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Lessons Learned: Diane Thompson

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Yale Program on Financial Stability
Lessons Learned

Diane Thompson

By Mary Anne Chute Lynch and Rosalind Z. Wiggins

Diane Thompson was of counsel at the National Consumer Law Center from 2006 to 2014, conducting policy advocacy on legal issues affecting low-income consumers during the housing crisis. Subsequently, she joined the new Consumer Financial Protection Bureau (CFPB), where she led the development of and provided guidance on federal consumer regulations in the areas of mortgage, fair lending, debt collection, credit reporting, and student loan servicing. She currently leads the Consumer Rights Regulatory Engagement and Advocacy Project, which she founded in 2020 to promote inclusive public engagement in regulatory work, particularly for low-income communities and communities of color and since 2021 has been senior adviser to the director of the CFPB. This "Lessons Learned" is based on an interview with Thompson held in September 2021; the full transcript may be accessed here.

Diverse viewpoints and opinions can fuel more effective crisis-fighting policies that better consider the impacts on individuals and communities as well as corporations.

As a consumer advocate, Thompson has scrutinized the government's crisis response from a viewpoint not often heard in discussions: that of individual homeowners and especially those from low-income communities and communities of color. She finds little fault with the government's spending on assisting large financial corporations. However, from her vantage point, the government's response was hobbled by its limited perspective. Other looming threats just as potentially dangerous as the buildup of risk and toxic assets in the large banks—the systemic infiltration of predatory practice into mainstream financial products and securities—were overlooked and minimized because of a certain myopia on the part of policymakers:

> Certainly, by 2000, many of us were ringing alarm bells at the Fed[eral Reserve] and saying, "We're seeing this happen in communities all across the country. There's no way this is sustainable. These loans are getting packaged and sold on Wall Street. They're in people's retirement accounts. This could create systemic risk." What we were consistently told by people at the Fed and other regulators is, "The problems of your clients will never lead to a national crisis. They're not big enough; they're not important enough; they're not systemic."
>
> [. . .] I do think that there was a bit of an echo chamber effect. The regulators largely are thinking about what's happening on Wall Street and in big financial firms and continued to think that the problems of the economy were really the problems of Wall Street firms and not of Main Street and communities across the country.

"Often, even when we think we're being impartial," said Thompson, "we're discounting some people's experiences and elevating and prioritizing others." The Fed and other policymakers thought that the foreclosure issues couldn't imperil the larger economy, Thompson said; history proved them wrong.

Given how interconnected the economic system is, said Thompson, policymakers must look past their biases and seek a variety of voices to ensure that all possibilities are examined and none are dismissed outright. Said Thompson, "to act quickly [in a crisis], you need to be taking in real-time information, and you need to be looking at it with an unjaundiced and impartial eye. The data says what the data says, and you shouldn't view it through the lens of whatever your particular biases are." She further explained:

> Had policymakers been more able, more willing to recognize that their own experiences were limited and biased, and that there were other experiences that were very different, that reflected real risk, I think they would have been able to and motivated to act much more quickly . . . If we do market monitoring, and we think about what is happening in all our communities—where are the risks, how is that happening, is that what we expect, is that what we want, what are the downstream consequences?—we are then well-positioned to intervene in a timely and effective way.

Crisis responses for corporations and individuals should be fair and equitable, based on impartial and rational standards.

Another issue Thompson criticized was the seemingly different standard of review policymakers applied to assistance provided to corporations and to individuals:

> There was a widespread belief that doing anything to relieve homeowners would create significant moral hazard, while at the same time there was virtually no concern about moral hazard for bailouts for large institutions. It was a striking example of "us-them" thinking. People defaulting on the loans were presumed to somehow be morally deficient, less deserving than people running investment companies and needing bailouts. I think that has to do with whom people knew, whom they were accustomed to thinking about.

Thompson doesn't argue that moral hazard and risk of fraud are valid concerns for any intervention or government program. However, these issues should be addressed based on objective and equitable standards rather than bias:

> That ties into the moral hazard and the moral framework around the deserving needy and fraud. We need to apply the same standards to individuals that we apply to corporations. If we're willing to tolerate a risk of fraud when we give a bailout to a corporate entity or risk of moral hazard when we give a bailout to corporations, we should be willing to take on at least as much risk with individuals. We should be as rational in how we provide aid to individual households and families as we are in how we provide aid to corporations. We're making decisions based on what we think the economic incentives are, what the needs are, what aligns with what our policy goals are. We don't require many certifications of heads of business showing they really need the money, and we don't make them document it three or six different ways. We do it fast and simple because we don't want to waste people's time and money. We don't do that with individuals. And that insistence on doing individualized, one-off

> assistance and not quickly and efficiently pumping the money out was a huge part of the failure of HAMP [the Home Affordable Modification Program].

To Thompson's mind, this kind of double standard might have caused the less than effective structure of the Treasury Department's HAMP, which was designed to assist homeowners in modifying their troublesome mortgages, but which was perceived by many commentators as not easy for homeowners to access.

Even in the heat of a crisis, the practical aspects of interventions need to be scrutinized, and it might make sense to consider new ways of doing things to enhance results.

A year after the government created HAMP, Thompson wrote a detailed testimony to the US Senate Committee on Banking, Housing, and Urban Affairs describing the inefficiencies in the government's flagship program for homeowners, which was voluntary. Then as now, Thompson saw HAMP as a program without the right incentives and with infrastructure poorly suited to its task. It was difficult to get servicers to participate in the program, she noted:

> There were very small incentives to comply with the program. There remained significant hurdles to comply. One of the significant problems is that default servicing has never been a moneymaker. Servicers don't get additional money for doing good default servicing. Investors were willing to tolerate poor default servicing, because overall they were worried about moral hazard, and that homeowners would try to defraud them if given a chance. They believed that, over time, it would be better for them if servicers push people out the door.

The program was set up very quickly, in the middle of the crisis, and relied on mortgage servicers to do the modifications. But, in Thompson's opinion, the Treasury Department did not adequately consider how the program would fit into mortgage servicers' normal activities and whether they had the necessary expert personnel or technology to operationalize it. She also pointed out that there were significant structural problems in the design of HAMP. Modifications had never been done on such a large scale before, said Thompson. The program basically tried to utilize a decentralized manual process run on older technology to address a systemic issue of massive scale.

> It was incredibly costly to do proper default mortgage servicing. Before the crisis, mods [modifications] had always been a one-off deal that you negotiate one-on-one with the servicer. That's not a system that's going to work when you have millions of people all at one time facing foreclosure. You've got to get more automation.

Although the Treasury reports that more than 5 million homeowners received modifications, many commentators, like Thompson, consider the program to have been less than a success and to have helped far too few.

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