged interest if they make payments on time and pay off the purchase balance within a set time frame, usually six months to a year.

However, if any balance remains unpaid at the end of that period, consumers can be hit with interest charges that are retroactively accrued from the date of the purchase on the entire amount of their original promotional balance. This can happen no matter how little remains unpaid, and whether or not they have actually paid more than the original balance, which can be the result when they have made other purchases in the meantime. All of this can make these deals confusing and surprisingly costly for consumers. This back-end pricing is less transparent and thus can obscure the costs and risks of entering into the promotion. The problem is compounded if the promotions are marketed in ways that may be questionable or even illegal.

This lack of transparency can also hamstring consumers who are trying to manage their finances. In 2015, our Consumer Credit Card Market study showed that a large percentage of consumers who fail to repay the balance during the promotional period - and thus get hit with all of the retroactive interest - will pay off the amount of the remaining principal and related interest charges shortly thereafter. That suggests that many consumers could have completed the terms of the promotion in a timely fashion, which suggests they may have misunderstood how the product works. We saw this again in the Monthly Complaint Report we issued last week, which noted that some older consumers on fixed incomes have expressed confusion about the terms and conditions of deferred-interest credit promotions.

The Bureau's research has found that deferred-interest programs tend to have uneven effects for different categories of consumers, predictably posing the greatest costs and risks for the most vulnerable. Those with low credit scores manage to avoid retroactive interest charges only about half the time. Yet those with high credit scores avoid interest nearly 90 percent of the time. When other purchases are made on the same card before the original promotion expires, it muddies the waters further. Our 2015 study showed that over half the people who were assessed deferred interest and had other balances on the account actually paid more than their full promotional balance during the promotional period. Over one-third paid more than 150 percent of their balance during that period. Yet they still suffered the adverse consequences of the retroactive deferred-interest charge.

The Consumer Bureau has long warned about the pitfalls associated with deferred-interest financing, which does not reflect the general shift toward more transparent upfront credit card pricing spurred by the CARD Act of 2009. Its reforms aimed to reduce back-end fees and abusive credit card policies. Over the past few years, we have taken legal action against credit card companies for deceptive marketing of deferred-interest financing and certain add-on products that carry risks for consumers. We have imposed penalties, secured relief for those who were harmed, and made clear that such practices can violate the law.

Last month, Walmart, one of the nation's largest retailers, in partnership with one of the largest U.S. credit card issuers, announced that it will no longer offer deferred-interest promotions on its store credit card. Instead, it will offer a more straightforward zero-percent-interest promotional program. Under this program, interest is not assessed retroactively if the full balance is not repaid at the end of the promotional period. Following the promotional period, the interest rate converts to the regular rate, and interest begins to accrue only on remaining balances. The terms are easier for consumers to understand and the costs are more transparent. So we are encouraging others to consider adopting this approach.

In the meantime, you can find consumer tips about credit card interest-rate promotions on our website at consumerfinance.gov. We have advice on ways to keep interest costs down and how to avoid surprise charges. Consumers who have complaints about credit cards can submit them on our website or by calling us toll-free at 855-411-CFPB.

Our second topic returns to the seminal research we have been doing on people who are "credit invisible" - those with no credit record with a nationwide credit reporting company. The Consumer Bureau estimates that 11 percent of adults in the United States, or about 26 million people, fall in this category, and we have discussed the obvious consequences. Lenders are hindered because they cannot

readily assess the creditworthiness of these potential customers. And consumers can be hindered if they have less or no access to responsible credit, which means less or no access to the opportunities that such credit can create.

Having pointed out these undesirable facts, we are now working to understand what can be done to change them for the better. One line of inquiry is to explore how those who start out as credit invisible could become more visible. For all the real challenges consumers face, millions of them every year do establish credit records. In particular, few Americans have any credit record before they turn 18. Yet by age 29, about 90 percent of Americans are able to become credit visible.

So the interesting question is: how do people make this transition? A new report we issued yesterday examines the transition to credit visibility – when and how consumers first establish a credit record. Our study found that the way consumers establish credit history can differ greatly based on their economic background. People in lower-income areas are more likely than people in higher-income areas to become credit visible due to negative records such as a debt in collection. Consumers in higher-income areas are more likely to establish credit history by using a credit card or relying on someone else.

Credit cards are the most common way that consumers establish their credit, with roughly 38 percent of consumers becoming credit visible with a credit card. Yet our study found this is more likely to be true of consumers in higher-income neighborhoods: 44 percent of them established a credit history with a credit card versus 34 percent of consumers in lower-income areas.

We also found that almost 25 percent of consumers become credit visible by relying on credit already established by someone else, such as a family member. About 15 percent opened a credit account with a co-borrower, and another 10 percent became an authorized user on someone else's credit card. Again, we see differences based on economic background. About 30 percent of consumers in higher-income neighborhoods turned first to co-borrowers or authorized users, but only 15 percent of consumers in lower-income neighborhoods did so.

A third way to become credit visible raises grave concerns. We found that 27 percent of consumers in lower-income neighborhoods first establish a credit record not through their own efforts to seek credit but instead when various items – such as debt collection accounts or public records – begin to populate their credit reports. This rate is 240 percent higher for them than it is for consumers in higher-income neighborhoods. And almost all of these credit records – 90 percent – reflect uniformly negative information about the person's creditworthiness. This tells us that consumers in lower-income neighborhoods often become credit visible in ways that leave their credit records shadowed by unfavorable items right from the start.

Another interesting finding is that student loans are becoming a more common means for consumers to establish a credit record. Ten years ago, about 40 percent of consumers who became credit visible before age 25 did so with a credit card, whereas only 10 percent did so as a result of a student loan. Today that gap has narrowed considerably: 26 percent of younger consumers who became credit visible in 2016 did so as a result of a student loan and 33 percent did so based on a credit card. This reflects both the increasing importance of student loans in the lives of younger consumers and some reduction in their use of credit cards.

This study on credit visibility is helping us learn more about how credit can be expanded to include more consumers so they can better participate in the mainstream financial system. Yet another way to achieve this outcome - and another potential route to establish a credit record - is through so-called "alternative data." This includes payments made on items such as rent or cell phone bills, which may be used to assess the creditworthiness of consumers that would otherwise remain credit invisible. We issued a Request for Information back in February to learn more about how this non-traditional information is used or can be used. The comment period has closed. We are now digesting what people have told us, and we will have more to say before long.

We are also studying the availability of credit to small businesses, which are so vital to the nation's economy and our communities. The primary basis for our interest is the Dodd-Frank Act. In creating the Consumer Bureau, Congress directed us to write a regulation about the collection of information from financial institutions that lend to small businesses. This data is intended to benefit small businesses, creditors, policymakers, and regulators so they can better understand the credit needs of small businesses and the opportunities to meet those needs.

There are other reasons why a deeper understanding of small business financing may be quite important to progress in our economy and quality of life. One 2013 study found that counties with higher percentages of their workforce employed by small businesses showed higher local income, higher employment rates, and lower poverty rates. Small businesses have created an estimated two out of every three jobs since 1993, and they provide work for almost half of all private sector employees. Yet we remain aware of large gaps in the public's understanding of how well the financing and credit needs of America's entrepreneurs are being served.

Last month, we issued a Request for Information to get feedback on how to carry out this task in a careful, thoughtful, and cost-effective way. We are facing a number of difficult questions as we assess how to proceed in this new area. In particular, we are looking at how a small business should be defined for these purposes, and what types of information lenders consider when financing them. We are looking into

where small businesses currently seek credit, and what credit is available to them. We also are considering the privacy implications that could arise in publishing this information.

The importance of this undertaking could not be clearer. In a white paper, we documented the importance of small businesses to our economy and the critical role that financing plays in enabling these businesses – and especially minority- and women-owned businesses – to thrive. At a recent field hearing in Los Angeles, we heard compelling reports that in many communities of color and immigrant communities the most frequent paths to wealth creation are to start a small business and to develop equity in one's home. Obviously if there are roadblocks that impede lending to such communities, then economic vitality can be severely diminished. So the same mechanisms that have been used for years to diagnose community development needs in the mortgage market and impediments to mortgage lending would now be applied, in some fashion, to small business lending as well. Our job is to figure out how best to accomplish that, recognizing the clear differences between these two lending markets.

The Bureau is also mindful of the potential complexity and cost of small business data collection and reporting. We will explore ways to fulfill this duty in a balanced manner, seeking to provide timely data with the highest potential to meet the statutory objectives, while minimizing the burdens for both industry and the Bureau. We welcome input from a wide range of stakeholders, including lenders and business trade associations. Several of these groups have asked for more time to respond to our Request for Information. We also have been hearing from congressional officials who want to see more progress made on this rulemaking. We have had a steady plan from the outset to take up this task right after we finished the HMDA rules, and we are now moving forward. We do recognize the importance of quality responses from the public, so the Bureau is granting the request for a 60-day extension to the comment period.

The final issue I will discuss today concerns our efforts to write new common-sense rules of the road for the debt collection market. We have already begun taking steps to develop new rules for this industry to protect both consumers and honest businesses. Debt collection is still the single largest source of complaints to the federal government of any area of consumer finance. People cannot "vote with their feet" if they experience problems because they have no choice over who collects their debts. This makes them less able to protect themselves from harmful practices, which is a classic example of what economists would term a "market failure." For these and other reasons discussed below, we are moving forward with the rulemaking process here.

In addition to those concerns, there are two other reasons why it would be appropriate to adopt new rules to govern the debt collection industry. Both tend to show how regulation can improve and benefit the marketplace by bringing more order, more clarity, and more transparency to its everyday functions. In the first place, this market is one where the primary governing law is a statute enacted way back in 1977. That law, the Fair Debt Collection Practices Act, contains broad prohibitions on practices that are "unfair or unconscionable" or acts whose "natural consequence" is to "harass, oppress or abuse."

Yet until the Consumer Bureau was created, no agency had the authority to define more specifically the scope of these broad prohibitions. As a result, this area of the law has become outmoded over the past 40 years. The courts have been forced to try to make sense of the statutory provisions and apply them to a very different world, leading to a patchwork of inconsistent rulings that breed disarray and uncertainty. Conflicting rulings from different courts make it difficult for compliance attorneys to give firm guidance to companies that operate in this realm.

So writing new regulations in this area makes a great deal of sense. Both industry and consumer groups are pressing for updated interpretations of the law because so much is happening in this marketplace that the law cannot easily keep pace with developments. The 1977 statute mentions telegrams and was written with landline phones and postal mail in mind. By contrast, many of today's consumers are adept in using the Internet, email, and social media, yet debt collectors are uncertain how to address many issues involving these new technologies. Cell phones were unknown at the time the law was drafted, and the debt-buyer industry barely even existed. Although the courts can try to use their tools of statutory construction to retrofit the statutory language in light of these vast changes, the better course is likely to be to reinterpret it based on a frank and thoughtful assessment through a rulemaking process. That process can be informed by industry officials, consumer advocates, and market experts about how to apply the statute to these new and unforeseen circumstances.

Last summer, we outlined proposals under consideration that would apply to third-party debt collectors and debt buyers. We also announced our intention to move forward with separate rules for first-party creditors who collect on their own accounts. The proposals we outlined focused on three primary issues. First, make sure that collectors are contacting the right consumers, for the right amount. Second, make sure that consumers clearly understand the debt collection process and their rights. Third, make sure that consumers are treated with dignity and respect, particularly in their communications with collectors.

As we evaluated the feedback we received on the proposals under consideration, one thing became clear. Writing rules to make sure debt collectors have the right information about their debts is best handled by considering solutions from first-party creditors and third-party collectors at the same time. First-party creditors like banks and other lenders create the information about the debt, and they may use it to collect the debt themselves. Or they may provide it to companies that collect the debt on their behalf or buy the debt outright. Either way, those actually collecting on the debts need to have the correct and accurate information. All of these parties must work together to ensure they are collecting the right amount of debt from the right consumer.

But breaking the different aspects of the informational issues into pieces in two distinct rules was shaping up to be troublesome in various ways. So we have now decided to consolidate all the issues of "right consumer, right amount" into the separate rule we will be developing for first-party creditors, which will now cover these intertwined issues for third-party collectors and debt buyers as well. That way, we can address this entire set of considerations, market-wide.

In the meantime, we will be able to move forward more quickly with a proposed rule focused on the remaining issues. These issues, again, are information third-party collectors must disclose to people about the debt collection process and their rights as consumers, and ensuring that third-party collectors treat people with the dignity and respect they deserve. Once we proceed with a proposed rule on these issues, we will return to the subject of collecting the right amount from the right consumer, which is a key objective regardless of who is collecting the debt. And we will take care to get it right.

The issues I have just discussed span a considerable spectrum, but at their core, they have much in common. They touch on fairness and protection for all consumers, especially those who are underserved or having financial problems. Our mission is to make sure that markets are fair and transparent, that people are treated with dignity and respect, and that every consumer counts. We look forward to hearing from you today in order to better inform our approach to our work. As always, we are giving a great deal of thought to these and other issues and we welcome your suggestions. Thank you.

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The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit consumerfinance.gov.

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