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Introduction to Financial Services: Consumer Finance

Consumer finance refers to the borrowing, saving, and investment choices that people (i.e., households) make over time. These financial decisions can be complex and can affect financial well-being both now and in the future. Understanding why and how consumers make financial decisions is important when considering policy issues in consumer financial markets. Research on household finance suggests that all of the components of a household's finances—income, consumption, savings, assets, and debts—are important to understand its financial experience over time.

Safe and affordable financial services are an important tool for most Americans as they work to achieve financial security over the course of their lives. People use three types of financial products: credit, insurance, and financial investments. This CRS product focuses on the first category—credit products (loans) for household purposes.

Consumer Debt

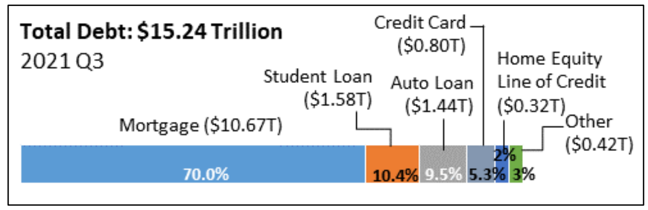
Households typically borrow money for the following reasons:

- **Asset building.** Using credit to make investments can allow a household to build wealth over time (e.g., a mortgage or student loan).
- **Consumption smoothing.** Using credit to buy and consume now and pay later (e.g., a credit card).
- **Financial shocks or emergencies.** Using credit to pay for unexpected expenses, such as a car or home repair, a medical expense, or a pay cut (e.g., a payday loan).

Most households rely on credit to finance some of these expenses, either to avoid having to postpone consumption until sufficient funds have been saved or to avoid having to liquidate wealth that is being accumulated for other purposes, such as retirement.

According to the Federal Reserve Bank of New York, mortgage debt is by far the largest type of debt for households, accounting for approximately 70% of household debt. Student debt (10.4%) is the second-largest household debt, followed by auto loans (9.5%) and credit cards (5.3%). As of the third quarter of 2021, household debt totaled $15.24 trillion. (See **Figure 1** for more information on household debt as of the third quarter of 2021.)

Figure 1. Household Debt Breakdown in Q3 2021



Source: Federal Reserve Bank of New York, Center for Microeconomic Data, *Quarterly Report on Household Debt and Credit*, 2021.

Consumer Lending Regulation

In economic theory, consumer lending markets that are competitive should lead to efficient outcomes for consumers; yet, sometimes, market inefficiencies may be observed. Common issues in consumer financial markets include (1) information asymmetries between financial firms and consumers and (2) behavioral biases that predictably bias consumers when making financial decisions. In these cases, government policy can potentially bring the market to a more efficient outcome. Policymakers must monitor the benefits and costs of various regulatory approaches to determine whether a policy intervention will help or harm the market.

Although each consumer financial market is governed by various distinct laws and regulations, three types of policy interventions are common.

1. **Standardizing consumer disclosures.** Financial products can be complex and difficult for consumers to fully understand. Mandated consumer disclosures are generally intended to give consumers more information about the costs and terms before they take out new loans, thus reducing information gaps in understanding. Standardized disclosures can also help consumers shop for the best terms, because all financial product terms are required to be disclosed in the same way.
2. **Preventing unfair, deceptive, or abusive practices or acts.** Consumers seeking financial services could be vulnerable, because some consumers may lack financial knowledge or be susceptible to behavioral biases. For this reason, certain consumer protection laws prohibit unfair, deceptive, or abusive acts or practices. These acts and practices can include both individual firm conduct and product features.
3. **Ensuring fair lending.** Fair lending laws prohibit discrimination in credit transactions based upon certain borrower characteristics, such as sex, race, religion, and age. These laws have historically been interpreted to prohibit discrimination, whether intentional or due to *disparate impact*, in which a

facially neutral business decision has a discriminatory effect on a protected class.

Consumer Financial Protection Bureau

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) established the Consumer Financial Protection Bureau (CFPB) to implement and enforce federal consumer financial law while promoting fair, transparent, and competitive markets for consumer financial services and products.

The CFPB may regulate providers of an array of consumer financial products and services, including deposit taking, mortgages, credit cards and other extensions of credit, loan servicing, consumer reporting data collection, and consumer debt collection. The CFPB's authorities fall into three broad categories: *rulemaking* (writing regulations to implement laws under the CFPB's jurisdiction), *supervision* (the power to examine and impose reporting requirements on financial institutions), and *enforcement* of various consumer protection laws and regulations. The act also directed the CFPB to develop and implement financial education initiatives, collect consumer complaints, and conduct consumer finance research.

Selected Policy Issues

This section highlights selected policy issues of congressional interest relating to consumer finance.

The Economic Impacts on Consumers of the COVID-19 Pandemic. Since the onset of the COVID-19 pandemic, many Americans have lost income and had difficulty paying their debts. *Loan forbearance* has become a common form of consumer relief during the COVID-19 pandemic. Loan forbearance plans are agreements that allow borrowers to reduce or suspend payments for a short period of time, providing extended time for consumers to become current on their payments. These plans do not forgive unpaid loan payments. The CARES Act (P.L. 116-136) established consumer rights to be granted forbearance for many types of mortgages (Section 4022) and for most federal student loans (Section 3513). Moreover, financial regulatory agencies responded to the COVID-19 pandemic using existing authorities to encourage loan forbearance and other financial relief options for affected consumers. Although these efforts have prevented many consumers from falling delinquent so far, as these programs expire, it is difficult to predict how the ongoing pandemic will impact consumer credit markets in the future.

CFPB Regulation and Structure. In the decade since the CFPB was created, it has been actively engaged in many rulemakings. Policy debates concern whether the CFPB has appropriately balanced protecting consumers, credit access, and costs to industry. Significant and contentious CFPB rulemakings have regulated the payday lending and small-dollar credit market, the mortgage market, and the debt collection market. In addition, the CFPB's structure and budget continue to be debated by Congress.

Debt Collection. When a consumer defaults on a debt, lenders often hire third parties to collect those debts. Consumers have no say over the debt collectors that lenders choose, arguably making consumer protection laws and regulations particularly consequential in this market. The CFPB recently finalized two new regulations to implement the Fair Debt Collection Practices Act (15 U.S.C. §§1692-1692p), which regulates the third-party debt collection market. The rules clarify how debt collectors may communicate with consumers and the information debt collectors must disclose to consumers. Policy issues related to debt collection include debt collector communication frequency, how time-barred or obsolete debts should be treated, and debt validation.

Credit Reporting. The credit reporting agencies (also called *credit bureaus*) collect and subsequently provide information to firms about the behavior of consumers when they participate in various financial transactions. Firms use consumer information to screen for consumer risks. For example, lenders rely upon credit reports and scores to determine the likelihood that prospective borrowers will repay their loans. Various policy issues related to credit reporting include how to address inaccurate or disputed consumer information; how to ensure consumers are aware of their rights, such as the right to dispute inaccurate information; and what information is fair to include in consumer credit reports, for example, whether medical debt or new types of consumer data should be included.

Financial Technology. Financial technology, or *fintech*, refers to financial innovations that apply new technologies to financial services or products. Related policy questions include whether the current regulatory framework appropriately fosters technological benefits while mitigating potential risks to consumers. The CFPB has launched several programs designed to reduce regulatory uncertainty for fintech products, facilitate industry and stakeholder coordination, and learn more about fintech services and products through research projects. The agency is developing a new rule that would clarify standards around consumer-authorized access to financial data.

CRS Resources

CRS Report R45813, *An Overview of Consumer Finance and Policy Issues*

CRS Insight IN11550, *COVID-19: Consumer Debt Relief During the Pandemic*

CRS In Focus IF10031, *Introduction to Financial Services: The Consumer Financial Protection Bureau (CFPB)*

CRS Report R46477, *The Debt Collection Market and Selected Policy Issues*

CRS Report R44125, *Consumer Credit Reporting, Credit Bureaus, Credit Scoring, and Related Policy Issues*

CRS Report R46332, *Fintech: Overview of Innovative Financial Technology and Selected Policy Issues*

CRS Insight IN11745, *Open Banking, Data Sharing, and the CFPB's 1033 Rulemaking*, by Cheryl R. Cooper

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