STATEMENT PREPARED FOR
CONSUMER FINANCIAL PROTECTION BUREAU
ABUSIVE ACTS OR PRACTICES SYMPOSIUM

June 25, 2019

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[1] I would like to thank Karin Thrasher for her research assistance in preparation of this statement.

Enacted in response to the 2008 financial crisis, the Dodd-Frank regulatory reform law was one of the most consequential pieces of financial regulatory reform legislation since the Great Depression. Among its myriad provisions was the creation of the Bureau of Consumer Financial Protection Bureau ("CFPB"). Among the CFPB's substantive powers is to ensure that "consumers are protected from unfair, deceptive, or abusive acts and practices." The terms "unfair" and "deceptive" are well-established terms that despite their apparent vagueness have come to take on relatively predictable and determinate meaning over time. "Abusiveness," however, is a novel term with limited predecessors.

The CFPB, scholars, and commenters have struggled to define the term "abusive" in a manner that effectuates Congress's language and intent in a predictable and consumer welfare-enhancing manner. During the tenure of Director Richard Cordray, the CFPB eschewed any settled or precise definition of the term but instead adopted a policy of defining the term on a case-by-case enforcement process. Still, the CFPB has struggled to define the term "abusive" so as to distinguish it from "unfair" and "deceptive" acts and practices. In light of the substantial penalties that the CFPB is entitled to mete out, the lack of a predictable definition of the term "abusive" has given rise to great consternation by regulated entities about basic due process rights and their ability to engage in useful transactions with their customers.

Despite this stated preference by Director Cordray to not adopt a formal definition of "abusive," the CFPB has nevertheless done so through a piecemeal process, using the concept to regulate particular products and services, most notably through the Small-Dollar Loan rule finalized in 2017 and in the Notice of Proposed Rule-Making issued in

2019 with respect to small-dollar lending that effectively rescinds the 2017 Rule. As will be seen, the definition of "abusive" adopted in the two Small-Dollar Loan Rule proceedings differ from the definition suggested by the small number of enforcement actions that the CFPB has taken with respect to "abusive" acts and practices.

The definitions offered by the CFPB's enforcement and rulemaking divisions are not only at odds with each other, they also are inconsistent with Congress's intent and the CFPB's policy mission. Providing a clear and predictable definition of "abusiveness" should be a high priority for the new leadership of the CFPB in building an agency culture that promotes the rule of law, economic prosperity, and consumer welfare.[2] Thus, I congratulate Director Kraninger for convening this Workshop to discuss the definition of the term "abusive" and to consider whether a rulemaking process to define the term would be appropriate.

Definitions are important for two reasons. Most obvious, definitions tell parties what acts and practices will be considered abusive and thereby gives notice and warning to them as to what activities to avoid. As noted, this element of fair notice is particularly important in light of the massive penalties that CFPB can impose for violations. But equally important, definitions tell parties what acts and practices are *not* abusive.

Defining the term "abusive" can serve as a ring fence, defining what behaviors are inside the fence and therefore are "abusive," but also defining what terms are outside the fence and therefore, are not abusive. In fact, Congress added the term "abusive" precisely as a distinction from unfairness and deception to cover behavior that does not qualify as improper under those two traditional headings. Distinguishing abusiveness clearly from

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[2] *See* Todd Zywicki, *The CFPB Could Be a Force for Good*, WALL ST. J. (Feb. 20, 2018), *available in* https://www.wsj.com/articles/the-cfpb-could-be-a-force-for-good-1519070012.

unfairness and decepetion will create predictability for providers and consumers of financial products in entering into transactions. Moreover, defining the term "abusive" more clearly and coherently will also be beneficial to the CFPB itself in articulating a clear and consistent understanding of not only abusiveness across the Bureau, but also the other elements of CFPB's UDAAP authority. In several enforcement matters, the CFPB has alleged based on the same facts that certain behaviors were both abusive on one hand and unfair and/or deceptive, on the other. That is incorrect, and the CFPB's "kitchen sink" practice of pleading has dramatically muddied the waters around what practices will be considered unfair, deceptive, or abusive. Inconsistent and duplicate articulations of UDAAP's terms make it more difficult for the enforcement, rulemaking, supervision, and education divisions of the CFPB to develop consistent policies and practices.

I. "Abusive" Defined

The proximate cause of the creation of the CFPB was the financial crisis and the enactment of Dodd-Frank, and in particular, the role of subprime mortgages in precipitating the financial crisis and, in particular, the belief that a major cause of the foreclosure crisis was widespread mortgage lending fraud against consumers.[3] The particular economic and historical context in which the term "abusive" was framed appears to be significant in understanding the derivation and meaning of the term.

A. Statutory Language

Dodd-Frank provided the CFPB with authority to regulate any "abusive… act or practice" and defines "abusive" as follows:

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[3] In reality, the causes of the crisis were much more complex and little evidence exists to support the hypothesis that the mortgage crisis resulted from widespread fraud against consumers.

> ABUSIVE.—The Bureau shall have no authority under this section to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless 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
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> (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

The contours of the CFPB's "abusive" authority are unclear. There is little legislative history to guide the interpretation of the term and no obvious parallels in other statutes.[4] Perhaps the only thing that one can really know with confidence is that whatever "abusive" is meant to mean, it must differ in some fashion from the terms "unfair" and "deceptive."

The term "unfairness" is defined under Dodd-Frank as applying where an act or practice is "likely to cause substantial injury to *consumers* which is not reasonably avoidable by *consumers*," and where the substantial injury is not outweighed by "countervailing benefits to *consumers* or to competition."

Unlike "unfairness," "deception" is not defined by statute. Through common law, however, it has come to have a standard definition that is closely tied to the traditional common law notion of fraud. Case law establishes that an act or practice is deceptive if: "(1) there is a representation, omission, or practice that, (2) is likely to mislead

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[4] The Court in *CFPB v. ITT Educational Services, Inc.*, 219 F. Supp. 3d 878 (S.D. Ind. 2015) rejected ITT's claim that the term "abusive" was unconstitutionally vague, in part because the same term was used by Congress in the Fair Debt Collection Practices Act. The definition of the term "abusive" under the FDCPA, however, bears no relevance to the definition for purposes of the Consumer Financial Protection Act, from which the CFPB draws its authority. Under the FDCPA, "abuse" includes acts such as threatening violence, use of obscene or profane language, repeated phone calls, and the like. 15 U.S.C. §1692d. None of those covered acts bear relevance to the definition of abusive acts or practices for current purposes. The similarity of language is simply coincidental.

consumers acting reasonably under the circumstances, and (3) the representation, omission, or practice is material."[5]

Notably, both "unfair" and "deceptive" refer to the actions and understanding of *reasonable* consumers under the circumstance. This emphasis on the average or reasonable implies that particularly atypical, unreasonable, gullible, or foolish consumers are generally not those who are protected by the unfairness or deception elements of the statute. If most consumers use a product in a welfare-enhancing fashion, the fact that some consumers are disappointed by the product's performance, failed to understand the relevant benefits and costs of the product, or failed to fully understand the terms and conditions of the product even when given a reasonable opportunity to do so, will not render the product unfair or deceptive. As CFPB Deputy Director Brian Johnson has recently suggested, prohibiting unfair and deceptive practices advance consumer welfare by suppressing the flow of false and misleading information or prohibiting products and services that are likely to cause unavoidable injury to consumers and for which there are minimal countervailing benefits.[6] The focus of deception and unfairness, therefore, is on the adverse impact of certain acts or practices on consumers at large that interfere with the ability of the average or reasonable consumer to make a free and informed choice about the products and services that they consume. The terms "unfair" and "deceptive" refer to acts or practices that are, on net, welfare-reducing for *most* consumers *most* of the time, either by corrupting the flow of information that consumers use to make decisions,

[5] *CFPB v. Gordon*, 819 F.3d 1179, 1192-93 (9th Cir. 2016).
[6] *See* Brian Johnson, *Consumer Protection and Financial Inclusion: Remarks to the CATO Institute's Summit on Financial Inclusion (as prepared for delivery)*, WWW.CONSUMERFINANCE.GOV (June 12, 2019), https://www.consumerfinance.gov/about-us/newsroom/consumer-protection-and-financial-inclusion/.

or by offering products that have very small benefits for most consumers relative to the costs.

"Abusiveness," by contrast, appears to be designed to cover those situations in which a product is *not* unfair and deceptive when marketed to or used by the average consumer, but is predictably harmful when marketed to a particular, identifiable individual or group of individuals, under conditions in which the relationship between the provider and consumer gives rise to a heightened risk of exploitation by the provider. "Abusive" acts and practices are those that do not meet the standard of being welfare-reducing for most consumers most of the time. Instead, it refers to particular acts and practices that are *not* unfair in general, precisely because they are appropriate for some (or many) consumers some (or most) of the time, and for which the provider has not engaged in deceptive behavior that misleads reasonable consumers or otherwise misrepresents the costs and benefits of the product or service. For example, selling stock in an Internet startup company with a high probability of failure but also a high probability of a massive long-run return on investment is a perfectly reasonable (albeit risky) investment for a 24-year old investor or many others with long time horizons or high risk tolerance, so long as there is no fraud in sale. But although the sale of that stock would not be unfair or deceptive because of the potential benefit to consumers, that stock might not be beneficial on net for an elderly retiree living on a fixed income and a much shorter time horizon.

With important limits and caveats to be explained in a moment, addressing acts or practices that are *not* unfair or abusive to the reasonable consumer or consumers at large, but result in harm to an identifiable individual or group of similarly-situated individuals, is the domain of the new "abusiveness" requirement created by Dodd-Frank. Equally important, "abusiveness" does *not* apply to gross generalizations about undifferentiated groups of individuals that are supposedly considered vulnerable to particular acts or practices. Those sorts of undifferentiated harms are properly the domain of the unfair and deceptive inquiries.

B. Defining "Abusive" Acts and Practices

Although the term "abuse" is unclear, the language and sparse legislative history, combined with the historical context of Dodd-Frank birth as a response to the financial crisis and the CFPB's mandate, provide guidance as to the meaning of the term "abusive," and particularly how the term was intended to differ from unfair and deceptive.

The CFPB should define "abusive" as having two elements: (1) The complained-of act or practice must relate to the offering of a particular product that the provider knew or should have known was reasonably *unsuitable* to a particular consumer in a particular context, and (2) In order to possess the requisite knowledge and ability to exert such abusive influence over the consumer, the provider must have possessed some relationship with the consumer such that the consumer reasonably relied on the belief that the provider is acting in the consumer's best interest, the provider has some ability to exercise undue influence or pressure over the consumer, or that enables the provider to materially interfere with the consumer's ability to understand the terms and conditions of the product or take unreasonable advantage of the consumer's inability to protect his own interest.

The plain language of the statute is consistent with defining abusiveness according to these two elements. First, the plain language suggests that the term "abusive" is tailored to the particular facts and circumstances of particular consumers, not consumers at large. Whereas unfairness repeatedly uses the plural term "consumers," the term "abusive" uses the singular term "a consumer" or "the consumer" throughout. Similarly, a "deceptive" practice is one that is "likely to mislead consumers under the circumstance," instead of the singular. This implies that deception for purposes of the CFPA reaches a *pattern* or practice of behavior by the lender that is deceptive with respect to *reasonable* consumers.

1. The Act or Practice Must be Clearly and Reasonably Not Suitable for the Consumer's Particular Characteristics and Circumstances

The case-by-case nature of the "abusive" inquiry resembles the obligation of investment professionals to recommend "suitable" investments to their clients. This obligation arises from the fact that investments that are appropriate for some or even many investors may not be appropriate to a particular investor. In determining whether investments are suitable for a particular investor, the investment advisor should consider among other facts the client's age, financial condition, investment objectives, investment experience, investment time horizon, liquidity needs, and risk tolerance.[7] In order to collect this information, the investment advisor has an affirmative duty to ask his client these questions before providing investment advice.

The requirement under securities law that advisors recommend "suitable" investments also requires the advisor to engage in searching inquiry and questioning

[7] *See* FINRA, *Suitability: What Investors Need to Know*, WWW.FINRA.ORG, *available in* https://www.finra.org/investors/suitability-what-investors-need-know.

about the customer’s needs and limitations before recommending investment opportunities. Liability attaches if the broker “knew or should have known” that the recommended securities were “unsuited to the borrower’s needs.” An unsuitability claim arises under a subset of 10(b) securities claims.[8] There are five factors a plaintiff must prove: “(1) that the securities purchased were unsuited to the buyer's needs; (2) that the defendant knew or reasonably believed the securities were unsuited to the buyer's needs; (3) that the defendant recommended or purchased the unsuitable securities for the buyer anyway; (4) that, with scienter, the defendant made material misrepresentations (or, owing a duty to the buyer, failed to disclose material information) relating to the suitability of the securities; and (5) that the buyer justifiably relied to its detriment on the defendant's fraudulent conduct.”[9] The first circuit in *Cody v. SEC* applied the five-prong suitability test and found that the recommender must have “reasonable grounds” to believe that the “recommendation is suitable for such consumer upon . . . his financial situation and needs.”[10]

Companies providing consumer financial products stand in a very different relationship to their customers than an investment advisor does to his client. As a result, the provider of a typical consumer financial product or service typically lacks the information and relationship toward the consumer that a financial advisor has. In the context of investment advisors, of course, the customer is relying on the recommendations of the investment advisor, which is the basis of an affirmative obligation on behalf of the advisor to acquire the necessary information to make suitable

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[8] *Brown v. E.F. Hutton Group, Inc.,* 991 F.2d 1020 (2nd Cir. 1993).
[9] 991 F.2d 1020; *see also National Union Fire Insurance Co. v. Woodhead*, 917 F.2d 752, 757 (2nd Cir. 1990).
[10] *Cody v. SEC,* 693 F.3d 251 (1st Cir. 2012).

recommendations that will meet the customer's needs. A transaction to provide a credit card or auto loan, by contrast, is an arms-length transaction that generally does not take place within a context of trust, reasonable reliance, or undue influence.

The attenuated relationship and the realities the situation suggest that rather than imposing an affirmative suitability requirement on providers of consumer financial services, providers should be expected to provide products and services that are *not reasonably unsuitable* to a particular person, as evaluated on a case-by-case basis. This requirement should not require an extensive affirmative obligation on the part of the provider to acquire extensive information about the borrower's overall financial condition, but that the provider should not provide products that are manifestly unsuitable for a particular borrower. Again, abusiveness should focus on those acts and practices that the provider knew or should have known was unsuitable to that particular consumer in that particular context.

Available legislative history supports this understanding of the definition of "abusive." For example, in a 2011 hearing, Representative Barney Frank stated, "you should not take unreasonable advantage of a lack of understanding. [For example], there are mortgage products that are not suitable for an 89-year old woman who has never had her own experience in economic affairs."[11] His remarks during a 2012 hearing point in the same direction:

> People say, "What do you mean by abusive?" We defined it. We defined it in the statute to say it is abusive if it materially interferes with the ability of a consumer to understand the term or a condition; or takes unreasonable advantage of a lack of understanding on the part of the consumer—the risks, costs or conditions; the inability of the consumer to protect the

[11] House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit Hearing, "The Consumer Financial Protection Bureau: the First 100 Days," 112th Con. (November 2, 2011).

> interest. In other words, it may depend on the consumer. And if people think that is some farfetched notion, remember that one of the problems we had with the subprime loans was they were going to an 80-year-old and urging her to refinance when she had nearly paid off her mortgage. *Now, refinancing for some people might be a good idea. When it is sold to an 80-year-old, it is probably not such a good idea*.[12]

As Representative Frank notes, "abusiveness" applies to the situation where, even if refinancing for "some people" might be a good idea, it plainly is "not such a good idea" for an 80-year-old who has nearly paid off her mortgage. In this context, it is the evident unsuitability of the product for that particular consumer that is problematic. This example echoes the first one in arguing that there are some products that are perfectly reasonable for the typical consumer, and so are not unfair, such as refinancing a later-term mortgage This example echoes the first, showing that certain financial measures such as refinancing a mortgage might be perfectly reasonable for the typical consumer, and thus, are not unfair. In certain contexts and with respect to certain consumers, however, the measures nevertheless could be abusive.

Representative Frank's statement suggests that the scope of the abusiveness inquiry is highly limited and does not imply an affirmative obligation on the provider of a financial product to engage in extensive inquiry or fact-finding before offering a particular product to a particular consumer. Thus, the obligation not to provide unsuitable products extends only to those attributes of the borrower that are easily ascertainable and for which any reasonable person would conclude that the particular product or service is not unsuitable for that particular consumer in that particular context under those particular conditions.

[12] Transcript, House Committee on Financial Services, "The Semi-Annual Report of the Consumer Financial Protection Bureau,'' 112th Cong. (March 29, 2012), at 10 (emphasis added).

The limited ability of the provider to acquire detailed information about the consumer explains why a provider of consumer financial services should only be required to avoid selling goods and services that it knows or should have know are reasonably unsuitable to particular consumers instead of carrying an affirmative obligation to recommend only products that are deemed "suitable" to the consumer, as is required of investment advisors.

The requirement that lenders offer products that are "not unsuitable" to the consumer (instead of "suitable") finds parallel in other contexts or countries. For example, Australia's National Consumer Credit Protection Act ("NCCP") imposes an obligation on lenders to offer products that are not unsuitable to specific consumers. As described by a report of Australia's Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry:

> Suitability suggests an element of 'fitness for purpose' a standard long used in sale of goods contexts. The central obligation under the responsible lending regime in the NCCP is to ensure that credit is 'not unsuitable' for a consumer. The use of a double negative in describing the required protective standard is awkward. The phrasing may emphasise that the standard is based on a lower bar than what would be best, or most 'appropriate' for a consumer.[13]

Another report on Australia's NCCP noted:

> Consumer advocacy groups urged me to recommend that the NCCP Act be amended to require lenders to determine whether a loan contract (or credit limit increase) was 'suitable' for the consumer (as distinct from 'not unsuitable').
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> I do not favour that proposal.

[13] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Everyday Consumer Credit—Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans: Background Paper* (Mar. 14, 2018), WWW.APO.ORG.AU, *available in* https://apo.org.au/node/136491.

> The double negative 'not unsuitable' does seem clumsy and, at first sight, may be thought no different in substance from the lender being required to determine that the loan is 'suitable' for the borrower. But there is an important practical difference between the two tests. The 'not unsuitable' test may be described as directed to avoiding harm. By contrast, asking about suitability invites attention to whether there is benefit to the borrower. The inquiries and verification required by the NCCP Act put the lender in a position where it can assess whether making the loan is unsuitable because it is likely that the consumer will be unable to comply with the consumer's financial obligations under the loan or could only comply with them by enduring what section 133(2) refers to as 'substantial hardship'. Those inquiries and verification are not suited to assessing what, if any, benefit the consumer will gain by borrowing.[14]

Other evidence regarding the relationship between a limited suitability requirement and the abusiveness authority is ambiguous. To the extent that the evidence is probative of Congress's intent, however, it tends to support the idea that the particular concern of the "abusiveness" standard was the pre-mortgage crisis practice of selling "alternative mortgages" to particular consumers who were unable to understand the risks and complexities of those products. For example, the Obama Administration used the term "suitable" in passing when it discussed the regulation of "alternative" or "high cost mortgage" products in its financial regulatory reform White Paper.[15] It noted that mortgages with particularly complex or complicated products, such as negative-amortization mortgages, might not be "suitable" for consumers when marketed to unsophisticated consumers. In turn, this emphasis on the interaction between the atypical and complex nature of the product and the particular characteristics of the consumer implies that commonplace, standard, non-complex financial products are unlikely to be

[14] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Everyday Consumer Credit—Overview of Australian Law Regulating Consumer Home Loans, Credit Cards and Car Loans: Background Paper* (Mar. 14, 2018), WWW.APO.ORG.AU, *available in* https://apo.org.au/node/136491.

[15] *See* DEPARTMENT OF THE TREASURY: FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 66 (2009), *available in* https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

considered "abusive."[16] On the other hand, the requirement of a full suitability requirement did not survive to the final draft of Dodd-Frank,[17] presumably because of the excessive risk and costs it would impose on mortgage providers to determine the full range of risks and benefits to the consumer (as suggested by the Australian discussion above). Nevertheless, this would not necessarily rule out the possibility that abusiveness was meant to refer to a less-burdensome standard, such as requiring that a product not be clearly unsuitable for a particular consumer.

2. Abusiveness Requires the Provider Possess Some Relationship of Reasonable Reliance by the Consumer on the Provider or Some Special Knowledge of the Consumer's Vulnerabilities and that the Provider Take Unreasonable Advantage of that Relationship

Defining abusiveness as requiring providers to provide products that are not unsuitable for a particular consumer implies a second element to the test, that the provider have some relationship of reliance or some particular knowledge about the particular vulnerabilities of the borrower that the provider can exploit. Again, this relationship test is highly context dependent and requires a case-by-case analysis, in contrast to unfair and deceptive inquiries, which speak to the more general attribute of products and consumers and do not require the provider to have any type of particularized relationship with the consumer.

The statutory definition of abusive supports this element of the test. For example, subsection (2)(C) of the definition of "Abusive" under the statute specifically prohibits an

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[16] Again, however, those products could be unfair or deceptive, especially if, for example, they are so atypical and unnecessarily complex that the reasonable consumer would suffer harm that could not be avoided by reasonable effort.
[17] Kate Davidson, *Abuse Standard's Unclear and Banks Clearly Dislike It*, AM. BANKER Issue 137, p. 1-3 (Sept. 6, 2011).

act or practice that "takes unreasonable advantage of… the reasonable reliance by the consumer on a covered person to act in the interests of the consumer." Commenting on the possible relationship between abusiveness and suitability, in March 2011 Elizabeth Warren provided the example of consumers who "go to a mortgage broker and reasonably expect that every broker puts the customer's interest first."[18] The basis for Warren's factual assertion that consumers "reasonably expect that every broker" will "put their interests first" is unclear and by no means obvious.[19] More relevant, however, is that she suggests that if consumers do "reasonably expect" that brokers put "their interests first," and that if they are able to demonstrate that factually, this reasonable reliance on that relationship is one of the predicate factual bases that could potentially trigger the abusiveness standard, as opposed to unfairness and deception which do not require this showing.

Other elements of the abusiveness standard also suggest some degree of particularized knowledge of the borrower or some other relationship that enables the provider of the product to exploit the borrower's particular vulnerabilities or some relationship that enables the product provider to exert undue influence or pressure on the consumer. For example, abusiveness can arise when the seller "materially interferes with the ability of a consumer to understand a term or condition" of the product or service, which implies some affirmative act by the provider to be able to prevent the borrower from understanding the product and some particularized ability to do so, as opposed to

[18] Kate Davidson, *Abuse Standard's Unclear and Banks Clearly Dislike It*, AM. BANKER Issue 137, p. 1-3 (Sept. 6, 2011).
[19] For example, many home buyers, especially inexperienced home buyers, might not be aware that a real estate agent works for the seller, not the buyer. That erroneous belief, however, would not necessarily satisfy the abusiveness standard's requirement of reasonable reliance unless the agent made additional representations that promoted that belief.

deceptiveness which is otherwise somewhat similar substantively. Similarly, abusiveness refers to taking unreasonable advantage of the consumer's "lack of understanding of the material risks, costs, or conditions" of the product or service or taking unreasonable advantage of the consumer's inability to protect himself. In these instances, "abusive" implies some unique knowledge or relationship between the provider of the service and the customer that can be exploited, as opposed to the more generalized harm created by unfair and deceptive acts and practices.

The degree of relationship and knowledge that is required will be on a sliding scale and will have to be determined on a case-by-case basis; still, even in relatively obvious cases the provider will have to have some degree of personalized knowledge of the borrower's facts and situations. For example, even in Representative Frank's example of the unsuitable nature of inducing refinancing by an elderly widow of limited financial sophistication who has nearly paid off her home, the lender would be required to know of her age, current financial condition, and degree of financial sophistication. It is not obvious, for example, that if a mortgage offer is determined by a purely automated underwriting system could act in an "abusive" fashion, although such algorithms could be unfair or deceptive, and to the extent that there is human intervention in the process, could be abusive if the human is aware of the particular situation and vulnerabilities of the borrower. On the other hand, standardized products offered on an impersonal basis to the public, such as credit cards or online payday loans, would rarely satisfy this predicate element to trigger the abusiveness standard.

With respect to securities advisors, the affirmative suitability requirement arises specifically from the fact that, by definition, the consumer is reasonably relying on the interest of the broker to protect his interests, which in turn generates an affirmative obligation on the part of the broker to determine what is suitable for a buyer. And that obligation suggests a corollary obligation on the advisor to collect enough information about the client to decide of what types of investments are suitable. Platforms that simply process transactions, such as electronic facilitator of stock transactions or a mutual fund that does not offer recommendations or advice, by contrast, have no obligation to ensure that their products are suitable to particular buyers. And, to repeat, while such practices might be unfair or deceptive, they lack the particularized knowledge of the consumer's particular circumstances to be classified as "abusive."

The requirement under Australian law that consumer financial products not be unsuitable for the consumers to whom they are sold is also rooted in an affirmative obligation of the provider to collect more information and assess certain characteristics of the consumer before providing products to that consumer. Australian law and regulatory authorities, for example, require that lenders "make reasonable inquiries about the consumer's financial situation, *and their requirements and objectives*" and to "make a preliminary or final assessment "about whether the credit contract is 'not unsuitable' for the consumer (based on the inquiries and information obtained in the first two steps."[20] Thus, credit providers under the NCCP Act are required to gather information about "the client's needs and objectives, and an assessment of product(s) against those need and objectives."[21] On the other hand, the obligations under the NCCP do not require the provider to determine that the provided products are in the "best interests" of the consumer, simply that they are "not unsuitable" for the consumer.

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[20] *See* Australian Securities & Investment Commission, *Responsible Lending*, WWW.ASIC.GOV.AU, *available in* https://asic.gov.au/regulatory-resources/credit/responsible-lending/.
[21] Royal Commission, *Everyday Consumer Credit Overview*, *supra* note at 46-47.

Requiring that a provider hold a relationship with the consumer that creates a degree of reliance, knowledge of particular vulnerabilities, or ability to material interfere with the consumer's ability to comprehend the product likely explains why most or all examples of abusive behavior offered at the time of Dodd-Frank concern mortgage transactions and mortgage brokers specifically. Few other consumer financial transactions in the United States involve the provision of so much information about the borrower's overall financial needs and objectives and such a large financial obligation, so that in theory mortgage brokers could arguably be required to assess whether a particular mortgage product was not unsuitable for a particular consumer's level of understanding, risk-tolerance, and financial objectives. Even then, lenders and mortgage brokers have less information and less of a relationship of reasonable reliance than an investment advisor. On the other hand, unlike the statutorily-based affirmative obligation apparently imposed by Australian law or the particularized reliance relationship that exists between brokers and personal investors, the typical American consumer financial transaction does not require routine collective of extensive information about a consumer's particular needs and objectives. As a result, the requirement that the provider only offer products that are not unsuitable to the consumer is unlikely to apply to many relationships outside of the mortgage context, and even then, it is unlikely to be routine.

II. What Is Not "Abusive"

As noted at the outset, definitions provide two functions: they define what a term is, but they also define what a term is not. Definitions build fences around terms, identifying what behaviors are inside the fences and which are outside the fences while also distinguishing different fenced areas from one another. Thus, while the definition of what constitutes abusive behavior is inevitably fuzzy around the perimeter, language, legislative history, and policy all provide examples of behaviors that fit within the fence, such as Representative Frank's example of an elderly, financially unsophisticated widow who reasonably relies on a mortgage broker who persuades her to enter into a refinancing transaction that the lender knew or should have known was clearly unsuitable for her. Other examples will depend heavily on particularized fact-intensive inquiries, such as whether the provider knew or should have known the product was unsuitable, and the consumer's reliance on a particular provider was reasonable or whether a provider's acts or practice "materially" interfered with a consumer's ability to understand a term or condition of the product or service.

What lies outside the fences also will sometimes be fuzzy. But understanding a basic definition of "abusive" can provide some clear guidance as to what type of acts or practices are not abusive and will reduce the term's uncertainty, thereby reinforcing the rule of law and enabling better matching of consumers with desired products and services.

Two particular elements stand out in terms of defining what abusiveness is not. First, abusiveness is not "unfair" and/or "deceptive," even though the CFPB typically has used it interchangeably with those terms. Second, abusiveness is not related to behavioral economics, especially in the absence of any particularized relationship between providers and particular consumers.

A. "Abusive" is Not "Unfair" or "Deceptive"

As has been emphasized throughout, the very fact that Congress supplemented UDAP's traditional definition to include "abusive" acts or practices strongly implies that “abusive” must mean something distinct from those long-established terms. As we have seen, in fact “abusive” refers to acts and practices that are by definition *not* unfair or deceptive because while those acts or practices may be appropriate for the average, reasonable consumer, certain consumers acting in certain contexts may nevertheless be harmed. Unlike unfair and deceptive acts and practices, therefore, abusive acts and practices imply a case-by-case, fact-intensive analysis of the particular product, consumer, and provider’s relationship with the consumer. “Abusive,” therefore, can be seen as filling in the gaps with respect to products that are not generally unfair or deceptive, but which can nevertheless harm particular consumers in particular contexts.

Despite Congress’s obvious intent for abusiveness to mean something distinct from unfair and deceptive, the CFPB has nevertheless often used the terms interchangeably and alleged harms arising under multiple provisions of UDAAP based on a common factual foundation. Even worse, in its enforcement actions the CFPB has in some cases alleged behavior to be both unfair and abusive while in other cases on virtually identical facts has alleged only that the practices were abusive. The Bureau has provided no explanation for these inconsistent methods of pleading.

In some instances, the CFPB has characterized certain acts as unfair and abusive when the facts suggest that the acts were simply unfair. In other cases, the CFPB has characterized acts as unfair when the facts alleged suggest that they were properly alleged as abusive.

For example, in 2017 the CFPB brought an action against Aequitas Capital Management, a third-party loan provider for for-profit college provider Corinthian

Colleges.[22] Under the federal student loan regulatory regime, Corinthian was required to provide at least 10% of its revenue from private sources. According to the Complaint, Corinthian satisfied this requirement by raising its tuition costs by 10% and then directing students to Aequitas, who would then provide a private loan to cover the new 10% gap. These loans, however, had high default rates and were characterized by the CFPB as having high costs. In turn, Aequitas held a right to put-back bad loans to Corinthian, thereby essentially making the loans a sham to comply with the technicalities of federal regulation but not serve any net benefit to the students. Thus, the CFPB considered this arrangement to be a "sham" to evade federal regulation.

The CFPB's Complaint argued that Aequitas engaged in abusive conduct because student borrowers were not able to protect their interests and took unreasonable advantage of the student borrowers' inability to protect their interests in selecting or using the private loans and that as a result, the student borrowers were harmed. The crux of the CFPB's arument was that the students could not protect their interests "because they could not have known or understood that Corinthian and Aequitas were using the [private loans], and the tutition charge they funded, as a loss leader and a ruse designed to generate Title IV federal loan revenue for Corinthian, and because most borrowers did not have other options to pay for Corinthian's artificially-inflated tuition." In turn, the CFPB alleged that Aequitas took unreasonable advantage of the student borrowers' inability to protect their interests in selecting or using the private loans "by funding, supporting, and maintaining its purchase of Corinthian student loan portfolios and by

[22] *Consumer Fin. Prot. Bureau v. Aequitas Capital Mgmt., Inc*., No. 3:17-cv-01278-MO 1, 2 (D. Or. Aug. 17, 2017).

participating in the [private loan program] through the 'forward flow' agreements with Corinthian, all while continuing to reap significant profits from the scheme."

But this argument that this practice is "abusive" is misguided. The actual target of CFPB's ire is the perceived effort to defraud the Department of Education by this end-run around the "90-10 rule." But the details of the underlying purpose of the scheme has nothing to do with the tangible impact on consumers of the scheme. More relevant, although the Bureau made much of the low-income and compartively low-education status of those students, it provided no indication that any of those factors were relevant to vulnerability of those students to the alleged "sham" or the harm they suffered as a result. Corinthian was disproportionately populated by lower-income students and the CFPB quoted a Corinthian official as describing its competition for students as "the couch, inertia, and gangs," and that it students were "looking to get a life, looking for a mother figure and father figure."

But would a hypothetical middle-income student have any greater knowledge of Corinthian's alleged scheme to evade the Department of Education's regulatory requirements for eligibility for the federal student aid program? Or, more relevant, would a middle-income student or anyone have any greater reason to *care* about that particular scheme as an explanation for why tuition was higher than it otherwise would have been? How would knowing details of the scheme materially impact the consumer's use of the loan product? For a student making a decision as to which college to attend, does it matter whether a school's overall tuition cost is higher because of an effort to satisfy Department of Education loan program eligibility requirements as opposed to, for example, raising tution to cover a $500 million liability judgment for ignoring widespread sexual abuse in its athletic program[23] or raising tuition to satisfy a $44 million tort judgment for libel and slander against a neighborhood business[24]? Neither of those examples of improper behavior, or many others that could be identified,[25] provide any benefit to current or future students yet result in higher tuition costs to students, many of whom will have to increase their student loan debt to cover the difference.

For purposes of determining the impact on consumers, the background of the scheme is irrelevant—all that really matters is the final, bottom-line price, the terms of the loan, and the prospective benefits that a student will receive from the program. Why the school costs more than it otherwise might doesn't seem to be relevant to the consumer any more than all of the other costs of providing an education. All of those factors might be relevant to whether the practice of marking up tuition and then inducing students to take a high-cost loan to make up the difference is an unfair or deceptive practice. But the CFPB's core allegations have nothing to do with the factors that determine whether it was "abusive" as opposed to "unfair" or "deceptive."

In fact, in its action against ITT Colleges, which was very similar to its action in *Aequitas*, the Bureau alleged that ITT's practices were both unfair and abusive. The Bureau claimed that ITT acted in an unfair manner by subjecting "ITT consumers to undue influence… through a variety of unfair acts and practices designed to interfere

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[23] *See* Dan Bauman, *Michigan State Just Agreed to Pay $500 million to Settle Sexual-Abuse Claims. Where Will It Find the Money?*, CHRONICLE OF HIGHER EDUCATION (May 16, 2018), https://www.chronicle.com/article/Michigan-State-Just-Agreed-to/243431.

[24] *See* Sammy Westfall, *Jury Hits Oberlin College With a Total of $44.2 million in Damages*, THE TOLEDO BLADE (June 13, 2019), https://www.toledoblade.com/local/education/2019/06/13/jury-hits-oberlin-with-31-million-punitive-damages-bakery-protests/stories/20190613148.

[25] Such as the costs and potential liability arising out of the now-infamous practice of creating fake sports dossiers to increase an applicant's chances of admission.

with the consumer's ability to make informed, uncoerced choices."[26] ITT knew the financial aid process was difficult and tedious to understand but continued to exploit their low-income student base by "pushing students into expensive, high-risk loans that… were likely to default." The only apparent difference between the two cases was the CFPB's extended discussion of the motives behind the Corinthian-Aequitas relationship, which seems to be irrelevant to the central question of the harm to consumers.

The *Aequitas* case, however, suggests a hypothetical situation that might provide a foundation for an abusiveness claim. As noted, the CFPB stated that Corinthian's internal communications stated that Corinthian students were "looking for a mother figure and father figure." The CFPB did not elaborate on that statement. But if it were hypothetically the case that Corinthian students actually *did* see Corinthian and its financial aid office as "a mother figure and father figure," that as a result students reasonably relied on Corinthian's loan officers in the belief that they were acting in the best interests of the student, and that Corinthian took unreasonable advantage of that reasonable reliance to peddle products that it knew or should have known were clearly unsuitable, then there could be a complaint that Corinthian and Aequitas's behavior was abusive. That scenario was not alleged and is far-fetched, of course, but it illustrates the sort of fact pattern—like the mortgage broker who the consumer supposedly reasonably relies on to act in the consumer's best interest—under which a proper abusiveness action might hold. As suggested by the *ITT* case, to the extent that the lending practices were improper, they were so for most of ITT's (or Corinthian's) customers and did not depend

[26] *Consumer Fin. Prot. Bureau v. ITT Educational Services, Inc.*, No. 1:14-cv-292 (S.D. Ind. Feb. 26, 2014).

on a relationship of reasonable reliance or special knowledge, and thus these cases are much more likely to satisfy the elements of unfairness rather than abusiveness.

The CFPB's action in *Zero Parallel, LLC* provides a second example of the misguided effort to recharacterize arguably unfair behavior as abusive.[27] Zero Parallel did not make loans. It was a lead generator company that sold leads to small-dollar and installment lenders by referring potential customers to the websites of potential lenders. As recited in the Consent Order entered into between the CFPB and Zero Parallel, the CFPB claimed that company had engaged in "abusive" practices because it did not inform the consumer that Zero Parallel had referred the consumer to that website or that the third-party website had paid Zero Parallel for the lead.

Of particular concern to the CFPB, however, was that many of the consumers who were referred to small-dollar lenders lived in states where any eventual loans that were entered into were void because they exceeded the state's maximum interest rates or state licensing laws. As a result, the CFPB claimed that by selling leads that could result in loans being made that would be void under the consumer's state law, Zero Parallel took "unreasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs, and conditions of the loan."

Zero Parallel's approach to defining abusiveness is peculiar on multiple levels. First, although the CFPB implies that lead generators are some sort of exotic business enterprise, in fact lead generation is ubiquitous in many industries, including insurance, credit cards, home remodeling services, education, and even legal services.[28] Thus,

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[27] *Zero Parallel, LLC,* CFPB No. 2017-CFPB-0017 (Sep. 6, 2017).
[28] *See* Michael Johnston, *What Are the Largest Lead Generation Niches?*, WWW.MONETIZEPROS.COM (Jan. 9, 2014), https://monetizepros.com/lead-generation/what-are-the-largest-lead-gen-niches/.

although the CFPB complained that Zero Parallel did not inform the consumer that it was reselling the lead, there is nothing unusual about that business arrangement.

If there is harm to consumers from being offered the option to borrow money that they are not legally required to pay back, it is again not clear why the act or practice in question in *Zero Parallel* is categorized as abusive, rather than unfair. The case of *D&D Marketing* provided a similar example, where the CFPB characterized the acts as unfair as well as abusive.[29] In *D&D Marketing,* T3 did not monitor or vet lead generators and lead purchasers, exposing consumers to the risk of having their information purchased by lenders who might offer void loans.[30] In both *D&D* and *Zero Parallel,* the intermediary made no attempt to "match the consumers with the best loan for their needs."[31] The possibility of being matched with a purchaser who may not provide the most favorable terms, including the possibility of being matched with an illegal lender, was the crux of both actions. The *D&D* complaint cites the lack of information regarding the existence of the intermediary and the inability of consumers to reasonably investigate the loan as the reasons for unfairness. Both elements are present in *Zero Parallel*.

The *D&D* complaint goes on to cite "the cost of a loan relative to what other lenders might offer, the law governing a loan contract, including whether the lender complies with laws of the consumer's state, and the available forum for raising disputes" as material risks, costs, and conditions that are likely to be misunderstood by a consumer.[32] But the essential nature of the complained-of scheme had nothing to do with the particular vulnerabilities or characteristics of the borrower. Nor in *Zero Parallel* was

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[29] *Consumer Fin. Prot. Bureau v. D&D Marketing Inc*., No. 2:15-cv-9692 (C.D. Cal. Dec. 17, 2015).
[30] *Id.* at 2:8-10.
[31] *Id.* at 6:11; *see also Zero Parallel* at 5.
[32] *Id.* at 11:1-5.

there any allegation that the company took affirmative acts to interfere with the customer's ability to comprehend the risks of the underlying product or created some personal relationship with the customer that would have led the customer to reasonably rely on the belief that Zero Parallel was acting in the customer's interest.[33]

A similar effort to recharacterize an unfairness allegation as an abusiveness claim by focusing on consumers' knowledge of an irrelevant business structure is presented in the 2017 version of the small-dollar loan rule.[34] According to the 2017 Rule, the payday loan industry takes unreasonable advantage of consumer vulnerabilities because they supposedly are not aware that payday lenders draw much of their lending volume and profit from repeat customers. As the Bureau wrote, "In the markets for covered loans, however, lenders have built a business model that—unbeknownst to borrowers—*depends* on repeated re-borrowing, and thus on the consumer's lack of capacity to repay such loans without needing to re-borrow."[35] Yet like the irrelevance of the question as to why the price of a particular university is higher than it otherwise would be, or the implication that there is something inherently suspicious about a commonplace industry practice such as lead generation, the mere fact that a disproportionate amount of a business's revenue is derived from a subset of repeat customer is a *non sequitur* as to the impact of an act or practice on a consumer.

Every retail industry depends for most of its business on repeat customers, whether department stores or hamburger joints. In fact, the so-called "80-20 Rule," also

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[33] Indeed, the undisclosed information—that the loans were legally unenforceable under state law and that the borrower thus had no legal obligation to repay them—actually made the loans *less* risky for the borrower, not more risky. Thus, learning about the undisclosed terms and conditions would have actually reduced the risk to the borrower.
[34] *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 84 Fed. Reg. 31, cmt. 2019-0006-28084 (May 16, 2019).
[35] 82 F.R. 54472, 54621.

known as the "Pareto Principle"—that 20% of a company's customers provide 80% of its sales—is such a well established adage among retailers that it has achieved the status of a virtual cliché.[36] Retail financial services are no exception to this rule, whether considering consumer deposits, commercial loan commitments, or overdraft protection use by consumers. [37]

The 2017 Rule also suggests that the payday loan industry is unique in its reliance on a substantial amount of its income on borrowers who remain in debt for extended periods. But this too is incorrect. For example, credit card issuers derive two-thirds of its revenues from cardholders who revolve balances from month to month, sometimes for years at a time.[38] Indeed, mortgage lenders "depend" on customers remaining in debt for up to thirty years. Thus, despite the 2017 Rule's innuendo to the contrary, the idea that the standard business model of payday lenders "*depends*" (emphasis in original) on repeated re-borrowing renders the product abusive is no more suspicious than the equally accurate statement that the "business model" of credit cards *depends* on revolving balances from month to month. Nor is it clear why this particular piece of information as to the source of payday lender's revenues more important to a consumer than similar information about the operations of credit card issuers, mortgage companies, or McDonald's for that matter. Rhetoric, even rhetoric written in italics, does not establish that a practice is abusive.

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[36] *See*, *e.g.*, Perry Marshall, "The 80/20 Rule of Sales: How too Find Your Best Customers, WWW.ENTREPRENEUR.COM (Oct. 9, 2013), https://www.entrepreneur.com/article/229294.
[37] *See* G. Michael Flores and Todd J. Zywicki, "Commentary: CFPB Report, Data Point: Checking Account Overdraft" at p. 8 (Sept. 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2499716.
[38] *See* Thomas A. Durkin, Gregory Elliehausen, Michael E. Staten, and Todd J. Zywicki, *Consumer Credit and the American Economy* at p. 347, Figure 7.1 (2014). Historically, this figure was closer to 80 percent, but the growth of revenue from interchange fees has reduced the percentage of revenue derived from finance charges on revolving balances. *Id.*

The CFPB further makes much of the fact that some extended borrowers may end up paying more in fees than the original principal they borrowed after several roll over. But this too is a *non sequitur*. For example, many consumers with a 30-year fixed rate mortgage will end up paying more in interest payments than in principal. To take a simple numerical example, if a consumer borrows $100,000 on a 30 year mortgage at a modest rate of interest of 6%, that consumer will eventually pay $115,838 in interest. At an interest rate of 10%, the consumer will pay a whopping $215,925 in interest over the life of a $100,000 loan. Moreover, this feature is built into the structure of the mortgage loan itself.

In developing the definition of abusive as distinct from unfair and deceptive, I strongly urge the CFPB to cease its practice of pleading abusiveness interchangeably with unfairness and deception. Given the vague and undefined nature of abusiveness, it is tempting for the agency to throw in abusiveness claim as part of a kitchen-sink pleading strategy designed to raise the likelihood of prevailing in litigation and provide alternative grounds for liability. Yielding to the temptation to engage in kitchen-sink pleading, however, erodes clarity in the understanding of both abusiveness and its sister UDDAP terms over time. The terms were intended to operate within different fenced-in areas and the CFPB should be vigilant about keeping them separate and ensuring that the facts that are pleaded actually fit the substantive basis for the action.

B. "Abusiveness" Does Not Incorporate Behavioral Economics into Consumer Protection Policy

Second, "abusiveness" does not incoporate behavioral economics into consumer protection policy. Some commenters have argued that the term "abusive" is intended to provide free license to the CFPB to rely on behavioral economics in its rulemaking and enforcement decisions.[39] This claim has taken on particular interest in light of the CFPB's two rulemaking proceedings involving "Payday, Vehicle Title, and Certain High-Cost Installment Loans," in which the first version (2017) relies heavily on the claims of behavioral economics in defining the term "abusive" whereas the second proposed rulemaking (2019), which repeals the key elements of the first rulemaking, properly does not.

The argument that Congress intended the term "abusive" to invite wholesale incorporation of behavioral into consumer financial protection policy is incorrect. First, in contrast to a proper definition of abusiveness, which rests on a case-by-case, fact-intensive inquiry about the particular vulnerabilities of particular consumers to particular acts and practices in particular contexts, behavioral economics rests on broad, sweeping generalizations about consumers at large and their supposed shopping and purchasing patterns. Second, there is no affirmative evidence that Congress intended abusiveness to serve as a charter to unleash behavioral economics, and available evidence of Congressional intent indicates otherwise. Third, the claims of behavioral eocnomics are so vague, unproven, and arbitrary that they cannot be implemented with a sufficient degree of predictability to anchor a regulatory definition of "abusive," much less serve as the basis for enforcement actions that could potentially impose millions of dollars in fines and penalties on businesses and deprive consumers of useful financial products.

1. Use of Behavioral Economics is Inconsistent with the Language and Purpose of the Abusiveness Standard in Dodd-Frank

[39] *See*, *e.g.*, Patrick M. Corrigan, Note, *"Abusive" Acts and Practices: Dodd-Frank's Behaviorally Informed Authority Over Consumer Credit Markets and Its Application to Teaser Rates*, 18 NYU J. OF LEGS. & PUB. POL'Y 125 (2015).

Behavioral economics ("BE") paints in broad brushes about the supposed biases and cognitive deficiencies of the general population. The fundamental nature of BE's claims is unclear, but it appears to describe a general statistical distribution in the population with respect to the presence of certain biases and cognitive attributes. For example, BE purports to identify something called an "optimism" bias. Yet the nature of that claim is unclear. Is it intended to mean that every single person in the population is "overoptimistic" on average and that no one is accurately optimistic or even pessimistically biased? Is it a claim that there is a statistical distribution in society, such that some people suffer from an overoptimism bias and others are accurately optimistic or pessimistic? Is it a claim about a statistical distribution at large or the tendencies of an individual drawn at random, the average person, or every person in the population?

The vague nature of the actual claims of behavioral economics matters. For example, behavioral economists have claimed to identify a purported cognitive bias that they refer to as "loss aversion." Yet research indicates that "loss aversion" is not universal among individuals or contexts. In fact, individuals exhibit behavior at various times and in various contexts that are consistent with not only loss-averse behavior, but loss-neutral, or even loss-preferring behavior. As summarized by David Gal and Derek Rucker in their review of the literature on the supposed "loss aversion" bias, "Our main conclusion is that the weight of the evidence does not support a general tendency for losses to be more psychologically impactful than gains (i.e., loss aversion). Rather, our review suggests the need for a more contextualized perspective whereby losses sometimes loom larger than gains, sometimes losses and gains have similar psychological impact, and sometimes gains loom larger than losses."[40] Similar concerns have been raised about the robustness of the supposed "endownment effect" bias, as the outcomes of studies purporting to document the phenomenon are highly context-dependent and dependent on the structure of the experiments that purport to test the hypothesis.[41]

Whatever the nature of the claim, BE rests on broad, gross claims about the population at large or unidentified individuals within the population. As noted, however, abusiveness rests on a fact-intensive, case-by-case inquiry of alleged harms that arise within specific contexts with respect to specific consumers. To the extent that BE's claims refer to broad claims about the population at large, therefore, those claims (to the extent that they are coherent and correct) are better aimed at the questions of unfairness and perhaps deception, not abusiveness.[42]

Statutory language and legislative history support the conclusion that abusiveness does not create a license to rely on behavioral economics. The Obama Administration's regulatory reform White Paper made no direct mention of behavioral economics, despite the fact that Elizabeth Warren and Oren Bar-Gill had proposed the idea several years earlier in a law review article.[43] The White Paper did, however, mention of the idea of providing preferred access by consumers to certain "plain vanilla" products, an idea proposed by behavioral economics enthusiasts Michael Barr, Sendhil Mullainathan, and

[40] David Gal and Derek Rucker, *The Loss of Loss Aversion: Will It Loom Larger Than Its Gain*, 28 J. CONSUMER PSYCHOLOGY 497 (2018).
[41] Charles Plott and Kathy Zeiler, *The Willingness to Pay-Willingness to Accept Gap, the "Endowment Effect," Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*," 95 AM. ECON. REV. 530 (2005).
[42] Although there are insurmountable problems in applying behavioral economics concepts in those contexts as well.
[43] Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 33(2008).

Eldar Shafir.[44] Yet this proposal garnered minimal political support and although it appeared in the initial Obama Administration reform framework, it never moved forward as a serious legislative proposal.

Moreover, trafficking in broad, unproven stereotypes of consumer behavior that certain subgroups of consumers are presumptively irrational, unintelligent, or biased without examining their particularized situations is incongruent with the modern nature of consumer financial regulation today. In an earlier era, discrimination against women in consumer credit provision was justified on the pernicious stereotype that it was conventional knowledge that women were "math-impaired" and thus unable to understand complex mathematical concepts like interest rates and the full cost of credit.[45] To simply declare that those who decide that a consumer who decides to take a sixth payday loan in a one-year period is engaging in rational behavior, yet as soon as that person decides to take a seventh payday loan suffers is crippled by cognitive biases and thus unable to protect himself, is not a serious approach to regulatory analysis.

Moreover, it is unclear on which consumers the CFPB is focused in its 2017 Rulemaking—is it generalizations about the population as a whole, payday loan customers as a group, or perhaps just a conclusion that only a small subset of payday loan borrowers are too mentally deficient to protect themselves? And what about other products that supposedly implicated the same biases, such as long-term revolving balances on credit cards, or even federal student loans, for which one could easily spin an

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[44] *See* Michael S. Barr, Sendhil Mullainathan, and Eldar Shafir, *Behaviorally Informed Financial Services Regulation* Policy Paper, New America Foundation, Washington, DC, (Oct. 2008). For a discussion of the "plain vanilla" proposal, *see* Todd J. Zywicki, *Market-Replacing versus Market-Reinforcing Consumer Finance Regulation*, *in* REFRAMING FINANCIAL REGULATION: ENHANCING STABILITY AND PROTECTING CONSUMERS 319, 333-36 (2016).

[45] LENDOL CALDER, FINANCING THE AMERICAN DREAM 166 (1999).

equally-plausible (or implausible) story about "optimism" bias and for which the federal government hands out trillions of dollars with no ability-to-repay assessment. Yet even though behavioral economists argue that the supposed "optimism bias" is a universal human cognitive trait, according to the CFPB as expressed in the 2017 small-dollar loan rule, it is only the decision-making of a subset of payday loan customers (who themselvers are a small subset of the population) and that there is no way to identify that minority subset of consumers in general, or even payday loan customers, in advance of making the initial loan. The Bureau has no idea who these individuals are or the actual reasons that they chose to rollover their loans each period rather than choosing to default. The CFPB is unable to identify before the fact which borrowers supposedly suffer from this crippling cognitive infirmity and simply attaches a speculative label after the fact as to what supposedly explains their behavior.

Of particular irony is that the CFPB's assessment in the 2017 small-dollar loan rule that some payday loan customers suffer from cognitive biases is grounded in a fundamental analytical error by the CFPB about what would constitute rational use of payday loans.[46] The logic that payday loans are "abusive" because some customers end up unexpectedly re-borrowing for extended sequences and thus the total costs of the loan sequence exceed the total financial benefits of the loan sequence, a conclustion that is merely asserted and not demontrated, fundamentally misconceives the relevant question for understanding the rationality of consumer behavior.[47] The 2017 Rule acknowledged that it could be rational, and certainly not "abusive," for a consumer to choose to take out

[46] Payday, Vehicle Title, and Certain High-Cost Installment Loans, 84 Fed. Reg. 31, cmt. 2019-0006-28084 at 4 (May 16, 2019).
[47] Notably, this inquiry only considers the financial benefits of the loan (i.e., the amount borrowed), not any non-pecuniary benefits of using the funds (such as buying food, medicine, or avoiding eviction or utility termination).

a payday loan, in that the marginal benefits of a particular loan might exceed the marginal costs. The 2017 Rule even acknowledged that a few payday loans could be rational. But inexplicably the 2017 Rule believed that while the *sixth* payday loan in a twelve-month period was acceptable and even rational, the *seventh* loan demonstrated that customer was cognitively imparied and thus special rules should be triggered before taking the seventh loan.[48]

Proper economic analysis, however, examines consumer choice at the *margin*, not over some arbitrary total cost assessment. Thus, if the marginal value of any particular payday loan exceeds the marginal cost, it follows that this is true regardless of how many payday loans the borrower has taken out in the past. The "sunk cost" of past loans is irrelevant. What matters is the marginal benefits and marginal costs of the next prospective extension of liquidity for another period. Consumers who take payday loans generally do so because of a pressing need for cash and because they lack less-expensive and more-attractive options. The options available do not change based on how many loans the consumer has taken in the past. Thus, ironically, the CFPB falls prey to the sunk cost fallacy while at the same time claiming consumers exhibit irrational behavior.

In a comment on the 2017 Rule, economists Hal Singer and Kevin Caves write:

> If—as the Bureau concedes—a single, two-week [payday loan] can benefit a Repayer by allowing her to satisfy critical and immediate financial obligations, then by extension so can a second two-week loan offered on the same terms at the first, and a third one after that, and so on. Given the absence of compounding interest on [payday loans], a borrower contemplating a rollover transaction *faces the same tradeoff* as a borrower taking out the first in a sequence of loans: If the benefit of extra the [sic] liquidity exceeds the biweekly interest cost, then the consumer benefits from having access to [payday loan] credit. The accumulated interest cost at that point is a sunk expense, and thus should not enter the decision

[48] *Id.* at 19.

calculus. While it might make for good rhetoric, a simplistic comparison of cumulative interest payments relative to the principal is economically irrelevant.[49]

2. Behavioral Economics is Incapable of Being Applied in a Predictable and Non-Arbitrary Fashion That Can Serve as an Appropriate Basis for Enforcement and Regulation

The methodological, conceptual, and empirical deficiencies of behavioral economics in its current intellectual state of development make it impossible to apply in a sufficiently predictable and non-arbitrary fashion so as to provide a foundation for regulation and enforcement. To be sure, the term "unfairness" requires an analysis of benefits and costs that will sometimes be difficult to measure. But over time that term has established a relatively predictable definition and methodology for establishing its elements of unfairness and standard and predictable methods of economics analysis have evolved to create some degree of predictability in its application.

Behavioral economics, by contrast, is fundamentally incapable of being applied with a sufficient degree of predictability to serve as a basis for regulation, much less enforcement. More important, based on the current state of the science of behavioral economics, there is no basis to assume that the application of behavioral economics will become more reliable and predictable over time or provide useful insights to improve the consumer financial protection regulatory system. Indeed, as the field of behavioral economics has developed, its findings have actually become *less* predictable in many areas as new biases continue to be "discovered," older biases that were thought to have been well-confirmed have been reconsidered by subsequent research, and the highly

[49] Singer and Caves, "Re: Docket No. CFPB-2016-0025/RIN 3170-AA40," 22.

contextual nature of how and when supposed cognitive biases are supposedly manifested in real-world consumer decision-making has been further researched. As noted, several recent key studies have cast doubt on the predictability and stability of several supposed consumer cognitive biases, such as the "endowment effect" and "loss aversion."[50] In a similar vein, behavioral economics founding father Daniel Kahneman has admitted that in his own writing he placed undue reliance on "underpowered studies." That recognition has caused him to reconsider earlier claims.[51]

An additional problem for using behavioral economics as the basis of regulation and enforcement is the sheer number and inconsistency of purported behavioral biases. One recent count reported that *Wikipedia* listed 257 different biases that can infect consumer decision-making at various times.[52] These supposed biases, to the extent that they actually exist at all, operate with varying degrees of consistency, frequency, or strength. Many of those purported biases generate diametricaly contradictory predictions about consumer behavior in general or generate inconsistent predictions about behavior in different contexts, or even in the same context across time.[53]

Other claims of behavioral economics turn out to be grounded in nothing more than speculation and supposition, not actual empirical research. These types of "just-so stories," in which a researcher selectively identifies some purported erroneous decision

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[50] *See* discussion *supra* at 3-10.

[51] I have suggested that one possible explanation for the common tendency of behavioral economists to place undue reliance on poorly-designed studies and to ignore evidence that is plainly inconsistent with their hypothesis may be that behavioral economists themselves illustrate the biases that they attribute to consumers, most notably confirmation bias, but that unlike consumers, researchers lack incentives to correct those biases. *See* Todd J. Zywicki, *The Behavioral Economics of Behavioral Law & Economics*, 5(3-4) J. OF BEHAVIORAL ECON. 439-472 (2018).

[52] Deirdre McCloskey, *The Applied Theory of Bossing People Around: Thaler's Nobel*, REASON, (Feb. 2018).

[53] *See* Todd J. Zywicki, *Do Americans Really Save Too Little and Should We Nudge Them To Save More? The Ethics of Nudging Retirement Savings*, 16 GEO. J. L. & PUB. POL'Y 877 (2016).

by consumers and then offers some purported cognitive bias to "explain" it, comprise the bulk of behavioral law and economics analysis.[54] For example, some behavioral economists claim that surcharging credit card transactions will be more effective at changing consumer payment behavior than will offering cash discounts because of several purported consumer biases, such as the "endowment effect," and have even gone so far as to urge the United States Supreme Court to adopt this claim as part of its First Amendment jurisprudence. The conclusion, however, was based on nothing more than an off-hand musing by economist Richard Thaler which was later reiterated and through repetition came to be accepted as established proof. In fact, the limited empirical research on point actually *rejects* the claim, finding that, if anything, cash discounts are more effective at changing consumer payment choice.[55] Perhaps even more telling, the claim by these behavioral economists that consumers will be benefited if merchants are permitted to surcharge payments was squarely contradicted by the claims of behavioral economists at the United Kingdom's Office of Fair Trading, which reached exactly the *opposite* conclusion, finding that merchants can exploit *the exact same consumer biases* (such as the endowment effect) to engage in so-called "drip pricing" behavior, which will *reduce* consumer welfare and increase the opportunity for merchants to expropriate wealth from consumers.[56] When the *same* supposed cognitive biases can be asserted to operate in the *same* contexts and behavioral economists reach diametrically *opposite*

[54] *See* Todd J. Zywicki, *The Behavioral Law & Economics of Fixed-Rate Mortgages (And Other Just-So Stories)*, 21 SUP. CT. ECON. REV. 157 (2014).

[55] *See* Todd Zywicki, Geoffrey Manne, and Kristian Stout, *Behavioral Law & Economics Goes to Court: The Fundamental Flaws in the Behavioral Law 7 Economics Arguments Against No-Surcharge Laws*, 82 U. MISSOURI L. REV. 770 (2017).

[56] *Id.* In fact, Canadian authorities have sued Ticketmaster for allegedly engaging in "drip pricing" practices that are functionally similar to surcharging that it alleges are harmful to consumers. *See* Sean Burns, *Canadian Authorities Ratchet up Criticism of Ticketmaster/LN Drip Pricing*, WWW.TICKETNEWS.COM (Mar. 28, 2018), *available in* https://www.ticketnews.com/2018/03/canadian-authorities-fight-ticketmaster-pricing/.

conclusions about the welfare effects for consumers, there is simply no way for any regulated party to predict with any certainty whether their action will be considered to proper.

The unpredictability created by the poorly-identified and *ad hoc* theorizing of behavioral economics is especially problematic when combined with a tendency to engage in results-oriented analysis that mischaracterizes relevant evidence. Perhaps the most egregious example was the misuse during the 2017 small-dollar loan rule process of the conclusions of Professor Ronald Mann's study. Mann found that payday loan borrowers, on average, correctly anticipate how long they will remain in debt, and there was no evidence of any "optimism bias" among payday loan customers in general. Moreover, even among consumers who predicted and experienced extended borrowing sequences, errors were unbiased in their distribution, meaning that payday loan borrowers as a whole were equally prone to exhibit "pessimism" bias as "optimism" bias—i.e., they predicted long-term borrowing sequences and then payed off their loans earlier than expected.[57] Nevertheless, the CFPB ignored all of these findings, instead focusing selectively on simply a hand-picked group of consumers and concluded that long-term borrowing sequences resulted from some unspecified "optimism bias."

The 2017 Rule's claim that payday loan customers suffer from so-called "tunneling" behavior is similarly contradicted by available evidence. "Tunneling" refers to the alleged tendency of consumers to fail to appreciate the full scope and implications of their decisions when made under conditions of crisis or stress, such as financial distress leading up to a payday loan. Yet as the 2017 Rule acknowledges, payday loan

[57] Letter of Professor Ronald J. Mann to Consumer Financial Protection Bureau, Re: Docket No. CFPB-2016-0025 (RIN 3170-AA40), Oct. 4, 2016.

customers search extensively for credit before finally deciding to take out a payday loan.[58] Moreover, most consumers who choose to take out a payday loan actually have alternatives available, such as overdraft protection, pawn shops, auto title, loans and in some instances, credit card cash advances. Available evidence suggests that in deciding whether to take out a payday loan, consumers appear to act in a cost-minimizing fashion, relative to realistic available options.[59] This too suggests an absence of desperation or pressure of the sort postulated by the label "tunneling."

Consider the logical steps that would be necessary for a regulated party to predict that making payday loans to long-term borrowers might be considered "abusive" because of the supposed tendency to exploit based on the theory that some consumers are supposedly overoptimistic some of the time: (1) The Bureau would have to endorse the behavioral economics theory of "optimism bias," despite the fact that the theory has been proven false in every context in which it has been empirically tested, *including* payday loans themselves (as well as credit cards and auto title loans, as noted), (2) That the CFPB would cherry-pick some small data subsample of Professor Mann's study on which to focus, (3) That the CFPB would ignore that *even with respect to that subsample* the claim of optimism bias is rejected, (4) That the CFPB would arbitrarily apply the theory only to these particular products while refusing to do so in other similar situations where the optimism bias has been claimed to operate (such as credit cards), and (5) That the CFPB would ignore the standard economic approach of examining consumer welfare by

[58] Neil Bhutta et al., "Payday Loan Choices and Consequences," 47 J. of Money, Credit and Banking 223 (2015).
[59] Brian T. Melzer & Donald P. Morgan, Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit 1–2 (Dec. 2, 2009) (unpublished manuscript), available at http://www.clevelandfed.org/research/conferences/2010/9-9-2010_ household-finance/melzer_morgan_2_16_2010.pdf.

examining the marginal benefits and marginal costs of particular choices in favor of a novel approach of considering the total costs of a multi-period decision process. Yet these concerns about arbitrary and *ad hoc* reasoning are simply the tip of the regulatory iceberg. Any theory that can be applied after the fact to explain any observed behavior does not provide a sound foundation for policy or enforcement. Especially when the theory itself is invalidated by available evidence.

To empower a regulator to effectively prohibit consumers from accessing useful products based on this weak and subjective theorizing is unwise and it is difficult to believe that Congress could have intended that result. Even more, to empower a regulatory authority to mete out potentially millions of dollars in fines and punishments based on hand-waving, speculation, and "just-so stories" is unwise and unlikely to survive judicial review under the Administrative Procedure Act. It is telling that although the 2017 small-dollar loan rule relied on behavioral economics claims to support its claims about abusiveness under the rule, to date the enforcement division of the Bureau has not expressly done so.

Behavioral economics also provides a questionable basis for regulatory policy because of the unpredictable fashion in which the CFPB has made use of behavioral economics concepts and its tendency to manipulate research conclusions to support its regulatory aims. As noted above, Professor Ronald Man has harshly—and correctly—criticized the CFPB's misrepresentation of his research to support its 2017 Rule, calling the rulemaking's summary of his research "unrecognizable."[60] And, as he notes, the CFPB not only ignored the central finding of his study—that there is no evidence of systematic "optimism bias" by payday loan customers—but that even with respect to

[60] Mann Letter at p. 2.

long-term borrowers there is no evidence of systematic bias, as many consumers predicted long-term borrowing sequences and eventually paid off their loans earlier than expected.[61]

III. Conclustion

Director Kraninger is to be commended for taking this opportunity to convene this important Symposium on the question of the definition and future of "abusiveness." Adopting a rule or some other official announcement or guidance that provides greater certainty about the meaning of abusiveness would be of manifest value and importance to consumers and the economy. A clear definition of abusiveness that vindicates Congress's intent to reach specific acts and practices that are distinct from the traditional definitions of unfair and deceptive, without imperiling the rule of law by creating arbitrary and unpredictable standards of liability would benefit consumers and the marketplace alike. In addition, providing a clear definition of abusiveness will also constrain the future use of subjective, arbitrary, and unscientific methodologies of analysis such as behavioral economics.

[61] Indeed, there is no evidence of optimism bias in other areas in which it asserted, such as credit card usage. *See* Durkin, Elliehausen, and Zywicki, *Consumer Use of Credit Cards*, *supra* (summarizing research). Similarly, the contention that consumers supposedly exhibit optimism bias with respect to auto title loans is based on misreading by the authors of their own data and, in particular, failing to identify the unbiased nature of the distribution of errors (i.e., that consumers were equally likely to overestimate how long it would take to pay off their auto title loan as to underestimate it). *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 84 Fed. Reg. 31, cmt. 2019-0006-28084 at 7 (May 16, 2019).