

See how fresh thinking can help redefine your IRA.



- Online Retirement Center with tools and guidance to help you manage your IRA
- Chartered Retirement Planning CounselorsSM to talk you through rollovers and transfers

OPEN AN IRA IN 15 MINUTES OR LESS

▶ GET STARTED

IBD FREE TRIAL

- Home
- Stock Research
- eIBD
- News
- IBD Editorials
- Education
- Community
- IBD TV
- Store

Enter Symbol/Keyword

- Get Quote
- Search Site

Commentary Editorial Cartoons

IBD EDITORIALS



PERSPECTIVE

Along The Flaming Paper Trail Of Crusader Elizabeth Warren

By ALAN REYNOLDS

Posted 08/27/2010 06:06 PM ET



Out to protect "uninformed" and "irrational" financial consumers — from themselves. AP [View Enlarged Image](#)

The Consumer Financial Protection Agency is the new kid on the block, a stranger among many agencies regulating financial institutions. The new kid has an agreeable name, but may turn out to be a bothersome nanny or the school bully.

The CFPA is the brainchild of Elizabeth Warren, Harvard law professor, author and head of a TARP oversight panel. She is obviously

eager to run the agency and, as a Washington Post article noted, "has received fervent backing from consumer advocates, labor unions, academics and scores of Democratic lawmakers. ... If Obama doesn't choose her, he risks infuriating his already-agitated liberal supporters."

Mother Jones added that "progressive groups" like MoveOn.org have "organized petitions and endorsement statements on her behalf."

All this liberal fervor and well-funded agitation looks suspicious. Why do liberals talk, write and petition as if it would make such a huge difference if one person rather than another ran this supposedly kind and gentle new agency? What do they know that you don't?

Warren's writing about the mission of the CFPA provides a preview of what she might try to do with that agency's capricious power. Her most serious effort to promote a CFPA appeared in a rambling 100-page article in the November 2008 Pennsylvania Law Review, "Making Credit Safer." Although it was co-authored with Oren Bar-Gill of New York University, it simplifies things to refer to it as Warren's paper.

Her thesis is that "many consumers are uninformed and irrational," so they need to be protected from themselves. For example, "over half of all African-American and Hispanic borrowers" suffer from "misplaced trust in lenders and mortgage brokers."

Warren cites a newspaper article that suggested mortgage brokers steered borrowers toward subprime loans to collect kickbacks. A few pages later, borrowers are said to be irrational because of a survey that "revealed a significant bias against mortgages generated by brokers."

Registration Benefits

IBD Forums

Participate in an IBD Forum and connect with other IBD subscribers.

Free IBDeditorials Newsletter!
Get the latest cartoons & commentary from IBD...
▶ GET IT NOW!

Three of the many reasons why TD AMERITRADE could be right for you.

- Fair, straightforward pricing
- Independent, third-party research
- Clear, objective guidance

▶ ROLL OVER TO PLAY VIDEO

TRADE FREE FOR 30 DAYS + GET \$100

▶ SIGN UP NOW

Attend an IBD Workshop [Click Here](#)

Most Popular

Most Viewed Highest Rated

- All
- Articles
- Media

- [How 'Brilliant' Can President Obama Be?](#)
- [Stocks Add Big Gains In Faster Volume](#)
- [Crying Bigotry: Last Refuge Of The Liberal](#)
- [Run Like A Deere From Cap-And-Trade](#)
- [IBD Market Wrap - 08/27/2010](#)

08/30/2010 09:00:21 AM ET

Investing Tip

Don't use P/E ratios to make your stock buying decisions. The P/E ratio is the result of a stock's price move, not the cause of it.



How dumb are we? Well, says Warren, "Many consumers do not know their credit scores." Count me among those irrational consumers. I vet yearly credit reports for errors, but do not pay the fee to see my scores.

Warren finds it irrational that "a majority of consumers who accepted a credit card offer featuring a low introductory rate did not switch out to a new card with a new introductory rate after the expiration of the introductory period," and then keep switching cards again and again. Such an endless flood of new credit application would, of course, threaten those credit scores.

Warren has repeatedly argued that the "most striking" evidence "that errors are prevalent" in the mortgage market is that "a substantial number of middle-income families (and even some upper-income families) with low default risk sign up for subprime loans. Because these families qualify for prime-rate loans, these data indicate a very costly mistake on the part of these middle-income borrowers."

This is the Warren Myth. Although Warren imagines "the evidence of prime consumers taking subprime loans is most striking," that was the first of "Ten Myths of the Subprime Crisis" debunked by economist Yuliya Demyanyk in a 2009 paper for the Federal Reserve Bank of Cleveland.

Contrary to Warren, Demyanyk explains that prime consumers taking subprime loans is not, in fact, "evidence ... that such borrowers must have been steered unfairly and sometimes fraudulently into the subprime market." What the Warren Myth fails to grasp is that "subprime mortgages are defined in a number of ways — not just by the credit quality of borrowers."

"A loan can be labeled subprime," Demyanyk notes, "because of the type of lender that originated it, features of the mortgage product itself or how it was securitized." Some types of mortgages were automatically labeled subprime, for example, such as "2/28 hybrids" that in 2005 started with average rates of 7.5% for two years but switched to an adjustable rate.

Many mortgages were also securitized into pools that defined risk differently, so a borrower with a high credit score but a low down payment could easily end up within a pool that became defined as consisting primarily of subprime loans — not of subprime borrowers (as gauged by credit scores).

Warren depicts all borrowers as innocent victims. She even includes the "liar's loan" as an example of "innovations that have exploited consumers' imperfect understanding of complex credit products."

Many borrowers who chose low-down-payment subprime loans in 2004-06 were spendthrifts who refinanced into larger mortgages in order to cash out equity and get more cash. The average down payment on subprime loans in 2006 was only 6%, according to the Dallas Fed, compared with 12% for near-prime loans.

Nearly all of those subprime loans were used for refinancing. The smaller the down payment or lower the documentation the higher the risk, which makes such loans worthy of a subprime designation regardless of the borrower's credit history. Speculators hoping to flip houses for a quick tax-free capital gain likewise had a powerful incentive to minimize down payments.

Warren offers a bizarre explanation of the foreclosure crisis. She thinks "the high rate of foreclosures in the subprime market suggests that not all consumers knowingly assumed such a high risk of foreclosure."

What happened is that many who knowingly became overleveraged did not expect to lose their job, or to see house prices collapse, or both.

Trading Center

TradeKing - Only \$4.95 per trade, market or limit

Trade free for 30 days at TD AMERITRADE.

Practice No Risk Trading at optionsXpress

Trade Now at Fidelity

thinkorswim: join the revolution! Member FINRA SIPC

E*TRADE SECURITIES LLC Trade Free for 60 Days. E*TRADE Securities.

IBD Workshops

- Lessons on Buying Stocks
- Lessons on Selling Stocks
- What is CAN SLIM?
- How to Invest in Options
- Investing Education Videos

Warren finds more proof of consumer stupidity from a survey finding "30% of Americans did not know what the letters 'APR' stand for." But most Americans, including blacks and Hispanics, can tell the difference between one year and two weeks.

Warren, by contrast, converts a \$30 fee for a two-week \$200 loan into "an annual interest rate of almost 400%." That would be true if anyone kept rolling it over all year, as some do with credit cards. In reality, borrowers understand they're paying 15% to get \$100-500 a couple of weeks early. That can be cheaper than a bounced-check fee.

Warren says "paying a 400% interest rate ... is very difficult to rationalize when the borrower can draw on substantial liquid assets." The study she cites, however, is not about liquid assets, but about "\$1,000 of credit card liquidity."

When it comes to credit cards, though, Warren finds "further evidence of seemingly irrational consumer behavior. The most striking data show that ... more than 90% of consumers with credit card debt have some very liquid assets in checking and savings accounts."

It is rarely prudent to empty your checking and savings accounts to pay off one bill out of many. Warren nonetheless finds it striking that "one-third of credit card borrowers hold more than one month's income in these liquid assets." Investment advisers suggest keeping enough cash on hand to cover three to six months of expenses.

What does Warren dream of doing with all the power that Congress has so capriciously bestowed on this new agency? She would most like to impose national usury laws.

Prior to a 1978 Supreme Court ruling, Warren notes, "The linchpin of consumer credit regulation was usury law. ... (State) usury laws regulated credit by imposing a cap on the interest rate that any lender could charge." Today, however, "any lender with a federal bank charter can locate its operations in a state with high usury rates (e.g., South Dakota or Delaware) and then export that interest rate to customers located anywhere else in the country."

Any economist will tell you that ceilings on interest rates would simply ration-out all but the most creditworthy borrowers, particularly hurting young people and business startups. But Warren is no economist. She's no investment adviser either.

Warren's writing about consumer irrationality in the markets for mortgages, credit cards and payday loans displays massive misinformation and unwarranted hubris. Her nostalgia about usury laws is economically illiterate and potentially disastrous.

The Financial Reform Act was commonly described as "rewriting the rules" of lending. But it was mostly about delegating vast new discretionary powers to regulators who can later make up rules by whim and enforce them with stiff penalties.

Nobody doubts Warren's personal charm or missionary zeal, but her qualifications and competence merit a much closer look.

- Reynolds is a senior fellow with the Cato Institute, and author of "Income and Wealth."

Avg. Rating: (13) Your Rating: ☆☆☆☆☆

Email | Print | Comment | License

« [Previous Article in Perspective](#)

See Also

- [From World Wars I And II To 9/11, Lessons In Late-Summer Cataclysm](#) 08/26/2010 07:00 PM ET
- [Mideast Peace Process A Threat To Peace](#) 08/25/2010 06:15 PM ET
- [The Peace Process Mirage](#) 08/25/2010 06:10 PM ET
- [Climate Change Lawsuits Heat Up, Led By An End Run In Connecticut](#) 08/24/2010 06:17 PM ET
- [Barney Frank Comes Home To The Facts](#) 08/23/2010 07:10 PM ET

Comments Showing 11-12 of 12

[Leave a comment](#)

« [First](#) | « [Previous](#) 0 [Next](#) » | [Last](#) »

Posted By: investorLoonie1(745) on 8/27/2010 | 9:47 PM ET

Imagine , someone out there trying to stop right wingers stealing from the poor. No wonder the Fascist Business Daily is upset. Most thieves hate any obstacles being put in their way. Just like FBD and the right hate this consumer protection agency.

Posted By: longplay(230) on 8/27/2010 | 9:18 PM ET

"How dumb are we? Well, says Warren, "Many consumers do not know their credit scores." The people for whom knowing a credit score is important are, I'll bet, those who shouldn't be paying on credit or borrowing a dime - and they know it. You don't need a credit score to know an unpaid bill or two when you see it. By the way, does Ms. Warren know her prospective employer's credit score? I have a feeling it's pretty dismal.

« [First](#) | « [Previous](#) 0 [Next](#) » | [Last](#) »

Leave a Comment

[Back to Top](#)

To participate in Community areas, please [Sign In](#) or [Register](#)

Stock Research IBD Charts Stock Checkup Screen Center Options Center ETF Center IBD Indexes Daily Graphs Online	eIBD Investing Business Economy Technology Management Politics Blogs Special Reports Econ Calendar	IBD Editorials Editorial Cartoons	Education Daily Stock Analysis Online Courses Ask IBD Financial Dictionary IBD Workshops	Community Forums Meetups Calendar	IBD TV	Store
---	--	---	--	---	---------------	--------------

Get Quote Search Site

IBD® Home Study Program
 Take IBD's Level I Investing Workshop on Your Schedule! [Check It Out](#)

Life Insurance Withou...
www.QuoteWhiz.com/Te...

Looking For The Best ...
www.stockpreacher.com

[Home](#) | [About IBD](#) | [Advertising](#) | [Contact Us](#) | [Classifieds & Partner Offers](#) | [Retail Locations](#) | [IBD Editorials](#) | [CAN SLIM Advisors](#) | [Affiliates](#) | [Stock Pages](#)

Investor's Business Daily, IBD and CAN SLIM and their corresponding logos are registered trademarks of Data Analysis Inc. © 2000-2010 Investor's Business Daily, Inc. All rights reserved. [Copyright and Trademark Notice](#) | [Privacy Statement](#) | [Terms and Conditions of Use](#)

© 2010 William O'Neil + Co. Incorporated. All Rights Reserved. The William O'Neil + Co. Database and all data contained herein are provided by William O'Neil + Co. Incorporated and are used by IBD under license agreement. Daily Graphs and Daily Graphs Online are trademarks of William O'Neil + Co. Incorporated or its subsidiaries.

This site is powered by Interactive Data Corp. Real Time Services market data. Price and Volume data is delayed 20 minutes unless otherwise noted, is believed accurate but is not warranted or guaranteed by Interactive Data Corp. Real Time Services and is subject to Interactive Data Corp. Real Time Services terms. All times are Eastern United States.

