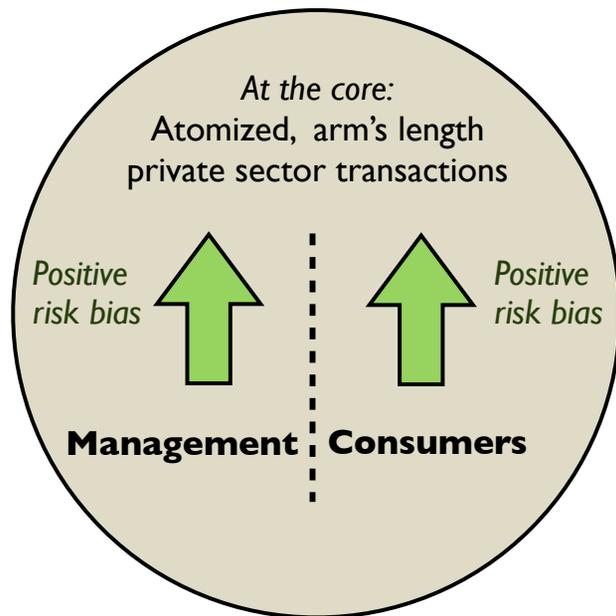


Mitigating the “Scalability of Bad Practices” in Consumer Finance

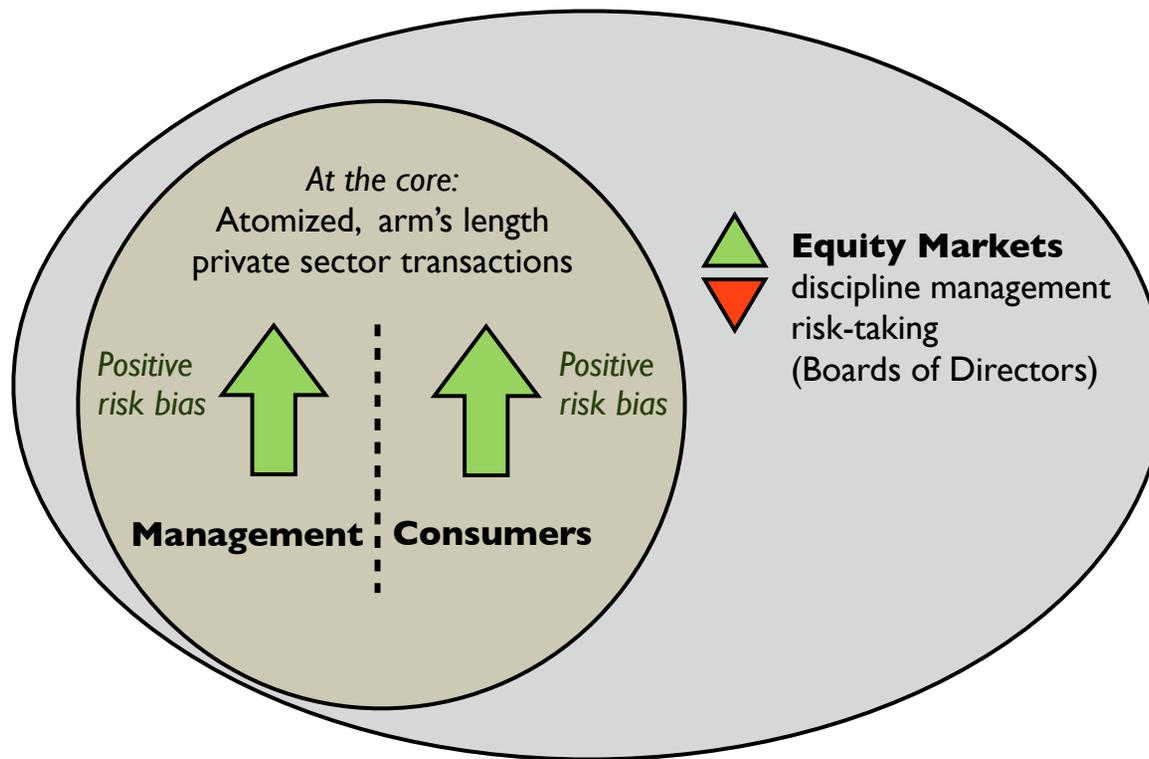
Raj Date
Executive Director, Cambridge Winter Center

Conference on Regulating Consumer Financial Products
Federal Reserve Bank of New York
January 6, 2010

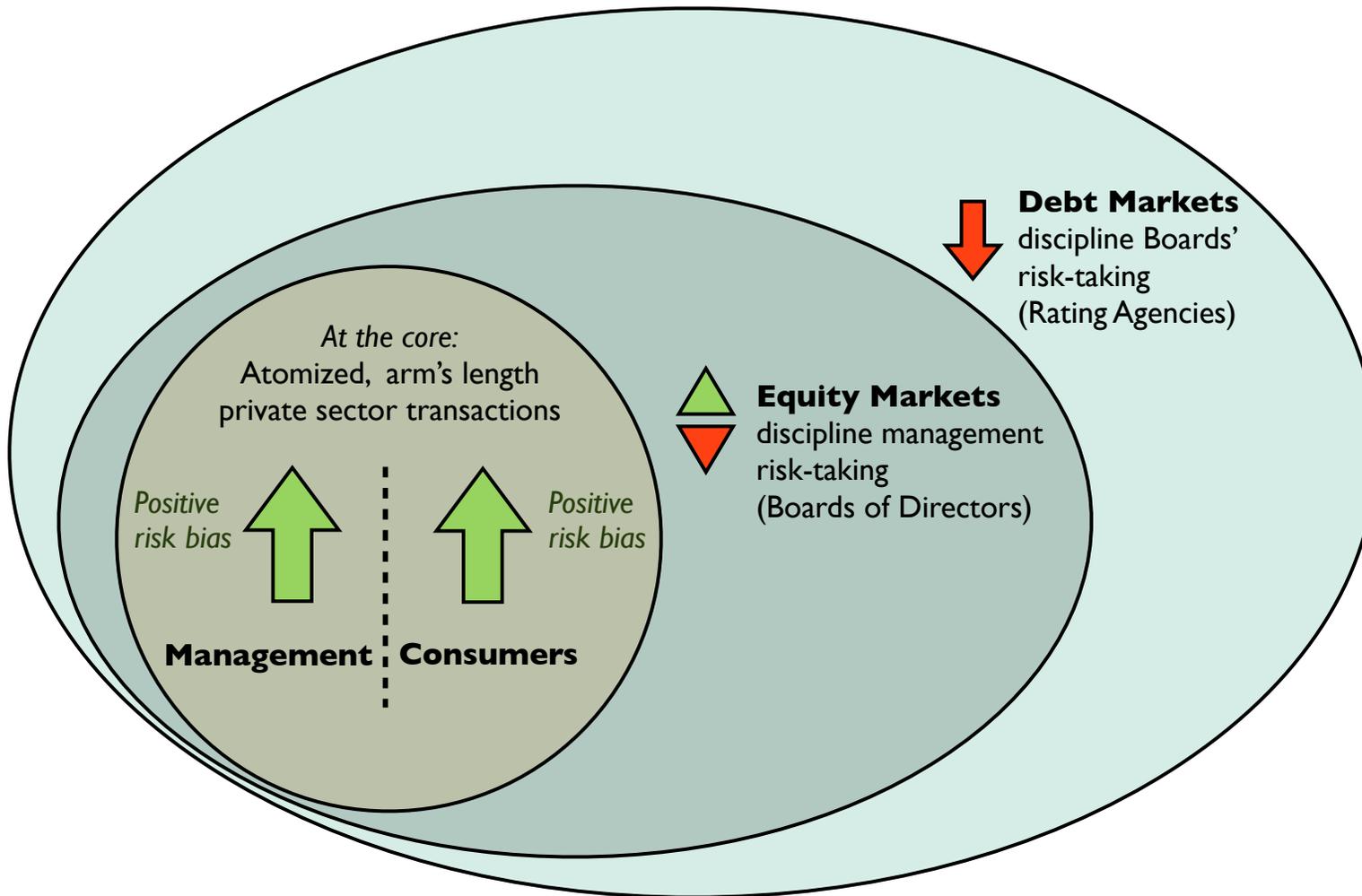
CONSUMER PRODUCT REGULATION IS AT THE CORE OF EFFECTIVE FINANCIAL REGULATORY REFORM



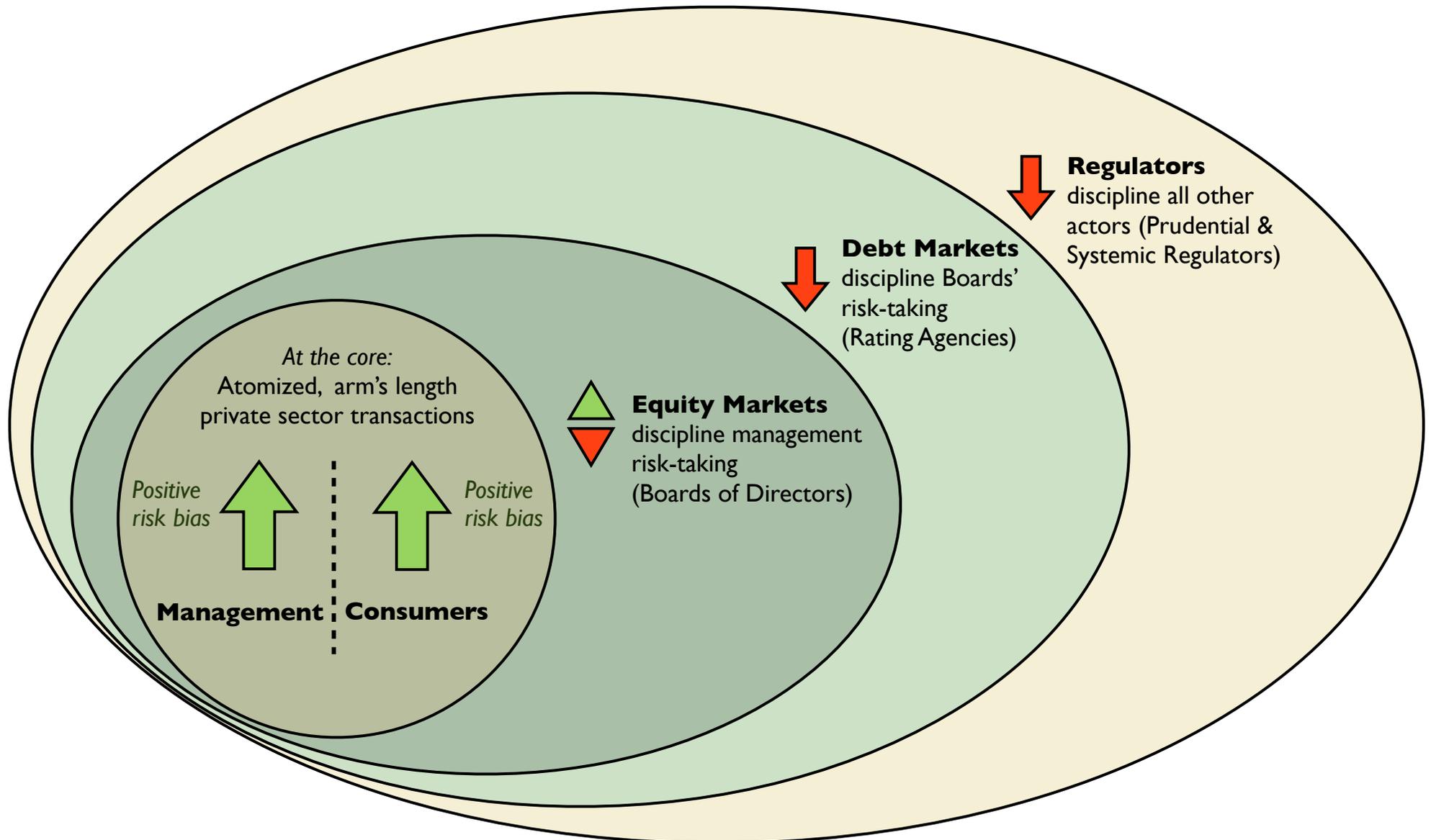
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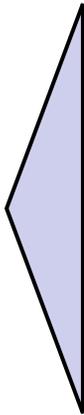
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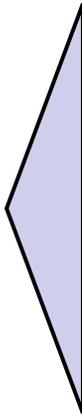


**REGULATING CONSUMER FINANCE IS HARD BECAUSE OF
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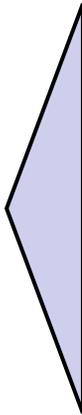
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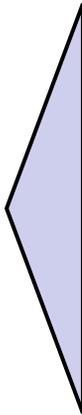
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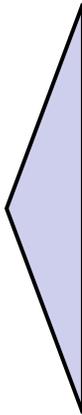
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 - The “grandmother” test
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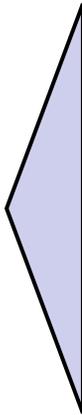
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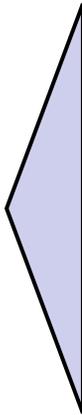
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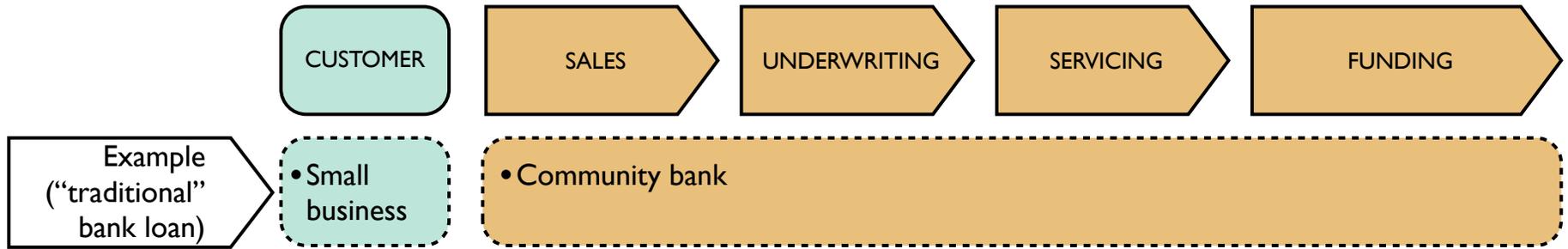
Information Asymmetry

INFORMATION ASYMMETRY HELPS BAD PRODUCTS TO CROWD OUT GOOD ONES

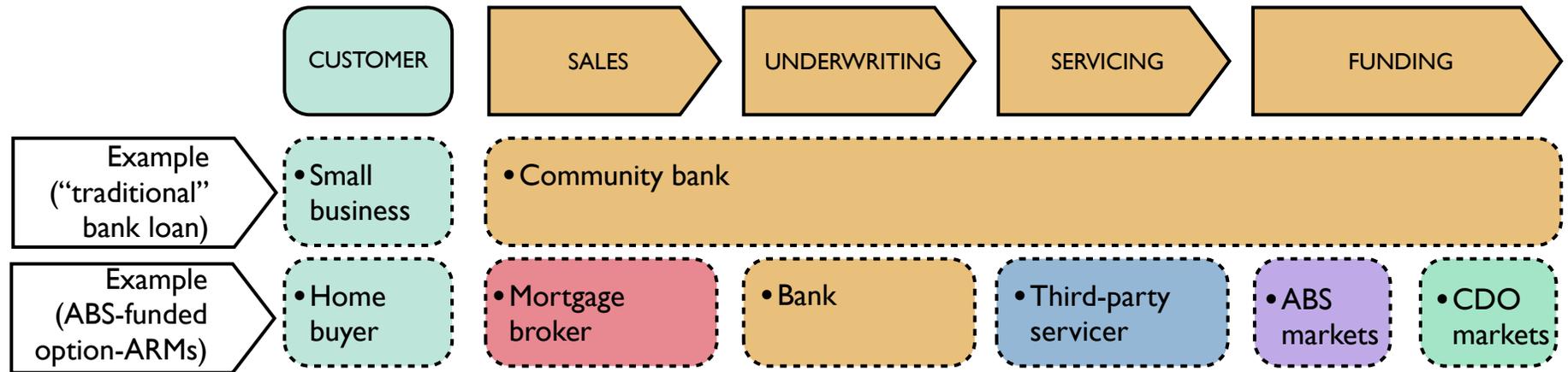


Example
("traditional"
bank loan)

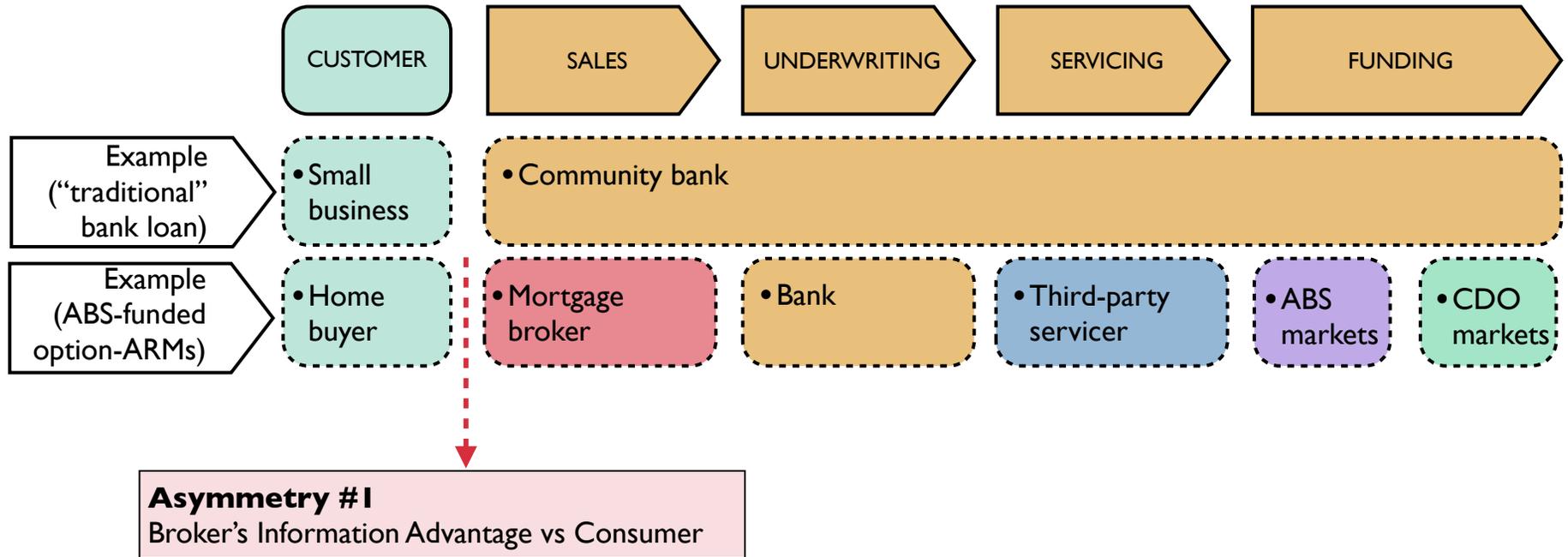
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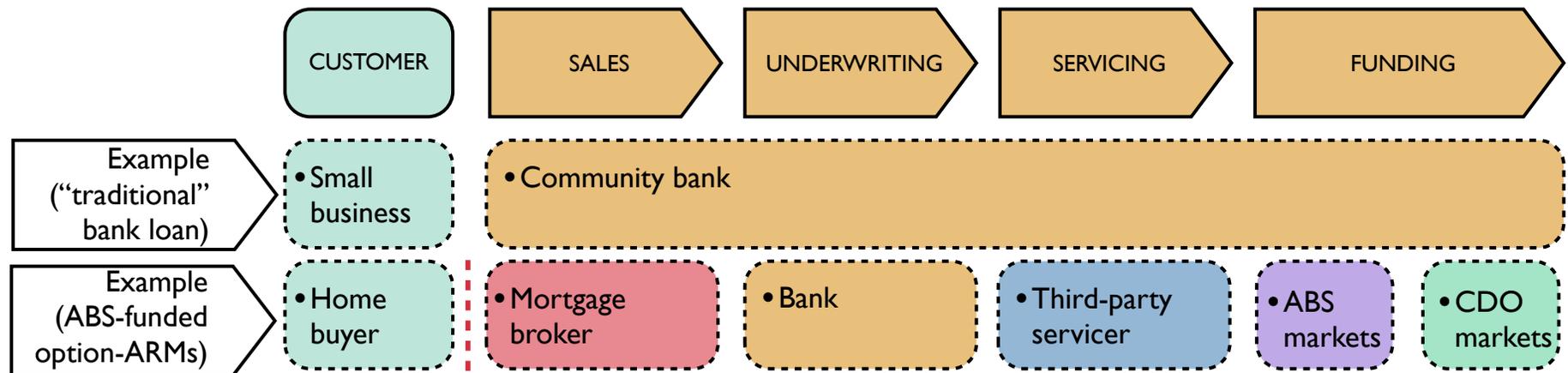
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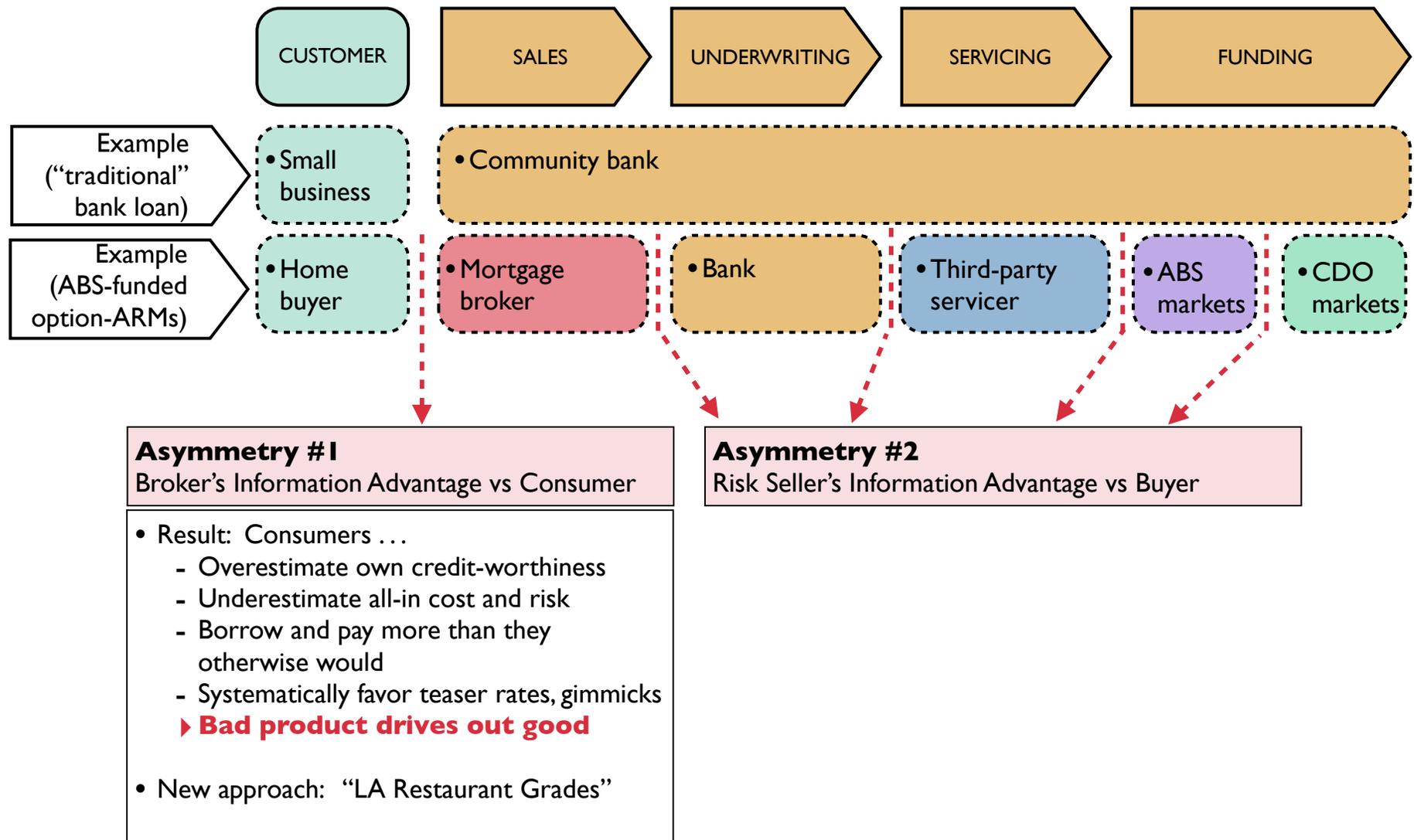
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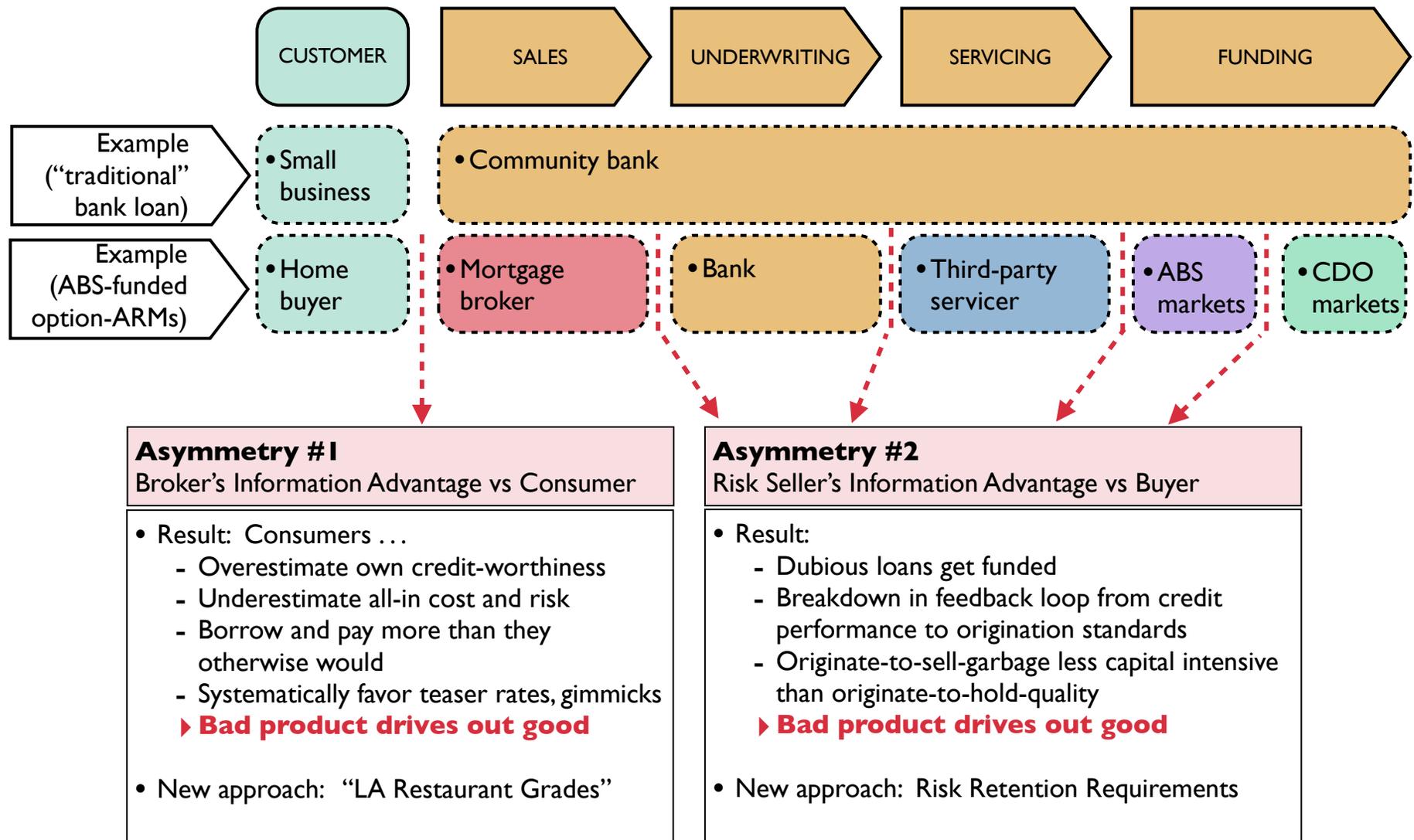
Asymmetry #1
 Broker's Information Advantage vs Consumer

- Result: Consumers ...
 - Overestimate own credit-worthiness
 - Underestimate all-in cost and risk
 - Borrow and pay more than they otherwise would
 - Systematically favor teaser rates, gimmicks
 - ▶ **Bad product drives out good**
- New approach: "LA Restaurant Grades"

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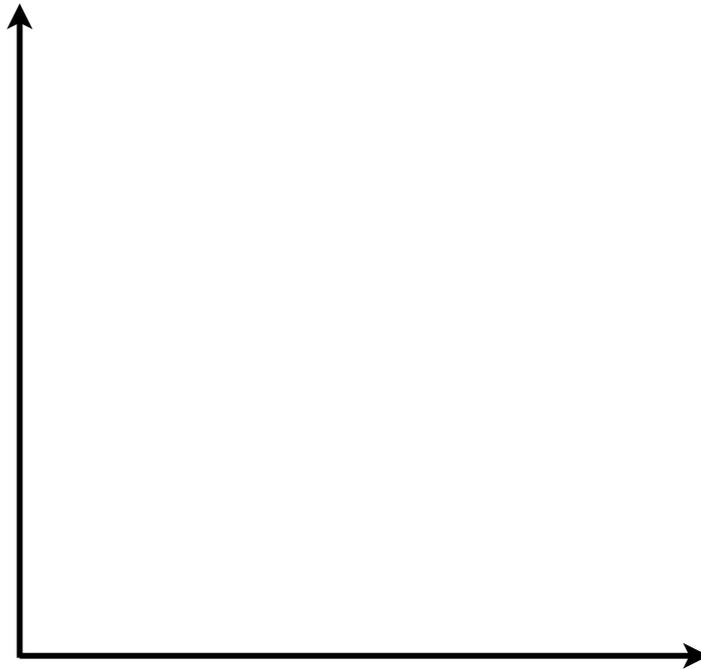


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NEW RISK RETENTION REQUIREMENTS SHOULD BE IMPLEMENTED ON TWO DIMENSIONS

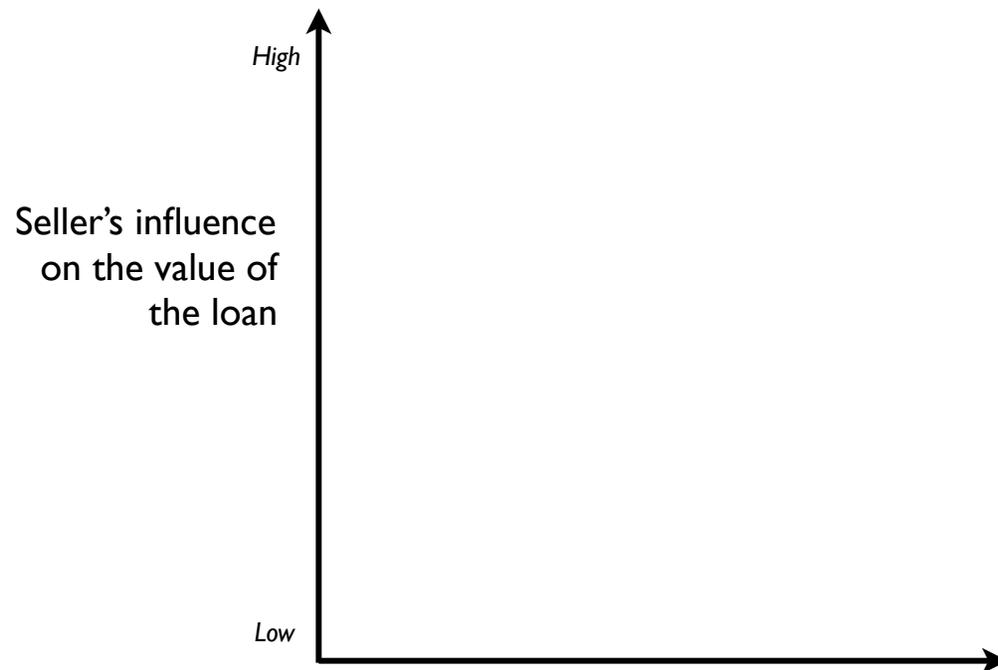
Potential Risk Retention Framework and Examples



- Twin objectives:
 - Prevent breakdown of performance-to-origination feedback loop ... *but*
 - Preserve liquidity throughout capital structure
- Not all products & channels are created equal
- Not all market-driven structures were broken (e.g. credit card residuals)

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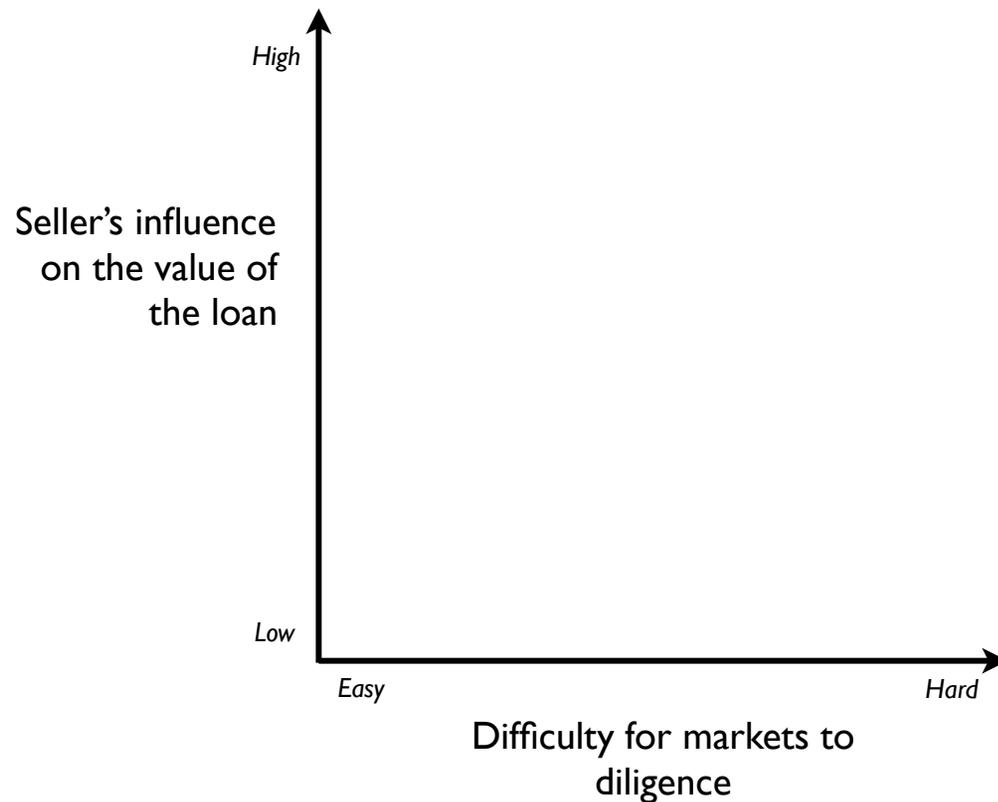
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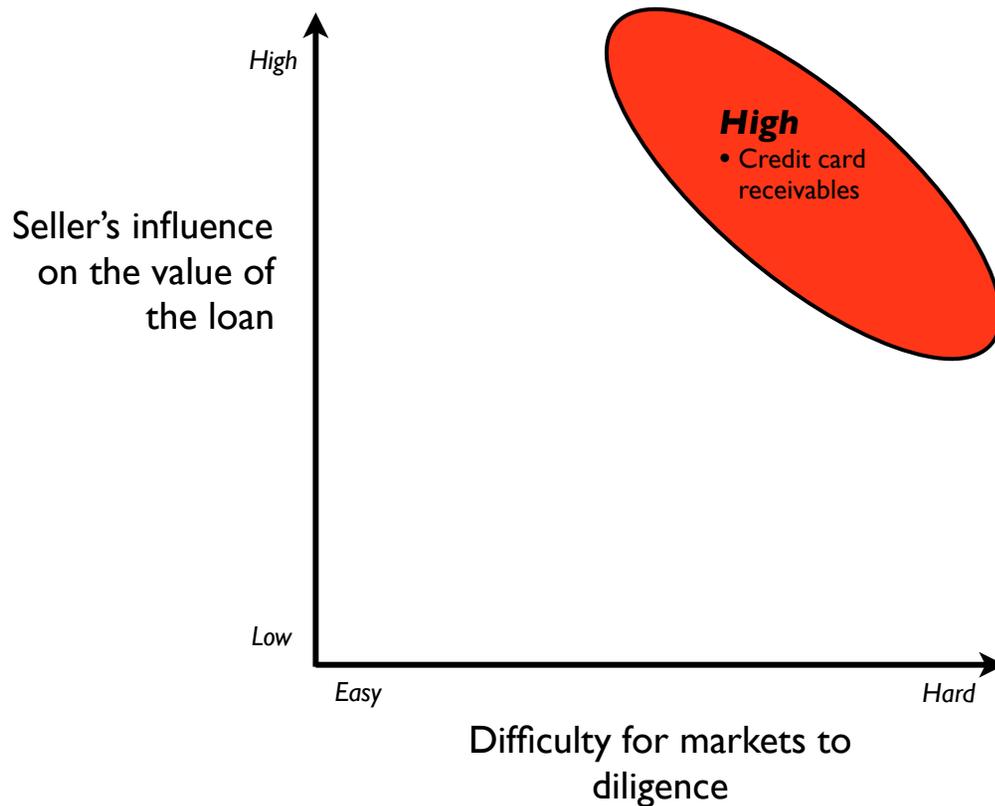
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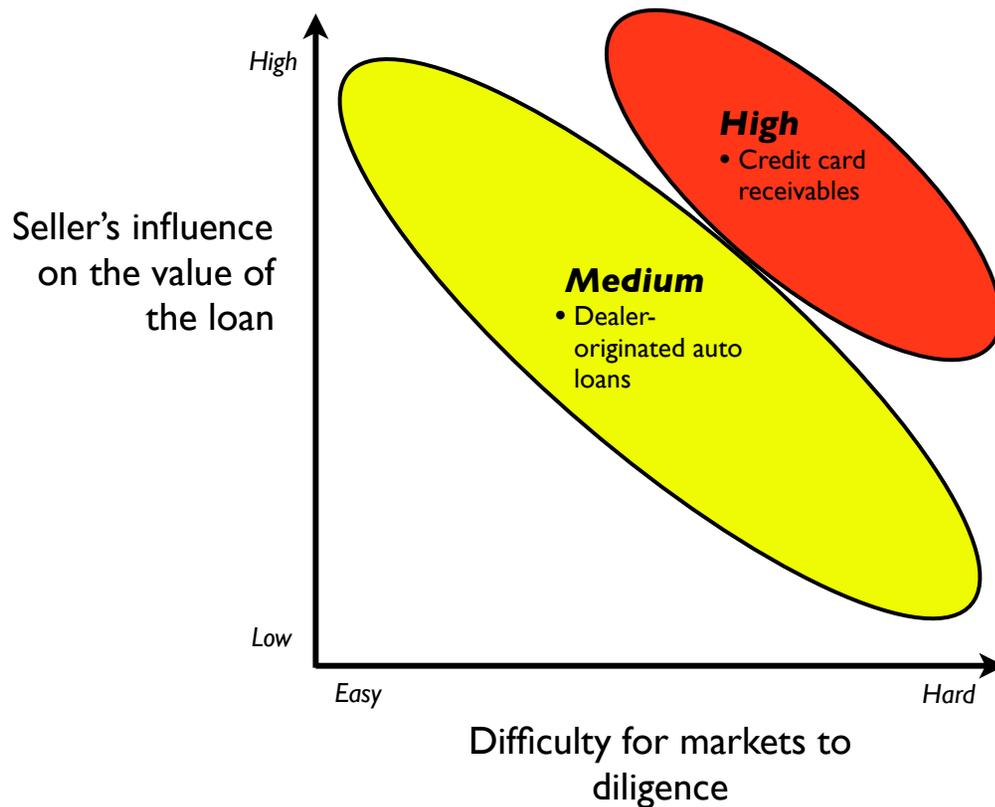
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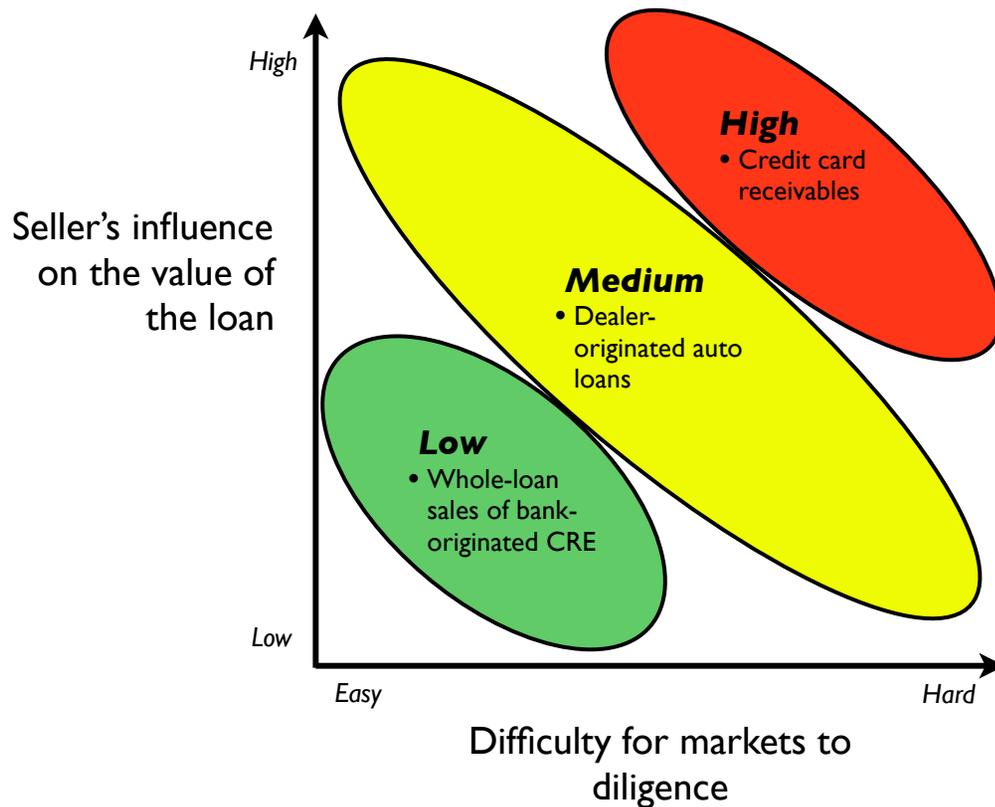
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