The Consumer Financial Protection Bureau's minority power play

ANTONY DAVIES & JAMES R. HARRIGAN | Saturday, Feb. 20, 2016, 9:00 p.m.

The Consumer Financial Protection Bureau (CFPB) bills itself as an agency that “helps consumer finance markets work by making rules more effective.” So why is the bureau determined to send checks to thousands of people for no reason?

In 2013, the CFPB accused lender Ally Financial of charging higher interest rates for auto loans made to minority borrowers. Following investigation and negotiation, Ally agreed to pay $80 million to, what the agency estimated, were 235,000 victims. This seems straightforward enough. Racial discrimination in lending is illegal and the CFPB is charged with ferreting out such discrimination. But there's more to the story.

It turns out that the CFPB doesn't actually know the supposed victims' racial identities. And since the supposed crime is racial discrimination, that also means that the bureau doesn't know whether the people involved are victims at all. The problem, of course, is that it's illegal to ask a person's race on a loan application. So here we have a federal law that, in the interest of preventing racial discrimination, prohibits lenders from asking an applicant's race.

This means that the federal agency charged with monitoring for racial discrimination can't determine whether discrimination has occurred, because it doesn't actually know anyone's racial identity. This sort of comedy of errors is only funny outside of a government bureaucracy. Inside, it's simply business as usual.

So how does the CFPB do its job when it doesn't know the races of the people involved? Apparently, it guesses. The agency developed a method that uses borrowers' ZIP codes and last names to guess their races. When the racial guesswork was done, the bureau compared the interest rates for people it guessed were minorities to the interest rates for people it guessed were not. The two numbers were different, so CFPB demanded that Ally Financial mail checks to the people it guessed were minority victims of discrimination that it guessed had happened.

Shockingly, this guesswork was far from foolproof. In 2014, Charles River Associates conducted a study in which it tested the CFPB's method for guessing borrowers' races. What Charles River found was that the bureau's method comes with a significant margin of error that likely overstates the discrimination that the agency claims.

In other words, faced with having to guess at which borrowers were minorities, the CFPB seems to have guessed in such a way as to make racial discrimination appear to be a bigger problem than it actually is. In fact, the CFPB's guesses were so bad that some white people will be receiving compensation for discriminatory lending because the bureau mistakenly thinks they are black.

A reasonable person might expect that, once informed that they aren't good at guessing a person's race, the CFPB would strive to improve its guesswork. Please. This is an arm of the federal government. The most charitable thing that can be said is that it doesn't have to care about such things. Less charitably, one can note that it is in the CFPB's interest to find and punish as much discrimination as it can, regardless of whether said discrimination actually exists. The more discrimination the agency can find, the more political power it wields.

The bottom line is that the federal government will hand out money to thousands of people for no other reason than that doing so helps to justify the CFPB's existence. Government regulation is not a cure for market greed; it is simply a different way in which greed plays out. Where businesses pursue profit, bureaucrats pursue power. And in answering which of these is more dangerous, guesswork is unnecessary. It's power.

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