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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?

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Cover Page Footnote

Professor of Law, Michael E. Moritz College of Law, Ohio State University. For excellent comments and suggestions, I gratefully acknowledge my mentor and friend Professor Patrick Bauer. For research assistance, I thank Ama Attah-Mensah and Shaun Markley (both 2013 graduation candidates).

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?

Creola Johnson[+]

I. THE DEBT TRAP OF PAYDAY LOANS 387
 A. *Electronic Access to Consumers' Bank Accounts Facilitates the Debt Trap* 388
 B. *The Payday-Loan Industry's Revenues: Earnings from Repeat Borrowers* 392
II. NON-BANKS AND BANKS CONTINUE TO EXPAND THEIR PAYDAY-LOAN OPERATIONS 395
 A. *Payday Lenders Find New Ploys to Avoid States' Attempts to Regulate Them* 396
  1. *Lenders Tweak Products to Avoid Regulation* 396
  2. *Payday Lenders Disguise Their Operations* 398
  3. *Payday Lenders Create Rent-A-Tribe Partnerships* 399
  4. *Payday Lenders Either Obtain Different Licenses to Operate or Drop Them* 401
 B. *Mainstream Financial Institutions Offer So-Called Direct-Deposit Advances* 404
  1. *Payday Loans Disguised as Direct-Deposit Advances* 404
  2. *The OCC's Guidance for Direct-Deposit Advances: A Possible Window Dressing* 407
III. THE EMERGENCE OF THE CONSUMER FINANCIAL PROTECTION BUREAU 409
 A. *The Scope of the CFPB's Authority over Financial Institutions* 410
 B. *The CFPB Has Rulemaking Authority to Define Payday Loans and Covered Persons* 412
 C. *The CFPB Can Declare Many Payday-Loan Practices Unfair, Deceptive, or Abusive* 415
  1. *Unfair Practices Inflict Substantial Injury* 415

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2. Deceptive Practices Mislead Consumers 423
3. Abusive Practices Take Unreasonable Advantage of Consumers 425
D. Additional Considerations for CFPB Action 427
IV. CONCLUSION 428

Labeled by one lawmaker as "the worst financial product out there,"[1] the payday loan drives many borrowers into long-term debt because the borrowers cannot repay a high-cost loan in a short time frame and in a single payment, as required by the typical loan contract.[2] Consequently, many borrowers suffer serious financial harm, including lacking money to pay monthly bills, experiencing disconnection of utility services, and even being forced to file for bankruptcy relief.[3]

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1. 151 CONG. REC. E1386 (daily ed. June 28, 2005) (statement of Rep. Luis Gutierrez). Similarly, some Republicans have called payday lenders loan sharks and predatory lenders. *See, e.g.*, 152 CONG. REC. H7981 (daily ed. Sept. 29, 2006) (statement of Rep. Duncan Hunter) (identifying members of Congress who urged passage of legislation to protect the troops from payday lending and thanking "all of them for their great work and also to the gentleman [Robert Simmons (R-CT)] for his hard work on payday lender and trying to make sure that our troops have a good situation now and will not be the victims of loan sharks"); 152 CONG. REC. S6406 (daily ed. June 22, 2006) (statement of Sen. James Talent) ("[P]redatory payday lenders are targeting American troops and are trying to make a buck off of their service to our country. . . . I recognize that payday lending can be a risky business, but a triple-digit interest rate, which is commonly charged today, is simply too much.").

2. *See, e.g.*, JEAN ANN FOX & EDMUND MIERZWINSKI, CONSUMER FED'N OF AM. & U.S. PUB. INTEREST RESEARCH GRP., RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 6 (2001), *available at* http://www.consumerfed.org/pdfs/paydayreport.pdf (finding that payday loans are a coercive practice that require repayment of the principal in a short period of time and lead to long-term indebtedness).

3. *See* Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q.J. ECON. 517, 550 (2011). One academic conducted a comparative study of households in states with and without access to payday loans over a five-year period, eventually concluding that access to payday loans "increases households' difficulty in paying mortgage, rent and utilities bills" and positing, though not as strongly, that such access "increase[s] the likelihood of delaying needed medical care, dental care and prescription drug purchases." *Id.*; *see, e.g.*, DENNIS CAMPBELL, ASÍS MARTÍNEZ JEREZ & PETER TUFANO, BOUNCING OUT OF THE BANKING SYSTEM: AN EMPIRICAL ANALYSIS OF INVOLUNTARY BANK ACCOUNT CLOSURES 2, 39 (2008), *available at* http://www.bos.frb.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf (finding that payday borrowing increases the risk of involuntary bank-account closures); Michael S. Barr, Jane Dokko & Ben Keys, Financial Services, Savings, & Borrowing Among Low- and Moderate-Income Households, Presentation at the Federal Reserve Bank of Cleveland Conference on the Community Reinvestment Act 2, 21–22 (Feb. 6, 2009), *available at* http://www.clevelandfed.org/research/Conferences/2009/2-6-2009/Keys_presentation.pdf (comparing low- to moderate-income payday borrowers in the Detroit metropolitan area with similar households that did not use payday loans and finding that payday borrowers were twice as likely to be evicted, three

Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) created the Bureau of Consumer Financial Protection (CFPB), which has regulatory authority to protect consumers from payday lending.[4] However, several Republican lawmakers have taken actions aimed to put the CFPB, America's first consumer financial watchdog, on a *tight* leash.[5] Those actions include introducing a series of bills intended to weaken the CFPB's overall power[6] and to reduce its funding.[7] For example, one proposed bill would replace the CFPB's current leadership structure of one director with a five-member bipartisan commission.[8]

Besides to proposing bills to limit the CFPB's effectiveness, Republicans in the U.S. Senate successfully blocked one vote to confirm a director for the

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times as likely to file for bankruptcy, and almost three times more likely to have utility service disconnected).

4. *See* Dodd-Frank Wall Street Reform and Consumer Financial Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, §§ 1011, 1022, 124 Stat. 1376, 1964, 1980 (2010) (codified as amended at 12 U.S.C. §§ 5491, 5512 (Supp. IV 2010)).

5. *See infra* notes 7–8.

6. *See Legislative Proposals to Improve the Structure of the Consumer Financial Protection Bureau: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of H. Comm. on Fin. Servs.*, 112th Cong. app. at 81, 88 (2011) [hereinafter *Legislative Proposals Hearing*] (testimony of Professor Adam J. Levitin, Georgetown University Law Center) (discussing four bills that, according to Professor Levitin, would hinder the CFPB's effectiveness before it even began exercising its regulatory authority); *see also* 157 CONG. REC. H5326 (daily ed. July 21, 2011) (statement of Rep. Mazie K. Hirono) (opposing the proposed Consumer Financial Protection Safety and Soundness Improvement Act of 2011 because it "seeks to limit the independence and effectiveness of the CFPB").

7. *See* Financial Services and Central Governmental Appropriations Act, H.R. 2434, 112th Cong. §§ 101–102 (2011); H.R. REP. NO. 112-136, at 8 (2011). For example, Representative Jo Ann Emerson, Chairwoman of the Appropriations Subcommittee on Financial Services, introduced a bill to cap the CFPB's funding for the 2012 fiscal year and to place further funding under the purview of the congressional appropriations process. *See* H.R. 2434, §§ 101–102. Currently, the CFPB's funding falls outside Congress's reach because the Federal Reserve funds CFPB's operations, and the yearly funding is capped at approximately 10% of the Federal Reserve's total operating expenses. Dodd-Frank Act § 1017(a)(1), (2)(A); *see also Legislative Proposals Hearing*, *supra* note 6, at 83 (testimony of Professor Adam J. Levitin, Georgetown University Law Center) (explaining that the CFPB "has less budgetary independence than any other federal bank regulator" because of this cap). An additional proposed bill would facilitate a panel of financial regulators' ability to reverse any CFPB regulations by reducing the required veto vote from two-thirds of the panel members to a simple majority. *See* Consumer Financial Protection Safety and Soundness Improvement Act of 2011, H.R. 1315, 112th Cong. § 102 (2011). *But see Legislative Proposals Hearing*, *supra* note 6, at 85 (testimony of Professor Adam J. Levitin, Georgetown University Law Center) (arguing that H.R. 1315 "provides an unnecessary and possibly unconstitutional check on the CFPB and should be eliminated").

8. Responsible Consumer Financial Protection Regulations Act of 2011, H.R. 1121, 112th Cong. § 2 (2011). *But see Legislative Proposals Hearing*, *supra* note 6, at 83 (testimony of Professor Adam J. Levitin, Georgetown University Law Center) (recommending that House representatives vote against the bill because "switching to a five-member panel would tilt the balance at the agency to gridlock and inaction, would add unnecessary big government bloat, and would reduce accountability").

Bureau.[9] As was widely reported, these lawmakers refused to confirm Richard Cordray as director not for lack of qualification, but to "force structural changes to the agency."[10] In response, President Barack Obama used his executive power to appoint Mr. Cordray as the director during a Senate recess.[11] Amid threats from the financial-services industry to challenge the legality of his appointment,[12] Mr. Cordray, taking cue from President Obama,[13] is rightfully focusing his attention on all financial entities engaged in payday lending.[14]

At the first field hearing as director, Mr. Cordray announced that the CFPB had begun examination of non-bank lenders and released guidelines for examination procedures.[15] Non-bank payday lenders[16] are snubbing their noses at state lawmakers by continuing to offer loans in circumvention of state laws.[17] Payday lenders charge fees that equate to triple-digit annual interest

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9. *See* Laura Meckler & Victoria McGrane, *Obama Picks Nominee Fight*, WALL ST. J., Jan. 5, 2012, http://online.wsj.com/article/SB10001424052970203513604577140990785063430.html.

10. *See, e.g.*, *id.*

11. David Nakamura & Felicia Sonmez, *Obama Defies Senate, Puts Cordray in Consumer Post*, WASH. POST, Jan. 5, 2012, at A1.

12. *See* Kate Davidson, *Citi on CFPB: Lawsuits 'Likely to Come From Every Quarter'*, AM. BANKER (Jan. 11, 2012, 12:45 PM), http://www.americanbanker.com/issues/177_8/citi-lawsuits-cfpb-1045627-1.html?zkPrintable=true. The Office of Legal Counsel in the U.S. Justice Department released a memorandum that explained the recess-appointment process and concluded that President Obama's appointment was legal. *See* Memorandum from Virginia A. Seitz, Assistant Attorney Gen., U.S. Dep't of Justice, on Lawfulness of Recess Appointments During a Recess of the Senate Notwithstanding Periodic Pro Forma Sessions 17–18 (Jan. 6, 2012), *available at* http://www.justice.gov/olc/2012/pro-forma-sessions-opinion.pdf.

13. Ylan Q. Mui, *Obama Praises Consumer Bureau*, WASH. POST, Jan. 7, 2012, at A11 (quoting President Obama as stating that "irresponsible debt collectors and payday lenders and independent mortgage servicers and loan providers . . . are bound by the same rules as everybody else").

14. *See* Maya Jackson Randall, *Consumer Bureau Targets Payday Loans*, WALL ST. J. (Jan. 19, 2012), http://online.wsj.com/article/SB10001424052970204301404577171001066772154.html (quoting Cordray as telling a crowd in Birmingham, Alabama that payday loans will be given "much more attention" (internal quotation marks omitted)).

15. *Id.* Mr. Cordray also announced the release of *Short-Term, Small-Dollar Lending Procedures*, which CFPB examiners will use when they visit banks and non-banks to assess their payday loan operations. *Id.* *See generally* CONSUMER FIN. PROT. BUREAU, EXAMINATION PROCEDURES: SHORT-TERM, SMALL-DOLLAR LENDING PROCEDURES, *available at* http://www.consumerfinance.gov/wp-content/uploads/2012/01/Short-Term-Small-Dollar-ending-Examination-Manual.pdf (last visited Mar. 1, 2012).

16. In this Article, "non-bank payday lenders" refers to those institutions that fall outside of the mainstream financial institutions, such as banks and credit unions. *Cf.* REBECCA BORNÉ ET AL., CTR. FOR RESPONSIBLE LENDING, BIG BANK PAYDAY LOANS 2 (2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf (distinguishing non-bank payday-loan lenders and mainstream banks).

17. *See infra* Part II.A.1–4 (explaining the four methods payday lenders have used to avoid state regulation).

rates, issue loans frequently in excess of the borrower's next paycheck, and require borrowers to repay the loans in a single balloon payment—usually in two weeks.[18] Payday loans are considered so predatory that several states have banned payday lending or have capped the annual percentage rate (APR) at 36% or less.[19]

To stop payday lenders from skirting state laws, this Article asserts that the CFPB should exercise its rulemaking authority to declare many payday loan practices as unfair, deceptive, abusive, and, consequently, unlawful.[20] Part I explains how payday lending ensnares the majority of borrowers in a debt trap. For instance, because large repayment amounts are due within a short time frame, the majority of payday borrowers cannot repay the entire loan on time and thus must pay multiple rollover fees to extend the due date or obtain additional consecutive loans.[21] Part I also describes how some payday lenders repeatedly debit borrowers' bank accounts to collect rollover fees and thereby force borrowers to close their bank accounts to stop these rapacious collection activities.[22]

Part II describes the schemes non-bank payday lenders use to avoid state-law restrictions on payday loans. To circumvent the definition of a payday loan or to avoid being classified as an entity regulated by payday-loan statutes, payday lenders tweak their loan products, masquerade as different types of financial institutions, partner with Native American tribes, obtain different lending licenses to operate, or drop their licenses altogether.[23]

After discussing non-bank lenders, Part II moves on to describe the role of mainstream financial institutions in payday lending. As uncovered in a recent report surveying four states, major banks finance 42% of non-banks' payday lending.[24] Major banks, such as Wells Fargo, also offer their own versions of payday loans, usually under the misnomer of "direct deposit advances," which

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18. Jean Ann Fox, *Safe Harbor for Usury: Recent Developments in Payday Lending*, ADVANCING CONSUMER INT., Fall/Winter 1999–Spring/Summer 2000, at 7, 7.

19. *See, e.g.*, OHIO REV. CODE ANN. § 1321.40(A) (LexisNexis Supp. 2010) (capping short-term loan APRs at 25%).

20. The Dodd-Frank Act grants the CFPB authority to prevent financial-service providers from "committing or engaging in an unfair, deceptive or abusive act or practice." Dodd-Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 1376, 2006 (2010) (codified as amended at 12 U.S.C. § 5531 (Supp. IV 2010)).

21. *See, e.g.*, URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, FINANCIAL QUICKSAND: PAYDAY LENDING SINKS BORROWERS IN DEBT WITH $4.2 BILLION IN PREDATORY FEES EVERY YEAR 3, 4 (2006), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/rr012exec-Financial_Quicksand-1106.pdf (stating that rollover fees extend a loan's due date).

22. *See infra* Part I.

23. *See infra* Part II.A.

24. *See* NICHOLAS BIANCHI, NAT'L PEOPLE'S ACTION, PROFITING FROM POVERTY: HOW PAYDAY LENDERS STRIP WEALTH FROM THE WORKING-POOR FOR RECORD PROFITS 12 (2012), *available at* http://www.npa-us.org/files/images/profiting_from_poverty_npa_payday_loan_report_jan_2012_0.pdf.

are only available to customers who arrange for direct deposit of their income checks.[25] These bank-issued loans have triple-digit interest rates and short maturity dates, require single balloon payments, and give banks unfettered access to the borrowers' bank accounts.[26] Therefore, these bank-issued loans are not meaningfully distinguishable from non-bank payday loans because they have the same predatory characteristics and, therefore, need to be regulated.[27]

Part III describes the CFPB's broad rulemaking authority over all financial institutions and its enforcement authority over regular non-bank payday lenders as well as large financial institutions.[28] However, the CFPB lacks enforcement authority over smaller financial institutions; therefore, this Article posits that the CFPB can, and should, use its various powers to persuade prudential regulators of smaller financial institutions to exert enforcement authority over them to secure their compliance with the herein proposed regulations.[29]

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25. *See* JEAN ANN FOX, CONSUMER FED'N OF AM., BANK PAYDAY LOAN PRODUCTS 1 (2009), *available at* http://www.stoppaydaypredators.org/CFA%20-%20Bank%20Direct%20Deposit%20Payday%20Loan%20Products,%20Aug.%203,%202009.pdf; Alex Ulam, *Consumer Groups Call N.Y. Plan an Invitation to Usury*, AM. BANKER, Jun. 2, 2011, http://www.nedap.org/documents/2011-06-02AmericanBanker.pdf.

26. *See* NAT'L CONSUMER LAW CTR., 300% BANK PAYDAY LOANS SPREADING 1 (2011) [hereinafter NAT'L CONSUMER LAW CTR., 300% BANK PAYDAY LOANS SPREADING], *available at* http://www.nclc.org/images/pdf/banking_and_payment_systems/ib_bank_payday_spreading.pdf (reporting that bank-issued payday loans are spreading and specifically identifying Regions Bank as the most recent large bank to offer payday loans). Unless otherwise indicated, "mainstream financial institutions" includes banks and credit unions, whereas "non-banks" refers to the typical payday lender, as well as companies masquerading as other entities to avoid state law. NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON: HOW THE GOVERNMENT'S PUSH FOR DIRECT DEPOSIT OF SOCIAL SECURITY EXPOSES SENIORS TO PREDATORY BANK LOANS 16 (2010) [hereinafter NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON], *available at* http://www.nclc.org/images/pdf/pr-reports/runaway-bandwagon.pdf (explaining why bank-issued payday loans "look just like payday loans").

27. *See* Ulam, *supra* note 25; *see also* NAT'L CONSUMER LAW CTR., 300% BANK PAYDAY LOANS SPREADING, *supra* note 26, at 1 (explaining how bank-issued payday loans have "the *same dangerous features* of traditional payday loans that make them unaffordable and lead to a debt trap"); Maya Jackson Randall & Alan Zibel, *Banks' Direct-Deposit Advances Spark Lending Debate*, WALL ST. J. (Aug. 13, 2011), http://online.wsj.com/article/SB10001424053111904006104576502793158420916.html (reporting the story of a borrower who had experience with non-bank payday loans from six lenders and a direct-deposit loan from U.S. Bank, who stated that based on her experience, "the [U.S. Bank loan is] the same as any [non-bank] payday loan").

28. *See* Dodd-Frank Act, Pub. L. No. 111-203, § 1025(a), 124 Stat. 1376, 1990 (2010) (codified as amended at 12 U.S.C. § 5515 (Supp. IV 2010)). The Dodd-Frank Act defines large financial institutions as those institutions having more than $10 billion in assets. *Id.*; *see also* Adam Belz, *Iowa Community Bankers Worry New Regulations Could Bind Them*, DES MOINES REG., Aug. 7, 2011, at 1D, *available at* 2011 WLNR 15619427 (reporting that the nation's largest banks control 79% of the financial markets, whereas smaller financial institutions control only 11%).

29. *See infra* Part III.A; *see also* Dodd-Frank Act § 1002(24)(A)–(B) (identifying the Federal Deposit Insurance Corporation (FDIC) as the prudential regulator for insured depository

Part III explains how the CFPB should exercise its rulemaking authority to declare that several payday-loan practices are unfair, deceptive, and abusive. Such declarations would be similar to a federal law that restricts payday lending by bank and non-bank lenders to military personnel in several ways, including capping the APR at 36% on loans to active-duty military members and their dependents.[30] Although the CFPB is explicitly prevented from establishing a national usury limit,[31] it should pass a regulation making it unlawful for any lender to charge an interest rate in violation of applicable laws.

Part III also asserts that the CFPB should establish regulations that define payday loans and expand the scope of regulated entities to address the growing trend of lenders using ruses to avoid applicable laws.[32] Additionally, it should declare the following practices as unfair, deceptive, or abusive: short maturity dates, single balloon payments, multiple rollover or refinancing fees, multiple back-to-back loans, and repetitive electronic bank-account access. These practices mislead many consumers and cause them to enter into financial transactions under terms they cannot hope to fulfill, thus destining them to suffer substantial economic injury.

The CFPB's imposition of restrictions on payday loans will not end short-term, small-dollar loans in America, but will cause an increased prevalence of responsible lending practices. The results of a recent pilot program implemented by the Federal Deposit Insurance Corporation (FDIC) demonstrate that lenders can issue small-dollar loans subject to the types of restrictions proposed above and still achieve long-term profitability.[33] Therefore, the CFPB's regulatory intervention will correct the continuing market failure by promoting profitable, yet fair loans by responsible lenders.

I. THE DEBT TRAP OF PAYDAY LOANS

When payday loans—also known as payday advances, deferred-deposit loans, or cash-advance loans—emerged over twenty years ago,[34] the payday-loan industry claimed that they were a short-term financial solution for

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institutions and the National Credit Union Administration (NCUA) as the prudential regulator for insured credit unions); *id.* § 1026(a) (defining smaller financial institutions as those with $10 billion or less in assets).

30. John Warner Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, sec. 670, § 987(b), 120 Stat. 2083, 2266 (2006) (codified as amended at 10 U.S.C. § 987(b) (2006)).

31. *Id.* § 1027(o).

32. *See infra* Part III.B.

33. Rae-Ann Miller et al., *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program*, 4 FDIC Q. 28, 28 fig.1, 32 (2010), *available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf.

34. Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 9–10 (2002).

families low on cash.[35] However, consumer advocates quickly recognized that payday loans were, and still are, a financially destructive form of short-term credit.[36] The fees charged to obtain a payday loan usually amount to APRs totaling several hundred percent and some payday loans today even have APRs exceeding 1000%; consequently, payday loans are one of the most expensive forms of credit available.[37] In addition to the astronomical APRs associated with payday loans, other problematic loan terms, such as short maturity dates and single balloon payments, trap many individuals in a financial nightmare from which it is very difficult to escape.[38] As discussed below, the payday-loan industry's business model and practices depend on ensnaring consumers via repetitive access to their bank accounts and multiple rollovers and loans.[39]

A. Electronic Access to Consumers' Bank Accounts Facilitate the Debt Trap

In the early days of the industry, a consumer obtained a payday loan by physically going to a store, presenting identification and proof of income, and giving the store clerk a post-dated personal check totaling the amount of the loan plus fees.[40] The consumer was then required to pay the loan in full by its due date, usually two weeks from the original loan date.[41] If the consumer failed to appear in person to pay off the entire loan by the due date and, thereby, reclaim the check,[42] the lender would normally present the check to the consumer's bank for loan repayment.[43] Clearly, this early repayment

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35. *See, e.g.*, Ray Lewis, *CG: Base Offers Alternatives to Payday Lenders*, MARINES (Aug. 3, 2005), http://www.marines.mil/unit/basecamppendleton/pages/news/2005/CG%20Base%20offers%20alternatives%20to%20payday%20lenders.asp (quoting a representative for Money Tree, a payday lender with a store located in San Diego, as stating that payday loans are a "short-term solution").

36. *See, e.g.*, Elizabeth Renuart & Jean Ann Fox, *Payday Loans: A High Cost for a Small Loan in Low-Income and Working Communities*, 34 CLEARINGHOUSE REV. 589, 589–90 (2001) (describing the trap of payday lending as a "debt treadmill").

37. *See* Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 564–65 & n.1 (2010); *see also* Renuart & Fox, *supra* note 36, at 589 ("The typical annual percentage rate is at least 390 and averages close to 500 percent, although advocates and credit code enforcement agencies have noted rates of 1,300 percent to 7,300 percent."). For example, a loan of $400 for a fee of $100 due in fourteen days equates to an APR of 650%, or $2600. *See* Martin, *supra*, at 589 & n.1; *see also* Michael A. Satz, *How the Payday Predator Hides Among Us: The Predatory Nature of the Payday Loan Industry and Its Use of Consumer Arbitration to Further Discriminatory Lending*, 20 TEMP. POL. & CIV. RTS. L. REV. 123, 129 (2010) (characterizing the fee as a finance charge that should be viewed in terms of an APR rather than a flat fee).

38. *See infra* Part I.A–B.

39. *See infra* Part I.A–B.

40. Johnson, *supra* note 34, at 9–10.

41. Satz, *supra* note 37, at 129.

42. Johnson, *supra* note 34, at 10.

43. Barbara A. Monheit, *The Regulators Speak*, *in* 1 CONSUMER FINANCIAL SERVICES LITIGATION 2003, at 459, 505 (PLI Corp. L. & Practice Course Handbook Series No. B-1361,

method could result in non-payment if other checks cleared before the lender's presentment and reduced the balance to zero.[44]

Payday lenders quickly realized the ineffectiveness of the old-fashioned check-presentment process and developed more efficient payment processes, most specifically electronic access to the borrowers' accounts.[45] As one state regulator uncovered, some payday lenders' initially gained electronic access by obtaining borrowers' personal identification numbers (PINs) during the loan application process and then later used the PINs, without the borrowers' knowledge, to withdraw funds.[46]

Instead of deceptively obtaining PIN numbers, the majority of payday lenders now have consumers sign contracts that allow electronic debits to their bank accounts to facilitate payment of the entire loan or only the rollover fee.[47]

Ordinarily, a consumer could revoke a debit authorization to avoid a negative balance and future overdraft fees; however, a recent trend in debit access is based on opaque contractual language intended to overrule the borrower's attempted revocation.[48] Payday lenders use the borrower's bank-routing information to create a demand draft, which is an electronically created, unsigned check by which the lender withdraws money from the borrower's bank account without the borrower's knowledge or explicit approval.[49] As a result, the lender can unilaterally withdraw funds from the borrower's bank account despite the borrower's previous request that the bank stop all electronic debits.[50]

2003) ("When the loan is due, the lender expects to collect the loan by depositing the check or debiting the borrower's account or by having the borrower redeem the check with a cash payment.").

44. *Id.*

45. *See* Johnson, *supra* note 34, at 10.

46. *The Payday Loan Reform Act of 2009: Hearing on H.R. 1214 Before the Subcomm. on Fin. Servs. of H. Comm. on Fin. Servs.*, 111th Cong. app. at 59 (2009) [hereinafter *Payday Loan Reform Act Hearing*] (testimony of Jean Ann Fox, Director of Financial Services, Consumer Federation of America) (stating that examiners for the Idaho Department of Finance discovered that several lenders, including Check 'n Go, used borrowers' PINs to electronically access borrowers' bank accounts).

47. *See* Johnson, *supra* note 34, at 32 n.156 (discussing the author's study of payday lenders in Franklin County, Ohio, which discovered that the majority of payday lenders had contractual language requiring the borrower to agree to an electronic debit); *see also Payday Loan Reform Act Hearing*, *supra* note 46, at 58–60 (describing the electronic debit authorization process).

48. *See Creating a Consumer Financial Protection Agency: A Cornerstone of America's New Economic Foundation: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 91–92 (2009) [hereinafter *Consumer Financial Protection Agency Hearing*] (statement of Travis B. Plunkett, Legislative Director, Consumer Federation of America) (stating that online payday lenders used borrowers' personal information to withdraw funds from the borrowers' accounts per language in the original loan contract).

49. *See id.* (defining demand drafts as "unsigned checks created by a third party to withdraw money from consumer bank accounts").

50. *Id.* (documenting that lenders created "demand drafts when consumers exercised their [Electronic Funds Transfer Act] right to revoke authorization to electronically withdraw money

Even when borrowers ask their banks to close their accounts to stop a payday lender's debits, banks routinely honor the debits causing the bank accounts to become active again and triggering additional overdraft fees by the banks.[51] Some consumer advocates now refer to this scenario as a zombie bank account and have to assist the borrowers in making the banks stop debits after the bank accounts have been closed.[52]

Consumer advocates argue that the foregoing methods of withdrawing funds from borrowers' accounts violate state consumer-protection laws and exploit loopholes in federal laws.[53]

These electronic-withdrawal methods set off an avalanche of detrimental consequences for consumers.[54] For borrowers with insufficient funds, the lender's repeated attempted debits can expose borrowers to numerous overdraft or insufficient-funds fees.[55] For example, one payday lender charged its borrower a $20 return-debit fee, and the borrower's bank charged her $2500 in overdraft fees as a result of her account balance being insufficient to cover the loans and other checks drawn on the account.[56] Consequently, although the payday loan is marketed as a better alternative to overdraft programs, it can result in the borrower incurring substantial overdraft fees.

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from their bank accounts"); *see, e.g.*, Dan Sorenson, *Unregulated Online Lenders Can Mean Stress, Frustration*, ARIZ. DAILY STAR (Mar. 14, 2010, 12:00 AM), http://azstarnet.com/business/local/article_4c1c4cc5-75d8-587c-954c-48b94430bf59.html (illustrating how one borrower's bank refused to allow access to her account to stop a payday lender from taking out large amounts of her money).

51. *See, e.g.*, E-mail from H.C. Klein to Claudia Wilner, paydayloans@yahoogroups.com (Nov. 22, 2011, 5:20 PM) (on file with author).

52. *See, e.g.*, E-mail from Claudia Wilner to paydayloans@yahoogroups.com (Nov. 22, 2011, 2:58 PM) (on file with author).

53. *See Consumer Financial Protection Agency Hearing*, *supra* note 48, at 38, 91 (statement of Travis B. Plunkett, Legislative Director, Consumer Federation of America) (testifying that state regulators condemned demand drafts to the Federal Reserve Board because lenders used them to defraud consumers).

54. *See* Renuart & Fox, *supra* note 36, at 590; *see also* Sorenson, *supra* note 50 (stating that an online payday lender debited a borrower's account every week for $60 to $70 for two months and that when the borrower was finally able to contact the lender's representative, the lender would not tell her how much she owed on the $300 loan, but encouraged her to keep making rollover payments).

55. *See Consumer Financial Protection Agency Hearing*, *supra* note 48, at 88–91 (statement of Travis B. Plunkett, Legislative Director, Consumer Federation of America) (describing overdraft fees, usually around $25 per overdraft transaction).

56. *See, e.g.*, Marc Lifsher, *Internet, Regulators Target Loans from Tribes*, L.A. TIMES, Apr. 13, 2009, at B1 (reporting that the borrower attempted to stop lenders beforehand from debiting her account once she realized that her employer's direct deposit of her income check would be delayed); Sorenson, *supra* note 50 (stating that an attempted electronic debit resulted in a $35 fee for insufficient funds because the borrower's account balance was too low, and that although the borrower attempted to revoke her debit authorization, the borrower's bank refused to honor it immediately and thereby allowed the lender to continue debiting her account).

As a result of consumers' debit authorizations, payday lenders often make numerous withdrawals of funds for renewals or rollovers.[57] These debits result in consumers' repeated and immediate payment of high fees and deprive them of much-needed funds for high-priority expenses, such as utility bills and housing.[58] Online payday lenders, which are now a widespread enforcement problem for state regulators, use debit authorization and frequently create fixed dates to renew the loan every pay day automatically and withdraw *only* the rollover fee or finance charge from the consumer's bank account.[59]

The story of Bonnie Bernhardt illustrates how lenders use electronic access to collect fees, leave the principal unpaid, and perpetuate the debt trap. Ms. Bernhardt, a single mother from Wisconsin, obtained a $300 loan with an APR of 782.14% from Arrowhead Investments, an online, Delaware-based payday lender.[60] Because Ms. Bernhardt failed to repay the loan after two weeks, Arrowhead automatically "refinanced" the loan at a cost of $90 and did so eight more times in two-week intervals, resulting in a total of $810 in refinancing fees.[61] Such refinancing did not give her additional cash; rather, it only served to generate profits for the lender by simply extending the due date on the loan for another two weeks.[62] By the time Ms. Bernhardt came up with

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57. *See, e.g.*, Sorenson, *supra* note 50.

58. *See, e.g.*, *id.*; *see also* Erik Eckholm, *Seductively Easy, 'Payday Loans' Often Snowball*, N.Y. TIMES, Dec. 23, 2006, at A1 (stating that a single mother of two children paid $180 in monthly fees on two $200 loans); Barr, Dokko & Keys, *supra* note 3, at 21 (reviewing a study of payday borrowers in Detroit showing that lenders were more likely to suffer eviction or disconnection of utility services).

59. *CFA: 'High Risks' in Online Payday Lenders' Websites*, AM. BANKER (Dec. 20, 2004), http://www.americanbanker.com/cuj/2004_250/-237381-1.htm. State regulators have tried to stop payday lenders from using electronic access to raid a consumer's bank account. For instance, the Oregon Department of Consumer and Business Services (ODCBS) recently issued a cease-and-desist order against Global Payday Loan (GPL), an online Salt Lake City-based company operating through Payday-Loan-Yes.com. Global Payday Loan, LLC, No. I-11-0024, at 4–6 (Or. Dep't Consumer & Bus. Servs. July 1, 2011) (order to cease and desist and order assessing civil penalties). According to the order, GPL debited consumers' bank accounts for an origination fee of at least $30 and then debited the accounts for finance charges ranging from $30 to $250 to renew the loan every two weeks. *Id.* at 3. Some borrowers resorted to closing their bank accounts just to stop GPL from withdrawing these fees. *Id.* The ODCBS fined GPL $90,000 for violating the state's payday lending statute by being unlicensed and issuing loans with effective APRs ranging from 353% to 2737% to Oregon borrowers. *Id.* at 3–6. Oregon state law caps the APR for payday loans at 36% and origination fees at $10 per every $100 loaned and places restrictions on renewing existing loans. *Id.* at 9.

60. Pat Schneider, *Online Payday Loans Pose New Challenges for Consumers, Regulators*, CAP. TIMES (Madison, Wis.) (Feb. 22, 2010, 2:05 PM), http://host.madison.com/ct/news/local/article_ba5dbf62-d466-5c7d-86b7-0977603fc490.html.

61. Amended Class Action Complaint ¶¶ 80–97, Bernhardt v. Arrowhead Invs., Inc., No. 07CU4773 (Wis. Cir. Ct. Oct. 31, 2009).

62. *Id.* ¶¶ 84–95.

enough money to pay the entire loan balance, she had paid a grand total of $1360 for a $300 loan.[63]

B. The Payday-Loan Industry's Revenues: Earnings from Repeat Borrowers

Besides anecdotal evidence, such as Ms. Bernhardt's story, research shows that payday loans result in a long-term cycle of indebtedness for the majority of borrowers[64] and that trapped, repeat borrowers are the source of most of the industry's revenues.[65] A study by the Center for Responsible Lending (CRL) demonstrates that "churning"—when lenders circumvent state-law prohibitions on rollovers or refinancing by closing out the current loan and almost immediately issuing the borrower a new loan—generates 76% of the industry's profits, amounting to $20.6 billion in loans.[66] Because payday lenders will not accept partial payments, it is common for consumers who are unable to provide lump-sum repayments to incur rollover or refinance fees, which results in an indebted aggregate far in excess of the original loan amount.[67] Another CRL study found that 90% of payday-lending revenues comes from fees assessed on trapped borrowers and that the typical borrower pays back more than double

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63. *Id.* ¶¶ 96–97. Ms. Bernhardt and 400 other Wisconsin residents obtained a court settlement for their class action lawsuit against Arrowhead, in which they split $100,000 in restitution, and Arrowhead agreed to forgive $432,000 in outstanding loans. *See* Schneider, *supra* note 60. The lender was also barred from doing business in Wisconsin for five years. *Id.*

64. URIAH KING & LESLIE PARRISH, CTR. FOR RESPONSIBLE LENDING, SPRINGING THE DEBT TRAP: RATE CAPS ARE ONLY PROVEN PAYDAY LENDING REFORM 7 (2007), http://www.stoppaydaypredators.org/pdfs2/07_1213_crl_springing.pdf ("The high price of a payday loan and the fact that it must be paid off in one lump sum two short weeks later, virtually ensures cash-strapped borrowers will be unable to meet their basic expenses and pay off their loan with a single paycheck."); *see supra* note 3 and accompanying text. According to the Center for Responsible Lending report, only 2% of payday lending transactions involve borrowers "who take out one loan, pay it off on time, and do not need to borrow again that year." KING & PARRISH, *supra*, at 7.

65. *See, e.g.*, KING ET AL., *supra* note 21, at 6 tbl.1 (listing study results from select states indicating that, on average, 90% of payday lenders' revenue comes from borrowers who obtain at least five payday loans per year).

66. *See* LESLIE PARRISH & URIAH KING, CTR. FOR RESPONSIBLE LENDING, PHANTOM DEMAND: SHORT-TERM DUE DATE GENERATES NEED FOR REPEAT PAYDAY LOANS, ACCOUNTING FOR 76% OF TOTAL VOLUME 7, 13 tbl.7, app. II at 27 (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf (explaining the various ways churning occurs and stating that churning costs borrowers $3.5 billion in fees annually).

67. *See, e.g.*, FOX & MIERZWINSKI, *supra* note 2, at 9 (finding that more than 50% of borrowers in North Carolina paid interest and fees that exceeded the initial loan amount); Sorenson, *supra* note 50 (stating that an online payday lender withdrew $60 to $70 from a borrower's account every week for two months and then insisted that she still owed a balance on the $300 loan without specifying how much); *supra* notes 61–63 and accompanying text (discussing the refinancing fee that Ms. Bernhardt incurred, which amounted to $810 on a $300 loan).

the amount of the original loan.[68] Debunking the industry's claim that payday loans are a short-term solution, research consistently shows that most borrowers obtain multiple rollovers or loans per year.[69] Even during the recession years of 2007 to 2010, the nation's largest payday lenders earned record profits from cash-strapped consumers.[70]

As the CEO of one of the largest payday lenders explained, the design of the payday-loan debt trap is a deliberate business decision: "[T]he theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profitability is."[71] Consequently, borrowers get stuck running on a debt

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68. *See* KING ET AL., *supra* note 21, at 6–8 & tbl.3 ("The typical payday borrower pays back $793 for a $325 loan.").

69. *See, e.g.*, *id.* at 7 (finding that the average annual number of loans per borrower shows that most borrowers are trapped in repeat borrowing); OHIO COAL. FOR RESPONSIBLE LENDING, TRAPPED BY DESIGN: PAYDAY LENDING BY THE NUMBERS 5 (2007), *available at* http://www.cohhio.org/pdf/919TrappedByDesignfinal.pdf (finding that the average annual number of loans is 12.6 percent and concluding that this results from borrowers' inability to repay the full loan and fees in such a short time period *and* cover living expenses); PARRISH & KING, *supra* note 66, at 15 (finding that rollover borrowing is the rule, not the exception); LINDA A. WATTERS, MICH. DEP'T OF LABOR & ECON. GROWTH, REPORT ON THE BUSINESS OF PROVIDING DEFERRED PRESENTMENT SERVICE TRANSACTIONS IN MICHIGAN 15 (2007), *available at* http://www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf (finding that only 1.1% of payday loans were issued to one-time borrowers between June 2006 and June 2007, and that the average number of loans per borrower was 8.3). Professor Michael Barr found the following:

> Evidence from multiple states points to the fact that significant proportions of payday loan consumers roll their loans over on a frequent, if not habitual, basis. A study of payday borrowers in Illinois found that the median borrower had more than ten loan contracts over a two-year period, and that one-fifth of borrowers had twenty or more contracts in that time. In Wisconsin, 56% of payday borrowers took out at least eleven loans in one twelve-month period. In Indiana, 77% of all payday transactions were rollovers, and the average annual number of loan renewals was ten. In North Carolina, the typical payday loan customer took out seven loans in one year from one lender. The CFSA study found that three-quarters of payday borrowers rolled over their loan at least once, and that 30% had seven or more rollovers. Using the Wisconsin statistic as an example, the typical payday loan consumer, who takes out eleven two-week payday loans per year, for the average loan amount of $300, at the average 470% APR from the Consumer Federation of America (CFA) survey, spends nearly $600 annually in fees.

Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 156–57 (2004) (footnotes omitted).

70. *See* BIANCHI, *supra* note 24, at 10 ("Annual filings show that the nation's major payday lenders collectively earn more from their high-cost cash advances than before the financial crisis. From 2007 to 2010 their combined revenues from payday lending have increased 2.6%, or some $30 Million in annual revenues.").

71. KING & PARRISH, *supra* note 64, at 1 (quoting a telling comment made at a 2007 industry conference by Dan Feehan, CEO of Cash America); *see also* KING ET AL., *supra* note 21, at 9 (pointing to industry practices that suggest competition to secure trapped customers, rather than a higher number of occasional borrowers). Cash America is one of the six largest payday lenders in America. BIANCHI, *supra* note 24, at 10.

treadmill[72] and postpone necessary purchases, lose important utility services, and often must file bankruptcy to escape.[73] In fact, one study of debtors in Texas found that payday-loan borrowers are approximately 88% more likely to file a Chapter 13 bankruptcy case in comparison to the general population.[74]

Organizations that advocate for and assist consumers see firsthand the negative impact payday loans actually have.[75] In a survey of non-profit organizations in Texas, respondents identified payday lenders as the greatest threat to consumer credit.[76] In 2010, a survey of clients of Catholic Charities in Texas revealed that most could not repay a payday or car-title loan by its initial due date and most had trouble paying other bills after getting the loan.[77] Similarly, in a survey conducted by the Bell Policy Center of Denver in 2007, *every* credit counselor who participated in the survey and had payday-loan borrowers as clients responded that payday loans had harmed their clients

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72. Renuart & Fox, *supra* note 36, at 590 (discussing the "debt treadmill"); *see also* Johnson, *supra* note 34, at 55–65 (discussing the debt treadmill propagated by industry practices).

73. *See supra* note 3 and accompanying text (describing the negative impact on many borrowers who obtain payday loans).

74. Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* 21 (Vanderbilt Univ. Law Sch. Law & Econ., Working Paper No. 11-13, 2011), *available at* http://www.law.virginia.edu/pdf/olin/conf08/skiba.pdf; *see also* Nathalie Martin & Koo Im Tong, *Double Down-and-Out: The Connection Between Payday Loans and Bankruptcy*, 39 SW. U. L. REV. 785, 803 (2010) ("[T]he data show that bankruptcy filers in New Mexico used a tremendous number of payday loans, and unquestionably far more than in the general population.").

75. *See, e.g.*, *Testimony of Kelly Rand, Catholic Charities of Fort Worth—Close the CSO Loophole—Support HB 410*, TEX. CATH. CONF. (Mar. 22, 2011), http://www.txcatholic.org/index.php/component/content/article/72-testimony-and-letters-82nd-legislative-session/1069-testimony-of-kelly-rand-catholic-charities-forth-worth-close-the-cso-loophole-support-hb-410 [hereinafter *Testimony of Kelly Rand*] (reporting that 20% of Texas Catholic Charities' clients sought cash assistance through payday and car title loans and discussing these clients' "financial stress").

76. *See* TEX. APPLESEED, RESHAPING THE FUTURE OF SMALL-DOLLAR LENDING IN TEXAS: AFFORDABLE ALTERNATIVES TO HIGH-COST PAYDAY AND AUTO TITLE LOANS 14 (2012), *available at* http://www.texasappleseed.net/index.php?option=com_docman&task=doc_download&gid=664&Itemid=.

77. *See* TEX. CATH. CONF. ET AL., 2010 CATHOLIC CHARITIES SURVEY ON PAYDAY AND AUTO TITLE LOAN USE 1 (2010), *available at* http://www.occc.state.tx.us/pages/Legal/ANPR/Credit_Access_Business/2010%20Catholic%20Charities%20CABs%20Survey%20Exec%20Summ.pdf (reporting several findings including that "83% of payday or auto title loan users [that sought help from Catholic Charities] had trouble paying back the full loan when it came due," "70% had to extend or get new loans because they could not pay the full loan amount," and "77% of loan users believed that the loans made it hard to cover other bills"). Because of the financial harm payday loans inflict, many religious organizations around the country are opposed to payday lending. *See, e.g.*, Emily Wagster Pettus, Associated Press, *Miss. Religious Group Seeks End to Payday Loan Law*, BLOOMBERG BUSINESSWEEK (Jan. 24, 2011, 2:58 PM), http://www.businessweek.com/ap/financialnews/D9KUTJVG0.htm; *Payday Lender Curbs Backed*, COURIER-J. (Louisville, Ky.) (Nov. 15, 2011), http://www.courier-journal.com/article/20111115/NEWS01/311150045/Payday-lender-curbs-backed (identifying numerous religious organizations in support of Kentucky passing legislation to curb payday lending); *Testimony of Kelly Rand*, *supra* note 75.

financially and "73% . . . said they would 'never' recommend a payday loan to a client."[78] Notably, 75% of credit counselors indicated that payday loans were "very harmful" to their clients' ability to both make mortgage and rent payments and to pay other expenses.[79] These and other studies[80] confirm the financial hardship imposed on payday borrowers.[81] Along with consumer advocates and non-profit organizations, the majority of federal lawmakers[82] and many state lawmakers now recognize that payday loans are not a beneficial form of short-term credit because of the long-term financial problems generated.[83]

II. NON-BANKS AND BANKS CONTINUE TO EXPAND THEIR PAYDAY-LOAN OPERATIONS

Several states have been very actively trying to protect their residents by curbing payday lending.[84] As explained below, payday lenders are essentially ignoring or circumventing state lawmakers' recent attempts to curb payday lending.[85] Moreover, some mainstream financial institutions are unwilling to allow only non-bank payday lenders to reap the significant profits of high-cost lending and now offer consumers their own versions of payday loans.[86] These banks are free to ignore state laws restricting the predatory characteristics of payday loans because federal banking laws preempt such laws.[87] Furthermore, the prudential regulator of the national banks, the Office of the Comptroller of

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78. Press Release, Bell Policy Ctr., Credit Counselors Unanimous: Payday Loans Harm Coloradans (Feb. 4, 2009), *available at* http://bellpolicy.org/sites/default/files/PaydayCreditCounselorPR.pdf.

79. *Id.*

80. *See supra* note 3 and accompanying text (describing other studies).

81. *See, e.g.*, *Testimony of Kelly Rand*, *supra* note 75 (reporting that in Fort Worth, Catholic Charities "provided $800,000 of financial assistance in 2010 to clients struggling with payday or auto title loans").

82. *See supra* note 30 and accompanying text (discussing the U.S. Congress's passage of a federal law imposing numerous restrictions on payday loans to active-duty military families); *see also* Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. (forthcoming 2012) (describing how even Republican lawmakers called payday lenders "loan sharks" on the debate floor when urging members of Congress to vote in favor of a federal law protecting military families from payday lending).

83. *Cf.* Aaron Huckstep, *Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?*, 12 FORDHAM J. CORP. & FIN. L. 203, 214–15 (2007) (citing Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 6 (FDIC Ctr. for Fin. Research, Working Paper No. 2005/09, 2005)).

84. *See* Glen Fest, *A Case for Payday Loans: There Actually May Be One, But Making It Won't Win You Any Friends*, U.S. BANKER, July 1, 2011, at 9, *available at* 2011 WLNR 13079103 (reporting that ten states and the District of Columbia have banned payday lenders).

85. *See infra* Part II.A (discussing the schemes payday lenders devised to circumvent state laws).

86. *See* Ulam, *supra* note 25.

87. *See, e.g.*, *id.*

the Currency (OCC), only offers guidelines for bank-issued loans that give the banks broad latitude to issue high-cost loans.[88] Consequently, as explained in Part III of this Article, the new Consumer Financial Protection Bureau, which has rulemaking authority over banks and non-banks, needs to exercise its authority to protect consumers from payday lending.

A. Payday Lenders Find New Ploys to Avoid States' Attempts to Regulate Them

Although many academics and consumer advocates have uncovered numerous recent schemes employed by non-bank payday lenders to avoid state-law caps on APRs, several schemes are noteworthy. In particular, payday lenders (1) make superficial changes to their loan products; (2) disguise their operations as different types of financial institutions; (3) create partnerships with Native American tribes; or (4) obtain different licenses to operate or drop their licenses altogether.

1. Lenders Tweak Products to Avoid Regulation

Some payday lenders tweak their loan products to avoid falling within a state's definition of payday loan so that they can skirt payday-loan regulations altogether and continue to charge exorbitant interest rates.[89] For example, after Illinois passed the Payday Loan Reform Act (PLRA) in 2005, defining a payday loan as "a loan with a finance charge exceeding an annual percentage rate of 36% and with a term that does not exceed 120 days,"[90] payday lenders increased the loan period by one day, called these products "installment loans," and continued charging APRs in excess of 700%.[91] This change in the maturity period did not go unnoticed by state legislators, who recently amended the PLRA to broaden the definition of payday loans covered by the statute.[92] Payday lenders employed the same tactic in New Mexico and also substantially increased the cost of the loan.[93] Not only are payday lenders using this tactic to avoid usury limits, but one survey of payday borrowing in New Mexico demonstrates that such tactics are also used to bypass the statutory limit on the number of outstanding loans a borrower can have and to

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88. *See infra* Part II.A.2.

89. *See* Martin, *supra* note 37, at 585–91.

90. 815 ILL. COMP. STAT. ANN. 122/1-10 (West 2008 & Supp. 2011).

91. *See* Martin, *supra* note 37, at 590 & n.145; *see also* S. 96-120, Reg. Sess., at 99–100 (Ill. 2000).

92. Ill. S. 96-120, at 99–100 (quoting an Illinois state senator, Kimberly Lightford, as stating that "many lenders evaded that payday regulation by making consumer installment loans at a hundred and twenty-one days").

93. *See* Martin, *supra* note 37, at 585–88 (providing, as an example, that a consumer who obtains a $500 loan would be required to repay the $500 and an additional $585 in interest and fees over the period of the loan, totalling $1085).

skirt database reporting requirements to prevent state regulators from accurately tracking payday lending.[94]

Some payday lenders changed their loan products to be open-ended loan transactions to avoid interest-rate caps.[95] Until recently, payday loans were closed-end transactions; that is, a single loan transaction payable by the due date.[96] After the Virginia legislature passed a law restricting payday lending, many lenders began offering open-end payday loans and claimed that the loans were lines of credit, similar to a credit card, against which the consumer could borrow in the future once the initial loan was paid in full.[97] By claiming to offer lines of credit, these payday lenders claim such credit products are outside the scope of payday-loan regulations, thus allowing lenders to charge fees exceeding state usury caps.[98] For example, a $100 payday loan made in compliance with Minnesota's payday-loan statute would restrict the APR to 391%. However, by making the loan open-ended, the payday lender charges an APR of 815% if it does not impose an annual fee and an APR of 2118% if it imposes an annual fee.[99] Even when the loan is structured as open-ended credit, payday borrowers get trapped in a long-term debt cycle, potentially lasting a year or more, via multiple back-to-back loans.[100] Consequently, the "open-ended" line of credit is merely a payday loan.[101]

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94. *See id.* at 586–89.

95. *See id.* at 590 (citing *SCC Plugs Payday Lending Loophole*, RESPONSIBLELENDING.ORG (Mar. 19, 2010), http://www.responsiblelending.org/tools-resources/headlines/SCC-Plugs-Payday-Loan-Loophole.html).

96. *See* Tom Shean, *Credit Rules Won't Protect Borrowers, Critics Say*, VIRGINIAN-PILOT, Apr. 13, 2007, at D2 (warning that payday lenders would avoid narrow regulations by "switch[ing] from their closed-end loans, which have defined amounts and terms, and use open-ended loans, the sort provided by credit card lenders"); *see also* RON ELWOOD & KARI RUDD, LEGAL SERVS. ADVOCACY PROJECT, HISTORY REPEATS ITSELF: A NEW GENERATION OF PAYDAY LENDERS EXPLOIT A LEGAL LOOPHOLE TO PICK MINNESOTANS' POCKETS 17 (2010), *available at* http://www.mylegalaid.org/wp-content/uploads/2010/03/legal-loophole-report.pdf (defining a closed-end loan as a "one time transaction, with the balance payable on the due date").

97. *See* Martin, *supra* note 37, at 590 & n.144.

98. *See* Kimball Payne, *Payday Lenders' Loophole Narrowed*, DAILY PRESS (Newport News, Va.), Dec. 14, 2009, http://articles.dailypress.com/2009-12-14/news/0912130080_1_payday-lenders-open-end-credit-allied-title-lending.

99. *See* ELWOOD & RUDD, *supra* note 96, at 13.

100. *See, e.g.*, Ruby v. Cashnet, Inc., 708 S.E.2d 871, 872–85 (Va. 2011) (holding that a payday lender's practice of making back-to-back loans violated Virginia's prohibition of refinancings and renewals despite the lender's claim that it issued the borrower thirty-three "new" loans).

101. The author's conclusion that these restructured loans are disguised closed-end credit is contrary to one court's interpretation. *See* Janos v. Wells Fargo Bank, Nat. Ass'n, No. CV05-1504PHX-NVW, 2006 WL 359758, at *6 (D. Ariz. Feb. 14, 2006) (holding that the bank's direct deposit advance program is an "open-end" plan).

2. Payday Lenders Disguise Their Operations

Rather than tweaking their loan products, some payday lenders are masquerading as different types of organizations or financial institutions.[102] For instance, payday lenders in Minnesota are perpetrating this deception to evade a 1995 payday-lending law limiting fees and interest rates and preventing rollovers.[103] This law explicitly prohibited lenders from operating as industrial loan and thrifts,[104] which were originally created during the Great Depression to provide consumers with funds to obtain affordable housing.[105] Unfortunately for Minnesota consumers, a subsequent amendment to the 1995 law removed the prohibition and consequently created a loophole for payday lenders to exploit.[106]

Since lenders learned of the loophole, the number of loans made by lenders claiming to be an industrial loan and thrift increased dramatically from only 21 loans in 2003 to a whopping 161,031 loans in 2008.[107] In contrast, the number of regulated payday loans dropped from a record high of 233,926 in 2004 to only 69,912 in 2008.[108] Of the three licensed Minnesota payday lenders actively masquerading as an industrial loan and thrift in 2010, none offered the consumer financial services usually available from legitimately licensed industrial loan and thrifts, which notably do not issue payday loans.[109] As a result of the rapid increase in the number of payday lenders masked as industrial loan and thrifts, researchers estimate that payday lenders have swindled Minnesotans of nearly $6 million in illegal fees, "[there]by subverting the basic purpose of the Industrial Loan and Thrift model, designed to provide home ownership opportunities and . . . to help stanch foreclosures."[110] In the early 1980s, one lending institution's vice president commented that the thrifts were intended to serve consumers "who cannot borrow funds on a balance-sheet basis from commercial banks but who are deserving of credit at a much lower cost than 36 percent per annum."[111]

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102. *See, e.g.*, Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1152–53 (2008) (stating that payday lenders operate in Texas as "credit service organizations" and charge hefty "brokerage" fees for brokering loans from the payday lenders).

103. MINN. STAT. § 47.60 (2009); ELWOOD & RUDD, *supra* note 96, at 13 (citing Act of Mar. 24, 1995, ch. 202, art. 2, § 1, 1995 Minn. Laws, 917, 946–49 (codified as amended at MINN. STAT. ANN. §§ 47.59, 47.60 (West Supp. 2011))).

104. MINN. STAT. ANN. § 47.59.

105. *See* United States v. Winstar Corp., 518 U.S. 839, 844 (1996).

106. *See* ELWOOD & RUDD, *supra* note 96, at 15; *see also* MINN. STAT. ANN. § 47.59.

107. *See* ELWOOD & RUDD, *supra* note 96, at 16.

108. *Id.*

109. *Id.* at 4.

110. *Id.* at 3.

111. *Id.* at 19 (quoting State *ex rel.* Duluth Clearing House Ass'n v. Dep't of Commerce, 73 N.W.2d 790, 792 (Minn. 1955)).

However, the APRs for payday loans are exponentially more than 36%.[112] As will be discussed, the CFPB must play an active role in clearly defining a payday-lending business and must enforce penalties against those "disguised" lenders in noncompliance with applicable laws.[113]

3. Payday Lenders Create Rent-A-Tribe Partnerships

In addition to masquerading as some other type of financial institution, some payday lenders are entering into partnerships with Native American tribes to avoid state law.[114] These partnerships, commonly referred to as rent-a-tribes,[115] are a reincarnation of the now-illegal partnerships with banks, known as rent-a-banks.[116] In these partnerships, online payday lenders register businesses on Native American lands[117] and claim to be exempt from lawsuits and state usury caps under tribal sovereign immunity.[118] Using this doctrine, lenders argue that because their businesses are located on or headquartered within the borders of a Native American reservation, they are bound by the laws of that reservation only, not the laws of the state in which the reservation is located or the state in which the borrower resides.[119]

Although several states, including California, Colorado, Maryland, New Mexico, and West Virginia, have initiated proceedings against online payday lenders claiming tribal sovereign immunity,[120] enforcement actions against these entities have been somewhat unsuccessful.[121] One court, however,

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112. *See id.* at 19 n.57; *see also supra* note 37 and accompanying text.

113. *See infra* Part III.A–B (explaining the CFPB's authority to define payday lending and pass regulations expanding the scope of persons covered by the Dodd-Frank Act).

114. Michael Hudson & David Heath, *Fights Over Tribal Payday Lenders Show Challenges of Financial Reform*, IWATCH (Feb. 7, 2011, 11:00 AM), http://www.iwatchnews.org/2011/02/07/2151/fights-over-tribal-payday-lenders-show-challenges-financial-reform.

115. *Id.*

116. *See id.* For several years, payday lenders partnered with nationally charted banks to use the doctrine of federal preemption—available to national banks under the National Bank Act—to avoid compliance with state laws capping interest rates on payday loans. *See* FOX & MIERZWINSKI, *supra* note 2, at 15–23. Federal banking regulators eventually put an end to rent-a-banks, but only after years of numerous enforcement actions by state regulators, private lawsuits by consumer attorneys, and campaign efforts directed at the bank regulators by consumer advocacy groups. *See id.* at 22–24; Hudson & Heath, *supra* note 114.

117. *See, e.g.*, Hudson & Heath, *supra* note 114; Ben Mook, *South Dakota Payday Lender Fights Cease-and-Desist Order by Md. Financial Regulators*, DAILY REC. (Balt., Md.), May 15, 2011, http://thedailyrecord.com/2011/05/15/s-d-payday-lender-fights-cease-and-desist-order-by-md-financial-regulators, *available at* LEXIS, News & Business.

118. *See* Hudson & Heath, *supra* note 114.

119. *See, e.g.*, Mook, *supra* note 117.

120. *See* Hudson & Heath, *supra* note 114.

121. *See, e.g.*, Jessica Silver-Greenberg, *Payday Lenders Join with Tribes*, WALL ST. J., Feb. 10, 2011, at C2 (reporting that since 2005, Colorado Attorney General John Suthers has tried (without success) to stop rent-a-tribe lenders from affecting his state's residents); *see also* Cash Advance & Preferred Cash Loans v. State, 242 P.3d 1099, 1102 (Colo. 2010) (remanding to the trial court to determine whether tribal immunity applies to two payday lenders by considering the

provided some guidance regarding whether tribal sovereign immunity protects such partnerships. In *Ameriloan v. Superior Court*, the California Department of Corporations sought to enforce state law against five online payday-loan companies claiming to be wholly owned by the Miami Tribe in Oklahoma.[122] The appellate court held that the trial court erred in concluding that tribal sovereign immunity did not apply to off-reservation activity, such as online payday loans issued to California residents.[123] However, the court remanded the case for a factual determination of whether the companies were acting on behalf of the Miami Tribe, as tribal sovereign immunity would only insulate the lenders if the companies operate as actual "arm[s] of the tribe."[124]

State regulators argue that these payday lenders are not arms of the tribes, and that such arrangements are mere shams, intended to allow lenders to circumvent state law.[125] For example, authorities in Colorado assert that only after the state initiated enforcement proceedings did the tribes incorporate the payday lending companies as tribal business enterprises and establish lending ordinances for their operations.[126] Similarly, several states are pursuing enforcement actions against Martin A. Webb, a member of the Cheyenne River Sioux Tribe and the owner of several online payday-loan companies.[127] The websites for two of his companies, Western Sky Financial and Lakota Cash, feature Native American logos but clearly state that each company "is owned wholly by an *individual Tribal Member* of the Cheyenne River Sioux Tribe and is not owned or operated by the Cheyenne River Sioux Tribe or any of its political subdivisions."[128] As one knowledgeable academic has rightfully pointed out, because an individual tribe member owns the payday-loan

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following: "(1) whether the tribes created the entities pursuant to tribal law; (2) whether the tribes own and operate the entities; and (3) whether the entities' immunity protects the tribes' sovereignty").

122. 86 Cal. Rptr. 3d 572, 575–76 (Cal. Ct. App. 2008).

123. *Id.* at 575.

124. *Id.* at 585–86 (quoting Allen v. Gold Country Casino, 464 F.3d 1044, 1046 (9th Cir. 2006)).

125. *See, e.g.*, *id.* at 585. The California Department of Corporations urged the court to consider evidence "show[ing] the payday loan companies' alleged tribal associations are 'a sham,' part of a 'rent-a-tribe' scheme designed to immunize their flagrant violations of" California law. *Id.*

126. *See* Hudson & Heath, *supra* note 114.

127. *See, e.g.*, Mook, *supra* note 117 (reporting that Maryland issued a cease-and-desist order against Martin Webb's lending company for charging outrageous APRs and that Colorado's attorney general filed a lawsuit against it as well); *see also* Press Release, Office of W. Va. Attorney Gen., Attorney General McGraw Sues Eight More Payday Lenders, Demands Companies Stop Doing Business in W.V. (Aug. 18, 2010), *available at* http://www.wvago.gov/press.cfm?ID=533&fx=more (announcing charges against Martin Webb and his lending company in West Virginia for soliciting payday loans with illegal APRs).

128. *See* LAKOTA CASH, http://www.lakotacash.com/ (last visited Mar. 1, 2012); WESTERN SKY FINANCIAL, http://www.westernsky.com/ (last visited Mar. 1, 2012).

companies, rather than the tribe itself, these companies cannot be "arms of the tribes" and are not entitled to immunity.[129]

4. Payday Lenders Either Obtain Different Licenses to Operate or Drop Them

Instead of modifying their business format or relationships, some payday lenders rid themselves of state licenses to operate and become illegal businesses to avoid regulation.[130] Others obtain new licenses to operate under other lending statutes to avoid being covered by recently revised state payday-loan statutes.[131] Ohio, North Carolina, South Carolina, and Virginia have seen this happen.[132] This problem has become so prevalent that one Florida lawmaker proposed legislation to make an unlicensed payday lender's collection on an illegal payday loan a felony.[133]

Ohio, in particular, has produced many glaring examples of payday lenders exploiting various state lending licenses. In 2008, then-Governor Ted Strickland signed into law the Short-Term Loan Act[134] to curb predatory payday lending.[135] Specifically, the Short-Term Loan Act capped the maximum loan amount at $500,[136] limited the APR on payday loans to 28%,[137] and mandated a loan maturity date at a minimum of thirty-one days.[138] Shortly after its passage, the payday-loan industry loudly voiced its disapproval of the

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129. *See* Mook, *supra* note 117 (quoting Sarah Deer, a tribal law professor at William Mitchell College of Law, as stating that the "immunity argument might prove to be a tough one for Webb to prove since the companies are registered with the South Dakota Secretary of State and are not owned by the tribe" and that only the tribe can claim immunity, not an individual simply living on the reservation).

130. Payne, *supra* note 98 (explaining the unlicensed-lender problem in Virginia).

131. *See, e.g.*, Associated Press, *Payday Loan Restrictions Could Backfire*, AUGUSTA CHRON., Dec. 24, 2010, http://chronicle.augusta.com/news/business/your-business/2010-12-24/payday-loan-restrictions-could-backfire?v=1293308441 (stating that according to the South Carolina Board of Financial Institutions, "99 of the 245 payday lenders that discontinued their licenses in 2009 applied for a supervised license so they could make short-term, unsecured loans that don't have the same restrictions as payday loans").

132. *See, e.g.*, *id.*; Payne, *supra* note 98 (stating payday lenders dropped their licenses in Virginia).

133. *See* S.B. 536, 2010 Leg., Reg. Sess. (Fla. 2010).

134. OHIO REV. CODE ANN. §§ 1321.35–1321.48 (LexisNexis Supp. 2010).

135. Jim Siegel, *Strickland Signs Payday-Lending Bill*, COLUMBUS DISPATCH, July 8, 2008, http://www.dispatch.com/content/stories/local/2008/06/02/payday.html. For a full list of the Act's prohibitions, see OHIO REV. CODE ANN. § 1321.41. The Act also requires mandatory disclosures of fees and higher costs, as compared to other forms of lending, before issuing a loan to a consumer. *Id.* § 1321.39.

136. OHIO REV. CODE ANN. § 1321.39(A).

137. *Id.* § 1321.40(A).

138. *Id.* § 1321.39. Other prohibitions designed to address the debt trap include banning lenders from issuing more than four loans per year to a borrower, issuing a loan to a borrower for the purpose of retiring an outstanding payday loan between the borrower and lender (refinancing), and charging a fee to extend the loan's maturity date (roll-over). *See id.* § 1321.41(G), (K), (R).

new law by mounting a $20 million campaign to defeat the law through a voter initiative placed on the November 2008 ballot.[139] In response, Ohio voters overwhelmingly defeated the industry's initiative by a twenty-seven point margin.[140]

After the defeat, payday lenders in Ohio started skirting the new law even before its effective date.[141] According to a March 2009 study conducted by the Housing Research and Advocacy Center, only nineteen lenders had obtained a license under the new law.[142] Because the Short-Term Loan Act only applies to businesses licensed under the Act and does not actually compel short-term lenders to obtain licenses under it,[143] most lenders avoided getting licenses under the new law and obtained licenses under Ohio's two more lenient lending laws: Ohio's Mortgage Loan Act and the Small Loan Act.[144] Licensing under the Mortgage Loan Act is attractive because it does not require issuance of an actual mortgage, does not define the length of the loan term, and although it does cap APRs at 25%, the lender may charge various fees, effectively resulting in triple-digit APRs.[145] Similarly, the Small Loan Act does not define the loan term and allows payday lenders to charge an effective APR of 423%, which is higher than the 391% allowed under the repealed payday-lending statute.[146] Consequently, since the inception of the

139. Editorial, *End Loan Abuses*, BLADE (Toledo, Ohio), May 2, 2010, at B6; James Nash & Jim Siegel, *2 Ballot Issues Cost $82 Million: Battle over Issues Was Priciest in Ohio's History*, COLUMBUS DISPATCH, Dec. 13, 2008, at A1, A4.

140. *See* Nash & Siegel, *supra* note 139, at A1, A4 (describing how the payday-loan industry spent millions in comparison to the thousands spent by consumer advocates); Thomas Suddes, *Lender Loophole Isn't Getting Fixed*, PLAIN DEALER (Cleveland, Ohio), Aug. 23, 2009, at G1 (stating that "legislators' delay in closing loopholes in Ohio's anti-payday-loan law" was a "key" example of the General Assembly's failure to address pitfalls in legislation).

141. Payday lenders are similarly defying a new law in South Carolina. *See* Warren Bolton, Editorial, *Payday Lenders Are at It Again*, STATE (Columbia, S.C.), Feb. 3, 2010, at 6 ("Payday lenders were happy to operate under the law adopted expressly for them as long as there were no consumer protections . . . .").

142. *See* JEFFREY DILLMAN ET AL., HOUS. RESEARCH & ADVOCACY CTR., THE NEW FACE OF PAYDAY LENDING IN OHIO 1 (2009), *available at* http://www.thehousingcenter.org /docman/Download-document/68-The-New-Face-of-Payday-Lending-in-Ohio-March-2009.html# storylink=misearch.

143. *See* OHIO REV. CODE ANN. §§ 1321.35–.36 (LexisNexis 2006 & Supp. 2010).

144. *See* DILLMAN ET AL., *supra* note 142, at 1.

145. *See id.* at 8–9.

146. *Id.* at 7–8. Although the Small Loan Act provides for an interest-rate cap of 28% on loans under $1000, payday lenders can charge higher interest rates because the Small Loan Act's definition of APR does not include any extra fees charged by the lender. OHIO REV. CODE ANN. §§ 1321.10(A)(10), 1321.13(A) (LexisNexis 2010). Lenders under the Small Loan Act may charge origination fees of $15 for loans under $500, and $30 for loans over $500. *Id.* § 1321.13(I)(1)–(2). The Act also allows lenders to charge $15 and $30 origination fees, respectively, on each refinancing made six months after the original loan. *Id.* Additionally, a licensee can contract for default charges for any payment not made within ten days after its due date. *Id.* § 1321.13(K). Because the Act does not limit the length of the loan, lenders can charge an APR of 423% on a fourteen-day, $100 loan. *See* DILLMAN ET AL., *supra* note 142, at 7–8.

Short-Term Loan Act, over 1000 payday lenders have obtained licenses under the other two acts, as opposed to the new law.[147]

A September 2009 study by Policy Matters Ohio found that *every* payday lender surveyed continued to charge triple-digit interest rates and required loan repayment within two weeks or less, and *most* lenders issued loans in amounts exceeding $500.[148] Many lenders are Internet-based and charge interest rates *higher* than, and issue loans in amounts *greater* than the brick-and-mortar stores.[149] Each of these practices would violate Ohio's new law had these lenders properly obtained licenses under the Act instead of circumventing the Act by operating under laws intended to regulate different businesses.[150] In an unpublished opinion, an Ohio magistrate judge recently held that the Mortgage Loan Act did not cover a payday lender's loan product, labeled as a "Short Term Financed Loan."[151] Because the lender was not licensed under the Short-Term Loan Act, it was only entitled to interest at a rate of 8%, not the triple-digit interest rate called for in the contract.[152] The payday lender's employee admitted that its operations were basically the same as when licensed as a "payday lender."[153] Because this decision does not have precedential value, the payday lenders in Ohio continue to violate state law. Payday lenders in other states are also allowing their payday-lending licenses to expire and are instead getting licenses to operate under state laws not intended to cover their loan products.[154]

The payday lending situation in Ohio and other states demonstrates that payday lenders can and will skirt state legislative efforts to curb predatory practices.[155] If state regulators seek enforcement actions against them, payday lenders keep regulators tied up in protracted litigation that unnecessarily

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147. *See* DILLMAN ET AL., *supra* note 142, at 3–5.

148. *See* DAVID ROTHSTEIN, POL'Y MATTERS OHIO, NEW LAW, SAME OLD LOANS: PAYDAY LENDERS SIDESTEP OHIO LAW 1–4 (2009), *available at* http://www.policymattersohio.org/wp-content/uploads/2011/09/NewLawSameOldLoans2009.pdf. Despite multiple visits and calls to sixty-nine payday loan stores in Ohio, testers had trouble obtaining information about loan terms. *Id.* at 2.

149. *Id.* at 4–5.

150. OHIO REV. CODE ANN. §§ 1321.39, 1321.41 (LexisNexis Supp. 2010); ROTHSTEIN, *supra* note 148, at 2.

151. *See* Ohio Neighborhood Fin., Inc. v. Scott, No. 09CVF01488, slip op. at 1 (Elyria Mun. Ct. Mar. 25, 2011).

152. *Id.* at 13–14.

153. *Id.* at 1.

154. *See, e.g.*, Associated Press, *supra* note 131 (noting the high percentage of South Carolina payday lenders that let their licenses expire in order to obtain different licenses to make unsecured loans).

155. The exploitation of these loopholes has led to a proposed federal bill. *See* Protecting Consumers from Unreasonable Credit Rates Act of 2009, S. 500, 111th Cong. § 2 (2009).

diverts limited governmental resources.[156] The CFPB is, therefore, an essential part of stopping the payday-loan industry's flagrant violations of state laws.

B. Mainstream Financial Institutions Offer So-Called Direct-Deposit Advances

Unlike non-bank payday lenders, traditional banks have no rules regulating their high-interest, short-term loans to civilian consumers;[157] consequently, several banks now offer payday loans cleverly labeled "direct deposit advances."[158] As a condition for receiving the direct-deposit advance, a consumer must have a bank account with the lender-bank and must have his or her income check automatically deposited into that account each pay period.[159] These bank-issued loans are currently available in at least half of the states.[160] Because banks are seeking to replace revenues lost from legal restrictions on overdraft programs, analysts predict banks will promote their payday loans more aggresively.[161] In the absence of legal restrictions on the terms of these bank-issued loans, they cannot be considered a safe, affordable alternative to non-bank payday loans.[162]

1. Payday Loans Disguised as Direct-Deposit Advances

Bank-issued payday loans have triple-digit interest rates, short maturity dates, and single balloon payments.[163] Major banks, including Fifth Third

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156. *See, e.g.*, Jessica Legge Borders, *Fight Against Internet Payday Lenders Continues*, TIMES W. VIRGINIAN, Nov. 22, 2009, http://timeswv.com/business/x546416422/Fight-against-Internet-payday-lenders-continues ("Since 2005, the Attorney General [of West Virginia] . . . has been aggressively fighting against Internet payday lenders and trying to enforce the law."); Andrew DeMillo, *Ark. AG Asks Payday Lenders to Shut Down or Face Lawsuits*, S. BANCORP (Mar. 19, 2008), https://banksouthern.com/news/ark-ag-asks-payday-lenders-to-shut-down-or-face-lawsuits/ (reporting Arkansas Attorney General Dustin McDaniel's decision to shut down payday lending even though he expects payday lenders to fight in court for years).

157. *See supra* note 30 and accompanying text (discussing a federal law imposing numerous restrictions on payday loans to active-duty military families, and noting that such restrictions are applicable to all financial institutions, not just non-banks).

158. *See* Chris Serres, *Biggest Banks Stepping in to Payday Arena*, STARTRIB., Sept. 6, 2009, at D1, D7; Ulam, *supra* note 25.

159. *See* Serres, *supra* note 158, at D7; *see also* David Lazarus, *120% Rate for Wells' Advances*, S.F. CHRON., Oct. 6, 2004, at C1.

160. *See* Ulam, *supra* note 25.

161. *See* NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON, *supra* note 26, at 16 (stating that "[t]he new limitations on overdrafts, which will require affirmative consumer opt-in for banks' overdraft loan programs, will likely reduce banks' overdraft fee revenues, perhaps by 27% to 34%," and, consequently, "[b]anks are likely to push customers toward bank account advance loans to replace this lost revenue").

162. *See* Ulam, *supra* note 25.

163. *See* Letter from Adam Rust, Research Dir., Cmty. Reinvestment Ass'n of N.C., to the Office of the Comptroller of the Currency 1 (July 14, 2011), *available at* http://cra-nc.org/sites/cra-nc.org/files/pdf/occ%20guidance%20comment2.pdf (describing how the banks' direct deposit advances have the same characteristics as payday loans and lead to a similar cycle

Bank, U.S. Bank, and Wells Fargo, offer short-term loans that carry fees ranging from $7.50 to $10.00 for every $100.00 borrowed.[164] The banks' disclosures indicate that the maximum time a loan can remain unpaid is thirty-five days; however, the loan amount and finance charge will be offset automatically against incoming direct deposits of greater than $100.[165] Because consumers typically are paid twice per month, this practice results in the repayment of the loan in fourteen days, which translates into an APR of 261% or higher with a finance charge of $10 per $100.[166] One study found that the term for a typical bank-issued payday loan is only ten days, which results in an APR of 365% for a $100 loan with a $10 finance charge, and that the borrower enters a cycle of debt for an average of 175 days.[167] Consequently, the bank's direct-deposit loan product obligates the consumer to pay a high-cost loan in a single balloon payment in a short amount of time.[168] This process "forces most customers into a long-term cycle of borrowing that systematically strips them of their funds."[169]

Some banks claim to have policies preventing rollovers or renewals so as to distinguish their loans from non-bank payday loans.[170] Although this may be technically true, consumers with account balances insufficient to cover both the automatic loan payment and checks drawn on the accounts incur overdraft fees, depriving them of money to cover other living expenses and forcing them to obtain numerous back-to-back loans.[171] As one study found, borrowers

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of debt); *see also* Serres, *supra* note 158, at D7 (reporting how institutions issuing direct-deposit advances debit borrowers' accounts as soon as the paychecks for the following pay period have been deposited).

164. *See* Serres, *supra* note 158, at D7; *see also* WELLS FARGO BANK, WELLS FARGO DIRECT DEPOSIT ADVANCE SERVICE AGREEMENT AND PRODUCT GUIDE 3 (2011) [hereinafter WELLS FARGO AGREEMENT], *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

165. *See* WELLS FARGO AGREEMENT, *supra* note 164, at 4 (stating that although "each advance must be repaid within 35 days, your advance may be repaid much sooner depending on the timing of your next [incoming] *Qualified Deposit*," which is defined broadly to cover deposit sources such as paychecks and tax refunds (emphasis in original)).

166. *See* BORNÉ ET AL., *supra* note 16, at 5; *see also* NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON, *supra* note 26, at 16 (stating that although banks technically disclose an APR, it is grossly below the actual APR associated with the bank-issued loan); Serres, *supra* note 158, at D7 ("[C]ustomers can't extend on 'roll over' the loans because the amount owed is automatically repaid with the next direct deposit.").

167. *See* BORNÉ ET AL., *supra* note 16, at 5. Although the APR on bank-issued loans are slightly lower than the APR on non-bank payday loans, the bank-issued loans carry late fees not charged by non-bank payday lenders. NAT'L CONSUMER LAW CTR., 300% BANK PAYDAY LOANS SPREADING, *supra* note 26, at 1.

168. *See* BORNÉ ET AL., *supra* note 16, at 5.

169. *Id.*

170. *See* Serres, *supra* note 158, at D7 (discussing a Wells Fargo spokesperson's statements claiming that the institution's loan product differs from payday loans).

171. *See* BORNÉ ET AL., *supra* note 16, at 5; Randall & Zibel, *supra* note 27 (describing the story of an Ohio resident, who incurred so many bounced-check fees as a result of her lender's

obtain, on average, sixteen bank-issued loans per year.[172] Moreover, a Wells Fargo employee admitted that "[m]any [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken."[173] Thus, *if it quacks like a payday loan, then it is a payday loan*.

If the consumer's direct deposit is too small to pay the loan in full, the bank's automatic deduction for payment will lead to overdraft fees, thereby creating a need for an additional loan and worsening the consumer's financial crisis.[174] This cyclical process is especially prevalent among social-security recipients, who comprise a substantial percentage of the borrowers obtaining bank-issued payday loans.[175] Banks access a large percentage of social-security recipients' checks to pay off the loans.[176] For example, a social-security recipient who applied for a direct-deposit advance from Wells Fargo ultimately obtained 24 loans in a 39-month period, paid $1200 in finance charges with effective APRs ranging from 182% to 1825%, and paid $676 in overdraft fees on loans marketed as a means of avoiding such fees.[177] This example illustrates that bank-issued loans are arguably worse than regular payday loans because the bank's automatic deduction process ensures priority over any other creditors[178] and violates consumer-protection laws enacted to protect due-process rights and certain income sources from garnishment.[179]

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automated debits—despite the lender's so-called procedures to forestall long-term use of the payday-loan and direct-deposit products—that she lost her bank account and is now unable to open another).

172. BORNÉ ET AL., *supra* note 16, at 5.

173. *See* Lazarus, *supra* note 159, at C8.

174. *See* Letter from Adam Rust, *supra* note 163, at 5 ("US Bank charges an overdraft fee when a customer is delinquent on their outstanding checking account . . . [and] puts any future payments towards the overdraft fee before satisfying the principal[,] . . . creating overdrafts.").

175. BORNÉ ET AL., *supra* note 16, at 8 ("Nearly one-quarter of all bank payday borrowers are Social Security recipients, who are 2.6 times as likely to have used a bank payday loan as bank customers as a whole." (footnote omitted)).

176. *See id.* ("[W]hen a Social Security recipient had an outstanding bank payday loan, the bank took a sizeable proportion (33 percent) of the borrower's next deposit to repay the loan and fee.").

177. *See* CTR. FOR RESPONSIBLE LENDING ET AL., COMMENTS TO THE OFFICE OF THE COMPTROLLER OF THE CURRENCY: PROPOSED GUIDANCE ON DEPOSIT-RELATED CONSUMER CREDIT PRODUCTS 19 (2011) [hereinafter CRL COMMENTS ON PROPOSED OCC GUIDANCE], *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/occ-comments-payday-overdraft.pdf.

178. *See, e.g.*, FOX, *supra* note 25, at 3 (stating that regardless of the means by which U.S. Bank obtains repayment of its bank-issued loan, the loan "is paid before all other transactions are processed, including checks, preauthorized transfers and any other transactions").

179. *See* Letter from Adam Rust, *supra* note 163, at 6; *see also* NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON, *supra* note 26, at 18–21 (asserting that banks violate the Social Security Act when they use a borrower's direct deposit of a social-security check to pay off the payday loan, the Electronic Funds Transfer Act by requiring borrowers to authorize electronic debits to repay loans, and lending regulations by issuing loans without assessing a borrower's ability to repay the loan).

2. The OCC's Guidance for Direct-Deposit Advances: A Possible Window Dressing

With the limited exception of one federal law protecting military families from payday lending, no federal law exists that imposes restrictions on banks issuing payday loans to civilian consumers, and the Office of the Comptroller of the Currency (OCC), the prudential regulator of national banks, is currently not inclined to regulate bank-issued payday loans.[180]

Before entering directly into the payday-loan market, some banks were involved behind the scene for several years and provided billions of dollars to finance the operations of non-bank payday lenders.[181] This financing enabled the payday-loan industry to borrow at a rate of 3.3% while charging consumers an average APR of 455%.[182] Some national banks entered into partnerships with payday lenders, commonly known as rent-a-banks, so that the non-bank payday lenders could use the doctrine of federal preemption available to national banks to avoid compliance with state laws capping interest rates on payday loans.[183] After urging by consumer advocacy groups, the OCC put a stop to rent-a-bank partnerships because of concerns that payday lending posed risks to the safety and soundness of banks and risks to consumers.[184] In 2000, an OCC advisory letter regarding payday lending recognized that "payday lending carries significant credit, transaction, reputation, and compliance and

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180. *See* John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, sec. 670, § 987, 120 Stat. 2083, 2266 (2006) (codified at 10 U.S.C. § 987 (2006)); Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 32 C.F.R. § 232.1 (2009). These laws and regulations apply to all financial institutions offering loans that meet their definition of a payday loan. *See* 32 C.F.R. § 232.3(e) (defining a creditor as "a person who is engaged in the business of extending consumer credit with respect to a consumer credit transaction covered by this part"). However, because the Act defines a payday loan as a closed-end credit product, 32 C.F.R. § 232.3(b)(1)(i), some banks circumvent this definition by claiming that their direct-deposit advances are open-ended credit products. CRL COMMENTS ON PROPOSED OCC GUIDANCE, *supra* note 177, at 21. The OCC originally took the position that payday lending was unacceptable among banks. *See id.* at 27 (urging the OCC not to adopt guidelines proposed in 2011 that would legitimize triple-digit APRs on loans issued by banks); Andrew Kahr, *New Loan Type Will Force New Limits*, AM. BANKER, Dec. 22, 2010, at 9 (reporting on an OCC statement from years ago, which asserts that "payday lending is not an appropriate activity for a national bank").

181. *See* KEVIN CONNOR & MATTHEW SKOMAROVSKY, NAT'L PEOPLE'S ACTION & PUB. ACCOUNTABILITY INITIATIVE, THE PREDATORS' CREDITORS: HOW THE BIGGEST BANKS ARE BANKROLLING THE PAYDAY LOAN INDUSTRY 18–19 (2010), *available at* http://media.miamiherald.com/smedia/2010/09/14/19/paydayreport_FINAL.source.prod_affiliate.56.pdf.

182. *Id.* at 19.

183. *See* CRL COMMENTS ON PROPOSED OCC GUIDANCE, *supra* note 177, at 8.

184. *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC ADVISORY LETTER AL 2000-10, PAYDAY LENDING 3 (2000) [hereinafter OCC ADVISORY LETTER], *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf.

legal risks that raise supervisory concerns."[185] In 2003, then-Comptroller John D. Hawke Jr. told payday lenders to "[s]tay the hell away from national banks" when explaining the OCC's enforcement action against Peoples National Bank for its rent-a-bank partnership in South Carolina.[186]

In a remarkable flip-flop, the OCC, under different leadership, has ignored its previous guidance addressing payday loans and proposed new guidelines that would allow national banks to continue offering their own versions of payday loans.[187] The OCC's 2011 proposed guidelines regarding direct-deposit advances avoid the "payday loan" term and are vague on many of the payday-loan characteristics that are considered predatory.[188] For example, although the OCC is aware that payday lending leads to multiple rollovers or back-to-back loans, the OCC's guidance states only that "[d]eposit-related credit products should be subject to prudent limitations on credit extensions, customer costs, and usage."[189] Incredibly, the OCC fails to provide examples of "prudent limitations;"[190] thus banks like Wells Fargo would be free to interpret the rules to allow consumers to obtain multiple back-to-back loans.[191] Because the OCC's guidelines are indefinite and leave untouched many of the payday-loan characteristics that are considered predatory, they may be a mere window dressing designed to legitimize bank-issued payday loans.[192] The OCC's actions are particularly unfortunate for consumers because bank-issued payday loans and regular payday loans are

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185. *Id.*

186. *See* Ben Jackson, *OCC Payday Purge Done; Lenders Eye State Banks*, AM. BANKER, Feb. 3, 2003, at 1 (identifying several banks that the OCC ordered to sever their partnerships with payday lenders).

187. *Compare* OCC ADVISORY LETTER, *supra* note 184, at 1–8 (describing the risks associated with bank payday lending), *and* CRL COMMENTS ON PROPOSED OCC GUIDANCE, *supra* note 177, at 4–8 (critiquing the proposed OCC guidance and recommending heightened restrictions), *and* Letter from Adam Rust, *supra* note 163, at 1–10, *with* Guidance on Deposit-Related Consumer Credit Products, 76 Fed. Reg. 33,409, 33,410–13 (proposed June 8, 2011) (detailing the OCC's proposed guidance). *See also Enhanced Consumer Financial Protection After the Financial Crisis: Hearing Before the S. Comm. On Banking, Hous., & Urban Affairs*, 112th Cong. 21–22 (2011) (written testimony of Michael D. Calhoun, President, Ctr. for Responsible Lending), *available at* http://banking.senate.gov/public/index.cfm ?FuseAction=Hearings.Testimony&Hearing_ID=1980c90b-c8f9-4278-b509-d9de43e8506a& Witness_ID=3cb65047-012f-4110-991a-ec0463ae648d (stating that the "OCC recently proposed weak guidance addressing the bank[-issued] payday loans").

188. *See* Guidance on Deposit-Related Consumer Credit Products, 76 Fed. Reg. at 33,409–13; *see also* Letter from Adam Rust, *supra* note 163, at 2 (criticizing the guidelines as being "too vague").

189. *See* Guidance on Deposit-Related Consumer Credit Products, 76 Fed. Reg. at 33,410.

190. *Id.*; Letter from Adam Rust, *supra* note 163, at 6.

191. *See supra* notes 171–73 and accompanying text.

192. *See* CRL COMMENTS ON PROPOSED OCC GUIDANCE, *supra* note 177, at 23 (criticizing the "high degree of flexibility" included in the OCC's guidance); *see also* BORNÉ ET AL., *supra* note 16, at 12 ("[T]he OCC proposed guidance on payday lending that accepts many current bank practices and essentially condones the most harmful aspects of the product . . . .").

practical equivalents.[193] Additionally, the OCC requested written comments on its proposed guidance less than forty-five days before the day the CFPB became operational.[194] Critics rightfully question the timing of the OCC's guidelines as an attempt to stealthily usurp rulemaking authority from the CFPB.[195]

III. THE EMERGENCE OF THE CONSUMER FINANCIAL PROTECTION BUREAU

When President Obama signed the Dodd-Frank Act into law and established the CFPB, he remarked that "our financial system only works—our market is only free—when there are clear rules and basic safeguards that prevent abuse, that check excess, that ensure that it is more profitable to play by the rules than to game the system."[196]

President Obama's remarks are clearly applicable to payday loans. As explained in Part II, regular non-bank payday lenders are constantly gaming the system; that is, circumventing state laws intended to regulate their loan products.[197] In addition, mainstream banks are now players in the payday-loan business and are subject to only vague guidelines the banks could choose to ignore.[198] Although credit unions have a reputation comparable to a trusted uncle from whom one could obtain a loan,[199] some credit unions have been accused of offering high-cost loans similar to regular payday loans.[200] A rule recently adopted by the National Credit Union Administration (NCUA) sets a 28% APR cap on short-term loans offered by federal credit unions and imposes other lending restrictions as well.[201] Despite the NCUA's rule, however, circulating media reports document some credit unions charging excessive

193. *See* Letter from Adam Rust, *supra* note 163, at 1; *see also supra* Part II.B.1.

194. *See* Letter from Adam Rust, *supra* note 163, at 1.

195. *Id.* at 1, 5. The Dodd-Frank Act explicitly transfers "[a]ll consumer financial protection functions of the Comptroller of the Currency" to the CFPB. Dodd-Frank Act, Pub. L. No. 111-203, § 1061(b)(2), 124 Stat. 1376, 2036 (2010) (codified as amended at 12 U.S.C. § 5581 (Supp. IV 2010)); *see also id.* § 1061(a)(1)(A) (defining "consumer financial protection functions" as "all authority to prescribe rules or issue orders or guidelines pursuant to any Federal consumer financial law, including performing appropriate functions to promulgate and review such rules, orders, and guidelines").

196. William D. Cohan, Op-Ed., *Make Wall Street Risk It All*, N.Y. TIMES, Oct. 8, 2010, at A27.

197. *See supra* Part II.A–B.

198. *See supra* Part II.A–B.

199. *See* Frank J. Diekmann, *The Agenda Item You Won't Find on the Agenda*, CREDIT UNION J., June 27, 2011, at 6 (discussing which credit unions act morally and responsibly and which have suffered a "moral lapse" as result of their so-called alternatives to payday loans); Ben Hallman, *More Credit Unions Offering Payday Loans*, WASH. POST, May 31, 2011, at A8 (reporting that credit unions traditionally offer "prudent loans . . . without the profit motive of traditional banks").

200. *See, e.g.*, Hallman, *supra* note 199, at A8 (reporting that Mountain American Federal Credit Union and other credit unions offered loans with triple-digit interest rates).

201. *See* 12 C.F.R. § 701.21(c)(7)(iii) (2011).

application fees disguised as finance charges, which cause the loans to have effective APRs in excess of 100%.[202] Thus, the current financial landscape for payday loans demonstrates that many market participants play by their own rules and that "competition" among them has not resulted in the widespread availability of reasonably priced loans to consumers.[203] Consequently, the CFPB needs to exercise its regulatory authority and intervene.

The Consumer Financial Protection Act (CFPA)—Title X of the Dodd-Frank Act—establishes several objectives for the CFPB,[204] and this section focuses on two: (1) to exercise its authority under federal consumer-protection laws to ensure consumers are protected from unfair, deceptive, or abusive acts and practices; and (2) to ensure such laws are enforced consistently, without regard to the status of a depository institution, to promote fair competition.[205] This section asserts that the CFPB can declare predatory characteristics of payday loans to be unlawful, unfair, deceptive, or abusive, and thereby federally regulate payday lending to afford consumers basic protections from payday loans, regardless of which type of financial institution issues them.[206]

A. The Scope of the CFPB's Authority over Financial Institutions

The CFPB's purpose is to "seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring [1] that all consumers have access to markets for consumer financial products and services and [2] that markets for consumer financial products and services are fair, transparent, and competitive."[207] The CFPB's jurisdiction under the Act is over only a "covered person," which includes both non-bank payday lenders and traditional financial institutions like banks and credit unions so long as

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202. *See, e.g.,* Diekmann, *supra* note 199, at 6; Hallman, *supra* note 199, at A8.

203. *See* Hallman, *supra* note 199, at A8.

204. Dodd-Frank Act, Pub. L. No. 111-203, §§ 1001, 1021(b), 124 Stat. 1376, 1964, 1980 (2010) (codified as amended at 12 U.S.C. §§ 5301, 5511 (Supp. IV 2010)).

205. Dodd-Frank Act § 1021(b)(2), (4).

206. *See infra* Part III.A–D.

207. Dodd-Frank Act § 1021(a). Under Title X, the CFPB's enumerated primary functions are:

> (1) conducting financial education programs; (2) collecting, investigating, and responding to consumer complaints; (3) collecting, researching, monitoring, and publishing information relevant to the functioning of markets for consumer financial products and services to identify risks to consumers and the proper functioning of such markets; (4) subject to sections 1024 through 1026, supervising covered persons for compliance with Federal consumer financial law, and taking appropriate enforcement action to address violations of Federal consumer financial law; (5) issuing rules, orders, and guidance implementing Federal consumer financial law; and (6) performing such support activities as may be necessary or useful to facilitate the other functions of the Bureau.

Id. § 1021(c)(1)–(6).

they "engage in offering or providing a consumer financial product or service."[208]

Although the CFPB has exclusive rulemaking authority with respect to all financial institutions offering payday loans,[209] its actual authority to *enforce* its promulgated rules is dependent on the kind of financial institution. The CFPB has examination and primary enforcement authority over large financial institutions (LFIs)—banks, credit unions, and savings and loan associations—with assets exceeding $10 billion.[210] However, the CFPB has the authority only to accompany prudential regulators on examinations of financial institutions with $10 billion or less in total assets—smaller financial institutions (SFIs).[211] In other words, the prudential regulators of the SFIs still have primary responsibility for examining the SFIs and exclusive authority to enforce their compliance with consumer-protection laws and regulations.[212] As for the typical non-bank payday lender, the CFPB has rulemaking, examination, supervisory, and enforcement authority over any non-depository covered person that "offers or provides to a consumer a payday loan."[213]

Based on the foregoing, the CFPB has broad enforcement authority over non-banks engaged in payday lending, as well as primary enforcement authority over LFIs offering payday loans.[214] Unfortunately, the CFPB has no enforcement authority over SFIs like the credit unions that are allegedly now offering high-priced loans;[215] therefore, it is likely to encounter opposition in affording consumers protection from payday lending. Nevertheless, because the CFPB has rulemaking authority over all financial institutions[216] and has the ability to recommend best practices to the FDIC, NCUA, and other prudential

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208. *See id.* § 1002(6)(A)–(B).

209. *See id.* § 1022(b)(4)(A).

210. *See id.* § 1025(a)–(b); *id.* § 1025(b)(1)(A)–(C) (granting the CFPB "exclusive authority to require reports and conduct examinations on a periodic basis" of LFIs for several purposes, including "detecting and assessing associated risks to consumers and to markets for consumer financial products and services"); *id.* § 1025(c)(1) ("To the extent that the Bureau and another Federal agency are authorized to enforce a Federal consumer financial law, the Bureau shall have primary authority to enforce that Federal consumer financial law."); *see also id.* § 1002(a)(24) (identifying the FDIC as the prudential regulator for insured depository institutions and the NCUA as the prudential regulator for insured credit unions).

211. *See id.* § 1026(a); *id.* § 1026(d)(1) ("Except for requiring reports under subsection (b), the prudential regulator is authorized to enforce the requirements of Federal consumer financial laws and, with respect to a covered person described in subsection (a), shall have exclusive authority (relative to the Bureau) to enforce such laws.").

212. *See id.* § 1026(d)(1).

213. *See id.* § 1024(a)(1)(E), (c)(1).

214. *See supra* notes 209–10 and accompanying text.

215. *See, e.g.*, Hallman, *supra* note 199, at A8.

216. Dodd-Frank Act § 1022(h)(4)(A).

regulators of the SFIs,[217] the CFPB should encourage these regulators to force SFIs to comply with the CFPB's regulations.[218]

The CFPB is specifically authorized to issue "rules, orders, and guidance implementing Federal consumer financial laws."[219] The CFPB's rulemaking authority is exclusive;[220] however, it shares part of that authority with the Federal Trade Commission (FTC).[221] The CFPA mandates that courts afford deference to the CFPB with respect to "the meaning or interpretation of any provision of a Federal consumer financial law" as though "the [CFPB] . . . were the only agency authorized to apply, enforce, interpret or administer the provisions of such Federal consumer financial law."[222]

Although courts must defer to the CFPB's interpretations, the CFPA imposes some constraints on the CFPB's rulemaking authority.[223] First, the CFPA obliges the CFPB to consult with the "appropriate prudential regulators or other Federal agencies prior to proposing a rule" and release any of their objections.[224] Second, the Financial Stability Oversight Council (FSOC) can veto, by a two-thirds majority vote, any CFPB regulation that "would put the safety and soundness of the United States banking system or the stability of the financial system of the United States at risk."[225] These constraints, however, should not deter the CFPB from exercising its authority to regulate payday lending by prohibiting the worst payday-loan practices.

B. The CFPB Has Rulemaking Authority to Define Payday Loans and Covered Persons

The CFPB first and foremost must use its rulemaking authority to define a "payday loan."[226] Although the definition appearing in an earlier draft of the Dodd-Frank Act was ultimately eliminated,[227] the Act unquestionably covers

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217. *Id.* §§ 1002(a)(24), 1024.

218. *See id.* § 1026(d)(2)(A) ("When the Bureau has reason to believe that a person described in subsection (a) has engaged in a material violation of a Federal consumer financial law, the Bureau shall notify the prudential regulator in writing and recommend appropriate action to respond.").

219. *Id.* § 1021(c)(5).

220. *See id.* § 1022(b)(4)(A).

221. *See id.* § 1061(a)(5).

222. *Id.* § 1022(b)(4)(B).

223. *Id.* § 1022(b)(2).

224. *Id.* § 1022(b)(2)(B)–(C). The CFPB must release any written objections submitted in opposition to the proposed regulation and its response to the objection. *Id.* § 1022(b)(2)(C).

225. *Id.* § 1023(a).

226. The author argues in another forthcoming law review article that the CFPB should establish guidelines for safe, affordable loans and eliminate using the words "payday loans" as they have become synonymous with predatory credit transactions.

227. *See* Payday Loan Reform Act of 2007, H.R. 2871, 110th Cong. sec. 2, § 128(e)(2)(B) (2007) (defining a "payday loan" as "a small cash advance . . . made" in exchange for "(A) the personal check or share draft of the consumer, in the amount of the advance plus a fee, where

the typical payday loan, as well as any purported "nonfinancial good or service [that] is done as a subterfuge, so as to evade or circumvent the provisions of" the Act.[228] In crafting an explicit definition, the CFPB should look to other definitions of payday loans to avoid making the definition too narrow. For example, Illinois initially defined a payday loan as a loan with a 120-day loan period; however, the definition was ineffective because payday lenders simply expanded the loan maturity date by one day to skirt the usury cap.[229] Similarly, Congress passed a law—commonly referred to as the Military Lending Act—to protect active-duty soldiers and their families from payday lending.[230] The law defines a payday loan as a closed-end credit transaction with a term of ninety-one days or less and an amount no greater than $2,000.[231] As explained previously, many non-bank payday lenders and, in particular, bank-issued direct-deposit advances have abandoned contractual language identifying their loans as closed-end credit and now claim to offer open-ended credit.[232] Because these open-ended loans often result in multiple back-to-back loans for the consumer, they function just like regular payday loans[233] and, therefore, should be included in the CFPB's definition of a payday loan.

This Article does not aim to recommend a precise definition; rather, it recommends that the CFPB should broaden the payday-loan definition to include payday loans having the semblance of another loan product.[234] In broad terms, a payday-loan definition should acknowledge that the loan is an

presentment or negotiation of such check or share draft is deferred by agreement of the parties until a designated future date; or (B) the authorization of the consumer to debit the transaction account or share draft account of the consumer, in the amount of the advance plus a fee, where such account will be debited on or after a designated future date").

228. Dodd-Frank Act § 1027(a)(B)(ii).

229. *See* Stephen Franklin, *Interest Still High in Payday Battle*, CHI. TRIB., June 29, 2008, § 5 (Business), at 1 (reporting that payday lenders exploited the loophole by issuing loans for a term of 121 days and calling them installment loans).

230. *See* John Warner Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, sec. 670, § 987(b), 120 Stat. 2083, 2266 (2006) (codified as amended at 10 U.S.C. § 987(b) (2006)).

231. *See* 32 C.F.R. § 232.3(b)(1)(i) (2011).

232. *See* CRL COMMENTS ON PROPOSED OCC GUIDANCE, *supra* note 177, at 21 (explaining how banks call their loans open-ended credit to circumvent the Military Lending Act's (MLA) definition of payday loan for the purpose of issuing high-cost loans to military personnel); *see also* BORNÉ ET AL., *supra* note 16, at 12 (asserting that by structuring their loans as open-ended credit, banks "undermine[] federal law aimed at protecting military service members"); *supra* notes 31, 95–97, 180 and accompanying text (explaining that the MLA imposes restrictions on bank-issued payday loans to military families if the loans meet the MLA's definition of payday loan).

233. *See, e.g.*, *supra* notes 176–77 and accompanying text (describing how a social-security recipient's initial direct-deposit advance (a bank-issued payday loan) caused him to obtain 24 of these loans in a 39-month period).

234. *See supra* Part II.A.1 (describing how non-bank lenders tweak their loans to evade state law restrictions on payday loans).

unsecured,[235] small-dollar loan of $3000 or less and should not distinguish between closed-end and open-ended terms. If the definition must have a maturity period, the CFPB should regulate all loans with a one-year term or less, because many consumers may become trapped in long-term payday-loan debt cycles for several months.[236]

The CFPB's "payday loan" definition should also identify all known subterfuges, regardless of lenders' clever labeling. This will help counteract the amply evidenced practice of lenders disguising payday loans as other products and services.[237] The CFPB should also draft language, such as "including, but not limited to," to appear at the beginning of the subterfuge list. Such language enables courts to encompass within the CFPB's regulation any future subterfuge used by lenders to dodge state or federal regulations.

In addition to defining payday loans, the CFPB should exercise its authority to expand the definition of a "covered person"[238] to include companies pretending to be some other type of entity, such as a financial thrift institution or a tribal partnership.[239] For example, an investigation into the Oklahoma Tribe of Miami, which claimed to operate payday-lending businesses as economic tribal subdivisions, revealed an empty warehouse at the businesses' address.[240] Such payday lenders with only a tangential connection to Native American tribes should be identified as a "covered person."[241] If the CFPB fails to expand the scope of covered persons, more payday lenders will form nominal tribal partnerships and continue to offer loans in violation of state laws.[242]

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235. The loan would be considered unsecured even if the lender claims as collateral a post-dated check, instrument, property worth little value, or property the lender would never repossess.

236. *See supra* note 100 and accompanying text.

237. *See, e.g.*, Short On Cash.Net of New Castle, Inc. v. Dep't of Fin. Insts., 811 N.E.2d 819, 826 (Ind. Ct. App. 2004) (enjoining a purported Internet service provider's operations and finding its sale of bimonthly one-hour web access to be a disguised payday loan in violation of state usury law); Johnson, *supra* note 34, at 18–20 (discussing payday loans disguised as a "sale-lease-back" transaction or "catalog sale"); *see also supra* Part II.A–B.

238. Dodd-Frank Act, Pub. L. No. 111-203, § 1024(a)(2), 124 Stat. 1376, 1987 (2010) (codified as amended at 12 U.S.C. § 5514(a)(2) (Supp. IV 2010)) ("The Bureau shall consult with the Federal Trade Commission prior to issuing a rule . . . to define covered persons subject to this section.").

239. *See supra* Part II.A.2–4.

240. Hudson & Heath, *supra* note 114.

241. *See supra* Part II.A.3.

242. Furthermore, because the CFPB has examination authority over non-banks, Dodd-Frank Act § 1024(d), it should investigate companies claiming tribal immunity.

C. The CFPB Can Declare Many Payday-Loan Practices Unfair, Deceptive, or Abusive

After expanding the definitions of payday loans and covered persons, the CFPB should prescribe rules that make common payday-loan terms and practices unlawful.[243] The CFPB has explicit authority under the CFPA to identify as unlawful any act or practice that is "unfair, deceptive, or abusive" in connection with a consumer financial product or service.[244] This statutory authority is similar to the FTC's authority to prohibit unfair and deceptive acts or practices;[245] however, the FTC's statute does not mention authority to proscribe "abusive" practices.[246]

This section discusses payday-loan practices that the CFPA should deem unfair, deceptive, and abusive, respectively, and the bases for such determinations.

1. Unfair Practices Inflict Substantial Injury

The CFPA should identify certain "unfair" payday-lending practices as unlawful. The CFPA imports the standard for unfairness from the law governing the FTC.[247] When the CFPB has a reasonable basis, it may declare an act or practice to be unfair if the act causes the consumer substantial and reasonably unavoidable injury that is not outweighed by any countervailing benefits to the consumer.[248] The data clearly support the conclusion that high interest rates, short maturity dates, single balloon payments, multiple rollover or refinancing fees, and repetitive electronic bank-account access substantially injure some consumers and that the economic injury caused by these practices outweighs any benefits to consumers.[249] Multiple studies show that triple-digit interest rates, often in violation of state law, cost consumers millions of dollars.[250] Moreover, most consumers are unable to repay the loans in a short

243. *See id.* § 1022(b)(1).

244. *Id.* § 1031(b) ("The Bureau may prescribe rules applicable to a covered person or service provider identifying as unlawful unfair, deceptive, or abusive acts or practices 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. Rules under this section may include requirements for the purpose of preventing such acts or practices.").

245. 15 U.S.C. § 45(a)(2) (2006).

246. *Compare id.*, *with* Dodd-Frank Act § 1031(a).

247. *Compare* 15 U.S.C. § 45(n), *with* Dodd-Frank Act § 1031(c).

248. Dodd-Frank Act § 1031(c)(1)(A)–(B). The CFPB may also consider public policy in determining fairness. *Id.* § 1031(c)(2).

249. *See supra* note 3 and accompanying text; *see also supra* Part I.

250. *See, e.g.*, ELWOOD & RUDD, *supra* note 96, at 3 (estimating that payday lenders collected nearly $6 million in fees from Minnesotans, which was in violation of state law); PARRISH & KING, *supra* note 66, at 13 (finding that "churning" accounts for $3.5 billion in fees); Martin, *supra* note 37, at 885–91 (describing how lenders subvert state laws in order to charge higher APRs).

period, usually two weeks, as required under their contracts,[251] and must resort to paying multiple rollover fees or obtaining several successive loans.[252] Recall the earlier, illustrative example of Bonnie Bernhardt, whose bank account was debited nine times to obtain more than $800 in refinancing fees for a mere $300 loan.[253] The harm caused by these practices substantially outweighs any potential benefit.

Furthermore, the lenders' use of repeated debits or demand drafts to withdraw funds from the borrowers' bank accounts worsens the borrowers' economic injury by depleting account funds needed to pay bills and by triggering NSF or overdraft fees for consumers with insufficient account balances.[254] Consumer advocates maintain that federal regulators have largely turned a blind eye to this practice,[255] which is often carried out through contract terms that would likely confuse the average consumer and are in violation of state consumer-protection statutes.[256] In states that ban rollovers, some lenders induce consumers to obtain multiple consecutive loans, crafted as a means of collecting additional fees on the original loan.[257] Some lenders also structure loans that automatically deduct from the borrower's bank account *only* a rollover or refinancing fee, unless the borrower takes additional steps to

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251. *See supra* Part I.B. A report prepared by the U.S. Department of Defense found that "75% of payday customers are unable to repay [the entire] loan within two weeks and are forced to get a loan 'rollover' at additional cost." *See* U.S. DEP'T OF DEF., REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 14 (2006) [hereinafter DOD REPORT ON PREDATORY LENDING], *available at* http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

252. *See, e.g.*, DOD REPORT ON PREDATORY LENDING, *supra* note 251, at 30 (finding that since August 2001, slightly over $2.5 million has been provided to service members experiencing financial crises due to payday-loan debt traps).

253. *See supra* notes 61–63 and accompanying text.

254. *See supra* notes 47–59 and accompanying text; *see also* PARRISH & KING, *supra* note 66, at 12–13 (stating that that multiple back-to-back loans cost borrowers $3.5 billion in fees annually).

255. *See, e.g.*, *Community and Consumer Advocates' Perspectives on the Obama Administration's Financial Regulatory Reform Proposals: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 108 (2009) [hereinafter *Consumer Advocates' Perspective Hearing*] (testimony of Travis B. Plunkett, Legislative Director, Consumer Federation of America) ("The Federal Reserve has supported the position of payday lenders and telemarketing fraud artists by permitting remotely created checks (demand drafts) to subvert consumer rights under the Electronic Funds Transfer Act.").

256. *Consumer Financial Protection Agency Hearing*, *supra* note 48, at 92 (testimony of Travis B. Plunkett, Legislative Director, Consumer Federation of America). One contract stated, "While you may revoke the authorization to effect ACH debit entries at any time up to 3 business days prior to the due date, you may not revoke the authorization to prepare and submit checks on your behalf until such time as the loan is paid in full." *Id.* (emphasis omitted) (internal quotation marks omitted).

257. *See supra* notes 66–68 and accompanying text; *see also* Ruby v. Cashnet, Inc., 708 S.E.2d 871, 874 (Va. 2011) (finding that this practice is equivalent to a renewal or refinancing, which are prohibited).

pay off the loan in full.[258] Consequently, many payday-loan borrowers end up financially worse off after having obtained the payday loan and, therefore, suffer substantial economic injury.[259]

The financial injury from payday loans is particularly acute in African American and Latino communities. One California study found that "[p]ayday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods, draining nearly $247 million in fees per year from these communities."[260] Similarly, when the loans are bank-issued payday loans, the financial injury to senior citizens dependent on social-security benefits is acute because the banks take a large portion of their check to repay the loans.[261] Accordingly, because the above-mentioned payday-loan practices worsen the consumer's financial condition, the substantial injuries arising from them are not outweighed by any potential benefits to the consumer.

Although the prongs of "substantial injury" and "not outweighed by countervailing benefits" are evident, the debatable prong of the unfairness test is whether the financial injury arising from major payday-loan practices is *reasonably* unavoidable.[262] An injury is not reasonably avoidable if consumers lack any "free and informed choice" enabling them to avoid the unfair

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258. DOD REPORT ON PREDATORY LENDING, *supra* note 251, at 16; *see supra* notes 60–63 and accompanying text (discussing the example of Ms. Bernhardt's experience with this practice).

259. 151 CONG. REC. E1386 (daily ed. June 28, 2005) (statement of Rep. Luis Gutierrez) ("[M]any who turn to these payday loan outlets end up *far worse* off than before." (emphasis added)); *see supra* notes 71–83 and accompanying text (discussing the financial hardships resulting from payday lending).

260. WEI LI ET AL., CTR. FOR RESPONSIBLE LENDING, PREDATORY PROFILING: THE ROLE OF RACE AND ETHNICITY IN THE LOCATION OF PAYDAY LENDERS IN CALIFORNIA 10 (2009), *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf ("When [the authors] compare[d] the neighborhoods with the highest and lowest shares of African Americans and Latinos, [the authors found] that African American and Latino neighborhoods have a 2.4 times greater concentration of payday lending storefronts."); *see also* Creola Johnson, *The Magic of Group Identity: How Predatory Lenders Use Minorities to Target Communities of Color*, 17 GEO. J. ON POVERTY L. & POL'Y 165, 166 (2010) (describing the prevalence of various predatory loan products in communities of color and identifying specific ways in which corporate America uses individual minorities to target communities of color with these loan products).

261. *See* BORNÉ ET AL., *supra* note 16, at 8 (finding that banks deducted an average of 33% of a social-security recipient's next deposit to repay the bank-issued loan). Gender disparity is also at play in payday lending. A recent study of payday lending in Texas reported that women, and in particular single women and single mothers, comprise the majority of Texas payday borrowers. TEX. APPLESEED, *supra* note 76, at 13–14 (implying that Texas provides a snapshot of the typical payday borrower because "Texas is the source of 60% of the annual profits reported nationwide by the four largest publicly traded companies offering payday loans").

262. Dodd-Frank Act, Pub. L. No. 111-203, § 1031, 124 Stat. 1376, 2006 (2010) (codified as amended at 12 U.S.C. § 5531 (Supp. IV 2010)); *see also* 15 U.S.C. § 45(n) (2006) (declaring that "unfair" practices are those that "cause[] or [are] likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition").

practice.[263] The unavoidable-injury prong is not interpreted conservatively.[264] The FTC and the courts have held that this prong of the unfairness test does not mean that an injury is avoidable just because the consumer could have chosen not to enter into the contract or that the consumer could have chosen to do business with a competitor; rather, the consumer must have a basis to anticipate the financial harm.[265] Before entering into a payday-loan contract, average consumers have no reason to anticipate that their payment of fees for due-date extensions will not count towards reducing the principal on the loan because all other forms of traditional consumer credit allow for partial payments that reduce some portion of the principal.[266] Moreover, average consumers have no reason to anticipate that lenders will repeatedly debit their bank accounts, thereby triggering multiple overdraft or NSF fees for those with extremely low balances.[267] Additionally, consumers with some money in their account have no reason to anticipate that lenders will debit the accounts repeatedly to collect *only* rollover fees, thereby depleting funds needed to pay other bills and forcing consumers to figure out how to pay off the entire loan or how to take extra steps to close their bank accounts so the debits will cease. Finally, consumers, at the time of contracting, have no reason to anticipate that banks may allow their accounts to become zombie accounts, allowing withdrawals even after consumers have officially closed their accounts.[268] Because consumers have no reason to anticipate harm from the foregoing lending practices, the financial injury from these payday-lending practices are therefore reasonably unavoidable.[269]

Even if the unavoidable-injury prong is interpreted conservatively, the CFPB has several reasons to conclude that such free and informed choice is lacking and, therefore, the injury arising from the six major payday-loan practices[270] is not reasonably avoidable. For one, the payday loan industry and borrowers

263. *See* FTC v. Neovi, Inc., 598 F. Supp. 2d 1104, 1115 (S.D. Cal. 2008) (citing FTC v. J.K. Publ'ns, Inc., 99 F. Supp. 2d 1176, 1201 (S.D. Cal. 2000)).

264. *See* NAT'L CONSUMER LAW CTR., UNFAIR AND DECEPTIVE ACTS AND PRACTICES 251–52 (7th ed. 2008) (discussing the unavoidable-injury standard and providing examples of companies' common arguments that have been rejected by courts and the FTC).

265. *See, e.g.*, Orkin Exterminating Co. v. FTC, 849 F.2d 1354, 1365 (11th Cir. 1988); Orkin Exteriminating Co., 108 F.T.C. 263, 266 (1986) ("Consumers may act to avoid injury before it occurs *if* they have reason to anticipate the impending harm and the means to avoid it." (emphasis added)).

266. *See infra* notes 304–06 and accompanying text.

267. *See supra* note 254 and accompanying text.

268. *See supra* notes 51–55 and accompanying text.

269. Orkin Exterminating Co., 108 F.T.C. at 263 ("Whether some consequence is 'reasonably avoidable' depends, not just on whether people know the physical steps to take in order to prevent it, but also on whether they understand the necessity of actually taking those steps.").

270. The six practices include the following: (1) usurious interest rates; (2) short maturity dates; (3) single balloon payments; (4) multiple rollover or refinancing fees; (5) multiple back-to-back loans; and (6) repetitive electronic bank-account access.

admit that the loans cater to people with no other choice to resolve unexpected monetary shortages.[271] Furthermore, many borrowers admit that they do not understand the APR associated with payday lending or the risks arising from defaulting on quickly approaching loan-repayment dates.[272] The lack of choice is understandable given the ubiquitous presence of payday lenders in low-income and minority neighborhoods,[273] the dearth of mainstream financial institutions in these neighborhoods,[274] the millions of dollars spent on advertising by payday lenders,[275] and the consumers' urgent need for immediate cash.[276]

One might argue that borrowers could obtain a loan from a credit union, ask their creditors for time extensions on payments, or seek the assistance of a consumer credit-counseling agency.[277] These possible options have weaknesses and may be largely theoretical for payday borrowers. The "reasonably avoidable" determination depends on whether consumers are

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271. *See, e.g.*, Carrie Dann, *Group Says Payday Lenders Spent $2.1M Lobbying in 2008*, NAT'L J. (Apr. 24, 2009), http://www.nationaljournal.com/member/daily/group-says-payday-lenders-spent-2-1m-lobbying-in-2008-20090424, *available at* 2009 WLNR 7767921; Mediha Fejzagic DiMartino, *Debt's Vicious Cycle*, INLAND VALLEY DAILY BULL. (Ontario, Cal.) (Apr. 2, 2011, 6:35 AM), http://www.dailybulletin.com/ci_17758730?source=most_viewed (interviewing customers at a payday-loan store who "admitted no other options were available to address their monthly financial obligations").

272. *See* DiMartino, *supra* note 271 (reporting that California borrowers "are aware of the fees associated with payday loans, but they do not understand the [APR] that is associated with long-term borrowing"); *see also* Martin, *supra* note 37, at 611–12 (reporting that a borrower, acting on her mother's advice, opted for a payday loan, rather than a student loan, even though student loans have APRs between 0% and 8.5%).

273. *See* LI ET AL., *supra* note 260, at 10; *see also* TEX. APPLESEED, *supra* note 76, at 19 (finding that payday-loan and car-title stores greatly outnumber traditional lenders in one of the poorest neighborhoods in Houston, Texas and suggesting that consumers may use these lenders because of "aggressive advertising and plentiful payday and auto title loan store locations," rather than the "capacity of a payday or auto title loan to meet borrower needs").

274. *See* TEX. APPLESEED, *supra* note 76, at 19; LI ET AL., *supra* note 260, at 10.

275. *See, e.g.*, TEX. APPLESEED, *supra* note 76, at 19; Jim DuPlessis, *Industry Tightens Rules in an Attempt to Head Off Regulation, Lenders to Tout Education, Limit Ads*, STATE (Columbia, S.C.), Feb. 22, 2007, at C8, *available at* 2007 WLNR 3434932 (reporting that payday lenders budgeted $10 million for their publicity blitz).

276. *See, e.g.*, Kevin Flowers, *Payday Lenders Targeted*, ERIE TIMES-NEWS (Pa.), Apr. 2, 2006, at 1 (reporting that payday lenders "often prey[] on low-income and minority borrowers, who may have few other options when they desperately need money" and that they are "prevalent in minority neighborhoods"); Jake Lewis, *Taming the Banking Predators*, MULTINAT'L MONITOR, Jan.–Feb. 2004, at 27, 28 ("Predatory lenders use door-to-door solicitations, phone calls and mailings to badger homeowners into refinancing their existing loans to obtain cash. This is a tempting idea for families on low and moderate incomes and strapped for cash, but an expensive remedy laced with high interest charges and fees which ultimately strip away what little equity remains in the house.").

277. *See* Martin, *supra* note 37, at 612–13 (discussing alternatives to payday loans).

knowledgeable about what options they can exercise to avoid the harm.[278] One poll shows that many high school students do not even know about the existence of credit unions, let alone the membership-eligibility requirements.[279] The general public's lack of knowledge may be attributed to credit unions' traditional practice of restricting memberships to people employed in a limited number of professions, which excluded many Americans from credit-union services.[280] For consumers who are aware of their eligibility to join a credit union, some may not (1) qualify for a loan; (2) find credit unions that offer low-cost loans; or (3) secure a loan in enough time to deal with the financial crisis.

Consumers could try negotiating with a creditor directly or seek the assistance of a credit counselor. Generally, creditors do not have a good reputation for being willing to work with consumers who are unable to pay their debts.[281] Credit counselors are willing to work with consumers, but they are limited in what they can accomplish for consumers because they only handle unsecured debt and primarily credit-card debt.[282] Moreover, a consumer may not find a legitimate counselor in sufficient time to handle the financial crisis. Because the credit-counseling industry is rife with for-profit companies known for scamming consumers, some consumers will get defrauded because they are unable to ascertain the legitimacy of such counselors.[283]

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278. *Cf.* Int'l Harvester Co., 104 F.T.C. 949, 1066 (1984) (noting that *knowledge* of the steps for avoiding injury is not enough for the injury to be reasonably avoidable; rather, the consumer must also understand and appreciate the necessity of taking those steps).

279. *See, e.g.*, *Poll: Only 15% of H.S. Students Aware of CU Difference*, CUNA (June 24, 2011), http://www.cuna.org/newsnow/11/system062311-2.html (reporting that not only are high school students ignorant of credit unions, but "the majority of [the 900] students responding to the survey (60%) believe that credit card companies often entice people into taking on more debt than they can handle").

280. *See What Is the Credit Union Difference?*, CUNA, http://www.cuna.org/gov_affairs/legislative/cu_difference.html (last visited Nov. 19, 2011); *see also* Joe Rauch, *Jax Federal Credit Union to Serve More Residents*, JACKSONVILLE BUS. J. (Jan. 30, 2006), http://www.bizjournals.com/jacksonville/stories/2006/01/30/story2.html?page=all (reporting that Jax Federal Credit Union recently expanded its membership beyond federal employees to anyone who lives in nearby counties).

281. The current protracted foreclosure crisis, in which horror stories abound regarding mortgage companies stringing homeowners along with unfulfilled promises to modify their mortgage loans to prevent foreclosure, evidences creditors' unwillingness to negotiate. *See, e.g.*, Kenneth R. Harney, *FTC Targeting Foreclosure-Prevention Scams, Thousands of Homeowners in U.S. Have Been Victimized*, BALT. SUN, Sept. 13, 2009, at 4.

282. *See, e.g.*, FTC, FISCAL FITNESS: CHOOSING A CREDIT COUNSELOR 3 (2011), *available at* http://www.ponyexpr.com/cre26.pdf.

283. *See* Rana Cash, *Not All Credit Services Are Equal*, ATLANTA J.-CONST., May 27, 2010, at D1 (reporting that illegitimate credit counselors have names very similar to reputable ones, which prompted the reputable Consumer Credit Counseling Service of Greater Atlanta to change its name to CredAbility); Press Release, Rob McKenna, Attorney Gen., McKenna Warns

The weaknesses in the aforementioned possible options suggest that consumers do not have an informed choice and, therefore, that the injury from payday loans is unavoidable.

These same options were available to military borrowers, yet Congress passed the Military Lending Act (MLA) to protect military borrowers.[284] Congress relied on a 2006 Department of Defense (DOD) report when passing the MLA, which clearly states that "[a]lternatives to payday loans and high interest installment loans *are available* through the Military Aid Societies and through several banks and many credit unions located on or near military installations."[285] Yet, the DOD report concluded that the existence of these low-cost loans and financial counseling efforts were insufficient to keep military borrowers from obtaining payday loans: "Education, counseling, assistance from Aid Societies, and sound *alternatives are necessary but not sufficient to protect Service members from predatory lending practices or products that are aggressively marketed to consumers in general and to military personnel directly*."[286] The report concludes unequivocally that "statutory protections are necessary to protect Service members from unfair, deceptive lending practices and usurious interest rates."[287]

Along with the DOD report's findings, the actions of Congress, state legislatures, and prudential regulators confirm the conclusion that many payday-loan practices are unfair because they cause substantial and reasonably unavoidable harm to consumers that outweighs any potential benefit. For example, MLA regulations and several state statutes cap the APR on payday loans at 36% or less,[288] and the NCUA caps the APR on payday loans by federal credit unions at 28%.[289] Similarly, the FDIC small-dollar-loan pilot program capped the APR on participating banks' small-dollar loans at 36%, and banks participating in the program reported APRs below 36% even after factoring origination fees into the APR calculation.[290] Notably, the FDIC pilot

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Consumers About Debt-Relief Scams (July 1, 2009), *available at* http://www.atg.wa.gov/pressrelease.aspx?id=23146.

284. 10 U.S.C. § 987 (2006); *see supra* note 180 and accompanying text.

285. DOD REPORT ON PREDATORY LENDING, *supra* note 251, at 5 (emphasis added).

286. *Id.* at 9 (emphasis added).

287. *Id.* at 46.

288. 32 C.F.R. § 232.4(b) (2008); *e.g.*, OHIO REV. CODE ANN. § 1321.40(A) (LexisNexis Supp. 2010) (capping the APR 28%).

289. NCUA Short-Term, Small Amount Loans Rule, 75 Fed. Reg. 58,285, 58,286 (Sept. 24, 2010). After considering comments about lower and higher APRs, the NCUA decided to adopt a rule using a "an APR 1000 basis points above the Board approved interest rate ceiling," thereby capping the APR at 28%. *Id.*; *see also* Dodd-Frank Act, Pub. L. No. 111-203, § 1042(a), 124 Stat. 1376, 2012–13 (2010) (codified as amended at 12 U.S.C. § 5552(a) (Supp. IV 2010)) (subjecting non-banks and mainstream financial institutions to state enforcement actions depending on the type of violations at issue).

290. *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program*, 4 FDIC Q. 28, 28 & fig.1 (2010) [hereinafter *FDIC Pilot Program*], *available at* http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_ SmallDollar.pdf (stating that the

program demonstrated that banks could achieve long-term profitability with APRs capped at 36%.[291]

Because the CFPA prohibits the CFPB from establishing a national usury limit, the CFPB cannot cap the APRs on payday loans at 36%.[292] It can, however, declare as unfair the practice of lenders charging an APR that exceeds the permissible interest rate as established by applicable state and federal laws.[293] With such a declaration, a bank could not charge an active-duty soldier an APR in excess of 36%, and a federal credit union or a non-bank lender could not charge, for example, an Ohio resident an APR greater than 28% because both institutions are subject to this APR cap.[294] Financial institutions that choose to engage in this unfair practice would, therefore, be subject to enforcement actions by the CFPB and state attorneys general.[295]

In addition to APRs, the CFPB has grounds to declare other payday-loan practices unfair. Several states, the MLA, and the NCUA ban rollovers.[296] The NCUA and several states also ban multiple outstanding loans to one borrower at a time and restrict multiple back-to-back loan transactions by imposing cooling-off periods between loans or limiting the number of loans a borrower can receive in a specified time frame.[297] Moreover, the NCUA rules and the FDIC pilot-program guidelines establish minimum maturity dates and require installment payment plans to provide borrowers with a realistic time frame and manner in which to repay the loans.[298] The MLA regulations also

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FDIC pilot program for small-dollar loans sought to "illustrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products").

291. *See id.* at 32.

292. Dodd-Frank Act § 1027(o).

293. *See supra* Part III.A.

294. *See supra* note 288–89 and accompanying text; *see also* OHIO REV. CODE ANN. § 1321.40(A) (LexisNexis Supp. 2010). If the CFPB broadly defines payday loans, as proposed herein, banks would be in violation of the CFPB if they issued open-ended loans with APRs exceeding 36% to military personnel covered under the MLA.

295. *See supra* Part III.A.

296. *See, e.g.*, OHIO REV. CODE ANN. § 1321.41(G) (prohibiting a lender from "[m]ak[ing] a short-term loan to a borrower for purposes of retiring an existing short-term loan between any licensee and that borrower"); 12 C.F.R. § 701.21(c)(7)(iii)(4) ("The Federal credit union must not roll-over any STS [short-term, small] loan."); 32 C.F.R. §§ 232.1(a), 232.8(a)(1) (2008) (declaring it unlawful under the MLA if a lender "rolls over, renews, repays, refinances, or consolidates any consumer credit extended to the covered borrower by the same creditor with the proceeds of other consumer credit extended by that creditor to the same covered borrower, unless the new transaction results in more favorable terms to the covered borrower").

297. *See, e.g.*, OHIO REV. CODE ANN. § 1321.41(E) (prohibiting a licensed lender from "[m]ak[ing] a short-term loan to a borrower if there exists an outstanding loan between the licensee and that borrower"); 12 C.F.R. § 701.21(c)(7)(iii)(3) (limiting lenders to three short-term loans in a six-month period and to only one outstanding loan per borrower at a given time).

298. 12 C.F.R. § 701.21(c)(7)(iii)(2) (requiring that a "loan ha[ve] a minimum maturity term of one month"); *id.* § 701.21(c)(7)(iii)(5) ("The Federal credit union fully amortizes the loan."); *FDIC Pilot Program*, *supra* note 290, at 28 (recommending a loan term of ninety days or more).

limit the lender's ability to electronically access the borrower's account unless the loan meets certain criteria, including an APR cap at 36%.[299]

In summary, lawmakers' and regulators' actions establish the six problematic characteristics of payday loans to be unfair, and such characteristics, therefore, should be banned outright or restricted. As a consequence, the CFPB will be on sure footing if it declares the following practices to be unfair and thereby unlawful: (1) usurious interest rates; (2) short maturity dates; (3) single balloon payments; (4) multiple rollover or refinancing fees; (5) multiple back-to-back loans; and (6) repetitive electronic bank-account access. These practices are reasonably unavoidable and inflict substantial injury to consumers that is not outweighed by benefits to them.

2. *Deceptive Practices Mislead Consumers*

In addition to declaring some practices unfair, the CFPB should declare some common payday practices to be deceptive.[300] The CFPA does not define a deceptive act or practice.[301] However, because the CFPA adopted the FTC Act's definition of unfair,[302] it seems logical that the CFPB adoption of the FTC Act's definition of deceptive would be appropriate. The FTC Act defines a deceptive act as "a representation, omission, or practice, . . . that is likely to mislead consumers acting reasonably under the circumstances, and . . . the representation, omission, or practice is material."[303]

Multiple rollovers, refinancings, and back-to-back loans are typical payday loan practices that should satisfy the definition of deceptive.[304] When borrowers are unable to pay the entire loan by the original due date, payday lenders either impose a rollover or refinancing fee or require a back-to-back loan transaction in states where rollovers or refinancings are technically banned.[305] However, the fees charged to do a rollover, refinancing, or back-to-

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299. *See* 32 C.F.R. § 232.8(a)(5).

300. *See* Dodd-Frank Act, Pub. L. No. 111-203, § 1031(b), 124 Stat. 1376, 2006 (2010) (codified as amended at 12 U.S.C. § 5531 (Supp. IV 2010)) (authorizing the CFPB to "prescribe rules applicable to a covered person or service provider identifying as unlawful unfair, deceptive, or abusive acts or practices").

301. *See id.* § 1031 (defining "unfair" and "abusive").

302. *See supra* note 247 and accompanying text.

303. Cliffdale Assocs., Inc., 103 F.T.C. 110, 164–65 (1984) (citing FTC Policy Statement on Deception from James C. Miller III, Chairman, FTC, to Rep. Dingell, Chairman, Comm. on Energy & Commerce, House of Representatives (Oct. 14, 1983) [hereinafter FTC Policy Statement], *available at* http://www.ftc.gov/bcp/policystmt/ad-decept.htm).

304. *See, e.g.*, Sorenson, *supra* note 50 (reporting that after an online lender debited a consumer's bank account for $60 to $70 every two weeks for two months to cover a $300 loan, the lender refused to tell the consumer the amount still owed and tried to persuade her to continue making rollover payments).

305. *See, e.g.*, Ryan Keith, *State May Muzzle Payday Lenders; Loan Stores Wary of Proposed Rules*, STATE J.-REG. (Springfield, Ill.), Aug. 28, 2000, at 1 (reporting that one former manager of a payday loan store in the greater Chicago area stated that his company encouraged borrowers to get rollovers to the degree that borrowers paid "five times as much in fees above

back loan do not count toward reducing the principal of the loan and often total several times the original loan amount.[306] Some customers believe that these charges reduce the outstanding amount owed and are surprised, after months or even years of paying fees, that the payday lender still insists that the original loan amount is due.[307] A lender's contractual and verbal omissions regarding the function and the application of such fees are materially misleading to consumers who are acting reasonably and thus meet the standard for a deceptive practice.[308] The consumers' expectation that the fee payments apply to their outstanding loans is reasonable given that other traditional forms of consumer credit allow for partial payments and a way to pay a sufficient amount to reduce the principal and interest.[309] In fact, the deceptive practices of encouraging multiple rollovers or issuing back-to-back loans are considered so harmful to consumers that many states, the NCUA, and the MLA ban them.[310] Consequently, the CFPB has a reasonable basis to declare these practices deceptive and, therefore, unlawful.

A lender's use of demand drafts or repetitive electronic debits to the borrower's bank account for rollover or finance fees is another practice that also should meet the definition of deceptive. For example, one payday-loan lender relies on the following contract language and thus uses demand drafts to drain the borrower's bank account: "While you may revoke the authorization to effect . . . debit entries at any time up to 3 business days prior to the [loan's] due date, *you may not revoke the authorization to prepare and submit checks on your behalf until such time as the loan is paid in full.*"[311] This practice counters the average consumer's ability to stop payment on checks or revoke

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their original loan amount"); *see supra* Part I.B. In *Ruby v. Cashnet, Inc.*, Wilma Ruby obtained a $500 payday loan from Cashnet. 708 S.E.2d 871, 873 (Va. 2011). Unable to pay the debt and her monthly expenses on time, Ms. Ruby went to Cashnet each month for two and a half years, paid off her $500 principal plus a $75 finance charge, and immediately obtained a new $500 loan. *Id.* at 874. To circumvent Virginia's ban on rollovers and refinancings, Cashnet claimed that it had issued Ms. Ruby thirty-three "new" loans over that period. *Id.* The Supreme Court of Virginia held that "Cashnet's practice of making a loan to Ruby immediately after she repaid a previous loan was a refinancing or renewal under Code § 6.2–1816(6)(i) and, therefore, in violation of the Act." *Id.* at 875.

306. *See supra* notes 60–63 and accompanying text (reporting the story of Bonnie Bernhardt, a borrower who paid a grand total of $1600 for a $300 loan from an online payday lender); *see also* Keith, *supra* note 305, at 1.

307. *See, e.g.*, Sorenson, *supra* note 50 (reporting that a borrower thought she had paid off a $300 loan from an online lender after the lender debited her bank account for $60 to $70 every two weeks for two months).

308. *See* Cliffdale Assocs., Inc., 103 F.T.C. at 164–65; *see also supra* note 49.

309. *See Payday Lenders: Small Loans, Hefty Fees, Big Problem*, CONSUMERREPORTS.ORG (Jan. 2009), http://www.consumerreports.org/cro/aboutus/mission/viewpoint/small-loan-big-problems/overview/small-loan-big-trouble-ov.htm.

310. *See supra* Part II.

311. *Consumer Financial Protection Agency Hearing*, *supra* note 48, at 92 (statement of Travis B. Plunkett, Legislative Director, Consumer Federation of America) (emphasis added).

debit authorizations.[312] Moreover, the payday lenders' practice of withdrawing only the rollover fee or finance charge from the bank account keeps the borrower indebted and burdens the borrower with determining how to pay the loan in full to cease electronic access.[313] Again, this practice is so egregious that the MLA bans electronic access unless the loan transaction actually complies with the MLA, under which rollovers are banned.[314] As a result, the CFPB should declare as deceptive and unlawful demand drafts and any means of electronic access that are set up to withdraw only rollover fees or finance charges, or that violate federal and state restrictions on payday loans. This declaration would also include banning banks and non-banks from requiring consumers to agree to debit authorizations to obtain a loan.[315]

3. Abusive Practices Take Unreasonable Advantage of Consumers

The CFPB should also use its authority to declare the problematic characteristics of payday loans to be abusive. Under the CFPA, the CFPB can declare an act abusive if it "materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service."[316] The CFPB can also declare an act abusive if it

> takes unreasonable advantage of-
>
> (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
>
> (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
>
> (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[317]

Although the CFPB may declare all of the problematic aspects of payday loans to be abusive, this section focuses on one practice that, heretofore, has not been discussed: the practice of payday lenders failing to assess the borrower's ability to repay.[318] Non-bank payday lenders advertise that they do

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312. *See id.*

313. *See* DOD REPORT ON PREDATORY LENDING, *supra* note 251, at 16.

314. *See* 32 C.F.R. § 232.8(a)(5) (2008).

315. *See supra* note 49 and accompanying text (asserting that lenders require consumers to agree to debit authorizations); *see also* NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON, *supra* note 26, at 26 (urging bank regulators to impose a "prohibition against [lenders] securing the loans through electronic access to a bank account—which means that recipients cannot be required to agree to electronic repayment, and for those who have agreed, they should be permitted to at any time stop the bank's access *without cost* from seizing funds from their account[s]").

316. Dodd-Frank Act, Pub. L. No. 111-203, § 1031(d)(1), 124 Stat. 1376, 2006 (2010) (codified at 12 U.S.C. § 5531(d)(1) (Supp. 2010)).

317. *Id.* § 1031(d)(2).

318. *Id.* § 1031(d).

not perform credit checks and that consumers can obtain a loan with as little documentation as a driver's license, a pay stub, and a checking-account statement.[319] Similarly, banks issue their versions of payday loans so long as the customer has a bank account set up with automatic deposit of income checks.[320] By failing to assess the consumer's ability to repay and by providing loans on the barest of documentation without undergoing a traditional credit check, lenders knowingly lead consumers to obtain a loan transaction in which they are destined to fail and thereby suffer substantial economic harm. Therefore, the CFPB should prohibit as abusive the practice of issuing loans without doing an assessment of a borrower's ability to repay. Such a declaration would be consistent with several state regulations requiring payday lenders to do some type of assessment[321] and the FDIC pilot program and NCUA rule, which require the development of and adherence to guidelines for underwriting standards.[322] Even the OCC's regulations prohibit asset-based lending,[323] and its guidelines for safety and soundness require a national bank to "assess the ability of the borrower to repay the indebtedness in a timely manner."[324]

Undeniably, requiring lenders to assess the borrower's ability to pay will prompt lenders to refuse to issue loans to some borrowers. However, easy

319. Kim Christensen, *Hooked on Debt: A Middle-Class Move to Payday Lenders*, L.A. TIMES, Dec. 24, 2008, at A1; *see also* Satz, *supra* note 37, at 128 (stating that "payday lenders typically require a driver's license, paystub or other proof of income, bank statement, telephone bill, and checkbook").

320. *See* NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON, *supra* note 26, at 16.

321. *See, e.g.*, 7 TEX. ADMIN. CODE § 83.604(f)(3) (2010) ("A lender must make a good faith effort to assess the borrower's ability to repay the payday loan or deferred presentment transaction under the loan terms.").

322. 12 C.F.R. § 701.21(c)(7)(iii)(8) (2011) ("The Federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of loans made under this section of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs."); *FDIC Pilot Program*, *supra* note 290, at 28.

323. *See* 12 C.F.R. § 7.4008(B) (2011) ("A national bank shall not make a consumer loan subject to this § 7.4008 based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors."). In the context of this article, asset-based lending includes banks conditioning payday loans upon the borrowers setting up automatic deposits of income checks and agreeing to debit authorization to facilitate payment. Asset-based lending also includes non-banks issuing loans, claiming post-dated checks as collateral, and requiring debit authorization to facilitate payment.

324. *See* OFFICE OF THE COMPTROLLER OF CURRENCY, OCC ADVISORY LETTER AL 2003-2, GUIDELINES FOR NATIONAL BANKS TO GUARD AGAINST PREDATORY AND ABUSIVE LENDING PRACTICES 7 n.22 (2003) (quoting 12 C.F.R. § 30 App. A (2002)), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2003/advisory-letter-2003-2.pdf.

access to credit is not appropriate if the borrower is destined to default. Denial of loans may sometimes lead the consumer to consider more feasible options.[325] Consider, for example, a single mother with a past-due utility bill who is denied a payday loan. If the CFPB requires lenders to provide a list of social-services organizations to consumers who are denied a loan, the single mother may learn that she qualifies for social programs, such as the Low Income Energy Assistance Program, which would allow her to avoid entrapment in a payday-loan debt cycle.[326]

D. Additional Considerations for CFPB Action

A few additional considerations arise regarding the CFPB's ability to declare payday loan characteristics as unfair, deceptive, or abusive, and, thereby, unlawful. For instance, if federal lawmakers successfully reduce funding to the CFPB,[327] then adoption of regulations like those this Article proposes will be crucial for empowering states to pursue enforcement actions against all financial institutions in noncompliance with the regulations.[328] Before the Dodd-Frank Act, the prudential regulators' use of the federal preemption doctrine to insulate banks severely hindered states in their attempts to hold banks accountable for their violations of state consumer-protection laws.[329] Now, under the CFPA, state regulators and attorneys general may assert the CFPB's enforcement authority against a national bank or federal savings association for violating "a regulation prescribed by the [CFPB] under a provision of this title and to secure remedies under provisions of this title or remedies otherwise provided under other law."[330] As for non-banks, state attorneys general may pursue enforcement for violations of both the CFPA and any rules adopted by the CFPB, and state banking regulators can seek penalties against any institutions chartered, incorporated, or licensed in their states to enforce both the CFPA and the CFPB's rules.[331] Accordingly, state regulators and attorneys general can act to protect consumers even if the CFPB is hampered financially from pursuing enforcement actions.[332]

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325. *See, e.g.*, Martin, *supra* note 37, at 611–13.

326. *See Low Income Home Energy Assistance Program*, U.S. DEP'T HEALTH & HUM. SERVS.-ADMIN. FOR CHILDREN & FAMILIES, http://www.acf.hhs.gov/programs/ocs/liheap/about/factsheet.html (last updated Jan. 18, 2011).

327. *See supra* note 7 and accompanying text.

328. This Article leaves for future discussion whether threats to weaken the CFPB's authority and the 2012 presidential election results will hinder the CFPB from enforcing the regulations proposed herein against payday lenders and large financial institutions.

329. *See* FOX & MIERZWINSKI, *supra* note 2, at 22–24.

330. Dodd-Frank Act, Pub. L. No. 111-203, § 1042(a)(2)(B), 124 Stat. 1376, 2012–13 (2010) (codified as amended at 12 U.S.C. § 5552(a) (Supp. IV 2010)).

331. *Id.* § 1042(a)(1).

332. In another article, the author discusses how the CFPB can use its authority to issue guidelines and a policy statement to motivate lenders to discontinue the predatory payday-lending practices discussed herein and grant a safe harbor from enforcement actions to lenders who

IV. CONCLUSION

Imagine that drug manufacturers had put into the market a drug that seriously injured or killed 30% of its 100,000 users. Would the Food and Drug Administration (FDA) allow the drug to stay on the market if the manufacturers placed crystal clear, plain-language disclosures in the drug packaging about the high risks of serious injury or death? Of course not—drugs have been pulled off the shelf for far fewer incidents of serious injury or death out of concern for the physical safety of consumers.[333]

A consumer's financial well-being deserves basic protection, just as his or her physical well-being. Substantial financial hardship is the equivalent of serious physical injury; yet, some federal lawmakers and banking regulators think that it is acceptable to allow banks and non-banks to flood low-to-moderate income communities with payday loans, one of the most dangerous consumer-credit products on the market today. Persuaded, perhaps, that financial disclosures are sufficient, some politicians and banking regulators allow payday lending to occur in the face of evidence that the majority of payday borrowers get trapped in a cycle of debt and suffer substantial financial hardship, such as delaying receipt of important services, postponing prescription drug purchases, losing access to their bank accounts, and experiencing disconnection of utility services. Some borrowers are even forced to file bankruptcy to obtain relief from payday-loan debt.

Despite the unwillingness of some federal lawmakers and regulators to restrict the predatory aspects of payday lending directly, the newly created CFPB has the chance to act similarly to the FDA and protect consumers from payday loans. The CFPB should adopt regulations declaring several common payday-loan practices as unfair, deceptive, and abusive and, therefore, unlawful. As a result of these declarations, the CFPB may ban predatory payday-loan practices, such as charging usurious interest rates, requiring single balloon payments, demanding short maturity dates, and requiring multiple rollovers or loans. These declarations will force bank and non-bank lenders either to make payday-loan products safer and affordable or withdraw from the payday-loan business. Banks and credit unions that already offer affordable loan alternatives to payday loans can continue to emerge as responsible lenders to make the payday-loan market more fair and competitive.

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demonstrate a commitment to offering affordable loans to consumers. *See generally* Johnson, *supra* note 82.

333. *See, e.g.*, *MSU Researcher Studies Ties Between Cholesterol Drugs, Muscle Problems*, MICH. ST. UNIV. (Nov. 6, 2008), *available at* http://news.msu.edu/story/5716/ (reporting that in 2001, the FDA recalled the drug Baycol after it appeared to cause thirty-one deaths from a condition known as rhabdomyolysis).