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FEDERAL ACTION TO CURE STATE INACTION: PROTECTING CONSUMERS FROM THE PERILS OF PAYDAY LENDING

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I. INTRODUCTION

Imagine you are a person working paycheck to paycheck, yet, despite your hard work, your wage cannot cover a particular month's expenses. You have already exhausted your savings, and your poor credit prevents you from qualifying for more traditional loans. Then, you remember the myriad storefronts advertising "quick cash" near your home. You inform the clerk that you would like to take out the average loan of $325, confident that this amount will be sufficient to cover the month's deficits and convinced you can repay the $325 plus the $52 charge in two weeks' time. In accordance with the law, the clerk notifies you of the loan's annual percentage rate ("APR") of 417%, a rate that annualizes the accrued interest of the loan should you be unable to repay the principal and interest over the course of a year. Again, you assure yourself

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that you will be in a financial position in two weeks to pay the $377, so this shocking APR does not frighten you. As you fill out the necessary paperwork, you are thrilled when the clerk mentions that the establishment does not require a credit check but merely a proof of income. Relieved, you walk out cash in hand, ready to tackle this month's expenses. Yet, when two weeks elapse and the loan becomes due, you panic because you are in the same situation as before obtaining the loan. Money is still tight, and your limited budget does not allow for a lump payment of $377. So, unable to repay the loan, you passively allow the biweekly interest to accrue, doubting that you will have enough disposable income to make payments.

This unfortunate scenario is one that roughly 86% of the 12 million American borrowers experience yearly.[2] In fact, the data overwhelmingly suggests that the debt pit many payday loan borrowers fall into is not a one-time occurrence but rather a cyclical, recurring problem.[3] Considering that the average payday loan borrower earns roughly $30,000 per year and that 80% of payday loans are secured within two weeks of repayment of a prior payday loan, one can easily see that the issue is ongoing, incrementally worsening the position of the borrower over time.[4]

Part II of this note outlines the evolution of the American payday loan industry, noting the states' gradual shift away from rigid consumer-protective usury laws toward laissez-faire usury laws that do little to impede rampant, exorbitant APRs. Part III of this note explores the current state usury laws, highlighting states with particularly troubling policies and addressing state legislative attempts to correct such policies and the federal response. Lastly, Part IV proposes the enactment of a federal policy to protect consumers and ward off excessive interest rates for payday loans. Specifically, this proposed federal legislation would cap APRs at an affordable rate, mandate true transparency of fees and rates, and end the loopholes that allow payday lenders to skirt states' laws.

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[2] Hanneh Bareham, *Payday Loan Statistics*, BANKRATE (Feb. 3, 2023), https://www.bankrate.com/loans/personal-loans/payday-loan-statistics/.

See PEW CHARITABLE TRUSTS, PAYDAY LOAN FACTS AND THE CFPB'S IMPACT 1 (2016), https://www.pewtrusts.org/-/media/assets/2016/06/payday_loan_facts_and_the_cfpbs_impact.pdf.

[4] *Id.*

II. THE EVOLUTION OF THE USURY LAWS AND THE RISE OF PAYDAY LOANS

The concept of usury is not a novel one. Indeed, usury has long been criticized, and the moral stigma surrounding excessive interest rates dates back to ancient scriptures such as the Bible and Quran.[5] In America, these theological and moral aversions to usury manifested in the first usury law, enacted in 1641 by the Massachusetts Bay Colony.[6] Then, by the end of the 18th century, the other 12 colonies followed suit by enacting usury laws that capped interest rates between 5% to 8% per annum.[7] This trend of relatively low interest rates survived in the U.S. until the end of the 19th century when many Western states began amending their usury laws, with some raising the maximum interest rates to as much as 500% per annum.[8] These lenders, charging excessive interest rates and operating on the fringe of legality, became known infamously as "loan sharks."[9] Although the predatory "loan shark" industry initially boomed in the West, it nonetheless spread to the East despite many Eastern states' relatively rigid usury laws.[10]

By the beginning of the 20th century, consumers, legislators, and non-profit organizations were fed up with the states' deregulated, disjointed usury laws.[11] Consequently, in 1916, after decades of market research and lobbying, the Russell Sage Foundation, a prominent non-profit, crafted the Uniform

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[5] *See* Efraim Benmelech & Tobias J. Moskowitz, *The Political Economy of Financial Regulation: Evidence from U.S. State Usury Laws in the 19th Century*, 65 J. FIN. 1029, 1070-71 (2010).
[6] *Id.*
[7] Christopher L. Peterson, *Usury Laws, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1118 (2008).
[8] *Id.*
[9] CHARLES R. GEISST, LOAN SHARKS: THE BIRTH OF PREDATORY LENDING 3 (2017), https://www.brookings.edu/wp-content/uploads/2016/07/chapter-one_-loan-sharks-9780815729006.pdf.
[10] Anne Fleming, *The Borrower's Tale: A History of Poor Debtors in Lochner Era New York City*, 30 L. & HIST. REV. 1053, 1054-55 (2012).
[11] William J. Boyes, *In Defense of the Downtrodden: Usury Laws?*, 39 PUB. CHOICE 269, 271 (1982).

Small Loan Law ("USLL").[12] The USLL was a model law that sought to extinguish the loan shark practice by providing a uniform law requiring lenders to obtain state licenses and raising the maximum interest rates from 24% to 42% per annum.[13] The USLL theorized that by raising interest rates and scrupulously regulating the small loan market, lenders would be incentivized to compete with one another, thereby eliminating the demand for the higher-interest, crippling loans that loan sharks offered.[14] Despite the sizeable coalition amassed in opposition to markedly raising interest rates, 34 states ultimately enacted the USLL or some amended variation thereof by 1943.[15]

While the law achieved its goal of conquering the loan shark industry, several unintended, undesired outcomes emerged by the middle of the 20th century.[16] Indeed, given the wide variation of economic conditions among the states coupled with the different costs and sizes of small loans, the Russell Sage Foundation begrudgingly admitted that perhaps the USLL and its one-size-fits-all small loan model was not the most effective solution.[17] Instead, the Russell Sage Foundation proffered that localized economic variables necessitated localized small loan usury policies, allowing states to grapple with the issue in a manner more tailored to their unique economic conditions.[18]

Moreover, by the mid-20th century, the small loan landscape dramatically changed.[19] First, the department store boom ushered in installment purchasing, allowing consumers to pay for goods over time rather than in a lump sum.[20] Second, the inception of the Federal Deposit Insurance Corporation in 1933 alleviated pressure for large commercial banks to maintain large cash reserves, which allowed them to enter the sphere of

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[12] Elisabeth Anderson, *Experts, Ideas, and Policy Change: The Russell Sage Foundation and Small Loan Reform, 1909-1941*, 37 THEORY AND SOC'Y 271, 292 (2008).
[13] Peterson, *supra* note 7.
[14] *See id.*
[15] Anderson, *supra* note 12, at 300.
[16] *Id.* at 297.
[17] *Id.*
[18] *See id.*
[19] *See id.* at 298.
[20] *Id.*

the small loan market.[21] Although the USLL seemingly failed to unify state usury laws, most states nonetheless maintained some variation of USLL-era interest rates throughout the majority of the 20th century.[22]

However, in the back half of the 20th century, the fight against usury laws returned and, upon the decisions of a slew of federal cases, usury and banking laws changed dramatically.[23] For example, in *Marquette National Bank v. First of Omaha Service Corp.*, the Supreme Court essentially gutted the traditionally state-governed realm of usury laws[24] In *Marquette*, the Court ultimately decided that national banks are not beholden to the usury laws of the states in which they lend and should instead utilize the usury laws of the bank's home state; in essence, the *Marquette* Court carved out a massive loophole through which national banks could export their more lender-friendly usury laws across the states, circumventing the authority of state legislatures.[25] Decisions like that in *Marquette*, coupled with the crescendo of the "great inflation," sparked new debates over state usury laws, particularly as they applied to non-traditional non-depository institutions.[26] Indeed, these non-depository institutions were not affected by *Marquette* and its progeny and were instead still subject to traditional state usury laws.[27]

So, under mounting pressure from the lobbying efforts from non-depository institutions and usury critics, many states relaxed their usury laws significantly, thus allowing for the reemergence of the loan sharks that states exiled only decades earlier.[28] After many states paved the way for non-depository

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[21] *Id.*
[22] Peterson, *supra* note 7, at 1121.
[23] *A Short History of Payday Lending Law,* PEW CHARITABLE TRUSTS (July 18, 2012), https://www.pewtrusts.org/en/research-and-analysis/articles/2012/07/a-short-history-of-payday-lending-law; *see also* Marquette Nat'l Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978).
[24] *See Marquette*, 439 U.S. at 314-15.
[25] *Id.*
[26] Peterson, *supra* note 7, at 1123; *see also* Veronica Dagher, *The Inflation Survivors of the 1980s Have Some Advice for You*, WALL ST. J. (Feb. 18, 2022, 5:30 AM), https://www.wsj.com/articles/the-inflation-survivors-of-the-1980s-have-some-advice-for-you-11645180202.
[27] *A Short History of Payday Lending Law, supra* note 23.
[28] *Id.*

institutions like payday lenders in the early 1990s, the market for payday lending boomed, and the number of such lenders increased exponentially over the following decades.[29] By 2000, there were about 10,000 payday loan locations across the country; by 2006, that number jumped to 25,000 locations.[30]

The U.S. transformed from a nation innately skeptical and derisive of exorbitant interest rates into one that welcomed payday lending with open arms.[31] However, the U.S. has long championed the freedom to contract, a notion woven into the American fabric.[32] Therefore, the ever-controversial yet highly lucrative payday lending practice and the corresponding regulation thereof necessarily engender tension between small-loan reformers and pro-business advocates. Next, part III of this note will outline the modern framework of payday loans, noting how the aforementioned tensions manifested in the varying state and federal laws that govern the payday loan industry today.

III. PAYDAY LOANS TODAY AND THE LAWS THAT GOVERN THEM

Before discussing the various state and federal laws that regulate the payday lending industry to some degree, it is essential to understand what payday loans are, the processes through which one obtains and repays such loans, and the demographical data of payday loan consumers.

Simply stated, payday loans are "a short-term source of liquidity used by low- to moderate-income customers."[33] Today, the average payday loan across the states amounts to roughly $375.[34] Moreover, the average fee associated with a $375 loan is about $55 per two weeks.[35] To obtain the loan, consumers generally need not submit a credit check, a feature that entices consumers who cannot qualify for safer, more

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[29] Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q. J. ECON. 517, 524 (2011).
[30] *Id.*
[31] *See* Peterson, *supra* note 7.
[32] *See* Mark Pettit, Jr., *Freedom, Freedom of Contract, and the Rise and Fall*, 79 B.U.L. REV. 263, 354 (1999).
[33] Melzer, *supra* note 29, at 523.
[34] PEW CHARITABLE TRUSTS, *supra* note 3.
[35] *Id.*

traditional loans with banks.[36] Instead, all that is generally required is that consumers produce a pay stub or some proof of income.[37] Upon establishing proof of income, the consumer then issues a check to the payday lender, post-dated two weeks in advance, for the amount of the loan plus the associated fee.[38] Once the fourteen-day duration expires, the lender deposits the post-dated check, and, in theory, the borrower's debt is satisfied.[39] However, the data suggests that debt satisfaction after the initial fourteen days is uncommon.[40] Should the borrower lack sufficient funds in his or her bank account after the initial fourteen-day period, most payday lenders charge an insufficient funds fee plus an additional $55 fee.[41] This cycle of nonpayment perpetuates the fee every fourteen days, often resulting in outstanding balances far above the initial principal plus its theoretical one-time fee.[42] Further, in the mind of the cash-strapped consumer, the $55 fee, representing the simple 6.8% interest rate of the $375 principal, may seem feasible enough to repay.[43] However, the results are staggering when one annualizes that simple interest rate; in fact, the average APR on payday loans is 391%, a figure that should terrify potential borrowers.[44] However, a reported 80% of payday loans are taken out within two weeks of repaying another payday loan.[45] This statistic, along with the fact that nearly 70% of payday loan borrowers use these loans for recurring expenses, demonstrates that those who utilize payday loans are overwhelmingly repeat customers.[46]

So, who are these consumers utilizing payday loans? As mentioned previously, the data suggests that the average payday loan consumer has a household income of $30,000 or less.[47] Moreover, 52% of borrowers are between the ages of 25 and 44, suggesting that the debt trap of payday loans affects

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[36] *Id.*
[37] *Id.*
[38] Peterson, *supra* note 7, at 1123.
[39] *Id.*
[40] PEW CHARITABLE TRUSTS, *supra* note 3.
[41] *Id.*
[42] *See id.*
[43] *See id.*
[44] *Id.*
[45] Bareham, *supra* note 2.
[46] PEW CHARITABLE TRUSTS, *supra* note 3.
[47] Bareham, *supra* note 2.

consumers from a relatively early age.[48] Further, African Americans are 105% more likely to take out a payday loan than those of another race.[49] The above statistics demonstrate that low-income, relatively young consumers predominantly feel the financial hardships of high-interest payday loans. Therein lies the issue: payday lenders thrive by issuing high-interest loans to financially vulnerable consumers, often ensnaring such consumers into a cyclical debt trap.

So, how is the practice of payday lending different from the loan shark industry of the mid-20th century that so many in the U.S. vehemently opposed? The short answer: payday lenders and loan sharks operate almost synonymously. To eradicate loan sharks in the USLL era, the federal government made it illegal for lenders to receive an assignment of income from borrowers.[50] Though the law remains on the books today, payday lenders shirk the regulation with their clever post-dated check system.[51]

With a base knowledge of how payday loans operate and the underlying problems therefrom, it is necessary to observe the relevant governing federal and state laws.[52] First, one must dive into the realm of federal law to understand the lack of federal regulation. Next, one must observe the varying state laws to truly understand the modern regulatory landscape of payday lending, as states have dominated this regulatory function in the modern era of payday lending.[53] While this note does not intend to serve as a fifty-state survey of usury laws, it is essential to highlight the wide variation of payday loan treatment among the states. Indeed, five states have outright banned the practice of payday lending, others have capped interest rates sufficiently to stifle excessive profits for payday lenders, and numerous states have done very little to address the issue, allowing APRs to skyrocket.[54] For the sake of conciseness, this note will conduct a handful of case studies

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[48] *Id.*
[49] *Id.*
[50] 16 C.F.R. § 444.2 (2022).
[51] Peterson, *supra* note 7, at 1123.
[52] *See* Melzer, *supra* note 29.
[53] *See id.*
[54] Heather Morton, *Payday Lending State Statutes,* NAT'L CONF. OF STATE LEGIS. (Nov. 12, 2020), https://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.

focusing on different states that fall under the aforementioned categories of payday lending treatment.

a) THE FEDERAL RESPONSE (OR LACK THEREOF)

Since the demise of the USLL and its ultimate goal to unify state usury laws, federal lawmakers and regulators have generally done little to bridge the usury law gaps among the states.[55] Instead of attempting to usher in a politically dubious broad-sweeping federal usury law reform, the federal government has pulled its punches, enacting smaller consumer protective measures over the years.[56]

1) TRUTH-IN-LENDING ACT

Although the payday lending boom did not truly occur until the end of the 20th century, the payday lending industry was nonetheless regulated under the Truth-in-Lending Act ("TILA"), which Congress first enacted in 1965, then referred to as the Consumer Credit Protection Act.[57] The purpose of the act was:

> [t]o safeguard the consumer in connection with the utilization of credit by requiring full disclosure of the terms and conditions of finance charges in credit transactions or in offers to extend credit; by restricting the garnishment of wages; and by creating the National Commission on Consumer Finance to study and make recommendations on the need for further regulation of the consumer finance industry; and for other purposes.[58]

Moreover, the legislation posits that "economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit."[59] In essence, this statute sought to protect consumers by mandating that lenders offer clear, digestible financial information about loans. In other words, the statute did nothing to regulate the actual terms of loans that lenders provided; it merely required lenders to disclose the

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[55] *A Short History of Payday Lending Law, supra* note 23.
[56] *Id.*
[57] Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146.
[58] *Id.*
[59] 15 U.S.C.S § 1601 (LEXIS through Pub. L. No. 117-214).

terms of the loans fully and clearly. Although payday lenders fought the contention that they were "engaged in the extension of credit," the Federal Reserve Board's Official Staff Commentary settled the debate once and for all in 2000, when it explicitly stated that payday lenders must abide by the disclosure requirements of TILA.[60] While TILA and its amendments generally forced payday lenders to refrain from the opacity that was rampant in the loan shark era, it did little to address the underlying financial problems inherent in payday lending.

2) FEDERAL CREDIT RESTRICTIONS WITH SERVICEMEMBERS

After recognizing a systemic revolving door of payday loan debt amongst military service members, military officials attempted to lobby state lawmakers for usury law reform at the state level.[61] Once these efforts proved unfruitful, the military officials shifted their efforts toward Congress.[62] Consequently, in 2006, Congress enacted legislation designed to protect servicemembers from the perils of payday loans.[63] The John Warner National Defense Authorization Act, commonly referred to as the Military Lending Act, prohibited payday lenders, among other creditors, from imposing an APR of greater than 36% on servicemembers or their dependents.[64] Although the protection only extended to servicemembers, the measure represented a dramatic exercise of federal authority; indeed, the legislation preempted the various state usury laws, affording servicemembers heightened consumer credit protection.[65]

Following the implementation of the APR cap, payday lending to servicemembers decreased in a dramatic fashion

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[60] Truth in Lending, 65 Fed. Reg. 17,129 (Mar. 31, 2000) (to be codified at 12 C.F.R. pt. 226).

[61] Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH & LEE L. REV. 649, 661 (2012).

[62] *Id.*

[63] John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2083.

[64] *Id.*

[65] Johnson, *supra* note 61, at 663.

across the country.[66] This marked shift away from payday loans was largely due to the fact that, with a capped APR of 36%, servicemembers were no longer viewed as profitable consumers to payday lenders.[67] Additionally, various banks, credit unions, and non-profits began offering low-interest small loans to servicemembers to fill the void left by payday lenders.[68] This response and the expanded access to low-interest loans dispelled fears that heavy regulation of payday lending would result in a lack of access to small loans.[69] Not only did access to small loans increase, but the loans boasted APRs well below the federal ceiling of 36%.[70] Although this legislation only affected a minute subsect of credit consumers, it nonetheless represents a success story in the short history of federal action aimed at usurious payday loans.

3) THE CONSUMER FINANCIAL PROTECTION BUREAU: REFORM OF FALSE HOPE?

By 2009, the banking industry and its problematic mismanagement of mortgages resulted in a $9.8 trillion loss in wealth to American citizens.[71] After the Great Recession wreaked havoc on credit consumers, there was a strong political demand for increased transparency and accountability across the credit markets.[72] This demand resulted in the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), a broad-sweeping legislation enacted to provide more robust financial regulation for various

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[66] *Id.*
[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] *Id.* at 665.
[71] Renae Merle, *A Guide to the Financial Crisis – 10 Years Later*, WASH. POST (Sept. 10, 2018, 1:47 PM), https://www.washingtonpost.com/business/economy/a-guide-to-the-financial-crisis--10-years-later/2018/09/10/114b76ba-af10-11e8-a20b-5f4f84429666_story.html.
[72] Elizabeth Warren, *Pro-business Supreme Court Shouldn't Defang Consumer Financial Protection Bureau: Elizabeth Warren*, USA TODAY (Mar. 3, 2020, 8:45 AM), https://www.usatoday.com/story/opinion/2020/03/03/elizabeth-warren-consumer-financial-protection-bureau-supreme-court-column/4930846002/.

market participants.[73] Significantly, the Dodd-Frank Act established the Consumer Financial Protection Bureau ("CFPB"), a regulatory watchdog designed to "implement and, where applicable, enforce Federal consumer financial law consistently to ensure that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[74] To effectuate this purpose, Congress equipped the CFPB with authority to issue "rules, orders, and guidance implementing Federal consumer financial law."[75] Before the CFPB determines a consumer financial product or service to be unfair, deceptive, or abusive, and thus unlawful, it must first demonstrate that the product or service in question meets all of the following criteria: (1) the act or practice is likely to or does cause substantial injury to the consumer; (2) the consumer has no reasonable way of avoiding the substantial injury; and (3) the countervailing benefits to consumers and competition do not outweigh the substantial injury.[76]

The formation of the CFPB was groundbreaking in the consumer finance sector, as federal consumer financial regulation was previously fragmented; the older, more dysfunctional structure of regulation included various agencies, all of which held overlapping authority to make rules, supervise, and enforce.[77] Among those financial institutions falling under the vast authority of the newly minted CFPB were "fringe bankers" like payday lenders.[78]

Considering Congress equipped the CFPB with a rather extensive regulatory arsenal with which to oversee the consumer credit markets, the CFPB made a strong showing of authority in its infancy.[79] By 2015, the CFPB won all 122 lawsuits

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[73] David S. Huntington, *Summary of Dodd-Frank Financial Regulation Legislation*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (July 7, 2010), https://corpgov.law.harvard.edu/2010/07/07/summary-of-dodd-frank-financial-regulation-legislation/.
[74] 12 U.S.C.S. § 5511(a) (LEXIS through Pub. L. No. 117-214).
[75] 12 U.S.C.S. § 5511(c)(5) (LEXIS through Pub. L. No. 117-214).
[76] 12 U.S.C.S. § 5511(c)(1) (LEXIS through Pub. L. No. 117-214).
[77] Christopher L. Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review*, 90 TUL. L. REV. 1057, 1066 (2016).
[78] *Id.*
[79] *Id.* at 1087.

it brought against various financial products.[80] However, it is worth noting that much of the CFPB's early success was against mainstream financial products like mortgages, credit cards, and debt collection practices.[81] In fact, the CFPB only tried 12 cases against payday lenders in this period, a seemingly low number of cases given that payday loans disproportionately affect low-income American consumers in contrast to mainstream financial products.[82]

While the CFPB did slap the wrist of the payday lending industry by trying some of the more egregious cases, it has hardly utilized its rulemaking authority to address payday lending.[83] For example, in 2017, the CFPB issued a final rule with its sights set on the payday loan industry.[84] The first prong of the rule required payday lenders to adhere to the standard underwriting provisions that other, more mainstream financial institutions must abide by.[85] Essentially, this prong mandated that payday lenders must reasonably determine that consumers have the ability to repay a given loan under its terms; if the payday lender failed to do so, it was deemed an unfair and abusive practice and was thus subject to penalty.[86] The second prong of the rule stated that "it is an unfair and abusive practice to withdraw payment from a consumer's account after two consecutive payment attempts have failed."[87] Taken together, these rules were not earth-shattering to the payday loan industry, but they provided a solid first step in genuinely protecting consumers. Yet, by 2020, the CFPB revoked the rule "based on its re-evaluation of the legal and evidentiary bases."[88]

Given the CFPB's timid discretion in exercising its rulemaking powers, it may be inferred that the CFPB has thus far been largely reactionary rather than proactive in its efforts to protect consumers. Although the CFPB has broad authority

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[80] *Id.*
[81] *Id*. at 1086-88.
[82] *Id.* at 1105.
[83] *See Payday Loan Protections,* CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/payday-rule/ (last visited Nov. 16, 2022).
[84] *Id.*
[85] *Id.*
[86] *Id.*
[87] *Id.*
[88] *Id.*

to act, incessant attempts to render the organization either unconstitutional or virtually toothless nonetheless hinder it.[89]

b) THE STATES' RESPONSE

1) ARKANSAS

The analysis of state usury laws necessarily begins with Arkansas, heralded as the most consumer-protective state in the U.S.[90] Arkansas is the only state with usury limits firmly included in its state constitution.[91] Specifically, concerning loans issued by non-depository institutions like payday lenders "shall not exceed seventeen percent (17%) per annum," as stated in the constitution.[92] Although state legislators attempted to circumvent this constitutional amendment with legislation aimed at easing restrictions on payday lenders, the Arkansas Supreme Court stood firm, holding that such attempts were unconstitutional.[93] Prior to this judicial fight, and despite Arkansas' constitutional interest rate caps, payday lenders defied the state laws by offering loans well above the 17% per annum.[94] However, after the Arkansas Supreme Court struck down payday loans with APRs exceeding 17%, the 275 payday lending storefronts closed their doors; by 2009, there were no

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[89] Johnson, *supra* note 61, at 689-90; *see also* Pratin Vallabhaneni, *US Supreme Court Rules CFPB's Leadership is Unconstitutional but Leaves CFPB Intact*, WHITE & CASE (July 8, 2020), https://www.whitecase.com/insight-alert/us-supreme-court-rules-cfpbs-leadership-structure-unconstitutional-leaves-cfpb-intact.

[90] *See* SUSANNA MONTEZEMOLO, THE STATE OF LENDING IN AMERICA & ITS IMPACT ON U.S. HOUSEHOLDS 14 (2013), https://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf.

[91] Garry S. Wann & Christi R. Wann, *The History of Payday Lending in Arkansas*, 12 J. ACAD. BUS. & ECON. 167, 167-68 (2012); Ark. Const. of 1874 amend. LXXXIX, § 3.

[92] Ark. Const. of 1874 amend. LXXXIX, § 3.

[93] Wann & Wann, *supra* note 91, at 174.

[94] MEREDITH COVINGTON & JENNIFER JOHNSON, INTO THE LIGHT: A SURVEY OF ARKANSAS BORROWERS SEVEN YEARS AFTER STATE SUPREME COURT BANS USURIOUS PAYDAY LENDING RATES 3 (2016), https://banksouthern.com/wp-content/uploads/2016/06/sbcp_policy-points-vol-43-payday-lending_20160628.pdf.

such payday lending storefronts in Arkansas.[95]

With a stricter, more closely regulated consumer credit market in Arkansas, payday lenders suffered a similar experience to that found in the aftermath of the federal ban on imposing APRs exceeding 36% to servicemembers.[96] Arkansas residents, shielded by the APR cap, were no longer profitable enough to justify in-state storefronts.[97] Although Arkansas seemingly succeeded in exiling payday lenders within the borders of its state, payday lenders adapted.[98] Indeed, Payday lenders rebranded themselves as Credit Service Organizations ("CSO"), which do not directly offer or originate loans; instead, these CSOs act as brokers for out-of-state loan providers, charging similar fees that a payday lender would offer.[99]

Moreover, with the effective expulsion of payday lenders, Arkansas residents experienced a lack of availability in credit.[100] Specifically, those consumers with no credit history or poor credit history no longer had access to small loans, considering that traditional lending institutions like banks could not offer a comparable small loan to such high-risk consumers.[101] Overall, to refer to Arkansas' consumer protection as a "success" would be an overstatement. Yes, reducing the number of payday lending storefronts to zero certainly reduced the volume of payday loans, but it did not eliminate them altogether. Moreover, the strict APR cap had unintended consequences for consumers and traditional lenders.

2) COLORADO

Instead of capping APRs at a dramatically lower rate, as seen in Arkansas, Colorado legislators took a different, perhaps more-tailored approach to combat payday lending within their

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[95] *Id.*
[96] SUSAN WESSON, A COST-BENEFIT ANALYSIS OF THE ARKANSAS USURY LAW AND ITS EFFECTS ON ARKANSAS RESIDENTS AND INSTITUTIONS (2000), https://hsu.edu/uploads/pages/2000-1afa_cost.pdf.
[97] *Id.*
[98] *Id.*
[99] *Push and Pull for Payday Lenders,* ARK. ADVOC. FOR CHILD. & FAMILIES (Mar. 10, 2017, 12:31 PM), https://www.aradvocates.org/push-and-pull-for-payday-lenders/.
[100] WESSON, *supra* note 96.
[101] *Id.*

state.[102] In 2010, Colorado passed the Deferred Deposit Loan Act, which entailed a multi-faceted assault on payday lenders and other non-depository institutions.[103] Colorado capped APRs on payday loans at 36% while simultaneously limiting a consumer's maximum loan amount to $500.[104] While virtually every state restricts the maximum amount lenders can offer to a given consumer, Colorado's law only allows small-loan consumers to secure $500 of loans *in the aggregate*.[105] This limitation essentially means that if a consumer takes out a $300 payday loan with one lender, any other lender could only issue $200 in loans. Moreover, while the traditional payday loan term is two weeks, Colorado extended the minimum loan term to six weeks.[106]

By 2016, the CFPB compiled enough data to analyze the effects of Colorado's law.[107] Consumers saved nearly $40 million on payday loans compared to years prior.[108] Moreover, about 75% of consumers paid back their loans early due to the extended six-week loan term, mostly avoiding the exorbitant fees associated with missing timely payments.[109] However, while the average consumer ended up paying less per loan, it is worth noting that payday lenders' new pricing strategy in Colorado seeks to offset losses in the face of stricter regulation.[110] To recover the losses experienced from smaller margins on lowered interest rates, payday lenders adapted yet again by raising their fees significantly.[111] So, while Colorado consumers are paying less on payday loans in the aggregate, the 36% APR coupled with higher fees stifles dramatic reform.

3) UTAH

Since the payday lending boom around the turn of the century, Utah has consistently been among the friendliest states

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[102] Nathalie Martin, *Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap*, 259 N. ILL. U. L. REV. 281, 304 (2014).
[103] COLO. REV. STAT. §§ 5-3.1-101 to 5-3.1-123.
[104] COLO. REV. STAT. §§ 5-3.1-105.
[105] COLO. REV. STAT. §§ 5-3.1-106.
[106] COLO. REV. STAT. §§ 5-3.1-103.
[107] PEW CHARITABLE TRUSTS, *supra* note 3.
[108] *Id.*
[109] *Id.*
[110] Martin, *supra* note 102, at 282.
[111] *Id.*

to payday lenders.[112] This assertion is unsurprising, considering Utah's statutory emphasis on contractual freedom.[113] For example, instead of capping interest rates, Utah law dictates that "the parties to a consumer credit agreement may contract for payment by the debtor of any finance charge and other charges and fees."[114] In addition, although Utah law restricts the term of the loan and the period of accruable interest to twelve weeks, it prescribes no APR limits nor a maximum loan amount.[115] Perhaps the only significant statutory safeguard provided to consumers is the doctrine of unconscionability.[116] Essentially, because Utah allows lenders and consumers to "negotiate" freely, Utah courts will generally uphold consumer credit agreements unless "the court finds the agreement or any part of the agreement to have been unconscionable at the time it was made."[117] In addition to unconscionability, Utah requires lenders to comply with relatively stringent disclosure regulations, requirements that go above and beyond those mandated by TILA.[118]

Utah's laissez-faire approach to consumer protection certainly incentivizes payday lenders to operate in the state. With very few regulatory impediments, the average payday loan APR has soared to about 652%.[119] While there is little published data revealing the statistics of the payday loan industry in Utah, there are nonetheless several critical implications worth discussing. First, due to Utah's relaxed laws on payday lending, fierce competition in the industry spurred consolidation among the dominant payday lenders in the state.[120] This consolidation, together with a relatively strong

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112 *See* Christopher L. Peterson, *Only Until Payday: A Primer on Utah's Growing Deferred Deposit Loan Industry*, 15 UTAH BAR J. 16, 17 (2002).
113 UTAH CODE ANN. § 70C-2-101.
114 *Id.*
115 UTAH CODE ANN. § 7-23-105.
116 UTAH CODE ANN. § 70C-7-106.
117 *Id.*
118 UTAH CODE ANN. § 7-23-105.
119 Lee Davidson, *Utah's Payday Loan Rates are 2nd Highest in America*, SALT LAKE TRIB. (Feb. 19, 2021, 5:56 PM), https://www.sltrib.com/news/politics/2021/02/18/utahs-payday-loan-rates/.
120 Lee Davidson, *Utah's Payday Lenders Hit Hard Times – 25% of Stores Close in 3 Years*, SALT LAKE TRIB. (Oct. 21, 2019, 2:36 PM),

Utah economy, forced many payday lenders out of business; in fact, 25% of payday lending storefronts closed between 2016 and 2019.[121] Regardless of the minor setback by the payday lending industry, it remained an active and dominant player in the consumer credit market in Utah.[122] Despite a statistical void, it is worth observing payday lenders' inundation of small claims courts across Utah to measure this activity.[123] Notably, payday lenders brought 66% of all small claim court cases heard in 2018.[124] This figure demonstrates that payday lenders are alive and well in Utah, operating under a lender-friendly framework that encourages the industry.

IV. POTENTIAL AVENUES OF REDRESS

As demonstrated, payday lending poses a unique problem without a simple solution. The federal government hesitates to enact sweeping reform and instead typically only punishes the worst actors involved. Moreover, federal laws like TILA mandate transparency from lenders but do little to police the industry and its underlying business practices truly. In the void left by the federal government, state governments are instead the primary regulators of the payday loan industry, for better or worse. Even those minority states that police the industry with a heavy hand, enacting highly consumer-protective policies, payday lenders nonetheless find footing.

Those in favor of payday lending argue that this niche small-loan industry provides credit to those who need it most and could not otherwise have access to small-loans, but for payday lenders' business model that encourages risky consumers. Moreover, these proponents posit that payday loans did not cause the "debt trap" experienced by so many payday loan consumers but rather likens the high-interest loans to the straw that broke the camel's back. In other words, the

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https://www.sltrib.com/news/politics/2019/10/21/utahs-payday-lenders-hit/.

[121] *Id.*

[122] *Id.*

[123] Hayley Crombleholme, *A Single Industry Dominates Small Claims Court Cases in Utah: Payday Loans*, 2KUTV (Dec. 9, 2019, 11:43 PM), https://kutv.com/news/local/a-single-industry-dominates-small-claims-court-cases-in-utah-payday-loans.

[124] *Id.*

argument is that many consumers are already insolvent when they take out payday loans, and access to small loans allows these consumers to pay for necessities and emergencies with cash they would not otherwise have.

While these payday lending advocates have a point that consumers with little to poor credit deserve access to small loans, payday loans should not be the solution. In fact, this argument only demonstrates the desperate need for heightened underwriting policies to ensure that consumers can repay the loans they are taking out. Though payday lenders require some proof of income to secure a loan, a simple pay stub does not portray the entire picture of a consumer's ability to repay. Even if a consumer can repay a given loan, should that consumer with poor credit have to repay the principal plus exorbitant fees and interest by virtue of being "risky?" There is a valid reason traditional financial institutions shy away from giving loans to risky consumers: they don't add to the bottom line the same way consumers with relatively good credit do. The balance between consumer protection and access to credit is a tight one. With inaction at the federal level, disparate action among the states, and a revolving door of loopholes, the payday lending industry remains a dominant yet controversial player in the world of small loans. This note proposes a multi-faceted approach to reform the current ineffectual patchwork of consumer protection laws to unify the states, close the loopholes that plague state usury laws, and offer safer, more affordable small loans.

1) THE NECESSITY FOR FEDERAL ACTION

As discussed throughout this note, federal deference to state regulation of payday lending and usury laws generally results in a disjointed, complicated system that does very little to protect consumers. Indeed, as the federal government slowly devolved much of its regulatory authority to the states, this deregulation led to a power vacuum among the states; while some states committed to more rigid usury laws, many others participated in a race to the bottom, enacting increasingly passive usury laws to encourage lenders to set up shop in a particular state. As such, the states proved unwilling or unable to adequately protect consumers, especially in the payday lending market. Although the states have varying credit needs that potentially demand narrowly tailored laws, the shockingly

relaxed laws of a handful of states necessitate federal action to unify all the states.

a. THE PROPOSED FEDERAL LAW AND THE REGULATION THEREOF

This note does not call for the states to adopt a model law like the failed USLL; instead, this note demands federal legislation that preempts state law and forces obeyance. The ideal federal legislation would cap APRs at 36% while allowing states to impose APRs lower than the federally mandated ceiling. Considering the mixed success experienced by Colorado after capping its APRs at 36%, this federal legislation will amend TILA, requiring lenders to include in their APRs all fees associated with the given loan. This rule of heightened disclosure will buttress the APR cap by disallowing lenders from offering an artificial APR of 36% that does not account for various miscellaneous fees that, in fact, raise the APR well above the statutorily mandated 36%. The federal legislation will also set the maximum small loan amount at $500, with a minimum six-week loan term in which the consumer may repay the loan.

To further fortify the prospective federal legislation and ensure lenders' adherence, the CFPB must be more active in holding payday lenders accountable. Accordingly, with a firm federal APR of 36%, the CFPB should keep busy suing those lenders who will inevitably attempt to evade the legislation by utilizing creative models to recover losses. Moreover, with the passage of federal legislation, the CFPB should operate with increased confidence as it will have a newly minted, congressionally ordained mandate to live up to its potential and scrupulously safeguard consumer protection in the payday lending market.

b. COMBATTING GAPS IN ACCESS TO CREDIT

As mentioned previously, critics of usury reform validly note that, in the absence of payday lenders, there will inevitably be a gap in access to credit among consumers. Although traditional financial institutions have entered the small loan market, such loans are typically only available to those

consumers with solid credit scores.[125] To ensure that the proposed federal legislation does not wholly deprive "risky" consumers of access to necessary small loans, the legislation should empower the Federal Deposit Insurance Corporation ("FDIC") to revive and expand its Small-Dollar Loan Pilot Program. In 2008, the FDIC conducted the program by encouraging banks to participate in a two-year case study where participating banks would offer small loans at affordable rates to assess whether banks could profitably offer such loans to those "risky" consumers with poor credit history.[126] Moreover, to be eligible for the program, banks had to (1) charge reasonable interest rates, (2) encourage principal reduction, (3) streamline the underwriting process, (4) maximize technology and automated processes, (5) consider the inclusion of a savings aspect to the repayment of the loan, (6) collaborate with other financial institutions and organizations to develop small loan programs for communities, and (7) improve financial literacy with regard to loans.[127]

Although the program was not as financially profitable in the short term as the participating banks might have hoped, the program nonetheless proved that banks could offer safer, more affordable small loans and still profit from doing so.[128] Specifically, the participating banks noted that, by allowing extended loan terms, consumers were given more time to repay their loans, thus resulting in a net profit to the banks.[129] More notably, one of the resounding successes that participating banks experienced is the formation of long-term relationships with consumers.[130] In other words, by offering affordable small loans to these new consumers, banks formed relationships with these consumers, many of whom either took out more loans after repaying them or consumed other products offered by the

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[125] PEW CHARITABLE TRUSTS, STANDARDS NEEDED FOR SAFE SMALL INSTALLMENT LOANS FROM BANKS, CREDIT UNIONS 2 (2018), https://www.pewtrusts.org/-/media/assets/2018/02/standards_needed_final.pdf.
[126] *Id.*
[127] Press Release, Federal Deposit Insurance Corporation, FDIC Issues Final Guidelines on Affordable Small-Dollar Loans (June 19, 2007), https://archive.fdic.gov/view/fdic/2956.
[128] *Id.*
[129] *Id.*
[130] *Id.*

banks.[131] So, with the passage of federal legislation, a revival and expansion of the FDIC's small loan program would quell many concerns over reduced access to credit.

V. CONCLUSION

The pervasive payday lending industry is one that desperately needs reform. Between the exorbitant APRs, short loan terms, and "debt traps" that many consumers experience, the payday lending industry unnecessarily plagues the small loan sector of the United States. Although states have historically governed usury laws, the relative inaction of a few compels a reform for all. To adequately protect consumers from the economic hazards of payday lending and close the various loopholes, this note urges Congress to act swiftly. Congress proved its willingness to provide extensive consumer protection to servicemembers with the passage of the Military Lending Act; it is now time to extend such protections to civilians. Federal legislation will preempt the various state laws, ultimately solidifying a unified approach to usury reform. Moreover, with strong public opinion favoring interest rate caps and viable market incentives to offer more affordable small loans to "risky" consumers, such legislation should not be so prohibitively politically polarizing.

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[131] *Id.*