

**CAMBRIDGE WINTER CENTER**

for Financial Institutions Policy

# Mitigating the “Scalability of Bad Practices” in Consumer Finance

Raj Date

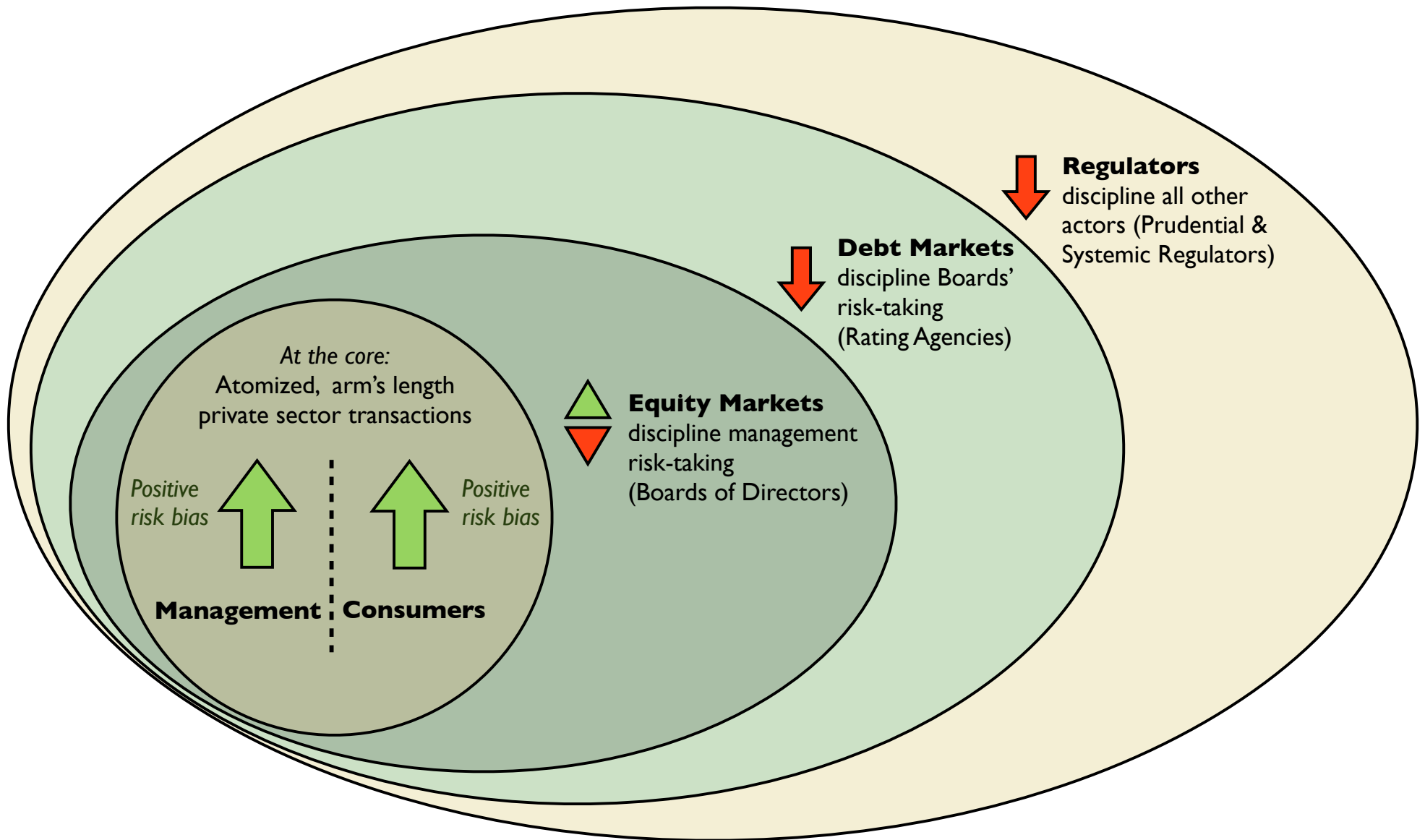
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Conference on Regulating Consumer Financial Products

Federal Reserve Bank of New York

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



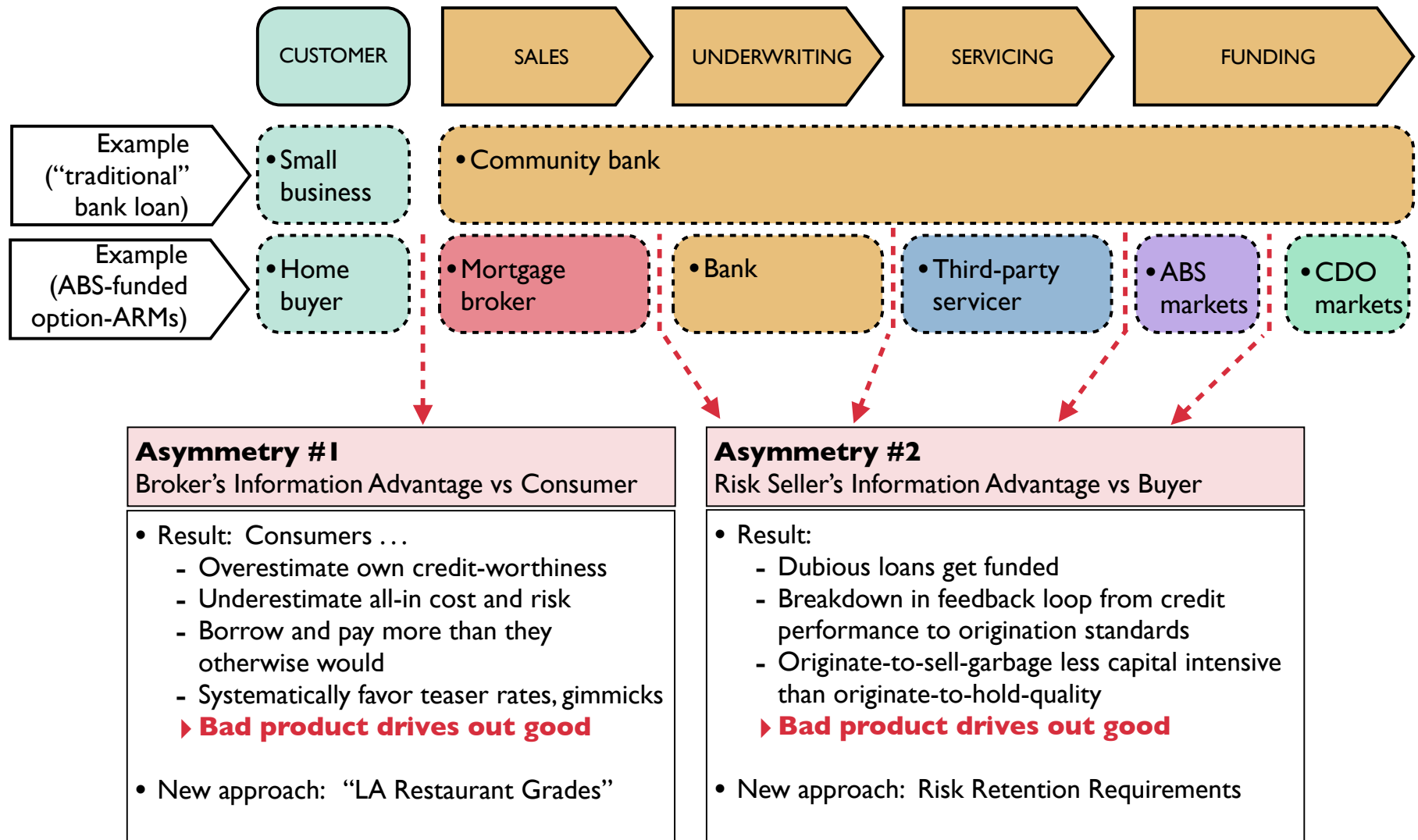
## REGULATING CONSUMER FINANCE IS HARD BECAUSE OF “THE SCALABILITY OF BAD PRACTICES”



- “Bad” products quickly crowd out “good” ones
  - Bad for consumers
    - The “grandmother” test
    - Transparency, fairness, suitability
  - Bad for investors
- What enables this scalability of bad practices?
  - Broken ethics
  - Broken value transparency
  - Broken funding market feedback

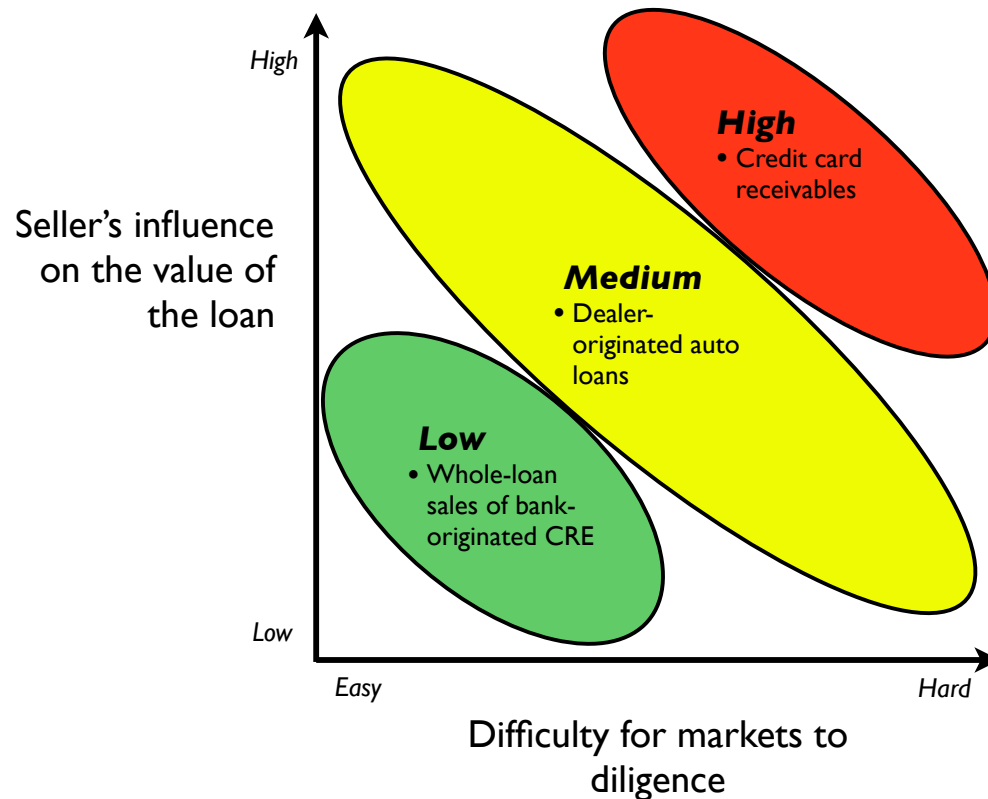
*Information Asymmetry*

# INFORMATION ASYMMETRY HELPS BAD PRODUCTS TO CROWD OUT GOOD ONES



# 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)