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Nathalie Martin
University of New Mexico - School of Law

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Nathalie Martin*

In response to the nation's biggest financial challenge since the depression,[1] Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"),[2] which in turn created the Consumer Financial Protection Bureau (the "CFPB"). The mission of the CFPB is to ensure that "markets for consumer financial products and services are fair, transparent, and competitive."[3] The Act prohibits unfair, deceptive, and abusive acts,[4] and charges the CFPB with creating rules and enforcement actions against all covered persons that engage in an "unfair, deceptive, and abusive act or practice."[5] The Act also requires that the CFPB regulate consumer disclosures and test consumers to see how those disclosures are working.[6]

While the CFPB has been controversial with politicians, its approval rating is high among every-day Americans.[7] Conversely, as every public referendum on the subject shows, high interest loans like title loans and payday loans are very unpopular with Americans.[8] This is understandable, given that such loans take advantage of society's

* Keleher & McLeod Professor of Law, University of New Mexico School of Law. The author thanks Ryan Kluthe and Anne Hemmens for their excellent research and editorial assistance, and Margaret Harrington for her fine formatting assistance.

1 Jared Elosta, *Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate*, 89 N.C.L. REV. 1273, 1273 (2010).

2 H.R. 4173, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) (hereinafter, the "Dodd-Frank Act"). Regarding Title XIV of the Dodd-Frank Act, the Mortgage Reform and Anti-Predatory Lending Act, *see also* Robert A. Cook & Meghan Musselman, *Summary of the Mortgage Lending Provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 64 CONSUMER FIN. L.Q. REP. 231 (2011).

3 Dodd-Frank Act §1021(a).

4 *Id*. §1036(a)(1)(B).

5 *Id*. §1031.

6 *Id*. §1032(a).

7 *See* Lydia Saad, *Among Recent Bills, Financial Reform a Lone Plus for Congress,* Gallup (Sept. 13, 2010), http://www.gallup.com/poll/142967/Among-Recent-Bills-Financial-Reform-Lone-Plus-Congress.aspx. (last visited on July 17, 2011) (finding that 61% of Americans approve of the CFPB).

8 Sandra Block, *Montana Voters Cap Payday Short-term Loans at 36%*, U.S.A. TODAY (Nov. 4, 2011),

most needy, costing them money they cannot afford to lose. Lenders who make these loans charge interest rates and fees so high that when they hear the details, most Americans insist that the loans must be illegal. This article briefly describes the history of the CFPB, describes payday and title loan products and their customers, describes the CFPB's general powers, then discusses how and why the CFPB might use its particular powers to bring this industry into compliance with lending norms used throughout the rest of the civilized world.[9]

I. THE HISTORY OF THE CFPB

The CFPB has been described by some as the most powerful agency in the history of the United States.[10] While there have been a number of attempts to weaken the CFPB, through defunding and substituting a real director with a five-person panel,[11] Richard Cordray has been nominated as its first five year-director and on July 21, 2011, the agency took over all the consumer protection power previously found in other federal agencies.[12] The agency will now set out to protect the public from dangerous credit products, similar to the way in which the U.S. Consumer Product Safety Commission (the "CPSC") has saved thousands of lives by protecting the public from dangerous goods.[13]

The CFPB has been very unpopular with lenders that will be regulated by it, as well as with conservative politicians. Politics and self-preservation aside, there may be other reasons why some people resist the need for such a watchdog. As posited by Drexel law professor Adam Benforado, we all have an overriding motivation to believe that the world is a just place, that our legal system is fair, and that for the most part,

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http://www.usatoday.com/money/perfi/credit/2010-11-04-payday04_ST_N.htm (last visited on July 18, 2011); Michelle Price, *Arizona Payday Lenders leave State After Voters, Legislature, Let High-Interest Loans expire,* Huffington Post, June 9, 2010, http://www.huffingtonpost.com/2010/07/09/arizona-payday-lenders-le_n_641676.html,(last visited on July 18, 2011); Eric Dinnocenzo, *Ohio and Arizona Voters Reject Payday Lenders' Move for High Interest Rates,* WHAT LAWYERS DO, Nov. 11, 2008, http://whatlawyersdo.com/2008/11/11/ohio-and-arizona-voters-reject-payday-lenders-move-for-high-interest-rates/, (last visited on July 18, 2011).

[9] This issue will be discussed at much greater length at a conference on Fringe Banking to be held at Washington and Lee University this fall, so this piece is a brief exploration of the topic. *See* http://law.wlu.edu/lawcenter/page.asp?pageid=1218, (last visited on July 20, 2011).

[10] Kathryn Reed Edge, *Bank on It: Only a Framework,* 46 TENN. B.J. 28, 29 (2010) (stating that "Many believe that this new agency has more unbridled power than any other agency of the federal government. Theoretically, the CIA has more oversight"). *See also* Adam Benforado, *Don't Blame Us: How our Attributional Proclivities Influence the Relationship between Americans, Business and Government*, 5 ENTREPREN. BUS. L. J. 509,546 (2010).

[11] CREDIT UNION NATIONAL ASSOCIATION, *CFPB, Tax Hearings on Tap as Congress Returns*, Credit Union national Association, CFPB, May 3, 2011, http://www.cuna.org/newsnow/11/wash050211-5.html?ref=hed, (last visited on July 18, 2011) (discussing H.R. 1121, which would have replaced the proposed single CFPB director position with a five-person panel).

[12] Some claim that the agency owes its existence to the Obama Administration's desire to throw the public a bone, after spending billions to bail out big banks.

[13] Benforado, *supra* note 10, at 515-16. Just like the CPSC when it was formed, the CFPB has been controversial. *Id.* at 515-16.

people get what is coming to them.[14] Evidence to the contrary is often rejected by us outright as too challenging to this fundamental belief system. This belief system can keep us from appreciating the ways certain advertisers and businesses manipulate us, as well as from seeing these purveyors as blameworthy and thus deserving of regulation. This paper describes one context in which such manipulation is obvious, namely the world of payday lending.

II. THE FACTS ABOUT PAYDAY AND TITLE LOANS

A. Introduction to Payday and Title Lending

Payday loans are high-interest loans designed to help a consumer make it from now until her next payday. While the going rate is between 400 and 600% per annum, some payday loans exceed 1,000% per annum.[15] Most loans are rolled over time and time again, by lenders who encourage more lending at these rates whenever they can.[16] Lenders say they provide a valuable service to low-end consumers, particularly in an emergency, but study data show that the loans are most often used for non-emergencies, by people who have other low-cost or no-cost options.[17] In states where payday lending is permitted, payday lenders are more common than Starbucks.[18]

While payday loans are ubiquitous and prolific, they are not the only high-interest loan products on the market. Title loans are another form of high-interest lending, similar to payday loans but collateralized by an unencumbered auto. Title lenders typically lend 40% or less of the value of a vehicle that is otherwise unencumbered, and make the loan based solely on the value of the collateral.[19] There typically are no income requirements at all. If the customer has very little income and the loan is large enough, the lender is virtually assured of recovering its loan by repossessing the collateral. In one study, data show that that over one-third of title loan consumers do lose their car in a title loan.[20]

B. The Lack of Understanding, Transparency, and Market Competition for Payday Loans

There is a tremendous lack of transparency, not to mention customer understanding, about how payday loans work. Most are interest-only loans but this is rarely clear at the beginning. In my own study of payday lending customers interviewed

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14 *Id.* at 521-23, 540-41.

15 Nathalie Martin, *1,000% Interest – Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 564 n. 1 (2010).

16 In a typical payday loan, a customer might pay $25 for every $100 he or she borrows, for a loan between now and payday. These loans are two weeks long or less. If a customer does not have the $500 (the original $400 loan, plus the $100 fee) by next payday, the customer can just pay the $100 until next time. Some customers do this numerous times, even for years at a time. If a customer does manage to pay off a loan, some lenders call right back and try to get them to take out another loan.

17 *See* Martin, *supra* note 15, at 610.

18 See Steven Graves, *Nationwide Growth of Starbucks vs Payday Lenders*, *available at* http://www.csun.edu/~sg4002/research/starbucks_pdlenders.xls

19 *See* Nathalie Martin & Ozymandius Adams, *Grand Theft Auto Loans: Repossession and Demographic Realties in Title Lending*, 76 MISSOURI L. REV. ___ (forthcoming 2011).

20 *Id.*

at curbside, several customers explained that the clerks did not tell them that the minimum fees do not pay down the principal amount of the loan before they took out the loan.[21] Others described how the paperwork for the loan was given to them in a sealed envelope, so they never saw the rates or fees at all until they were out the door. When asked, few respondents could recite the annual percentage rate ("APR") on their loans.[22] The vast majority understated the interest rate,[23] perhaps thinking that $20 per $100 every two weeks was 20% per annum. Even when interviewers pointed out the APR in the Truth-in Lending Disclosure on the paperwork in hand, customers said they thought that had to be a "mistake."

Borrowers also had difficulty stating the dollar cost of their loans over various periods of time, even though many customers kept the loans out for a very long time.[24] Borrowers were also hopelessly optimistic in terms of when they expected to be able to repay the loan, particularly at the beginning of the relationship. Many customers reported thinking they would be able to pay back the loans much more quickly than they actually could.[25]

Some consumers thought payday loans were cheaper than credit cards. Others said that even if their credit card was not maxed out, they would not use a credit card at this time because credit cards were for emergencies only. One even thought a payday loan was cheaper than a student loan, suggesting that customers simply do not understand the true cost of these loans.[26]

Study data demonstrate that customers often have other low-cost or no-cost options for obtaining credit but go to payday lenders instead because they are ubiquitous and keep long hours.[27] Finally, because people do not shop around for price when obtaining a payday loan, there is a market failure in selling this type of credit, impairing competition.[28] All of these conditions suggest a need for regulation by the CFPB.

C. The Regulation of Payday Loans

Numerous states have made regulating payday loans a priority,[29] but the payday

21 *See* Martin, *supra* note 15, at 598.
22 *Id.* at 600.
23 *Id.* at 600-01.
24 *Id.* at 602-04.
25 *Id.* at 605. One customer explained that she did not realize that it would be so hard to pay her loan back. She had become a hair stylist and needed money to establish clientele while still meeting her other bills and obligations. She quickly found, however, that the payday loan made it harder to fulfill those obligations. *Id.*
26 *Id.* at 605-08. As described above, despite that the going rate is 400-600% per annum, the majority of people also thought the APR for a payday loan was a single- or double-digit number, suggesting that when consumers hear that they are being lent money at $15 or $20 per $100, even over a two-week period or less, they may equate this with 15% or 20% per annum. This may appear cheaper than the average 25% many credit-challenged people pay on their credit card balances. *Id.* at 599-603.
27 *Id.* at 610.
28 *Id.* at 613.
29 Leah A. Plunkett & Ana Lucia Hurtado, *Small-Dollar Loans, Big Problems: How States Protect*

loan industry has found loopholes around literally every state law passed.[30] Under the most recent loophole, lenders are teaming with Indian tribes in order to get sovereign immunity from state laws.[31] Regulating payday loans, a product used primarily by the working poor, has not gained much national attention to date. Rather, middle class people with more political capital have seen their credit products regulated first, for example, through the Credit Card Act.[32]

III. THE GENERAL POWERS OF THE CFPB

The CFPB clearly has the authority to regulate payday and title loans.[33] The CFPB is charged with policing activities relating to financial products and services for unfair, deceptive, and abusive acts or practices[34] and routinely examining large depository institutions as well as non-depository entities for compliance with federal consumer financial laws.[35] The CFPB has become the administrator for all "federal consumer financial laws," which include nearly every existing federal consumer financial statute, as well as new consumer financial protection mandates prescribed by the Act.[36] Thus, the CFPB has the exclusive authority to promulgate regulations, issue orders, and provide guidance to administer the federal consumer financial laws.

Even though it cannot set interest rate caps, the CFPB has plenty of power to curb abusive lending. The agency has general authority to monitor financial products and services for risks to consumers[37] and, as part of this monitoring function, may require covered persons to file reports and participate in interviews and surveys as well as gather information from consumers.[38] More importantly, the Act specifically prohibits all unfair,

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Consumers from Abuses and How the Federal Government Can Help. 44 SUFFOLK U.L. REV. 31 (2011) (providing a detailed report of each state's payday lending regulations).

[30] Martin, *supra* note 15, at 578-95.

[31] Mark Fogarty, *Payday Lenders using 'Tribes as Fronts*,' INDIAN COUNTRY TODAY MEDIA NETWORK, Feb. 14, 2011, http://indiancountrytodaymedianetwork.com/2011/02/payday-lenders-'using-tribes-as-fronts'/, (last visited on July 20, 2011); Jessica Silver-Greenberg, *Payday Lenders Join with Indian Tribes*, WALL ST. JOURNAL, Feb. 10, 2011, http://online.wsj.com/article/SB10001424052748703716904576134304155106320.html, (last visited on July 20, 2011); Michael Hudson, *Fights over Tribal Payday Lenders Show Challenges of Financial Reform*, IWATCHNEWS, Feb. 7, 2011, http://www.iwatchnews.org/2011/02/07/2151/fights-over-tribal-payday-lenders-show-challenges-financial-reform, (last visited on July 21, 2011).

[32] *See* Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (2010).

[33] Dodd-Frank Act. **§**1024 (a)(1). If the CFPB's regulations are strongly pro-consumer, and after all, the purpose of the agency is to protect consumers, preemption of state laws should become less of an issue because the federal laws will be more rather than less protective that state laws. Elosta, *supra* note 2, at 1286-87. Moreover, if a state law is more protective, the CFPB regulation will not preempt it. *Id.*

[34] Dodd-Frank Act § 1021(b)(2).

[35] *Id.* § 1022(a).

[36] *Id.* § 1002(14).

[37] *Id.* § 1022 (c)(2)(A).

[38] *Id.* §§ 1022 (c)(4)(B)(i), 1026 (b) & (c), 1031.

deceptive, or abusive acts or practices by covered persons and their service providers.[39] The CFPB is also given broad power to make rules and take enforcement action with respect to any "unfair, deceptive, or abusive act or practice ... in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service."[40]

An act or practice is considered "unfair" if it is likely to cause substantial injury to consumers that cannot be reasonably avoided by consumers, whenever this substantial injury is not outweighed by countervailing benefits to consumers or to competition.[41] An act or practice can be deemed abusive in two different ways. First, it can be found to be abusive if it materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service. Second, an act can be found to be abusive if it takes unreasonable advantage of one of these three things:

a. a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; or
b. the inability of the consumer to protect the interests of the consumer in selecting or using consumer financial products or services, and
c. the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[42]

This definition of "abusive" is very broad and certainly includes situations in which the consumer lacks understanding of a consumer financial product, particularly where a covered person's acts or omissions contributed to this lack of understanding. According to some commentators, this definition might even apply to disallow complicated disclosure terms, the provision of terms that are not translated to the native language of a consumer, or even an agreement that the consumer fully understands, but that the CFPB feels is not reasonably in the consumer's interest.[43] Depending on how the CFPB interprets this definition of abusive, certain consumer financial products could be forbidden entirely.[44]

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39 *Id.* § 1036.

40 *Id.* § 1031 (a).

41 *Id.* § 1031(c)(1). Obviously since this is a consumer protection statute, even the benefit to competition must benefit consumers.

42 *Id.* § 1031(d)(2). The CFPA does not define the term "deceptive," so the meaning of "deceptive" may be construed under § 5 of the FTC Act, and the regulations and other guidance of the FTC. The Senate Report states that the existing law prohibits unfair and deceptive practices, suggesting the term is used with the same meaning here. S Rep. No. 111-176 (2010).

43 Michael B. Mierzewski, Beth S. DeSimone, Jeremy W. Hochberg, & Brian P. Larkin, *The Dodd-Frank Act Establishes the Bureau of Consumer Financial Protection as the Primary Regulator of Consumer Financial Products and Services,* 127 BANKING L. J. 722, 730 (2010).

44 *Id.* Covered persons and their service providers are also required to maintain and share information about their practices with the CFPB. Dodd-Frank Act §1036(a)(2). "[A]ny person" who knowingly or recklessly provides "substantial assistance" to covered persons and service providers who violate these prohibitions will be equally liable for the violation. *Id*. §1036(a)(3). Disclosures must be

IV. THE CFPB AND PAYDAY LENDING

As set out in the prior section, the CFPB can ban outright any product that is either unfair or abusive. The CFPB can also regulate all products that have the potential to be abusive or unfair. Payday loans arguably fit both definitions. Again, a practice or product is unfair if it is likely to cause substantial injury to consumers that cannot be reasonably avoided, whenever this substantial injury is not outweighed by countervailing benefits to consumers or to competition. While one could quibble about whether consumers could avoid substantial injury from payday loans by using them less frequently and not rolling them over, lenders do what they can to make sure consumers use the products continuously. Because these loans are most frequently used by people of lesser means for non-emergencies, the loans usually cause substantial injury that is not outweighed by a countervailing benefit. This part of the Act asks specifically whether the cost of the loan is worth what the consumer pays for it over the full life of the loan. Most consumers say no.

A product is abusive if it takes unreasonable advantage of one of the following: (i) a lack of understanding of the material risks, costs, or conditions of the product or service, (ii) the inability of the consumer to protect his or her interests in selecting or using consumer financial products or services, or (iii) reasonable reliance on a covered person to act in the interests of the consumer.[45] You need just one of these for a product to be deemed abusive, and here at least two of three are present. First, lenders clearly take unreasonable advantage of consumers' lack of knowledge of the loan terms. There is tremendous subterfuge of the actual terms of payday loans, as is true in so many consumer lending contexts today. Yet subterfuge in payday lending causes more individual harm than subterfuge in other contexts. It is difficult to calculate the actual costs of these products over time and up front, given that the loans are not only short term and interest-only but are also usually renewed and rolled into a new loan.

Lenders also encourage borrowing whenever possible and discourage paying off the loans. Customers also have various behavioral biases, including optimism bias and framing.[46] Additionally, payday loan customers are less sophisticated than many other consumers and presumably have less financial knowledge overall. This by no means suggests that payday loan customers are stupid but only that they are easier to take advantage of. Also, there is much more at stake for them in taking out these loans, which ultimately represent a huge percentage of their overall cash flow. The costs are high by any standard, but by the average payday loan customer's standard, they are excessive

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provided not just at the time of the initial loan, but over the life of the relationship. These disclosures must allow "consumers to understand the costs, benefits, and risks associated with the product or service." *Id.* § 1032(a) Form disclosures must contain "plain language comprehensible to consumers," have "a clear format and design," explain information "succinctly," and be "validated through consumer testing." *Id.* § 1032(b). Finally, large fines can be assessed for non-compliance. *Id.* § 1055(c).

[45] *See supra note 41.*

[46] Regarding the latter, because consumers are used to hearing interest rates stated in terms of 20-25% and believe that 20% over two weeks equals 20% per annum.

beyond imagination. Additionally, consumers cannot protect their interests because the true terms of the loans are often hidden from consumers at the point of sale. Finally, consumers cannot protect their interests because all of the products are offered under the same or similar unfavorable terms. The market is simply not working. Considering all of the above, it is hard to picture a product more likely to fit within these definitions of unfair and abusive than a payday loan.

V. CONCLUSION

So what can the CFPB do, short of setting interest rates? At the very least, the CFPB can insist on removal of the subterfuge and insist that all loans be recorded in a national database accessible by the CFPB. It can then carefully study the industry by closely monitoring lender activity through required lender databases and by gathering information directly from consumers. The CFPB can rewrite disclosures in a way that parrots those now found on credit card statements and use customer studies to see if these disclosures are working. It can also require strict underwriting based upon a borrower's ability to pay back the loan.

As to remedies, it can set and enforce steep penalties for non-compliance that include an absolute inability to enforce any loan that does not comply strictly with the CFPB regulations. It can ban all waivers of trials by consumers, including mandatory arbitration clauses, as well as waivers of class actions. Finally, the CFPB can limit or deny payday lenders access to the banking system, given that banks are used to process the loans. Depending on what the data show, the CFPB might consider outlawing these loans outright, as an unfair, abusive, and/or deceptive practice.

The question of course is whether regulating these products, used mostly by the working poor, will be a priority for the CFPB. Elizabeth Warren, Interim Director of the CFPB, included payday lending regulation in her short list of four immediate priorities for bureau enforcement, which included transparency in mortgage markets, disclosures for credit cards and payday loans, financial education, and supervision, enforcement, and fair lending for non-banks. Within this last category, Professor Warren again mentioned payday lending, stating that payday lenders would be among those subject to compliance examinations.[47] We can only hope that these regulations curb current abuses in payday lending, once and for all.

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[47] Elizabeth Warren, *Warren Outlines the Consumer Financial Protection Bureau: Part 1*, March 17, 2011, GRC DAILY, http://www.grc-daily.com/dsp_getFeaturesDetails.cfm?CID=2660, (last visited on July 20, 2011). While Professor Warren was not nominated as the first five-year Director of the CFPB, nominee Richard Cordray presumably shares her goals.