



Tuesday, August 6, 2013

Revolving Door Regulators

Senator yesterday. Lobbyist today.

Representative yesterday. CEO today.

Cabinet level appointee yesterday. Bank Chairperson today.

Government Agency Director yesterday. Law firm senior partner today.

CFPB Regulator yesterday. Competitor today.

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The Inside-Outside Gambit

There are many forms of corruption. Perhaps the most pernicious is where an elected or duly appointed representative of the citizenry leaves office to use the sloughed off position for financial gain in the private sector.

Let's set up a definition for such (mostly unregulated) behavior. I will give it a phrase: "inside-outside gambits."

What is an inside-outside gambit? It is the use of information obtained in the course of a former governmental position by an official for financial gain, directly or indirectly, soon or immediately after leaving government employment in that position. Such information includes contacts with decision-makers in the government; providing information about proprietary conversations leading up to the promulgating of laws, rules, and regulations; access to insiders and knowledge of their views; navigating the systemic and organizational structure; non-public facts regarding the governmental plans or condition that could provide a financial advantage. Note that I use the phrase "inside-outside," not "insider trading."

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I am not talking about a situation where there is the illegal trading of a public company's stock or other securities (such as bonds or stock options) by individuals with access to non-public information about the subject company (such trading being illegal).

However, the effect of "inside-outside gambit" and "insider trading" is practically the same: these strategies lead to an unfair, usually economic, advantage.

A basic concept of law is that an injury must be sustained by a plaintiff. Broadly speaking, no injury, no case.

So who is harmed when an equity trader uses inside information for personal financial benefit? The public, of course. Certainly, that part of the public that invests in the stock market, relying on rules, regulations, and laws to be impartially applied, with equal access to all. And who is harmed when a former government official uses inside information for personal financial benefit almost immediately after being employed in the government position. Of course, the public. Certainly, that part of the public that relies on rules, regulations, and laws to be impartially applied, with equal access to all.

How about when regulators in the most powerful agency that regulates the origination of residential mortgage loans, the Consumer Financial Protection Bureau (CFPB), leave that agency and start a mortgage company soon after leaving the CFPB, to compete or partner with mortgage companies?

When Thomas Jefferson advocated that legislators should have term limits in order to prompt the return to private life in order to live under the rules they promulgated, somehow I don't think this is what he had in mind.

In a letter of 1776, Jefferson wrote:

[His] "reason for fixing them [elected representatives] in office for a term of years rather than for life was that they might have an idea that they were at a certain period to return into the mass of the people and become the governed instead of the governor, which might still keep alive that regard to the public good that otherwise they might perhaps be induced by their independence to forget."

In other words, Jefferson viewed public service as a privilege. He fully expected government officials to return to private life and live under the laws they passed. I quite doubt that he viewed such a return to be a means for an ex-official's self-enrichment, by utilizing public service to exploit – or even appear to exploit - the very laws promulgated by the ex-official.

The Four Horsemen

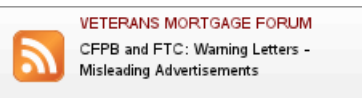
On July 31, 2013, the [House Committee on Oversight and Government Reform](#) and the [House Committee on Financial Services](#) sent an eight page Congressional letter (Letter) to Richard Cordray, the Director of the Consumer Financial Protection Bureau (CFPB). Signed by a bi-partisan group of Representatives, it expressed concern about the recent departure from the CFPB of four high level officials. The Letter forms the basis of further inquiries by the Committees. Noting a news report, the Representatives indicated it appears that certain officials "have left the CFPB in order to profit from rules they helped create."

Who are these individuals? What were their former CFPB positions?

First, there is Raj Date, former Deputy Director of the CFPB, who left the CFPB on January 31, 2013, shortly after a whole set of Final Rules were issued. (Of course, he gave the unimaginatively standard reason: to spend more time with this family.) Yet a month and a half later he incorporated an "advisory and investment firm," Fenway Summer LLC" (Fenway), which focuses "on those borrowers who do not meet the standards for 'qualified mortgages' as set by the CFPB under rules." If you would like to know more about this new firm, you can visit its website at <http://www.fenwaysummer.com>. (Website)

Promoting himself now as the "first-ever Deputy Director" and the Bureau's "second-ranking official," Mr. Date describes his responsibilities as helping to "steward the CFPB's strategy, its operations, and its policy agenda."

Next in line are the recruits to the new firm. Mr. Date was joined by three other former CFPB big shots: Garry Reeder, Chris Haspel, and Mitch Hochburg.



Mr. Reeder was the Chief of Staff of the Bureau, where, among other things, he was "directly involved with the creation and establishment of the Research, Markets & Regulations division." (Website)

Mr. Haspel served on the Bureau's Mortgage Markets team as its "senior expert in residential mortgage servicing and securitization;" indeed, he "managed many of the CFPB's efforts in developing and executing mortgage policy and led Mortgage Markets' efforts in developing the CFPB's mortgage servicing rules." (Website)

And then there is Mr. Hochburg, who served on the Mortgage Markets team as another "senior expert in residential mortgage servicing and securitization", in which position he "managed many of the CFPB's efforts in developing and executing mortgage policy and led Mortgage Markets' efforts in developing the CFPB's mortgage servicing rules." (Website)

Their positions now at Fenway?

Raj Date: Managing Partner

Garry Reeder: Partner and Head of the Advisory Practice

Chris Haspel: Partner and the Head of Capital Markets

Mitch Hochburg: Partner and General Counsel

Other people Mr. Date and his cohort picked away from the CFPB are Alison Miller, former Deputy Executive Secretary for the Bureau, now a Director at Fenway; and Sean O'Mealia, former Project Manager in the Card and Payment Markets group in the Office of Research, Markets, and Regulations, now a Director at Fenway. (Website)

A Business Model for Former Regulators

Before us we see emerging a business model that, if it works for these former regulators, just might work for others similarly situated.

What might that model look like? Let's speculate.

Some basic steps must be deployed.

Step One: You become employed by the government as a regulator.

Step Two: If and when possible, you rise up in the ranks of regulators.

Step Three: You gain decisive authority over regulatory rules and regulations.

Step Four: You give speeches and publicly opine to build your credibility and prestige.

Step Five: You develop rapport with superior, lateral, and subordinate regulators and also politicians.

Step Six: You plan a private, commercial enterprise that advises on the regulatory rules you promulgated.

Step Seven: You approach certain other regulators to join you in your plan. (Steps Six and Seven are interchangeable.)

Step Eight: When the time is right, you resign to spend more time with your family.

Step Nine: Shortly thereafter, you start a company to compete with and/or advise and/or partner with firms that must abide by the regulatory rules you promulgated.

Step Ten: You become the Regulatory Oracle, the Guy-with-the-Roller-Deck, the Man with the Connections, the Mister Know-It-All, the Guide to the Perplexed, the awesome Business Leader.

(And still, now more than ever, you get to make speeches and publicly opine!)

Voila! The whole process can be completed in just a few years or even sooner!

Partners in Business

What does Fenway do?

It appears that Fenway has two services at this time.

In the first place, it is an advisory service, specializing in helping its "partners **design and launch responsibly designed consumer finance offerings,**" with the intention "to

reshape consumer finance into a trusted industry by supporting products that solve problems for people." But it doesn't seem to stop at acting in a "design and launch" advisory capacity. Specifically, Fenway's website states that "such products can be both profitable and sustainable, which is why **we co-invest with our partners**, sharing in the risk and success of new offerings." (Emphases added.) (Website)

The second service is associated with investments; in particular, co-investing "in products developed with advisory partners, sharing the risk and success of these new offerings," including a claimed specialty "in building new consumer financial institutions from the ground up." (Website)

Interestingly, Fenway has a "**signature investment**," which is investment "in new business that will **originate non-Qualified Mortgages**." (Emphases added.) (Website)

Ironically, Fenway's motto is: "Rebuilding Consumer Finance on a Foundation of Trust." (Website)

As Jefferson would say, to "become the governed instead of the governor." Got it!

Making a Market in Non-QM

In ancient Greece, the market place was called an Agorá. The word itself derives from the notion of a place for people to assemble. Much of economic and political life of a Greek town or city took place in the Agorá. The Agorá was a cultural feature of the Greeks' way of doing business. Market value, you might say, had its roots in such and similar market places. But are the QM and Non-QM markets an Agorá?

One of my concerns with the Ability-to-Repay, QM, and Non-QM rules set forth by the CFPB - a requirement necessitated by Sections 1411 and 1412 of the Dodd-Frank Wall Street Reform and Consumer Protection Act - has been that a market is not organically forming to price QM and Non-QM loans (which I shall call "NQM"). Practically speaking, these markets are being manufactured by the CFPB.

Obviously, the risk associated with the NQM loan is much higher than the QM loan. So a new market must emerge for the NQM. However, it is not a market that comes into being as a result of market action itself; rather, the NQM market comes into being because certain regulators and politicians manufactured it. Very few markets begin this way. And historically speaking, they are not stable.

Yet here comes Fenway to help companies to navigate this new market's regulations. Ready to "design and launch" offerings in which it takes equity interests. And the former regulators who manufactured the market's rules? Now Partners and Directors of Fenway. This is the nascence of a new kind of market maker, literally.

"Although the CFPB is now two years old, it remains 'something of a mystery to many market participants as it ramps up operations.' (see Nick Timiraos & Alan Zibel, "Rides Set for Home Lenders," WSJ, 1/10/13) This lack of transparency has apparently incentivized Mr. Date and other CFPB alumni to create a **cottage industry** unique to the Bureau's regulatory agenda. Simply put, it appears that former CFPB employees are now offering financial products in a market sector created by the very rules they were in a position to influence while working in senior leadership positions at the CFPB." (Letter) (Emphasis added.)

"Richard Painter, a former White House ethics officer, characterized Fenway as '**an extortion racket**' that 'hire[s] alumni of the agency and they'll call up their buddies in the agency to call off the dogs.'" (Letter) (Emphasis added.)

"According to Mr. Date's own estimates, non-qualified mortgages may make up as much as \$1.5 trillion of the \$10 trillion home-loan market, a market that Fenway is uniquely positioned to serve." (Letter)

Keep in mind that the QM rules began in drafting on or about February 17, 2011. The aforementioned, former CFPB senior leadership, now Partners of Fenway, were certainly involved in the drafting of these rules, directly or indirectly.

Timeline

The following is the ostensible timeline for certain salient facts in this matter, since the issuance of the Final Rule:

- January 10, 2013: CFPB issues the Final Rule on Ability-to-Repay and Qualified Mortgages.
- January 30, 2013: The Office of the Federal Register publishes the Final Rule.
- January 31, 2013: Mr. Date leaves his Deputy Director position at the Bureau with "no current plans for his career after the CFPB, other than to spend more time with his family."
- March 11, 2013: Mr. Date incorporated Fenway, a firm that focuses "on those borrowers who do not meet the standards for 'qualified mortgages' as set by the CFPB under the Final Rule.

What did they know, and when did they know it?

In the last twelve months or so, the CFPB's employee attrition rate has skyrocketed. Many CFPB personnel, including individuals in senior leadership positions, have left the Bureau to get into the commercial space. At a recent conference, a former, senior CFPB employee who now holds a senior position in a consulting firm, began his presentation with the remark that, among other things, the pay is much better! Considering that the CFPB is paying exceedingly high salaries, in some instances far above the salaries available in private businesses, that must be a considerable sum! Why did that consulting firm pay so much to this former CFPB regulator?

After Mr. Date's incorporation of Fenway, few regulators or politicians seemed to take much notice.

Indeed, it was only after the revelations brought forth by the investigative journalism of several fine reporters that anybody ventured an opinion on this matter. And it is just very recently that considerable coverage and Congressional scrutiny has commenced.

Is it possible that the Director, the Acting Director, the senior leadership, and other personnel of the CFPB, did not see the appearance of impropriety or potential for conflict of interest?

I have a few questions.

- What documents and communications were exchanged between Mr. Date, Mr. Reeder, Mr. Haspel or Mr. Hochburg and any other official at the CFPB referring or relating to Fenway between February 17, 2011 and the present?
- When did Mr. Date communicate with any CFPB employee or agent, referring or relating to the conception, design, or mission of Fenway, at least as far back as February 17, 2011?
- What documents and communications were exchanged between any partner or employee of Fenway and any CFPB employee or agent between March 11, 2013 and the present?
- What documents and communications were exchanged between Mr. Date, Mr. Reeder, Mr. Haspel or Mr. Hochburg and any other official at the CFPB referring or relating to the drafting of the qualified mortgage rule between February 17, 2011 and the present?
- Precisely what is the full description of the business model of Fenway?
- When was the Fenway business model conceived and drafted?
- In addition to the Partners, who are the other investors in or advisors to Fenway?
- What companies, subject to the QM and NQM rules, are being solicited by Fenway to form advisory and investment relationships?
- What companies, subject to the QM and NQM rules, are Fenway's current clients or relationship partners?
- What procedures are currently in place at the Bureau to mitigate or prevent conflict of interest and appearance of impropriety, with respect to prospective and existing employees of the CFPB, before, during, and after employment by the CFPB?

Extinguishing the Fire

Whether the appearance of impropriety or conflict of interest dominates the disputations of this matter, it is somewhat predictable that all the pertinent questions will not be resolved satisfactorily. In my view, damage has been done to the Bureau's reputation, prestige, and credibility. This damage has been done by members of its own senior leadership. The damage has been done by other senior leaders of the CFPB, allowing this unseemly debacle to happen in the first place. The QM and NQM rules have been controversial even from their inception in legislation, and this untenable situation makes them even more controversial.

It will take more than a Congressional hearing to overcome the distrust that now unduly compromises the relationship between those governed by the CFPB's rules and the CFPB itself.

But this fire, however caused, must be extinguished quickly, completely, and with full accountability.

I shall let Thomas Jefferson's words be the best guide:

"If our house be on fire, without inquiring whether it was fired from within or without, we must try to extinguish it."

(Letter to James Lewis, Jr., May 9, 1798)

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Letter to Richard Cordray, Director, Consumer Financial Protection Bureau,
from Committee on Oversight and Government Reform
and the Committee on Financial Services
July 31, 2013



Labels: [Ability to Repay](#), [CFPB](#), [Consumer Financial Protection Bureau](#), [Dodd-Frank Act](#), [Fenway Summer LLC](#), [Non-Qualified Mortgages](#), [Qualified Mortgage](#), [Raj Date](#), [Richard Cordray](#)

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