Payday lenders' critics overstate case

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In 2017, the Obama administration advanced regulations effectively designed to force most payday lenders out of business. Under the Trump administration, the Consumer Financial Protection Bureau has proposed eliminating those rules. Critics decry this effort as leaving the poor vulnerable to exploitation, but research indicates low-income citizens are smarter and service is more reasonable than payday lending's critics imply.

Writing for the libertarian Cato Institute, Peter Van Doren bluntly says evidence "indicates that the predatory costs of payday loans may be nonexistent and the benefits are real and measurable."

Payday lenders provide short-term, uncollateralized loans that typically range from $100 to $500 per loan. The lender makes money off a fee, usually about $15 per $100 borrowed for two weeks.

Critics call that $15 unconscionable, noting it converts into an annualized rate of 391 percent. But Van Doren says such comments are misleading because they ignore the true economics of payday lending. Research shows lenders' fixed and marginal costs run about $25 for a $300 loan if no one fails to repay the loan. But if just 5 percent of borrowers default, the lender's cost increases to $40 per $300 in loans, which comes out to $13.33 for every $100 provided as a loan.

Thus, a $15 fee may provide less than $2 in profit for every $100 in loans. That's not an egregious profit margin. Van Doren notes payday lenders' stock prices further undermine the idea that the industry is a cash cow.

"The apparently 'high' fees are a natural outcome of lending small amounts to riskier borrowers," Van Doren writes. "Any restrictions that limit these fees or impose increased costs on lenders may eliminate access to any loans, leaving former borrowers with less-desirable, higher-cost options."

The industry is also criticized because borrowers can roll over loans, raising the associated fees in the process. Yet research shows most borrowers understand the financial reality.

In 2016, the Global Strategy Group and The Tarrance Group polled 1,000 payday loan borrowers for the Community Financial Services Association of America. That poll, which included oversamples of blacks and Hispanics, found 96 percent of borrowers said they completely understood before they took out the loan how long it would take to pay off a payday loan and the finance charges involved. Seventy-two percent said they received better treatment from a payday lender than from a bank or credit card company, and 75 percent said they were likely to recommend payday loans to friends and family.

Those responses don’t paint a picture of people who have been ruthlessly exploited and financially victimized.

As we have argued before, government regulations should target and prevent fraud. Otherwise, citizens should be free to determine for themselves which lender they believe offers the best terms.