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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

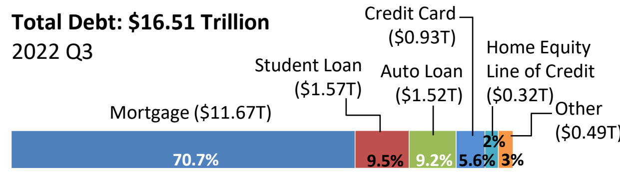
Households typically borrow money for the following reasons:

- **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 almost 71% of household debt. Student debt (9.5%) is the second-largest household debt, followed by auto loans (9.2%) and credit cards (5.6%). As of the third quarter of 2022, household debt totaled $16.51 trillion. (See **Figure 1** for more information on household debt as of the third quarter of 2022.)

Figure 1. Household Debt Breakdown in Q3 2022



Source: Federal Reserve Bank of New York, Center for Microeconomic Data, *Quarterly Report on Household Debt and Credit*, 2022.

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.

Financial Technology. Financial technology, or *fintech*, refers to financial innovations that apply new technologies to financial services or products, such as "peer to peer" payments, digital wallets, and "Buy Now, Pay Later" financing. The innovated use of technologies—including internet access, mobile technology, electronic payment improvements, alternative data, and artificial intelligence—to develop consumer financial products could potentially improve consumer experiences, lower costs, and expand access to underserved consumers. Fintech products could also pose consumer protection and data security risks. Related policy questions generally concern whether the current regulatory framework appropriately fosters the benefits of new technologies while mitigating potential risks to consumers.

The CFPB is developing a new rule to implement Dodd-Frank Section 1033 that would clarify standards regarding consumer-authorized access to financial data and could significantly affect the fintech industry. According to the CFPB, a goal of the rulemaking would be to enable consumers "to more easily and safely walk away from companies offering bad products and poor service and move towards companies competing for their business with alternative or innovative products and services." The rulemaking has the potential to lead to more consumer-friendly innovation and choice, but it could also introduce new risks to consumers.

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, Congress continues to debate the CFPB's structure and budget, including the degree of independence the CFPB should have from Congress. The CFPB, much like the banking regulators, is funded outside the traditional congressional appropriations process. The agency is funded via a transfer from the Federal Reserve System's combined earnings in an amount the CFPB director determines to be "reasonably necessary" to perform its statutory functions, subject to a cap. This nontraditional funding source limits congressional oversight of the agency and is the subject of legal challenges. A three-judge panel of the U.S. Court of Appeals for the Fifth Circuit, in *Community Financial Services Association of America v. CFPB*, ruled that the CFPB's funding is unconstitutional in violation of the Constitution's Appropriations Clause and separation of powers. The Department of Justice, on behalf of the CFPB, petitioned the Supreme Court for a writ of certiorari to review and reverse the Fifth Circuit's decision.

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 ensure data security and privacy; how to address inaccurate or disputed consumer 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.

CRS Resources

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

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

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

CRS In Focus IF12079, *Digital Wallets and Selected Policy Issues*

CRS Insight IN11784, *Rapidly Growing "Buy Now, Pay Later" (BNPL) Financing: Market Developments and Policy Issues*

CRS Insight IN11745, *Open Banking, Data Sharing, and the CFPB's 1033 Rulemaking*

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

Cheryl R. Cooper, Analyst in Financial Economics

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