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The Federal Government in the Fringe Economy

*Jim Hawkins**

When most Americans need to borrow money, they turn to their local bank or credit union. For a substantial minority, around thirty million people, however, banks and credit unions never enter the picture.¹ Instead, people who are unbanked or underbanked turn to payday lenders, pawnshops, rent-to-own stores, or auto-title lenders for loans.² These businesses, commonly referred to as fringe banking companies, offer short-term loans to people who have been excluded from mainstream financial services because of poor or nonexistent credit histories or sporadic incomes.³

The term “fringe banking” almost conveys the erroneous notion that these lenders are a trivial part of the economy. In fact, quite the opposite is true; payday lenders and check cashers outnumber McDonald’s restaurants and Wal-Mart stores in the United States.⁴ Some estimates indicate that one in every ten Americans borrows money from a pawnshop every year.⁵ For many Americans, alternative financial services providers represent their only access to financial services.⁶

Despite the important role fringe creditors play in the lives of millions of Americans, the federal agencies that regulate consumer credit have paid little attention to these lenders.

* Assistant Professor of Law, University of Houston Law Center. I am grateful to the *Chapman Law Review* for hosting such a superb, timely symposium, to Ronald Mann for comments, and to Eamon Briggs, Jason Gay, and Blaine Larson for excellent research assistance.

¹ FEDERAL DEPOSIT INSURANCE CORPORATION, FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (2009) [hereinafter FDIC SURVEY] (reporting that 7.7 percent of American households, or nine million people, are unbanked, and 17.9 percent of households, or twenty-one million people, are underbanked).

² See Ronald H. Silverman, *Toward Curing Predatory Lending*, 122 BANKING L.J. 483, 486 (2005).

³ *Id.*

⁴ HOWARD KARGER, *SHORTCHANGED: LIFE AND DEBT IN THE FRINGE ECONOMY* 6 (2005).

⁵ Jarret C. Oeltjen, *Florida Pawnbroking: An Industry in Transition*, 23 FLA. ST. U. L. REV. 995, 998 (1996).

⁶ FDIC SURVEY, *supra* note 1, at 10.

Indeed, almost no federal laws are aimed directly at fringe banking.⁷ Although many states have implemented measures to protect consumers, the federal government has largely sat on the sidelines—until now.

The Dodd-Frank Wall Street Reform and Consumer Protection Act represents a massive overhaul of the federal government approach to financial markets generally, and a momentous sea change in the relationship between the federal government and fringe banking. One part of this legislation created the Bureau of Consumer Financial Protection (Bureau). Unlike the federal agencies before it, the Bureau presents a remarkable opportunity for the federal government to intervene in the fringe economy. For the first time ever, the federal government has empowered an agency to monitor and supervise fringe creditors, to study fringe credit markets, and to promulgate rules relating to fringe banking transactions.

This Article aims to describe and assess the effects the Bureau will have on fringe credit markets. I make two central claims. First, I argue that the Consumer Financial Protection Act (Act) gives broad, novel powers to the Bureau to regulate fringe credit. Part I describes the scope of the Bureau's power under the Act, demonstrating how the Act covers the vast majority of fringe credit transactions. Part II surveys the substance of the Act to reveal the surprising emphasis the Act places on the Bureau governing fringe banking transactions. The scope of the Bureau's authority coupled with its substantive mandate to confront problems in fringe credit markets signal the new power and interest the federal government has taken in the fringe economy.

Second, I argue that most of the justifications that have been offered for the Bureau regulating fringe credit are flawed. To understand why people have contended the Bureau should govern the fringe economy, I surveyed the two most important academic articles arguing in favor of the Bureau, and I conducted an empirical study to measure the frequency of the rationales for the Bureau regulating fringe credit in media, government press releases, and testimony to Congress. Part III presents the results of the study, and it assesses the different rationales for the Bureau intervening in fringe credit markets. Some

⁷ The one exception is the Talent-Nelson Amendment aimed at stopping payday lenders from lending money to military personnel. 10 U.S.C. § 987 (2006). See generally Patrick M. Aul, Note, *Federal Usury Law for Service Members: The Talent-Nelson Amendment*, 12 N.C. BANKING INST. 163 (2008) (discussing the intent and effects of the Talent-Nelson Amendment).

important rationales, such as the idea that the Bureau is needed to make fringe credit contracts less opaque or to prevent fringe credit from causing borrowers to experience financial distress, fail to comprehend fringe banking transactions and their effects. Other rationales for the Bureau, however, represent solid opportunities for the Bureau to improve the functioning of fringe credit markets and protect consumers. For instance, the Bureau can fill the need for a nimble regulator that can stop innovative ways fringe creditors avoid existing regulation. I conclude by urging the Bureau to seize the opportunity to act and to solve real problems in the fringe economy, not problems that are merely assumed to exist without evidence.

I. THE FRINGE ECONOMY AND THE SCOPE OF THE CONSUMER FINANCIAL PROTECTION ACT

For some time, legislators and commentators debated whether the Act should include pawnbrokers and payday lenders.⁸ With the possible exception of rent-to-own contracts, however, it is clear that fringe banking services to consumers are within the scope of the Act. This part outlines which parts of the statute authorize the Bureau to regulate fringe credit.

A. Coverage Generally

The Act empowers the Bureau to “regulate the offering and provision of consumer financial products or services under the federal consumer financial laws.”⁹ In determining what consumer financial products or services means, it is important to note that the Bureau only has authority over *consumer* financial products and services. The Act defines “consumer” as an individual or someone acting on behalf of an individual,¹⁰ although it does not define an individual, and limits consumer financial products or services to those “offered or provided for use by consumers primarily for personal, family, or household purposes.”¹¹ In light of these definitions, a portion of fringe banking activity will not fall under the Bureau’s authority because these products are used for business purposes, not personal ones.¹² This definition should assuage the fears of those

⁸ Binyamin Appelbaum, *Compromise Would Shield Some Lenders*, WASH. POST, Mar. 11, 2010, at A14.

⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1011(a), 124 Stat. 1376, 1964 (2010) [hereinafter Dodd-Frank].

¹⁰ Dodd-Frank § 1002(4).

¹¹ Dodd-Frank § 1002(5).

¹² See, e.g., Todd J. Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONS. L. REV. 425, 449 (2010) (asserting that around twenty-five to thirty percent of auto-title loans are taken out by small businesses).

who think that the Bureau's regulations will prevent small businesses from accessing credit.¹³

The definition for financial products and services reveals the lion's share of what the Act covers. The Act offers a list of transactions that it defines as financial products or services. Most significantly, the term includes "extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit."¹⁴ Credit is given the same expansive definition as debt is in the Fair Debt Collection Practices Act¹⁵ and is given a more expansive definition than in the Truth in Lending Act.¹⁶ Credit means "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase."¹⁷

Based on this provision alone, the bulk of fringe banking transactions fall within the scope of the Act. In payday loans, auto-title loans, secured credit cards, and pawn loans, the lender generally directly extends credit to consumers. This definition encompasses the activity of payday and auto-title lenders who act as credit service organizations and merely charge a fee for connecting customers with lenders¹⁸ because it includes firms that broker extensions of credit.¹⁹

¹³ See *id.* at 425–26 (expressing concern that the creation of the Consumer Financial Protection Bureau could eliminate auto title lending which would "create hardship for many Americans who rely on auto title lending [such as unbanked consumers and independent small businesses] to meet urgent short-term expenses for utilities, housing and home repairs, and business expenses").

¹⁴ Dodd-Frank § 1002(15)(A)(i).

¹⁵ 15 U.S.C. § 1692a(5) (2006) ("The term 'debt' means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.")

¹⁶ 15 U.S.C. § 1602(e) (2006); 12 C.F.R. § 226.2(14) (2010) ("Credit means the right to defer payment of debt or to incur debt and defer its payment.")

¹⁷ Dodd-Frank § 1002(7).

¹⁸ For a discussion of how payday lenders operate as credit service organizations, see Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 983–95 (2008).

¹⁹ Dodd-Frank § 1002(15)(A)(i). Not only is the definition of credit more expansive in the Consumer Financial Protection Act than the Truth in Lending Act, the Truth in Lending Act's restrictions on who is a creditor are not found in the Consumer Financial Protection Act. See 15 U.S.C. § 1602(f) (2006) ("The term 'creditor' refers only to a person who both (1) regularly extends, whether in connection with loans, sales of property or services, or otherwise, consumer credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required, and (2) is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence of indebtedness or, if there is no such evidence of indebtedness, by agreement.")

In some cases, the statute even specifies that fringe banking transactions are governed by the Bureau. For instance, check cashing is defined as a financial service.²⁰ Also, one section empowering the Bureau to obtain reports and conduct examinations of a limited number of non-depository entities specifically gives the Bureau such powers over anyone who “offers or provides to a consumer a payday loan.”²¹ Thus, it is clear that the Act is intended to cover payday loans.

There are several groups exempted from the Act’s coverage, but in discussing these exemptions, the Act carefully specifies that fringe transactions are included under the Bureau’s power. The Act exempts tax preparers from the Bureau’s authority,²² but the Act excludes firms offering refund anticipation loans from this exemption.²³ In a controversial provision,²⁴ the Act exempts car dealerships,²⁵ but it still includes companies commonly considered to offer car loans in the fringe economy—car dealerships that directly offer loans to customers and do not assign the loans to third parties.²⁶

It is possible that some fringe banking firms will be exempt from the Bureau’s power if the Bureau itself exempts them. The Act gives the Bureau the power to exempt any business from any provision of the Act or rule promulgated by the Bureau.²⁷ The factors the Bureau must consider in exempting a category of firms include the assets of the category of firms, the volume of transactions in which the firm engages, and “existing provisions of law which are applicable to the consumer financial product or service and the extent to which such provisions provide consumers with adequate protections.”²⁸ Pawnshops are the

²⁰ Dodd-Frank § 1002(15)(A)(vi).

²¹ Dodd-Frank § 1024(a)(1)(E).

²² Dodd-Frank § 1027(d).

²³ Dodd-Frank § 1027(d)(2)(B) (“For purposes of this subsection, extending or brokering credit is not a customary and usual accounting activity, or incidental thereto.”).

²⁴ For an account of the controversy, see Appelbaum, *supra* note 8.

²⁵ Dodd-Frank § 1029(a) (“Except as permitted in subsection (b), the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both.”).

²⁶ Dodd-Frank § 1029(b)(2)(B) (“Subsection (a) shall not apply to any person, to the extent that such person . . . operates a line of business . . . in which . . . the extension of retail credit or retail leases are provided directly to consumers; and . . . the contract governing such extension of retail credit or retail leases is not routinely assigned to an unaffiliated third party finance or leasing source . . .”).

²⁷ Dodd-Frank § 1022(b)(3).

²⁸ Dodd-Frank § 1022(b)(3)(B).

most likely possibility because they are declining in number²⁹ and they are extensively regulated by every state.³⁰

Finally, the Act has built into it a mechanism to prevent lenders from circumventing regulation by disguising credit sales as sales of other products or services. Reports indicate some fringe bankers have created such schemes in attempt to avoid state interest rate limits.³¹ To prevent this strategic behavior, the Act clarifies that although the Bureau does not have authority to regulate a “merchant, retailer, or seller of any nonfinancial good or service,”³² this exemption

does not apply to any credit transaction or collection of debt . . . in which the credit extended significantly exceeds the market value of the nonfinancial good or service provided, or the Bureau otherwise finds that the sale of the nonfinancial good or service is done as a subterfuge, so as to evade or circumvent the provisions of this title.³³

B. Pawnshops as Exchange Facilitators?

One commentator has argued that the Act singles out pawnshops for a study, which would reinforce the belief that pawnshops are covered by the Act.³⁴ The Act calls for a report on exchange facilitators,³⁵ and the commentator argues that the report thus refers to pawnshops:

Among other kinds of fringe financial services, pawn shops as a source of temporary credit is suspected to be asset-stripping and predatory. The Bureau must conduct a study on consumers who use exchange facilitators for transactions primarily for personal, family, or household purpose to analyze the effect of these firms on consumer credit.³⁶

This is almost certainly not right. The Act’s definition of an “exchange facilitator” is a person who

²⁹ See John Caskey, *Fringe Banking and the Rise of Payday Lending*, in *Credit Markets for the Poor* 26 (Patrick Bolton & Howard Rosenthal eds., 2005) (noting that the growth in pawnbroking stopped around 1997 and in “many states, the number of pawnshops actually declined between 2000 and 2002”).

³⁰ See generally Oeltjen, *supra* note 5 (discussing the effect of state regulations on the pawnshop industry).

³¹ See Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 20–21 (2002) (reporting that some payday lenders avoided rate caps by selling advertising space to consumers).

³² Dodd-Frank § 1027(a)(1).

³³ Dodd-Frank § 1027(a)(2)(B).

³⁴ TIM FERNHOLZ, NEW AMERICA FOUNDATION, THE CONSUMER FINANCIAL PROTECTION BUREAU: TOOLS, TRANSITIONS, AND CHOICES 9 (2010), available at http://pubcit.typepad.com/files/fernholz_cfpb_10-2010_final.pdf.

³⁵ Dodd-Frank § 1079.

³⁶ FERNHOLZ, *supra* note 34, at 9.

facilitates, for a fee, an exchange of like kind property by entering into an agreement with a taxpayer by which the exchange facilitator acquires from the taxpayer the contractual rights to sell the taxpayer's relinquished property and transfers a replacement property to the taxpayer as a qualified intermediary (within the meaning of Treasury Regulations section 1.1031(k)-1(g)(4)) or enters into an agreement with the taxpayer to take title to a property as an exchange accommodation titleholder (within the meaning of Revenue Procedure 2000-37) or enters into an agreement with a taxpayer to act as a qualified trustee or qualified escrow holder (within the meaning of Treasury Regulations section 1.1031(k)-1(g)(3)).³⁷

The term exchange facilitator, in both the Act's definition and common usage within the tax community, references tax transactions where an intermediary facilitates a tax-deferred exchange under section 1031 of the Internal Revenue Code.³⁸ Thus, while pawnshops are covered in the Act because they extend credit, the Act does not call for a special report on the industry.

C. Rent-to-Own

The only fringe banking product not clearly covered by the statute is rent-to-own. Commentary has covered a wide spectrum in discussing whether rent-to-own is covered by the Act. Some reports about³⁹ and analyses of⁴⁰ the Act conclude that

³⁷ Dodd-Frank § 1079(d)(1).

³⁸ See *FEA Calls New Financial Reform Bill a Good Start Toward Federal Regulation*, NEWSWIRE TODAY, July 21, 2010, <http://www.newswiretoday.com/news/74271/> (reporting that the Federation of Exchange Accommodators support this provision of the Dodd-Frank Act because they want federal regulation of their tax-related conduct).

³⁹ See Ezra Klein, *Digging Into Finance's Pay Dirt*, WASH. POST, July 25, 2010, at G1 ("Sometime this spring, Democrats stopped calling Sen. Chris Dodd's bill 'financial reform' and started calling it 'Wall Street reform.' Most of the headlines and news releases on the sweeping legislation focused on the well-heeled, white-collar, upper crust of finance—investment banks, private-equity firms and hedge funds. But the bill President Obama signed into law Thursday will have a lot to say about payday lenders and check cashers and rent-to-own furniture stores—the blue-collar, far-off-Main Street joints."); Jonathan D. Epstein, *Financial Reforms Mean Big Changes*, BUFFALO NEWS, July 4, 2010, at C1 ("The new consumer financial protection bureau would have extensive power to make and enforce regulations, even over industries previously subject to little federal regulation. It will have authority over traditional products such as mortgage, credit card, student and other consumer loans, as well as non-banks like check-cashers, pawn shops, payday lenders and rent-to-own stores."); Jessica Machetta, *New Federal Oversight Bureau to Crack Down on Payday Lenders*, MISSOURINET, Nov. 23, 2010, <http://www.missourinet.com/2010/11/23/new-federal-oversight-bureau-to-crack-down-on-payday-lenders/> ("[Brenda Procter of the University of Missouri] believes this new step of hiring a director to oversee non-depository institutions such as payday lenders and rent-to-own stores will give some focused attention to the issues that consumer advocates have requested for years.").

⁴⁰ See JAY KIM ET AL., DORSEY, DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT 17 (2010), <http://www.dorsey.com/files/upload/DoddFrankOverview.pdf> ("The BCFP [Bureau of Consumer Financial Protection] is authorized to regulate the activities of any person or entity (a 'covered person') engaged in the business of providing

rent-to-own is covered by the Act. Some consumer advocates have noted it is unclear whether rent-to-own falls within the Act's control,⁴¹ and some industry sources have similarly expressed concern over whether the Bureau will regulate rent-to-own.⁴²

But beyond comments made mostly in passing, there has not been a clear exposition of the Act's coverage of rent-to-own based on the legislative history, the position taken by supporters of the Act, and the text of the statute. The following surveys the evidence from each of these categories and concludes that although the legislative history and positions taken by supporters do not give a clear indication about whether the law is intended to cover rent-to-own, the text of the statute suggests rent-to-own is not covered by the Act.

First, the legislative history is inconclusive regarding whether rent-to-own falls within the Bureau's purview. The rent-to-own industry tried to obtain language in the Act which

consumer financial products or services, including taking deposits; extending credit; servicing loans; leasing or brokering leases of real or personal property on a rent-to-own basis . . ."); SUTHERLAND, NEW WHISTLEBLOWER PROTECTIONS FOR FINANCIAL SERVICE EMPLOYEES 1 (2010), <http://www.sutherland.com> (follow "Alerts+Publications" hyperlink, search "new whistleblower protections") ("The whistleblower must be in the employ of a 'covered person' (or a service provider assisting such covered person). A covered person is defined by Title X as any individual or incorporated entity that provides 'consumer financial products or services,' defined broadly to include lending (including payday lending), loan servicing, 'rent-to-own' leasing . . ."); RICHARD P. HACKETT & FRANK H. BISHOP JR., PIERCE ATWOOD LLP, WORKING SUMMARY OF THE CONSUMER FINANCIAL PROTECTION ACT OF 2010 9 n.26 (2010), http://pierceanwood.com/files/811_WorkingSummaryoftheConsumerFinancialProtectionActof2010.pdf ("This exclusion does not apply if: (i) the person assigns, sells, or otherwise conveys non-delinquent debt (i.e., sells the consumer obligation); (ii) the credit extended significantly exceeds the market value of the non-financial good or service provided (e.g., rent-to-own); or (iii) the person regularly extends such credit and the credit is subject to a finance charge.") (emphasis added).

⁴¹ *Special Double Issue on the Dodd-Frank Financial Reform Bill*, NAT'L CONSUMER L. CENTER, July–Aug. 2010, at 7, <http://www.nclc.org/dodd-frank/nclc-rpts-ccu-jul-aug-2010-web.pdf>.

⁴² *Consumer Protection Agency Passes Key Committee*, TARGETED NEWS SERVICE, Oct. 22, 2009, available at <http://www.rtohq.org/02826apro-consumer-protection-agency-passes-key-committee.html> ("The U.S. House Financial Services Committee today approved creation of a controversial Consumer Financial Protection Agency (CFPA), charged with writing rules for mortgage and credit card lenders and other financial service providers which could include rent-to-own."); *Rent-A-Center Inc. Outlook Revised To Stable; 'BB' Corporate Credit, All Other Ratings Affirmed*, MARKET NEWS PUBLISHING, Nov. 10, 2009 ("The outlook revision to stable from positive reflects our reassessment of the probability of a ratings upgrade over the near term, and not any recent substantial unfavorable developments with respect to potential future RTO industry regulation under the proposed Consumer Financial Protection Agency Act of 2009 (CFPA). The reassessment reflects uncertainty surrounding whether the CFPA will be passed, what industries (including RTO) may be regulated by the act, and the impact of any such regulation. If we had greater assurance that Rent-A-Center would not be substantially negatively impacted by CFPA regulation, we would give consideration to a ratings upgrade.").

would have explicitly excluded rent-to-own, and this effort failed, potentially signaling that the Act includes rent-to-own.⁴³ Some Senators balked at the idea of exempting rent-to-own from the Act's coverage.⁴⁴ On the other hand, Charles Schumer attempted to insert language into the Act to ensure the Act covered rent-to-own and failed to get this language passed into law, suggesting the opposite conclusion, that rent-to-own is not covered.⁴⁵

Several pieces of evidence from discussions and testimony about the Act suggest that some Senators thought rent-to-own was covered. For instance, consider this exchange between Senators Dodd and Schumer when discussing the differences between the bill the House and Senate passed:

DODD: Could we try, I'm not going to—as I said I'm not going to offer the amendment now but could we try to deal with the non-bank payday lenders and the non-bank rent to own type people who escape regulation here?

DODD: Well, we've raised that with the other side . . .

SCHUMER: The House put it in. No, the House is OK with it. The House has it in their bill.⁴⁶

⁴³ Letter from Americans for Financial Reform, to Christopher Dodd, Chairman, Senate Banking Committee (Dec. 7, 2009), available at <http://ourfinancialsecurity.org/2009/12/consumer-financial-protection-agency-should-cover-rent-to-own-transactions/> ("In particular, we write to urge you to reject any amendments that would exempt the Rent-to-Own industry from coverage by the CFPB. Such an amendment was offered in House, phrased as an exclusion from the definition of credit of 'a bailment or lease which is terminable without penalty at any time by the consumer.'"); Victoria McGrane, *Industries Covet CFPB Exemptions*, POLITICO.COM, Oct. 21, 2009, <http://www.politico.com/news/stories/1009/28538.html> ("Every industry is working hard to weaken the bill," said Ed Mierzwinski, director of U.S. PIRG's consumer program, observing that even the rent-to-own industry is getting help seeking its own exemption from Democratic Rep. Joe Baca of California. 'Rent-to-own is just another predatory lender,' he said.").

⁴⁴ See 156 CONG. REC. S3303-03 (daily ed. May 6, 2010) (statement of Senator Charles Schumer) ("And many of these businesses-payday lenders, rent-to-own companies—currently operate below the radar screen to prey on vulnerable communities. How can we exempt some of these payday lenders and rent-to-own companies? I have seen them prey on poor people in my State. How can we exempt them from regulation when they often are worse than many of the financial institutions?").

⁴⁵ See 156 CONG. REC. S3065-02 (daily ed. May 4, 2010) (statement of Senator Charles Schumer) ("I am sponsoring an amendment to expand the enforcement authority of the Consumer Protection Bureau over all nonbanks, such as payday lenders and rent-to-own companies, to make sure consumers are protected no matter who they rely on for financial services."). See also Brian Tumulty, *New York Senators Buck Wall Street*, GANNETT NEWS SERVICE, Apr. 29, 2010 ("[Schumer's] working with Democratic Sen. Jack Reed of Rhode Island on an amendment that would create an independent Consumer Financial Protection Agency. The current bill would make the agency part of the Federal Reserve. Schumer also hopes to cosponsor an amendment with Sen. Kay Hagan, D-N.C., that would put payday lenders and rent-to-own centers under federal regulatory control.").

⁴⁶ *House/Senate Conference Committee Holds a Meeting on the Wall Street Reform and Consumer Protection Act*, FD (FAIR DISCLOSURE) WIRE, June 22, 2010.

Testimony from people supporting the Act also assumes rent-to-own is covered. For instance, in support of an amendment to the Act regarding military families, Senator Jack Reed stated:

Rent-to-own loans. This is where you go to a shop and you say I would like to rent a TV for 30 days because you am [sic] deploying in 45 days. Then you don't deploy so you keep it, and in some cases you end up paying two to three times the retail price of the appliance. At least individual soldiers have to be informed of those practices and know about it. We have to be sure they are getting that information That is what we want to do—coordinate these activities through a military liaison at a consumer financial protection agency. We want to do that because it is the right thing to do and because if we cannot protect the men and women who are protecting us, then we have to ask seriously whether we are doing our job. I know they are doing their job.⁴⁷

Of course this testimony merely represents a single Senator's view about the law, and it is not even clear from the statement that Senator Reed believes rent-to-own is covered by the Act, as opposed to Reed believing the Act should cover rent-to-own. In the end, this testimony is like the other evidence of legislative intent—inconclusive.

With the evidence from legislative history being inconclusive, the text of the statute—the starting point for statutory interpretation⁴⁸—is the best guide for determining rent-to-own's status under the Act. As is the case with many consumer protection laws, how rent-to-own is categorized will determine whether it is covered by the Act.

If rent-to-own is treated as a lease, it will almost certainly fall outside the Bureau's authority. The Act only governs leases of personal property within the definition of a financial product or service if “the lease is on a non-operating basis . . . [and] the initial term of the lease is at least 90 days”⁴⁹ Rent-to-own

⁴⁷ Senator Jack Reed, *Floor Statement Introducing Joint Amendment to Strengthen Consumer Protection for Military Families*, STATES NEWS SERVICE, May 7, 2010. See also *Media Conference Call with Senator Richard Durbin (D-IL); Senator Jack Reed (D-RD); And Holly Petraeus, Director, Better Business Bureau Military Line; Subject: Protection for Military Families Against Abusive Lending Practices*, FEDERAL NEWS SERVICE, May 12, 2010 (“They're numerous. They're legion. And, you know, we've got Marine squad leaders who need to do a lot more than, you know, take care of consumer activities of their Marines. This is something that should be done systematically by a consumer protection agency. Our families, our military families are vulnerable not just to auto dealers. They've [sic] vulnerable to pay-day loans who offer up to—interest rates up to 800 percent. You know, back where I come from, you know, that's—that would be frowned on by people who, you know, aren't legitimate businessmen and women. Rent-to-own loans, two to three times the price of the goods. We could go on and on and on.”).

⁴⁸ *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1988).

⁴⁹ Dodd-Frank § 1002(15)(A)(ii).

contracts are almost universally for less than 90 days, causing them to fall outside the Act.⁵⁰ On the other hand, if rent-to-own is considered an extension of credit, it will fall within the basic definition of a financial product or service.⁵¹

There is a significant debate both in courts and in academic commentary about whether rent-to-own transactions are sales on credit or leases.⁵² People who argue it is a lease focus on the fact that the consumer does not have any obligation to complete the contract but can terminate it at any time.⁵³ Those who claim it is a credit sale emphasize the fact that the transaction is the functional equivalent of credit even if the form is different because the end result is people acquire ownership of a good over time and pay a premium for the good.⁵⁴

The Bureau could govern rent-to-own transactions either if they fall within the Act's definition of credit or if the Bureau determines rent-to-own is a subterfuge to avoid federal consumer credit laws, like the Truth in Lending Act. The latter power is found in a provision of the definition of financial product or service which states that the Bureau can define rent-to-own as a financial product or service by rule "if the Bureau finds that such financial product or service is entered into or conducted as a subterfuge or with a purpose to evade any Federal consumer financial law."⁵⁵ The fact that some people consider rent-to-own a disguised credit sale might empower the Bureau to regulate it.

One way we could imagine determining whether rent-to-own is credit is by looking to state law. Different states define the transaction differently—most treating it as a lease by statute,⁵⁶ and some considering it a credit-sale by judicial decision.⁵⁷ Based on differences in state statutes, it is possible the Bureau would only have authority over rent-to-own transactions in states that treat the transaction as a form of credit. This, however, is

⁵⁰ See generally Jim Hawkins, *Renting the Good Life*, 49 WM. & MARY L. REV. 2041 (2008) (discussing the rent-to-own industry and examining arguments for regulating it).

⁵¹ *Id.*

⁵² *Id.* at 2048 (collecting arguments for both sides).

⁵³ *Id.* at 2051.

⁵⁴ *Id.* at 2050.

⁵⁵ Dodd-Frank § 1002(15)(A)(xi).

⁵⁶ See, e.g., CAL CIV. CODE § 1812.622(d) (West 2010) ("Rental-purchase agreement" . . . means an agreement between a lessor and a consumer pursuant to which the lessor rents or leases, for valuable consideration, personal property for use by a consumer for personal, family, or household purposes for an initial term not exceeding four months that may be renewed or otherwise extended, if under the terms of the agreement the consumer acquires an option or other legally enforceable right to become owner of the property.").

⁵⁷ *Perez v. Rent-A-Center, Inc.*, 892 A.2d 1255, 1268 (N.J. 2006); *Miller v. Colortyme, Inc.*, 518 N.W.2d 544, 549 (Minn. 1994).

unlikely because the Bureau or any court interpreting the Act will have to look to the Act's definition of credit, not any individual state's definition of credit. The Act sets out a definition of credit.⁵⁸ It does not defer to states' definitions of credit, so courts will have to analyze transactions in light of the Act's definition regardless of state law. In similar contexts, courts look only to the federal statute's definition of a term to determine its meaning. For example, in determining whether rent-to-own transactions are credit within the meaning of the Truth in Lending Act, courts do not consider state law but instead just evaluate the definition of credit in the Truth in Lending Act statute.⁵⁹

Looking instead to the Act itself, it seems unlikely rent-to-own is credit. Credit means (1) "the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment" or (2) "the right granted by a person to . . . purchase property or services and defer payment for such purchase."⁶⁰ Rent-to-own agreements fall outside both of these parts of the definition. The statute does not define debt, but debt is commonly defined as an obligation to pay money arising out of a transaction.⁶¹ Rent-to-own-agreements do not involve taking on debt because the rental agreements obligate consumers to pay for rental periods at the start of the rental period, not the end, so the consumer generally does not owe money because of the agreement.⁶²

Additionally, rent-to-own agreements do not involve deferring payment for a purchase. Like debt, the statute does not define purchase, but in most cases purchase involves a transfer of an interest in property for money.⁶³ Because

⁵⁸ Dodd-Frank § 1002(7).

⁵⁹ See *Ortiz v. Rental Mgmt., Inc.*, 65 F.3d 335, 341 (3d Cir. 1995) (determining rent-to-own is not "credit" based on the definition in the statute and the Regulations promulgated to implement it and the federal commentary on the statute); *Starks v. Rent-A-Center*, No. 3-89-0786, 1990 U.S. Dist. LEXIS 20099 (D. Minn. May 16, 1990) (concluding that rent-to-own contracts are not extensions of credit under TILA even though the court found that rent-to-own contracts were credit sales under Minnesota law); *In re Crawford*, No. 90-50066, 1992 Bankr. LEXIS 2515 (E.D. Bankr. Ky. 1992) (assessing whether rent-to-own was a credit sale under TILA completely separately from assessing rent-to-own's status under Kentucky law).

⁶⁰ Dodd-Frank § 1002(7).

⁶¹ See, e.g., 15 U.S.C. § 1692a(5) (2006) (reporting the Fair Debt Collection Practices Act's definition of debt).

⁶² Even cases finding that rent-to-own agreements are credit sales state that rent-to-own does not entail accumulating debt. See *Miller*, 518 N.W.2d at 549.

⁶³ See, e.g., 16 U.S.C. § 3372(c)(2) (2006) ("It is deemed to be a purchase of fish or wildlife in violation of this Act for a person to obtain for money or other consideration . . . (A) guiding, outfitting, or other services; or (B) a hunting or fishing license or permit . . ."); U.C.C. § 1-201(29) (2007) ("Purchase' means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift,

payments for renting are due before the rental period begins, rent-to-own does not entail deferring payment for purchasing even the right to possess the goods during the rental period. Also, the consumer must pay in advance to actually acquire ownership of the goods, so purchasing the title of the goods is not deferred. The only way rent-to-own involves a purchase under common definitions of that term is if it is a disguised deferred purchase—i.e., the consumer really purchases title of the goods at the start of the first rental period but defers payment for the title until the end of the rental agreement.

More compelling than the definition of credit, however, is the section of definitions dealing with leases. That section sets out a specific type of lease that is a financial product or service under the Act.⁶⁴ Under the principle of *expressio unius*, the fact it states one type of lease and does not state other types of leases suggests that all leases not covered by the stated definition are not financial products.⁶⁵

More to the point, the section covering leases is plainly aimed at lease contracts that are disguises for credit sales. The only leases covered by the Act are leases that are “*the functional equivalent of purchase finance arrangements.*”⁶⁶ Thus, the statute implies that a deferred purchase that is disguised as a lease should not be considered credit but should instead be covered only if it meets the requirements of the section of leases. The Bureau merely finding that a lease is a disguise for a credit sale should not be enough for the Bureau to govern such a lease or to consider the transaction to be a subterfuge. Instead, deciding that a transaction is the functional equivalent of a credit sale merely meets one of the parts of the definition of what leases are financial products or services.

In the end, it appears that almost all fringe banking products except rent-to-own are within the Bureau’s purview. In surveying the definitions in the Act, this part has taken the first step in establishing the claim that the Act empowers the Bureau to intervene into fringe credit markets because it demonstrates the Bureau has power over fringe banking. The next part looks at the substantive rules of the Act to illustrate the impressive opportunity Congress has given the Bureau to regulate fringe credit.

or any other voluntary transaction creating an interest in property.”).

⁶⁴ Dodd-Frank § 1002(15)(A)(ii).

⁶⁵ *Expressio unius* is the principle of statutory interpretation which states that the expression of one thing means the exclusion of another. *Chevron U.S.A. v. Echazabel*, 536 U.S. 73, 80 (2002).

⁶⁶ Dodd-Frank § 1002(15)(A)(ii) (emphasis added).

II. THE CONSUMER FINANCIAL PROTECTION ACT'S SUBSTANTIAL POWER TO REGULATE FRINGE CREDIT

This part discusses the major components of the Consumer Financial Protection Act that will affect fringe banking and reveals how the federal government will now be directly involved in the fringe economy in a substantial way. Fringe banking permeates the bill. Even beyond the components this section analyzes in depth, which all involve fringe banking, consider the following provisions which demonstrate the sustained attention the Act pays to fringe banking:

- The Act instructs the Bureau's Director to establish an entire unit dedicated solely to consumers who are unbanked or underbanked.⁶⁷
- The Office of Financial Education created by the Act is charged with moving people from fringe banking firms to mainstream financial institutions.⁶⁸
- In creating the Consumer Advisory Board, the Director must seek "representatives of depository institutions that primarily serve underserved communities."⁶⁹
- To encourage less reliance on fringe banking services, the Act requires "[e]ach of the Federal banking agencies and the National Credit Union Administration [to] provide guidelines to financial institutions under the jurisdiction of the agency regarding the offering of low-cost remittance transfers and no-cost or low-cost basic consumer accounts, as well as agency services to remittance transfer providers."⁷⁰

The following goes beyond these few examples to explain the power the substance of the Act gives to the Bureau to affect fringe banking.

A. Research

A major focus of the Bureau will be research,⁷¹ and the Act instructs the Bureau's Director to create a research unit.⁷²

⁶⁷ Dodd-Frank § 1013(b)(2) ("The Director shall establish a unit whose functions shall include providing information, guidance, and technical assistance regarding the offering and provision of consumer financial products or services to traditionally underserved consumers and communities.").

⁶⁸ Dodd-Frank § 1013(d)(2)(C) (setting as a priority of the Office of Financial Education the provision of "opportunities for consumers to access . . . savings, borrowing, and other services found at mainstream financial institutions").

⁶⁹ Dodd-Frank § 1014(b).

⁷⁰ Dodd-Frank § 1073(c).

⁷¹ Dodd-Frank § 1021(c)(3) (stating a primary function of the Bureau will be "collecting, researching, monitoring, and publishing information relevant to the

Remarkably, three of the six foci of the research unit directly relate to fringe banking, and the other three are indirectly related to it.

The first area the Act directs the research unit to study is developments in credit markets, “including market areas of alternative consumer financial products or services with high growth rates and areas of risk to consumers.”⁷³ The phrase “alternative consumer financial products or services” mirrors almost exactly a common name for fringe banking: alternative financial services. While not directly stating that the unit should research fringe banking, this language and the fact fringe banking is a high growth industry that many consider a risk to consumers suggest that this agenda item for the research unit is directed at fringe banking. The other two areas the unit must research involve fringe banking customers in a much clearer way, as one directs the unit to research “access to fair and affordable credit for traditionally underserved communities,”⁷⁴ and the other demands research about “experiences of traditionally underserved consumers, including un-banked and under-banked consumers.”⁷⁵

The other three areas of research do not explicitly involve only fringe banking, but they all relate to concerns people have expressed about fringe credit: disclosure and suboptimal consumer decision-making. The research unit must analyze consumers’ understanding of disclosures, awareness of risks and costs of credit, and behavior regarding financial products and services.⁷⁶ Each of these three items has been the focus of significant academic debate about fringe banking,⁷⁷ and so a study of any one of them is likely to involve fringe credit.

Given the preeminence of fringe banking in the Bureau’s research agenda, it is likely the Bureau will produce a significant number of reports about fringe credit and will fill in some holes in the academic literature about fringe banking. The next section outlines one source of data from which the Bureau will

functioning of markets for consumer financial products and services to identify risks to consumers and the proper functioning of such markets”).

⁷² Dodd-Frank § 1013(b)(1).

⁷³ Dodd-Frank § 1013(b)(1)(A).

⁷⁴ Dodd-Frank § 1013(b)(1)(B).

⁷⁵ Dodd-Frank § 1013(b)(1)(F).

⁷⁶ Dodd-Frank § 1013(b)(1)(C)–(E).

⁷⁷ See generally Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided “Reform” of Bankruptcy Law*, 84 TEX. L. REV. 1481 (2006) (providing an in-depth analysis of these three items in the context of fringe banking).

draw: information obtained directly from fringe banking firms through the Bureau's supervision powers.

B. Monitoring and Supervision

Fringe banking will also be affected in a second innovation found in the Act: the Act empowers the Bureau to monitor and supervise nondepositories.⁷⁸ These powers have the potential to dramatically increase the amount of data available about fringe banking firms, but also to impose costs on firms operating in these markets.

First, the Act mandates that the Bureau “monitor for risks to consumers in the offering or provision of consumer financial products or services.”⁷⁹ As in other contexts, the fringe economy should play an important role in this monitoring because the Act instructs the Bureau to allocate its resources for monitoring in light of “the extent, if any, to which the risks of a consumer financial product or service may disproportionately affect traditionally underserved consumers”⁸⁰

This monitoring power has the potential to supply the Bureau with substantial information about the fringe economy because the Bureau can require covered entities to file special or annual reports or to submit answers to questions from the Bureau.⁸¹ This power to obtain information even extends to entities that are not determined to be covered by the Act; the Bureau can require firms to file annual reports so that the Bureau can assess whether they are covered by the Act.⁸²

In addition to requiring reports, the Bureau can also require fringe banking firms to register with the federal government.⁸³ Registration requirements in some cases will be duplicative of the extensive state registration rules,⁸⁴ so the Act requires the Bureau to consult with state agencies when promulgating its rules.⁸⁵

⁷⁸ Dodd-Frank § 1024(b).

⁷⁹ Dodd-Frank § 1022(c)(1).

⁸⁰ Dodd-Frank § 1022(c)(2)(E).

⁸¹ Dodd-Frank § 1022(c)(4)(B)(ii).

⁸² Dodd-Frank § 1022(c)(5) (“In order to assess whether a nondepository is a covered person, as defined in section 1002, the Bureau may require such nondepository to file with the Bureau, under oath or otherwise, in such form and within such reasonable period of time as the Bureau may prescribe by rule or order, annual or special reports, or answers in writing to specific questions.”).

⁸³ Dodd-Frank § 1022(c)(7)(A).

⁸⁴ *See, e.g.*, DEL. CODE ANN. tit. 5, § 2202 (2010) (requiring title lenders to obtain licenses from the state); FLA. STAT. § 537.007 (2010) (same); IDAHO CODE ANN. § 28-46-503 (2010) (same).

⁸⁵ Dodd-Frank § 1022(c)(7)(C).

Second, in addition to monitoring, the Act empowers the Bureau to supervise some fringe lenders. The Act specifically empowers the Bureau to supervise just three types of lenders: (1) mortgage originators, brokers, and servicers; (2) those offering education loans; and (3) payday lenders.⁸⁶ The specific language of the section granting supervisory power over payday lenders is broad enough to include payday lenders operating in a variety of business models because it is not limited to companies that provide payday loans—it includes anyone who even offers them.⁸⁷ Thus, the Bureau will supervise payday lenders who operate as Credit Service Organizations that merely connect borrowers with third-party lenders.⁸⁸

In addition to these specific firms to be supervised, the Act sets out two general nets to catch other firms for supervision, both of which have a strong potential to bring in fringe creditors other than just payday lenders. First, the Bureau can supervise anyone who is “a larger participant of a market for other consumer financial products or services”⁸⁹ Several large pawnbrokers,⁹⁰ auto-title lenders,⁹¹ and refund anticipation lenders⁹² are large publicly held companies and could easily fall into this category. Second, the Bureau can supervise any person who “is engaging, or has engaged, in conduct that poses risks to consumers.”⁹³ As Part III.C points out, many people believe fringe credit is risky for consumers, so the potential to draw in fringe lenders is substantial. The upshot of these provisions is that payday lenders will certainly be supervised by the Bureau and many other fringe lenders have a strong potential to be supervised.

Being supervised by the Bureau may require firms to produce “reports and conduct examinations on a periodic basis[;]”⁹⁴ maintain a certain level of capital or bonds;⁹⁵ submit to “background checks for principals, officers, directors, or key personnel[;]”⁹⁶ and generate and maintain records so that the

⁸⁶ Dodd-Frank § 1024(a)(1)(A), (D), (E).

⁸⁷ Dodd-Frank § 1024(a)(1)(E) (granting power to supervise a person who “offers or provides to a consumer a payday loan”).

⁸⁸ Spector, *supra* note 18, at 983–95.

⁸⁹ Dodd-Frank § 1024(a)(1)(B).

⁹⁰ Cash America International, Inc. is a pawnshop traded on the New York Stock Exchange listed under the symbol “CSH.”

⁹¹ EZ Corp. offers title loans and is traded on NASDAQ under the symbol “EZPW.”

⁹² Advance America is one of the largest payday lenders and is traded on the New York Stock Exchange under the symbol “AEA.”

⁹³ Dodd-Frank § 1024(a)(1)(C).

⁹⁴ Dodd-Frank § 1024(b)(1).

⁹⁵ Dodd-Frank § 1024(b)(7)(C).

⁹⁶ *Id.*

Bureau can perform its supervisory function.⁹⁷ These requirements could have a variety of effects in fringe markets. For instance, if only payday lenders are supervised, it could put other fringe lenders in a better competitive position because they will be able to avoid the costs payday lenders are paying for compliance. More generally, capital requirements and substantial reporting requirements could favor larger firms and drive mom and pop shops out of business.

It would be easy to underestimate the importance of this information-gathering function. As David Skeel points out:

The power to investigate and require data may be the most important power of all. As a scholar seeking data, Warren was not a welcome presence at the office of the credit card banks. But now banks are required to open their doors and answer questions about their business practices.⁹⁸

This observation is especially true for fringe banking operations that have not been subject to examinations like banks but, for the first time, will have to produce significant amounts of information for the Bureau.

C. Rulemaking

The Bureau's ability to promulgate rules is the least delimited of its powers, has the least understood power, and has the greatest potential to affect businesses in the fringe economy. The Act empowers the Bureau to make rules supporting two goals: sections 1021(c)(5) and 1022(a) authorize rulemaking to enforce federal consumer protection laws,⁹⁹ and section 1031(b) gives the Bureau the right to create rules to identify "unlawful, unfair, deceptive, or abusive acts or practices . . ."¹⁰⁰ The Bureau's power to write new rules to enforce existing federal consumer laws might affect fringe lenders, but there is little room for surprise here as the federal consumer laws are already on the books and have been implemented by other agencies writing rules for years. The main effect of this rulemaking power will be that existing laws will be more stringently enforced.

⁹⁷ Dodd-Frank § 1024(b)(7)(B).

⁹⁸ DAVID SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* 112 (2011).

⁹⁹ Dodd-Frank § 1021(c)(5) ("The primary functions of the Bureau are . . . issuing rules, orders, and guidance implementing Federal consumer financial law."); § 1022(a) ("The Bureau is authorized to exercise its authorities under Federal consumer financial law to administer, enforce, and otherwise implement the provisions of Federal consumer financial law.")

¹⁰⁰ Dodd-Frank § 1031(b).

On the other hand, the Act's instruction to create rules to regulate "unfair, deceptive, or abusive acts"¹⁰¹ has much more potential to affect fringe lenders. None of these terms are explicitly defined by the Act. The Act does give some indication of when the Bureau can define a practice as unfair and abusive, but it gives no guidance concerning defining acts as deceptive.

The Bureau cannot define a practice as unfair "unless the Bureau has a reasonable basis to conclude that . . . the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and such substantial injury is not outweighed by countervailing benefits to consumers or to competition."¹⁰² The Bureau can only define an act as abusive if it:

- (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
- (2) 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.¹⁰³

In addition to this language in the Act, we have some idea of what sort of rules the Bureau will write for unfair and deceptive acts because the Federal Trade Commission (FTC) has had a similar mandate for a considerable time.¹⁰⁴ The FTC Act empowers the FTC to prevent businesses from engaging in unfair or deceptive acts,¹⁰⁵ and the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act gives the FTC rulemaking authority.¹⁰⁶ Thus, the FTC's enforcement activities against

¹⁰¹ *Id.*

¹⁰² Dodd-Frank § 1031(c)(1).

¹⁰³ Dodd-Frank § 1031(d)(1)&(2).

¹⁰⁴ See 15 U.S.C. § 45(a) (2006) (using the same language as the Consumer Financial Protection Act when empowering the FTC to prevent unfair and deceptive acts or practices but omitting "abusive").

¹⁰⁵ 15 U.S.C. § 45(a)(2) ("The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.").

¹⁰⁶ See 15 U.S.C. § 57a(a)(1)(B) (2006) ("[T]he Commission may prescribe . . . rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce (within the meaning of section 45(a)(1) of this title), except that the Commission shall not develop or promulgate any trade rule or regulation with regard to the regulation of the development and utilization of the standards and certification activities pursuant to this section. Rules under this subparagraph may

unfair and deceptive conduct may help predict what conduct the Bureau will define as unfair and deceptive.

Like the Consumer Financial Protection Act, the FTC Act does not define unfair or deceptive and only gives guidance about how to formulate rules relating to unfair acts.¹⁰⁷ In the early 1980s, the FTC issued policy statements on both unfairness and deception that are still routinely cited today.¹⁰⁸ The following sections attempt to identify what unfair, deceptive, and abusive mean. Because these terms do not have specific definitions, these sections demonstrate that they give substantial power to the Bureau to regulate fringe credit markets.

i. Unfair Acts or Practices

The FTC's policy statement on unfairness explains that an act or practice is "likely to cause substantial injury to consumers" only if the injury is a "monetary, economic, or other tangible harm"¹⁰⁹ that is more than "trivial or speculative" and not subjective injuries like "embarrassment, emotional distress, etc."¹¹⁰ In determining if consumers can reasonably avoid the injuries, the FTC looks to whether something about the act or practice unjustifiably hinders free market decision-making.¹¹¹ Thus, in most cases where the FTC claims an act is unfair, the consumer has been tricked in some way or there will be some sort of market failure.¹¹² As Jean Braucher summarizes, "The FTC

include requirements prescribed for the purpose of preventing such acts or practices.").

¹⁰⁷ 15 U.S.C. § 45(n).

¹⁰⁸ See Stephen Calkins, *FTC Unfairness: An Essay*, 46 WAYNE L. REV. 1935, 1936 (2000).

¹⁰⁹ 49 Fed. Reg. 7740, 7743 (Mar. 1, 1984); Unfair or Deceptive Acts or Practices, 74 Fed. Reg. 5498, 5502 (Jan. 29, 2009).

¹¹⁰ 49 Fed. Reg. 7740, 7743 (Mar. 1, 1984).

¹¹¹ 49 Fed. Reg. 7740, 7744 (Mar. 1, 1984). See also Unfair or Deceptive Acts or Practices, 74 Fed. Reg. 5498, 5503 (Jan. 29, 2009) ("An injury is not reasonably avoidable when consumers are prevented from effectively making their own decisions about whether to incur that injury The test is not whether the consumer could have made a wiser decision but whether an act or practice unreasonably creates or takes advantage of an obstacle to the consumer's ability to make that decision freely.").

¹¹² H.R. REP. NO. 98-156 (1983); FTC Policy Statement on Unfairness, (Dec. 17, 1980), available at <http://www.ftc.gov/bpc/policystmt/ad-unfair.htm> ("Normally we expect the marketplace to be self-correcting, and we rely on consumer choice—the ability of individual consumers to make their own private purchasing decisions without regulatory intervention—to govern the market. We anticipate that consumers will survey the available alternatives, choose those that are most desirable and avoid those that are inadequate or unsatisfactory. However, it has long been recognized that certain types of sales techniques may prevent consumers from effectively making their own decisions, and that corrective action may then become necessary. Most of the Commission's unfairness matters are brought under these circumstances. They are brought, not to second-guess the wisdom of particular consumer decisions, but rather to halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decisionmaking. Sellers may adopt a number of practices that unjustifiably

has come to the initially surprising conclusion that unfairness in consumer contracts means gross inefficiency.”¹¹³ Under the statute and its policy statement, the FTC will only take action when the benefits of further regulation outweigh the costs to consumers and competition.¹¹⁴

A recent case exemplifies how the FTC approaches unfairness. In *F.T.C. v. IFC Credit Corp.*, a telecommunications company leased telecommunications equipment to consumers.¹¹⁵ The Equipment Rental Agreements contained a “hell or high water” clause which obligated the consumer to continue making rental payments even if the telecommunication services were terminated, despite the fact the services were the only purpose of the equipment.¹¹⁶ The FTC alleged that the business’ attempt to collect on the rental agreements “when they are worthless is unfair.”¹¹⁷ In deciding the issue, the court found that the practice caused a substantial injury to consumers because the cost of renting the worthless equipment was significant and because the practice affected many consumers.¹¹⁸ Furthermore, it found that the consumers could not reasonably avoid the injury, despite the fact they should have known about the hell or high water clause and had not been deceived under traditional contract law notions.¹¹⁹ The court explained:

hinder such free market decisions. Some may withhold or fail to generate critical price or performance data, for example, leaving buyers with insufficient information for informed comparisons. Some may engage in overt coercion, as by dismantling a home appliance for ‘inspection’ and refusing to reassemble it until a service contract is signed. And some may exercise undue influence over highly susceptible classes of purchasers as by promoting fraudulent ‘cures’ to seriously ill cancer patients. Each of these practices undermines an essential precondition to a free and informed consumer transaction, and, in turn, to a well functioning market. Each of them is therefore properly banned as an unfair practice under the FTC Act.”)

¹¹³ Jean Braucher, *Defining Unfairness: Empathy and Economic Analysis at the Federal Trade Commission*, 68 B.U. L. REV. 349, 351 (1988).

¹¹⁴ 49 Fed. Reg. 7740, 7745 (Mar. 1, 1984).

¹¹⁵ *FTC v. IFC Credit Corp.*, 543 F. Supp. 2d 925, 928 (N.D. Ill. 2008).

¹¹⁶ *Id.* at 930 (“The ERA appeared to be a standard form equipment lease, covering both sides of a single page. It made no mention of telecommunications services and covered only the rental of the equipment necessary to provide the services. Its terms were straightforward and understandable. The front side provided that the ‘renter’ agreed that the equipment would ‘not be used for personal, family or household purposes.’ Also on the first side, in bold type a bit above the signature line, the ERA stated that the ‘**obligations to make all Rental Payments for the entire term are not subject to set off, withholding or deduction for any reason whatsoever.**’ Directly over the signature lines, also in bold-faced type but capitalized as well, the ERA stated: ‘**THIS RENTAL MAY NOT BE CANCELLED OR TERMINATED EARLY.**”).

¹¹⁷ *Id.* at 945.

¹¹⁸ *Id.* (“Here the injuries were substantial, both in monetary terms and in numbers of consumers affected. The total payments under an ERA over its five-year term ranged from \$4,439 to \$160,672, depending on the lease—even though the cost of a box never exceeded \$1,300 and in a number of cases was less than \$300.”).

¹¹⁹ *Id.* at 945–48.

While the consumers knew that their monthly payment was being allocated in prescribed percentages, that fact would have been meaningless to a reasonable consumer and would not have alerted the consumer of what was to come. While the ERA said that the obligation to make monthly payments was unconditional, the consumers could not have reasonably anticipated that, to use Justice Cardozo's phrase, "the doom of mere sterility was on the [transaction] from the beginning," and that it was a virtual certainty, not merely a possibility inherent in any comparable transaction, that its contracted for telecommunications services would cease and they would be on the hook to an assignee. Having no reason to anticipate the harm that was certain to befall them, there was no occasion for the consumers even to consider taking steps to avoid it.¹²⁰

Because the practice caused substantial injury that could not be avoided, it was considered unfair.

How might unfairness factor into the rules the Bureau makes concerning fringe banking products? It opens a significant number of practices up to scrutiny. It will not be difficult for the Bureau to establish that some aspects of fringe transactions cause substantial harm because even if the actual dollar amount of each harm is low, fringe banking is a common source of credit,¹²¹ so many consumers will be affected. Also, critics of fringe banking consider several different aspects of fringe transactions to be a result of market failures, meeting the test that consumers cannot reasonably avoid the harm.¹²²

The most likely target of rules based on unfairness is payday loan rollovers. Payday lending appears to be a high priority to the Bureau,¹²³ although it is possible the Bureau will first

¹²⁰ *Id.* at 948.

¹²¹ See KARGER, *supra* note 4, at 6 (reporting the United States has more payday lending and check cashing stores than McDonald's, Burger King, Target, Sears, JC Penney, and Wal-Mart locations combined).

¹²² See, e.g., Alan M. White, *Behavior and Contract*, 27 LAW & INEQ. 135, 159 (2009) ("Payday loans, for example, are described (falsely) as a short-term credit product, exploiting the consumer's optimism bias that predicts an ability to pay the loan in full at the next payday, and discounts the inevitable recurrence of the cash shortage that prompted the loan. 'Framing,' which consists of altering a consumer's preferences by defining the menu from which choices are made, is also used by payday lenders. Payday lenders compare the extremely high Annual Percentage Rate (APR) of a payday loan to the cost of bank overdraft fees if the payday loan is not used (avoiding a loss) rather than, say, the much cheaper alternative of a cash advance on a credit card.").

¹²³ Ann Sanner, *White House Consumer Adviser Gathers Input in Ohio*, DAILY CALLER (Oct. 14, 2010), <http://dailycaller.com/2010/10/14/obama-consumer-adviser-gathers-input-in-ohio/> ("Warren told reporters before the round-table that payday lending would be a 'high priority' for the agency. People should have access to small-dollar loans for emergencies, she said, but 'a model that is designed to keep those families in a revolving door of debt is not good for families—and ultimately not good for the economy.' Warren said federal regulators would look at the business models used in payday lending, the costs to consumers and the actions states have taken to regulate it.").

address credit cards and mortgages.¹²⁴ Some payday lenders think the Bureau will address payday lending first because it is low hanging fruit and an easy early win for the Bureau.¹²⁵ In any case, given the emphasis on payday lending in the Act itself and news stories about the Act, it is highly likely the Bureau will make rules about it.

Rollovers are a probable place for the Bureau to start. “Rollover” refers to the practice of payday borrowers paying just the interest due on their loans and rolling over the principal for another loan period and thereby incurring another interest fee.¹²⁶ Although an amendment to limit rollovers in the Act itself failed,¹²⁷ Warren has criticized rollovers both in her academic writing¹²⁸ and in her activities as a special advisor to President Obama;¹²⁹ some experts have claimed that the Bureau has the

¹²⁴ See Janet Bodnar, *Elizabeth Warren Explains What We Can Expect from the New Consumer Agency*, KIPLINGER (Nov. 24, 2010), <http://community.nasdaq.com/News/2010-11/elizabeth-warren-explains-what-we-can-expect-from-the-new-consumer-agency.aspx?storyid=46462#ixzz16fLrAGh3> (reporting Warren’s response to an interview question about the first steps the Bureau will take: “The first two initiatives are centered around credit cards and home mortgages. I’ve already met with CEOs of the major credit-card issuers and other financial-services companies and with consumer groups on the readability of credit disclosures.”); Rebecca Christie & Carter Dougherty, *Treasury Aide Says Consumer Bureau Job Likely Filled by July*, BLOOMBERG (Nov. 18, 2010), <http://www.bloomberg.com/news/2010-11-18/treasury-aide-says-consumer-bureau-job-likely-filled-by-july.html> (“[Treasury Department’s general counsel George Madison] said the consumer bureau probably would start by focusing on consumer banking products before adding in oversight of payday lenders and other financial firms not traditionally monitored by bank regulators.”).

¹²⁵ Hilary B. Miller, *The Future of the Payday Loan Industry Revisited Again—An Expert Opinion*, PAYDAY LOAN INDUSTRY BLOG (July 28, 2010), <http://paydayloanindustryblog.com/the-future-of-the-payday-loan-industry-revisited-again-an-expert-opinion/> (“The industry’s antagonists have pronounced that the [Bureau of Consumer Financial Protection’s (BCFP)] . . . first act will be to regulate payday lenders out of business (even though payday lending was entirely unrelated to the causes of the recent financial crisis, they assume that the BCFP will have no bigger fish to fry than payday lending). Some of my colleagues believe that payday lending is ‘low-hanging fruit’ that the BCFP can use to put up a quick and easy ‘W’ on the scorecard and, in the process, placate consumer groups.”).

¹²⁶ *Researcher Tackles Payday Loan Industry*, GUELPHMERCURY (Jan. 19, 2010), <http://www.guelphmercury.com/news/article/467344--researcher-tackles-payday-loan-industry>.

¹²⁷ Ylan Q. Mui, *Storefront Operations Argue for Exclusion from Financial Bill; Lawmakers Hear from Payday-Lending and Check-Cashing Firms*, WASH. POST, May 10, 2010, at A4 (“The industry also faces a renewed fight on payday lending. Consumer groups have long criticized the practice for charging triple-digit interest rates and accused lenders of preying on low-income customers. The nonprofit Center for Responsible Lending worked with North Carolina Sen. Kay Hagan (D) to introduce an amendment to the financial reform bill last week that would limit the number of payday loans consumers can take out to six per year and require lenders to give customers more time to repay the loan if needed. In addition, the amendment would give the Federal Reserve the authority to license payday lenders.”).

¹²⁸ Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 55–56 (2008).

¹²⁹ See Sanner, *supra* note 123 (quoting Warren as saying: “[A] model that is designed

power to eliminate rollovers.¹³⁰ The Bureau could argue that rollovers are expensive for individual payday lending customers¹³¹ and could use evidence that rollovers are common to establish that many consumers are affected by the practice.¹³² Many people claim that consumers do not anticipate rolling over their loans when they take them out, suggesting a market failure,¹³³ which implies consumers could not reasonably avoid the injury.

What effect would banning rollovers or limiting the number of rollovers have on the industry? It might significantly decrease the number of companies willing to make short term loans. The cost of originated two week loans is high, and rollovers are an important component to payday lenders' profit models.¹³⁴ It is possible that a complete ban on rollovers could cripple the industry.

One industry attorney, Hilary Miller, is tentatively skeptical that the Bureau could take action against payday loans under either the unfairness or deceptive prongs of the Act.¹³⁵ Because the FTC already has had the authority to prevent unfair and deceptive acts but has never found payday lending to fall within these categories, Miller argues that the Bureau cannot use these prongs against the industry: "To my mind, this argument entirely disposes of two of the three 'bad conduct' badges in the Act The FTC Act and Title X of Dodd-Frank are manifestly *in pari materia*, and chaos would result if they were interpreted differently."¹³⁶

to keep those families in a revolving door of debt is not good for families—and ultimately not good for the economy.”).

¹³⁰ Machetta, *supra* note 39 (“Whiel [sic] the bureau does not have the authority to cap interest rates, as some states have done, she says they do have the power to regulate other aspects of payday lending, such as limiting the number of loans. [Brenda Procter of the University of Missouri, a payday loan expert,] believes this is the first step in leveling the playing field between consumers and lenders.”).

¹³¹ See *Payday Loans Tempting, But Not Good Deals*, WIS. STATE J., Jan. 17, 2010, at C1 (giving the example of a “\$200 two-week payday loan charging \$38.36 in interest. Within 10 weeks, the interest totals \$191.78.”).

¹³² See *infra* notes 239–240 and accompanying text.

¹³³ See *infra* notes 241–246 and accompanying text.

¹³⁴ Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?*, (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005).

¹³⁵ Miller, *supra* note 125.

¹³⁶ *Id.* See also Carey Alexander, Note, *Abusive: Dodd-Frank Section 1301 and the Continuing Struggle to Protect Consumers*, ST. JOHN’S L. REV. (forthcoming 2011) (manuscript at 13), available at <http://ssrn.com/abstract=1719600> (citing *Capital Traction Co. v. Hof*, 174 U.S. 1, 36 (1899) and *Carolene Prods. Co. v. United States*, 323 U.S. 18, 26 (1944) for the proposition that “[w]henver Congress adopts language with a ‘known and settled construction,’ it is presumed to adopt the previous judicial interpretations surrounding the language.”).

The problem with the argument, however, is that the FTC has never affirmatively found payday lending to be fair or not deceptive. It just has not taken action either way. It is possible to read this as an affirmation of the industry, but it is more likely that the FTC has never acted because it does not have infinite resources. As Jeff Sovern has argued, the FTC lacks the resources to bring even cases it considers worthwhile.¹³⁷ Thus, the Bureau could rule that rollovers or some other aspect of a fringe credit transaction are unfair despite the fact the FTC has never pursued a suit against this conduct on the theory that the FTC's past actions just reflect scarce resources, not a judgment about all consumer credit practices that currently exist in the market. Moreover, because the Bureau was created out of a sense that other agencies were not actually protecting consumers,¹³⁸ it is likely the Bureau will take a more aggressive stance than the FTC on many issues. Also, the Bureau will have a much easier time promulgating rules than the FTC. The FTC has a burdensome rulemaking procedure¹³⁹ compared to the Bureau's procedure, which is relatively straightforward. For instance, from 1980 to 2000, the FTC did not create a single rule related to unfair acts or practices.¹⁴⁰ This difference may result in the Bureau having an easier time creating rules for fringe creditors. Finally, the language defining unfairness in the FTC Act is not exactly the same as the language in the Dodd-Frank Act, suggesting the Bureau has a new chance to define unfairness.¹⁴¹

¹³⁷ See Jeff Sovern, *Private Actions Under the Deceptive Trade Practices Act: Reconsidering the FTC Act as Rule Model*, 52 OHIO ST. L.J. 437, 441–42 (1991) (“One practical limit restraining FTC abuses is, of course, politics. FTC commissioners are appointed by the President and confirmed by the Senate for terms of seven years. While commissioners may be removed only for ‘inefficiency, neglect of duty, or malfeasance in office,’ thus insulating commissioners to some extent from political considerations, it is inevitable that at least some commissioners will remain sensitive to the winds of political life A second practical limit to FTC excess is scarce resources. The FTC budget is less than 55 million dollars, which is obviously a small sum for regulating the many transactions and businesses within the FTC's purview. Because the FTC lacks the staff to pursue many significant improprieties, it is unlikely to expend its scarce resources on trivial deceptions.”).

¹³⁸ Adam J. Levitin, *The Consumer Financial Protection Agency* (The Pew Financial Reform Project, Briefing Paper No. 3, 2009), available at <http://www.aei.org/docLib/Levitin%20-%20Consumer%20Financial%20Protection%20Agency.pdf>.

¹³⁹ 15 U.S.C. § 57a(b). See Mark E. Budnitz, *The FTC's Consumer Protection Program During the Miller Years: Lessons for Administrative Agency Structure and Operation*, 46 CATH. U. L. REV. 371, 417 (1997) (“[T]he Improvements Act of 1980 imposed stringent procedural requirements relating to the FTC's rulemaking procedures.”).

¹⁴⁰ Calkins, *supra* note 108, at 1960.

¹⁴¹ Alexander, *supra* note 136, at 13 (“Had Congress codified the House language expressly adopting the FTC's policy statements, the CFPB's powers to prohibit unfair and deceptive acts would be known and settled; they would be the same as the FTC's under the FTC Act. Instead, because Congress effectively rejected the FTC's definitions, the

ii. Deceptive Acts or Practices

The second prong of rulemaking power for the Bureau—deception—is also in the FTC Act. In general, the FTC produces rules to make it easy to find particular actions deceptive.¹⁴² “A representation or omission is deceptive if the overall net impression created is likely to mislead consumers.”¹⁴³ The business’ intent is unimportant,¹⁴⁴ and the act does not actually have to deceive anyone—it is enough that the act is likely to deceive someone,¹⁴⁵ and that the representation is material.¹⁴⁶ Usually, deception cases relate to advertising claims,¹⁴⁷ and the FTC has provided a non-exhaustive list of misleading or deceptive practices:

[F]alse oral or written representations, misleading price claims, sales of hazardous or systematically defective products or services without adequate disclosures, failure to disclose information regarding pyramid sales, use of bait and switch techniques, failure to perform promised services, and failure to meet warranty obligations.¹⁴⁸

Federal Trade Comm’n v. Pharmtech Research, Inc. provides an example of the FTC’s understanding of the term deceptive.¹⁴⁹ In *Pharmtech*, the court granted a preliminary injunction preventing a business from continuing to advertise its dietary supplement.¹⁵⁰ The business sold pills made of dehydrated and compressed vegetables and claimed that taking the pills reduced the risk of certain cancers because a study found that “frequent consumption of certain fruits and vegetables is associated with a reduction in the incidence of cancer in human beings, and found that carotene-rich vegetables, such as carrots, and cruciferous vegetables, such as broccoli, cabbage and Brussels sprouts, provide this benefit.”¹⁵¹ The business’ advertisements were

CFPB may have a freer hand to define its ability to reach unfair and deceptive practices under Dodd-Frank.”).

¹⁴² Sovern, *supra* note 137, at 444.

¹⁴³ Unfair or Deceptive Acts or Practices, 74 Fed. Reg. 5498, 5504 (Jan. 29, 2009).

¹⁴⁴ FTC v. Bay Area Bus. Council, Inc., 423 F.3d 627, 635 (7th Cir. 2005).

¹⁴⁵ *In re Cliffdale Assocs., Inc.*, 103 F.T.C. 110, 174 app. at 4 (1984) [hereinafter FTC Policy Statement on Deception] (Appendix titled “FTC Policy Statement on Deception”).

¹⁴⁶ *Id.* at 15–16.

¹⁴⁷ FTC v. IFC Credit Corp., 543 F. Supp. 2d 925, 941 (N.D. Ill. 2008) (observing that deception cases “usually involve advertisements made by the defendant to induce consumers into purchasing the defendant’s products or services” and giving as examples FTC v. Bay Area Bus. Council, Inc., 423 F.3d 627, 635 (7th Cir. 2005), which found that “defendants misled consumers with bad credit into believing they were buying credit cards when in fact they were buying worthless ‘ChexCards,’” and F.T.C. v. World Travel Vacation Brokers, Inc., 861 F.2d 1020, 1029 (7th Cir. 1988), which found that “defendants misrepresented the cost of vacation packages to Hawaii”).

¹⁴⁸ FTC Policy Statement on Deception, *supra* note 145, at 2–3.

¹⁴⁹ FTC v. Pharmtech Research, Inc., 576 F. Supp. 294 (D.D.C. 1983).

¹⁵⁰ *Id.* at 296.

¹⁵¹ *Id.* at 297.

deceptive within the meaning of the FTC Act because “they convey a misleading impression.”¹⁵² They implied that the study found that vegetable pills could reduce the risk of cancer when the study did not explicitly find that; in fact, the study specifically expressed doubts about whether processed vegetables could have the same salutary effects as fresh ones.¹⁵³

The Bureau might use this prong of its rulemaking power to require new disclosures on fringe banking products. For instance, the Bureau might require payday lenders to post information about how often borrowers rollover loans or how much an average loan costs a borrower in total, much like the requirement that credit card companies put information on credit card statements which discloses how long it would take to pay off the debt and how much money borrowers will spend in interest payments if they only make minimum monthly payments.¹⁵⁴

For the most part, such disclosure requirements will likely have little effect on fringe creditors. As discussed in Part III.A.ii, fringe credit contracts are relatively straightforward. Disclosure regimes are usually supported by mainstream fringe creditors, so such rules would probably not encounter significant opposition. However, some disclosure requirements may have unintended consequences. For instance, some states require rent-to-own stores to disclose APRs on rented goods. This requirement has resulted in rent-to-own firms exiting these states almost completely.¹⁵⁵ Thus, even in promulgating disclosure requirements, the Bureau may exercise its new power in a way to significantly limit the availability of alternative financial services to consumers.

iii. Abusive Acts or Practices

Few federal agencies have powers related to abusive acts or practices, so we have the least guidance when predicting what sorts of rules the Bureau may promulgate pursuant to this power.¹⁵⁶ The examples in current statutes empowering agencies to regulate abusive contracts have either been basically unused or do not parallel the Bureau’s power. For instance, the Federal Reserve has the power to find lending practices related to

¹⁵² *Id.* at 301.

¹⁵³ *Id.* at 302.

¹⁵⁴ 15 U.S.C. § 1637(b)(11) (2006).

¹⁵⁵ See Hawkins, *supra* note 50, at 2045.

¹⁵⁶ Michael A. Benoit, *The Birth of a New Financial Services Regulator*, BUS. L. TODAY (Nov. 22, 2010), <http://www.abanet.org/buslaw/blt/content/2010/11/article-benoit.shtml> (last visited Nov. 30, 2010) (“While we have years of jurisprudence from which providers may glean what acts or practices may be unfair or deceptive, the standard for ‘abusive’ practices is new and untested.”).

mortgage financing abusive.¹⁵⁷ The Federal Reserve, however, rarely exercises that power, leaving us with little understanding of the term.¹⁵⁸ Also, the FTC has the power to regulate abusive telemarketing acts or practices,¹⁵⁹ and it has promulgated regulations under this statute, but the regulations do not provide a meaningful parallel to the Bureau's power. The term "abusive" is not defined in the Telemarketing and Consumer Fraud and Abuse Prevention statute,¹⁶⁰ but the statute and regulations give examples of abusive acts,¹⁶¹ and courts have deemed some conduct abusive under the statute.¹⁶² Unfortunately, however, very little of the FTC's power in this area relates to credit,¹⁶³ so it is difficult to extrapolate what abusive means from the regulations in this statute.

This lack of current precedent has caused some observers to worry that the Bureau will have vast power to curtail consumer lending products. One recent article in the *American Banker*, for instance, quotes, among other concerned parties, the president of the Consumer Bankers Association, a partner with Morrison & Foerster LLP, a partner at Covington & Burling LLP, and a partner at Goodwin Procter saying that the power to create rules under the abusive standard is "egregious," allows the Bureau to

¹⁵⁷ 15 U.S.C. § 1639(l)(2)(B) (2006).

¹⁵⁸ Alexander, *supra* note 136, at 19–20 ("The Fed hesitantly declared only two practices as abusive: loan flipping and equity stripping The Fed's findings suggest that two threads run through both practices: consumer action is induced by a potential benefit that is suppose to run to him, and the action taken causes either no benefit or a detriment of the consumer. Such a definition was far too restrictive to carry out the Fed's mandate to address abusive practices. If anything, it serves as an example of a narrow definition that the CFPB should avoid.")

¹⁵⁹ 15 U.S.C. § 6102(a)(1) (2006) ("The Commission shall prescribe rules prohibiting deceptive telemarketing acts or practices and other abusive telemarketing acts or practices.")

¹⁶⁰ 15 U.S.C. § 6106 (2006).

¹⁶¹ 16 C.F.R. § 310.4(a)(1) (2010) (outlawing "[t]hreats, intimidation, or the use of profane or obscene language"); 16 C.F.R. § 310.4(c) (2010) ("Calling time restrictions. Without the prior consent of a person, it is an abusive telemarketing act or practice and a violation of this Rule for a telemarketer to engage in outbound telephone calls to a person's residence at any time other than between 8:00 a.m. and 9:00 p.m. local time at the called person's location.")

¹⁶² *FTC v. MacGregor*, 360 F. App'x 891, 894–95 (9th Cir. 2009) (holding that high volume of consumer complaints, high refund and return rates, and the number of investigations by state Attorney General was enough for the court to hold that there was a practice of engaging in abusive conduct); *The Broadcast Team, Inc. v. FTC.*, 429 F. Supp. 2d 1292 (M.D. Fla. 2006) (finding for-profit "telefunders" utilizing prerecorded calls to solicit funds on behalf of non-profit charities is abusive).

¹⁶³ The only regulation related to initiating credit relationships (and not debt settlement) is in section 310.4(a)(4) which states that it is abusive to "[r]equest[] or receive[] payment of any fee or consideration in advance of obtaining a loan or other extension of credit when the seller or telemarketer has guaranteed or represented a high likelihood of success in obtaining or arranging a loan or other extension of credit for a person." 16 C.F.R. § 310.4(a)(4).

pass any rule because the standard is “whatever the bureau director says it is,” and is likely impossible for businesses to comply with because “the term is so broad and the definition is so broad” and the standard is “very subjective.”¹⁶⁴

The language of the statute, however, suggests that the standard for abusive acts is, for the most part, very similar to the standard for deceptive acts and unfair acts.¹⁶⁵ Several of the bases the Bureau can use to determine an act is abusive relate to a consumer being deceived and misunderstanding a transaction: An act is abusive if it “materially interferes with the ability of a consumer to understand” or unreasonably takes advantage of a consumer’s lack of understanding of the material risks, costs, or conditions of the product or service.¹⁶⁶ Indeed, the requirements that the act “materially” interfere with the consumer’s ability to understand the transaction and that the consumer misunderstand the “material” risks of the product incorporate the court-created requirement that the deceptive act must be material to the transaction.¹⁶⁷

Similarly, the ability to declare an act abusive if the consumer cannot protect herself from harm contains almost the same language as the definition of an unfair act.¹⁶⁸ The major difference is that this part of the standard for abusive conduct does not require a “substantial injury” to the consumer, potentially opening up new rulemaking for acts that cause insubstantial injury. The standard does, however, require that the transaction unreasonably take advantage of the consumer who cannot protect herself, so the Bureau cannot declare all such acts abusive. Considering the fact the Bureau will not likely concern itself with acts that cause little harm, it is not clear that

¹⁶⁴ Cheyenne Hopkins, *New ‘Abusive’ Standard in Dodd-Frank Has Bankers Nervous*, AM. BANKER, Nov. 23, 2010, available at http://www.americanbanker.com/issues/175_225/dodd-frank-abusive-1028984-1.html.

¹⁶⁵ In contrast to my view here, Carey Alexander suggests the fact that “abusive” was added to “unfair and deceptive” means that they necessarily mean different things. See Alexander, *supra* note 136, at 4 (“Unfairness and deception have well-established meanings, and their inclusion alongside ‘abusive’ suggests that the new doctrine represents something unique and apart from the old doctrines.”).

¹⁶⁶ Dodd-Frank § 1031(d).

¹⁶⁷ FTC Policy Statement on Deception, *supra* note 145, at 4.

¹⁶⁸ Compare Dodd-Frank § 1031(c)(1) (stating the Bureau can only declare an act unfair if “the Bureau has a reasonable basis to conclude that . . . the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers . . . and such substantial injury is not outweighed by countervailing benefits to consumers or to competition”), with Dodd-Frank § 1031(d)(2)(B) (stating that the Bureau can define an act as abusive if it “takes unreasonable advantage of . . . the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service”).

the ability to declare acts abusive without substantial injury really gives the Bureau any new authority.

The only truly new part of the standard is the Bureau's ability to declare an act abusive if it "takes unreasonable advantage of . . . the reasonable reliance by the consumer on a covered person to act in the interests of the consumer."¹⁶⁹ One commentator has suggested that businesses will be able to protect themselves from problems under this part of the standard by disclosing to consumers that they should not rely on the business to protect their interests in the transaction.¹⁷⁰ Such statements have been effective to negate reliance under state consumer protection laws. In Texas, if a consumer signs a contract that states the consumer is purchasing a good or property "as is" and without reliance on the seller's representations, the consumer cannot claim that she relied on the seller's representations.¹⁷¹ The Texas Supreme Court explained in a seminal case that:

[The plaintiff's] 'as is' agreement negates his claim that any action by Prudential caused his injury. His contractual disavowal of reliance upon any representation by Prudential was an important element of their arm's-length transaction and is binding on Goldman unless set aside. The 'as is' agreement negates causation essential to recovery on all theories Goldman asserts¹⁷²

Thus, it is possible through effective disclosure that businesses will be able to avoid liability under this part of the abusive standard.

The fact that this prong requires the consumer's reliance be reasonable seems to again incorporate deception into this prong. In most commercial relationships, all parties assume that the other negotiates in such a way as to obtain the maximum benefit for itself under the transaction.¹⁷³ Thus, to create a situation in which a consumer reasonably relies on the business to act in the consumer's interest would seem to require that the business

¹⁶⁹ Dodd-Frank § 1031(d)(2)(C). See Benoit, *supra* note 156 ("There is, however, a new twist to this standard that has not been seen before. That is, this 'abusive' standard includes a fiduciary element unprecedented in the consumer lending industry, i.e., taking unreasonable advantage of the 'reasonable reliance by the consumer on a covered person to act in the consumer's interests.'").

¹⁷⁰ Benoit, *supra* note 156.

¹⁷¹ TEX. BUS. & COM. CODE ANN. § 17.42 (West 2009).

¹⁷² Prudential Ins. Co. of Am. v. Jefferson Assocs. Ltd., 896 S.W.2d 156, 161 (Tex. 1995). See also Larsen v. Carlene Langford & Assocs., 41 S.W.3d 245, 255 (Tex. App. 2001) (holding that an "as is" clause in a contract illustrated that the consumer did not rely on the seller's representations).

¹⁷³ See e.g., U.C.C. § 1-304 (2007) (requiring parties to use good faith in performing and enforcing contracts but not in negotiating them).

falsely communicate to the consumer that it will act in the consumer's interest.

Despite my analysis that the abusive power seems largely repetitive of the unfair and deceptive powers, the Bureau may construe the word very differently, as others have urged it to do.¹⁷⁴ As with the unfairness prong, the abusive prong of the Bureau's rule-making power enables it to potentially intervene into fringe credit markets in substantial, innovative ways.

D. Enforcement

Fringe banking firms will also likely be affected by enhanced enforcement of existing federal consumer protection laws. As Part III.D explains, current federal consumer law constrains fringe banking transactions. The Act increases the likelihood fringe lenders will pay penalties for violating these laws as well as any rules the Bureau creates because it gives the Bureau significant enforcement powers.

Under the Act, the Bureau can demand material and testimony if it suspects a violation of federal consumer protection law,¹⁷⁵ it can issue cease and desist orders,¹⁷⁶ and it can commence litigation against violators.¹⁷⁷ Although it cannot seek exemplary or punitive damages,¹⁷⁸ it can seek a variety of remedies, including rescission or reformation of contracts, restitution, payment of damages or other monetary relief, civil penalties, and the costs of pursuing the violator.¹⁷⁹ The civil penalties are severe. For violations without recklessness, "a civil penalty may not exceed \$5,000 for each day during which such violation or failure to pay continues," but "for any person that recklessly engages in a violation of a Federal consumer financial law, a civil penalty may not exceed \$25,000 for each day during which such violation continues."¹⁸⁰ If the person knowingly violates the law, "a civil penalty may not exceed \$1,000,000 for each day during which such violation continues."¹⁸¹

Perhaps even more threatening to fringe lenders is the increase in information the Bureau will have about businesses

¹⁷⁴ Alexander, *supra* note 136, at 20 ("Congress's enactment of a flexible definition of abusive, coupled with Congress's clear dissatisfaction with the Fed's narrow interpretation of its powers to reach abusive practices suggests that the CFPB should adopt a broad, expansive interpretation of its powers to address abusive practices.")

¹⁷⁵ Dodd-Frank § 1052.

¹⁷⁶ Dodd-Frank § 1053(b).

¹⁷⁷ Dodd-Frank § 1054(a).

¹⁷⁸ Dodd-Frank § 1055(a)(3).

¹⁷⁹ Dodd-Frank § 1055(a)(2)&(b).

¹⁸⁰ Dodd-Frank § 1055(c)(2).

¹⁸¹ *Id.*

violating federal consumer protection law. A primary function of the Bureau is “collecting, investigating, and responding to consumer complaints.”¹⁸² One mechanism the Bureau will have for learning about violations is a consumer hotline for complaints established by the Act.¹⁸³ In her work establishing the Bureau, Warren has pledged to use new technologies, such as crowdsourcing,¹⁸⁴ to enhance the amount of information that the Bureau gathers from consumers.¹⁸⁵ After gathering this information, the Bureau will establish procedures to “provide a timely response to consumers . . . to complaints against . . . a covered person . . .”¹⁸⁶ Both the powers to gather information and to act on that information give the Bureau the power to take definite action to affect fringe lenders who violate federal rules and statutes.

E. The Act’s Relation to State Law

New federal laws and rules governing the fringe economy add to an extensive, diverse array of existing state law. In light of the fact that most fringe banking regulations currently are based in state law, this section analyzes the relationship the Act has to that important body of law and demonstrates that the

¹⁸² Dodd-Frank § 1021(c)(2).

¹⁸³ Dodd-Frank § 1013(b)(3)(A).

¹⁸⁴ Crowdsourcing is “the act of a company or institution taking a function once performed by employees and outsourcing it to an undefined (and generally large) network of people in the form of an open call.” Jeff P. Howe, *Crowdsourcing: A Definition*, CROWDSOURCING (June 2, 2006, 10:30 AM), http://crowdsourcing.typepad.com/cs/2006/06/crowdsourcing_a.html. This alternative model of peer production allows for “companies to engage with and harness the crowd for help.” John Winsor, *Crowdsourcing: What It Means for Innovation*, BUS. WEEK, June 15, 2009, available at http://www.businessweek.com/innovate/content/jun2009/id20090615_946326.htm; Daryl Lim, *Beyond Microsoft: Intellectual Property, Peer Production and the Law’s Concern with Market Dominance*, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 291, 301–04 (2008).

¹⁸⁵ Eileen Ambrose, *Elizabeth Warren: Three Top Goals for New Consumer Protection Agency*, CONSUMING INTERESTS (Nov. 10, 2010, 2:22 PM), http://weblogs.baltimoresun.com/business/consuminginterests/blog/2010/11/elizabeth_warren_three_top_goa.html (noting that one of Warren’s top three priorities of the Bureau is “using technology to tap into the experience of millions of consumers so the bureau can develop a rapid response to problems”); Bill Swindell, *Warren Outlines Sweeping New Approach to Consumer Financial Protection*, NATIONAL J. (Oct. 26, 2010), <http://www.nationaljournal.com/daily/warren-outlines-sweeping-new-financial-protection-approach-20101026> (“In an interview on Tuesday with *National Journal*, Warren said new techniques like crowd-sourcing—scaled-up variations on Wikipedia—make it possible to collect valuable information from millions of ordinary consumers who report problems as they arise. Using new systems to organize and find patterns in all that information, Warren said, the bureau could be able to spot new enforcement targets in a matter of days—an unheard-of response time for traditional regulators Under her vision, Warren imagines a subset of Americans reporting on a specific problem, such as extraneous fine print included in a bank’s checking account statement, documenting it through use of a camera phone, and then emailing it to the bureau within seconds. The bureau would use such data to target its enforcement.”).

¹⁸⁶ Dodd-Frank § 1034(a).

Bureau will only add regulations to fringe credit markets, not take any away.

i. The Effect of Existing State Laws on Rulemaking

Several provisions in the Act suggest that the Bureau will be less involved in regulating industries that are already covered by extensive state regulation.¹⁸⁷ For instance, in determining how to supervise nondepository firms like fringe bankers, the Bureau will consider “the extent to which such institutions are subject to oversight by State authorities for consumer protection.”¹⁸⁸ Presumably, if transactions are heavily regulated by states, the Bureau will be disinclined to promulgate additional rules.

One problem the Bureau will encounter in following these provisions is the disparate approach states have taken to regulating fringe credit. As just one example, some states outlaw, either explicitly or implicitly, title lending,¹⁸⁹ while others permit it with virtually no restraints.¹⁹⁰ Thus, it is not entirely clear whether title loans are “subject to oversight by State authorities” because it depends entirely on the state. If the Bureau does not create rules on these sorts of transactions, then people in many states are left unprotected; if the Bureau does create rules, the rules may impose duplicative requirements on firms.

ii. Coordination

The Act attempts to mitigate the effects of duplicative requirements on businesses by requiring the Bureau to coordinate with state regulators. For instance, with the express goal of minimizing regulatory burden, the Bureau must coordinate its supervisory activities with state regulators, “including establishing their respective schedules for examining

¹⁸⁷ See, e.g., Dodd-Frank § 1022(b)(3) (instructing the Bureau to consider the extent of state regulation when determining if an industry should be exempt from its rules).

¹⁸⁸ Dodd-Frank § 1024(b)(2)(D).

¹⁸⁹ For an example of a state explicitly banning title lending, see LA. REV. STAT. ANN. § 37:1801(D) (2010). For an example of states that effectively ban title lending by capping interest rates at a level that prevents firms from operating in the state, see COLO. REV. STAT. § 5-2-201(2) (2010) (capping loans under \$1000 at 36% APR); VT. STAT. ANN. tit. 9, § 41a(4) (2010) (capping loans secured by vehicles at 20% APR).

¹⁹⁰ For instance, New Mexico sanctions small dollar loans and does not place a cap on the interest lenders can charge either in the small loan statute or general state law. See generally N.M. STAT. ANN. § 58-15-17 (2010). Section 56-8-3 sets out that interest rates in the state generally “in the absence of a written contract fixing a different rate, shall be not more than fifteen percent annually,” but it does not prevent the parties agreeing in a written contract to a higher interest rate. N.M. STAT. ANN. § 56-8-3 (2010). The end result is that title lenders have restrictions on the interest rate they can charge, and title borrowers have no specific protections beyond those afforded to borrowers generally in the Uniform Commercial Code.

persons . . . and requirements regarding reports to be submitted by such persons.”¹⁹¹ Additionally, in setting capital requirements for supervised nondepositories “the Bureau shall consult with State agencies regarding requirements or systems (including coordinated or combined systems for registration), where appropriate.”¹⁹² Finally, the Act mandates that the Bureau coordinate with states when setting up registration requirements for all business it monitors.¹⁹³ To the extent this coordination is successful, it will obviously reduce demands on fringe banking firms, but it is again questionable how the Bureau will be able to coordinate with states that have different requirements. While it might be simple to harmonize the federal requirements with a single state, it seems impossible to do so with several states that have different registration requirements, for example.

iii. Powers Given to State Governments

The Act actually confers some powers on state regulators. First, states can prompt the Bureau to consider proposing a rule if a majority of states enact a resolution supporting a rule.¹⁹⁴ Second, in addition to clarifying that states still have the authority to enforce their own consumer protection laws,¹⁹⁵ the Act empowers states to file suits in consultation with the Bureau¹⁹⁶ to enforce Bureau regulations,¹⁹⁷ except against national banks and federal savings associations.¹⁹⁸ These provisions should increase the potential that fringe banking businesses will face enforcement actions of the Bureau’s rules—even beyond the augmentation of general enforcement powers

¹⁹¹ Dodd-Frank § 1024(b)(3).

¹⁹² Dodd-Frank § 1024(b)(7)(D).

¹⁹³ Dodd-Frank § 1022(c)(7)(C).

¹⁹⁴ Dodd-Frank § 1041(c)(1) (“The Bureau shall issue a notice of proposed rulemaking whenever a majority of the States has enacted a resolution in support of the establishment or modification of a consumer protection regulation by the Bureau.”).

¹⁹⁵ Dodd-Frank § 1042(d)(1).

¹⁹⁶ Dodd-Frank § 1042(b).

¹⁹⁷ Dodd-Frank § 1042(a)(1) (“[T]he attorney general (or the equivalent thereof) of any State may bring a civil action . . . to enforce provisions of this title or regulations issued under this title, and to secure remedies under provisions of this title or remedies otherwise provided under other law. A State regulator may bring a civil action or other appropriate proceeding to enforce the provisions of this title or regulations issued under this title with respect to any entity that is State-chartered, incorporated, licensed, or otherwise authorized to do business under State law . . . and to secure remedies under provisions of this title or remedies otherwise provided under other provisions of law with respect to such an entity.”). States are limited from enforcing the Bureau’s rules against exempt merchants, just as the Bureau cannot enforce those rules. Dodd-Frank § 1027(a)(2)(E) (“To the extent that the Bureau may not exercise authority under this subsection with respect to a merchant, retailer, or seller of nonfinancial goods or services, no action by a State attorney general or State regulator with respect to a claim made under this title may be brought under subsection 1042(a) . . .”).

¹⁹⁸ Dodd-Frank § 1042(a)(2).

discussed above—because state attorneys general will have a new tool to combat what they perceive to be sharp practices.

iv. Preemption

The Act specifies that it does not relieve lenders from complying with applicable state laws. The statute asserts that state laws remain in effect “except to the extent that any such provision of law is inconsistent with the provisions of this title.”¹⁹⁹ State laws are not inconsistent with the Act if “the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title.”²⁰⁰

Several federal statutes contain language that is similar to the Act’s language permitting states to offer consumers greater protections.²⁰¹ In discussing these statutes, courts have used the requirement that states provide greater consumer protection to be a one-way ratchet to enforce state laws that offer heightened restrictions on businesses’ conduct; only laws that further restrict businesses are said to offer consumers greater protection.²⁰²

Having a federal law that regulates fringe banking but does not preempt state law is the worst-case scenario for fringe lenders because it involves an expansion of regulatory control over their activities. Many people in the fringe banking industry have pushed for federal laws, but their purpose in doing so is to prevent less favorable state laws from limiting their activities. For example, the rent-to-own industry trade association has

¹⁹⁹ Dodd-Frank § 1041(a)(1).

²⁰⁰ Dodd-Frank § 1041(a)(2).

²⁰¹ See 12 U.S.C. § 2616 (2006) (“The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.”); 15 U.S.C. § 1692n (2006) (“For purposes of this section, a State law is not inconsistent with this subchapter if the protection such law affords any consumer is greater than the protection provided by this subchapter.”); 15 U.S.C. § 1691d(f) (2006) (“The Board may not determine that any State law is inconsistent with any provision of this subchapter if the Board determines that such law gives greater protection to the applicant.”); 12 U.S.C. § 2805(a) (2006) (“The Board may not determine that any such law is inconsistent with any provision of this chapter if the Board determines that such law requires the maintenance of records with greater geographic or other detail than is required under this chapter, or that such law otherwise provides greater disclosure than is required under this chapter.”).

²⁰² See *Washington Mut. Bank, FA v. Superior Court*, 75 Cal. App. 4th 773, 783 (1999) (approving of a state law that offers consumers remedies beyond those given in federal laws); *Pirouzian v. SLM Corp.*, 396 F. Supp. 2d 1124, 1131 (S.D. Cal. 2005) (holding a federal law does not preempt a state law if the state law expands the coverage of the law against additional businesses); *Sibley v. Firstcollect, Inc.*, 913 F. Supp. 469, 473 (M.D. La. 1995) (approving of a state law that prohibits additional conduct beyond that prohibited by federal laws); *Desmond v. Phillips & Cohen Assocs., Ltd.*, 724 F. Supp. 2d 562, 567–68 (W.D. Pa. 2010) (upholding a state law that furthered the goals of a federal law).

supported a federal law on rent-to-own called the Consumer Rental Purchase Agreement Act.²⁰³ This law sets out a variety of rules for rent-to-own and even includes similar language to the Consumer Financial Protection Act regarding state laws that provide greater protection for consumers.²⁰⁴ But, the bill clarifies that no state law can regulate rent-to-own as a credit sale or require businesses to disclose interest rates.²⁰⁵ These two rules have historically been of overwhelming importance to rent-to-own companies,²⁰⁶ so the passage of the bill would be a major victory because it would prevent states from enacting these disfavored regulations. The new Consumer Financial Protection Act as written, however, does not bring this benefit, it only adds restrictions onto fringe lenders' conduct. As with the other substantive provisions on fringe banking, the sections discussing preemption reveal a profound new power the federal government now has to govern the fringe economy. The next part asks a more basic question: Is this power justified?

III. THE RATIONALES BEHIND THE BUREAU REGULATING FRINGE BANKING

As the previous two parts have indicated, it is difficult to predict what the Bureau will do when it begins promulgating rules and enforcing federal consumer protection laws. And, even if we knew exactly what it intended to do, it is impossible to understand all of the effects of the Bureau's conduct before those effects play out. Thus, the primary way to assess the Bureau's import before it begins significantly intervening in the fringe economy is to assess the rationales for the Bureau. As David Skeel points out:

We can't really know in advance whether these costs will materialize, of course. Moreover, the answer will depend on how the Consumer Bureau pursues its regulatory mandate, which will be different at different times in the Bureau's life. For now, the chief question is simply whether the new consumer champion is justified.²⁰⁷

This part takes up that inquiry.

²⁰³ Association of Progressive Rental Organizations, *RTO Legislative Activity—Why the Rent-to-Own Industry is Seeking Federal Legislation*, RTOHQ.COM, <http://www.rtohq.org/apro-seeking-the-support-of-congress.html> (last visited Mar. 22, 2011); Consumer Rental-Purchase Agreement Act of 2009, S. 738, 111th Cong. (2009) [hereinafter Consumer Rental Purchase Agreement Act] (the text of the bill as proposed by the Association of Progressive Rental Organizations is available at <http://www.rtohq.org/pdfs/RTOBillText.pdf>).

²⁰⁴ See Consumer Rental Purchase Agreement Act § 1018(a)(3).

²⁰⁵ Consumer Rental Purchase Agreement Act § 1018(b).

²⁰⁶ See Hawkins, *supra* note 50, at 2101–09.

²⁰⁷ SKEEL, *supra* note 98, at 113.

In order to assess the rationales offered for the Bureau regulating fringe credit, it is important to group different rationales into categories. This part categorizes the diverse reasons that popular press, government officials, and academics have proffered to justify the Bureau's control over fringe banking products. To describe the rationales, I draw primarily on two of Elizabeth Warren's articles proposing the Bureau.²⁰⁸ Although these two articles are not the only academic works advocating for the Bureau, they are significant because the President appointed Warren as a special advisor to oversee the creation of the Bureau²⁰⁹ and these two articles are widely considered the academic work that propelled the Bureau into existence.²¹⁰

To understand how prominent and significant these justifications were in public statements about the Bureau and its relationship to fringe banking, three research assistants and I read virtually every article that mentioned both the Bureau and fringe banking that was found in LexisNexis' "News, All" source from January 2007, before the Bureau was proposed, to May 21, 2010, the day the President signed the Act into law.²¹¹ This source draws from more than 4650 news outlets across the United States and a variety of countries. The search terms we entered generated 1520 results, and we reviewed 1496 of those results.²¹²

We assessed and coded each result to record: (1) the nature of the source (news article, editorial, or government publication);

²⁰⁸ Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY, Summer 2007, at 1; Bar-Gill & Warren, *supra* note 128.

²⁰⁹ Warren's Appointment Rankles GOP, CREDIT UNION J., Sep. 27, 2010, at 39.

²¹⁰ See SKEEL, *supra* note 98, at 50–51, 100 ("The agency had been conceived by Harvard law professor and TARP Oversight Committee head Elizabeth Warren, first in a short 2007 article whose title—"Unsafe at Any Rate"—consciously linked her to the Ralph Nader crusades of the 1960s, and then a more detailed, co-authored article a year later With a few exceptions, the legislative blueprint for the new Consumer Bureau reads as if it came straight from these two articles, as in many respects it did."); Michael Tomasky, *The Elizabeth Warren Story*, GUARDIAN (July 20, 2010, 21:05 BST), <http://www.guardian.co.uk/commentisfree/michaeltomasky/2010/jul/20/obama-administration-finreg-consumers-warren> (describing Warren's article in *Democracy* as the first call for an agency to oversee consumer financial protection).

²¹¹ We ran the following search: "(fringe-bank! or fringe-financial-service or alternative-financial-service or nonbank-lend! or payday-! or pawn! or rent-to-own or title-! or refund-anticipation-loans) and ((consumer-financial-protection w/3 bureau) or (consumer-financial-protection-agency))."

²¹² I say we read virtually every article that appeared in this database because during the time we performed the study (September 2010–November 2010), the number of results from the search jumped from 1520 to 1560 as additional articles were added. This change in the number of results combined with the fact multiple people were working on different sections of the result led to twenty-four results being coded twice and twenty-four not being coded at all. I eliminated the twenty-four results that were coded twice from the database because it only represented 1.5% of the total results. In the end, we reviewed 1496 stories instead of the 1520 that were originally generated by the search.

(2) the extent of the coverage (provides no coverage, merely mentions the Bureau and fringe banking, merely explains the law, or offers justifications for the Bureau regulating fringe banking); and (3) the justification, if any, offered for the Bureau governing fringe banking. The coding information was imputed into a custom-designed Microsoft Excel database. Each researcher underwent a training class and received detailed written coding protocols about how to code the results, and we met periodically to ensure we were uniformly carrying out the coding protocol. I reviewed each researcher's data to lessen the chance of a coding error.

Of the 1496 results we reviewed, 897 were unique articles, and 599 of the results repeated an earlier article verbatim. Of the 897 unique results, 539 were newspaper articles, 121 were newspaper editorials, and 237 were government documents. The government documents consisted of press releases from Congressmen and women and transcripts of hearings.

The majority of the results did not mention any arguments in favor of the Bureau regulating fringe banking. Twenty-one of the results were false positives—they were not actually about the Bureau and fringe banking. Five hundred ninety-eight of the results merely mentioned fringe banking and the Bureau or explained the Act, and thirty-eight of the results presented arguments against the Bureau regulating fringe banking. The remaining 240 results offered arguments for the Bureau regulating fringe lenders, either directly in the case of press releases, testimony at hearings, and editorials, or indirectly by reporting the views of others. For each result that coded a justification, the researcher pasted the text of the article related to the justification in a separate cell of the spreadsheet. Table 1 summarizes the results, which are discussed in more depth below:

TABLE 1

Prominence of Justifications for the Bureau Regulating Fringe Banking		
	Percent of Articles Discussing This Justification	Number of Articles Discussing This Justification ²¹³
Fringe Banking Relies on Deception	19%	46
Fringe Banking Is Too Costly	28%	68
Fringe Banking Causes Financial Distress	15%	35
Fringe Banking Is Unregulated	49%	118
Fringe Banking is Abusive or Predatory	55%	133

In addition to describing the rationales offered for the Bureau's power over fringe banking, this part evaluates whether these rationales can sensibly be applied to fringe credit products. Some of the justifications are plainly inapplicable to fringe banking transactions, while others accurately point out problems the Bureau could correct in fringe credit markets. One goal of this part is to focus regulators' attention on the real problems the Bureau could solve in fringe markets and urge the Bureau not to act to "fix" problems that evidence has not demonstrated exist in fringe credit industries.

A. Deception

A central focus of those justifying the Bureau has been the confusing and deceptive consumer credit contracts that borrowers face when borrowing money. Warren has introduced a catchy phrase to sum up the problem, "tricks and traps,"²¹⁴ that has been repeated over and over in the media.²¹⁵ Our study of news sources regarding the creation of the Bureau found that 19

²¹³ These numbers add up to more than 240 because some results had more than one justification in them.

²¹⁴ See Warren, *supra* note 208, at 9 ("Lenders have deliberately built tricks and traps into some credit products so they can ensnare families in a cycle of high-cost debt.").

²¹⁵ For instance, a search for "(tricks w/3 traps) and consumer-financial-protection" in LexisNexis' "News, All" source yielded 379 results on October 24, 2010.

percent (n=46) of the stories provided deception as a reason the Bureau should regulate fringe credit.²¹⁶ Some of the sources noted that payday loan documents are “incomprehensible”²¹⁷ and hide terms in fine print,²¹⁸ while others simply stated the Bureau will be able to prevent deceptive payday loans.²¹⁹ This section discusses the two ways supporters of the Bureau claim credit contracts are deceptive: the terms of the contracts themselves and the credit products’ designs.

i. Tricks and Traps in Contracts

First, consumer credit contracts themselves came under fire from those seeking to establish the Bureau. Warren’s first article proposing the Bureau emphasized how credit contracts have become extremely long and complicated in order to hide unfavorable terms:

Part of the problem is that disclosure has become a way to obfuscate rather than to inform. According to the *Wall Street Journal*, in the early 1980s, the typical credit card contract was a page long; by the early 2000s, that contract had grown to more than 30 pages of incomprehensible text. The additional terms were not designed to make life easier for the customer. Rather, they were designed in large part to add unexpected—and unreadable—terms that favor the card companies. Mortgage-loan documents, payday-loan papers, car-loan terms, and other lending products are often equally incomprehensible.²²⁰

The sheer length and complexity of the contract makes it prohibitively costly for borrowers to understand the terms of the transaction or compare different lenders’ terms.²²¹

Warren even uses a payday lending contract as an example of the sort of “devilishly complex financial undertakings” the

²¹⁶ We determined a result used deception as a justification for the Bureau regulating fringe credit if the result discussed (1) consumers being tricked in any way by the fringe bankers or (2) consumers making poor decisions when evaluating fringe banking products.

²¹⁷ Tomasky, *supra* note 210.

²¹⁸ Ronald D. Orol, *Why Washington Can't Agree on Consumer Protection*, MARKETWATCH (Mar. 4, 2010, 12:56 PM), <http://www.marketwatch.com/story/why-washington-cant-agree-on-consumer-protection-2010-03-04> (“A consumer agency could cap the interest rate that pay-day lenders charge and require these companies to disclose their fee structure that is often hidden in the fine print.”).

²¹⁹ See, e.g., Robert Weissman, *Congress Passes Financial Reform, Consumer Protections; Much More Must Be Done to Rein in Wall Street*, COMMONDREAMS.ORG (July 15, 2010, 4:53 PM), <http://www.commondreams.org/newswire/2010/07/15-22> (“This bureau will have the authority to crack down on unfair, deceptive and abusive practices in connection with consumer products such as payday loans, credit cards and mortgages by using new rules and enforcement powers.”).

²²⁰ Warren, *supra* note 208, at 11–12.

²²¹ Bar-Gill & Warren, *supra* note 128, at 13–14.

Bureau would police.²²² She claims that payday lenders hide “a staggering interest rate” in “the tangle of disclosures,” giving the example of one contract which only listed the interest rate in a page of disclosures and not on the fee page.²²³ In a subsequent article, Warren and her co-author, Oren Bar-Gill, point out that payday borrowers frequently know the finance charge for the loan but do not know the interest rate,²²⁴ presumably because it is hidden.

To evaluate whether this rationale is a persuasive basis for the Bureau regulating the fringe economy, I collected contracts from several different fringe banking transactions. Surveying the characteristics of these contracts casts serious doubt on the Bureau regulating fringe credit because of the opaque nature of its contracts.

The first contract I evaluated was a rent-to-own contract used by a regional rent-to-own company headquartered in the Midwest.²²⁵ Its rent-to-own agreement is two pages long, written in ten point font, and contains approximately 2000 words; 576 of those words relate to the mandatory arbitration clause. All of the costs of the transaction are written in a separate box near the top of the first page of the contract. There are several ways to evaluate the complexity of a writing, but under any of these standards, this contract seems basic. Consider the following paragraph which is written in a similar manner as the rest of the contract:

Reinstatement: If you fail to make a rental renewal payment by the renewal date, this Agreement terminates and we are entitled to the immediate return of our property. To reinstate, you must return the property to us as soon as we ask you to. Then, you can reinstate this agreement by making all payments due to us within 21 days of the renewal date if you pay weekly or within 90 days if you pay monthly. If you reinstate, we will provide you the same merchandise, or with substitute merchandise of comparable quality and conditions.

The reader can judge whether this term is comprehensible, but it seems like a significant stretch to call this contract “incomprehensible text.”

Similarly, Rent-A-Center, the nation’s largest rent-to-own company, has a contract that is two pages long, but unlike the first rent-to-own company’s contract, Rent-A-Center has a separate arbitration agreement in addition to these two pages. Like the

²²² Warren, *supra* note 208, at 10.

²²³ *Id.* at 13.

²²⁴ Bar-Gill & Warren, *supra* note 128, at 30.

²²⁵ In exchange for me using its contract, the company asked it not be identified in my paper.

other rental agreement I discussed, Rent-A-Center's agreement discloses all costs on the first page of the contract and is written at a similar level of complexity. Rent-A-Center is currently rewriting its rental agreement in New York because of recent changes in the law, and the General Counsel is explicitly attempting to write the contract at a seventh grade reading level.²²⁶

In addition to rent-to-own contracts, I secured a pawnshop contract from A Plus Pawn Shop, a stand-alone pawnshop located in Houston, Texas.²²⁷ A Plus' contract is a double sided, half-page document. The font of the text is small, around six point font, and the entire contract contains probably 1000 words. The back page of the contract has two dense paragraphs of text. The following is the entire second paragraph:

If you pay the loan we will return the property to you in the same condition we received it. If we lose your property or if it is damaged while in our possession, we will replace it with identical or similar property or similar property of the same kind and quality or have your property restored to its condition at the time it was deposited with us. All replacements are subject to approval by the Consumer Credit Commission. Any person who possesses this payment ticket may pay us the amount due and we must give that person the pledged goods if we have not been notified in writing that this ticket has been stolen. IF THIS TICKET IS LOST OR STOLEN, YOU MUST NOTIFY US IN WRITING TO PROTECT YOUR PLEDGED GOODS. Fee for lost ticket and statement.

The contract's front page has very little text, but instead is separated out into numerous boxes that state the amount financed, the finance charge, the APR, and a description of the pawned good, among other things.

The final contracts I obtained were from Speedy Cash, a payday lending company that originated in California and has over ninety locations.²²⁸ Speedy Cash has different payday loan contracts for each state in which it operates to comply with state regulations. The contract from Kansas is five pages long and has 4415 words.²²⁹ The Truth in Lending Act disclosures are on the first page of the contract and in separate boxes, with the APR and finance charges highlighted. The majority of the text is in ten point font, and most of it—2822 words—is an arbitration

²²⁶ Telephone Interview with Ron Demoss, General Counsel, Rent-A-Center, Nov. 13, 2010.

²²⁷ A+ PAWN SHOP, <http://apluspawnshop.com/> (last visited Mar. 22, 2011).

²²⁸ SPEEDY CASH, Store Locations, <http://www.speedycash.com/payday-loan-store/> (last visited Mar. 22, 2011).

²²⁹ I also reviewed the contract from California, which is similar to the Kansas contract.

agreement. One thousand three hundred twenty of the words of the contract are definitions and various terms.²³⁰ In addition to payday lending, Speedy Cash also does auto-title loans. Its auto-title loan documents are similar to its payday loan contracts but they have a single additional paragraph relating to the vehicle as collateral for the loan.²³¹

These contracts certainly appear different than the contract Warren refers to in her article in *Democracy* arguing for the need to regulate payday lending contracts.²³² Without a survey of every payday lender's contract in America, it is impossible to know the extent of the conduct Warren observed, or that I report here. But, my analysis of these fringe banking contracts reveals that Warren's observation is not ubiquitous in the payday lending industry or across fringe banking products, suggesting at least a need for more study to make the claim that payday lending contracts are misleading.

More to the point, the contract Warren discusses is already an illegal contract under the Truth in Lending Act (TILA). First, having an APR hidden in the contract violates the TILA provision requiring the APR to be more conspicuous than other disclosed terms.²³³ Additionally, an APR disclosure in a place other than the fee page does not follow the tabular format mandated by the TILA.²³⁴ Courts have already found at least one payday lender and one pawnshop to have violated this provision of TILA. In *Turner v. E-Z Check Cashing*, the payday lender's APR disclosure was even more conspicuous than the one Warren

²³⁰ The following paragraph is representative of the level of complexity:

Telephone Calls—Monitoring: You agree that if you are past due or in default, you will accept calls from us or a third party we have contracted with regarding the collection of your Account. You understand these calls could be automatically dialed and a recorded message may be played. You agree such calls will not be unsolicited calls for purposes of state and federal law. If you provide us with a wireless or cellular telephone number, you agree that we may place calls to that number which may result in charges from your wireless or cellular carrier. You also agree that, from time to time, we may monitor telephone conversations between you and us to assure the quality of our customer service.

²³¹ Rent-A-Center also provided me with its payday loan contract from Kansas. It is seven pages long and has similar font and contents to Speedy Cash. Like Speedy Cash, it also has the Truth in Lending Act disclosures prominently on the first page of the agreement.

²³² Warren, *supra* note 208, at 13 ("For example, buried in a page of disclosures for one lender (rather than on the fee page, where the customer might expect to see it) was the note that the interest rate on the offered loan was 485.450 percent.").

²³³ 15 U.S.C. § 1632(a) (2006) ("The terms 'annual percentage rate' and 'finance charge' shall be disclosed more conspicuously than other terms, data, or information provided in connection with a transaction, except information relating to the identity of the creditor.").

²³⁴ 15 U.S.C. § 1632(c).

reports because it was in a block of fee disclosures, but a court in Tennessee found it violated the TILA because “EZ’s disclosure document uses the same typesize, font, and boldness in listing the terms ‘annual percentage rate’ and ‘finance charge’ as it does in listing other terms, data, and information; thus these terms are no more conspicuous than others.”²³⁵ Similarly, in a case involving a contract very similar to the one Warren reports, the court held a pawn ticket violated the TILA because the term “APR” was “contained in the middle of a paragraph in the smallest print on the pawn ticket” and because “this section is similar in appearance to a section entitled ‘Customer Information’ and is less conspicuous than the section setting forth information on the vehicle used for collateral which is outlined in a box.”²³⁶

Thus, we cannot justify the Bureau because of a need for additional rules for fringe banking contracts because the contracts to which Warren objects are already illegal. It is possible the Bureau’s enforcement powers are needed to enforce the existing laws to a greater extent than other existing agencies have been able to do in hopes of eliminating illegal contracts from the market, but before reaching this conclusion, at least we need more evidence of how widespread confusing terms are used in fringe credit markets.

ii. Tricks and Traps in Product Design

Another basis for the Bureau regulating fringe banking is that fringe banking transactions are designed in a way to deceive borrowers. Bar-Gill and Warren make the argument that people taking out payday loans expect to pay them off in a short period of time, but they actually have to roll the loans over repeatedly.²³⁷ Borrowers are overly optimistic about the likelihood they will be able to pay off the loan, Bar-Gill and Warren contend, so they underestimate the cost of the loan and the risk of nonpayment.²³⁸

This rationale for regulating payday lending reflects some evidence of how people use payday loans. Studies report a significant number of people rollover their loans, ranging from the modal number of payday loans per year being one or two, an

²³⁵ Turner v. E-Z Check Cashing of Cookeville, TN, Inc., 35 F. Supp. 2d 1042, 1050 (M.D. Tenn. 1999).

²³⁶ Yazzie v. Ray Vicker’s Special Cars, Inc., 12 F. Supp. 2d 1230, 1233 (D.N.M. 1998).

²³⁷ Bar-Gill & Warren, *supra* note 128, at 55–56.

²³⁸ *Id.* See Karen E. Francis, Note, *Rollover*, *Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry*, 88 TEX. L. REV. 611, 612, 617–18 (2010).

estimate that is likely too low,²³⁹ to customers averaging 12.5 loans a year.²⁴⁰ Similarly, a study from Tennessee found that “25% [of active title loans in the state] had been renewed one (1) time and 49% were renewed between two and nine times. Fourteen percent (14%) renewed 10 or more times.”²⁴¹

Critical to proving that people are tricked into rolling over their loans at a higher rate than they intended to at the start of the transaction, however, is proof that people did not anticipate rolling over their loans when they took them out. A study from economists Marianne Bertrand and Adair Morse attempts to offer proof that people make mistakes when they take out payday loans, such as rolling over loans at a rate higher than they anticipate.²⁴² Bertrand and Morse provided four different types of information to different payday lending customers as they were taking out their loans.²⁴³ The information caused borrowers to borrow with reduced frequency than the control group, suggesting that the control group would have acted differently with more or better information about the loan product.²⁴⁴

The problem with this study, however, is that it does not offer any conclusions about why borrowers changed their behavior, so it fails to identify any specific cognitive defect that would cause people to rollover at a higher rate than anticipated.²⁴⁵ Also, Bertrand and Morse do not report whether people anticipated rolling over their loans at a rate lower than their actual rollover activity, so we still do not have a direct answer to the central empirical question: Do borrowers underestimate the likelihood they will rollover their payday loan? Finally, even if we did have evidence payday borrowers acted overly optimistically, this rationale is inapplicable to other forms of fringe credit, like rent-to-own leases, which do not have short-term contracts, and refund anticipation loans, which only involve a single loan based on tax refunds without the possibility of rolling over the principle.

²³⁹ FDIC SURVEY, *supra* note 1, at 31.

²⁴⁰ Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of “Payday” Loans in Military Towns*, 66 OHIO ST. L.J. 653, 663 (2005).

²⁴¹ TENN. DEP’T. OF FIN. INST., THE 2008 REPORT ON THE TITLE PLEDGE INDUSTRY 6 (2008).

²⁴² Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing* (Chicago Booth School of Bus., Working Paper No. 10-01, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1532213.

²⁴³ *Id.* at 11–13.

²⁴⁴ *Id.* at 33–35.

²⁴⁵ *Id.* at 9.

Despite these limitations, the case for intervening in payday lending markets because of mistakes people make about rollovers is slightly more persuasive than the case for deceptive contracts because at least some studies have documented high numbers of rollovers in payday lending markets.²⁴⁶ But, direct evidence of over optimism in payday lending markets simply does not exist at this point, so it is troubling to think that the Bureau would act on mere speculation about how borrowers use payday loans.

B. Cost

A second basis for the Bureau regulating fringe banking is the high cost involved in these transactions. Twenty-eight percent of the articles and documents we reviewed (n=68) that offered justifications for the Bureau regulating fringe credit cited the cost of fringe credit. Sources said things such as payday loans have “high,”²⁴⁷ “astronomical”²⁴⁸ and “outrageous” rates.²⁴⁹ Refund anticipation loans were claimed to be “high-cost”²⁵⁰ and involve “super-high-interest,”²⁵¹ and sources reported that rent-to-own and payday loans rates are so high they are surprising²⁵² and that fringe services are usurious.²⁵³ Some sources made the point just by stating the interest rate: “Exhibit A: payday loans and their just-as-evil twin, car title loans . . . [A] typical borrower will pay \$500 in interest on a \$300 loan.”²⁵⁴

²⁴⁶ See Graves & Peterson, *supra* note 240, at 663.

²⁴⁷ *Administration Takes Aim at Fine Print*, LEWISTON MORNING TRIBUNE (IDAHO), July 1, 2009, at 3A (“The agency would be dedicated to protecting consumers when buying mortgages, using credit cards and taking out high-rate ‘payday loans.’”).

²⁴⁸ Hector Becerra, *Payday Advance Lenders Targeted*, L.A. TIMES, Mar. 8, 2008, at B1.

²⁴⁹ President Barack Obama, Weekly Address: Time for Action on Financial Reform for the Economy, Mar. 20, 2010, available at <http://www.whitehouse.gov/the-press-office/weekly-address-president-obama-urges-action-financial-reform>.

²⁵⁰ *Predatory Lending and Reverse Redlining: Are Low-Income, Minority and Senior Borrowers Targets for Higher-Cost Loans?: Hearing Before the Joint Econ. Comm.*, 111th Cong. 13 (2009) (statement of Sarah Bloom Raskin, Comm’r of Fin. Regulation, State of Md.).

²⁵¹ Jon Green, *Proposal Offers Vital Consumer Protection*, HARTFORD COURANT (CONNECTICUT), Jan. 12, 2010, at A11.

²⁵² *Regulatory Restructuring: Enhancing Consumer Financial Products Regulation: Hearing Before the Comm. on Fin. Servs.*, 111th Cong. 48–49 (2009) (statement of Luis V. Gutierrez, H. Comm. on Fin. Servs., State of Ill.) (“So I just wanted to say to Professor Warren, Ms. Seidman, and others, I would like to put a floor on payday lending, a national one, so that at least we have some minimum standard. I would like for the remitters to have somebody nationally, you know a federal regulator, I would like to see people maybe not buy an \$800 TV and 3 years later pay \$2,400 for it, or people to kind of, I don’t know, escape to installment loans at 500 and 600 percent. Some people might be surprised that happens. It happens.”).

²⁵³ *Perspective and Proposals on the Community Reinvestment Act: Hearing Before the Subcomm. on Fin. Inst. and Consumer Credit of the Comm. on Fin. Servs.*, 111th Cong. 10 (2010) (statement of Cy Richardson, V.P. Hous. And Cmty. Dev.).

²⁵⁴ Elizabeth Palmberg, *Ground Rules: Troubled Assets on Main Street*, SOJOURNERS

Warren's work exhibits a general concern that trusting lenders can cause consumers to pay a high price.²⁵⁵ She points to payday lending specifically as a product with abusive pricing, citing several examples of individuals who paid a lot to service payday loans, and concluding, "In total, the cost to American families of payday lending is estimated to be \$4.2 billion a year"²⁵⁶ and "each year, predatory payday lending practices cost U.S. families \$3.4 billion in excess fees and charges."²⁵⁷ More significant than just pointing out the high cost of payday loans, however, is Warren's forecast that the Bureau would allow people to get short-term, small-dollar loans for lower costs.²⁵⁸ With the Bureau in place, Warren predicted, "An older person who needed a little cash to make it until her Social Security check arrived would have a manageable loan, not one that would escalate into thousands of dollars in fees."²⁵⁹

The claim that fringe financial services are very expensive is undeniably true. While there may be some debate about whether these high costs are justified,²⁶⁰ no one argues that fringe banking transactions involve low or even moderate cost products. Thus, if policymakers believe price alone is a reason to prevent credit transactions, this rationale represents a strong reason for the federal government to intervene in fringe credit markets.²⁶¹

Yet, despite the relevance of this justification for the Bureau's activity, it is difficult to see what the Bureau can do to affect the cost of fringe credit. The most significant barrier is the Act's provision preventing the Bureau from setting a usury limit: "No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law."²⁶² Indeed, some

MAGAZINE, Jul. 2009, at 12, 13.

²⁵⁵ Warren, *supra* note 208, at 9.

²⁵⁶ *Id.* at 13.

²⁵⁷ Bar-Gill & Warren, *supra* note 128, at 56–57; Warren, *supra* note 208.

²⁵⁸ Warren, *supra* note 208 at 19.

²⁵⁹ *Id.* at 19.

²⁶⁰ Compare Aaron Huckstep, *Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?*, 12 FORDHAM J. CORP. & FIN. L. 203, 230–31 (2007) (concluding payday lenders' profits are not highly profitable), with Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 571 (2010) ("While some scholars have questioned the profitability of the industry and the industry sometimes denies that its returns are excessive, the mere existence of such a large number of lenders belies the conclusion that these loans are not highly profitable.").

²⁶¹ I have argued elsewhere that high prices alone are a poor reason to regulate fringe credit. See Hawkins, *supra* note 50, at 2041.

²⁶² Dodd-Frank § 1024(o).

reports suggest this provision was added under pressure from payday lenders.²⁶³

While the Bureau may be able to limit some fees, such as late fees or fees for products bundled with loans like credit insurance, fringe bankers can easily reprice the loan with a higher interest rate to compensate for any lost revenue.²⁶⁴ There are many examples of businesses doing repricing, but one recent example from the Credit Card Accountability Responsibility and Disclosure Act of 2009 is illustrative.²⁶⁵ This act limits upfront fees for secured credit cards, a form of fringe credit lending, but in response at least one card issuer has dramatically increased the interest rate on its secured card to offset losses from lower fees.²⁶⁶ Thus, without being able to limit both pricing mechanisms, the Bureau may have trouble affecting the cost of fringe credit.

One way the Bureau may reduce the cost of credit to the poor is less direct. The Bureau is required to study mechanisms for encouraging people in the fringe economy to use mainstream financial services.²⁶⁷ It is possible the Bureau will be able to move some borrowers from fringe credit sources into mainstream credit sources that have lower costs. The FDIC has done a pilot program to encourage banks to supplant payday lenders,²⁶⁸ and the results are mixed, with payday lenders seeing the experiment

²⁶³ Timothy Noah, *Legal Usury*, SLATE (Oct. 5, 2010, 6:53 PM), <http://www.slate.com/id/2270044/> (“Indeed, one of the sketchier provisions in Dodd-Frank affirmatively *prohibits* Warren’s new agency from setting a maximum interest rate on payday loans. This was inserted at the behest of Senator Bob Corker, R-Tenn. (The payday-loan business was reportedly born in Corker’s home state and continues to thrive there.)”). Skeel, on the other hand, implies that credit card issuers were behind the ban on usury limits. SKEEL, *supra* note 98, at 109.

²⁶⁴ See generally Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAP. L. REV. 79 (2000) (discussing the market operations of credit card companies in the context of bankruptcy law).

²⁶⁵ 15 U.S.C. 1637 (2006).

²⁶⁶ Adam Levitin, *New Credit Card Tricks, Traps, and 79.9% APRs*, CREDIT SLIPS (Dec. 18, 2009, 3:48 PM), <http://www.creditslips.org/creditslips/2009/12/new-credit-card-tricks-traps-and-799-aprs.html> (last visited Mar. 22, 2011) (“Currently, a First Premier card bears a 9.9% purchase APR, a \$250 line of credit and at least \$256 in fees in the first year, \$179 of which are immediately applied. The \$256 is divided among four different fees. First Premier is apparently now using direct mailing offers to test a new product that conforms with the Credit CARD Act. This new card has \$75 in fees and a \$300 credit line, but a 79.9% purchase APR.”).

²⁶⁷ Dodd-Frank § 1013(d)(2)(C). See also Dodd-Frank § 1073(c) (mandating that other agencies regulating commercial banks and credit unions find ways to encourage people to move from the fringe economy to mainstream institutions).

²⁶⁸ See *Small-Dollar Loan Pilot Program*, FDIC, <http://www.fdic.gov/small-dollar-loans/> (last visited Mar. 22, 2011) (noting the program was “designed to illustrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products, such as payday loans”).

as a flop²⁶⁹ and consumer advocates judging the experiment to be a success.²⁷⁰ To the extent that the Bureau can lower the cost of credit by matching borrowers with less expensive alternatives, it will add significant value to the welfare of borrowers, but it will be a long time before we know if this feat is possible.

C. Financial Distress

The potential end result of high costs and deception—financial distress—is the third justification offered for the Bureau governing fringe credit. Fifteen percent of sources we found arguing for the Bureau to regulate fringe credit (n=35) asserted that fringe banking causes financial distress.²⁷¹ Sources described the effect fringe credit has on the entire economy, on individual borrowers who declare bankruptcy because of fringe credit, and on borrowers who are trapped in debt because of fringe credit. For instance, sources mentioned that payday lending, along with mortgages, “not only cause harm to individual consumers [but] can have a cumulative effect on our economy that is nothing short of devastating.”²⁷² Testimony to Congress stated that “[o]ne in two consumers who get payday loans default within the first year, and consumers who receive these loans are twice as likely to enter bankruptcy within two years as those who seek and are denied them.”²⁷³ Finally, numerous sources described payday loans as a debt trap.²⁷⁴

Warren also states plainly that payday lending causes people to experience financial ruin, noting examples of people hounded by payday lenders until they declare bankruptcy,²⁷⁵ and

²⁶⁹ See *FDIC Small Loan Program Doesn't Live up to the Hype*, PAYDAY PUNDIT (Aug. 12, 2008), <http://paydaypundit.org/2008/08/12/fdic-small-loan-program-doesnt-live-up-to-the-hype/> (arguing the program has been unsuccessful and the FDIC is “still trying to figure out how to make it work”).

²⁷⁰ See *FDIC's Small-Dollar Loan Pilot Shows Banks Can Offer Alternatives to High-Cost, Short-Term Credit for Small-Dollar Loans*, LOANSafe.ORG (June 24, 2010), <http://www.loansafe.org/fdics-small-dollar-loan-pilot-shows-banks-can-offer-alternatives-to-high-cost-short-term-credit-for-small-dollar-loans> (claiming the FDIC's program has been highly beneficial for both banks and consumers).

²⁷¹ We coded a source as claiming that the Bureau is justified in regulating fringe banking if it said fringe banking causes people to declare bankruptcy, causes people to suffer under unmanageable debt loads, causes people to lack the ability to make ends meet, or caused the current economic crisis.

²⁷² Green, *supra* note 251.

²⁷³ Consumer Federation of America Legislative Director Travis B. Plunkett Prepared Testimony Before the Senate Banking, Housing and Urban Affairs on Creating a Consumer Financial Protection Agency: A Cornerstone of America's New Economic Foundation, as Released by the Committee, July 15, 2009.

²⁷⁴ National Consumer Law Center Managing Attorney Lauren Saunders Testifies Before the House Financial Services Subcommittee—Final, FD (Fair Disclosure) Wire, July 16, 2009; *Local Voices*, CHI. TRIB., Dec. 2, 2009.

²⁷⁵ Warren, *supra* note 208, at 13.

explaining that payday loans with individuals can impose costs on third parties:

Credit cards, subprime mortgages, and payday loans can lead to financial distress, bankruptcy, and foreclosure. Economic losses can be imposed on innocent third parties, including neighbors of foreclosed property, and widespread economic instability may affect economic growth and job prospects for millions of families that never took on a risky financial instrument.²⁷⁶

Bankruptcy is an unlikely result for a consumer who simply pays a small fee, Bar-Gill and Warren note, but “[t]he problem lies with the substantial subset of consumers who take out multiple advances and pay the \$30 fee many times over.”²⁷⁷ Things will be different under the Bureau, Warren asserts, because “[r]ollovers that can turn a simple loan into a mountain of debt would stop.”²⁷⁸

I have argued at length in another article that this rationale for regulating fringe banking is flawed.²⁷⁹ Two major features of fringe transactions make it highly unlikely that they cause borrowers to become overindebted and experience financial distress. First, most forms of fringe credit are self-liquidating—if the borrower does not make payments on the loan, the lender sells the collateral and does not seek a deficiency from the borrower, so it is literally impossible to become overindebted because the borrower is not personally liable for the debt.²⁸⁰ Second, all forms of fringe credit involve people borrowing small amounts of principle. Unlike credit cards and mortgages, which can lead to significant amounts of debt, fringe credit transactions all involve very limited debt loads, so the effect of the transactions on the people using them and the economy as a whole is small, especially relative to other credit products.²⁸¹ Because of the dubious link between fringe banking and financial distress, the Bureau is on shaky ground regulating fringe credit on this basis.

D. Unregulated Markets

A fourth justification offered for the Bureau regulating fringe credit markets is the claim that these markets are currently

²⁷⁶ Bar-Gill & Warren, *supra* note 128, at 3.

²⁷⁷ *Id.* at 44.

²⁷⁸ Warren, *supra* note 208, at 19.

²⁷⁹ See generally Jim Hawkins, *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress*, 86 IND. L.J. (forthcoming 2011), available at http://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1649094_code600329.pdf?abstractid=1554768&mirid=5.

²⁸⁰ *Id.* (manuscript at 33–35).

²⁸¹ *Id.*

unregulated. In the results from our study of rationales for the Bureau governing fringe banking, we repeatedly found claims that fringe banking is currently unregulated. Forty-nine percent (n=118) of the results presenting arguments for the Bureau claimed that fringe banking transactions currently operate under little regulation.²⁸² Some sources contended that fringe lenders have escaped regulation entirely²⁸³ or that they operate in the Wild West of financial services with little oversight.²⁸⁴ Other sources noted the inconsistency in state regulations that left some consumers completely unprotected,²⁸⁵ and others asserted that no federal regulator governed fringe credit before the Bureau.²⁸⁶

Warren's foundational articles take a much more sophisticated position, although at times in making her argument, she seems to suggest that credit markets "follow a *caveat emptor* model."²⁸⁷ She points out that there are some state and federal regulations, but she posits that these regulations of credit products are insufficient because they are not structured to adapt to frequently changing credit markets²⁸⁸ and they are too diffuse—merely "a loose amalgam of common law, statutory prohibitions, and regulatory-agency oversight . . . structurally incapable of providing effective protection."²⁸⁹ These sorts of

²⁸² We coded sources as justifying the Bureau because fringe banking products are unregulated if the source said fringe transactions are unregulated either by state or the federal governments. We did not code the source as saying fringe credit is unregulated merely because the source stated something like "we need a new regulator or cop devoted to consumers." The source had to say affirmatively that fringe banking products have few regulations now.

²⁸³ Ronald D. Orol, *Why Washington Can't Agree on Consumer Protection*, MARKETWATCH (Mar. 4, 2010, 12:56 PM), <http://www.marketwatch.com/story/why-washington-cant-agree-on-consumer-protection-2010-03-04> ("They want the agency to cover a hodge-podge of financial companies that, so far, have escaped regulation of any sort. These include pay-day lenders, who offer high-risk, short-term cash loans to low-income individuals, the predatory rent-to-own industry, the mortgage modification consultants, and smaller state and local mortgage brokers, who originated many of the worst mortgages.").

²⁸⁴ *The Rachel Maddow Show* (MSNBC television broadcast Mar. 9, 2010) (Heather McGhee, Director, Washington Office of Demos, stated: "But at the consumer level, there's just a new Wild West situation out there where the banks, the payday lenders, the rent-to-own stores, the used auto dealers have just basically had very little oversight and they've profited from that regime").

²⁸⁵ *Regulatory Restructuring: Enhancing Consumer Financial Products Regulation: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 16 (2009) (statement of Ellen Seidman, Senior Fellow, New Am. Found.).

²⁸⁶ John Ydstie, *Overhaul Rules Stuck On Financial Protection Agency*, NATIONAL PUBLIC RADIO (Mar. 11, 2010), <http://www.npr.org/templates/story/story.php?storyId=124559223>.

²⁸⁷ Warren, *supra* note 208, at 14.

²⁸⁸ *Id.* at 9.

²⁸⁹ Bar-Gill & Warren, *supra* note 128, at 6. Another argument Warren makes to support the claim that credit markets are insufficiently regulated is that states lack the

arguments have been made by others as well, who point out that current federal regulation of credit markets fall to seven different regulators, none of whom have consumers as their central focus.²⁹⁰ Having divided missions resulted in agencies, like the Federal Reserve, neglecting consumer protection: “It never made sense to simply include consumer protection among the Fed’s other tasks, for instance, since the Fed’s primary concern is maintaining the stability of the banking system, which stands in considerable tension with consumer protection.”²⁹¹

The common claim that fringe banking operates in a regulatory vacuum is easy to dismiss as a faulty reason for the Bureau regulating fringe credit. In every state and under federal law, lending activity is subject to some general regulations, such as the Truth in Lending Act²⁹² or the state equivalent.²⁹³ Moreover, for many fringe credit transactions, state statutes aimed specifically at that type of transaction govern fringe credit.²⁹⁴

Warren’s claim that state and federal regulations are not effective at countering innovative creditor malfeasance is much more applicable to fringe banking markets. Many commentators have noted how adept fringe creditors are at avoiding restrictive regulations.²⁹⁵ The recent change in the payday lending law in Arizona provides an example. In Arizona, a specific statute enabled payday lenders to operate above the thirty-six percent usury cap in the state for ten years, but in 2010, that statute

power to set rate caps on credit products. See Warren, *supra* note 208, at 13–14. (“While states still play some role, particularly in the regulation of real-estate transactions, their primary tool—interest rate regulation—has been effectively destroyed by federal legislation. Today, any lender that gets a federal bank charter can locate its operations in a state with high usury rates (e.g., South Dakota or Delaware), then export that states’ interest rate caps (or no caps at all) to customers located all over the country. As a result, and with no public debate, interest rates have been effectively deregulated across the country, leaving the states powerless to act.”). This rationale is plainly inapplicable to fringe banking products. Numerous states have capped rates for payday loans, pawn loans, auto-title loans, and rent-to-own transactions. See Leah A. Plunkett et al., *Small Dollar Loan Products Scorecard—Updated*, NAT’L CONSUMER L. CTR. (May 2010), http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/cu-small-dollar-scorecard-2010.pdf.

²⁹⁰ Levitin, *supra* note 138, at 3.

²⁹¹ Skeel, *supra* note 98, at 15.

²⁹² 15 U.S.C. § 1601 et seq. (2006).

²⁹³ See, e.g., MASS. GEN. LAWS ch. 140D (2010).

²⁹⁴ Proof of this claim would result in an article-long footnote, but for a few examples, see LA. R.S. 37:1801(D) (2010) (“Under no circumstances shall the practice commonly referred to as motor vehicle ‘title only’ pawn transactions be allowed in this state.”); Martin, *supra* note 260, at 564 (noting payday lending is legal in only thirty-five states); ALA. CODE § 5-19A-3 (West 2010) (requiring pawn tickets to contain extensive amounts of information); OHIO REV. CODE ANN. § 1351.05(A) (West 2010) (requiring rent-to-own dealers to reinstate rental agreements even after default).

²⁹⁵ Johnson, *supra* note 31, at 18–21.

sunset, effectively making payday lending illegal.²⁹⁶ In response to the rate cap, some payday lenders are operating as they did before the sunset, but are now essentially offering payday loans disguised as auto-title loans, which remain legal in the state.²⁹⁷ Before the law even sunset, 200 payday lenders filed for licenses to operate as title lenders, and the Attorney General of Arizona believed that “a lot of people are [getting] ready by telling their customers to shift to auto-title loans, even if they don’t have a car.”²⁹⁸ Lenders can offer payday-like loans to customers with cars by extending the loan based on the person’s paycheck and taking a second-lien position on the car without ever intending to use the vehicle as collateral.²⁹⁹ If Arizona really intended to ban payday lending, it appears to have failed. To truly eliminate payday lending, the legislature will have to pass another law altering the title loan statute to prevent the conduct described here.

The Bureau, however, will be able to learn about and act on subterfuge more quickly than a legislative body. Instead of going through the complex steps to pass a law and have it approved by the executive branch, the Bureau will be able to make rules to clarify the consumer protection laws and rules it enforces. If the Arizona situation had happened under the Bureau’s watch, the Bureau could have drafted a rule that prevents lenders from taking a second lien position on the title loan or making a title loan to someone without a vehicle. Although the rulemaking process may take some time, the Bureau would be much more nimble and able to respond to problematic practices. Given the penchant some fringe creditors have shown for evading

²⁹⁶ Allison S. Woolston, Law & Policy Note, *Neither Borrower Nor Lender Be: The Future of Payday Lending in Arizona*, 52 ARIZ. L. REV. 853, 854–55 (2010).

²⁹⁷ A similar thing happened in Virginia when it banned payday lending. See Corey Clark, *States Put Brakes on Auto Title Lending*, STATE NET CAPITOL J., July 26, 2010, at 6 (“In fact, industry lobbyists and consumer groups in Arizona expect payday lenders to switch to car title lending as a result of the ban imposed on payday lending this past spring, because that’s exactly what has happened in Virginia since it restricted payday lending. ‘They moved to the car title model because they realized there were hardly any requirements,’ said Dana Wiggins of the Virginia Poverty Law Center, an advocacy group for low-income people that pushed for the payday lending restrictions. ‘It was kind of like a newfound treasure trove. You saw all of these folks who used to have payday loans were being moved into car title loans by payday lenders.’”).

²⁹⁸ Michelle Price, *Payday Lending Expires in Arizona, Officials Keeping an Eye on Loan Practices*, THE GAEA TIMES (June 29, 2010), <http://business.gaeatimes.com/2010/06/29/payday-lending-expires-in-arizona-officials-keeping-an-eye-on-loan-practices-74739/>.

²⁹⁹ Dale Quinn, *Industry Shifting to New Services as Payday Lending Becomes Illegal*, ARIZ. DAILY STAR, June 27, 2010, at A1 (“Auto-title loans should be given only to the owner of the vehicle being used as collateral. If a lender says ownership of the vehicle and its value are not important, the borrower should proceed with caution and consider contacting the Attorney General’s Office, said Goddard, who is running for governor.”).

regulation, the Bureau has an important opportunity to ensure lenders actually comply with federal regulations.

E. Predatory and Abusive Lending

Finally, our study recorded instances where results described fringe banking products as abusive, unfair, or predatory without any further explanation. Most sources, fifty-five percent (n=133), discussing justifications for the Bureau regulating fringe credit appealed to this rationale. The results decried fringe creditors as unscrupulous,³⁰⁰ rapacious,³⁰¹ notorious,³⁰² unconscionable,³⁰³ like crack,³⁰⁴ and the worst actors,³⁰⁵ along with simply abusive³⁰⁶ and predatory³⁰⁷. Warren almost completely avoids merely characterizing fringe banking as predatory without additional details.³⁰⁸

It appears that these statements, although common, do not assert separate bases for regulating fringe credit from those already discussed but instead operate as either simply vacuous attacks or summaries of other reasons for regulating fringe credit. Unless the Bureau acts with the least amount of

³⁰⁰ *Proposed Consumer Financial Protection Agency: Implications for Consumers and the FTC, Hearing Before the Subcomm. On Commerce, Trade, & Consumer Protection of the H. Comm. on Energy & Commerce*, 111th Cong. (2009) (statement of Michael Barr, Asst. Sec'y for Fin. Inst.) (“A wide range of credit products are offered—from payday loans to pawn shops, to auto loans and car title loans, many from large national chains—with little supervision or enforcement. Closely regulated credit unions and community banks with straightforward credit products struggle to compete with less scrupulous providers who appear to offer a good deal and then pull a switch on the consumer.”).

³⁰¹ Congresswoman Carolyn B. Maloney Holds a Hearing on the Economic Outlook, CQ Transcriptions, LLC, Apr. 14, 2010 (“Payday lenders, rent to own, debt collectors, these are some of the most rapacious people. They prey on the poor.”).

³⁰² Bill Swindell, *Payday Lenders Hope to Win Changes By Blaming Banks*, CONGRESSDAILY (May 4, 2010), <http://www.nationaljournal.com/member/daily/payday-lenders-hope-to-win-changes-by-blaming-banks-20100504> (subscription required).

³⁰³ David Lazarus, *Payday Lenders Pressure Borrowers to Get Political*, L.A. TIMES, May 7, 2010, at B1.

³⁰⁴ David Lazarus, *Payday Lenders Sink Loan Limits*, L.A. TIMES, May 21, 2010, at B1.

³⁰⁵ Sen. Richard J. Durbin (D-IL), *Durbin Statement on the Passage of Sweeping Wall Street Reform Bill* (July 15, 2010), <http://durbin.senate.gov/showRelease.cfm?releaseId=326420>; Victoria McGrane, *Dodd Moving Ahead with Reform*, POLITICO.COM (Jan. 15, 2010), <http://www.politico.com/news/stories/0110/31548.html>.

³⁰⁶ Mike Lillis, *Dodd (Alone) to Unveil Financial Reform Bill Monday*, WASHINGTON INDEPENDENT, Mar. 11, 2010, <https://washingtonindependent.com/78978/dodd-to-unveil-financial-reform-bill-monday>.

³⁰⁷ *Mind the Gap: Discriminatory Practices, Public Policies Foster Accelerating Wealth Disparity*, HOUSTON CHRONICLE, Jun. 3, 2010, at B8.

³⁰⁸ The only instance I found was Warren’s claim that the change in law protecting military personnel from payday lending “will protect military families from payday lenders, but it will leave all other families subject to the same predatory practices.” Warren, *supra* note 208, at 14. This assertion, however, is probably just a summary of the other arguments she had already made against payday loans and not a stand-alone point.

reflection, it is unlikely these blanket assertions will have any influence on its behavior. Because this category is merely a rehash of earlier rationales, I do not discuss it in further detail here.

CONCLUSION

This Article has argued that the Dodd-Frank Act gives the Bureau the power to intervene in a substantial way in fringe credit markets for the first time. The Consumer Financial Protection Bureau will amass a lot of information about how fringe creditors operate and about market failures in these industries. Moreover, it will have unprecedented power and resources to enforce and promulgate rules restricting fringe banking activities.

The justifications for the Bureau intervening in fringe credit markets are a very mixed lot—some plainly misunderstanding the nature of the markets, and others offering a real opportunity for the Bureau to improve the experience consumers have with these financial services. My fear is that the Bureau will regulate in view of the former instead of the latter. If the Bureau works to restrict fringe credit on the erroneous assumption that fringe credit contracts are deceptive or lead borrowers to financial distress, consumers may lose access to financial services that they desperately need and already understand. Or, in a less extreme scenario, the Bureau could focus its attention on reforming the form of the contracts and miss the opportunity to actively detect and police creditors evading existing laws.

The final part of this Article hopes to urge the Bureau to carefully consider its rationales for regulating fringe credit before undertaking studies, promulgating rules, or engaging in enforcement actions. By ensuring that it acts in response to problems that have been demonstrated with evidence, the Bureau can work to improve credit for those who have been excluded from mainstream financial services without jeopardizing the welfare-enhancing function fringe creditors can have.