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Jean Braucher

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FORM AND SUBSTANCE IN CONSUMER FINANCIAL PROTECTION

*Jean Braucher**

The Consumer Financial Protection Bureau (CFPB), created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, went live on July 21, 2011. Less than three months later, the CFPB published its Supervision and Examination Handbook, which outlines, among other topics, how the bureau is using its new authority to regulate abusive practices as well as unfair and deceptive ones. This Article examines the theory underlying the new agency's anti-abuse regulatory power and its early implementation efforts. Armed with insights from behavioral economics supported by extensive research, the CFPB is targeting credit products designed to exploit consumer error. This new approach, based mostly on the substance of deals rather than disclosure, is arguably the most exciting development in consumer protection since the advent of the modern consumer movement in the 1960s. Some states can be expected to follow the federal lead and incorporate "abusive practices" into their laws, creating UDAAP powers (for unfair, deceptive, and abusive acts and practices) that support and extend those of the CFPB.

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INTRODUCTION

Bad consumer deals, often structured using complicated and nasty terms buried in long forms, are an old problem, and the law has long struggled to find adequate tools to deal with them.¹ Thus, it comes as good news that the fledgling Consumer Financial Protection Bureau (CFPB) is honing a brand new tool handed to it by Congress: the concept of abusive practices.² Using insights from behavioral economics, the CFPB is paying close attention to the substance of consumer financial products—that is, to whether consumers are being exploited.³ The new anti-abuse authority

* Roger C. Henderson Professor of Law, University of Arizona. Thanks to Ted Janger for encouraging me to write this piece and to John Pottow for comments on an earlier version.

1. See KARL N. LLEWELLYN, *THE COMMON LAW TRADITION—DECIDING APPEALS* 362–66 (1960) (discussing the struggles of courts and legal scholars to deal with the problem of overreaching in standard form contracts).

2. See Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1031(a), (d), 124 Stat. 1376, 2005, 2006 (2010) (codified at 12 U.S.C. § 5531) (authorizing the CFPB to regulate abusive practices, along with unfair and deceptive ones).

3. The nature of the theory being used by CFPB is explored in Parts II and III below. Although my title echoes Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976), that classic article dealt with dualities in legal thought such as rules versus standards and individualism versus a sense of community. My reference to form and substance may owe more to Arthur Leff's exposition of the dimensions of unconscionability as involving both form, in the sense of the procedure by which a contract is made, and substance, in

shows promise, particularly because the CFPB has incorporated this authority into its examination standards, which can be used to pressure financial institutions to stop employing exploitative practices and to identify practices to target in its enforcement actions.⁴

We have long known that consumer assent to standard form terms is typically fictional and that common law concepts such as unconscionability, involving “case-to-case sniping” as Arthur Leff put it, do not amount to an effective technique for controlling the quality of mass contracts when the market fails.⁵ The consumer movement of the 1960s brought a flowering of administrative consumer protection at the state and federal levels. However, disclosure regulation became its most common, yet insufficient, technique, as exemplified by the alphabet soup of regulations written and enforced by the Federal Reserve Board.⁶ Truth in Lending regulation was the most intricately disappointing example.⁷

the sense of whether the deal is too one-sided or too harsh on the weaker party. *See generally* Arthur Allen Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485 (1967). Of course, Kennedy’s emphasis on the importance of substantive justice and community is reflected in the abiding popularity of consumer protection. *See* Press Release, Ctr. for Responsible Lending, *New Poll Shows Broad Support for Financial Reform: 77% of Americans Want Tougher Rules for Wall Street* (July 19, 2011), <http://www.responsiblelending.org/media-center/press-releases/archives/New-Poll-Demonstrates-Broad-Support-for-Financial-Reform.html> (reporting that in a nationwide survey of likely voters, 93 percent want clearer explanations of credit rates and fees, 77 percent want it to be harder for lenders to offer loans with risky or confusing features, and 74 percent want a single consumer financial protection agency).

4. *See* CFPB, SUPERVISION AND EXAMINATION MANUAL (Oct. 2011), http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/supervision_examination_manual_11211.pdf [hereinafter EXAMINATION HANDBOOK 2011]; *see also infra* note 122 (discussing how the agency links examination to enforcement).

5. Arthur Allen Leff, *Unconscionability and the Crowd—Consumers and the Common Law Tradition*, 31 U. PITT. L. REV. 349, 358 (1970) (arguing that the biggest problem with unconscionability is the ineffectiveness of case-by-case litigation to address mass problems in mass contracts, and arguing that administrative regulation is more effective). Tort law theories, such as fraud or misrepresentation, involve a similar problem of dependence on case-by-case inquiry into the facts of individual interactions, and, lately, some courts have invented the idea that an “economic loss rule” bars use of fraud, or even consumer protection theories, if the parties had a contract. *See* Jean Braucher, *Deception, Economic Loss and Mass-Market Customers: Consumer Protection Statutes as Persuasive Authority in the Common Law of Fraud*, 48 ARIZ. L. REV. 829, 835–39 (2006) (noting that fraud and consumer protection are quintessentially about economic loss, almost always in a contractual context, and that the idea of barring tort or statutory recovery in contracts, especially consumer contracts, is based on a mistake in reading dicta of the U.S. Supreme Court in the 1980s).

6. Prior to the Dodd-Frank Act, *see* Dodd-Frank Act § 1031(a), (d), 124 Stat. at 2005, 2006 (codified at 12 U.S.C. § 5531), and the creation of the CFPB, the Federal Reserve Board had primary responsibility for administering consumer protection regulation of financial institutions, and it promulgated numerous regulations to do so. *See* DEE PRIDGEN & RICHARD M. ALDERMAN, CONSUMER CREDIT AND THE LAW, ch. 5, § 15:2 (West 2011).

7. Truth In Lending Act (TILA), Pub. L. No. 90-321, 82 Stat. 146 (1968) (current version at Title I of the Consumer Credit Protection Act, 15 U.S.C. § 1601–1667f (1968)). *See generally* Edward L. Rubin, *Legislative Methodology: Some Lessons from the Truth-In-Lending Act*, 80 GEO. L.J. 233 (1991) (discussing the thinking that led to TILA and its limitations); Christopher L.

The common law and administrative regulation have too often taken the unthreatening approach of primarily focusing on the form rather than the substance of bad deals, leaving drafters to recur to the attack.⁸ The CFPB is taking over a vast amount of disclosure regulation,⁹ and this burden should not distract the CFPB from its very important new substantive tools.¹⁰

Two core policy arguments were used to justify creating the CFPB. One was the need for a consolidated and independent rule-making and enforcement agency with consumer financial protection as its only task to avoid both conflict among multiple banking regulators as well as the internal conflict of having an agency primarily responsible for regulating the safety and soundness of financial institutions also in charge of consumer protection; as finally structured, CFPB is a bureau within the Federal Reserve Board with financial independence, although not complete independence because its regulations can be set aside by the Financial Stability Oversight Council of the U.S. Department of the Treasury.¹¹

Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 880–85, 900–01 (2003) (discussing both the nonthreatening nature of disclosure regulation to free market ideology and also the point that TILA is easily evaded by the use of fees that do not have to be stated in the finance charge or annual percentage rate); Dee Pridgen, *Putting Some Teeth in TILA: From Disclosure to Substantive Regulation in the Mortgage Reform and Anti-Predatory Lending Act of 2010*, 24 LOY. CONSUMER L. REV. 615, 616–21 (2012) (discussing early recognition that complexity thwarted the effectiveness of TILA, but also noting the lack of sufficient correction by regulators, who only renewed their tinkering with disclosures).

8. LLEWELLYN, *supra* note 1, at 364 (quoting Karl N. Llewellyn, *Book Review*, 52 HARV. L. REV. 700, 702–03 (1939)) (stating that the difficulty with many techniques for dealing with troublesome form clauses, such as construing clauses contrary to their patent meaning, is that since they “rest on the admission that the clauses in question are permissible in purpose and content, they invite the draftsman to recur to the attack. Give him time, and he will make the grade.”).

9. The Dodd-Frank Act moved authority over most existing federal consumer financial disclosure regulations to the CFPB. Dodd Frank Act § 1031(a), (d), 124 Stat. at 2005, 2006 (codified at 12 U.S.C. § 5531). An example of how burdensome designing disclosures can be is the eighteen-month-long process of coming up with mortgage application and closing forms, a process that began in December 2010 and resulted in release of proposed new disclosures on July 9, 2012. *See* Integrated Mortgage Disclosures under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), 77 Fed. Reg. 51116 (August 23, 2012); *see also* Jeff Sovern, Op-Ed, *Help for the Perplexed Home Buyer*, N.Y. TIMES, July 18, 2012, <http://www.nytimes.com/2012/07/19/opinion/a-guide-for-the-new-mortgage-form.html> (discussing the long process of drafting and testing the new disclosures but arguing that many consumers will need mortgage counselors to understand the home loans they are offered). For a prescient analysis of the inadequacy of disclosure regulation to deal with predatory subprime mortgages, one made before the bubble burst, *see* Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 831 (2006) (concluding that “[t]he current information-based legal paradigm confuses disclosure with knowledge, understanding, and rational choice”).

10. *See* Pridgen, *supra* note 7, at 627–28 (listing the new substantive regulation of residential mortgages included in the Dodd-Frank Act § 1031(a), (d), 124 Stat. at 2005, 2006 (codified at 12 U.S.C. § 5531) that the CFPB will oversee).

11. *See* Pridgen, *supra* note 7, at 625 (discussing the desire for a “non-captive government agency” with a primary mission to protect consumers). *See also*, Dee Pridgen, *Sea Changes in*

Although the first policy argument, about the need for a structurally strong consumer financial protection agency, is an important one, the type of regulation a consumer protection agency pursues is equally important. Even dedicated and relentless disclosure regulation can only do so much—it is a good first line of defense, but far from sufficient.¹² Attention to substance is also key.

The second policy argument for the CFPB, the focus of this article, emphasized the type of regulation needed and stressed that consumer financial products should be free from “tricks and traps.”¹³ This rhetoric was politically smart because it did not sound like anything daring, perhaps calling only for better disclosure to prevent trickery. However, it would have been disappointing indeed if the CFPB had turned out to be nothing more than a consolidated agency to oversee disclosure regulation. In addition to the emphasis on eliminating tricks and traps, however, a related rhetorical move used to advocate for creating the CFPB compared financial products to toasters and other physical products and argued that both types of products should be safe.¹⁴ This argument focused more clearly on the need for substantive consumer protection. Early CFPB implementation efforts suggest that these arguments, against tricks and traps and for financial product safety, are two sides of one coin. The CFPB appears focused on eliminating financial products that are based on tricks and traps, that is, on working to do away with substantively bad, unsafe deals. Also, the CFPB is armed with a newly sophisticated theory of what it should be doing, as will be explained below in Parts II and III. Thus, the agency is poised to make exciting advances in consumer protection.

In Part I, this Article begins by reviewing theoretical approaches used over the course of several millennia to deal with bad consumer deals.

Consumer Financial Protection: Stronger Agency and Stronger Laws, 13 WYO. L. REV. (forthcoming 2013) (at Part II) (discussing restructuring of consumer financial protection to make for a stronger, although not completely independent, agency and also the centralization of consumer financial protection in the CFPB, rather than having consumer protection authority spread among numerous banking regulators), *supra* note 9, and *infra* note 109 concerning consolidation of consumer financial protection in the CFPB.

12. The obvious point that disclosure is insufficient as consumer protection is sometimes used as the basis for the arguments that we should do away with disclosure or that we should not worry if disclosure is delayed until it is too late to do any good; this is certainly not my position. See Jean Braucher, *Delayed Disclosure in Consumer E-Commerce as an Unfair and Deceptive Practice*, 46 WAYNE L. REV. 1805, 1809–18 (2000) (discussing the importance of both early disclosure and substantive regulation). However, it would have been a waste of political capital to have a protracted fight such as that over the Dodd-Frank Act § 1031(a), (d), 124 Stat. at 2005, 2006 (codified at 12 U.S.C. § 5531), and end up with nothing more in the way of consumer protection than a new agency to house disclosure regulation.

13. See Elizabeth Warren on Credit Card “Tricks and Traps,” PBS NOW (Jan. 2, 2009), <http://www.pbs.org/now/shows/501/credit-traps.html>.

14. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 98 (2008) (underscoring the nature of the approach as focused on substance with a different name for the proposed agency, the Financial Product Safety Commission); see also *infra* notes 15 and 90–95 and accompanying text (discussing the product safety analogy).

Policing of the marketplace was substantive for a long time, and disclosure regulation was a twentieth century innovation. Part II traces the scholarly development of the theory underlying the CFPB's regulation of abusive practices, a theory that refocuses consumer protection on substance. In Part III, the Article describes and evaluates the CFPB's initial mobilization of its anti-abuse authority. It concludes that anti-abuse regulation based on behavioral economics promises to be an important development, arguably the most significant innovation in consumer law in decades.¹⁵

I. THE RISE AND EVENTUAL DOMINANCE OF DISCLOSURE

The earliest consumer financial protection was substantive—prohibiting usury.¹⁶ In the ancient world, lending at interest, particularly if at high rates for purposes of consumption, was often considered immoral.¹⁷ Interest was either prohibited or rates were capped at modest levels, although evasion of the law was also common.¹⁸ Early and medieval Christianity condemned the charging of any interest, and usury became a sin punishable by excommunication, but various fictions effectively permitted charging interest or fees for some loans.¹⁹ The practical Protestants loosened the law of usury to permit interest that was not “biting” and facilitated trade.²⁰ With the rise of the Enlightenment and modern economic thinking, abolition of usury laws was the result in England.²¹ Usury law lingered much longer in the United States, particularly in the Bible Belt of the South, but a U.S. Supreme Court decision in 1978 prompted its effective abolition over the

15. In addition to regulation of consumer credit in the Truth in Lending Act, 15 U.S.C. §§ 1601–1700, and in other laws, the consumer movement of the 1960s focused on physical product quality regulation, eventually producing both product safety and warranty initiatives in the 1970s. Like TILA, the Magnuson-Moss Warranty and Federal Trade Commission Improvement Act of 1975, 15 U.S.C. §§ 2301–2312, was too complicated and relied too heavily on disclosure. The consumer movement scored better on regulation of product safety, resulting in the creation, in 1972, of the U.S. Consumer Product Safety Commission (CPSC). *See* 15 U.S.C. §§ 2051–2073 (creating the agency and outlining its powers). CPSC is the inspiration for CFPB, but the latter also owes much to observation of the failings of the long experiment with disclosure as the primary means to regulate credit products.

16. James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61, 64 (1981).

17. *Id.* at 63–71 (recounting moral views about lending at interest as well as legal constraints on interest rates applicable in various cultures, including Hebrew, Sumerian, Babylonian, Greek, and Roman).

18. *See id.*

19. *See generally id.* at 72–77 (discussing the seriousness with which usury was treated and also describing numerous structures used to evade the prohibition, such as use of silent partnerships or sale of “annuities,” inflated currency exchange rates, and late payment charges).

20. *See generally id.* at 77–79 (recounting developments during the Reformation and Calvin's interpretation that “the Bible prohibits only ‘biting’ interest that oppresses the poor,” permitting moderate interest that facilitated trade).

21. *See generally id.* at 82–85 (discussing the writing of John Locke and Jeremy Bentham, especially the latter's 1787 *Letters in Defense of Usury*, and the repeal in 1854 in England of all acts against usury).

next few years, clearing the way for an explosive growth in high cost and high risk consumer credit.²²

As a companion to strict usury prohibitions that kept a lid on risky consumer credit, the medieval approach to regulation of markets for goods and services used authoritarian control of fairness and involved enforced communal solidarity against all manner of cheats.²³ Local and special courts and inspectors exercised paternal solicitude in many ways, for example, in the assizes of bread and beer, in oversight of notions of gallons and quarts, in proper content of sausages (no pieces of drowned cow allowed), in sizes of bricks, and even in policing to see that porters did not stop to play cards and backgammon.²⁴ In a foreshadowing of the problem of tricks and traps in complicated financial products, authorities looked for physical traps used by scamming bakers:

A number of bakers were hailed into court for contriving holes in their counters, artfully concealed by ingenious trapdoors, through which their customers' dough was stolen before their very eyes. The makers knew their wares; their customers, who were inexpert, did not. The law was invoked lest there be deceit of many people having no knowledge of the same.²⁵

Caveat emptor was an occasional, mostly late, and contested idea, with the law of warranty and deceit contradicting the philosophical pull of laissez-faire, which had perhaps its fullest flowering in nineteenth-century America.²⁶ In a restless and far-flung population with little recourse to magistrates, the law in action left consumers mostly to protect themselves if they could.

Even as the common law of contract became more formal and de-emphasized substantive fairness, equity pulled the other way. This tension produced the doctrine of unconscionability, which became a settled part of

22. See James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 450–54 (2000) (discussing how the Supreme Court's interpretation of the National Bank Act of 1863 in *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), led to federal and state legislative changes that effectively ended usury regulation except in isolated local pockets). Notably, the Dodd-Frank Act, § 1027(o), 124 Stat. 1376, 1995 (codified at 12 U.S.C. § 5517(o)), bars the CFPB from imposing usury limits, but with the implication that other substantive regulation is permissible. See *infra* note 125 and accompanying text discussing this point.

23. William H. Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L.J. 1133, 1136 (1931) (referring ironically in the title to the "ancient maxim," and explaining, "*Caveat emptor* is not to be found among the reputable ideas of the Middle Ages. As custom of trade or rule of law it is not to be met with upon the highways of mediaeval culture. To priest and lord, to yeoman and villain, and even to burglar and lawyer, it would have fallen strangely upon the ear. They did not talk that language.").

24. *Id.* at 1142–46.

25. *Id.* at 1151–52 (footnotes omitted).

26. *Id.* at 1171–75, 1178–81.

the federal common law by the late nineteenth century.²⁷ When the doctrine was included in Article 2 of the Uniform Commercial Code, it was not defined other than in a rambling and somewhat contradictory comment.²⁸ The case law developed the idea that both form (also referred to as “procedure,” in the sense of the process by which a contract was entered into) and substance mattered.²⁹ Application of the flexible doctrine has, of course, varied. The case law in some places has developed a “sliding scale” approach to unconscionability, requiring less of one type of unfairness where there is more of the other kind.³⁰ One state’s highest court has noted the lack of any mention of procedure in the language of section 2-302 itself and concluded that unconscionability can be found on the basis of substantive unfairness alone, an approach followed by a sprinkling of other courts.³¹

The Restatement (Second) of Contracts also recognized unconscionability.³² In addition, it included an innovative doctrine, derived from a scholarly analysis by Karl Llewellyn, concerning unenforceability of standard-form terms contrary to reasonable expectations.³³ While the black letter of the Restatement’s section 211(3) could be read narrowly, the American Law Institute (ALI) restatements are not statutes; as to this provision, a comment makes clear that the ALI endorses a broad concept that parties to standard form contracts “are not bound to unknown terms which are beyond the range of reasonable expectation.”³⁴ The black letter test—which is whether there was “reason to believe the adhering party

27. *Pope Mfg. Co. v. Gormully*, 144 U.S. 224, 236–37 (1892) (refusing specific enforcement of an unconscionable contract in a case involving diversity of citizenship of the parties); *Hume v. United States*, 132 U.S. 406, 415 (1889) (refusing to enforce a contract with an unconscionable price charged to a federal agency); see also 2 DAN B. DOBBS, *LAW OF REMEDIES* 703 (2d ed. 1993) (discussing lack of enforcement in equity of unconscionable contracts).

28. UNIF.COMMERCIALCODE § 2-302, cmt. 1 (including the idea that clauses in contracts should not be “so one-sided as to be unconscionable” and that this should be judged “under the circumstances existing at the time of the making of the contract,” and also that “[t]he principle is one of the prevention of oppression and unfair surprise” and “not of disturbance of allocation of risks because of superior bargaining power”; the focus on one-sidedness and oppression suggests a substantive test, while the focus on the circumstances at the time of making and on unfair surprise suggests a procedural test).

29. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449–50 (D.C. Cir. 1965); see also Leff, *supra* note 3, at 486–88.

30. *Armendariz v. Found. Health Psychcare Servs., Inc.* 6 P.3d 669, 690 (Cal. 2000) (“[T]he more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.”).

31. *Maxwell v. Fid. Fin. Servs., Inc.*, 907 P.2d 51, 59 (Ariz. 1995) (“[E]vidence that the dual requirement position is more coincidental than doctrinal is found within the very text of the statute on unconscionability, which explicitly refers to ‘the contract or any clause of the contract.’ . . . Conspicuously absent from the statutory language is any reference to procedural aspects.”); see also, e.g., *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569, 574 (App. Div. 1998).

32. RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981).

33. *Id.* § 211(3). See *infra* notes 37–46 and accompanying text concerning the origins of this doctrine in the work of Llewellyn.

34. RESTATEMENT (SECOND) OF CONTRACTS § 211, cmt. f. (1981).

would not have accepted the agreement if he had known that the agreement contained the particular term”—is expanded by the comment, which states that “reason to believe” can be filled in by inference:

Reason to believe may be inferred from the fact that the term is bizarre or oppressive, from the fact that it eviscerates the non-standard terms explicitly agreed to, or from the fact that it eliminates the dominant purpose of the transaction. The inference is reinforced if the adhering party never had an opportunity to read the term, or if it is illegible or otherwise hidden from view. This rule is closely related to the policy against unconscionable terms³⁵

While the reasonable expectations doctrine has a primarily substantive thrust, it also embodies an idea of extraordinarily effective disclosure as a means to avoid creating expectations; for example, a party with knowledge of a harsh term can hardly claim that it was contrary to his or her reasonable expectations.³⁶ As we shall see, this is why the concept of “abusive practices” is so important: parties can know of a term but not appreciate how it will affect them. Trickery need not involve nondisclosure or even buried disclosure; rather, it can be based on exploiting another’s lack of understanding of what has been clearly disclosed as well as consumer errors, such as underestimation of future credit use.

The origins of the reasonable expectations doctrine are in the jurisprudential work of Llewellyn, who recognized that standard form contracts present a challenge to a contract theory grounded in mutual assent.³⁷ He took on the difficult question of how we can see an adhering party as agreeing, even objectively, to form terms that the drafter knows the adhering party did not read or otherwise know about. Llewellyn’s theoretical solution was what he called “blanket assent,” as distinguished from specific assent to “the few dickered terms, and the broad transaction type.”³⁸ Blanket assent, he argued, is given

to any not unreasonable or indecent terms the seller may have on his form.
. . . The fine print which has not been read has no business to cut under the

35. *Id.*; see also Braucher, *supra* note 12, at 1814–18 (discussing Karl Llewellyn’s concept of blanket assent, discussed *infra* at notes 37–46 and accompanying text, and the Restatement’s reasonable expectations doctrine as involving more substantive policing than mixed procedure-and-substance unconscionability).

36. It is interesting that in Arizona, which has a robust general doctrine of reasonable expectations not limited to the insurance context, unconscionability is treated as a theory that can be used on the basis of substantive unfairness alone, see *supra* note 31, while the reasonable expectations doctrine is treated as a mixed matter of substance and process. See Jean Braucher, *Cowboy Contracts: The Arizona Supreme Court’s Grand Tradition of Transaction Fairness*, 50 ARIZ. L. REV. 191, 213–21 (discussing how the Arizona court defined reasonable expectations and unconscionability).

37. LLEWELLYN, *supra* note 1, at 362 (discussing the problem of form “Agreement” with the scare quotes in the heading of the original).

38. *Id.* at 370.

reasonable meaning of those dickered terms which constitute the dominant and only real expression of agreement, but much of it commonly belongs in.³⁹

If one focuses on Llewellyn's support for throwing out unreasonable terms, one may miss the real thrust of this passage: that, in his view, most of what is in a form should be enforced. But why? Is it really about assent? The answer, explained earlier in the same section of Llewellyn's book, *The Common Law Tradition*, is decidedly in the negative. Instead, one finds a paean to business efficiency, with the emphasis on the convenience of the business drafting the form, not on the adhering party's assent:

The impetus to the form-pad is clear, for any business unit: by standardizing terms, and by standardizing even the spot on the form where any individually dickered term appears, one saves all the time and skill otherwise needed to dig out and record the meaning of variant language; one makes check-up, totaling, follow-through, etc., into routine operations; one has duplicates (in many colors) available for the administration of a multidepartment business; and so on more.⁴⁰

Llewellyn was deeply sympathetic to businesses' desire for flexibility to create their own certainty. He romantically believed that businesses would, on the whole, refrain from acting unreasonably or indecently, so that a light hand of constraint would be sufficient. He was even willing to concede that he was picturing not agreement but "private government in the lesser transactions of life."⁴¹ To serve business efficiency, he built his "blanket assent" theory. So here is the kicker: blanket assent is a fiction, albeit a convenient one, and is not about any real assent of the adhering party but is rather about the perceived needs of the business doing the drafting.⁴² In other words, our best explanation of standard forms as contractual, as about agreement—by the leading American legal realist no less—is constructed around fictional assent.

Of course, Llewellyn recognized the need for remedies against unreasonable forms. He said the problem was real, sometimes amounting to "flagrant trickery,"⁴³ but he also hoped that judicial policing would largely be sufficient, while acknowledging that perhaps it would not be. Concluding his hymn of praise for standard forms as a means to save time and skill, he wrote, "It would be a heart-warming scene, a triumph of private attention to what is essentially private self-government in the lesser transactions of life or in those areas too specialized for the blunt, slow tools of the legislature—if only all businessmen and all their lawyers would be

39. *Id.*

40. *Id.* at 362.

41. *Id.*

42. *Id.* at 362–63.

43. *Id.* at 363.

reasonable.”⁴⁴ He referred also to “gentlemanly restraint” as well as fully negotiated trade rules as solutions.⁴⁵

Thus, there is an even bigger problem with Llewellyn’s theory of standard form contracts than its core fiction of “blanket assent.” It is also an unrealistic way to think about business norms in the face of intense market competition; more than weak judicial policing is needed if we want businesses to be able to act decently. It should be noted that Llewellyn was mostly focused on contracts between two businesses; he was not expounding a theory of consumer contracts in particular.⁴⁶ Without deep investigation, it is hard to say whether businesses were more reasonable and decent in their standard form deals when Llewellyn wrote in the mid-twentieth century than they are today. Llewellyn may have been naïve, as well as romantic, about business culture even then. But, carrying his theory forward to today clearly makes no sense in many realms, particularly that of consumer finance, which has one of the most ruthless industry cultures of all, a product of stiff competition to attract investors seeking the highest possible returns.⁴⁷ We cannot expect credit card issuers to act with gentlemanly restraint; competitive conditions have driven them to create a business model that has been described as a debt “sweatbox.”⁴⁸

The common law has proved incapable of doing better than developing doctrines of unconscionability and reasonable expectations as ways to police bad standard form deals. Furthermore, common law methodology, no matter the details of the doctrine, is unequal to the task of policing lender exploitation of consumers.

44. *Id.* at 362.

45. *Id.* at 363.

46. Llewellyn mostly used business-to-business examples, but lumped in a few consumer examples too, such as apartment leases and installment sales of appliances; but, in his consumer examples, Llewellyn also referred to the fact that legislative intervention was underway. *Id.* at 362, 366. Llewellyn had earlier written specifically about consumer protection as an enormous problem beyond the capacity of common law methodology, and thus one that called for the incisive diagnosis and efficient treatment that a statute can provide. KARL N. LLEWELLYN, *THE CASE LAW SYSTEM IN AMERICA* 67–68 (1989). For why this is referred to as “earlier” writing, see KARL N. LLEWELLYN, *THE CASE LAW SYSTEM IN AMERICA* ix–x (1989), explaining that the original edition of this book was published in German in 1933 based on lectures given in 1928–1929.

47. Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 *THEORETICAL INQUIRIES* L. 323, 334–36 (2006) (discussing the hard-edged nature of the culture of the consumer credit industry, in which competition forces lenders to go to the limits of what the law allows).

48. Ronald J. Mann, *Bankruptcy Reform and the “Sweat Box” of Credit Card Debt*, 2007 *U. ILL. L. REV.* 375, 384–92 (2007) (describing how credit card issuers make the most money on borrowers who become distressed and pay high interest on their balances for a period of time, even if they eventually default); see *infra* notes 79–81 and accompanying text (discussing further the predatory nature of the sweatbox business model). See also Jean Braucher, *The Sacred and Profane Contracts Machine: The Complex Morality of Contract Law in Action*, 45 *SUFFOLK U. L. REV.* 667, 684–88 (discussing moral ideas in business and how competition can force business persons to act amorally, so that regulation is needed to permit them to act decently).

The consumer movement produced administrative regulation, much of it involving disclosure.⁴⁹ Lately, there has also been a turn to specific substantive requirements, such as in the Card Act⁵⁰ and in recent mortgage regulation.⁵¹ While this is promising because businesses tend to avoid violating explicit commands,⁵² more flexible approaches are also needed to address the creativity of consumer creditors in coming up with new ways to trap hapless borrowers. This problem demands regulation that can nip in the bud innovations in exploitation. For this part of the task, administratively policed general standards are needed.

Open-textured and potentially anticipatory consumer protection regulation has long been the province of the Federal Trade Commission (FTC), with its mission to police unfair and deceptive practices.⁵³ The FTC has defined each of these concepts as best as it could, particularly given the pressures of industry-influenced congressional oversight.⁵⁴ As will be discussed in Part III of this Article, both deception and unfairness can have elements of nondisclosure, but unfairness in particular goes somewhat beyond an approach focused on form. Unfortunately, the FTC never had authority to police directly the deception and unfairness practiced by financial institutions.⁵⁵ The Dodd-Frank Act has solved this problem by

49. See *supra* notes 6–7 and accompanying text; see also MICHAEL M. GREENFIELD, CONSUMER LAW: A GUIDE FOR THOSE WHO REPRESENT SELLERS, LENDERS, AND CONSUMERS 228–30 (Little, Brown and Co. 1995) (discussing history of disclosure regulation and its full flowering with administrative implementation of the Truth in Lending Act of 1968).

50. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 124 Stat. 1743 (codified in scattered sections of 15 U.S.C.); see ADAM J. LEVITIN, THE CREDIT C.A.R.D. ACT: OPPORTUNITIES AND CHALLENGES FOR CREDIT UNIONS 1–2 (Filene Research Institute, 2009), available at <http://ssrn.com/abstract=1544885> (describing most significant provisions of the law as involving limits on changes in terms and on fees that can be charged).

51. Pridgen, *supra* note 7, at 627–35; see *supra* note 10 and accompanying text.

52. William C. Whitford, *Structuring Consumer Protection Legislation to Maximize Effectiveness*, 1981 WIS. L. REV. 1018, 1022 (1981) (noting the tendency of merchants to do what they are specifically directed by statute to do out of “belief in law-abidingness and fear of bad publicity,” and also discussing generally the mostly symbolic effect of vague, admonitory legislation that depends on private rights of actions for enforcement).

53. Federal Trade Commission Act of 1914, 15 U.S.C. §§ 41–58 (codified as amended 2006) (including, in particular, § 45, which addresses unfair or deceptive acts and practices).

54. Unfairness is now defined in 15 U.S.C. § 45(a)(4), which codifies an FTC policy statement made in Letter to Senators Ford & Danforth, Consumer Subcommittee, Committee on Commerce, Science and Transportation (Dec. 17, 1980), reprinted in *In re Int’l Harvester*, 104 F.T.C. 949, 1070 (1984) [hereinafter FTC Unfairness Policy Statement]; see also Jean Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U. L. REV. 349, 405–12 (1988) (discussing the political pressures that led to the Unfairness Policy Statement and discussing its analysis). Deception is defined in the FTC’s Policy Statement on Deception, Letter to John D. Dingell, Chairman, Subcommittee on Oversight and Investigations, Committee on Energy and Commerce (Oct. 14, 1983), reprinted as applied to *In re Cliffdale Assocs.*, 103 F.T.C. 110, 174 (1984) [hereinafter FTC Deception Policy Statement].

55. See generally Julie L. Williams & William S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by*

giving the CFPB authority to address unfair and deceptive acts and practices of financial institutions and, for good measure, Dodd-Frank added abusive practices, too.⁵⁶ Now, one agency has power to require disclosure under the Truth in Lending Act and to regulate unfair, deceptive, and abusive practices. The regulatory mission is not merely disclosure, but consumer protection, broadly and flexibly defined.⁵⁷

This broad definition of mission is needed more now than ever. Indeed, as will be described in the next section, the consumer credit industry has become driven by a science of studying and exploiting patterns of consumer error. In the fight against over-indebtedness, we need regulation of the credit industry to reduce this sort of lending.⁵⁸ This is where the CFPB's new authority to regulate abusive practices comes in, but first it will be helpful to understand the theory behind the CFPB's anti-abuse power.

II. THE THEORY OF ABUSIVENESS AND ITS SUBSTANTIVE FOCUS

A rich body of theoretical and empirical work supports the need for regulation of abusive extensions of credit. The idea that lenders should not abuse borrowers by extending overly risky credit can be traced back at least to the advocacy of Vern Countryman in the 1960s, when he chaired a committee of the National Bankruptcy Conference (NBC) formed to propose improvements in the wage earner plan under Chapter XIII of the Bankruptcy Act, the predecessor of today's Chapter 13 repayment plan form of bankruptcy.⁵⁹ Countryman was concerned that consumer finance companies were inducing debtors not to disclose their full indebtedness by using forms that only provided space to list a few debts, sometimes followed by a printed line saying "we have no other debts."⁶⁰ He saw this practice as a trick designed to manufacture bankruptcy nondischargeability due to a debtor's use of a false financial statement to obtain credit.⁶¹ More

Banks, 58 BUS. LAW. 1243 (2003) (discussing various banking agencies' use of their authority to regulate unfair and deceptive practices).

56. Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), (d), 124 Stat. 1376, 2005, 2006 (2010) (codified at 12 U.S.C. § 5531).

57. See Rubin, *supra* note 7, at 283–84 (critiquing the legislative drive for TILA as based on a premise that its goal was disclosure, with insufficient evaluation of whether disclosure would achieve consumer protection).

58. Braucher, *supra* note 47, at 342–46 (discussing the structural and cultural dimensions of both creditor and debtor behavior and arguing that the least promising way to address overindebtedness is by efforts to change informally the culture of the consumer credit industry; because the industry operates under competitive conditions, regulation affecting its structure is more promising, although politically challenging).

59. Margaret Howard, *Vern Countryman and Barry Zaretsky: A Legacy of Ideas*, 75 AM. BANKR. L.J. 283, 296 (2001); see also Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1, 8–9 (1975).

60. Countryman, *supra* note 59, at 3.

61. *Id.* at 3–4.

broadly and importantly, he was also concerned that creditors were not checking credit reports maintained by credit bureaus to find out about total indebtedness or were ignoring information creditors did collect.⁶² As a result, he proposed two defenses to creditors' claims in bankruptcy: unconscionability and improvident extension of credit.⁶³ Only unconscionability made it into the 1966 NBC proposal,⁶⁴ but Countryman later wrote an article in which he expanded his analysis of creditor improvidence.⁶⁵

Countryman was concerned with a consumer credit business model based on "volume rather than on thorough credit investigation."⁶⁶ This was the essence of what he termed improvident extension of credit, which he defined as extending credit "where it cannot reasonably be expected that the debtor can repay the debt according to its terms" in view of "circumstances of the debtor at the time the credit was extended . . . known to the creditor or [that] would have been revealed to him on reasonable inquiry prior to the credit extension."⁶⁷ The objects of his concern were "gullible or necessitous debtors" who took on impossible debt burdens, as well as their "responsible creditors."⁶⁸ While conceding that debtors are also responsible for taking out loans they cannot afford, he packed an elaborate economic analysis, one that behavioral economists have since documented, into one sentence: "Although both the debtor and the offending creditor have been improvident, typically the creditor is the better equipped—by education, experience, resources, and the nature of his role—to avoid and distribute the risk of improvidence."⁶⁹ Although he considered the desirability of a tort claim, not just a contract defense, that could be asserted outside bankruptcy to recover all losses brought on by resulting overindebtedness, Countryman focused on creating a cause of action for improvidence in bankruptcy because such a cause of action would provide a ready means of recovering the losses and returning them to the estate for the benefit of all creditors.⁷⁰

At the core of Countryman's concept of improvident lending, then, is the idea that a creditor has a responsibility to evaluate borrowers' ability to repay, so as to protect debtors as well as other creditors. The essence of predatory lending is extending credit to those who can be expected to default, and creditors who fail to evaluate creditworthiness know that they are setting up some of their customers for a fall. Creditors can make money

62. *Id.* at 5–6.

63. *Id.* at 8–9.

64. *Id.* at 8–10.

65. *See generally id.* (developing the idea that creditors should evaluate their debtors' ability to repay and advocating a bankruptcy remedy for improvident lending).

66. *Id.* at 2.

67. *Id.* at 23.

68. *Id.* at 9.

69. *Id.* at 17.

70. *Id.* at 20–21.

on such credit in various ways—on volume, as Countryman noted, or alternatively by having substantial collateral or, as we shall see, by charging high interest for long enough that eventual default does not cause a loss.⁷¹

In the wake of a mortgage crisis brought on by “no doc” and “liar” loans and similar subprime mortgage products offered with little or no underwriting of the risk of default, the concept that lenders must evaluate ability to pay has finally been explicitly embraced in federal consumer financial protection law.⁷² Assessment of ability to pay became a requirement for all mortgage originators under the Dodd-Frank Act.⁷³ Also, the Federal Reserve Board had earlier adopted this standard, effective October 1, 2009, for most high-cost mortgage loans.⁷⁴ Furthermore, Congress directly required credit card issuers to determine ability to pay by legislation in 2009.⁷⁵ Thus, it is fair to say that Countryman has been posthumously triumphant, as powerful ex ante statutory and administrative regulation now goes far beyond his proposals for ex post tort and bankruptcy remedies.

Countryman focused on the most obvious abusive practices of his day, but what has happened since involves a whole new level of sophisticated abuse by design. In an analysis predating the bursting of the housing bubble fueled by predatory lending, John Pottow picked up on this change in credit industry practices in an article published in 2007 that reacted to Congress’s steps in the 2005 bankruptcy law to get tough on debtors.⁷⁶ He argued that if we really want to reduce bankruptcy, it would be more effective to get tough on creditors, who are better positioned to reduce the bad credit that causes it.⁷⁷ He proposed reviving Countryman’s idea of improvident credit, renaming it “reckless credit” to emphasize that more than negligence is involved.⁷⁸

Pottow based his calls for both a contract defense and a tort cause of action for reckless credit on insights of behavioral economics and on

71. See *infra* notes 79–81 and accompanying text.

72. See generally John E. Pottow, *Ability to Pay*, 8 BERKELEY BUS. L.J. 175 (2011) (discussing origins of the new regulations, their mechanics, and their normative justification). See also KATHLEEN C. ENGLE & PATRICIA A. MCCOY, *THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS* 35–38 (Oxford University Press, 2011) (discussing loose underwriting and lack of documentation in the run-up to the mortgage crisis).

73. Dodd-Frank Act, Pub. L. No. 111-203, § 1411, 124 Stat. 1376, 2142 (2010) (codified at 15 U.S.C. § 1639c).

74. 12 C.F.R. §§ 226.31–226.39 (2010) (regulation Z, subpart E); see Jean Braucher, *Humpty Dumpty and the Foreclosure Crisis: Lessons from the Lackluster First Year of the Home Affordable Modification Program (HAMP)*, 52 ARIZ. L. REV. 727, 734–35, 734 n.28 (2010) (concerning the belated adoption of this rule after the mortgage crisis).

75. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, § 109, 123 Stat. 1734, 1743 (2009) (codified in scattered sections of 15 U.S.C.).

76. John E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 U. ILL. L. REV. 405, 406 (2007).

77. *Id.* at 406–07.

78. *Id.* at 428.

research into the business model known as the “sweatbox” of consumer credit.⁷⁹ Behavioral economics analysis posits that creditors have comparative advantages over debtors both in avoiding cognitive biases, such as debtors’ underestimation of their future credit use and optimism about their financial prospects in general, and in creditors’ superior access to information to evaluate risk.⁸⁰ Pottow’s analysis of the troublesome business model focused on industry reliance on defaulters for profitability by luring customers with low initial rates and then cranking up the heat on “sweaters” by charging late payment fees and penalty rates, making a lot of money on them before they eventually default.⁸¹

Pottow might be criticized for an almost quaint endorsement of the use of the common law to regulate creditors; he even extolled case-by-case policing in the mold of unconscionability.⁸² But this line of attack would be to miss that Pottow stresses that his proposal is “complementary, not exclusive.”⁸³ His advocacy for complementary approaches suggests that we may need, along with CFPB administrative oversight to prevent abuse, something like a cause of action for reckless credit extension to provide private rights of action, but perhaps implemented by state statutes rather than common law. This could be done by amendment of the state statutes addressing unfair and deceptive acts and practices (UDAPs)—sometimes called “little FTC acts”—to add abusive acts and practices and cover all three types of practices (hence, UDAAPs), so that in addition to CFPB regulation, there would be state-level administrative enforcement and statutory private rights of action with multiple damages and attorneys’ fees.⁸⁴ Alternatively, even without statutory amendment, state consumer protection agencies and courts could interpret the deliberately flexible phrases “deceptive practices” and “unfair practices” to encompass abusiveness as developed by CFPB, particularly in light of advances in our research-based understanding of the mechanisms of consumer exploitation.

For his analysis of reckless credit, Pottow drew upon Oren Bar-Gill’s work applying the insights of behavioral economics to explain credit card

79. See Mann, *supra* note 48, at 384–92.

80. See Pottow, *supra* note 76, at 431–34.

81. *Id.* at 415–17.

82. *Id.* at 426–29, 434.

83. *Id.* at 435.

84. See Dodd-Frank Act, Pub. L. No. 111-203, § 1041, 124 Stat. 1376, 2011–12 (2010) (codified at 12 U.S.C. § 5551) (making clear that Dodd-Frank establishes a federal floor and does not preclude states from providing consistent additional protection, including greater consumer protection); see also Arthur E. Wilmarth, Jr., *The Dodd-Frank Act’s Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893, 922–25 (discussing Dodd-Frank’s anti-preemption provision and the possibility that states could interpret their UDAP statutes to also cover abusive practices and use CFPB authority as persuasive authority). On the other hand, adding “abusive acts and practices” to a state’s UDAP statute could do this explicitly. See also generally CAROLYN L. CARTER ET AL., UNFAIR AND DECEPTIVE ACTS AND PRACTICES (2008 & 2011 Supp.) (discussing both federal and state UDAP law and their interaction).

pricing.⁸⁵ In *Seduction by Plastic*, Bar-Gill examined the complex mix of fees and rates used by card issuers, which included at the time of his investigation “low introductory rates that appear alongside high long-term interest rates, zero annual and per-transaction fees, large penalties for late payments and for deviations from the credit limit, and low (and even negative) amortization rates.”⁸⁶ Bar-Gill argued that these pricing practices reflected a studied exploitation of consumers’ underestimation of their own likelihood of running a balance and other consumer errors, such as thinking they would switch to a lower-rate card before the teaser rate ran out.⁸⁷ He noted that such complex pricing practices can be a telltale sign of exploitation in consumer markets more generally, even beyond the realm of credit products.⁸⁸ While challenging a position favoring nonintervention, Bar-Gill put off making a particular regulatory proposal and awaited the opportunity for further analysis.⁸⁹

Following the mortgage crisis, Bar-Gill and coauthor Elizabeth Warren returned to the concerns of his earlier article and took on the prescriptive task. They argued, in *Making Credit Safer*, for an administrative agency with ex ante power to prevent consumer exploitation by lenders offering unsafe credit products.⁹⁰ This article is sometimes remembered for the use of a toaster analogy, that is, the idea that consumer financial products should have to be safe just as physical products must be. While the toaster analogy is used in the introduction and elsewhere in *Making Credit Safer*,⁹¹ it originally comes from an earlier advocacy piece by Warren.⁹²

More significantly, *Making Credit Safer* lays out a vast amount of empirical support, taken from studies conducted by many researchers, for the proposition that creditors have exploited consumer errors systematically and designed traps to make consumers pay more than they expected.⁹³ Bar-

85. See Pottow, *supra* note 76, at 418 & n.60 (citing Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2004)). See also Pridgen, *supra* note 11, at pts. III.A, III.B (discussing CFPB’s greater reliance on insights of behavioral economics and consequent de-emphasis of disclosure regulation).

86. Bar-Gill, *supra* note 85, at 1374.

87. *Id.* at 1376.

88. *Id.* at 1379, 1428–34 (discussing how exploitation of consumer biases is not limited to the credit card industry or even consumer credit).

89. *Id.* at 1378, 1411–27 (discussing reasons for intervention and possible means of doing so).

90. Bar-Gill & Warren, *supra* note 14, at 98 (making a proposal for such an agency).

91. *Id.* at 7 (noting that “[t]oday, consumers can enter the market to buy physical products, confident that they will not be deceived into buying exploding toasters Consumers entering the market to buy financial products should enjoy the same benefits.”).

92. Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY J., Summer 2007, at 8, available at <http://www.democracyjournal.org/pdf/5/Warren.pdf> (opening with an analogy between a toaster bursting into flames and a mortgage with a high risk of putting the family out on the street).

93. Bar-Gill & Warren, *supra* note 14, at Part I.B (setting forth evidence that markets for consumer credit products are failing).

Gill and Warren also examined why disclosure regulation will not work.⁹⁴ Here, the toaster analogy is useful because no one thinks the primary and best way to regulate against dangerous toasters is better disclosure about their risks. Also, despite their homey familiarity, toasters are surprisingly complex—most of us will never understand exactly how they work—but we want and expect them to be safe.⁹⁵

The rich description of pricing practices in *Making Credit Safer* draws on examples involving credit cards, subprime mortgages, and payday loans. Credit cards provide perhaps the most interesting example, because practices were so different before and after the beginning of the Great Recession as the industry adjusted to changing consumer preoccupations. Credit card pricing used to focus on low teaser rates to get debtors into the sweatbox.⁹⁶ After the Great Recession, and the reduced consumer confidence that followed, creditors adapted to consumers' caution about debt by emphasizing lower long-term rates while adding many extra charges to which consumers did not pay attention.⁹⁷

During the housing bubble, subprime mortgage lenders emphasized low or zero down payments, with low interest for two or three years that then reset to a high rate.⁹⁸ Once again, creditors used low initial rates in the same way cheese is used in a mousetrap. Many consumers failed to appreciate the risk and also failed to refinance when they could, so that they were caught by falling home values when the housing market snapped.⁹⁹ Another form of consumer error, a particularly gross one, was common—taking out a subprime loan when the borrower could have qualified for a prime one.¹⁰⁰

94. *Id.* at Part I.A (concerning the limits of consumer learning); see also Lauren E. Willis, *Against Financial Literacy Education*, 94 IOWA L. REV. 197, pt. II (2008) (pointing out that advocates of financial literacy education lack empirical support that this type of education works to change behavior, and questioning the plausibility of its premises given the gap between the skills needed to understand complex financial products and the general educational attainment of much of the U.S. population as well as evidence of consumer error in financial decision-making).

95. See generally THOMAS THWAITES, *THE TOASTER PROJECT—OR A HEROIC ATTEMPT TO BUILD A SIMPLE ELECTRIC APPLIANCE FROM SCRATCH* (2011) (detailing the author's attempt to build a toaster from scratch by crafting and assembling more than 400 parts). See also Michael Hanlon, *Killers in your Kitchen: Gender-bending Packaging, Exploding Floor Cleaners and Toasters More Deadly than Sharks*, DAILYMAIL.COM (Jan. 22, 2010), <http://www.dailymail.co.uk/femail/food/article-1245151/Killers-kitchen-Gender-bending-packaging-exploding-floor-cleaners-toasters-deadly-sharks.html> (reporting that “[s]everal hundred people a year worldwide are killed by their toasters, compared to eight or nine by sharks,” suggesting that toasters remain appliances to handle with caution).

96. Bar-Gill & Warren, *supra* note 14, at 33–37 (discussing use of teaser rates, with consumers making mistakes both in not switching before the introductory rate expired and in making calculations about the benefits of the teaser as opposed to the long-term rate for their eventual use patterns).

97. *Id.* at 46–52 (noting proliferating additional fees).

98. *Id.* at 53–54 (concerning low down payments and initial rates).

99. *Id.* (discussing failures to make optimal refinancing decisions).

100. *Id.* at 38–39 (concerning various surveys indicating that 35 to 50 percent of subprime borrowers could have obtained prime mortgages).

Errors in the use of payday loans are also common—including using high-cost payday loans when liquid assets or cheaper credit products are available and getting trapped by the fact that these loans do not typically provide for installment repayment—resulting in multiple rollovers with a new fee charged each time.¹⁰¹

With all three of these credit products, regulation by disclosure often fails to work for an array of reasons. Complexity and variety prevent transparency.¹⁰² Even when creditors try to explain complex features, they cannot always get through to consumers.¹⁰³ Constant changes in terms make pricing opaque.¹⁰⁴ Furthermore, segmentation of the market means that savvy borrowers who shop for better terms do not police the market on behalf of non-shoppers, so that creditors can market worse deals to the less educated, the poor, and racial minorities.¹⁰⁵ Disclosure also fails to work because consumers mispredict their own future use of credit; creditors, meanwhile, make a science of studying consumers and adapting to their patterns, pricing low what consumers are currently paying attention to while charging high prices for things consumers do not believe they will use but which they later end up using.¹⁰⁶

Based on their exploration of research into industry practices, Bar-Gill and Warren argued that specific, frozen substantive regulation would not work to address exploitation of consumer error; they advocated creation of an agency that could respond quickly to market innovation in design of credit products.¹⁰⁷ In sum, *Making Credit Safer* provides the regulatory analysis for why the CFPB is needed and a blueprint for what it should be doing, particularly with its power over abusive lending practices.¹⁰⁸

101. *Id.* at 44–45 and 55–56 (discussing high rollover rates among payday loan customers and accumulation of fees); see also Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 596–608 (2010) (discussing empirical findings concerning consumers’ lack of understanding of payday loans and their conduct in using them).

102. Bar-Gill & Warren, *supra* note 14, at 16 (noting that one issuer alone, Bank of America, offered more than 400 credit card options).

103. *Id.* at 20 (concerning Citibank’s efforts to try to get credit card customers to understand the benefits of not having universal default clauses or any-time interest rate changes).

104. *Id.* at 13 (discussing the cost of acquiring information when terms change frequently).

105. *Id.* at 7 (concerning customization of products to undercut the policing effect of an informed minority); *id.* at 43 (concerning the better deals obtained by the college-educated); *id.* at 64–66 (concerning targeting the less educated, the poorer, and racial minorities to receive higher-priced products, even controlling for their risk factors); *id.* at 69 (noting that the wealthy are more commonly insulated from exploitation).

106. *Id.* at 23 (discussing superior information access of creditors, who amass vast data and make a science of analyzing it); *id.* at 79 (concerning constant market innovation).

107. *Id.* at 79, 84–85, 98 (discussing the problem that specific statutes do not lend themselves to regulatory adaptation needed to avoid lagging far behind the market, and calling for an agency that can respond quickly).

108. This is unsurprising, given that Elizabeth Warren, one of the two co-authors, was responsible for standing up the CFPB as a White House advisor. See Elizabeth Warren, *Standing Up the Consumer Financial Protection Bureau*, THE WHITE HOUSE BLOG (Oct. 28, 2010, 6:00

III. CFPB ROLLS OUT ITS ANTI-ABUSE AUTHORITY

The Dodd-Frank Act gives the CFPB authority to regulate UDAAPs, an acronym that requires a drawl to pronounce, but the agency has not been slow to roll out its new anti-abuse authority in its Examination Handbook, released in October 2011—less than three months after the agency went live on July 21, 2011.¹⁰⁹ The section giving the CFPB UDAAP powers picks up concepts of unfair or deceptive acts or practices from the FTC Act and adds abusive acts or practices to the list.¹¹⁰ For unfairness, the section uses the same statutory definition as in the FTC Act.¹¹¹ Deception is not defined in either Dodd-Frank or the FTC Act, but the CFPB has defined it in the same way as the FTC Deception Policy does.¹¹²

Unfairness, deception, and abusiveness are overlapping standards, but the overlap does not matter much because any one of them is sufficient to find a violation of the law.¹¹³ The three-part statutory test for unfairness is: (1) substantial consumer injury (which can be by small injury to many consumers), (2) that is not reasonably avoidable by consumers, and (3) that is not outweighed by benefits to consumers or competition.¹¹⁴ The three-part administrative test of deception is: (1) a material (2) representation, omission, act, or practice that misleads, or is likely to mislead, the consumer, and (3) that the consumer's misinterpretation is or would be reasonable under the circumstances.¹¹⁵ The differences between unfairness and deception are subtle, with the emphasis in unfairness on substantial injury and whether the consumer can avoid it, and the emphasis in deception on the likelihood of misleading. The CFPB has given examples

AM EDT), <http://www.whitehouse.gov/blog/2010/10/28/standing-consumer-financial-protection-bureau>; see also Edward J. Janger, *Locating the Regulation of Data Privacy and Data Security*, 5 BROOK. J. CORP. FIN. & COM. L. 97, 97–98 (2010) (crediting Bar-Gill and Warren with the idea of creating the agency).

109. See EXAMINATION HANDBOOK 2011, *supra* note 4, at UDAAP 1–9. The “went live” date for the CFPB is more formally known as “the designated transfer date”: the date when powers from seven other agencies were transferred to the CFPB. In September 2010, the Treasury Secretary set this date as July 21, 2011, the one-year anniversary of when the Dodd-Frank Act became law. See Designated Transfer Date, 75 Fed. Reg. 57,252 (Sept. 20, 2010).

110. Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 1376, 2005 (2010) (codified at 12 U.S.C. § 5531).

111. See Federal Trade Commission Act of 1914, 15 U.S.C. § 45(a)(4) (codified as amended 2006); Dodd-Frank Act § 1031(c), 124 Stat. at 2006 (codified at 12 U.S.C. § 5531); see also *supra* note 54 and accompanying text (discussing fact that the FTC Act definition of unfairness codified the FTC Unfairness Policy Statement).

112. See EXAMINATION HANDBOOK 2011, *supra* note 4, at UDAAP 1–9; FTC Deception Policy Statement, *supra* note 54.

113. Dodd-Frank Act § 1031(a), 124 Stat. at 2005 (codified at 12 U.S.C. § 5531) (stating the three standards in the disjunctive); see also EXAMINATION HANDBOOK 2011, *supra* note 4, at UDAAP 9 (“abusive acts also may be unfair or deceptive”).

114. Dodd-Frank Act § 1031(c), 124 Stat. at 2005 (codified at 12 U.S.C. § 5531).

115. See EXAMINATION HANDBOOK 2011, *supra* note 4, at UDAAP 5 (citing the FTC Deception Policy Statement, *supra* note 54).

of each drawn from federal enforcement actions.¹¹⁶ The examples of unfairness involve not releasing a lien after final payment on a mortgage, dishonoring credit card convenience checks without notice, and processing payments for companies engaged in fraudulent activities.¹¹⁷ The examples of deception involve inadequate disclosure of material vehicle lease terms in television advertising and misrepresentation of loan terms.¹¹⁸

As noted above, the Dodd-Frank Act also gives the CFPB authority to regulate abusive acts or practices; in addition, Dodd-Frank defines abusiveness by requiring that the act or practice:

- (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- (2) takes unreasonable advantage of—
 - (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
 - (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
 - (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.¹¹⁹

The abusiveness test thus gives four disjunctive grounds for finding abusiveness, making any one of them sufficient. In light of Bar-Gill and Warren’s analysis,¹²⁰ as well as the language about taking “unreasonable advantage” of consumers’ “lack of understanding” of risks, costs, or conditions of a financial product or service,¹²¹ the emphasis seems to be on whether the creditor or other service provider is exploiting consumer error rather than on mere nondisclosure. Disclosure does not seem to be good enough if consumers still do not understand. Furthermore, supporting this analysis, the CFPB has stressed that consumer complaints alleging lack of understanding of the terms of a product or service may be “a red flag” for examiners.¹²²

The CFPB further fleshed out its understanding of its UDAAP powers in a risk assessment template, which sets forth the basis by which it will

116. See EXAMINATION HANDBOOK 2011, *supra* note 4, at UDAAP 3, 7.

117. *Id.* at UDAAP 4.

118. *Id.* at UDAAP 7–8.

119. Dodd-Frank Act, Pub. L. No. 111-203, § 1031(d), 124 Stat. 1376, 2006 (2010) (codified at 12 U.S.C. § 5531).

120. See generally Bar-Gill & Warren, *supra* note 14. See also *supra* notes 85–108 and accompanying text (discussing the analysis of the article).

121. Dodd-Frank Act § 1031(d)(2)(A), 124 Stat. at 2006 (codified at 12 U.S.C. § 5531).

122. See EXAMINATION HANDBOOK 2011, *supra* note 4, at UDAAP 9; see also *id.* at Overview 1, 3, 6 (quoting the Dodd-Frank Act § 1021(a), 124 Stat. at 1979–80 (codified at 12 U.S.C. § 5511)). The handbook ties supervision and examination to enforcement and also stresses that CFPB is “data driven” and relies on data accumulated in examinations as well as other research.

evaluate risk to consumers and ultimately decide whether to use its enforcement powers.¹²³ Particularly revealing is the first section of the template concerning “Nature and Structure of Products,” which sets out the following list of “factors that specifically increase the risk that unfair, deceptive, abusive acts or practices, discrimination, or other violations of Federal consumer financial law will occur”:

The profitability of a product is dependent upon penalty fees (e.g., fees for a late payment, for exceeding a credit limit, or for overdrawing deposited funds).

The terms of the product are subject to change at the discretion of the entity, and the entity has frequently made changes in the terms.

The entity reverses fees at a significantly higher rate than other entities of similar size offering similar products.

Pricing structure (interest rate, points, fees) and other features and terms are combined in a manner that is likely to make the total costs of the product difficult for consumers to understand.

Products are bundled in a way that may obscure relative costs.

Consumers pay penalties to terminate a relationship, including forgoing money or benefits they would otherwise earn.

Consumers face barriers to information, such as costs to access customer service or information about their account.

Credit decision-makers have wide discretion over setting terms and features of products with inadequate policies and procedures addressing appropriate exercise of that discretion.

Credit products are not underwritten based upon the likely ability of the consumer to make the required (or, in the case of adjustable rate products, potentially required) payments over the term of the loan.¹²⁴

This list, which is quite consistent with the concerns expressed in the Bar-Gill and Warren article discussed in Part II above, suggests that the Bureau uses examination to uncover creation of products that exploit consumers’ lack of *understanding* of costs and risks. The statute asks whether consumers understand risks, costs, and conditions—as opposed to requiring mere knowledge—and takes into account consumer appreciation of risks, including the risk that the consumer will use a given feature. Because Dodd-Frank explicitly bars the CFPB from imposing usury limits, the implication is that other substantive regulation of credit products is authorized, particularly under the agency’s anti-abuse power, to eliminate

123. EXAMINATION HANDBOOK 2011, *supra* note 4, at Risk Assessment 1–3.

124. *Id.* at Risk Assessment 2–3.

confusing intricacies that impair consumer understanding.¹²⁵ The CFPB is looking for pricing terms that are complex and changing and that include features that research shows consumers do not pay attention to but which come back to bite them.

Furthermore, the template asks whether a product or service is marketed to particular populations, such as students or young adults, the elderly, minorities, immigrants, military, those with limited education or English proficiency, low-income consumers, consumers receiving public assistance, or those who have recently experienced financial distress or who have low credit scores.¹²⁶ While some of these categories concern illegal discrimination based on suspect categorizations such as race and age, a number of the categories are indicative of vulnerability to exploitation. The CFPB seems to be looking for abuse in the form of targeting those who may have particular difficulty appreciating risks. Another section of the template focuses on sales force incentives and calls for examination of both compensation based on particular products sold without consideration of outcomes, such as default rates, and marketing materials, such as advertising that features teaser rates without important conditions or that targets consumers not likely to benefit from a product.¹²⁷ Once again, one can see that the CFPB is searching for exploitation of lack of consumer understanding of risks, costs, and conditions.

CONCLUSION

The CFPB's early articulation of its UDAAP authority is exciting because it represents a turn away from mere disclosure to more substantive consumer protection and provides a model that states could follow. The CFPB's new power to regulate abusive acts and practices gives it the means to target and eliminate consumer financial products that show signs of having been designed to exploit consumer misunderstanding of costs and risks. Furthermore, the CFPB's examination handbook, particularly in its risk assessment template, suggests that the agency is bringing to bear lessons of behavioral economics in its search for patterns of consumer error in the use of financial products. Of course, the CFPB's success in curbing abuses will depend on follow-through—particularly how hard it pushes financial institutions to stop marketing exploitative products and its willingness to use enforcement actions when subtler pressure does not accomplish this mission. Prevention of consumer abuse will also require

125. See Dodd-Frank Act, § 1027(o), 124 Stat. at 1995 (codified at 12 U.S.C. § 5517(o)) (providing that the CFPB has no authority to set usury limits); see also *supra* note 22 and accompanying text (concerning deregulation of interest rates for most consumer credit products after a 1978 U.S. Supreme Court decision and the Dodd-Frank Act's ban on CFPB reimposing them).

126. *Id.* at Risk Assessment 3–4.

127. *Id.* at Risk Assessment 5–6.

sticking with the project over time, even when the mania of a market bubble threatens to grip us again.