Loan Sharks

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Last week I wrote about the U.S. Consumer Financial Protection Bureau's efforts to regulate prepaid debit cards. Many Americans use these cards in lieu of checking accounts. The CFPB aimed to protect consumers from the high fees associated with these cards and provide them with other protections.

Well prepaid debit cards are just one item on the CFPB's to-do list; the next project the agency is tackling is payday loans.

The agency defines payday loans as being for $500 or less, come due on the borrower's next paycheck, and require borrowers to provide lenders with post-dated checks or access to the borrower's checking account. Finance charges for these loans range from $10 to $30 for every $100 borrowed. So, borrowing $100 for two weeks with a loan fee of $15 amounts to an annual percentage rate of nearly 400%.

The CFPB announced a proposal in June to impose stronger regulations on the payday loan industry. The agency believes that risky lending practices were "pushing borrowers into debt traps." According to the agency, almost 70 percent of payday loan borrowers take out a second loan, and one in five new borrowers ends up taking out at least 10 or more loans, paying more fees and interest on the same debt.

While the new rules would not abolish payday loans, they would require lenders to adopt stricter standards to determine if consumers truly have the ability to repay the debt and still meet basic living expenses and major financial obligations. The new measures would also further protect against debt traps by making it difficult for lenders to encourage distressed borrowers into borrowing again or refinancing the same debt. Finally, the proposal also would cap the number of short-term loans that can be made in quick succession.

The payday loan industry believes the new rules are extremely restrictive and exceed the authority granted to the CFPB by Congress. Lenders feel the proposal would limit their ability to serve a vulnerable portion of working Americans living paycheck to paycheck, who need help when an unexpected emergency arises.

However, consumer advocacy groups feel the proposal does not go far enough. For example, the measures do not put a cap on interest rates charged on payday loans. Because states currently regulate their own payday loans, the CFPB is hoping federal rules will bring more consistency to the industry.

For example, Wisconsin is one of only eight states that has no cap on annual interest rates for payday loans. According to the Wisconsin Department of Financial Institutions, the average annual interest rate on payday loans in Wisconsin was a whopping 565% in 2015. The new federal rules would not change this, however.

Consumers had until October 7 to submit comments to the agency about the provisions. Alex Horowitz, a researcher at The Pew Charitable Trusts, the financial research group that also investigated prepaid debit cards, claims the agency's proposal still does not address what consumers want: lower prices, smaller installment payments and quick approval.

There has to be a compromise that provides Americans in need with emergency funds and yet protect them from predatory lenders. At the same time, lenders need protections and incentives for making high-risk loans.

This year my daughter is studying Shakespeare in school. Some payday lenders remind me of Shylock in 'The Merchant of Venice,' who wants a pound of flesh if his loan is not repaid. Here's hoping lenders heed Portia's advice that mercy is twice blest: It blesseth him that gives and him that takes.