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REASONABLE BEHAVIOR AT THE CFPB

Norman I. Silber*

INTRODUCTION
Deceptive Behavior and Consumer Regulation
The impetus for the Consumer Financial Protection Bureau, an agency charged with diminishing deceit in the marketplace for financial products, has antecedents that stretch back into the distant past. The ancient Greeks were troubled by deceitful marketing practices—recall that Diogenes, walking up and down the marketplace, searched in vain for an honest man.1 Over the centuries, however, political leaders have usually resigned themselves to the persistence of unethical practices by tradesmen, considering these to be the insuppressible by-product of the contest between buyers and sellers that takes place whenever bargains are formed.2

American courts, notwithstanding the invocation of privity requirements and doctrines like caveat emptor, have been willing to provide recourse to victims of actual fraud, at root because sales transactions rooted in deceit have never been culturally popular or understood to be economically beneficial.3 During most of the nineteenth century, states and localities took responsibility for regulating markets to establish honest weights and measures and to promote honesty.4 The federal government,

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3. Jonathan Shelden, Deception, Unfair and Unconscionable Sales Practices, in Encyclopedia of the Consumer Movement 208 (Stephen Brobeck et al. eds. 1997); see also In re Int’l Harvester Co., 104 F.T.C. 949, 1056 (1984) (“[Deception] is harmful to consumers, undermines the rational functioning of the marketplace, and, unlike some other practices we are called upon to review, never offers increased efficiency or other countervailing benefits that must be considered.”).

responding to new circumstances as monopolies and mass production turned consumer problems into national phenomena, authorized independent agencies to foster competition, promote honesty in merchandising, and mandate product safety.5

Many consumer problems come to public attention most vividly in novels. The perils of unregulated mortgage markets received their first brilliant exposure in Upton Sinclair’s 1906 novel *The Jungle*.6 Those who remember *The Jungle* will recall that the protagonist, Jurgis Rudkis, and others in his immigrant family, looked forward as much as anything else to buying a home when they came to America, and they pooled their resources to come up with a down payment.7 But the process of buying a house was frightening to them—with one snare after another. They became suspicious of everyone with whom they dealt, and were scared of the documents they were asked to sign.

A lawyer, who might—or might not—be reliable, assured the family that the agreement they had been presented was a “standard” agreement of sale, despite language which, they feared, signified that it was a rental. They were relieved by the lawyer’s assurances, and they signed the document, without focusing on the high fees and the security provision that the agreement contained. Toward the conclusion of *The Jungle*, illness, tragedy, and the fine print have led to a default.8 The home is lost to the mortgagee, who forecloses and resells. Sinclair writes poignantly about Yurgis’s ultimate defeat:

> Their home! Their home! They had lost it! Grief, despair, rage, overwhelmed him—what was any imagination of the thing [compared] to this heart-breaking, crushing reality of it—to the sight of strange people living in his house hanging their curtains in his windows, staring at him with hostile eyes! . . . Only think what he had suffered for that house—what miseries they had all suffered for it—the price they had paid for it! The whole long agony came back to him. Their sacrifices in the beginning, their three hundred dollars that they had scraped together, all they owned

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7. *Id.* at ch. 4.

8. *Id.* at ch. 18.
in the world, all that stood between them and starvation! And then their
toil, month by month, to get together the twelve dollars, and the interest as
well, and now and then the taxes, and the other charges, and the repairs,
and what not! Why, they had put their very souls into their payments on
that house, they had paid for it with their sweat and tears—yes, more, with
their very life-blood. Jurgis could see all the truth now... That first lying
circular, the smooth-tongued slippery agent. That trap of the extra
payments, the interest, and all the other charges that they had not the
means to pay, and would never have attempted to pay!... And now, with
this hideous injustice... [the Justice system] had turned them out, bag and
baggage, and taken their house and sold it again! And they could do
nothing, they were tied hand and foot—the law was against them, the
whole machinery of society was at their oppressor’s command!9

In the end, Upton Sinclair exposes a truth about this consumer financial
product: that while the purchase agreement and mortgage may or may not
have been standard, they were unquestionably opaque and oppressive.10

Efforts to understand why consumer buyers were so frequently
victimized puzzled commentators, who came to attribute this problem to
what would now be called inherent relational disparities between buyers
and sellers. Writing in 1912, Wesley Clair Mitchell observed that
innovations in productive techniques had improved industrial efficiency and
turned the manufacturing of consumer demand into a corporate endeavor;
but factors including love, parental affection, and racial ties cemented
families together and ensured that consumption was not ever going to be a
corporate endeavor, but would be, unfortunately, “standardized in the
institution of monogamy.”11

In 1938, Congress broadened the Federal Trade Commission’s (FTC or
the Commission) “unfair competition” mandate, making it clear that the
Commission held a responsibility to police the market for “unfair and
deceptive practices.”12 It was at this time that the FTC received principal
federal responsibility not only to preserve and promote fair competition
among businesses, but to prohibit unfair treatment of consumers.13 The FTC

9. Id.
10. Id.
(1912).
deceptive acts or practices in or affecting commerce are hereby declared unlawful.”); see Patricia
849, 870 (1984). Congress expanded the FTC’s power after the Supreme Court ruled that the FTC
had to prove injury to competition in advertising cases, despite the widespread opposition of the
newspaper industry. See FTC v. Raladam Co., 283 U.S. 643, 649 (1931); Bailey & Pertschuk,
supra at 870.
13. See Marc Winerman, The Origins of the FTC: Concentration, Cooperation, Control, and
Competition, 71 ANTITRUST L.J. 1, 96 (2003).
has risen to this challenge on many occasions, saving the money and economic lives of consumers.  

The subsequent history of the FTC’s consumer protection activities, however, reveals periods of passivity as well as periods of active market vigilance. Part of the difficulty with making an impact on fair dealing in consumer markets has been a matter of politics and budgets—the resources available to agencies charged with consumer protection have not kept pace with the magnitude of the task. A more critical impediment has been those interpretations of the FTC’s statutory authority that have left many bad acts and practices untouched—practices which confuse consumers and misrepresent the quality, terms, and price of products.

A lenient approach to defining and discouraging “deceptive acts and practices” after 1980 reflects, in this view, the Commissioners’ dedication to infusing the FTC with a deregulatory spirit and to eschewing the prevention of the victimization of the most vulnerable consumers—typical consumers who behave normally, but irrationally, in reaction to the stimulus of sellers. Because of limits that the FTC imposed upon itself in this way, which continue to affect the jurisprudence of consumer protection, we inhabit a national marketplace where the legal threshold for what is “unfair” or “deceptive” does not correspond to our encountered experience with unfairness or deception.

The disconnection between law and experience emanates from rules, guidance, and decisions that vindicate only the disappointed expectations of consumers who respond “reasonably under the circumstances” to salesmanship and that impose expectations of rational behavior to explain what “reasonably” means. Nonenforcement and under-enforcement have

15. See infra pp. 6–7 and note 24 and accompanying text (discussing the case of Charles of the Ritz Distribs. Corp. v. FTC).
17. See infra notes 69–72 and accompanying text.
18. For an example of how consumers can behave normally but irrationally, see infra notes 65–68 and accompanying text.
been the result. This has led to a proliferation of objectionable behavior. The Commission’s conservative approach to these problems has increased the danger and expense of products to consumers, including cars, appliances, computers, and product warranties, and has increased the number of shoddy financial products, including mortgages, insurance policies, credit cards, and investments.20

In 2010, in response to the recent national financial difficulties spawned by under-regulated financial product marketing behavior, Congress created the Consumer Financial Protection Bureau (CFPB or the Bureau) as part of the Dodd-Frank Wall Street Reform Act (Dodd-Frank or the Act).21 The CFPB was charged with improving the overall quality of information and honesty in the marketplace for financial products and now holds responsibility for making sure that the markets of consumer financial products and services offered by both banks and nonbanks are “fair, transparent, and competitive.”22

To enable it to meet its objectives, Congress provided the CFPB with extensive supervision, enforcement, and rulemaking authority, including the


Even under that more conservative approach, the FTC may establish deception on a much lesser showing than is required of a consumer suing a merchant in, say, a common law fraud or breach of warranty action. Thus, in contrast with the common law rules, the FTC need not show that the merchant has made a false statement (in fact, the FTC may find even true claims deceptive); or that the merchant intended to deceive, or indeed that anyone relied upon the statement, was deceived by it, or even injured by it. . . . It would, in fact, be more accurate to refer to the law of confusing trade practices, rather than deceptive trade practices, because the FTC and the courts focus far more on confusion than on deception.


power to prevent “unfair, deceptive, or abusive” acts and practices by exercising the authority placed at its disposal.\textsuperscript{23} Now, if its Director chooses to do so, the CFPB has the ability to modernize the jurisprudence of unfairness and deceptiveness and endow “abusiveness” with a strong meaning that captures a robust understanding of what the term means. It can, furthermore, distinguish the restrictive interpretations of reasonable consumer behavior in areas outside financial consumer protection from new interpretations within the scope of the CFPB’s authority.

The remainder of this Article offers new possibilities. Part I addresses the limited approach to market supervision intrinsic to earlier legal doctrine. Part II explains the deficiencies of that jurisprudence in light of several decades of research in behavioral psychology. Part III suggests a policy shift to reverse current practice by focusing attention on whether sellers in a given transaction could have avoided confusing consumers by behaving responsibly, instead of focusing on whether buyers could have avoided injury by behaving reasonably.

I. REASONABLE BEHAVIOR AND THE CAPACITY TO DECEIVE

Among the matters to be decided when consumer protection agencies apply the prohibition against deception to the factual circumstances of a bargain’s formation are: (1) defining the population of consumers the prohibition is intended to protect; (2) establishing a minimal level of attentiveness that should be expected from members of the consumer population who may be deceived; and (3) identifying the degree of falsehood in a seller’s representation that qualifies the representation itself as being deceptive. Depending upon the choices made by the agency, the protection offered by government will either expand or contract.

The high water mark for imposing consumer-protective standards for marketplace behavior along the three lines mentioned above occurred between 1946 and 1983. During this period, the FTC consulted its own legislative history and interpreted its responsibility under the governing statute to oblige it to protect the entire public—a population which, as the U.S. Court of Appeals observed in the case of \textit{Charles of the Ritz Distributors Corp. v. FTC}, included the “ignorant, the unthinking and the credulous.”\textsuperscript{24}

The FTC proceeded on the assumption that consumers did not, and should not, be expected to exhibit entirely rational attentiveness to the advertisements and representations, or terms and conditions, of the bargains they struck. For example, misleading advertising included ads which created impressions with the capacity to deceive the unthinking consumer:

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{24}] Charles of the Ritz Distrib. Corp. v. FTC, 143 F.2d 676, 679 (2d Cir. 1944).
\end{itemize}
\end{footnotesize}
If an advertisement is capable of conveying more than one impression to the consumer and any one of them is false or misleading, the advertisement may be found to be false or misleading. From its own review of an advertisement, the Commission may find impressions which the advertisement is likely to convey to the public, and determine whether such impressions have a tendency or capacity to deceive the public, even in cases where a number of consumers may testify that they were not actually deceived. In determining the tendency and capacity of an advertisement to mislead, the Commission looks to the impression an advertisement may make on the average consumer—the gullible and unthinking as well as the trained and sophisticated. Indeed, the central purpose of Section 5 is “to abolish the rule of *caveat emptor* which traditionally defined rights and responsibilities in the world of commerce.”

Commissioners took as a point of departure that sellers would often try to exploit the weaknesses of consumers—years later, many of these weaknesses could be described within the Commission as “cognitive limitations”—and they understood the mission of the FTC as to restrain sellers’ inclination to engage in such exploitative behavior. The marketplace would be more efficient, and justice served better, by operating under the proposition that consumers who did not act with the requisite skills, educational background, or emotional level-headedness of the median American shopper deserved to be sheltered as much or more than anyone else. If sellers were discouraged from making representations which, although to some extent truthful, nonetheless had the capacity to deceive, this was an acceptable cost of regulation in the interest of safer markets and a higher volume of market activity.

The appointment of more new commissioners to the FTC by President Reagan in the years following his election in 1980, however, ushered in a different regime. Against vigorous dissent, a new majority of the Commission aligned itself with economists who embraced less market regulation and who believed that, to function properly, markets needed to

encourage reasonable, “rational actors.” They believed that the policies established by the FTC should allow a maximum possible range for sellers to design and market their products, and should encourage all consumers to balance costs against benefits to maximize their personal advantage when they shopped. From this perspective, the functioning of the marketplace would not be served well by compensating consumers who were injured because they responded irrationally or ignorantly to marketing appeals without calculating the costs and benefits. Coddling consumers paternally would not punish them sufficiently for their poor habits, choices, and abilities, and over time would produce poorly functioning markets.

And so, during the early years of the Reagan administration, the FTC issued a Policy Statement to accompany its decision in Cliffdale Associates. In its Policy Statement, the FTC revised, and in some respects reversed, its earlier positions. Notably, the FTC Commissioners defined three elements necessary to conclude that actionable deception had occurred:

First, there must be a representation, omission or practice that is likely to mislead the consumer. . . .

Second, we examine the practice from the perspective of a consumer acting reasonably in the circumstances. . . .

Third, the representation, omission, or practice must be a “material” one.

Each new requirement diminished the likelihood that a seller might be culpable for a deceptive advertising campaign or other sales practice. Demanding the establishment of a “likelihood” that a seller was misleading a consumer, for instance, imposed a higher threshold than determining whether there was a “capacity” to mislead. Requiring “materiality” imposed an old common law element of misrepresentation that provided sellers with opportunities to claim that their falsehoods did not really matter. Further, the second requirement demanded that the practice complained of should not simply be deceptive from the perspective of someone who might buy the product, but “from the perspective of a consumer acting reasonably in

29. This view has been rejected by many economists who would dispute that the efficient markets hypothesis requires a commitment to consumer rationality. See, e.g., Robert Shiller, The Sickness Beneath the Slump, N.Y. TIMES, Jun. 12, 2011, at BU6.
31. Id.
34. Id. at 174.
the circumstances.” 35 When, if ever, it would be reasonable to act irrationally was not explicated.

Although the Commission continued to take action against the egregious deception of the rational and sophisticated, the basic posture of the FTC had been transformed. The older test essentially sought to restrain sellers from trying to exploit the innate cognitive limitations and ignorance of consumers. The new test relaxed that standard by seeking to discover whether a consumer who responded to a seller’s representations reasonably or rationally would be deceived. 36

The change was indeed dramatic. Less than a decade afterward, the “gullible consumer” standard for deception had been thrown into some disrepute. Corporate advertisers petitioned the Commission arguing that earlier restrictions on their advertising were entered at a time when the “gullible” consumer standard prevailed, reflecting “a presumption that consumers cannot discern for themselves whether accurate information is ‘relevant’ or of ‘benefit.’” 37 “This now-rejected approach,” it was argued, “inhibits the flow of accurate information to consumers without providing significant compensating benefits in consumer protection.” 38

The doctrine of unfairness was also reoriented during the Reagan administration, which had long been distinguished from “deception” jurisprudence. 39 In earlier years, the Commission asserted broad authority, upheld by the Supreme Court, to create unfair trade practices as a new and wide-ranging field of law:

[The] responsibility of the Commission . . . is a dynamic one: it is charged . . . with utilizing its broad powers of investigation and its accumulated knowledge and experience in the field of trade regulation to investigate, identify, and define those practices which should be forbidden as unfair because contrary to the public policy declared in the Act. The Commission, in short, is expected to proceed not only against practices forbidden by statute or common law, but also against practices not previously considered unlawful, and thus to create a new body of law—a law of unfair trade practices adapted to the diverse and changing needs of a complex and evolving competitive system. 40

35. Id.
38. Id. But see Sovern, supra note 20, at 444–45.
40. In re All-State Indus. of N.C., Inc., 75 F.T.C. 465, 491 (1969); see also In re Pfizer, Inc., 81 F.T.C. 23, 61 (1970) (“Unfairness is potentially a dynamic analytical tool capable of a progressive, evolving application which can keep pace with a rapidly changing economy. Thus as consumers [sic] products and marketing practices change in number, complexity, variety, and function, standards of fairness to the consumer may also change.” (footnote omitted)).
Shortly after President Reagan appointees dominated, however, the Commission trimmed sails by more narrowly redrawing its mission through reinterpreting unfair acts and practices. It became incumbent on Commission investigators to first evaluate how a sales practice would be understood by consumers who were reasonably trying to avoid being misled, and then to ask whether the injuries due to unfairness to these consumers were outweighed by benefits to these consumers and to the market for the products and services being purveyed:

The Commission felt that one of the most crucial elements in finding an act or practice to be unfair was that consumers be injured: (1) the injury must be substantial; (2) the injury must not be outweighed by any countervailing benefits to consumers or competition produced by the practice; and (3) the injury must be an injury that consumers could not reasonably have avoided.\footnote{H.R. REP. NO. 98-156, pt.1, at 32 (1983).}

Congress codified the newer definition of unfairness in 1980.\footnote{15 U.S.C. § 45(n) (2006).} The Commission stated in policy guidance that substantial injury to consumers existed when it could be demonstrated that the practice did “a small harm to a large number of people or it raises a significant risk of concrete harm.”\footnote{MICHAEL PERTSCHUK ET AL., FTC, FTC POLICY STATEMENT ON UNFAIRNESS n.12 (1980), available at http://www.ftc.gov/bcp/policystmt/ad-unfair.htm (presenting FTC’s views on concept of “unfairness” and appended to In re Int’l Harvester Co., 104 F.T.C. 949, 1070 (1984)).}

As the FTC elaborated its approach in subsequent years, it became evident that a finding of unfairness would depend on calculating adverse “net effects” of an act or practice, weighing benefits against injuries or a significant risk of harm, and giving additional weight to whether consumers’ “free market decisions are unjustifiably hindered.”\footnote{Truth in Lending, 75 Fed. Reg. 58,509, 59,513 (Sept. 24, 2010) (to be codified at 12 C.F.R. pt 226) (commenting on the FTC interpretation of FTC Credit Practice Rule, 16 C.F.R. § 444.1 (1999)).}

The changes made at the FTC during the years of the Reagan administration shifted investigative attention away from the seller’s responsibility to design sales practices that did not confuse, exaggerate, or conceal qualities and terms, and toward permitting strategies of confusion when they did not preclude smart and attentive consumers from averting injury.\footnote{For another thing, California (and federal) case law have been very demanding in terms of the kind of evidence needed to prove[] the likelihood of deception. Thus, in Haskell v. Time, the court found that declarations from a “few” consumers and a professor of rhetoric to be insufficient. In William H. Morris Co. v. Group W, Inc., the Ninth Circuit concluded that the plaintiff had not carried its burden where the evidence consisted of testimony from two out of 300 recipients. It would be hard to square these proof requirements with a substantive rule requiring only proof of a “tendency or capacity” to deceive a credulous consumer.}
A concrete illustration of the shift described here can be drawn from the present efforts of well-intentioned FTC agents to pursue deception under the present regime. The credit reporting agency ConsumerInfo.com, which was acquired by Experian Consumer Direct in April 2002, widely advertises a profitable website named FreeCreditReport.com on television, in print, and on the Internet. Its target audience includes millions of Americans who are concerned about their precarious credit or contemplating seeking more credit. Despite its name, FreeCreditReport.com is a very costly site.

American consumers are entitled to free credit reports from Credit Reporting Agencies, which are regulated by the Fair Credit Reporting Act and other statutes, and may obtain them by using AnnualCreditReport.com. Every consumer can also obtain credit scores without great expense. Nevertheless, the Credit Reporting Agencies do not widely advertise AnnualCreditReport.com, and Experian-owned FreeCreditReport.com, in order to better market its largely superfluous products more effectively, does not reveal this information conspicuously—even after promising to do so. The site makes it highly unlikely that a consumer will order a “free” report without paying to obtain a score and monthly reports for a minimum of $16.99 per month, and much more for other reports, scores, and services. As of February, 2010, the Better Business Bureau had received more than 11,000 complaints about the website.


48. See photograph, infra Exhibit A.


50. Credit Scores, CONSUMER REP. (June 2009), http://www.consumerreports.org/cro/money/credit-loan/credit-scores/overview/credit-scores-ov.htm


52. FreeCreditReport.com, http://www.freecreditreport.com/ (last visited Aug. 30, 2012). The site does not provide a clear explanation of the difference between a credit score and a credit report; and few of those who obtain their credit report through FreeCreditReport.com end up doing so without paying amounts that are not easily calculated for unlimited periods of time. See supra note 47. In 2010, the FTC enacted a rule “to require certain advertisements for ‘free credit reports’ to include prominent disclosures designed to prevent” consumer confusion. Free Annual File Disclosures, 75, Fed. Reg. 9,726, 9,726 (Mar. 3, 2010) (to be codified at 16 C.F.R. pt. 610). In order to sidestep the required disclosures, Experian began charging $1 for credit reports and giving the money to charity. Rob Lieber, Free Report on Credit? No Longer, N.Y. TIMES, Apr. 8, 2010, at B1. Fine print at the top of its website indicates that if someone does nothing after ordering a $1 credit report, they will be charged $16.99 per month until they terminate the service. FreeCreditReport.com, http://www.freecreditreport.com/ (last visited Aug. 30, 2012).

For more than a decade, the FTC has tried to force Experian to clean up its website and to convey information without deception or confusion.\(^{54}\) In 2005, the FTC entered into a settlement agreement and obtained a small disgorgement of funds after filing a complaint.\(^{55}\) But as of the date this Article was written, the television ads and website were, in the opinion of thousands of people, still misleading, and the FTC has not yet been able to successfully address the problem.

Why is FreeCreditReport.com still allowed to operate? The advertising, directed especially at a vulnerable population of debtors, is confusing and makes a mockery of the word “free.” The website defends itself on the ground that, inter alia, it has not violated any law relating to unfair or deceptive practices.\(^{56}\) According to arguments Experian has made in court, its websites are educational and the governing “consumer protection statutes were not meant to stifle, but to encourage, the free flow of educational materials such as the ones it provides.”\(^{57}\) A spokesman for the FTC, who was asked why the website is still up, responded that “the agency must work within ‘a legal framework,’” and “does not have the power to take arbitrary actions.”\(^{58}\)

II. THE IMPACT OF BEHAVIORAL PSYCHOLOGY

Academic research into behavioral and cognitive psychology during the years since the 1980s has undermined the Commission’s key assumptions about the reasonable and rational behavior that is to be expected from economic actors.\(^{59}\) Nor did this research support the view that maximizing consumer rationality would maximize the efficiency of free markets.\(^{60}\) On the contrary, research into cognitive behavior has seriously undermined the rational choice paradigm with persuasive evidence that people who behave reasonably do not always make optimal, rational choices—consumers who

\(^{54}\) Press Release, FTC, supra note 51.

\(^{55}\) Id.

\(^{56}\) See e.g., Lieber, supra note 52 (“An Experian spokeswoman, Susan Henson, defended the new fee. ‘The offer for the $1 report is very clear and in compliance with the F.T.C.'s rule,' she said in an e-mail reply to questions.”). Interestingly, the standard in France is more protective of gullible consumers and could potentially prevent Freecreditreport.com from print advertising in that nation. Charlotte J. Romano, Comparative Advertising in the United States and in France, 25 NW. J. INT'L L. & BUS. 371, 397–98 (2005) (noting that the current French standard protects “credulous, ignorant and unthinking” consumers). I do not know what the rules are for website deception.


\(^{59}\) See e.g., Jolls et al., supra note 19, at 1541.

\(^{60}\) See supra notes 29–31 and accompanying text.
are “reasonable under the circumstances” do not characteristically behave like rational actors.61

The “reasonable under the circumstances” standard, as noted earlier, developed during the Reagan administration prior to the years when the research in behavioral psychology and behavioral economics that demonstrated the limits of “rational” choice became well known. As late as 1990, when efforts to consider the implications of behavioral psychology for the development of legal standards started to appear,62 the legal academy had not yet come to grips with the impact of cognitive psychology on legal standards of reasonableness in consumer law, criminal law, administrative law, or other fields. Not until after 2002, when Daniel Kahneman won the Nobel Prize in Economics for his work in exploring and critiquing conventional views about rational choice, did this work prompt a flood of attention in legal scholarship.63

In 2008, Professors Richard H. Thaler and Cass R. Sunstein familiarized the legal academy and the public with the implications of the shortcomings of rational choice models in their book Nudge: Improving Decisions about Health, Wealth and Happiness, which presented examples of the opportunities of generating incorrect answers by playing on cognitive limits and irrationalities.64 A few of their simple illustrations of generated cognitive mistakes reveal how easily rational actors are misled into making bad choices:

1. A bat and ball cost $1.10 in total. The bat costs $1.00 more than the ball. How much does the ball cost? ___ cents

2. If it takes 5 machines 5 minutes to make 5 widgets, how long would it take 100 machines to make 100 widgets? ___ minutes

3. In a lake, there is a patch of lily pads. Every day, the patch doubles in size. If it takes 48 days for the patch to cover the entire lake, how long would it take for the patch to cover half of the lake? ___ days65

Most people, they write, would say that the answers are “10 cents, 100 minutes, and 24 days,” respectively.66 As the authors point out, “all these answers are wrong,” and they are wrong because of innate processing


62. See e.g., Silber, Observing Reasonable Consumers, supra note 19.

63. See infra app. A.


65. Id. at 21.

66. Id.
limitations and because of the way in which the problems are framed to
generate difficulty in answering them correctly. Thaler and Sunstein argue
that an appreciation of neurological operation and psychology should drive
policymakers and lawmakers to create rules and regulations that are not
based on false assumptions about the employment of reason in decision
making.

Today, cognitive “frailties” can be, and frequently are, exploited by
merchandisers to their advantage. Departments of consumer research at
most major corporations devote substantial effort to learning how to sell
their products more effectively than their competitors by using
psychological insights into irrationality, and how to counter logical
objections consumers might have to purchasing their products. Ironically,
the older approach taken by the FTC, for all its faults and without the
benefit of the research of recent decades, anticipated this scholarship and
created a rule that would have been immediately responsive to it. The
FTC’s revised approach undervalued innate aspects of cognitive behavior
which affect rational action in the face of seller conduct, and crafted the rule
accordingly.

III. CFPB AND THE POTENTIAL TO RECREATE THE
JURISPRUDENCE OF DECEPTION, UNFAIRNESS, AND
ABUSE

On April 22, 2010, President Obama delivered his landmark address at
the Cooper Union Auditorium near Wall Street, in which he called upon the

67. Id. at 21–22. By considering the problems more closely they will become easier to solve:

If the ball costs 10 cents and the bat costs one dollar more than the ball, meaning $1.10,
then together they cost $1.20, not $1.10. No one who bothers to check whether his
initial answer of 10 cents could possibly be right would give that as an answer, but
research by Shane Frederick (2005) (who calls this series of questions the cognitive
reflection rest) finds that these are the most popular answers even among bright college
students.

The correct answers are 5 cents, 5 minutes, and 47 days, but you knew that, or at least
your Reflective System did if you bothered to consult it.

68. Id. at 252–53.
69. See id. at 144 (“For mortgages, school loans, and credit cards, life is far more complicated
than it needs to be, and people can be exploited. Often it’s best to ask people to take care of
themselves, but when people borrow, standard human frailties can lead to serious hardship and
even disaster.”).
70. See, e.g., N. Craig Smith et al., Smart Defaults: From Hidden Persuaders to Adaptive
/abstract=1116650 (discussing marketing ethics and defaults).
71. See supra pp. 6–7 (discussing “the high water mark for imposing consumer-protective
72. See supra notes 33–35 and accompanying text.
financial community to support a major overhaul of financial regulation. In his speech, he attributed the financial crisis to more than unfairness and deception:

[The financial crisis wasn’t just the result of decisions made in the executive suites on Wall Street; it was also the result of decisions made around kitchen tables across America, by folks who took on mortgages and credit cards and auto loans. And while it’s true that many Americans took on financial obligations that they knew or should have known they could not have afforded, millions of others were, frankly, duped. They were misled by deceptive terms and conditions, buried deep in the fine print.]

Consumers were not only deceived and treated unfairly, they were abused by sellers who tried to get them to act unreasonably. A few months later, when the Dodd-Frank legislation became law, it included the Consumer Financial Protection Act (CFPA), which created the new Consumer Financial Protection Bureau. The CFPA transferred from the FTC to the Bureau the FTC’s rulemaking authority with respect to consumer financial products. At its creation, the CFPB received authority

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74. Id.

75. Id. (noting that “a few companies made out like bandits by exploiting their customers”).


77. Under the Dodd-Frank Act, the FTC retained its authority to enforce those rules and to continue defining acts or practices that are unfair or deceptive with regards to non-depository institutions. Dodd-Frank Act § 1061(b)(5), 124 Stat. at 2036–38 (codified at 12 U.S.C. § 5561(b)(5)). Section 5 of the FTC Act prohibits “unfair or deceptive acts or practices in or affecting commerce.” Federal Trade Commission Act, 15 U.S.C. § 45 (2006). The FTC also has the authority to enforce rules prescribed by the CFPB under its “unfair, deceptive or abusive” authority as to entities in its jurisdiction. Dodd-Frank Act § 1061(b)(5), 124 Stat. at 2036–38. The CFPB is required to coordinate its rulemaking with the FTC to ensure that there is no overlap or conflicts between the two agencies. Id; see also FTC & CFPB, MEMORANDUM OF UNDERSTANDING BETWEEN THE FEDERAL TRADE COMMISSION AND THE CONSUMER FINANCIAL
from eighteen consumer protection statutes and regulations that were previously covered by many other agencies.78

The CFPB had been delegated considerable power to regulate consumer financial products—more than the FTC possessed when consumer financial products were within its jurisdiction. In addition to granting the Bureau the authority to issue regulations prohibiting “unfair or deceptive” acts or practices, Congress, as mentioned above, added the word “abusive” and included within its grant of authority extensive rulemaking, examination, and enforcement power.79 The CFPB announced that its enforcement standard for unfair and deceptive practices would be consistent with the FTC’s 1980 actions and its 1983 Policy Statement.80 In guidance that it

78. Dodd-Frank Act § 1002, 124 Stat. at 1957 (codified at 12 U.S.C. § 5481) (defining “enumerated consumer laws”). The agencies that gave up some or all of their power to the CFPB include the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Association, the Director of the Office of Thrift Supervision and the Department of Housing and Urban Development. These consumer agencies all add their own interpretations of who a reasonable consumer is and who the agency ought to be protecting. The date that this authority was meant to transfer to the CFPB was designated as the “transfer date.” See id. § 1062, 124 Stat. at 2039 (codified at 12 U.S.C. § 5582). Prior to the appointment of the Bureau Director, the Secretary of the Treasury had interim authority to run the CFPB. Id. § 1066, 124 Stat. at 2055 (codified at 12 U.S.C. § 5586). The Treasury Secretary set July 21, 2011 as the designated date. See Designated Transfer Date, 75 Fed. Reg. 57,252, 57,252 (Sept. 20, 2010).


80. See generally CFPB, SUPERVISION AND EXAMINATION MANUAL, at UDAAP 1–10 [hereinafter, CFPB EXAM MANUAL] (summarizing CFPB position on Unfair, Deceptive, or Abusive Acts or Practices (UDAAP)). To declare a practice unlawful because it is unfair, the Bureau must have “a reasonable basis to conclude that—(A) the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and (B) such substantial injury is not outweighed by countervailing benefits to consumers or competition.” Dodd-Frank Act § 1031(c)(1), 124 Stat. at 2006 (codified in 12 U.S.C. § 5531(c)(1)). The CFPB standard is consistent with the FTC standard. Although “the Bureau may consider established public policies as evidence . . . [s]uch considerations may not serve as a primary basis for such determination.” Id. § 1031(c)(2), 124 Stat. at 2006 (codified at 12 U.S.C. § 5531(c)(2)). No definition for “deceptive” is provided in the Dodd-Frank Act. But, the CFPB has provided that:

A representation, omission, actor practice is deceptive when:

(1) The representation, omission, act, or practice misleads or is likely to mislead the consumer;

(2) The consumer’s interpretation of the representation, omission, act, or practice is reasonable under the circumstances, and

(3) The misleading representation, omission, act, or practice is material.
issued, the CFPB stated that “[a]lthough abusive acts also may be unfair or deceptive, . . . the legal standards for abusive, unfair, and deceptive each are separate.”81 It proceeded to issue general guidelines describing the way in which the new term “abusiveness” would be regulated.82

And so, going forward, the CPFB stands in a position to move “back to the future”: to reformulate the definitions of unfairness and deception in order to bring them in line with the developments that have occurred in cognitive psychology and consumer behavior within the last thirty years. It also has the authority to develop the “abusiveness” standard to focus on sellers’ abuse of consumers.

IV. POLICY SHIFT: INCORPORATING BEHAVIORAL PSYCHOLOGY INTO THE CFPB’S AGENCY JURISPRUDENCE

It is beyond the scope of this Article to develop in detail the way in which the new agency should redevelop unfairness and deception and develop a new standard for abusiveness. But query how differently the marketplace would look if the CFPB could establish a standard that shifts attention from whether buyers could have avoided injury by behaving reasonably to whether sellers could have avoided confusing consumers by conveying information fairly. Why not make it plain that, in the case of deceptiveness, unfairness, and abusiveness, the CFPB will, assuming other elements of the offense are established, prosecute financial institutions whose representations and agreements have the effect of exploiting known cognitive limitations and that cause substantial injuries to consumers?83

CFPB EXAM MANUAL, supra, at UDAAP 5 (citing the FTC Policy Statement on Deception and instructing that “[e]xaminers should be informed by the FTC’s standard for deception”). Cooperation and consultation between the CFPB and the FTC in providing guidance in these matters is mandatory. See MEMORANDUM OF UNDERSTANDING, supra note 77.

81. CFPB EXAM MANUAL, supra note 80, at UDAAP 9.

82. An abusive act or practice is defined as one that:

   • Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or
     
     o Takes unreasonable advantage of—
     
     ▪ A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
     
     ▪ The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
     
     ▪ The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

CFPB EXAM MANUAL, supra note 80, at UDAAP 9.

83. If the regulations were reoriented in the manner suggested here, financial institutions might argue that the suggested approach infringes a First Amendment right to exaggerate or puff. See Shapero v. Kentucky Bar Ass’n, 486 U.S. 466, 467 (1988). However, “[t]he common theme that
Of course, such a rule would not resolve important issues of line-drawing. Pricing a product at $9.99 instead of $10, for example, leads many consumers to frame a product as a $9 product instead of a $10 product, and has the effect of exploiting a known cognitive limitation that can cause an injury to consumers.

Reasonable minds may differ as to whether injuries caused by these cognitive deceptions are substantial, but shifting to a standard for truthfulness that corresponds to our actual understanding of consumer behavior would revolutionize the marketplace.

seems to run through cases considering puffery in a variety of contexts is that consumer reliance will be induced by specific rather than general assertions.” Cook, Perkins & Liehe, Inc. v. N. Cal. Collection Serv., 911 F.2d 242, 246 (9th Cir. 1990). A statement that is quantifiable—that makes a claim as to the “specific or absolute characteristics of a product”—is actionable. Id. at 245. A prohibition of unspecific assertions that have the effect of misleading has been upheld against a First Amendment challenge. See id.