MERCATUS CENTER
George Mason University

RESEARCH SUMMARY

Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau

Following the financial crisis that began in 2008, President Obama signed into law the 2010 Wall Street Reform and Consumer Protection Act, commonly referred to as the Dodd-Frank Act. A centerpiece of the new law was the creation of the Bureau of Consumer Financial Protection (CFPB), which, among other things, has power to regulate all consumer credit products, including payday loan and bank overdraft protection.

In "Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau," former Comptroller of the Currency Robert L. Clarke and George Mason University School of Law professor Todd J. Zywicki examine the requirement of the CFPB to implement a regulatory regime that treats comparable products consistently, regardless of what kind of institution offers them. The authors largely ignore the threshold debates about whether further regulation of either payday lending or overdraft protection was warranted. Instead, they focus on the second-order question: if the CFPB decides that further regulation is warranted, how should it implement its mandate to preserve fair competition as it applies to payday lending and bank overdraft protection? Economics and history show that consumers benefit from a consumer protection regime that promotes fair competition, which in turn results in lower prices and better services for consumers. The CFPB should be careful when regulating payday lending and bank overdraft protection equally in order to preserve fair competition.

THE ROLE OF THE CFPB

- The integration of consumer protection regulation into one agency (the CFPB) provides an unprecedented opportunity to create a systematic regulatory regime that promotes fair competition and benefits consumers.
- Promoting fair competition is an essential ingredient of consumer protection. Regulation that inadvertently favors one product over another (specifically payday lending vs. bank overdraft protection) could have the unintended consequence of simply shifting consumers from one product to another, thereby reducing competition and producing higher prices and lower quality with no enhanced consumer protection.

PAYDAY LENDING AND BANK OVERDRAFT PROTECTION

The following three considerations are relevant to the CFPB's implementation of its mandate to preserve fair competition among the competing products of payday lending and bank overdraft protection:

Payday lending and overdraft protection draw similar customers and have similar uses.

- Payday loan and overdraft protection customers are similar. The biggest characteristic of both customers is poor credit and, therefore, lack of ready access to less expensive, mainstream credit products such as credit cards.
- These customers therefore choose payday loans as the best available alternative to meet expenses. When payday loans are restricted they turn to less preferred and more expensive alternatives such as overdraft protection.
- Understanding who uses these products and why is important to identifying how the products compete.

Payday lending and overdraft protection are competing services.

- Millions of Americans use payday lending and bank overdraft protection every year, and many consumers use both products, either simultaneously or at different times.
- Payday lending and overdraft protection directly compete against each other. Consumers can (and do) use both products to cover a temporary shortfall and thus meet their short-term financial obligations.
- Evidence indicates that consumers choose wisely between the two services. Therefore, regulation should be sensitive to preserving competition that will produce lower prices and higher quality for consumers. Regulations that favor some products over others will tend to divert consumers to the more favorably regulated product, even though the products are substantially similar. This result harms consumers and furthers no regulatory purpose.

Payday lending and overdraft protection raise similar potential consumer protection concerns.

- Not only are payday lending and bank overdraft protection similar in use and purpose, but the consumer protection regulatory concerns they raise are similar as well. This further supports Dodd-Frank's premise that they should be regulated in an even-handed manner.
- The similar concerns are that (1) consumers are not fully aware of the cost, (2) they use those products instead of less expensive alternatives, and (3) the high cost and limited underwriting can create a cycle of debt for a minority of users. If the consumer protection concerns are similar, therefore, it should not matter whether the offer is from a bank or nonbank lender; neither should the formal structure or classification of the terms matter.

CONCLUSION: FAIR COMPETITION AND CONSUMER PROTECTION

Payday lending and bank overdraft protection traditionally have been offered by different lenders and have been regulated differently. Yet they compete with each other and raise similar consumer protection concerns. Both economics and history lead to the conclusion that consumers benefit from a consumer protection regime that considers the interactions among different products and the competition that they provide.

The CFPB has the potential to integrate this fragmented regulatory structure into a coherent and consumer-friendly regulatory regime, provided that it appreciates the interdependencies between payday lending and bank overdraft protection. Dodd-Frank requires that the CFPB not provide a competitive advantage for one product over rival products simply because the rival products happen to be offered by different institutions through different distribution channels. Failing to take into account this requirement to preserve fair competition could expose the CFPB to litigation risk in the future.