Payday loans are high-cost, small-dollar loans to low-income, low-credit borrowers with a short term tracking the borrower’s pay cycle and a repayment system that involves the lender withdrawing funds directly from the borrower’s bank account. Until recently, the payday lending industry, which lends to roughly twelve million Americans annually, was regulated primarily at the state level. Empirical research assessing the effects of payday lending on consumers has produced mixed results: many studies find payday lending significantly harms consumers, others conclude lack of access to payday loans leaves consumers worse off, and some find the impacts limited or difficult to assess. On October 5, 2017, the Consumer Financial Protection Bureau (CFPB) finalized its “payday lending” rule, which requires that lenders determine consumers’ ability to repay (ATR) before issuing certain high-
cost, small-dollar loans and places other restrictions on a broader set of covered loans. In finding it an “unfair” and “abusive” practice to grant payday loans without assessing borrower ATR, the CFPB applied principles of behavioral economics (BE) to interpret its statutory authority to prevent “unfair, deceptive, or abusive act[s] or practice[s]” (UDAAPs) more broadly than other federal regulators have interpreted UDAAP authority precursors. BE-informed statutory interpretation like the Bureau’s here may serve as a basis for additional expansions of regulatory authority.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Dodd-Frank empowers the CFPB to promulgate rules to prevent UDAAPs and to take enforcement actions, such as investigation, adjudication, or litigation, in response to UDAAPs. In 2012, the CFPB started to regulate UDAAPs case-by-case via enforcement actions, including some against payday lenders. On March 26, 2015, it announced it was initiating a rulemaking process to craft regulations protecting payday borrowers. The CFPB chose to target payday loans because they commonly lead to “debt traps.” A debt trap results when a borrower is repeatedly unable to repay a loan and must reborrow, paying additional fees each time. Such borrowers routinely pay more in cumulative fees than they originally received in credit.

On July 22, 2016, the CFPB issued a Proposed Rule regulating payday lending, acting under its UDAAP authority. The Proposed Rule defined “covered loans” as loans whose entire amount must be repaid within forty-five days (“covered short-term loans”), or whose annual percentage rate (APR) was higher than thirty-six percent and that involved either a lender with the ability to collect funds directly from the bor-

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10 See id. at 54,472.
17 Id.
18 PEW CHARITABLE TRS., supra note 3, at 1.
rrower’s account or the use of the borrower’s auto title as collateral (“covered longer-term loans”). The Proposed Rule deemed it a prohibited “abusive and unfair practice” to make a covered short-term or longer-term loan without “reasonably determining” the borrower’s ability to repay the loan and meet basic living expenses without reborrowing within thirty days of repayment. It prescribed an ATR assessment methodology that involved identifying the borrower’s income and financial obligations. Lenders could avoid the ATR requirement for covered short-term loans by allowing borrowers unable to repay the loan all at once to instead reborrow, as long as, among other requirements, the value of the loan principal decreased by one-third of the original loan value with each successive loan — effectively capping the “debt trap” cycle at three loans. The rule applied additional restrictions to all covered loans, including loans not subject to the centerpiece ATR requirement. Importantly, the Proposed Rule exempted a number of generally less risky types of loans from the rule’s restrictions.

The Proposed Rule attracted well over one million comments. Lenders protested that the ATR requirement amounted to a ban because it would render their business model uneconomical, and that the withdrawal of payday loans from the market would leave consumers without access to credit or reliant on more harmful alternatives. Some lenders hinted at potential legal challenges to the rule, such as that

20 Id. at 48,167–68 (to be codified at 12 C.F.R. §§ 1041.2(a)(6)–(8), 1041.3(a)–(d)).
21 Id. at 48,168–69, 48,172–73 (to be codified at 12 C.F.R. §§ 1041.4–5, 1041.8–9).
22 Id. (to be codified at 12 C.F.R. §§ 1041.5, 1041.9).
23 Id. at 48,170–71 (to be codified at 12 C.F.R. § 1041.7). The ATR requirement also capped short-term loan sequences at three consecutive covered short-term loans. Id. at 48,169–70 (to be codified at 12 C.F.R. § 1041.6(a), (f)).
24 For example, lenders were required to seek affirmative reauthorization to debit a borrower’s account after two unsuccessful attempts in order to reduce account closures and nonsufficient funds fees for consumers. See id. at 48,176–79 (to be codified at 12 C.F.R. § 1041.15).
25 Exemptions included loans to finance the purchase of a good that are secured by the good’s value, credit secured by real property, credit card loans, student loans, and certain pawn loans and overdraft services. Id. at 48,168 (to be codified at 12 C.F.R. § 1041.3(e)).
28 See, e.g., Advance Financial Letter, supra note 27, at 5.
29 See, e.g., Final Rule, 82 Fed. Reg. at 54,841; see also Donald P. Morgan et al., How Payday Credit Access Affects Overdrafts and Other Outcomes, 44 J. MONEY CREDIT & BANKING 519, 521 (2012) (“[U]sing payday loans to avoid overdrafts could save households money.”).
the CFPB’s reliance on BE resulted in an overextended interpretation of its UDAAP authority. Consumer advocates, by contrast, suggested broader definitions of “lender” and “loan sequence.”

On October 5, 2017, the CFPB released its Final Rule. The rule narrows the subset of longer-term covered loans subject to the ATR requirement, perhaps responding to potential legal challenges flagged by commenters. Loans with terms longer than forty-five days are subject to the ATR requirement only if they require “balloon payments.” The rule also expands the list of loan types exempted from the rule entirely, creating a safe harbor for loans with specifications tracking those outlined by the National Credit Union Administration for “alternative loans,” and for covered loans from lenders making 2500 or fewer such loans annually that contribute less than ten percent of total lender revenue. The Final Rule requires compliance by mid-2019 but faces political threats before then.

The payday lending rule is the CFPB’s first final rule to rely upon the Bureau’s UDAAP authority, but the Bureau did not start with a blank slate. Previously, other federal regulators promulgated rules under precursors to UDAAP authority — primarily the FTC, acting under “UDAP” authority to regulate “unfair” and “deceptive” acts and practices “in or affecting commerce.” Since the 1980s, regulators acting under the “unfair” prong of UDAAP precursors have targeted harms not...

30 See Final Rule, 82 Fed. Reg. at 54,616. Some commenters also asserted the Proposed Rule violated Dodd-Frank’s prohibition on CFPB-imposed usury limits by effectively banning loans with annual percentage rates above thirty-six percent. Id. at 54,529.
31 Id. at 54,530–32.
32 For example, Colorado bans loans with terms shorter than six months. See id. at 54,538.
34 Final Rule, 82 Fed. Reg. at 54,873–73 (to be codified at 12 C.F.R. §§ 1041.2(a)(7), 1041.3(b)(2)). “Balloon payment” in the rule refers to a payment at least twice as large as any other under the loan. Id. In general, balloon payments are principal payoffs falling at the end of (rather than distributed throughout) a loan’s term. See id. at 54,475. Though longer-term covered loans without balloon payments are not subject to the ATR requirement, they remain subject to the rule’s other restrictions. See, e.g., id. at 54,878 (to be codified at 12 C.F.R. § 1041.8(b)(payment transfer restrictions).
35 Id. at 54,874 (to be codified at 12 C.F.R. § 1041.3(b)(4)).
36 Id. (to be codified at 12 C.F.R. § 1041.3(f)).
37 Id. at 54,472.
reasonably avoidable by the rational actor of neoclassical economics (NE). The CFPB’s interpretation of its UDAAP authority in the Final Rule expanded upon prior interpretations of UDAAP precursors in an important way: rather than confine itself to harms that rational consumers could not reasonably avoid or arising from market failures as defined by neoclassical economics, the Bureau incorporated concepts from behavioral economics, a newer and growing set of economic ideas, to interpret its UDAAP authority to extend to harms resulting from consumers’ decisions contrary to their own interests.

Before Dodd-Frank, regulators applied NE to identify “unfair” practices inflicting harms consumers could not reasonably avoid. Between 1914 and 1974, Congress expanded the FTC’s discretion over consumer protection, eventually granting it authority to promulgate rules to prevent UDAPs. Beginning in 1980, the FTC consistently interpreted “unfair” using NE theory, which treats consumers as rational actors with stable preferences who use available information to make decisions that maximize their welfare. Adherents to NE often prioritize policies that require market actors to supply consumers with information on which to base rational decisionmaking. The FTC promulgated rules and brought enforcement actions accordingly, protecting “consumer sovereignty” by targeting “practices that impede[d] consumers’ ability to make informed choices, such as fraud, unilateral breach of contract, and unauthorized billing,” and by favoring disclosure requirements.

In other rules, the FTC proceeded under its “unfair” authority to address market failures that arose when market dynamics prevented competition from “maximizing benefits and minimizing costs” for consumers. In a representative rule banning “nonpossessory security interest[s] in household goods” as a remedy in consumer contracts (which

43 See id. at 1533.
allow for repossession by the seller), the FTC determined such provisions were not “[r]easonably [a]voidable” by consumers because sellers’ market power made it difficult to bargain for alternative remedies and buyers rationally disregarded provisions for default given its rarity.\(^5\)

Other regulators promulgating rules under UDAP authority applied similar NE logic.\(^4\) In promulgating ATR requirements in particular, regulators have refrained from clearly relying on explicit interpretations of “unfair” and have rested rules on statutory provisions beyond UDAP authority alone.\(^5\) Taken together, such rules did not establish precedent for using BE to interpret UDAP authority.

Nonetheless, predictions that the rise of BE would inform agency rulemaking predated the CFPB.\(^6\) BE stresses that consumers, even knowing all relevant information, take mental shortcuts — the results of cognitive biases — that lead systemically to irrational decisions that do not maximize their welfare.\(^7\) The insight that such biases operate in predictable ways motivated an expansion of BE research aimed at building new models for consumer decisionmaking,\(^8\) with significant policy implications. Indeed, then-Professor Elizabeth Warren’s call for a dedicated ex ante regulator of consumer credit products was in part based on consumer irrationality,\(^9\) and later commentators suggested the CFPB should interpret its UDAAP authority using BE principles.\(^10\)

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\(^{49}\) See, e.g., OFFICE OF THE COMPTROLLER OF THE CURRENCY, ADVISORY LETTER NO. 2004–10, CREDIT CARD PRACTICES (2004) (identifying three “unfair or deceptive acts or practices” consisting of insufficient disclosure of credit card terms, id. at 1).


\(^{51}\) See Edwards, supra note 41, at 324.

\(^{52}\) Id.; Jolls, Sunstein & Thaler, supra note 42, at 1476–78.

\(^{53}\) Jolls, Sunstein & Thaler, supra note 42, at 1476–78.


But the CFPB’s pre–Final Rule UDAAP enforcement actions did not rest on BE-informed interpretative moves; those actions were consistent with narrower interpretations of “unfair” and “abusive” that did not hinge on consumer irrationality or misjudgment. Rather, they targeted practices rational consumers would struggle to avoid. For example, the Bureau initiated actions against financial service providers for “unfair[ly]” seeking to collect debts that were void under state law while telling consumers state laws did not apply, and threatening to contact borrowers’ friends, family, employers, or references in collecting debts. The Bureau exercised its “abusive” authority, similarly, by targeting practices a rational actor would fail to avoid. In contrast, the fact that payday lenders do not assess ATR is an advertised selling feature for low-credit customers, on display for the hypothetical rational actor.

The Bureau did apply BE principles in promulgating the Final Rule, when it concluded it is an “unfair and abusive practice” to make certain loans without determining borrower ATR. A practice is unfair under Dodd-Frank if it is “likely to cause substantial injury” that is “not reasonably avoidable by consumers” and that “is not outweighed by countervailing benefits.” The CFPB reasoned that harm caused by debt traps was not reasonably avoidable because borrowers systemically underestimate the likelihood they will be unable to repay without repeatedly re-borrowing, the number of times they will re-borrow, and the severity of the financial injuries likely to ensue. Under the Bureau’s BE-informed analysis, a “market failure” existed not because consumers do not understand the loans’ simple repayment schedules, but because consumers are unable to judge the degree of risk. The Bureau proceeded under similar logic to satisfy Dodd Frank’s definition of “abusive” practices, emphasizing consumers’ cognitive biases.

57 See id. at 60.
58 See, e.g., id. at 53, 57, 61–62. Moreover, the CFPB rarely relied on findings of unfairness or abusiveness; it typically also alleged harder-to-dispute “deceptive” practices or other statutory violations that may have been sufficient to secure settlements. See, e.g., id. at 53, 55–63; cf. Am. Fin. Servs. Ass’n v. FTC, 767 F.2d 957, 979 (D.C. Cir. 1985) (“Our task of reviewing [FTC] unfairness precedent is hindered by the [FTC’s] cautious use of its unfairness authority as an independent basis for decision . . . .”).
60 See id. at 54,874 (to be codified at 12 C.F.R. § 1041.4).
63 See id. at 54,596–98; see also id. at 54,568–75, 54,617, 54,816 n.1126.
64 See id. at 54,617–20. “Abusive” practices “take[] unreasonable advantage of [consumers’] lack of understanding . . . of the material risks, costs, or conditions” of a product or their “inability . . .
As the payday lending rule demonstrates, an agency expands its regulatory perimeter when it interprets its UDAAP authority using principles not only of neoclassical but also of behavioral economics. Such an agency, like the CFPB here, will identify “market failures” not only when market dynamics prevent (presumptively) rational consumers from making welfare-maximizing decisions, but also when consumers systemically choose to interact with products whose features they understand but that reduce welfare — as when they take out high-cost loans and end up in debt traps. Thus, it becomes an “unfair” practice to offer a product that harms consumers who systemically and irrationally choose to use it. The continued expansion of BE research, and its ongoing adoption by policymakers, will likely further enlarge BE-informed regulatory perimeters.65

The CFPB has thus adopted an interpretation of its UDAAP authority that empowers it to prevent a broader set of consumer harms than did earlier regulators’ interpretations of UDAP authority. The CFPB’s BE-based interpretation may lead it to take up particularly tough empirical and normative questions more frequently.66 Rather than weigh only the costs of compliance and enforcement against the benefit of restricting a practice that unambiguously harms rational actors, the Bureau may have to weigh the benefit of preventing harm to consumers who would otherwise systemically interact with a product in welfare-reducing ways (such as the many payday borrowers caught in debt traps) against the benefit that other consumers may derive from that product (some low-credit borrowers may use payday loans to cover emergency expenses and quickly pay them off).67 And it may have to address any normative questions raised by the trade-off between the welfare of those sets of differently acting consumers. The Bureau’s assertion of authority to make such difficult determinations could raise the political temperature surrounding the already fiercely contested68 agency.

66 See Edwards, supra note 41, at 324–25, 369–70.
67 Consider the empirical debate over the net desirability of access to payday loans, see sources cited supra notes 6–8, in the context of lender assertions that the Final Rule effectively bans common loan types, see sources cited supra notes 27–29.