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This Government Agency Is Seriously Overstepping Its Bounds

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The Consumer Financial Protection Bureau (CFPB) has a mission: to protect consumers from unfair, deceptive, or abusive practices. According to a new national poll by the Cato Institute in collaboration with YouGov, protection from deceptive practices is just what the American public wants. Asked to prioritize regulatory goals, the majority of respondents put "protect consumers from fraud" front and center.

Unfortunately, the CFPB continually misses the mark, issuing rules that make splashy headlines but in practice do little to stop bad behavior. Its latest proposed rule, expected to become final soon, doesn't target fraud itself. Instead, it goes after an entire industry and will significantly reduce consumers' access to credit at the exact moments they need it most. This rule would restrict the ability of short-term lenders, often known as "payday" lenders, to continue offering their services. These loans require no credit check and no collateral. For a flat fee, usually about $15 per $100 borrowed, the lender provides a loan lasting about two weeks. The borrower gives the lender a post-dated check for the full amount of the loan, plus the fee. At the end of two weeks, the lender deposits the check. If the borrower does not have the funds to repay the loan, the borrower can roll it over, taking out a new loan for another $15 per $100 fee.

The CFPB has claimed that these loans create a "debt trap" for borrowers, the majority of whom do roll over the loan. To protect people from these "traps," the CFPB wants to institute new compliance requirements. If payday loan consumers end up accruing fees equivalent to 36% or more of the amount originally borrowed as a result of rollovers, the CFPB's compliance requirements would kick in, requiring lenders to assess the borrower's ability to repay the loan in the two-week period, and limiting the number of times a loan can be rolled over.

But the word "trap" is misleading. In fact, the terms of the loans are remarkably clear. "Borrow $100." "Pay $15 plus the amount borrowed." "Payment is due in full in two weeks." Try putting the terms of any other credit instrument—a credit card, an auto loan, a mortgage—into just 15 words. Even putting such loans into 15 pages would be a challenge.

In fact, payday loans are a viable business model precisely because they're quick and require little paperwork, making it feasible for them to lend to people with poor credit. Those who use payday loans agree. As the Cato poll finds, the majority of payday borrowers say they receive good information about rates and fees from their payday lenders. The fact that payday borrowers remain in debt longer than two weeks is not evidence of deception; according to a recent Pew survey, the majority of borrowers correctly estimated how long it would take them to pay off the debt, even though for most of them, that would mean several months of repayment.

Using payday loans can be expensive. Often opponents of the loans cite the fact that the fees can ultimately total more than the amount initially borrowed if the loan is rolled over many times. Each time the loan is rolled over, the borrower effectively takes out a new loan and pays the applicable fees on the amount borrowed.

While some compare this fee to an interest rate, arguing that the total fees paid on a loan are comparable to an annual percentage rate (APR), in reality they are simply a flat fee for each $100 borrowed for a set period of time. It's true that the fees can add up, especially if a borrower rolls over the loan multiple times, but it doesn't make the loans deceptive. Limiting the effective APR would limit the number of times a loan could be rolled over, requiring borrowers to pay on the spot. Given the way payday loans are often used, being able to roll over the loan is a benefit to borrowers who might need more time to save up the cash.

New technologies and the widespread use of smartphones have made financial transactions easier and more widely available. Reducing regulatory barriers to the development of these products may be the best way to improve financial access for low- and moderate-income Americans. In the meantime, the CFPB needs to focus on preventing and punishing fraud, rather than making news with rules no one wants or needs.

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