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Foreword for Regulation in the Fringe Economy Symposium

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The timing of this symposium could not be better. The economy of the United States is still suffering the consequences of a financial crisis that had its origins in lax mortgage lending standards with cascading effects that threw millions out of work and wiped out the modest wealth of many low- and middle-income households. As one of its responses to the crisis, Congress created the Consumer Financial Protection Bureau (CFPB), which is charged with, among other things, devising regulations for banks and non-bank financial institutions that better protect individuals from unfair and abusive financial contracts.[1]

The CFPB will have to make tough decisions.[2] Although payday lenders, car title lenders, and other small-value, high-cost consumer finance firms, collectively commonly called "fringe" lenders, did not cause the financial crisis, the crisis made people acutely aware that not all debt contracts are individually or socially beneficial. Consequently, all types of subprime lending, which disproportionately go to low- and moderate-income individuals, are currently subject to heightened scrutiny. In the case of fringe lenders, there are two basic questions. First, does access to high-cost, small-value loans benefit borrowers? Second, do the regulations that govern fringe lenders need to be changed to improve transparency, to forbid certain contractual terms, or to make consumers more cognizant of potential pitfalls associated with the contracts?

The Articles in this symposium tackle these issues. Several of the Articles address payday lending. Others examine related issues in title lending; bank overdraft protection (ODP) programs; small-value, short-term lending outside the United States; and social and philosophical issues related to restrictions on free credit markets generally. A third set of Articles analyzes topics that are often not associated with small-

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1. 12 U.S.C. § 5511 (2011) (stating the purpose, objectives, and function of the CFPB).

2. Joseph Lynyak, *Commentary: Advice for the CFPB Head*, AM. BANKER, July 27, 2010, at 8 (describing the CFPB's charged tasks as "Herculean").

value subprime lending, but clearly should be, or arguably could be. Articles in this category cover peer-to-peer lending, government loans to students attending for-profit trade schools and colleges, and nonfinancial harms to families with excessive debt burdens.

It is common for academics writing about fringe credit markets to avoid taking definitive stands on what government regulatory agencies should do, ducking the tough issues with the safe statement, "More research is needed." The authors of the Articles in this symposium do not do that. Almost all take the bull by the horns and advocate specific regulations or regulatory approaches. Of course, the authors, who come from a variety of philosophical perspectives, advocate different policies. Some believe that if an individual freely agrees to borrow in a transparent credit contract it must be because this is the individual's best option, and eliminating or restricting access to this alternative can only reduce the well-being of that person. Others argue that cognitive or behavioral flaws can lead people to make short-term decisions that are not in their long-term interest and the elimination or restriction of some options can raise people's welfare. In the case of loans to attend for-profit schools, the loan contract itself may be transparent and fair, but the career benefits of the education it finances may not be.

Regardless of where the authors stand in this debate, they are uniformly well-informed about the regulatory environment and the business operations in the credit markets they analyze. Readers of the Articles in this symposium will learn important institutional details related to fringe lending in nearly all its forms.

In addition to providing a well-informed overview of the functioning of these credit markets, the Articles tackle a number of key themes that are critical to thinking about regulating high-cost consumer lending. In a short introduction, I cannot do justice to all of the important issues, but let me draw your attention to three basic questions that strike me as most important and pervasive in the symposium.

The first key question is: Does access to payday lenders, or close alternatives, benefit or harm their customers? The majority of Articles in the symposium address this issue, some directly and others obliquely. Several of the Articles emphasize a closely related point: the customer base of fringe lenders is heterogeneous, so access to high-cost, short-term loans might benefit some while hurting others. Some customers, for example, might rationally use a payday loan after considering the benefits and costs of the loan and close alternatives.

Other customers might focus only on the short-term benefits without rationally weighing the costs. In the face of such heterogeneity, determining the net social benefit is a complex empirical challenge. One of the Articles takes a different angle to the population diversity issue. It asks: If it makes sense to ban high-cost, short-term loans to one major segment of the population, such as military personnel, why does it not make sense to extend this ban to the rest of the population?

The second key question concerns how we should regulate businesses in the fringe economy. At an abstract level, this question is about whether there is an ideal set of limitations on the contractual terms or disclosures of payday lenders, peer-to-peer loan firms, bank ODP programs, title lenders, for-profit schools providing debt-financed educations, etc. Nearly all of the authors in this symposium take on this issue and, in doing so, also tackle a number of related practical questions, including:

- Should regulations be at the federal, state, or local level, or all three?
- Should high-cost consumer lenders be exempt from state laws if they are operated by Native American tribes? What if a tribe simply functions as a passive minority partner in a firm run by people who are not tribal members?
- Should there be an umbrella regulatory agency or should various regulatory agencies take responsibility for different aspects of the businesses?
- Should regulations focus on restricting contractual terms or should they try to address potential cognitive failures or information deficits among customers? If customers overestimate, for example, their probability of promptly repaying a loan, perhaps the lender should be required to inform potential clients of the typical number of loan renewals among its customers.

The third key question is: What happens if high-cost consumer lending is legally prohibited or severely restricted? Can and will banks and credit unions provide similar credit services at a lower cost? Will informal-sector lenders, operating illegally, step up to provide banned high-cost, short-term consumer loans? Would it be a good use of limited law enforcement resources to try to prevent the emergence of such informal-sector lenders? And, would the informal-sector lenders look like the Hollywood version—tough thugs who threaten to break kneecaps—or would they operate elusively over the Internet with no physical threats to customers who do not repay their loans?

Beyond the high quality of the Articles and the authors' efforts to address some or all of these three key themes, I was struck by another characteristic of the work: the great diversity in the methodological approaches to the issues. Not surprisingly, given the focus of the symposium and the legal background of most of the authors, several of the Articles contain nuanced analyses of existing legal and regulatory structures; how new financial products, which did not exist a decade or so ago, should fit into this environment; and how regulatory agencies should function within legal constraints. Other Articles depart dramatically from this approach. One, for example, draws lessons from a television drama intended to offer a realistic portrayal of communities of socially marginalized urban residents. Another is a careful econometric study of the effects of access to payday loans on populations within broad geographic areas. A third provides an historical analysis of the prevalence over time of illegal, high-cost, small-value lenders who employ physically coercive collection tactics. Yet another Article draws on the author's own small-scale survey of title loan customers. And, as noted above, one of the Articles examines the operations of micro-lenders outside the United States to assess lessons they might provide for regulatory structures and fringe financial operations relevant to this country.

Let me conclude by saying that I have followed the evolving fringe economy for over twenty years and have attended many conferences devoted to the topic, but this symposium stands out. As a group, the authors are strikingly well-informed about how these markets actually function, and the symposium includes eloquent and sincere exponents for vastly divergent views of what types of regulatory structures are likely to create the greatest social welfare. Readers will emerge with a solid knowledge of the fringe economy and will find persuasive arguments that challenge their initial perspectives.