PAYDAY LENDING, BANK OVERDRAFT PROTECTION, AND FAIR COMPETITION AT THE CONSUMER FINANCIAL PROTECTION BUREAU

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Introduction

In response to the financial crisis that began in 2008, in 2010 President Obama signed into law the Wall Street Reform and Consumer Protection Act, commonly referred to as the "Dodd-Frank Act."[1] A "centerpiece of the [new law] was the creation of the Consumer Financial Protection Bureau ("CFPB"),"[2] which was established in response to the perception of widespread failures in the federal consumer protection regime with respect to financial products and the belief that these regulatory failures contributed to the financial crisis.[3] But the reach of the CFPB goes far beyond mortgages and other financial products that were at the heart of the recent recession and reaches all consumer credit products, including small-loan products such as payday lending and pawnshops as well as nonlenders such as mortgage brokers and debt collectors.[4] In the wake of the financial crisis and the subsequent political response, short-term consumer lending products such as payday lending, bank overdraft protection, and pawnshops have grown in both popularity and regulatory scrutiny.[5] The crisis-induced recession, the retrenchment in retail banking, and the consequences of many

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010) (codified in scattered sections of 7, 12, 15, 31 U.S.C.).
[2] Todd J. Zywicki, *The Consumer Financial Protection Bureau: Savior or Menace?*, 81 GEO. WASH. L. REV. 856, 857 (2013) [hereinafter Zywicki, *The Consumer Financial Protection Bureau*].
[3] *See* DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 69 (June 17, 2009), http://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf [hereinafter DEP'T OF THE TREASURY, A NEW FOUNDATION].
[4] *See* Nathalie Martin, *Regulating Payday Loans: Why This Should Make the CFPB's Short List*, 2 HARV. BUS. L. REV. ONLINE 44, 45 (2011) [Martin, *Regulating Payday Loans*].
[5] *See* FED. DEPOSIT INS. CORP., 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 4 (2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf [hereinafter FDIC, SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS]. The Federal Deposit Insurance Corporation's 2011 national survey of unbanked and underbanked households found that from 2009 to 2011 the percentage of U.S. households that used an alternative financial services product rose from 36.3% to 40.9%. *Id.* at 30.

regulations enacted in the period since the recession began have reduced access to mainstream consumer credit products such as credit cards, home equity loans, and mortgages, thereby increasing demand for alternative credit products.[6]

The CFPB's mandate to advance the goal of heightened consumer protection is multifaceted. The facet on which we focus here is Dodd-Frank's requirement to "enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[7] Dodd-Frank further requires the CFPB to implement a regulatory regime that treats comparable products consistently, regardless of whether they are offered by a bank, a nonbank lender, or some other provider of consumer financial products.[8] The CFPB, in turn, has interpreted this mandate to require it to "[p]romote fair competition by consistent enforcement of the consumer protection laws in the [CFPB's] jurisdiction . . . ."[9]

In short, Dodd-Frank requires that the CFPB, in pursuing its rule-making, enforcement, and research capabilities, 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.[10] As the architects of Dodd-Frank recognized, providing unequal regulatory treatment of similar products could harm consumers by pushing them to choose among various competing products based on the products' degree of regulation rather than on their relative economic benefits.[11] In fact, in light of the explicitness of this mandate, failing to take

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[6] *See* discussion *infra* Part II.A.

[7] 12 U.S.C. § 5511(a) (2012).

[8] § 5511(b)(4) ("Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition . . . .").

[9] CONSUMER FIN. PROT. BUREAU, SEMI-ANNUAL REPORT OF THE CONSUMER FINANCIAL PROTECTION BUREAU 8 (2013).

[10] *See* § 5511(b).

[11] *See* DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, *supra* note 3, at 69 ("Fairness, effective competition, and efficient markets require consistent regulatory treatment for similar products. For example, similar disclosure treatment for similar products enables consumers to make informed choices based on a full appreciation of the nature and risks of the product and enables providers to compete fairly and vigorously.").

account of this requirement to preserve fair competition could expose the CFPB to litigation risk in the future.

In this article, we examine how the CFPB can advance its mission to promote fair competition with respect to two particular products: payday lending and bank overdraft protection. In fact, the Obama Administration's Treasury Department report that served as the foundation for Dodd-Frank specifically identified overdraft protection as an example of a product that was not traditionally regulated as a credit product, but which should be regulated as such in order to execute the new agency's mandate to "apply consistent regulation to similar products."[12] The report states, "[o]ne example is overdraft protection plans. These are a form of consumer credit, and consumers often use them as substitutes for other forms of credit such as payday loans, credit card cash advances, and traditional overdraft lines of credit."[13] Because consumers use overdraft protection in the same way they use a credit product and as a substitute for other types of credit, the Administration argued that the new agency should have the authority to regulate overdraft protection as it would regulate a credit product in order to apply consistent regulation to similar products.[14]

For purposes of the discussion in this article, we will largely ignore the threshold debates about whether further regulation of either payday lending or overdraft protection is warranted.[15] Instead, we focus on the second-order question: if the CFPB decides that

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[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] For the purposes of this article, we will assume that the CFPB might consider imposing enhanced regulation of both products. Nonetheless, we are concerned about new regulation that would unduly reduce consumer access to either product, and we fear that the unintended consequences of such regulation could prove harmful to consumers and the economy. For competing sides of the debate, compare Martin, *Regulating Payday Loans*, *supra* note 4, at 45 (arguing in support of the CFPB regulating payday loans), and Creola Johnson, *America's First Consumer Financial Watchdog Is on a Leash: Can the CFPB Use Its Authority to Declare Payday-Loan Practices Unfair, Abusive, and Deceptive?*, 61 CATH. U. L. REV. 381, 385 (2012) [hereinafter Johnson, *America's First Consumer Financial Watchdog Is on a Leash*] (same), with Jim Hawkins, *The Federal Government in the Fringe Economy*, 15 CHAP. L. REV. 23, 58–77 (2011) (arguing that some rationales in favor of CFPB regulation of payday loans have merit, while others "fail to comprehend fringe banking transactions").

further regulation is warranted, how should it implement its mandate to preserve fair competition as it applies to payday lending and bank overdraft protection? Concentrating on preserving fair competition between these two products is especially useful because they have typically been offered by distinctly different institutions through different channels: overdraft protection through banks and payday lending through non-depository small lenders.[16] Payday loans and overdraft protection traditionally have been regulated by two different levels of regulatory authority: the federal government for bank overdrafts and state governments for payday loans.[17] Finally, they have been primarily regulated through dissimilar approaches: ongoing prudential supervision in the case of bank overdrafts and licensing and an enforcement-based regime for payday lenders.[18] As a result, examining these two products provides an opportunity to understand both the promise and challenges for the CFPB to create a coherent regulatory framework that can benefit consumers through preserving fair competition.

The integration of consumer protection regulation into one agency provides an unprecedented opportunity to create a systematic regulatory regime that promotes fair competition and benefits consumers. Indeed, promoting fair competition is an essential ingredient of consumer protection, as regulation that inadvertently favors one product over another 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.

In this article, we first describe the regulatory background of the two products. We then describe three considerations—similar

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[16] *See* CONSUMER FINANCIAL PROTECTION BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS: A WHITE PAPER OF INITIAL DATA FINDINGS 6 (Apr. 24, 2013) [hereinafter CFPB, PAYDAY LOANS] ("Payday loans offered by non-depository institutions and deposit advances offered by certain depository institutions are generally marketed as a way to bridge unexpected financial short-falls between paychecks, receipt of benefits, or other sources of income.").

[17] *See* Hawkins, *supra* note 15, at 54–55.

[18] We recognize at the outset that Dodd-Frank itself places some limits on the CFPB's ability to develop a fully coherent regulatory system due to provisions that limit the federal government's ability to preempt state regulations and the state officials' ability to enforce Dodd-Frank's regulations under some circumstances. *See* Zywicki, *The Consumer Financial Protection Bureau*, *supra* note 2, at 923–26.

customers, evidence of competition between the products, and similar consumer protection concerns—that we believe are relevant to the CFPB's implementation of its mandate to preserve fair competition among competing products and indicate how the CFPB can promote fair competition and consistent enforcement of consumer protection rules.[19]

I. Regulation of Payday Lending and Overdraft Protection

Millions of Americans use payday lending and bank overdraft protection every year, and many consumers use both products, either simultaneously or at different times.[20] Each product serves as a way for consumers to cover a temporary shortfall in meeting their financial obligations.[21] Overdraft protection is a

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[19] Dodd-Frank itself does not define the CFPB's mission to promote fair competition. One contribution of this article therefore is to provide guidance on how that mission can be defined and executed in practice. Although the CFPB is a new regulatory body, the concept that fair competition benefits consumers and advances the goals of consumer protection policy is not new. The dual mission to preserve competition and provide consumer protection is an integral part of the Federal Trade Commission's mission, and we partly draw on this history to identify the factors that are relevant to determining the interactions between competing products. *See id.* at 877–78.

[20] Estimates vary as to how many people use each product. Moebs Services, for example, estimated that in 2010 nineteen million people used payday lending and thirteen million used overdraft protection. *See* Press Release, Moebs Services, Payday Loans Are a Better Deal for Consumers than Overdraft Fees (July 12, 2010), *available at* http://www.moebs.com/Pressreleases/tabid/58/ctl/Details/mid/380/ItemID/169/Default.aspx. JMP Securities, an industry analyst, estimates that seven million people use payday lending products each year (combining both brick-and-mortar and online lending). *See* JMP SEC., CONSUMER FINANCE: ONLINE FINANCIAL SERVICES FOR THE UNDERBANKED 15 fig.4 (Jan. 9, 2012) [hereinafter JMP SEC.]. The FDIC estimates that at the time of its 2011 survey, 1.7% of U.S. households had used payday lending within the last year. FDIC, SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS, *supra* note 5, at 33.

[21] ROB LEVY & JOSHUA SLEDGE, CTR. FOR FIN. SERVS. INNOVATION, A COMPLEX PORTRAIT: AN EXAMINATION OF SMALL-DOLLAR CREDIT CONSUMERS 4, 14 (2012), *available at* http://www.cfsinnovation.com/system/files/A%20Complex%20Portrait-%20An%20Examination%20of%20Small-Dollar%20Credit%20Consumers.pdf.

program offered by banks that pays for transactions made by customers who have insufficient funds in their bank accounts.[22]

Overdraft protection originated as a discretionary program by banks primarily to cover liquidity shortfalls for high-income customers, but over time it has evolved into a largely automated program available to most customers, including low-income customers who direct deposit paychecks or other regular sources of income.[23] Overdraft protection offers a limited line of credit (usually between $300 and $500) that can be triggered by checks, Automatic Clearing House ("ACH") transactions, ATM withdrawals, or point-of-sale purchases using a debit card.[24] When a customer uses overdraft protection, he or she pays a flat fee established by the financial institution (typically around $30 to $35) and a nominal interest rate for the period that the advance is outstanding.[25]

Payday lending is a short-term loan (typically about two weeks) provided by non-depository institutions that charge a fee based on the amount borrowed by a customer, usually about $15 per every $100 borrowed.[26] The loans are usually repaid in a single balloon payment that is equal to the principal plus the required fees, and the payment is generally due around the time of the borrower's next payday.[27]

A third product that has evolved in recent years is a bank deposit advance product. Offered to deposit accountholders at banks

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[22] CFPB EXAMINATION PROCEDURES, SHORT-TERM, SMALL-DOLLAR LENDING COMMONLY KNOWN AS PAYDAY LENDING 2 n.1 (2013), *available at* http://files.consumerfinance.gov/f/201309_cfpb_payday_manual_revisions.pdf [hereinafter CFPB EXAMINATION PROCEDURES].

[23] Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASH. & LEE L. REV. 1141, 1155–62 (2012) [hereinafter Zywicki, *Overdraft Protection*].

[24] CFPB, PAYDAY LOANS, *supra* note 16, at 15.

[25] Press Release, Consumer Fin. Prot. Bureau, CFPB Launches Inquiry into Overdraft Practices (Feb. 22, 2012), http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-launches-inquiry-into-overdraft-practices/.

[26] Brian T. Melzer & Donald P. Morgan, Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit 1–2 (Dec. 2, 2009) (unpublished manuscript), *available at* http://www.clevelandfed.org/research/conferences/2010/9-9-2010_household-finance/melzer_morgan_2_16_2010.pdf; *see* discussion *infra* Part III.B.

[27] CFPB, PAYDAY LOANS, *supra* note 16, at 6.

and operating much like payday loans, deposit advances are typically structured as short term loans that are repaid out of the next electronic direct deposit to the customer's account and, as with payday loans, customers typically pay a flat fee to draw the advance.[28] Unlike payday lending, deposit advances are not due on a scheduled date (i.e., two weeks later) but are withdrawn from the customer's next qualifying direct deposit.[29] Although comparable to payday loans in structure, deposit advance loans are less risky to underwrite because of the ongoing relationship between the bank and the customer and the assurance to the bank of the upcoming direct deposit that can be drawn against to repay the advance.[30] This ongoing relationship between the customer and the bank may also mean that the processing cost of making the advance may be lower than for payday loans.[31] Deposit advances appear to be slightly less expensive than payday loans, approximately $10 for every $100 advanced.[32]

Clearly, these are popular products with significant consumer demand.[33] But the growth in popularity of alternative credit products, especially in the aftermath of the financial crisis and subsequent recession, has generated heightened scrutiny from regulators, including the CFPB.

Payday lending and overdraft protection traditionally have been regulated by different regulatory jurisdictions pursuing different regulatory approaches. Payday lending has been regulated at the state and local level through oversight, licensing, and prosecutorial enforcement, primarily under traditional consumer protection laws,

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[28] *See id.* at 11–12.
[29] *Id.*
[30] *Id.* at 7.
[31] *Id.*
[32] REBECCA BORNÉ, JOSHUA FRANK, PETER SMITH & ELLEN SCHLOEMER, CTR. FOR RESPONSIBLE LENDING, BIG BANK PAYDAY LOANS: HIGH-INTEREST LOANS THROUGH CHECKING ACCOUNTS KEEP CUSTOMERS IN LONG-TERM DEBT 4–5 (2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.
[33] *See supra* note 5 and accompanying text (discussing estimates of how many people use these products); *see also* discussion *infra* Part III.A (discussing competition in and growth in markets for payday loans and overdraft protection plans).

with a modest federal role.[34] State regulation of payday lending varies widely, from effective prohibition in some states to light regulation in others.[35] Overdraft protection on the other hand, has been regulated by federal authorities such as the Federal Reserve System, the Office of the Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), and other federal banking regulators, through their safety and soundness and consumer protection missions, relying more on a supervisory and oversight model.[36] In 2003, the OCC took enforcement actions against banks, effectively prohibiting them from offering traditional payday loans through third-party providers.[37] Nevertheless, as described below, some banks today offer bank overdraft protection and direct deposit advance products that are functionally similar to payday lending.[38]

As a result of this division of regulatory authority, each regulator acts in isolation and may have only a limited knowledge of the full impact that the regulation of one product may have on the consumers and offerors of the alternative products. For example, if consumers view payday lending and overdraft protection as equivalent substitutes, then regulation that restricts or expands access to either product will have a dramatic effect on consumers depending on the availability and regulation of the other product.

The creation of the CFPB as a consolidated national regulator of consumer credit products provides a historic opportunity to establish a more coherent regulatory framework that can integrate enforcement, supervision, regulation, and research tools into one regulatory agency. Indeed, given the modest spillover effect on interstate commerce or on residents of other states from the use of products such as payday lending,[39] it may be that the sweeping

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[34] CONSUMER FIN. PROT. BUREAU, CFPB STUDY OF OVERDRAFT PROGRAMS: A WHITE PAPER OF INITIAL DATA FINDINGS 9 (2013) [hereinafter CFPB, OVERDRAFT PROGRAMS].

[35] *Id.*

[36] *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1143.

[37] *See Payday Lending*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, http://occ.gov/topics/consumer-protection/payday-lending/index-payday-lending.html (last visited Dec. 12, 2013) (summarizing enforcement actions and effects against banks for allegedly "renting out" charters to payday lenders).

[38] *See* discussion *infra* Part III.B.

[39] *See* Zywicki, *The Consumer Financial Protection Bureau*, *supra* note 2, at 923–26 (criticizing preemption scheme of Dodd-Frank with respect to the CFPB's powers). Payday lending typically does not raise issues of either

powers of the CFPB to regulate products with largely localized effects *only* makes sense if the CFPB uses its authority to provide an integrated regulatory framework that considers the full range of consumer credit products and their interaction. By integrating its regulatory program on payday lending within the framework of a broader consumer protection and competition policy for consumer financial products, the CFPB could achieve the balance and consistency needed for coherent regulation of these products.

To date, the CFPB's forays into both payday lending and overdraft protection have been tentative, but it is clear that both products are high regulatory priorities. In February 2012, the CFPB opened a public inquiry and industry research study to gain insight into overdraft protection.[40] In its request for information, the CFPB specifically sought information on how consumers use overdraft programs, the information consumers receive about various banking products, the impact of prior overdraft regulations, and the costs of providing overdraft protection.[41] Perhaps most relevant to this article, the CFPB sought to determine what "[a]lternatives consumers have for meeting short-term shortfalls."[42] In June 2013, the CFPB issued a white paper that summarized its findings on the use of overdraft protection but provided little analysis of the alternatives available to consumers for meeting those short-term shortfalls.[43] The CFPB's actions on overdraft protection follow a variety of actions in recent years by prudential regulators that have imposed limits on overdraft

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systemic risk or deposit insurance that give rise to safety and soundness concerns for banks. *See id.* at 924.

[40] *See* Impact of Overdraft Programs on Consumers, 77 Fed. Reg. 24,687 (Apr. 25, 2012).

[41] *Id.*

[42] Gary Stein, *Comment Period on Overdrafts Extended to June 29*, CONSUMER FIN. PROT. BUREAU (Apr. 25, 2012), *available at* http://www.consumerfinance.gov/blog/category/overdrafts/.

[43] *See generally* CFPB, OVERDRAFT PROGRAMS, *supra* note 34. Although the white paper provides some discussion of the cost of overdraft protection to consumers and its value to banks, it does not systematically attempt to determine what alternatives are available to consumers. Nor does it determine whether consumers who reduce their use of overdraft protection then increase their use of other expensive alternatives, or whether less-expensive alternatives (such as a bank line of credit or linked savings account) are actually available to overdraft users. *See* discussion *infra* Part II.B.

protection, including Federal Reserve amendments to Regulation E[44] and Guidance from the FDIC[45] and the OCC.[46]

With respect to payday lending, the CFPB held a high-profile field hearing[47] and published an examination manual for payday lenders that covers issues such as the following: marketing; application and origination processes; payment processing and sustained use; collections, default, and consumer reporting; and third-party relationships.[48] In April 2013, the CFPB published a white paper analyzing data on payday loan and direct deposit advance products, concluding that the findings of the study "raise[d] substantial consumer protection concerns" about both products.[49]

II. Payday Loans and Bank Overdraft Protection Are Used by Similar Customers for Similar Reasons

Payday loan and overdraft protection customers are demographically similar. Both payday loan customers[50] and frequent

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[44] 12 C.F.R. §§ 205.01–.20 (2013).

[45] FED. DEPOSIT INS. CORP., FIL-81-2010, FINAL OVERDRAFT PAYMENT SUPERVISORY GUIDANCE (2010).

[46] Guidance on Deposit-Related Consumer Credit Products, 76 Fed. Reg. 33,409 (proposed June 8, 2011). The substance of these various regulatory actions (amendments to Regulation E and FDIC and OCC guidance) is summarized in Zywicki, *Overdraft Protection*, *supra* note 23, at 1155–62.

[47] Press Release, Consumer Fin. Prot. Bureau, Consumer Financial Protection Bureau Examines Payday Lending, (Jan. 19, 2012), *available at* http://www.consumerfinance.gov/pressreleases/consumer-financial-protection-bureau-examines-payday-lending/.

[48] *See generally* CFPB EXAMINATION PROCEDURES, *supra* note 22.

[49] CFPB, PAYDAY LOANS, *supra* note 16, at 44.

[50] The CFPB study found that although most payday loan customers were low-income, a quarter of those in its study earned more than $33,876 per year. *Id.* at 18. Levy and Sledge report that 20% of those who use alternative credit products make above $50,000, consistent with other studies that find a nontrivial percentage of users of payday loans and other products are middle class or even upper-middle class. LEVY & SLEDGE, *supra* note 21. Those who use payday loans typically have higher incomes than those who use pawnshops, rent-to-own, and other lower-tier products. *See* Todd J. Zywicki, *The Case Against New Restrictions on Payday Lending* 9 (Mercatus Ctr., Working Paper No. 09-28, 2009), *available at* http://mercatus.org/sites/default/files/publication/WP0928_Payday%20Lending.pdf [hereinafter Zywicki, *Payday Lending*] (summarizing studies).

users of overdraft protection[51] have bank accounts and tend to have low to moderate income (but they are not poor).[52] More importantly, users of payday lending, bank overdraft protection, and other alternative credit products share one characteristic above all else: they have poor credit and therefore lack ready access to less-expensive, mainstream credit products, such as credit cards.[53] Understanding who uses these products and why is important to identifying how the products compete.

A. A Profile of Payday Loan Customers

Payday loan customers often, but not always, have impaired credit, which restricts their access to mainstream credit products.[54] Thus, they choose payday loans because such loans are their best available alternative to meet expenses.[55] As a result, when payday

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[51] *See* CFPB, PAYDAY LOANS, *supra* note 16, at 18 ("The median income is $22,476, although a quarter of borrowers have income of $33,876 or more."); Marc Anthony Fusaro, *Are "Bounced Check Loans" Really Loans? Theory, Evidence and Policy*, 50 Q. REV. OF ECON. & FIN. 492, 499 (2010) [hereinafter Fusaro, *Bounced Check Loans*] ("There is a common perception that primarily the poor overdraft but these data belie this perception.").

[52] *See* Zywicki, *Payday Lending*, *supra* note 50, at 8.

[53] LEVY & SLEDGE, *supra* note 21, at 11 (finding that 54% of small-dollar credit users self-report as having poor credit).

[54] Zywicki, *Payday Lending*, *supra* note 50, at 14.

[55] Critics of payday loans generally do not disagree with the proposition that those who use payday loans have impaired credit and limited credit choices. Instead critics express concern about the cost and other terms of payday loans. It has been argued, for example, that the presence of payday loans in a market might crowd out less-expensive credit alternatives. *See* Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. 649, 663–66 (2012) (describing responses to Military Lending Act, which effectively banned payday loans to military members). On the other hand, even if Johnson's anecdotes about market responses to the Military Lending Act are accurate, it is not obvious that the experience with military lending can be generalized, given the role of special military charities and similar entities in promoting low-cost credit products. Moreover, simply because alternative loans are less expensive in financial terms, they might not inherently be more attractive to borrowers. For example, although critics of payday loans often observe that consumers *could* borrow from friends and family instead of taking out a payday loan, many consumers might feel

loans are restricted, such customers generally turn to less-preferred, more-expensive alternatives, such as pawnshops or credit card cash advances, and—as will be discussed in detail below—overdraft protection.[56] Alternatively, they may be forced to bounce checks or suffer hardship from an inability either to pay bills or to obtain needed goods and services.[57] Moreover, despite the high cost of payday loans, those who use the product generally are aware of the price and are satisfied with the product.[58]

Bhutta, Skiba, and Tobacman found that the payday loan customers in their study had both average and median credit scores below 520, substantially lower than the average score of 680 for the general population.[59] These customers were also more likely than the general population to be delinquent on credit accounts.[60] In addition, the authors found that payday loan customers searched extensively for preferred credit before deciding on a payday loan—payday loan applicants had an average of over five credit inquiries during the twelve months leading up to their initial payday loan application, "a level three times higher than that of the general population and even considerably higher than that of the general 'subprime' population."[61] However, payday loan customers were "generally unsuccessful in [actually] getting credit" other than the payday loans

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embarrassment or fear strained relations with family and friends from doing so, especially if borrowing for certain purposes rather than others. *See* Zywicki, *Payday Lending*, *supra* note 50, at 16–17. Once these relevant psychological costs are considered, many consumers might rationally believe a high-cost lender to be less expensive overall. Indeed, it is even possible that a loan from an illegal loan shark might have a lower up-front cost than a loan from some legal lenders, although that observation ignores the potential costs of broken kneecaps from nonpayment. As a result, simply because the financial cost may be lower from borrowing from friends and family, that does not mean that consumers are better off when forced to use that option.

[56] *See infra* note 83 and accompanying text.

[57] Zywicki, *Payday Lending*, *supra* note 50, at 2.

[58] *Id.* at 24.

[59] Neil Bhutta, Paige Marta Skiba & Jeremy Tobacman, *Payday Loan Choices and Consequences* 13 (Vand. U. Law & Econ., Working Paper No. 12-30, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2160947.

[60] *Id.* at 10–11; *see also* LEVY & SLEDGE, *supra* note 21, at 11 (noting that 54% of small-dollar credit users self-report as having poor credit).

[61] Bhutta, Skiba & Tobacman, *supra* note 59, at 14.

and other alternative loan products.[62] "In other words," Bhutta, Skiba, and Tobacman concluded, "first-time payday applicants appear to be searching intensively, but unsuccessfully, for traditional (and presumably cheaper) credit."[63]

Other researchers have also found evidence of credit problems among those who use payday loans. A 2009 study found that 43% of payday loan customers had overdrawn their checking account at least once in the previous twelve months, and 21% were sixty or more days past due on a consumer credit account during the previous twelve months.[64] Fifty-five percent stated that during the preceding five years they had a credit request denied or limited, and 59% had considered applying for credit but did not because they expected to be denied.[65] Sixteen percent of payday loan customers had filed for bankruptcy in the past five years—four times the rate of all consumers.[66]

As a result, those who use payday loans generally either do not have access to preferred types of credit such as credit cards or would trigger expensive fees from credit card use if they continued to use them (such as over-the-limit or late fees). Bhutta, Skiba, and Tobacman found that only 59% of the payday loan applicants in their study had a general-purpose credit card.[67] Of those who had credit cards, the average cumulative credit limit was only $3000 and the average balance that they carried was about $2900, leaving very little remaining credit available.[68] Including those payday applicants with no credit cards at all, therefore, 78% had *zero* credit available on credit cards and 4% had less than $50 available.[69] Ninety percent had less than $300 in unused credit available.[70]

Bhutta, Skiba, and Tobacman's findings are consistent with other research that finds payday loans are used by those who lack

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[62] *Id.*
[63] *Id.*
[64] Gregory Elliehausen, *An Analysis of Consumers' Use of Payday Loans* 43 (Fin. Servs. Research Program, Monograph No. 41, 2009), *available at* http://www.cfsaa.com/portals/0/RelatedContent/Attachments/GWUAnalysis_01-2009.pdf.
[65] *Id.* at 33.
[66] *Id.*
[67] Bhutta, Skiba & Tobacman, *supra* note 59, at 13.
[68] *Id.*
[69] *Id.*
[70] *Id.*

access to credit cards or who would exceed their credit lines.[71] Lawrence and Elliehausen found that only half of payday loan customers have general-purpose bank credit cards and, of that group, over 60% reported that they had refrained from using their card within the year before their latest payday loan because they would have exceeded their credit limit.[72] Even these estimates tend to underestimate the constraints on access to credit card borrowing for many payday loan customers because some payday loan customers choose to maintain some precautionary unused credit card credit lines that can be drawn against in an emergency.[73] Levy and Sledge found that only 27% of small-dollar credit users have a credit card, compared with 61% of non-small-dollar credit users.[74] Over half of those who used alternative credit products reported that they did not qualify for a credit card, had "maxed out," or could no longer use their credit cards.[75] Moreover, those who have paid late fees on their credit cards are more likely to have used a payday loan than other cardholders.[76]

Demand for payday loans has increased in recent years as access to credit cards (especially for younger, lower-income, and higher-risk consumers) has fallen as a result of the financial crisis, the recession, and subsequent regulations that have further tightened

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[71] Edward C. Lawrence & Gregory Elliehausen, *A Comparative Analysis of Payday Loan Customers*, 26 CONTEMP. ECON. POL'Y 299, 306 (2008).

[72] *Id*. at 310.

[73] *Id.* at 304 (citing sources); Sumit Agarwal, Paige Marta Skiba & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* 7 (Nat'l Bureau of Econ. Research, Working Paper No. 14,659, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1327125.

[74] LEVY & SLEDGE, *supra* note 21, at 11. Note that their study includes all small-dollar products, not just payday lending, and ownership of credit cards is likely to be even less common for those who use lower-ranked products such as pawnshops.

[75] *Id.* at 16. Moreover, most payday loan customers have only one or two credit cards, usually with low credit limits; thus, they are unable to add accounts sequentially in order to increase their available credit as those with multiple cards and higher credit limits can. Lawrence & Elliehausen, *supra* note 71, at 309.

[76] MICHAEL S. BARR, NO SLACK: THE FINANCIAL LIVES OF LOW-INCOME AMERICANS 23 (2012).

credit access.[77] For example, the Credit CARD Act of 2009 imposed limits on the ability of credit card lenders to adjust credit card terms when cardholders become more risky.[78] As a result, higher-risk borrowers now receive fewer offers of credit and on worse terms than before the enactment of the legislation.[79] In addition, it is estimated that as a result of the financial crisis and the regulatory responses to it, such as the Credit CARD Act, credit card lines of credit have been slashed by some $1 trillion just as the onset of the recession and high unemployment increased the demand for credit from many consumers.[80] The combination of reduced credit lines and reduced access to credit for lower-income and higher-risk borrowers has driven a rapid growth in demand for alternative consumer credit products such as payday loans and overdraft protection.[81]

Because of this limited access to mainstream credit products, few who would otherwise use payday loans can switch to less-expensive alternatives, such as bank loans or credit cards, when payday loans are not available.[82] Instead, many consumers resort to

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[77] *See* David Stoesz, *Payday Loans and the Secondary Financial Market* 14-29 (Mar. 26, 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2029146.

[78] Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734, 1736 (2009) (codified in scattered sections of 15 U.S.C.).

[79] *See* Song Han, Benjamin J. Keys & Geng Li, Credit Supply to Bankrupt Consumers: Evidence from Credit Card Mailings (Mar. 2011) (unpublished manuscript), *available at* http://www-cfap.jbs.cam.ac.uk/news/events/2011/downloads/han_keys_li_credit.pdf (Figure 3).

[80] Meredith Whitney, Editorial, *America's 'Unbanked Masses'*, WALL ST. J. (Feb. 24, 2012), *available at* http://online.wsj.com/article/SB10001424052970204909104577235590714208670.html.

[81] *See* Kevin Wack, *Downfall of Subprime Cards Spawns Opportunity*, 178 AM. BANKER 2, 3 (June 27, 2013).

[82] PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 16–17 (2012), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf [hereinafter PEW, WHO BORROWS]. One study of U.S. consumers found that in states with strict usury ceilings, unbanked consumers tended to substitute pawnshops for payday loans, while those with access to mainstream credit markets made greater use of retail and revolving credit. *See* ANNA ELLISON & ROBERT FORSTER, POLICIS, THE IMPACT OF INTEREST RATE CEILINGS 40 (2008), *available at* http://www.policis.com/pdf/International/Australia%20The%20impact%20of%20intere

less-preferred products such as pawnshops or even to the outright sale of personal possessions.[83] Others may be forced to use credit cards or credit card cash advances even though doing so will trigger fees that exceed the costs of payday lending and may be even more likely to precipitate financial problems.[84] Still others will increase their use of overdraft protection (as will be discussed).[85]

Consumers typically use payday lending to meet important financial obligations, such as rent, utility bills, and mortgage payments, and rarely for frivolous or discretionary expenditures.[86]

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st%20rate%20ceilings%20FINAL%2020080326.pdf. While voluntary use of credit cards is usually welfare enhancing, consumers forced to use credit cards because they lack access to payday loans may pay more for credit because of their tendency to trigger fees that may make credit cards more expensive than payday loans. *Id.* at 32.

[83] Many pawnshop borrowers turn to pawnshops only as a last resort after being rejected for a payday loan. *See* ELLISON & FORSTER, THE IMPACT OF INTEREST RATE CEILINGS, *supra* note 82, at 40; Paige Marta Skiba & Jeremy Tobacman, Measuring the Individual-Level Effects of Access to Credit: Evidence from Payday Loans 23 (Jan. 19, 2007) (unpublished manuscript), *available at* http://www.clevelandfed.org/research/conferences/2007/october2/SkibaJMPaper.pdf. Pew Charitable Trusts found that 57% of payday loan customers in its survey would pawn or sell personal items if payday loans were not available. PEW, WHO BORROWS, *supra* note 82, at 16. Interest rates on pawnshops are comparable to payday loans. JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWN SHOPS AND THE POOR 36 (1994). Skiba and Tobacman found that pawn loans have a ninety day term with a monthly interest rate of 20% on loans of $1 to $150 and 15% on loans above $150. Skiba & Tobacman, Measuring the Individual-Level Effects of Access to Credit, *supra*, at 11.

[84] ELLISON & FORSTER, THE IMPACT OF INTEREST RATE CEILINGS, *supra* note 82, at 55. Both credit card delinquencies and delinquency-related revenues for issuers are higher in states that outlaw payday lending. *Id.* Those who use credit card cash advances frequently exhibit a much higher rate of missed payments on mainstream credit loans than those who use payday loans. *Id.* at 62. A 2008 study of Australian low-income consumers found that those who use credit card cash advances also had higher levels of indebtedness on average than payday borrowers. ANNA ELLISON & ROBERT FORSTER, POLICIS, PAYDAY IN AUSTRALIA: A RESEARCH STUDY OF THE USE AND IMPACT OF PAYDAY LENDING IN THE DOMESTIC AUSTRALIAN MARKET 57 (2008), *available at* http://www.policis.com/pdf/International/Payday%20borrowers%20FINAL.pdf [hereinafter ELLISON & FORSTER, PAYDAY IN AUSTRALIA].

[85] *See* discussion *infra* Part III.B.

[86] LEVY & SLEDGE, *supra* note 21, at 4.

Payday loan customers have little or no savings to fall back on.[87] Pew Charitable Trusts ("Pew") found that 58% of payday loan customers reported that they had trouble paying their bills more than half the time,[88] and 37% said that they have been so desperate to pay their bills that they would take a payday loan on any terms offered.[89] Sixty-nine percent of respondents in another Pew survey confirmed that their payday loans are used for expenses such as food, rent, utilities, or mortgage payments, and an additional 16% said they used a payday loan for an unexpected emergency or expense.[90] Moreover, 62% of payday loan customers stated that if payday loans were unavailable, they would be forced to delay paying some of their bills.[91] Only 8% of survey respondents said they used a payday loan for "something special," such as Christmas gifts, shopping, or a vacation.[92]

Other studies have also found that payday loans are overwhelmingly used to meet pressing expenses, such as utility bills, living expenses, rent or mortgage payments, car repairs, or medical

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[87] *Id.* at 14 (finding that 66% of those who use small-dollar lending products have no savings and 16% have insufficient savings to pay all their bills).

[88] PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA, REPORT 2: HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 9–10 (2013), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Choosing_Borrowing_Payday_Feb2013.pdf [hereinafter PEW, HOW BORROWERS CHOOSE].

[89] *Id.* at 21. This sense of desperation suggests that if payday loans were not available, customers would have resorted to even more expensive products.

[90] PEW, WHO BORROWS, *supra* note 82, at 13–14.

[91] *Id.* at 16.

[92] *Id.* at 14. In a study that provides indirect evidence of how payday loan customers behave, Bertrand and Morse examined what payday loan borrowers do when they receive tax rebates. *See* Marianne Bertrand & Adair Morse, *What Do High-Interest Borrowers Do with Their Tax Rebates?*, 99 AM. ECON. REV. 418, 421 (2009), *available at* http://pubs.aeaweb.org/doi/pdfplus/10.1257/aer.99.2.418. They found that only 9% of those with outstanding payday loans used their tax rebates for seemingly discretionary consumption expenditures such as "vacations, eating out or entertainment, or gifts, apparel, or electronics" rather than to pay down their outstanding payday loans, which the authors characterize as "not a very large group." *Id.* at 418. On the other hand, this estimate may be overstated if some expenditures, such as for apparel purchases, are not entirely immediate gratification purchases. *Id.* at 421.

bills.[93] Eighty-one percent of those who responded in the Pew survey said that they would "cut back" on necessary expenses, such as food and clothing, if payday loans were unavailable, which suggests that many households could suffer deeply in terms of their ability to provide adequate food, clothing, shelter, and medical care for their families if payday loans were prohibited by regulation.[94] On the other hand, critics argue that even if payday loans are useful to alleviate short-term financial pressures, they are excessively costly, and customers often use them to meet chronic budget problems and roll over their initial loans for multiple periods, thereby incurring repeated charges that may eventually exceed even the initial amount advanced and potentially lead to financial harm.[95]

Thus, although the overall effect of payday lending on consumers' welfare has been debated, losing access to payday loans

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[93] Levy and Sledge find that the most common reasons consumers use small-dollar lending products was for utility bills (36% of respondents), general living expenses (34%), rent (18%), car repairs (16%), and to help friends and family (7%). LEVY & SLEDGE, *supra* note 21, at 11 (chart 2). Ronald Mann finds in a survey of payday loan customers that two-thirds of borrowers used payday loans for expenditures such as rent, utilities, or groceries; 10% used payday loans for emergency expenses and less than 5% used payday loans for option expenditures such as gifts, dining, or entertainment. Ronald Mann, *Assessing the Optimism of Payday Loan Borrowers* 19 (Ctr. for Law & Econ. Studies, Working Paper No. 443, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_ id= 2232954. Jonathan Zinman finds that payday loan customers primarily use their funds for bills, emergencies (such as car repairs or medical expenses), food, and debt service; only 6% said that they used payday loan funds for "shopping or entertainment." Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the* Oregon Rate *Cap* 9 (Fed. Reserve Bank of Phila., Working Paper No. 08-32, 2008), *available at* http://papers.ssrn.com/sol3/ papers.cfm?abstract_id=1335438. Analysis of data from the 2007 Survey of Consumer Finances by the Center for American Progress found that the main reasons given by payday loan customers for their loans were "Convenience" (34%), "Emergency" (29%), "Basic consumption need" (21%), and "Home" (9%). *See* AMANDA LOGAN & CHRISTIAN E. WELLER, CTR. FOR AM. PROGRESS, WHO BORROWS FROM PAYDAY LENDERS? AN ANALYSIS OF NEWLY AVAILABLE DATA 11 (2009), http://www. americanprogress.org/issues/2009/03/pdf/payday_lending.pdf.

[94] PEW, WHO BORROWS, *supra* note 82, at 16.

[95] *See* discussion *infra* notes 225–31 and accompanying text.

could be harmful to many of those who use them.[96] Morgan, Strain, and Seblani found that in states where payday loans were restricted, bounced check revenues at banks increased.[97] One study found that 25% of payday loan customers reported that a loss of family income (such as from reduced hours or job loss of a spouse or partner) created the need for a payday loan.[98] A majority of those in a Pew study said that access to payday loans relieves stress and anxiety, compared to less than one-third of respondents who said that payday loans increase stress.[99]

B. A Profile of Overdraft Protection Customers

Like payday loan customers, those who use overdraft protection often have impaired credit and limited credit options. A study by Moebs Services research firm, for example, concluded that the only accurate predictor of the propensity to use overdraft protection is the consumers' credit score—those with lower credit scores are more likely to use overdraft protection—and that all other demographic information, including income, is nonpredictive of overdraft protection use.[100] Economist Marc Fusaro also found little correlation between income level and high overdraft use: high-income individuals are just as likely as lower-income individuals to use overdraft protection.[101]

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[96] *See* Richard Hynes, *Payday Lending, Bankruptcy, and Insolvency*, 69 WASH. & LEE L. REV. 607, 621 (2012) (summarizing research on effects of payday lending and concluding that the overall welfare effect is ambiguous); Paige Marta Skiba, *Regulation of Payday Loans: Misguided?*, 69 WASH. & LEE L. REV. 1023, 1041 (2012) (same); John P. Caskey, *Payday Lending: New Research and the Big Question* 25 (Fed. Reserve Bank of Phila., Working Paper No. 10-32, 2010).

[97] Donald P. Morgan, Michael R. Strain & Ihab Seblani, *How Payday Credit Access Affects Overdrafts and Other Outcomes*, 44 J. MONEY, CREDIT & BANKING 519, 519 (2012), *available at* http://jmcb.osu.edu/sites/jmcb.osu.edu/files/09453.pdf.

[98] *See* LEVY & SLEDGE, *supra* note 21, at 13.

[99] PEW, HOW BORROWERS CHOOSE, *supra* note 88, at 43.

[100] Press Release, Moebs Services, Who Uses Overdrafts? (Sept. 29, 2009), *available at* http://www.moebs.com/PressReleases/tabid/58/ctl/Details/mid/380/ItemID/194/Default.aspx.

[101] Fusaro, *Bounced Check Loans*, *supra* note 51, at 500; Marc Anthony Fusaro, *Hidden Consumer Loans: An Analysis of Implicit Interest Rates on Bounced Checks*, 29 J. FAM. & ECON. ISSUES 251, 257, 260 (2008). That many high-use overdraft customers are also high-income consumers should

A survey of overdraft users by the Raddon Financial Group found that only 7% of elevated users of overdraft protection view their credit rating as "excellent," while 70% characterize their credit rating as "fair" (38%) or "poor" (32%).[102] In contrast, 74% of individuals who do not subscribe to overdraft protection characterize their credit rating as "excellent" or "good," with only 9% characterizing their credit rating as "poor."[103] Another study found that those who self-identify as having "poor credit" are also three times more likely to say that access to overdraft protection is "extremely important" than those who self-report as having "excellent credit."[104] Only 10% of frequent overdraft users report that they would use a credit card if overdraft protection were not available, while a majority said that they would be unable to obtain needed funds if overdraft protection were not available.[105] Moreover, because those who use overdraft protection frequently have weak credit, they usually cannot qualify for less-expensive options, such as a bank line of credit, which require higher credit scores and much larger minimum loan amounts.[106]

Overdraft protection also is often used to ensure payment of important bills that would otherwise go unpaid or cause bounced

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not be surprising because overdraft protection was originally a convenience for higher-income borrowers. *See* discussion *supra* Part I. Access to overdraft protection has been extended to less-well-off consumers over time. *Id.*

[102] Raddon Fin. Grp., Inc., Custom Survey Research Findings 33 (June 2011) (prepared for International Bank of Commerce) (on file with author) [hereinafter Raddon Group]. A summary of the study findings can be found in Zywicki, *Overdraft Protection*, *supra* note 23, at 1173.

[103] *See* Raddon Group, *supra* note 102, at 33; *see also* Zywicki, *Overdraft Protection*, *supra* note 23, at 1173 (summarizing findings).

[104] Zywicki, *Overdraft Protection*, *supra* note 23, at 1174 (citing Baselice & Associates, Inc., Banking Survey (Aug. 29–31, 2011)).

[105] Raddon Group, *supra* note 102, at 30; *see also* Zywicki, *Overdraft Protection*, *supra* note 23, at 1173 (discussing survey by Raddon Financial Group, Inc.).

[106] *See* Raddon Group, *supra* note 102; *see also* Zywicki, *Overdraft Protection*, *supra* note 23, at 1192 (discussing Raddon Financial Group, Inc. study). Frequent overdraft users often do not have sufficient funds to maintain a separate savings account that they can link to their checking account to cover overdrafts. Only a minority of banks offer overdraft programs linked to other accounts, such as a line of credit or savings account, instead of traditional overdraft loan programs. *See* CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 56.

checks. For example, eight of nine respondents in a small focus group conducted by ICF Macro (in connection with the Federal Reserve's promulgation of its 2009 amendments to Regulation E regarding overdraft protection programs) said that they would keep their overdraft coverage—even if it meant triggering overdraft fees—because they wanted their checks to pay for important transactions.[107] In addition, according to one large regional bank, when it adopted a new policy of posting overdrafted checks in sequential order from the smallest to the largest dollar amount (as required by the FDIC), the number of checks and ACH items that were returned increased by 4%, but the total dollar amount of the rejected payments increased by 16%.[108] Furthermore, the returned payments included payments for key household expenses such as mortgages, utilities, medical bills, student loan bills, rent, and taxes.[109] Thus, although the FDIC's requirement that smaller payments be cleared first might have reduced the total number of overdrafts by consumers, it also led to a disproportionate return of larger, more important payments—for which consumers presumably might want overdraft protection—while smaller, less-important payments were honored.

Consumer behavior also illustrates the value of overdraft protection to heavier users of the product.[110] For example, the Federal Reserve's amendments to Regulation E required banks to obtain affirmative opt-in consent from consumers of overdraft protection for ATM and point-of-sale debit transactions.[111] Although comprehensive independent analysis of the effect of the regulation's opt-in requirement is lacking, one finding is clear: the likelihood that a consumer will opt in to overdraft protection is positively correlated with the consumer's frequency of use. For example, the CFPB's Overdraft Protection White Paper reports that while 15.2% of all bank accounts had opted in to overdraft protection following the issuance of the new requirement, the percentage of those accounts that opted in rose as the number of overdrafts increased ranging from

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[107] MACRO INT'L INC., REVIEW AND TESTING OF OVERDRAFT NOTICES 8–9 (Dec. 8, 2008), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20081218a6.pdf .
[108] *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1190 (describing data obtained from IBC Bank).
[109] *Id.*
[110] *See* CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 30.
[111] *See* 12 C.F.R. § 205.17 (2013).

11.3% for accounts that had no overdrafts to 44.7% for those with more than ten overdrafts.[112] A survey by Moebs Services of large banks found that about 75% of consumers opted in to debit card overdraft protection but that almost all of those who used overdraft protection ten or more times per year did so.[113] A June 2011 survey of its customers by one large regional bank also found that frequent users were more likely than infrequent users to report that access to overdraft protection was "extremely valuable."[114] The heightened willingness of heavier users of overdraft protection to opt in to coverage is suggestive of the value of the product to those consumers in light of available alternatives.

III. Competition Between Payday Lending and Overdraft Protection

Payday lending and overdraft protection also compete directly for consumers in that many consumers actually use, or could use, both products to achieve the same objectives.[115] Moreover, available evidence indicates that consumers generally choose wisely in deciding which product to use in light of their available options or in deciding whether to use either payday lending or overdraft protection compared to alternative products.[116] Standard economic theory demonstrates that robust competition is a vital source of

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[112] CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 31 fig. 5.

[113] *See* Press Release, Moebs Services, Banks Lower Overdraft Fees as Consumers Choose to Opt-In (Dec. 8, 2010), *available at* http://www.moebs.com/PressReleases/tabid/58/ctl/Details/mid/380/ItemID/197/Default.aspx ("[A]lmost 100[%] of those using overdrafts, [ten] or more times in a year, and over 50[%] of those who never overdraw their account, opted-in for overdraft protection.").

[114] *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1157 (citing study by the Raddon Financial Group, Inc. in June 2011 that "86% of elevated users stated that the availability of overdraft protection was 'extremely valuable'" while "only 2% said it was 'not at all valuable'" and "the percentage of those stating that overdraft protection is 'extremely valuable' rose consistently with the intensity of use, from 57% for non-users of overdraft protection to 86% for elevated users").

[115] *Id.* at 1185.

[116] Todd J. Zywicki, *The Case Against New Restrictions on Payday Lending* 2 (Mercatus Ctr., Working Paper No. 64, 2010), *available at* http://mercatus.org/sites/default/files/publication/MOP64_FMWG_Payday%20Lending_web.pdf.

consumer welfare, and consumer credit is no exception. Thus, regulation should be sensitive to preserving competition that will produce lower prices and higher quality for consumers.

A. Benefits of Competition Within Product Markets

Competition benefits consumers in the alternative consumer credit markets just as it does in any other market, providing consumers with the opportunity for lower prices, innovation, and higher-quality service.[117] Although prices seem high for both payday loans and overdraft protection, there is no evidence that either product generates sustainable economic profits (as opposed to normal economic returns).[118] Payday loan prices generally reflect underlying risk and operating costs.[119] There is no evidence of supranormal economic (or monopoly) returns to firms in the payday lending industry, indicating the competitive nature of the market.[120] Barriers to entry in the payday lending market appear to be low.[121]

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[117] *See* Philip Bond, David K. Musto & Bilge Yilmaz, *Predatory Lending in a Rational World* 14 (Fed. Reserve Bank of Phila., Working Paper No. 06-2, 2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=875621; *see also* Victor Stango, *Are Payday Lending Markets Competitive?*, REGULATION, Fall 2012, at 26, *available at* http://www.cato.org/sites/cato.org/files/serials/files/regulation/2012/11/v35n3-5.pdf.

[118] It is important to stress that we are referring here to *economic* profits—i.e., risk-adjusted returns above the opportunity cost of the inputs used (what the assets would receive in a competitive market), not merely accounting profits. Thus, it is possible to recognize accounting profits while receiving no economic profits once the opportunity cost and risk of the product is considered. *See Economic Profit (Or Loss)*, INVESTOPEDIA.COM, http://www.investopedia.com/terms/e/economicprofit.asp (last visited Dec. 12, 2013).

[119] Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 19 (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=771624.

[120] *See* Paige Skiba & Jeremy Tobacman, The Profitability of Payday Loans 2 (Dec. 10, 2007) (unpublished manuscript), *available at* http://www.cpla-acps.ca/english/reports/Vanderbilt%20Oxford%20profitability%20study%2012%2010%202007.pdf.

[121] Zywicki, *Payday Lending*, *supra* note 50, at 28. For example, there are twice as many licensed payday lenders in California as there are McDonald's restaurants, indicating the ease of entry. *See Think Payday*

Competition among payday lenders produces lower prices and higher quality, just as in other markets.[122] Donald Morgan also found that greater competition among payday lenders generated lower market prices.[123] In addition to competing on price, payday lenders compete on non-price margins such as convenience, customer service, and responsiveness, all of which are highly valued by payday loan customers.[124]

Those who use payday lending report high levels of satisfaction with their experiences, as would be expected in a highly competitive market with informed consumers.[125] For example, a study published in 2009 by economist Gregory Elliehausen found that 54.7% of borrowers reported being "very satisfied" and 33.7% reported being "somewhat satisfied" with their most recent payday loan.[126] By contrast, only 5.1% were "somewhat dissatisfied" and 5.7% were "very dissatisfied."[127] Levy and Sledge similarly found that a majority of those who used small-dollar lending products (such as payday lending and pawnshops) reported having a satisfactory experience.[128] Research by the Pew Foundation found that 62% of payday loan customers said that they would use payday loans again if they needed money.[129]

Lending Isn't Out of Control in the United States?, CSUN**,** http://www.csun.edu/~sg4002/research/mcdonalds_by_state.htm (last visited Dec. 12, 2013).

[122] Robert DeYoung & Ronnie J. Phillips, *Payday Loan Pricing* 29 (Fed. Reserve Bank of Kan. City, Working Paper No. 09-07, 2009), *available at* http://www.kc.frb.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

[123] DONALD P. MORGAN, FED. RESERVE BANK OF N.Y., DEFINING AND DETECTING PREDATORY LENDING 22 (2007), *available at* http://www.newyorkfed.org/research/staff_reports/sr273.html.

[124] LEVY & SLEDGE, *supra* note 21, at 4 ("The top three loan attributes that mattered most to [small-dollar credit] consumers were: quick access to money, ability to qualify, and clear terms."); Stango, *supra* note 117, at 27.

[125] Elliehausen, *supra* note 64, at 41.

[126] *Id.*

[127] *Id.* Of those who were dissatisfied, most thought the prices were too high. *Id.* at 42.

[128] LEVY & SLEDGE, *supra* note 21, at 5.

[129] PEW, HOW BORROWERS CHOOSE, *supra* note 88, at 49 exhibit 20.

Consumers also are attracted to payday lending because they feel that the pricing is simple, transparent, and understandable.[130] According to a survey by Pew, for example, 86% of payday loan customers said that the terms and conditions of payday loans are clear,[131] and Elliehausen found that only 2% of payday loan customers did not know the finance charge on their loan.[132] In fact, many payday loan customers prefer payday loans because they have had negative experiences with complicated products such as credit cards and bank accounts.[133]

The growth in the use of overdraft protection also came in response to competition and consumer demand in the banking industry. Like payday lending, the retail banking industry is "highly competitive"[134] and there is no evidence of supranormal profits arising because of the operation of overdraft protection programs.[135]

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[130] LEVY & SLEDGE, *supra* note 21, at 4 (reporting that "clear terms" is one of the main characteristics liked by users of payday lending and other short-term lending products).

[131] PEW, HOW BORROWERS CHOOSE, *supra* note 88, at 17 exhibit 5.

[132] Elliehausen, *supra* note 64, at 35–38. Ninety-four and one half percent of payday loan customers reported paying finance charges consistent with prevailing market rates. *Id.* Caskey reports a survey of California payday loan customers in which 92% of customers stated that they were aware of the fees on their payday loan before they borrowed. *See* Caskey, *supra* note 96, at 7.

[133] *See* Zywicki, *Payday Lending*, *supra* note 50.

[134] David S. Evans, Robert E. Litan & Richard Schmalensee, Economic Analysis of the Effects of the Federal Reserve Board's Proposed Debit Card Interchange Fee Regulations on Consumers and Small Businesses 20 (Feb. 22, 2011) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1769887.

[135] Although measures of return on assets and measures of return on equity are simply approximations of underlying economic profits, neither measure reflects the presence of economic rents compared to opportunity cost of capital nor that return on assets rose over the period during which access to overdraft protection increased. *See Return on Average Assets for All U.S. Banks (USROA)*, FED. RESERVE BANK OF ST. LOUIS (Nov. 8, 2013), http://research.stlouisfed.org/fred2/series/USROA (return on assets); *Return on Average Equity for all U.S. Banks (USROE)*, FED. RESERVE BANK OF ST. LOUIS (Nov. 8, 2013), http://research.stlouisfed.org/fred2/series/USROE?rid=55 (return on equity). We are not aware of anyone who has argued that economic rents *were* present as a result of increased access to overdraft protection. Indeed, return on equity for large banks was virtually constant from the early 1990s until the time of the financial crisis. *See*

Overdraft protection traditionally was available only to high-income or well-connected customers for whom overdrafts would be paid when they had "short-term liquidity problems."[136] The creation of automated overdraft protection, however, led banks to extend access to the product beyond its traditional elite, high-income customer base.[137] Since the creation of automated overdraft protection, use of the product has spread very quickly. The FDIC found in its 2008 report of 462 FDIC-supervised banks that 86% of banks "operated some form of an overdraft program" and that 40.5% of all banks offered automated overdraft programs.[138] Among larger banks with over $1 billion in assets, 76.9% offered automated overdraft programs.[139] Approximately 70% of banks with overdraft programs implemented their automated programs after 2001.[140] A 2011 study by the FDIC found that 70% of banks with assets of $38 billion or more, 54% of midsized institutions, and 32% of banks with assets of less than $1 billion operated automated overdraft programs.[141] A survey of 575 community banks undertaken in connection with the CFPB's overdraft protection study found that 71% of banks with over $250 million in assets use some degree of automated overdraft protection.[142] As the use of ATMs and point-of-sale debit cards has

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Return on Average Equity for U.S. Banks with Average Assets Greater than $15B (USG15ROE), FED. RESERVE BANK OF ST. LOUIS (Nov. 8, 2013), http://research.stlouisfed.org/fred2/series/USG15ROE?rid=55 (showing graphically the small change in return on equity from 1990 to 2008). Return on assets was largely unchanged as well. *See Return on Average Assets for U.S. Banks with Average Assets Greater than $15B (USG15ROA)*, FED. RESERVE BANK OF ST. LOUIS (Aug. 14, 2013), http://research.stlouisfed.org/fred2/series/USG15ROA?rid=55 (showing graphically the small change in return on assets from 1990 to 2008).

[136] Zywicki, *Overdraft Protection*, *supra* note 23, at 1151.

[137] *See id.* at 1152.

[138] *See* FED. DEPOSIT INS. CORP., FDIC STUDY OF BANK OVERDRAFT PROGRAMS 5 (2008), *available at* http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf [hereinafter FDIC STUDY OF BANK OVERDRAFT PROGRAMS] (describing the study, which consisted of a general analysis of the availability of overdraft programs and a detailed evaluation of these individual programs).

[139] *Id.* at 5 tbl. III-1.

[140] *Id.* at 8 tbl. III-4.

[141] FED. DEPOSIT INS. CORP., SURVEY OF BANKS' EFFORTS TO SERVE THE UNBANKED AND UNDERBANKED 16 (2012), *available at* http://www.fdic.gov/unbankedsurveys/2011survey/2011report.pdf.

[142] CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 14.

increased, banks have also extended overdraft protection to those products.[143]

One major reason for the growth of overdraft protection (along with the growth of debit card use and the interchange fees it generated) was its link to the expansion of free checking accounts.[144] From 2001 to 2009, "the percentage of accounts at large banks that qualified for free checking increased from 7.5%" to 76%, and the average minimum balance required for free checking fell from $440 in 2001 to $186 in 2009.[145] Consumers migrated to banks that offered the combination of free checking and overdraft protection, especially low-income consumers who either could not afford the monthly maintenance fees or high minimum balances necessary to obtain free checking or had limited credit options and thus valued access to overdraft protection.[146] Revenue from overdraft protection and other sources also enabled banks to increase other services valued by customers, such as free online banking, or to increase customer service by adding convenient branch locations and operating hours.[147] The combination of overdraft protection, free checking, and increased access to new customers increased the market share of those banks and imposed competitive pressure on other banks to respond.[148]

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143 According to the FDIC study, 81% of banks that operated automated overdraft programs allowed overdrafts to be paid at ATMs and POS debit card terminals. FDIC STUDY OF BANK OVERDRAFT PROGRAMS, *supra* note 138, at 9–10, 10 tbl.III-8.

144 *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1177–80.

145 Evans, Litan & Schmalensee, *supra* note 134, at 27.

146 It should be stressed that the "overwhelming majority" of consumers, including responsible low-income consumers, pay no or few overdraft fees each year and thus in fact do receive checking with no service or other charges. *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1163–66.

147 *See id.* at 1178 (discussing value of products in "free checking" bundle).

148 *See* Marc Anthony Fusaro, Consumers' Bank Choice and Overdraft Volume: An Empirical Study of Bounce Protection Programs 7–12 (Dec. 2003) (unpublished manuscript), *available at* http://faculty.atu.edu/mfusaro/fusarooverdraftvolume.pdf [hereinafter Fusaro, Consumers' Bank Choice]. This competitive growth may not be specifically because all customers consciously desire to have access to overdraft protection (although surely some do) but because consumers value the combination of terms and account features banks offer in combination with overdraft protection. In particular, increased use of overdraft protection enabled banks to offer accounts with free checking or other lower fees, which increased access for lower-income consumers who otherwise could not afford accounts with the higher monthly fees or high minimum balances necessary

On the other hand, overdraft programs carry risk for banks. The CFPB estimates, for example, that charged-off account principal balances were about 14.4% of the net overdraft fees charged by banks in 2011.[149] The competitive success of combining terms associated with overdraft protection—e.g., free checking, higher quality, and a variety of free services—over the competing model of monthly maintenance fees and minimal services presumptively suggests that consumers preferred the former to the latter.[150]

The role of overdraft fees in the competitive process was illustrated by the financial industry's response to the Federal Reserve's amendments to Regulation E in 2009, which imposed new limits on overdraft protection programs. According to Evans, Litan, and Schmalensee, "within days" of the Fed's announcement of its new overdraft rules, banks started scaling back access to free checking, imposed new fees, and eliminated services for consumers.[151] The number of accounts eligible for free checking fell eleven percentage points in one year—from 76% in 2009 to 65% in 2010—a figure that translates to approximately twenty million accounts.[152] When combined with the lingering effects of the financial crisis and subsequent recession, as well as the Durbin Amendment to Dodd-Frank (which became effective in 2010 and imposed price controls on debit card interchange fees that led to compensating increases in other banking fees),[153] access to free checking has plunged in recent years, reversing the gains of the prior decade in terms of mainstreaming many American financial consumers.[154]

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to qualify for free checking accounts. Zywicki, *Overdraft Protection*, *supra* note 23, at 1177.

[149] CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 17.

[150] Zywicki, *Overdraft Protection*, *supra* note 23, at 1179.

[151] Evans, Litan & Schmalensee, *supra* note 134, at 31.

[152] *Id.*

[153] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1075, 15 U.S.C. § 1693o-2 (2012).

[154] *See* Claes Bell, *Checking Fees Rise to Record Highs in 2012*, BANKRATE (Sept. 24, 2012), http://www.bankrate.com/finance/checking/checking-fees-record-highs-in-2012.aspx#slide=1. By 2012, the percentage of accounts eligible for free checking had fallen to 39%. *Id*. At the same time, many consumers have become unable to afford bank accounts: the FDIC reports that between 2009 and 2011, the number of unbanked Americans increased by just under one million and the number of underbanked by approximately

The growth of access to overdraft protection is largely consistent with consumer preferences, especially among frequent users of the product. According to a 2009 survey by the American Bankers Association ("ABA"), of those consumers who had paid an overdraft fee in the past twelve months, 96% wanted the bank to cover their payment.[155] A 2010 survey by the ABA found that 69% of those who paid overdraft fees in the previous twelve months "were glad the payment was covered."[156] Overall, available information indicates that the vast majority of overdraft customers self-report that they are happy that overdraft protection was available and that they value the ability to be free to use overdraft protection when they need it.[157] Consumers also reported that they generally understood the terms and costs of overdraft programs.[158]

Economist Mark Fusaro estimates that, on average, consumers gain a surplus of approximately $50 per year, or $2 billion economy-wide, from the availability of overdraft protection plus the accompanying benefits of avoiding nonsufficient funds (NSF) fees and maintaining lower precautionary balances.[159] Fusaro and Ericson conclude that overdraft protection generally benefits middle-class bank consumers and is neutral for low-income consumers.[160] They conclude that "eliminating [overdraft protection] through excess regulation would hurt the most vulnerable population the most, as they have the fewest alternatives to maintain necessary liquidity."[161]

2.5 million. FDIC, SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS, *supra* note 5, at 10.

[155] Press Release, Am. Bankers Ass'n, ABA Survey: More Consumers Avoid Overdraft Fees (Sept. 9, 2009), *available at* http://www.aba.com/aba/documents/press/ConsumerOverdraftSurvey2009.pdf.

[156] Press Release, Am. Bankers Ass'n, ABA Survey: Most Customers Avoid Overdraft Fees (Sept. 15, 2010) (on file with author).

[157] *Id.*

[158] *See generally* ICF MACRO, DESIGN AND TESTING OF OVERDRAFT DISCLOSURES: PHASE TWO (2009), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20091112a4.pdf.

[159] *See* Fusaro, Consumers' Bank Choice, *supra* note 148, at 3–16.

[160] Marc Anthony Fusaro & Richard E. Ericson, *The Welfare Economics of "Bounce Protection" Programs*, 33 J. CONSUMER POL'Y 55, 57 (2010).

[161] *Id*. at 71.

B. Benefits of Competition Across Product Markets: Payday Lending and Overdraft Protection

Economic analysis indicates that payday loans and overdraft protection compete with each other across the two product markets as well. Economists Brian T. Melzer and Donald P. Morgan have studied consumer decision making with respect to the choice between payday lending and overdraft protection to illustrate the manner in which they compete.[162] Payday loans and overdraft protection are offered on very different price terms, which Melzer and Morgan used as a natural experiment for testing whether consumers choose rationally between them.[163] Payday loans typically charge $15 for every $100 borrowed.[164] Overdraft protection plans charge a flat fee per overdraft, regardless of the size of the check that triggered it.[165] At the time of their study, Melzer and Morgan reported an average overdraft fee of $27.[166] Therefore a payday loan is less expensive when covering a single payment of $180 or less, but above that amount, overdrafts are less expensive.[167] This differential

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[162] *See* Melzer & Morgan, *supra* note 26.
[163] *Id.* at 3. It should be noted that price is not the only way in which the two products compete. For example, overdraft protection loans are more convenient and can be triggered at the point of making a purchase or paying a bill, anytime in the world twenty-four hours a day, thereby avoiding the "shoe leather" costs of obtaining a payday loan and the need to plan ahead to have sufficient funds available to cover transactions. *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1167–70. On the other hand, borrowers may prefer payday loans because defaulting on the payday loan does not jeopardize their access to a bank account (although it will eliminate access to further payday loans). *Id*. at 1169. This indicates that consumers shop among products on margins such as convenience and access, not just price.
[164] Melzer & Morgan, *supra* note 26, at 1.
[165] *Id.*
[166] *Id.* (citing FED. DEPOSIT INS. CORP., FDIC STUDY OF BANK OVERDRAFT PROGRAMS II-III (2008), *available at* http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf).
[167] *Id.* The equivalence is "$27/$180 = $15/$100." *Id.* at 1 n.1. The CFPB cites one estimate that "the average overdraft fee increased from $21.57 in 1998 to $31.26 in 2012." CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 17 (citing *Average Nonsufficient Funds Fee*, BANKRATE (Dec. 8, 2004), http://www.bankrate.com/brm/news/checkingstudy2004/interest/nsf-fee.asp; Claes Bell, *Checking Fees Rise to Record Highs in 2012*, BANKRATE (Sept. 24, 2012), http://www.bankrate.com/finance/checking/

pricing scheme also creates a potentially adverse selection problem because rational consumers will select the option that gives them the lowest price for their particular transaction.[168]

Melzer and Morgan's analysis confirms that when payday loans are available, the two products compete and consumers generally choose rationally whether to use overdraft protection or payday lending to cover a particular transaction.[169] Where payday loans are available, the number of overdrafts and bounced checks *falls* (as consumers use payday loans to cover some checks that otherwise might bounce),[170] but the "average dollar amount" of the overdraft *rises*, perhaps because payday loans are used to cover smaller checks.[171]

Subsequent research by Morgan, Strain, and Seblani on the impact of state payday loan bans also found that consumers substitute between the two products.[172] As predicted, they found that when a state bans payday lending, overdraft revenues increase at

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checking-fees-record-highs-in-2012.aspx#slide=5). Obviously, if the average fee for overdrafts increases or payday loan fees decrease, the break-even point will increase as well. In addition, if a consumer chooses to roll over an initial payday loan rather than paying it off at the end of the period, it might be argued that payday loans are more expensive. But this potential is functionally identical to that of an overdraft protection in that the customers must pay off both the item that triggered the overdraft and the fee. If the customers are left with insufficient funds to pay for new items, they will trigger a new overdraft and a new fee. As a result, the fact that many consumers roll over their payday loans does not seem to change the underlying comparison in any meaningful sense. If multiple payments must be covered, a single payday loan usually will be less expensive than multiple overdrafts.

[168] *See* Melzer & Morgan, *supra* note 162, at 1–3 (concluding that "adverse selection increases costs to overdraft providers in two ways; funding large overdrafts costs more, and if the credit is not repaid, lenders lose more").

[169] *Id.* at 2.

[170] *See id.* at 3.

[171] *See id.* They also find that where "payday credit is available, depositories reduce the availability of 'free' checking accounts only for accounts *without* direct deposit," but not for those *with* direct deposit. *Id.* (emphasis in original). According to the authors, direct deposit serves as insurance for the bank against "hit and run" customers who open an account without direct deposit, intending to make large overdrafts that will never be repaid, and then switch to using payday loans to meet short-term credit needs. *See id.* at 3, 19.

[172] Morgan, Strain & Seblani, *supra* note 97, at 520, 529.

banks, whereas allowing payday lending results in a decline in bank overdraft fee revenues.[173]

Consumers also identify the two products as competitive substitutes. One survey found that a quarter of those who frequently use overdraft protection say that they would switch to payday lending if overdraft protection were not available.[174] A survey of Australian payday loan customers by the Policis research group found that if payday loans were not available, approximately 20% of "Mainstream Excluded" payday loan customers said that they would increase their use of overdraft protection.[175] Jonathan Zinman also finds some evidence that the use of overdraft protection increased after Oregon imposed strict regulations on payday loan prices.[176]

In fact, the increasing convergence between nonbank payday lending and short-term bank lending products may be best illustrated by the "direct deposit advance" that has been developed by banks in recent years. This product is functionally similar to payday loans.[177] With a direct deposit advance, bank customers can have the bank deposit funds into their bank accounts as an advance against an expected direct deposit credit (such as a paycheck).[178] The bank can then withdraw the "loan amount, plus the fee, directly from the customer's next . . . direct deposit."[179] According to an analysis by the Center for Responsible Lending, the typical cost of bank direct deposit advance loans is "$10 per $100 borrowed," and the "typical loan term" is approximately ten days, producing an estimated APR of 365%, very similar to that of payday loans.[180] In fact, the CFPB's white paper on payday lending and deposit advance recognizes that these two products have "general similarities in structure, purpose,

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173 *Id.* at 519, 521.

174 Raddon Group, *supra* note 102; *see also* Zywicki, *Overdraft Protection*, *supra* note 46, at 1173 (summarizing findings by Raddon Financial Group, Inc.).

175 *See* ELLISON & FORSTER, PAYDAY IN AUSTRALIA, *supra* note 84, at 92.

176 *See* Zinman, *supra* note 93.

177 *See* BORNÉ, FRANK, SMITH & SCHLOEMER, *supra* note 31, at 4–5.

178 *See id.* at 3.

179 *Id.* at 3. If the customer does not deposit sufficient funds within thirty-five days to repay the loan, the bank can repay the amount due via an overdraft of the customer's account. *Id.*

180 *Id.* at 4–5. Of course, the APR varies according to the fees associated with the loan as well as the loan duration. *See id.* For example, a loan outstanding for ten days had an estimated APR of 365% while a loan of one month had an estimated APR of 120%. *Id.*

and . . . consumer protection concerns"[181] and "particularly in the consumer protection issues they raise."[182]

The fee-based nature of payday loan pricing and overdraft protection suggests another similarity between the products: in both cases, it might be appropriate to think of the charges either as a product or service price or as a convenience fee, rather than as a payment of interest. For example, payday loan customers pay for the service of having money advanced to them. They do not receive a discount for early loan repayment, as would be the case if the product price reflected accrued interest. Similarly, the primary pricing for "overdraft protection is a flat fee" for the convenience of payment of the check, rather than interest for the time the overdraft is outstanding.[183] Fundamentally, regardless of whether both products are classified as "credit" with the prices converted into an associated inferred APR or both are classified as charging a price or fee for a product or service, their term structure is essentially identical and should be considered so for regulatory purposes. In other words, if the price terms of payday lending are converted into an inferred APR and subjected to regulation on that basis, the price terms of overdraft protection should be as well.

C. History Lessons on Regulation and the Value of Preserving Fair Competition in Consumer Credit Markets

Dodd-Frank's recognition of the importance of maintaining a fair competitive market for consumer credit products is confirmed by experience. In the United States, consumer financial products historically were regulated on the state level in an ad hoc, product-by-product regulatory framework tailored to the unique

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[181] CFPB, PAYDAY LOANS, *supra* note 16, at 6.

[182] *Id.* at 7. The CFPB notes some differences between the two products based on their credit risk and delivery costs. *Id.* at 7–8. However, these product differences are largely unrelated to the consumer protection issues discussed here.

[183] *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1171. Overdraft protection does charge a nominal interest rate but the initial convenience fee is the primary price component. *See id.* at 1175–76.

characteristics of each product as it emerged.[184] Thus, as various new products were developed (often spurred by efforts to create products that would fall outside consumer credit regulations), they were governed by different regulatory schemes designed specifically for the features of those products.[185] For example, industrial banks (originally known as Morris Plan banks after Arthur J. Morris, who first conceived of the idea), first appeared in 1910.[186] Under the Morris Plan, lenders would offer a loan at the legal rate permitted by the state's usury law, but they also would require the borrower either to purchase a hypothecated, non-interest-bearing certificate from the bank or to make monthly deposits into a noninterest-bearing savings account equal to one-twelfth of the original principal amount.[187] This particular structure, while functionally equivalent to paying interest on a loan, was held to fall outside existing regulatory limits.[188] As a result, Morris Plan banks spread rapidly at the expense of functionally identical products having different formal structures that caused them to fall under existing regulations.[189]

This practice of designing substantively identical loan products to conform to the narrow letter of the law was ubiquitous. Within any particular state, different lenders would offer similar products that were structured differently and thus called forth different regulations.[190] As new products were designed to avoid regulation, legislatures would create a new set of laws tailored to the new product's particular characteristics.[191] Economist Robert W. Johnson wrote in 1968 that

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[184] *See* THOMAS A. DURKIN, GREGORY ELLIEHAUSEN, MICHAEL STATEN & TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY (Oxford University Press, forthcoming 2013).
[185] *See id.* (discussing the state regulation of consumer credit).
[186] Jarret C. Oeltjen, *Usury: Utilitarian or Useless?*, 3 FLA. ST. U. L. REV. 167, 178 (1975).
[187] IRVING S. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS 197–203 (2d ed. 1970); Oeltjen, *supra* note 186, at 178.
[188] *See* MICHELMAN, *supra* note 187, at 198.
[189] *See id.*
[190] *See* Robert W. Johnson, *Economic Rationale of the Uniform Consumer Credit Code*, 23 J. FIN. 303, 304 (1968) ("At the present time the legal framework prescribing the treatment that may be accorded consumers varies widely among the states and within any given state . . . .").
[191] *See id.* (discussing the "*ad hoc*" approach state legislatures took to deal with specific problems).

> [t]he result of this *ad hoc* development of legislation is clearly demonstrated for example, in New York, where there are separate statutes regulating instalment loans by commercial banks, loans by industrial banks, banks' check-credit plans, revolving charge accounts, motor vehicle instalment sales financing, instalment financing of other goods and services, insurance premium financing, loans by consumer finance companies, and loans by credit unions. In these nine statutes there are 14 different ceilings on consumer finance charges.[192]

The end result was a patchwork of product-by-product regulations with a thicket of inconsistent rules that governed everything from permissible interest rates to loan size.[193] These inconsistent laws artificially segmented consumer loan markets and dampened competition, which, as economist Robert P. Shay notes, "fostered monopolistic or oligopolistic markets with accompanying higher prices for credit."[194]

In fact, regulation itself could facilitate collusion among lenders, especially on interest rate ceilings.[195] For example, David H. Rogers's study of consumer banking in New York noted that rates charged by different types of lenders "closely followed" the statutory ceilings provided by state law for the different types of lenders and

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[192] *Id.*

[193] DAVID H. ROGERS, CONSUMER BANKING IN NEW YORK 33 (1974). Rogers notes that in New York, for example, industrial banks could offer loans of up to $5000 at 6% per year and commercial banks could offer loans of $500 to $3500 per year at an interest rate of 12% on unpaid balances. *Id.* Licensed small-loan companies, however, could make loans of up to $300 at 3% per month for the first $150 and 2.5% above $150. *Id.* at 34. Credit unions offered very small loans at lower rates (federal credit unions offered unsecured loans of $50 at 1% per month), but because they were available to members only, they were irrelevant for many customers. *Id.* at 33.

[194] Robert P. Shay, *The Impact of the Uniform Consumer Credit Code upon the Market for Consumer Installment Credit*, 33 LAW & CONTEMP. PROBS. 752, 752 (1968).

[195] *See generally* Christopher R. Knittel & Victor Stango, *Price Ceilings as Focal Points for Tacit Collusion: Evidence from Credit Cards*, 93 AM. ECON. REV. 1703 (2003) (explaining focal point effect of usury regulations).

that there was significant market segmentation in the size of loans offered by different types of lending institutions.[196] Economists have found similar focal point effects for interest rate ceilings on credit cards[197] and payday loans.[198] Disparate regulation of substitute products further distorted the market because capital tended to flow to less regulated markets, thereby expanding the market share of favored products and reducing the share of products subject to tight regulation.[199] As a result, although the products were substantively similar, their respective market shares often depended on their relative regulatory treatment rather than on consumer preferences and fair competition.[200]

In addition to promoting the use of some products relative to others, regulation also encouraged lenders to modify certain terms and features of their products in order to avoid formal restrictions. Thus, where certain terms (such as interest rates) were regulated and other terms were unregulated, lenders could alter the terms on the unregulated margins in order to offset the inability to freely set terms on the regulated margins.[201] For example, credit card issuers who were unable to charge a market rate of interest imposed annual fees on cardholders.[202] Once interest rates were effectively deregulated, however, annual fees quickly disappeared, consistent with expressed consumer preferences and spurring intense competition among credit card issuers.[203]

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[196] ROGERS, *supra* note 193, at 33.
[197] *See generally* Knittel & Stango, *supra* note 195 ("In the final section of the paper, we show that our estimates of state-level tacit collusion are directly related to state-level entry rates in credit cards.").
[198] DeYoung & Phillips, *supra* note 122, at 27.
[199] *See, e.g.*, William J. Boyes, *In Defense of the Downtrodden: Usury Laws?*, 39 PUBLIC CHOICE 269, 269–70 (1982).
[200] DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 184, at 654–56.
[201] Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79, 155 (2000).
[202] *Id.* at 155–65. In addition to dampening competition and reducing ownership of credit cards, there were distributional consequences from this term repricing. Annual fees are highly regressive, as traditionally annual fees were independent of the amount charged on the card or whether the cardholder revolved. Moreover, the combination of lower interest rates with higher annual fees forced those consumers who paid their balances in full to subsidize those who revolved from month to month, a cross-subsidy of questionable value. *Id.*
[203] *Id.* at 154–55.

But forcing lenders to go through this term repricing process was usually harmful both for borrowers and for the competitive process.[204] The terms that were regulated were usually the most prominent and important terms, such as the interest rate. The offsetting adjustments, however, tended to occur on less prominent margins; as a result, this term-repricing process made products heterogeneous and less transparent.[205] These market adjustments also created a competitive advantage for those products that were easier to modify for term-repricing purposes, namely complex products that have multiple price points. This, in turn, resulted in a competitive disadvantage for simpler products with transparent terms.[206]

This history lesson is relevant to the regulation of overdraft protection and payday lending today. Overdraft protection is embedded in bank accounts (which have numerous and diverse terms and features). As a result, it might be easier for banks to offset losses due to new regulations on overdraft protection than it would be for a payday lender to redesign its product to offset the impact of new regulations. As noted earlier, when access to overdraft protection was scaled back in response to regulation, banks reduced the availability of free checking and raised fees (such as monthly account maintenance fees) that are relatively easy substitutes for overdraft protection fees.[207] This action was potentially harmful to consumers who would not have chosen that combination of terms and prices on their own.[208]

Payday lending, by contrast, is a relatively simple product with fewer price points. It could therefore be difficult for payday lenders to alter their product's terms in order to adjust to regulations

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[204] DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 184, at 667–75.
[205] *Id.*
[206] Consumers could also be harmed indirectly by these regulations. For example, personal loan companies increased the minimum size of the loans that they would write, thereby amortizing the costs of making the loan over a larger principal, which artificially reduced the stated APR on the loan to bring it within the statutory requirements. James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61, 89 (1981). But requiring a larger loan size meant that only higher-income borrowers could qualify for the loans, and those who qualified were often required to borrow more than they would have preferred, thereby potentially exposing them to greater risk of financial distress. *Id.*
[207] *See* Evans, Litan & Schmalensee, *supra* note 134, at 31.
[208] *See* discussion *supra* notes 151–54 and accompanying text (describing market response to imposition of Regulation E).

such as those on allowable fees. For example, a state's imposition of APR caps has usually been the death knell of the payday lending industry in that state because of the industry's inability to redesign the product to preserve its viability.[209]

In some cases, although payday lending has disappeared after regulation has been imposed, payday lenders have converted to providers of other high-cost lending products such as installment loans or consumers have shifted to alternative lending products such as auto title loans.[210] In some instances, consumers may have crossed into nearby states or gone online to access loans that were unavailable at home due to state regulation.[211] The CFPB is prohibited from imposing interest-rate ceilings,[212] but if it imposes regulations on payday lending that reduce some sources of revenues or increase costs (such as reducing rollovers), payday lenders may be forced to alter the product dramatically in order to preserve its viability. This suggests that even facially neutral regulations can have a disparate competitive impact based on the relative ease with which products can be redesigned to meet formal rules. The CFPB should keep this in mind when considering the regulation of payday lending and overdraft protection.

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[209] *See* Colin Morgan-Cross & Marieka Klawitter, *Effects of State Payday Loan Price Caps & Regulation,* WASH. UNIV. 1, 4 (Dec. 2, 2011), *available at* http://depts.washington.edu/wcpc/sites/default/files/papers/Payday%20Lending%20Brief.pdf ("Capping rates at 36% appears to significantly reduce the frequency of payday providers . . . .").

[210] *See* Johnson, *America's First Consumer Financial Watchdog Is on a Leash*, *supra* note 15, at 396.

[211] *See* Midwest Title Loans, Inc. v. Mills, 593 F.3d 660, 662 (7th Cir. 2010); Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q. J. ECONOMICS 517, 518 (2011) (acknowledging that residents in states that do not allow payday lending can cross over to states that permit it); Matt Volz, *Montana Tribes Offer High-Interest Loans Online*, WASH. TIMES (Dec. 6, 2011), http://www.washingtontimes.com/news/2011/dec/26/montana-tribes-offer-high-interest-loans-online/?page=1&utm_medium=RSS&utm_source=RSS_Feed. *But see* PEW, WHO BORROWS, *supra* note 82, at 5 (arguing that banning bricks-and-mortar payday lending does not increase the use of online payday lending).

[212] *See* 12 U.S.C. § 5517(o) (2012) ("No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.").

Widespread deregulation of consumer lending markets in the 1980s and 1990s modernized the regulatory regime and eliminated regulatory-induced artificial product segmentation, which in turn spurred competition among different types of lenders.[213] Rather than imposing substantive regulation tied to particular product attributes, regulators shifted to generally applicable market-reinforcing regulatory systems such as the Truth in Lending Act and disclosure regulations.[214] This development prompted competition among products, which benefitted consumers through lower rates, higher quality, and greater innovation.[215]

These history lessons support Dodd-Frank's requirement to create a fair competitive structure for consumer lending markets.[216] Regulations that favor some products over others will tend to divert consumers to the more favorably regulated product, even though the products are substantively similar. This result harms consumers and furthers no regulatory purpose.

IV. Payday Lending and Overdraft Protection Raise Similar Potential Consumer Protection Concerns

The consumer protection regulatory concerns raised by payday lending and overdraft protection are similar as well, lending further support to Dodd-Frank's premise that they should be regulated in an even-handed manner.[217] Otherwise, policies that

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[213] Dean F. Amel, Arthur B. Kennickell & Kevin B. Moore, *Banking Market Definition: Evidence from the Survey of Consumer Finances* (Divisions of Research & Statistics & Monetary Affairs Fed. Reserve Bd., Working Paper No. 2008-35, 2008), *available at* http://www.federalreserve.gov/pubs/feds/2008/200835/200835pap.pdf; Thomas A. Durkin & Gregory Elliehausen, Interinstitutional Competition for Consumer Credit at the End of the Twentieth Century 2 (June 2000) (unpublished manuscript), *available at* http://faculty.msb.edu/prog/CRC/Publications%20PDF%20files/Manuscripts_interinstitutional_competition.pdf.

[214] *See* Truth in Lending Act (TILA), 15 U.S.C. §§ 1601–1667f (2012).

[215] *See* Durkin & Elliehausen, *supra* note 213, at 2.

[216] *See* 12 U.S.C. § 5511(a) (2012).

[217] We assume for the sake of argument that these consumer protection concerns are well supported by economic analysis and empirical evidence, although the factual basis for several of the asserted rationales for regulation is highly questionable. *See, e.g.*, Jim Hawkins, *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress*, 86 IND. L.J. 1361, 1384–85 (2011); Marc Anthony Fusaro & Patricia J. Cirillo,

artificially favor one product over another (thereby pushing consumers to greater use of the advantaged product), not only will produce higher prices, but will provide no corresponding increase in consumer protection. As noted earlier, the initial Treasury Department report that served as the basis for Dodd-Frank recognized that bank overdraft protection was used like a credit product by many consumers and thus should be subjected to similar regulation.[218] Because overdraft protection had not traditionally been regulated as credit, the report argued, consumers "may not overtly think of the plans as credit."[219] The report expressed concern that "[c]onsumers may not, therefore, take the same care in their use of overdrafts that they take with other, more overt credit products."[220]

The similarity in potential consumer protection concerns is most clear when comparing bank deposit advance products with payday loans, which, as noted earlier, are very similar both in structure and in the consumer protection concerns they raise.[221] In fact, in its analysis of these two products, the CFPB stated that "the current repayment structure of payday loans and deposit advances, coupled with the absence of significant underwriting, likely contributes to the risk that some borrowers will find themselves caught in a cycle of high-cost borrowing over an extended period of time."[222] The CFPB also expressed concern that both products essentially provide the lender with direct access to the borrower's bank account in order to withdraw the funds at the time of the borrower's next payday or direct deposit without further action by

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Do Payday Loans Trap Consumers in a Cycle of Debt? 6 (Nov. 16, 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1960776; Stoesz, *supra* note 77, at 5.

[218] *See* DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, *supra* note 3, at 69.

[219] *Id.*

[220] *Id.*

[221] CFPB, PAYDAY LOANS, *supra* note 16, at 44; *see also* discussion *supra* notes 177–82 and accompanying text (discussing the similarities between payday loans and overdraft protection).

[222] CFPB, PAYDAY LOANS, *supra* note 16, at 44. Elliehausen found, however, that only 11% of payday loan customers expressed dissatisfaction with their experiences, and of those, only about 16% said that it was because they thought that payday loans made it "too difficult to get out of debt." Elliehausen, *supra* note 64, at 42. Overall, therefore, only about 2% of all payday loan customers disliked payday loans because they made it too hard to get out of debt. *Id.*

the borrower or formal protections from the lender's collection activity.[223] Regulators also generally claim that both products are intended to be used as short-term loans to meet exigencies and emergency expenses and not for long-term sustained or repeated expenses or for non-emergencies.[224]

Consumer activists are also concerned that some consumers overuse payday lending when less-expensive alternatives are available[225] and that it is used disproportionately by lower-income and younger consumers.[226] Moreover, critics of payday lending protest the alleged unfairness of apparent cross-subsidies among different groups of payday loan customers.[227] They claim that those borrowers who roll over payday loans repeatedly (and thus generate repeated fees with modest expense and credit risk to the lender) essentially subsidize borrowing by those who use loans less frequently and more episodically.[228] They also express concern that

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[223] CFPB, PAYDAY LOANS, *supra* note 16, at 44. The CFPB provides no support for its normative classifications of legitimate versus illegitimate uses of short-term lending. *See id.* (discussing harm to consumers without calculating the monetary harm). Nevertheless, our point here is that, regardless of whether this justification for regulation is valid, it is equally present for both payday lending and overdraft protection. For example, industry analyst JMP Securities claims that the majority of those who borrow from traditional storefront payday lenders use the funds to cover recurrent expenses, whereas those who borrow from online payday lenders are more likely to do so in order to cover discretionary and emergency expenses. *See* JMP SEC., *supra* note 20, at 19. If it is true that online payday lending is not used as frequently as storefront lending for recurring expenses, that fact would seem to be irrelevant to the proper regulatory treatment of the two products.

[224] CFPB, PAYDAY LOANS, *supra* note 16, at 43.

[225] *See* PEW, HOW BORROWERS CHOOSE, *supra* note 88, at 36–38; PEW, WHO BORROWS, *supra* note 82, at 16–18, 28–29.

[226] CFPB, PAYDAY LOANS, *supra* note 16, at 15–20; PEW, WHO BORROWS, *supra* note 82, at 8–12. Neither the CFPB nor Pew expressly states why this disparity carries a normative dimension, but presumably they believe the disproportionate use by low-income consumers to be problematic. CFPB, PAYDAY LOANS, *supra* note 16, at 15–20; PEW, WHO BORROWS, *supra* note 76, at 10.

[227] Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 573–74 (2010).

[228] This concern is often more implied than directly stated. *See id.* (arguing that the greatest profits in payday lending are made off repeat customers).

payday lenders have direct access to consumers' bank accounts and therefore can withdraw funds (by cashing the borrower's check) or even cause the borrower to incur overdraft fees if the account has insufficient funds to cover the check.[229] Finally, although borrowers clearly understand the terms of payday loans,[230] some critics argue that consumers are fundamentally confused about the full expected cost of their loans, and, in particular, have unrealistically low estimates both of the amount of time it will take them to pay off the loan and of the fees that they eventually will incur.[231] As a result,

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[229] *See* PEW, HOW BORROWERS CHOOSE, *supra* note 88, at 32 (reporting that 27% of payday loan borrowers stated that a withdrawal by a payday lender caused an overdraft).

[230] *See* discussion *supra* notes 130–32 and accompanying text.

[231] Oren Bar-Gill and Elizabeth Warren state, for example, "The design of the payday loan as a short-term cash advance that is oftentimes continuously renewed for prolonged periods of time responds to consumers' underestimation of the likelihood and cost of loan rollover." Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 55 (2008). Remarkably, however, they cite no authority whatsoever for this unqualified statement. *See id.* In particular, they offer no discussion about whether consumer errors, although present, might be unbiased between overestimation and underestimation of the expected time it will take to pay off a loan. *See* Todd J. Zywicki, *The Behavioral Law and Economics of Fixed-Rate Mortgages: And Other Just-So Stories*, S. CT. ECON. REV. (forthcoming 2014) (claiming that behavioral economics predicts that consumer errors will be systematically biased and reporting evidence that rejects the hypothesis). In fact, recent studies indicate that although consumers may make mistakes about how long they expect it will take to pay off a payday loan, there is no evidence that consumers systematically underestimate the expected number of loan rollovers or how long their loan will likely be outstanding. *See* Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing*, 66 J. FINANCE 1865, 1878 (2011) (reporting that payday loan customers reported a mean estimate of how long it would take to repay a payday loan that was correct); Ronald Mann, *Assessing the Optimism of Payday Loan Borrowers* 18 (Columbia Law & Econ., Working Paper No. 443, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2232954 (finding that 60% of payday borrowers accurately estimate how long it will take them to repay their loans and that errors are randomly distributed between overestimates and underestimates of time). Bertrand and Morse also note that the form that required disclosures take may reduce consumer confusion and, if so, will enable consumers to use the products more efficiently. *See* Bertrand & Morse, *supra*, at 1889 ("[I]nformation disclosure that is inspired by, and responds to, cognitive biases or limitations that surround the payday

consumers may roll over their payday loans repeatedly, incurring high fees that result in financial harm.

The CFPB has expressed consumer protection concerns regarding overdraft protection that mirror those for payday lending and deposit advance products. In its white paper on overdraft protection, the CFPB expressed concern that some consumers overuse overdraft protection rather than turning to less-expensive alternatives.[232] In its "Notice and Request for Information" issued in February 2012, the CFPB also expressed concern that the heavy use of overdraft protection may result in long-term damages to a person's finances.[233] The CFPB also noted that a minority of customers pay a disproportionate share of all overdraft fees, thereby subsidizing free riders who do not.[234] In addition, the CFPB points out that the FDIC noted that low-income and younger consumers paid a disproportionate share of overdraft fees.[235] Finally, the CFPB and consumer activists have argued that consumers lack adequate

borrowing decision has a significant effect on individuals' decisions of whether to take out a payday loan.").

232 *See* CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 18, 54–58 (finding that heavy users of overdraft protection make up 9% of customers but account for 84% of overdraft and NSF charges); *but see* discussion *supra* note 106 and accompanying text (questioning whether less-expensive alternatives are available or appropriate for many overdraft protection users).

233 *See* Impacts of Overdraft Programs on Consumers, 77 Fed. Reg. 12,031, 12,034 (Feb. 28, 2012).

234 *Id.* at 12,034; *see also* Zywicki, *Overdraft Protection*, *supra* note 23, at 1181–84.

235 Impacts of Overdraft Programs on Consumer, *supra* note 233, at 12,031; *see also* CFPB, OVERDRAFT PROGRAMS, *supra* note 34, at 18 ("Thus, the [FDIC] study raised concerns that consumers from potentially vulnerable groups may shoulder a disproportionate share of NSF and overdraft fees and checking account costs."). Again, it is not stated expressly why this point is relevant, but it is suggested that this income disparity in product use is normatively problematic. In fact, the best predictor of overdraft use appears to be the borrower's creditworthiness, not income, age, or any other demographic. *See* Zywicki, *Overdraft Protection*, *supra* note 23, at 1164–65 (discussing studies). The FDIC "did not control for [the borrower's] credit score" in concluding that low-income and younger borrowers were disproportionately likely to use overdraft protection, nor did the CFPB note this caveat in its characterization of the study. *Id.* at 1165.

information and are often confused about the full cost and conditions associated with the use of overdraft protection.[236]

The consumer protection concerns about payday lending, deposit advance, and overdraft protection are all similar: consumers are not fully aware of the cost, they use those products instead of less-expensive alternatives, and 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 offeror is a bank or nonbank lender; neither should the formal structure or classification of the terms matter. If, for example, the CFPB is concerned that these products can create a cycle of debt for some consumers, then a regulatory regime that simply shifts consumers from one product to the other will further no coherent regulatory purpose.[237]

V. Conclusion: Fair Competition and Consumer Protection

The stated justification for the CFPB is that a single agency with highly specialized expertise in consumer lending and the full array of regulatory tools (research, supervision, and enforcement) can craft a consumer financial protection agenda that will be superior to an agency with a more general consumer protection agenda (such as the Federal Trade Commission) or an agency primarily focused on safety and soundness issues (such as prudential bank regulatory

[236] *See* Impacts of Overdraft Programs on Consumers, *supra* note 233, at 12,032.

[237] In fact, other consumer credit products raise many of these same consumer protection concerns. The CFPB should therefore avoid imposing regulatory burdens on payday lending and overdraft protection that would divert consumers to products such as pawnshop loans. For example, Levy and Sledge note that underestimating how long it will take to repay a loan is not unique to borrowers of payday loans. *See* LEVY & SLEDGE, *supra* note 21, at 21 (finding that 32% of payday lending borrowers reported taking longer than expected to repay their loans, as compared to 32% of auto title loans, 29% of pawnshop loan borrowers, and 20% of bank deposit advance borrowers); *see also* ELLISON & FORSTER, THE IMPACT OF INTEREST RATE CEILINGS, *supra* note 82, at 62. Thus, to the extent that restricting access to payday loans or overdraft protection causes consumers to substitute pawnshops or auto title loans, the results will not advance any coherent consumer protection purpose.

agencies).[238] Further, the stated justification is that a national agency with the authority to regulate the full scale of consumer credit products, from mortgages to payday loans, can create a more coherent and modern regulatory regime than one balkanized among the states or divided across myriad federal regulators.[239]

The regulation of payday lending and bank overdraft protection provides a compelling example of the CFPB's potential to execute its dual mandates to promote consumer protection and fair competition. The two products traditionally have been offered by different lenders and regulated by different approaches.[240] Yet they compete with each other and raise similar consumer protection concerns.[241] 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 the products.

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 to one another. Chopping up the market by writing different rules for similar products balkanizes the regulatory regime, dampens competition, and produces higher prices and lower quality for consumers.[242] At the same time, if various products present similar consumer protection concerns, then there is little benefit from unequal regulations that simply shift consumers from one product to a competitor's.

A final concern in this context is that interest groups may have differential influence on regulators and thus may be in a position to lobby for regulations that provide them with a competitive advantage.[243] Payday lending operations remain highly

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[238] DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, *supra* note 3, at 7 ("The CFPA should reduce gaps in federal supervision and enforcement; improve coordination with the states; set higher standards for financial intermediaries; and promotes consistent regulation of similar products.").

[239] *See supra* note 8 and accompanying text.

[240] *See* discussion *supra* Part I.

[241] *See* discussion *supra* Parts II, IV.

[242] *See* DURKIN, ELLIEHAUSEN, STATEN & ZYWICKI, *supra* note 184, at 667–75.

[243] *See* MAXWELL L. STEARNS & TODD J. ZYWICKI, PUBLIC CHOICE CONCEPTS AND APPLICATIONS IN LAW 70 (2009) (describing how special

local, distributed throughout the country; even chain payday lenders are highly localized in their customer base and operations. Overdraft protection, by contrast, is provided by banks, which have a much more organized lobbying operation in Washington, D.C., and thus may have a greater opportunity to influence regulators in a manner that will give them a competitive advantage against payday lenders.[244] On the other hand, banks offering overdraft protection must contend with potentially conflicting and overlapping supervision from prudential regulators as well as the CFPB. Even-handed regulation can reduce this potential for agency capture by the institutions that the agency regulates by limiting the opportunity for loopholes and special treatment. Representatives of nonbank lender associations, for example, have expressed concern about the potential of a "bank-centric" culture at the CFPB.[245] Thus, the CFPB should take special care that it is not co-opted by either industry and unwittingly used as a tool to reduce competition between products. In addition, given Dodd-Frank's express requirement that the CFPB preserve fair competition as part of its mission, a failure to regulate in an even-handed manner exposes the agency to litigation challenges.[246]

Competition and consumer choice can be powerful vehicles for improving consumer welfare and consumer protection. By keeping this in mind, the CFPB can ensure that its policies are truly beneficial to consumers.

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interests can use regulation strategically to gain a competitive advantage over rivals).

[244] *See* Todd Zywicki, *Economic Uncertainty, the Courts, and the Rule of Law*, 35 HARV. J.L. & PUB. POL'Y 195, 200–02 (2012) (identifying the rule of law as restraining special interest legislation).

[245] *See, e.g.*, *The Effect of Dodd-Frank on Small Financial Institutions and Small Businesses: Hearing Before the Subcomm. on Fin. Inst. and Consumer Credit of the Comm. on Fin. Servs.*, 112th Cong. 13 (2011) (statement of Chris Stinebert, President and CEO, Am. Fin. Servs. Ass'n).

[246] DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM, *supra* note 3, at 69.