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Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?

Creola Johnson

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Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?

Creola Johnson*

Abstract

In 2007, Congress enacted a law, commonly referred to as the Military Lending Act (MLA), which placed a 36% interest rate cap on several consumer loans, including payday loans, and prohibits lenders from engaging in several practices considered predatory. However, the MLA grants these protections only to active-duty military members and their dependent family members.

In the wake of the mortgage foreclosure crisis, Congress passed and President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), which creates a new federal agency, the Bureau of Consumer Financial Protection (CFPB), to focus on protecting consumers in the credit market place. In this Article, I assert that the newly-created CFPB should use its authority to afford to ordinary Americans protections similar to those now enjoyed exclusively by military families. To support my assertion, I describe how payday loans entrap civilian Americans in a cycle of indebtedness just like they once ensnared military families and yet both groups are equally lacking in financial sophistication. I further describe how regular payday lenders and now major banks, such as Wells Fargo, are engaged in reckless lending because when issuing a payday loan, they fail to do any assessment of a borrower's ability to repay, charge triple-digit-interest rates, issue loans frequently in excess of the

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borrower's next paycheck, and require loans to be repaid in a single balloon payment usually in fourteen days or less.

The CFPB needs to act to protect civilians because, despite attempts by several states to curb payday lending, payday lenders exploit loopholes in state laws or use scams to skirt consumer protection laws. The CFPB also needs to protect civilians because they are more vulnerable to ensnarement by payday loans than the active-duty military members. Military families enjoy a strong social safety net, which is comprised of numerous benefits, including complete health care coverage, educational assistance and subsidized housing. In contrast, average low-to-moderate-income civilian families face financial difficulties due to high unemployment rates and ever-shrinking compensation and benefits packages. If military families, who enjoy strong social safety nets, need protection from payday loans, then unquestionably civilian Americans, who are largely left to fend for themselves, deserve protection from payday loans.

Under Title X of the Dodd–Frank Act, the CFPB has the authority to issue rules as well as guidelines to prevent a covered financial institution from committing an unlawful practice in connection with any consumer financial product or service. Because the rulemaking process could take as long as ten years, I propose that the CFPB issue immediately guidelines and a policy statement to get lenders to voluntarily cease predatory lending practices. The guidelines would give notice to all lenders about which common payday lending practices the CFPB considers unfair, abusive and deceptive and, therefore, unlawful. The CFPB's policy statement would identify responsible lending practices, such as applying reasonable criteria to assess a consumer's ability to pay and avoiding any practice that extends the loan's due date for the primary purpose of generating fees for the lender. While the guidelines would warn lenders that they may be subject to enforcement actions for committing unlawful practices, the policy statement would provide a safe harbor, exempting from enforcement actions lenders who follow practices that comport with responsible lending standards. In addition to using the guidelines and policy statement to decrease the supply of payday loans, the CFPB should use its educational mandate to increase the demand for safe affordable loans. To accomplish this mandate, the CFPB needs to employ a multi-faceted strategy that harnesses the power of social media and uses a national

public service announcement campaign to make it easy for consumers to access safe affordable loans from lenders with a demonstrated commitment to responsible lending practices.

Table of Contents

- I. Introduction.....652
- II. Congress Passed Legislation to Protect Military Families from Payday Loans659
 - A. The Military Lending Act (MLA) Imposes a 36% APR Cap and Other Restrictions on Payday Loans662
 - B. After Enactment of the MLA, Payday Loans Decreased and Affordable Loans Increased.....663
- III. Arguments Made to Pass the MLA to Protect Military Personnel Are Applicable to Civilians.....666
 - A. Lenders Offer Civilians the Same Predatory Payday Loans Once Offered to Military Personnel.....667
 - B. Lenders Target Civilians and Military Personnel Similarly.....668
 - C. Both Civilian and Military Payday Borrowers Are Lacking in Financial Sophistication.....671
 - D. The Payday Loan Trap Hinders the Job Performance of Both Civilians and Military Personnel.....672
 - E. Payday Loans Lead to Unmanageable Debt for Both Civilians and Military Personnel.....674
- IV. Efforts to Afford Civilians Protections from Payday Lending679
 - A. Federal Lawmakers Have Been Unable to Muster Bipartisan Support to Protect Civilians680
 - B. Mainstream Financial Institutions Alone Cannot Be Trusted to Protect Civilians.....683
- V. The Consumer Financial Protection Bureau (CFPB) Has Authority to Protect Civilians689
 - A. The CFPB Should Issue Guidelines Identifying Many Payday Loan Practices as Deceptive690
 - 1. The Guide Needs to Warn Lenders About

Their Debt Entrapment Practices	694
2. The Guide Needs to Warn Lenders About Their Debt Treadmill Practices	700
B. The CFPB Should Issue a Policy Statement Granting Responsible Lenders a Safe Harbor	707
1. The CFPB Could Consider the FDIC's Guidelines for Its Pilot Loan Program	708
2. The Policy Statement Can Create a Safety Zone for Affordable Low-Cost Loans	711
C. The CFPB Can Use Its Educational Mandate to Foster Expansion of Affordable Low-Cost Loans	714
1. Social Media Networks Would be an Effective, Low-Cost Way to Educate Consumers	716
2. The CFPB Needs to Engage Consumers by Hosting a User-Generated Advertisement Competition	718
3. Crowd Sourcing Is a Productive Avenue for the CFPB to Interact with and Inform Consumers	720
4. The CFPB Needs to Secure Commitments from Banks and Credit Unions to Offer Safe Low-Cost Loans	721
5. Partnership with the Ad Council Would Lead to the Dissemination of the CFPB's Message Through PSAs	723
6. The CFPB Should Create "Apps" to Provide Easy Access to Affordable Loans from CFPB-Approved Financial Institutions	725
VI. Conclusion	726

I. Introduction

In the summer of 2003, Navy Petty Officer 2nd Class Jason Withrow, stationed at a naval base in Georgia, obtained a \$300 payday loan.¹ When the loan became due, he had to borrow from

1. 152 CONG. REC. S6405, S6406 (daily ed. June 22, 2006) (statement of Sen. Talent).

another lender to pay back that loan because he could not repay the original \$300 loan in a single payment, as required by the contract.² By February 2004, he had paid \$5,000 in interest and fees on payday loans totaling \$1,800 from four different lenders.³ If Petty Officer Withrow were in need of a short-term loan today, he would not have to settle for the typical payday loan, which carries a triple-digit interest rate and has to be repaid in a single balloon payment in a short time frame (e.g., two weeks).⁴

For military personnel in need of quick cash, the financial landscape has dramatically changed for the better.⁵ Persuaded by testimony that payday loans trap soldiers like Petty Officer Withrow in debt and interfere with their military preparedness, Congress passed in 2006 a federal law, commonly referred to as the Military Lending Act (MLA).⁶ It protects not only combat soldiers but *all* active-duty military personnel and their dependents from usurious loans by capping interest rates on several types of short-term loans, including payday loans, at 36% annual percentage rate (APR).⁷ Since the passage of the MLA, the number of loans offered by payday lenders to military families has drastically decreased.⁸ However, this decrease did not leave military families without access to short-term credit. Military relief societies—non-profit organizations established to help military families—expanded their

2. *See id.* (“He borrowed more to service the fee . . .”).

3. *Id.*

4. *See* 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, 660–61 (2005) (discussing interest rates for payday loans issued to military personnel and stating that interest rates averaged 498.75% in Indiana, 528.49% in Salt Lake City, and 474% in the District of Columbia).

5. While there are stories reporting that military families remain a target of predatory lenders, this Article demonstrates that military families have substantially more and better options for dealing with a financial crisis than the average low- to moderate-income civilian worker. *See infra* notes 6–23 and accompanying text.

6. *See* John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a), 120 Stat. 2083, 2266 (codified at 10 U.S.C. § 987(b)) [hereinafter Warner National Defense Act] (capping interest rates on payday loans, tax refund loans, and car title loans at 36%). Because the new law protects all active-duty soldiers, it protects many military personnel who will never see combat due to their gender or occupation, and who live stateside just like civilians, yet the civilians have no protection.

7. *Id.*

8. *See infra* notes 61–67 and accompanying text.

personal finance education outreach and began offering several interest-free loan products to help military families avoid payday loans.⁹ Similarly, many credit unions and banks challenged the payday loan industry's assertion that triple-digit-interest loans are necessary by offering military personnel loans with APRs below 36% and on terms resulting in successful loan repayment.¹⁰ Because of this, military families now have access to—and are increasingly using—safe, affordable short-term loans.¹¹

In contrast, the financial landscape for civilians seeking short-term loans was already bad and has become increasingly worse, due in part to online lending and other tactics by payday lenders.¹² For example, in 2007, the same year the MLA took effect to protect military families, Bonnie Bernhardt, a civilian single mother from Wisconsin, borrowed \$300 from a Delaware-based online payday lender.¹³ Two weeks later, when she could not repay it, the lender debited her bank account for \$90 to roll over—extend the due date—on the loan.¹⁴ After the lender debited Ms. Bernhardt's account for a total of \$810 in rollover fees, it still insisted that she owed the

9. See, e.g., Kevin Lonergan et al., *Before You Consider a Payday Lender, Consider This*, ARMY PRESS SERV. (Apr. 19, 2011 12:15 AM), http://www.army.mil/article/55185/Before_You_Consider_a_Payday_Lender_Consider_This/ (last visited Apr. 6, 2012) (outlining basic information on several loan products available from military-related organizations for service members and their families) (on file with the Washington and Lee Law Review).

10. See, e.g., NAT'L CREDIT UNION ADMIN., THE CREDIT UNION CONNECTION LOANS 5 (Sept. 30, 2008), available at <http://www.ncua.gov/resources/Documents/CUDev/TOCLoans.pdf> (describing the creation of the Military Appreciation Loan (MAL) "as a solution to high interest rate, unsecured loans granted to military personnel," enabling service members to "break the cycle of high interest rates and questionable practices exhibited by predatory lenders").

11. See *infra* notes 61–67 and accompanying text.

12. Office of Public Affairs, *FTC Returns Almost \$2 Million to Payday Loan Applicants Who Were Tricked Into Buying Prepaid Debit Cards*, FED. TRADE COMM'N DOCUMENTS (Aug. 31, 2011), <http://www.ftc.gov/opa/2011/08/everprivate.shtm> (last visited Apr. 6, 2012) (reporting that the FTC returned around \$1.9 million to customers after a payday lender partnered with debit card marketers "to design [a] deceptive payday loan application form that triggered a charge of up to \$54.95 for a prepaid debit card") (on file with the Washington and Lee Law Review).

13. Pat Schneider, *Who Oversees Online Payday Lenders?*, CAPITAL TIMES (Madison, Wis.), Feb. 24, 2010, at 8, available at 2010 WLNR 3938773.

14. *Id.*

original \$300 loan.¹⁵ Her case reflects a common debt trap for civilians borrowing online.¹⁶

Payday lenders are cleverly expanding their payday loan business to civilian consumers.¹⁷ For instance, an online payday loan company purportedly operating out of the Cheyenne River Reservation in South Dakota is fighting a cease-and-desist order issued by Maryland financial regulators and is claiming to have the right under tribal sovereign immunity to issue to Maryland residents loans with interest rates as high as 1,800%.¹⁸ Although several states have passed statutes in the last four years imposing greater restrictions on payday lending and capping APRs at 36% or less, payday lenders are routinely ignoring these laws and are developing more schemes to claim they are not subject to these laws.¹⁹

While state legislators have been wrangling over how to prevent payday lenders from circumventing state laws, major banks, such as U.S. Bancorp, Wells Fargo, and Fifth Third Bank—all three recipients of taxpayer bailout funds²⁰—have been stealthily creating their own payday loan products,²¹ cleverly labeled as “direct deposit advances.”²² These loans have triple-digit APRs, exceeding 100%, have short maturity dates, and require single balloon payments, just like payday loans.²³ Moreover, although credit unions largely have a reputation for offering consumers low-cost loans, a few of them have been accused of issuing loans that are similar to payday loans and also carry triple-digit APRs.²⁴

15. *Id.*

16. *See infra* notes 18–23 and accompanying text.

17. *See infra* notes 18–23 and accompanying text.

18. *See* Ben Mook, *South Dakota Payday Lender Fights Cease-and-Desist Order by Md. Financial Regulators*, DAILY REC. (Baltimore), May 15, 2011.

19. *See infra* note 216; *cf.* notes 217–223 and accompanying text.

20. *Where Is the Money? Eye on the Bailout—Bailout Recipients*, PRO PUBLICA (Jan. 17, 2012), <http://projects.propublica.org/bailout/list> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

21. *See* Chris Serres, *Biggest Banks Stepping in to Payday Arena*, STAR TRIB. (Minneapolis-St. Paul), Sept. 6, 2009, at 1D, *available at* <http://www.startribune.com/business/57364812.html>.

22. *Id.*

23. *Id.*

24. Press Release, Nat’l Consumer Law Ctr., NCUA Letter Highlights Dangers of False Credit Union Payday Loan “Alternatives” (July 30, 2009),

The outlook for civilian borrowers like Ms. Bernhardt, at first glance, appears bleak. However, this Great Recession, which originated in irresponsible subprime mortgage lending, has a silver lining: enactment of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act).²⁵ Title X of the Dodd–Frank Act is titled the Consumer Financial Protection Act of 2010 (CFPA), and it created the Bureau of Consumer Financial Protection (CFPB).²⁶ The CFPB is empowered to enforce existing federal consumer laws as well as adopt new regulations for enforcement. The CFPB can become the champion for civilian borrowers by taking on America’s financial institutions to combat predatory short-term loans.

Part II of this Article describes the predatory characteristics of payday loans. It also analyzes provisions of the MLA that prohibit some payday loan practices, including prohibiting rollovers and interest rates higher than 36%. Part II also explains how the enactment of the MLA eventually led to a dramatic decrease in payday lending to military personnel and a substantial increase in safe affordable loans to military families.

Part III describes the arguments used to pass a federal law that protects only military families from payday lending. Applying these same arguments to the civilian borrower, Part III makes a compelling case as to why civilian families need federal laws protecting them from payday lending. Payday lenders issue to civilians the same predatory loans they did to soldiers; however, the financial situation for the average civilian is worse, thereby making the civilian borrower more susceptible to the payday loan trap. Because of the sacrifices of military members in volunteering to protect America, we rightfully reward military families with a strong social safety net, which is comprised of numerous benefits, including free healthcare services, free public higher education, and subsidized housing.²⁷ In contrast, the average low-to-moderate-

http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/statement-ncua-0709.pdf (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

25. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd–Frank Act].

26. *See id.* § 1011(a), 124 Stat. at 1964.

27. MILITARY ADVANTAGE, *Military Benefits*, <http://www.militarybenefits.com/> (last visited Apr. 6, 2012) (providing comprehensive listing of informational

income civilian worker lacks these benefits and is in a precarious situation due to continuing high unemployment rates and an ever-shrinking benefits package.²⁸ If military families, who enjoy a strong safety net, need protection from payday loans, then unquestionably civilian families, who are largely left to fend for themselves, deserve the same protection.. Both groups of consumers are lacking in financial sophistication and are no match for the \$40 billion payday loan industry or Wall Street titans like Wells Fargo and other banks engaged in payday lending.

Part IV discusses failed attempts by federal lawmakers to pass laws directly regulating payday loans. The need for federal regulation continues to grow as payday lenders and their affiliates devise new schemes to circumvent laws passed by several states to protect civilians from predatory payday loans.²⁹ Part IV also explains why, in the absence of actions taken by the CFPB, mainstream financial institutions *alone* cannot be relied on to offer nationwide safe, affordable loans to civilians. While prudential regulators of nationally chartered banks and federal credit unions have taken measures to try to get these institutions to offer alternatives to payday loans,³⁰ many so-called alternatives are nothing more than payday loans by another name.³¹

Part V discusses the emergence of the CFPB as a watchdog to protect civilian borrowers from payday lending. It asserts that the CFPB has rulemaking authority to prohibit many payday loan

links on benefits of military service) (on file with the Washington and Lee Law Review).

28. See *infra* notes 113–40 and accompanying text (discussing the disparity in the benefits received by military families and civilian families). The discussion about the disparity in social safety nets for civilians and soldiers is not intended to downplay the sacrifices of military personnel. Rather, it is intended to show that civilians should be afforded comparable protection from payday lenders. While military personnel may face other forms of hardship, the average civilian is likely to be financially worse off than those in the military. Consequently, many civilians will obtain payday loans and get caught in a debt trap. The author was a member of the United States Army Reserves for six years and recognizes that incentives, such as free healthcare, are necessary to persuade some people to join America’s all-volunteer armed forces.

29. See *infra* notes 216–23 and accompanying text.

30. Cf. Serres, *supra* note 21 (noting the protests over banks skirting regulations meant to eliminate predatory lending).

31. See *id.* (calling the alternatives: “The same, but different”).

practices as unfair, deceptive, or abusive,³² as well as authority to issue a guide warning bank and nonbank lenders what practices it considers unfair, deceptive, and abusive.³³ Because the guideline-making process can be much shorter than the rule-making process and has other advantages over the rule-making process, the author proposes in Part V that the CFPB issue guidelines for financial institutions offering payday loans (CFPB's Guide for Payday Loan Providers) to deter their proliferation. This guide should be soundly rooted in provisions of the MLA and actions taken by state law makers and federal banking regulators, and should warn lenders that the CFPB considers common payday lending practices, such as those described above, unfair, deceptive, and abusive. The author also proposes that the CFPB should use its authority to issue a policy statement to create a zone of safety for loan products that meet criteria for affordable low-cost loans (Policy Statement for Safe Low-Cost Loans). The statement would be meant to encourage responsible lenders to develop loan products that can truly be considered low-cost alternatives to payday loans.

Having used its authority to issue the proposed Guide for Payday Loan Providers and the proposed Policy Statement for Safe Low-Cost Loans, the CFPB, as discussed in Part IV, can use its Office of Financial Education to fulfill its educational mandate to provide consumers "with timely and understandable information to make responsible decisions about financial transactions."³⁴ Because the possibility exists that the CFPB's funding will be substantially reduced,³⁵ the CFPB has to become adept at effectively using its funding for education outreach. Rather than the CFPB relying primarily on a web page with a wealth of information the CFPB hopes consumers will visit and learn from, the author proposes that the Office of Financial Education launch a public service education campaign using a strategy that harnesses the power of social media,

32. Dodd–Frank Act, Pub. L. No. 111-203, § 1031(a), 124 Stat. 1376, 2005 (2010).

33. See *infra* notes 214–20 and accompanying text.

34. Dodd–Frank Act § 1021(b)(1), 124 Stat. at 1980.

35. See Maya Jackson Randall, *Democrats Fight GOP Effort to Cut Consumer Bureau Funding*, WALL ST. J. (WASHINGTON WIRE) (July 13, 2011 5:46 PM), <http://blogs.wsj.com/washwire/2011/07/13/democrats-fight-gop-effort-to-cut-consumer-bureau-funding/> (last visited Apr. 6, 2012) (describing the political battle over CFPB funding) (on file with the Washington and Lee Law Review).

consumer-generated advertising, and wireless technology. Part V.C sets forth the author's proposed six-step strategy that includes the CFPB (1) increasing the number of fans on its social networking sites; (2) conducting a contest for the creation of consumer-generated advertising promoting safe, affordable loans; (3) utilizing crowdsourcing to select the best advertisements; (4) securing the agreement of banks and credit unions in every state to supply safe, affordable loans; (5) starting a public service campaign to increase consumer awareness; and (6) developing an electronic application that consumers can download to make it easy for consumers to find these loans. This would nudge consumers in the right direction and enable them to select appropriate loans, thus freeing them from their bounded rationality.³⁶

By taking the above actions, the CFPB will foster the expansion of affordable small-dollar loan programs and cause them to emerge as a viable alternative to the typical payday loan. As a result, the CFPB will afford ordinary Americans protections from payday lending similar to those extended to military families.

II. Congress Passed Legislation to Protect Military Families from Payday Loans

Payday lenders have been claiming for years that they offer consumers payday loans as a solution to a financial crisis, but the evidence shows otherwise. A payday loan is a consumer loan that averages an APR in the triple, even quadruple, digits and requires borrowers to repay the loan in a single balloon payment when they receive their next paycheck.³⁷ Because the high-cost loan must be repaid in a single payment and in a short period of time, the majority of payday borrowers cannot pay off the entire loan by its

36. See, e.g., RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* 3 (2008) (introducing the concept of "choice architecture").

37. See, e.g., *Cash Am. Net of Nev., L.L.C. v. Pa. Dep't of Banking*, 978 A.2d 1028, 1032, 1038 (Pa. 2009) (stating that an out-of-state online payday lender's APRs were as high as 1140.63% on an eight-day loan and as high as APR 260.71% on a thirty-five-day loan and holding that online lenders must be licensed to issue loans to Pennsylvania's residents and are subject to state laws limiting interest rates).

initial due date.³⁸ Therefore, borrowers get trapped in a cycle of paying rollover or refinancing fees to extend the loan's due date and ultimately end up paying far more than the original loan amount.³⁹ In states where rollovers or multiple outstanding loans are banned, lenders do back-to-back transactions to skirt state law⁴⁰ or borrowers get loans from different lenders to pay off the prior loans, thereby essentially borrowing from Peter to pay Paul.⁴¹ This cycle of multiple rollovers or loans is exacerbated by some payday lenders who repeatedly debit the borrower's bank accounts to facilitate repayment of the loan.⁴² For example, a payday lender attempted to collect on one single \$300 payday loan by electronically debiting a Florida-based sailor's account ten times, resulting in a \$200 charge by the sailor's credit union for returned debit fees.⁴³ Besides the

38. See, e.g., URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, FINANCIAL QUICKSAND: PAYDAY LENDING SINKS BORROWERS IN DEBT WITH \$4.2 BILLION IN PREDATORY FEES EVERY YEAR 2 (Nov. 30, 2006), available at http://www.responsiblelending.org/payday-lending/research-analysis/rr012exec-Financial_Quicksand-1106.pdf (“[L]enders . . . collect 90 percent of their revenue from borrowers who cannot pay off their loans when due . . .”).

39. See, e.g., Nathalie Martin & Koo Im Tong, *Double Down-and-Out: The Connection Between Payday Loans and Bankruptcy*, 39 SW. U. L. REV. 785, 790–93 (2010) (discussing the payday lending profitability model, which includes rollovers).

40. See, e.g., OHIO COAL. FOR RESPONSIBLE LENDING, TRAPPED BY DESIGN: PAYDAY LENDING BY THE NUMBERS 5, “Michigan Deferred Presentment Data” Chart in Appendix (Sept. 19, 2007), available at <http://www.cohio.org/pdf/919TrappedByDesignfinal.pdf> (finding in one study that the one-time borrowers constituted only 1.1% of the payday borrowers and that thirteen loans per year was the most common number of loans per borrower).

41. See, e.g., Paul Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENV. U. L. REV. 387, 411 (2005).

42. E-mail from Dana Wiggins, Coordinator, VPLC/VaPERL, to author (Nov. 16, 2011, 15:44 EDT) (on file with the Washington and Lee Law Review). According to information obtained from payday loan customers, electronic debit accounts seem to be the only option for payment for borrowers from the beginning. *Id.* If borrowers place a stop payment on the loan amount, online lenders will run the debit for a little over or a little under the original amount so it will go through. *Id.*

43. *Payday Loan Reform Act of 2009: Hearing on H.R. 1214 Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs.*, 111th Cong. 13 (2009) (statement by Jean Ann Fox, Dir. of Fin. Servs., Consumer Fed'n of America) [hereinafter Fox], available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/fox_testimony.pdf.

credit union's charges, the payday lender also charged him fees for the unsatisfied debits.⁴⁴

As early as 2002, military commanders started complaining to state lawmakers that soldiers were getting trapped in payday loan debt.⁴⁵ When military leaders realized state lawmakers were unable or unwilling to pass laws protecting the troops, military leaders focused their efforts on the federal level. In 2006, the United States Department of Defense (DOD) issued its *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (DOD Report).⁴⁶ This report examined payday loans, vehicle title loans, and other short-term consumer financial products and specifically concluded that payday loans were predatory.⁴⁷ The DOD Report stated that payday lending "harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force."⁴⁸ Statements like these were used to urge members of Congress to pass a federal law protecting military families. The author describes some of the key provisions of this law and explains in detail why the same arguments used to legislatively afford protections to military families can be used to afford protections to all Americans.

44. *Id.*

45. See, e.g., Tom Shean, *Payday-Loan Bill Draws Criticism From Military, Effort to Regulate High-Interest Loans Would Backfire, They Say*, VIRGINIAN-PILOT & LEDGER STAR (Norfolk, Va.), Feb. 16, 2002, at D1, available at 2002 WLNR 2427527 (reporting that Rear Admiral David Architzel, then-commander of the Navy's mid-Atlantic region, wrote a letter to members of Virginia's House Commerce and Labor Committee urging them to vote against a bill that he feared would make it easier for payday lenders to charge usurious rates for their loans); Kristen Wyatt, *Ga. Lawmakers Take Up Payday Loans*, MACON TELEGRAPH, Jan. 22, 2004, at B1, available at 2004 WLNR 18973050 (reporting that "military officers across the state [of Georgia] started complaining that payday loans are sinking their troops in debt").

46. U.S. DEP'T OF DEF., REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS (2006) [hereinafter DOD REPORT], available at http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf.

47. See *id.* at 15 (reporting that the "debt trap is the rule, not the exception: the average borrower pays back \$834 for a \$339 loan").

48. *Id.* at 53.

A. The Military Lending Act (MLA) Imposes a 36% APR Cap and Other Restrictions on Payday Loans

Section 670 of the John Warner National Defense Authorization Act⁴⁹ and subsequent regulations issued by the DOD,⁵⁰ collectively and commonly known as the Military Lending Act,⁵¹ regulates certain consumer credit extensions to military borrowers, defined as active-duty military personnel and their dependent families.⁵² Under the MLA, Congress capped the APR at 36% for payday loans, vehicle title loans, and tax refund loans to active-duty military personnel and their dependents.⁵³ It contains a definition of APR that is broader than the APR definition under the Truth in Lending Act.⁵⁴ This expanded definition is called the Military APR (MAPR) and is intended to keep lenders from misleading military borrowers about the true cost of credit by requiring that they include all their fees in the MAPR calculation.⁵⁵ The MLA restricts a lender's ability to debit the borrower's bank account unless the loan complies with the MAPR calculation and the MAPR is capped at 36% or less.⁵⁶ The MLA also preempts any inconsistent state or federal laws;

49. Warner National Defense Act, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2266 (2006) (codified at 10 U.S.C. § 987(b)).

50. Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 32 C.F.R. § 232 (2006).

51. See, e.g., Jason M. Gordon, *Legal Assistance: The John Warner National Defense Authorization Act for Fiscal Year 2007 and Protecting Soldiers Against Predatory Lending*, ARMY LAW., Apr. 2008, at 30, available at http://www.loc.gov/rr/frd/Military_Law/pdf/04-2008.pdf. Both the statute and its implementing regulations are referred to in this Article as the Military Lending Act. Some refer to them as the Talent-Nelson Amendment, probably because the bill pre-dating the enactment was sponsored by Senator Jim Talent (R-Mo.) and Senator Bill Nelson (D-Fla.). See Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 871 (2007).

52. See Warner National Defense Act, § 670(a), 120 Stat. at 2266 (codified at 10 U.S.C.A. § 987(b)) ("A creditor . . . may not impose an annual percentage rate of interest greater than 36 percent with respect to the consumer credit extended to a covered service member or a dependent of a covered service member.").

53. *Id.*

54. Truth in Lending Act, Pub. L. No. 90-321, § 107, 82 Stat. 149 (2006) (codified at 15 U.S.C. § 1606).

55. Warner National Defense Act, § 670(a), 120 Stat. at 2266 (codified at 10 U.S.C. § 987).

56. See *id.* (detailing limitations on terms of credit).

consequently, military personnel and their families are entitled to whatever laws provide them with stronger consumer protection.⁵⁷ The MLA prohibits rollovers and prohibits lenders from distributing multiple loans simultaneously to a military borrower.⁵⁸ It makes unenforceable any agreement to arbitrate disputes involving the extension of consumer credit to military borrowers.⁵⁹ The MLA applies to *all* financial institutions, not just nonbank lenders, so long as their loans meet the definition of a payday loan.⁶⁰

B. After Enactment of the MLA, Payday Loans Decreased and Affordable Loans Increased

Enactment of the MLA is not a panacea for all predatory lending to military borrowers, but it has resulted in a dramatic decrease in payday lending to military personnel.⁶¹ Since the MLA took effect October 1, 2007, official reports and anecdotal evidence confirms the decrease. For instance, according to a 2008 report by the Washington State Department of Financial Institutions, the majority of the payday lenders in Washington State stopped lending to military borrowers, resulting in a 92% decrease of loans to military borrowers from 2006 to 2008.⁶² In 2009 hearings held by Representative Chet Edwards on the quality of life among service members, military commanders testified about a reduction in payday lending and stated that payday lenders were “going out of business” around Camp Pendleton.⁶³ In 2007, the Navy-Marine Corps Relief Society (NMCRS), a charitable organization that aids active-duty and retired sailors, assisted sailors in trouble with

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. *See infra* notes 62–73 and accompanying text.

62. WASH. STATE DEPT’ OF FIN. INSTS, 2008 PAYDAY LENDING REPORT 6 (2009), *available at* <http://www.dfi.wa.gov/cs/pdf/2008-payday-lending-report.pdf>.

63. *See Rep. Chet Edwards Holds a Hearing on Servicemembers Quality of Life*, CQ CAP. TRANSCRIPTS, Feb. 4, 2009, *available at* 2009 WLNR 2268048 (reporting statements by Carlton Kent, Sergeant Major of the Marine Corps, and Rick West, Master Chief Petty Officer of the Navy, admitting that they lacked specific survey data to confirm what they were observing).

predatory loans by dispersing \$1.1 million to pay off the loans.⁶⁴ But in the first three quarters of 2008, which was post-enactment of the MLA, the NMCRS reported disbursements were down to only \$250,000 as a result of the decrease in payday loans.⁶⁵ Other military relief societies also reported a reduction in monetary assistance given to military members struggling with payday loan indebtedness.⁶⁶

The success in the decrease in payday loans is not attributable solely to passage of the MLA but also to an increase in education outreach directed to military families and an increase in the supply of affordable loans.⁶⁷ The NMCRS continued offering sailors financial counseling and began offering interest-free \$300 loans called the Quick Assist Loan.⁶⁸ The Rock Island Arsenal Army Community Service also issues to soldiers interest-free loans (up to \$1,000) and assists them in creating budgets and developing debt repayment plans.⁶⁹ Other military societies offer similar loan products and services.⁷⁰

Besides military societies offering military members interest-free loans and financial counseling to decrease their reliance on payday loans,⁷¹ politicians and military leaders used their influence to get banks and credit unions near or on military bases to offer low-

64. See Lisa Daniel, *Troops Escape Financial Trends, Enjoy Money Management Benefits*, AM. FORCES PRESS SERVS. (Dec. 23, 2008), <http://www.defense.gov/news/newsarticle.aspx?id=52455> (last visited Apr. 6, 2012) (reporting statement by John Alexander, vice president and chief communication officer at NMCRS) (on file with the Washington and Lee Law Review).

65. *Id.*

66. See Fox, *supra* note 43, at 18 (“[M]ilitary debt relief societies were able to reduce assistance given to indebted members of the military because of the reduction in payday loan usage.”).

67. See Daniel, *supra* note 64 (naming a variety of programs assisting military personnel).

68. See *id.*; Rep. Chet Edwards Holds a Hearing on Servicemembers Quality of Life, *supra* note 63.

69. Lonergan et al., *supra* note 9.

70. *Id.*

71. See Blair Martin, *NMCRS Quick Assist Loan Provides Emergency Relief To Sailors, Marines*, NAVY PRESS SERV. (Apr. 3, 2009 5:36 AM), http://www.navy.mil/search/display.asp?story_id=43987 (last visited Apr. 6, 2012) (stating that the “[Quick Assist Loan] program is an important alternative to payday loans so that our Sailors and Marines will not get left with . . . high interest” rates) (on file with the Washington and Lee Law Review).

interest loans to military members.⁷² For example, during congressional hearings related to passage of the MLA, Representative Duncan Hunter (R-Cal.) stated “we have got to get these credit unions that are [o]n the base, the guys in the institutions we allow to be inside the perimeter of that base, to reach out and establish short-term loans for our servicemembers so servicemembers go there instead of feeling they have got to go . . . to a loan shark to get that loan.”⁷³

While the author cannot prove that such statements by politicians and military leaders caused credit unions and banks to expand their offering of alternatives to payday loans, several low-interest loan programs were created in 2006 and 2007. For example, in 2006, VyStar Credit Union announced that, with the help of the NMCRS, it would offer military members based in Jacksonville, Florida a lower-priced alternative to payday loans called a “Pay & Save Loan,” which would have a 14.25% APR and be due within six months.⁷⁴

In its 2008 report on implementation of the regulations adopted under the MLA, the DOD stated that several banks and credit unions were offering low-cost loans to military families at hundreds of military installations worldwide and military families were increasingly using these loan products.⁷⁵ The Defense Credit Union Council, for instance, had 47 credit unions offering low-cost loans and lines of credit at 135 military installations.⁷⁶ The average interest rate on these loans was a 17% APR with no additional fees.⁷⁷ Similarly, 92% of the 156 credit union members of the National Association of Federal Credit Unions reported offering loans of \$500 or less without origination fees and “with APRs well below” 36%⁷⁸ and 75% of them reported their loans “are offered with

72. See *infra* note 73 and accompanying text.

73. 152 CONG. REC. H7979 (daily ed. Sept. 29, 2006) (statement of Rep. Hunter).

74. David Bauerlain, *Military Gets Loan Aid In New Program*, FLA. TIMES UNION (Jacksonville), Jan. 12, 2008, available at 2008 WLNR 767295.

75. See U.S. DEP'T OF DEF., REPORT ON IMPLEMENTATION OF LIMITATIONS ON TERMS OF CONSUMER CREDIT EXTENDED TO SERVICE MEMBERS AND DEPENDENTS 18–19 (July 22, 2008), available at <http://www.dcuc.org/PDF%20Files/Senate%20Report%20Final.pdf> (discussing developments and relevant statistics).

76. *Id.* at 22.

77. *Id.*

78. *Id.*

payment periods beyond one pay period.”⁷⁹ Clearly, loans like these are immensely better than the typical payday loan with a triple-digit interest rate, a two-week maturity date, and a single balloon payment requirement.⁸⁰

As the discussion above demonstrates, passage of the MLA did not result in military families lacking access to credit as some payday lenders tried to scare members of Congress into believing. Instead several forces came together to expand the military families’ access to affordable loan products and to increase their knowledge about how to better manage their finances.⁸¹ Similar results can happen for civilian consumers if federal politicians and policymakers combine forces. Perhaps they must be first convinced that compelling reasons exist to afford civilians protections from payday lending.

III. Arguments Made to Pass the MLA to Protect Military Personnel Are Applicable to Civilians

When testimony was presented to urge members of Congress to pass the MLA, five major arguments were made: (1) payday lenders offer predatory loan products,⁸² (2) payday lenders target soldiers as customers,⁸³ (3) these customers lack financial sophistication,⁸⁴ (4) payday loans interfere with preparedness,⁸⁵ and (5) payday loans lead to a cycle of unmanageable debt.⁸⁶ Each of these arguments will be discussed below and the author will demonstrate that nearly the exact same arguments can be made for protecting civilian borrowers.

79. *Id.*

80. *See supra* note 79, *infra* note 82, and accompanying text (describing common payday loan characteristics).

81. *See supra* notes 62–73 and accompanying text.

82. *See infra* notes 87–92 and accompanying text.

83. *See infra* notes 93–95 and accompanying text.

84. *See infra* notes 105–06 and accompanying text.

85. *See infra* notes 109–13 and accompanying text.

86. *See infra* notes 124–25 and accompanying text.

A. Lenders Offer Civilians the Same Predatory Payday Loans Once Offered to Military Personnel

The congressional record is replete with statements actually referring to payday lenders as loan sharks and arguing that their loans are predatory due primarily to their short maturity dates, high interest rates, and repeat rollovers. For example, Duncan Hunter, representing a state with several military bases, expressed his opinion that military members should not have “to go to a loan shark to get that loan,” and thanked members of Congress for ensuring “our troops have a good situation now and will not be the victims of loan sharks.”⁸⁷ Representative Thelma Drake (R-Va.), who also hails from a state with strong military interests, urged for passage of legislation protecting the troops and decried payday lenders’ extremely high interest rates, with rates “as high as 780 percent.”⁸⁸ Similarly, Senator Richard Durbin (D-Ill.) criticized the practice of rollovers and commented that “[p]ayday lenders are legal loan sharks that offer small, short-term loans at interest rates of 100, 500, even 1,000 percent.”⁸⁹

Although payday lenders are banned from offering such loan products to military families, compelling evidence shows payday lenders continue to peddle to civilian borrowers loans with the same predatory characteristics, including short maturity dates, triple-digit interest rates, and multiple rollovers or refinancing or multiple loans per year. For example, in its 2010 annual report on payday lending, the California Department of Corporations found that in California, the payday loan had an average term of 17 days and an average APR of 414%, and payday borrowers obtained almost eight loans per year.⁹⁰ Repeated-rollover and multiple-loan problems have

87. 152 CONG. REC. H7981 (daily ed. Sept. 29, 2006) (statement of Rep. Hunter).

88. *Id.* Representative Robert Simmons (R-Conn.) concurred with his statement that passage of legislation to protect the troops would “get the [sharks] off the backs of our soldiers.” *Id.*

89. See 151 CONG. REC. S1820-03 (daily ed. March 1, 2005) (commenting on a bill to bankruptcy law that contained provisions protecting soldiers from payday loans).

90. See CAL. DEP’T OF CORPS., 2010 ANNUAL REPORT: OPERATION OF DEFERRED DEPOSIT ORIGINATORS UNDER THE CALIFORNIA DEFERRED DEPOSIT TRANSACTION LAW 2–3 (Apr. 25, 2011), available at http://www.corp.ca.gov/Laws/Payday_Lenders/pdfs/CDDTL2010ARC.pdf (reporting statistics, including

been consistently reported among the civilian population and, thereby, seriously undermine the industry's contention that payday loans are a short-term solution.⁹¹ The foregoing characteristics of payday loans were prevalent among military borrowers prior to enactment of the MLA and were all identified as predatory along with other terms in the DOD Report to Congress on predatory lending in the military.⁹²

B. Lenders Target Civilians and Military Personnel Similarly

In addition to the predatory characteristics of payday loans, targeting by payday lenders was another justification for passage of the MLA and is another similarity shared by civilian families and their military counterparts. Geographic mapping evidence was used to demonstrate targeting.⁹³ This blatant targeting was easy to identify due to the abundance of payday loan stores that were located near military bases and that had military-sounding names.⁹⁴

the number of loans made and the total number of individual customers). The report actually refers to payday lenders as “deferred deposit originators.” *Id.* at 1.

91. *See, e.g.*, Keith Ernst et al., *Quantifying the Economic Costs of Predatory Payday Lending*, CTR. FOR RESPONSIBLE LENDING (2003) (finding that 91% of payday borrowers obtain five or more loans per year), available at <http://www.responsiblelending.org/payday-lending/research-analysis/CRLpaydaylendingstudy121803.pdf>.

92. *See* DOD REPORT, *supra* note 46, at 45–46.

93. *See* 152 CONG. REC. S6405, S6406 (daily ed. June 22, 2006) (statement of Sen. Talent) (relying on geographic mapping research and quoting “irrefutable geographic evidence demonstrates that payday lenders are actively and aggressively targeting U.S. military personnel”); 151 CONG. REC. S11423-01, S11437 (daily ed. Oct. 17, 2005) (statement of Sen. Akaka) (introducing the Predatory Payday Loan Prohibition Act, a bill that was not passed, and stating “[p]ayday lenders are concentrated around military bases, such as the Navy bases in Norfolk, Virginia, the Army’s Fort Lewis in Washington State, and the Marine Corps base at Camp Pendleton in California”).

94. *See* 152 CONG. REC. S6405 (daily ed. June 22, 2006) (statement of Sen. Talent) (noting a “relatively large number and high density of payday lenders” near a military base); *Review of the Dep’t of Def. Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 109th Cong. 9–10 (2006) (written statement of Christopher L. Peterson, Assoc. Professor, Univ. of Florida, Fredric G. Levin Coll. of Law), available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=9f348ce7-1c3b-4cd6-bcae-8c3cf9a8a4fe (discussing predatory lenders clustering

Various means of conducting electronic searches made it possible for researchers to uncover the types of businesses clustered around military bases and, therefore, determine the extent to which military-base populations were being targeted by payday lenders.⁹⁵

Pockets of civilian populations are also being targeted in a similar manner, though it is more costly and difficult for researchers to gather such data.⁹⁶ These pockets consist largely of low-income white and minority communities.⁹⁷ For instance, one study found that low-income consumers had a much higher probability of living near a payday loan store than consumers with relatively high income.⁹⁸ Another study found that more than 75% of payday lending stores in Arizona were located in only two counties and were clustered in those counties in minority neighborhoods comprised of African-Americans, Latinos, and/or Native Americans.⁹⁹ Minority

around military bases).

95. See Graves & Peterson, *supra* note 4, 699–700 (discussing in detail the methodology employed in gathering data).

96. See, e.g., WEI LI ET AL., PREDATORY PROFILING: THE ROLE OF RACE AND ETHNICITY IN THE LOCATION OF PAYDAY LENDERS IN CALIFORNIA, CTR. FOR RESPONSIBLE LENDING 4 (2009), available at <http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf> (noting that the California Department of Corporations released a survey of payday loan borrowers revealing that, “while they represent about a third of the overall adult population, over half of payday borrowers are African American or Latino”); NAT’L PEOPLE’S ACTION, CREDIT SEGREGATION: CONCENTRATIONS OF PREDATORY LENDERS IN COMMUNITIES OF COLOR 14 (Feb. 2011), available at http://showdowninamerica.org/files/images/Credit_Segregation_NPA_Report_v5.pdf (analyzing Advance America, the nation’s leading payday lender, and finding that its stores are “closest to and most densely concentrated in communities of color”).

97. See, e.g., Ellen E. Schultz & Theo Francis, *High-Interest Lenders Tap Elderly, Disabled*, WALL ST. J., Feb. 12, 2008, at A1, available at <http://online.wsj.com/article/SB120277630957260703.html> (arguing that elderly Americans are particularly susceptible to the payday lending debt trap because “they are typically dependent on smaller fixed incomes and are rarely able to pay off their loans quickly”).

98. See, e.g., Steven M. Graves, *Landscapes of Predation, Landscapes of Neglect: A Location Analysis of Payday Lenders and Banks*, 55 PROF. GEOGRAPHER 303, 309, 311–12 (2003) (demonstrating statistically strong locational bias of payday lenders for poorer areas and banks for wealthier areas).

99. See ARACELY PANAMEÑO & KEITH CORBETT, WEALTH-STRIPPING PAYDAY LOANS TROUBLE COMMUNITIES OF COLOR, CTR. FOR RESPONSIBLE LENDING ISSUE BRIEF 1, 3–6 (Oct. 2, 2008), available at <http://www.responsiblelending.org/payday-lending/research-analysis/az-payday-communities-of-color-10-2-final.pdf>;

consumers being disproportionately represented among payday loan borrowers is not by accident. For example, former employees of one Ohio-based payday lender testified that they targeted African-American borrowers in Washington, D.C. and surrounding areas¹⁰⁰ and used various strategies to solicit African-American borrowers.¹⁰¹

Although these civilian communities are more difficult to identify as targets than military-base populations, this difficulty should not make the targeting of civilian communities of any less concern to lawmakers. Federal lawmakers are overwhelmingly college-educated, white, and male,¹⁰² and many are wealthy.¹⁰³ That makes most of these lawmakers susceptible to being out of touch with payday loan borrowers, especially those lawmakers who do not spend time in low-income white and minority communities to understand the financial conditions confronting them. Congress should not view payday loans as magically turning into a viable

Martin & Tong, *supra* note 39, at 786–87 (citing studies showing a concentration of payday loan stores in minority communities).

100. Press Release, Ohio Coalition for Responsible Lending, Payday Lending Industry Insiders Tell All: Unsavory Details Emerge About the Debt Trap and Much More 3 (Sept. 11, 2007), *available at* http://www.cohhio.org/pdf/nr_09112007.pdf (stating that “[w]e didn’t restrict our marketing to businesses in the District [of Columbia]; [w]e went into Maryland, to College Park, Landover, Laurel, Bowie—always to areas with a high percentage of black customers”). “We seek out low-income African-American and Latino neighborhoods because we know that this is where our most profitable client base is located.” *Id.* at 9.

101. *See id.* at 3–4 (recounting that an employee was instructed to visit an African-American church to get into the “customer base” and employees routinely paid pastors a \$20 referral fee for each member sent to the payday lender).

102. *See* JENNIFER E. MANNING, CONG. RESEARCH SERV., MEMBERSHIP OF THE 111TH CONGRESS: A PROFILE 3, 5–6 (Dec. 27, 2010), *available at* [http://www.senate.gov/CRSReports/crs-publish.cfm?pid=%260BL\)PL%3B%3D%0A](http://www.senate.gov/CRSReports/crs-publish.cfm?pid=%260BL)PL%3B%3D%0A) (listing statistical demographic information on the members of Congress).

103. *Most Members of Congress Enjoy Robust Financial Status, Despite Nation’s Sluggish Economic Recovery*, CTR. FOR RESPONSIVE POLITICS (Nov. 15, 2011 10:30 AM), <http://www.opensecrets.org/news/2011/11/congress-enjoys-robust-financial-status.html> (last visited Apr. 6, 2012) (discussing an analysis of the financial status of members of Congress) (on file with the Washington and Lee Law Review); *see also* Gregory Korte & Fredreka Schouten, *57 Members of Congress Among Wealthy 1%*, USA TODAY, Nov. 16, 2011, at A1, *available at* <http://www.usatoday.com/news/washington/story/2011-11-15/congress-wealthy-1/51216626/1> (reporting that “[r]oughly 11% of Congress have net worth of more than \$9 million,” there are 250 millionaires in Congress, and the median net worth of \$891,506 is almost nine times that of typical households).

short-term credit option just because Shenequa obtains the loan and not Private Ryan.¹⁰⁴ If the targeting of military families was a justifiable basis for protecting them from payday lending, then likewise the targeting of civilian families is an equally justifiable basis for protecting civilians.

C. Both Civilian and Military Payday Borrowers Are Lacking in Financial Sophistication

The lack of financial sophistication among soldiers was a third argument raised in support of passage of the MLA, and this is another borrower characteristic that civilians and soldiers share. Senator Jim Talent (R-Mo.) argued that payday lending “is ruining the financial lives of thousands of our service men and women who unknowingly, because of their lack of sophistication, get into debts from these abusive lenders, far greater than they are able to pay.”¹⁰⁵ His lack-of-sophistication argument hinged on the young age of many of the soldiers, as well as their possession of only a high school diploma.¹⁰⁶ These characteristics are common among civilian borrowers as well.¹⁰⁷ Add to these characteristics the fact that consumer credit contracts tend to be more complicated than necessary,¹⁰⁸ and one can then understand why borrowers lack the sophistication to comprehend the likely negative consequences of getting a payday loan.

104. Both of these persons are fictional characters. Private Ryan is a white, male movie character. *SAVING PRIVATE RYAN* (Paramount Pictures 1998). Shenequa is a common name for African-American females and is meant in this Article to represent a typical payday loan customer.

105. 152 CONG. REC. S6405, S6406 (daily ed. June 22, 2006) (statement of Sen. Talent).

106. *See id.* (stating “these young men and women, many of whom are just out of high school, are not financially sophisticated and fall way behind in these payments”).

107. *See* Martin & Tong, *supra* note 39, at 793 (noting that “[s]tudies have consistently found that typical payday loan customers tend to be under the age of forty-five, have only a high school diploma or GED, and are disproportionately racial minorities”).

108. *See* Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL’Y 199, 224 n.136 (2005) (noting scholarly criticism of the credit industry for unnecessarily complex contracts).

*D. The Payday Loan Trap Hinders the Job Performance of Both
Civilians and Military Personnel*

A fourth argument for passing a federal law protecting soldiers from payday lending was that payday loans interfere with military preparedness. Master Chief Petty Officer of the Navy, Terry Scott, testified that “the No. 1 reason our sailors are forced from one job to another is because they lose their security clearance . . . and the No. 1 reason they lose their security clearance is because of financial difficulties.”¹⁰⁹ Similarly, Senator Talent, who is largely credited for getting the MLA passed, testified that “[t]his abuse of payday lending is compromising the readiness of the U.S. military.”¹¹⁰

This military preparedness argument is not just about clearances but also means that soldiers ensnared by payday loans cannot devote their attention to their jobs and, therefore, the loans negatively affect their performance.¹¹¹ As Representative Walter Jones, Jr., (R-N.C.) put it succinctly, “[w]hen relatively unsophisticated borrowers are unable to readily repay a loan from these lenders, they can become consumed with worries over their debt and this undercuts their abilities to fulfill their military duties.”¹¹² Military leaders like Staff Sergeant Carlton Brown echoed concerns that once soldiers are trapped by payday loans, they become distracted from performing their duties as they struggle to make loan payments.¹¹³

Although civilians cannot claim that payday loans may interfere with their ability to obtain security clearances, they nevertheless suffer in their job performance due to stress from over-indebtedness and aggressive collection tactics by payday lenders.¹¹⁴ Payday lenders or their agents have repeatedly

109. 152 CONG. REC. S6405, S6406 (daily ed. June 22, 2006) (statement of Sen. Talent).

110. *Id.*

111. See 151 CONG. REC. E1487-01 (daily ed. July 14, 2005) (statement of Rep. Jones).

112. *Id.*

113. See 151 CONG. REC. E1386-01 (daily ed. June 28, 2005) (statement of Rep. Gutierrez) (noting previous testimony on a distracting influence impacting “mission readiness”).

114. See *infra* notes 115–20 and accompanying text.

harassed civilian borrowers by calling their friends,¹¹⁵ relatives,¹¹⁶ and employers,¹¹⁷ and by threatening civilian borrowers with criminal prosecution for passing bad checks to pressure them into repaying the debt or paying rollover fees.¹¹⁸ As the author has previously pointed out, payday lenders have sometimes been able to make good on their threats of arrest or criminal prosecution due to the ignorance of some local judges and prosecutors.¹¹⁹ Some lenders have also threatened to call or have actually repeatedly called borrowers' employers in an attempt to get them fired for failure to repay.¹²⁰

115. The author has been the recipient of telephone calls from payday lenders looking for her friends who have failed to repay the loans because she was listed as a reference in the loan applications.

116. See, e.g., *Bill Would Clamp Down on Interest Charged by Payday Lenders*, NEWS JOURNAL (Mansfield, Ohio), Sept. 10, 2007, at A1, available at 2007 WLNR 28051189 (reporting that payday lenders have harassed, by telephone, young children of borrowers by warning them that bad things will happen to their parents if they fail to repay).

117. *Id.*

118. See, e.g., *Boyce v. Attorney's Dispatch Serv.*, No. C-39-94-347, 1999 WL 33495605, at *1, *3 (S.D. Ohio Apr. 27, 1999) (finding plaintiffs entitled to up to \$17,000 in damages where debt collection agents for payday lender made numerous telephone calls to the borrowers, representing themselves as police officers to the borrowers and one's co-worker and threatening to criminally prosecute the borrowers for failure to pay). In *Boyce*, the court found that as a result of these debt collection practices, the borrowers suffered significant distress and a strained marital relationship. *Id.* at *1; see also *Money Shop v. Hodge (In re Hodge)*, 367 B.R. 843, 849 (Bankr. M.D. Ala. 2007) (awarding a \$1,000 judgment for punitive damages against a payday lender after finding its "conduct involve[d] intentional malice, trickery, or deceit through its threat of arrest and criminal prosecution when such action was unavailable under [Alabama] law"); Don Baylor, *The Hidden Costs of Payday Lending*, TEX. BUS. REV., Apr. 1, 2008, at 1, 4, available at <http://www.ic2.utexas.edu/bbr/back-issues/2008-texas-business-review/april-2008-texas-business-review/view.html> (reporting a complaint by a borrower that a payday lender "threatened to have [a] constable come to her place of employment and have her arrested").

119. Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 32-33, 87-89 (2002) (discussing numerous instances of threats of criminal prosecution by lenders, including arrests and criminal complaints filed). Consumers have had to post bail just to get out of jail for failure to repay a payday loan, not for the actual commission of a crime. See, e.g., Dean Foust et al., *Easy Money: Subprime Lenders Make a Killing Catering to Poorer Americans*, BUS. WK., Apr. 24, 2000, at 107, 114 (describing the plight of a young mother jailed for missing a payment).

120. See, e.g., Baylor, *supra* note 118, at 3-4 (reporting consumer complaints about numerous types of threats made by payday lenders).

Unlike military personnel, civilian Americans do not have the benefit of powerful people or groups fighting to protect them from the stress brought on by payday loans. Most civilians are at-will employees¹²¹ and, therefore, their employers can fire them for being “deadbeats” as a result of aggressive debt collection practices by payday lenders. When military brass complained to Congress to pass the MLA on the basis that payday loans lead to revocation of soldiers’ security clearances, military brass stated that the loss of clearances, not their termination of employment, “forced [the soldiers] from one job to another.”¹²² Unlike soldiers who have had superiors come to their aid,¹²³ civilians trapped in payday loan debt do not have employers looking for ways to help them get free from the payday loan trap and to help them maintain employment. Thus, if payday loans had a negative impact on the job performance of soldiers, it has to have a similar negative impact on civilian job performance, especially when civilians have to function under the constant threat of criminal prosecution or employment termination.

*E. Payday Loans Lead to Unmanageable Debt for Both Civilians
and Military Personnel*

The last argument made in favor of protecting military families from payday loans is that these loans lead to unmanageable debt. Representative Drake made several references to payday loan debt being unmanageable and that it is exacerbated by lenders “encouraging extensions of the loan through refinancing.”¹²⁴ Her sentiments were repeated by other members of Congress.¹²⁵

121. See Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 108 (1997) (noting “the vast majority of nonunion, private sector employees are employed at will”).

122. 152 CONG. REC. S6405, S6406 (daily ed. June 22, 2006) (statement of Sen. Talent) (quoting Terry Scott, Master Chief Petty Officer of the Navy).

123. See, e.g., Annys Shin, *On Payday, Many GIs Pay Back*, WASH. POST, Sept. 11, 2006, at A8, available at 2006 WLNR 15759883 (reporting that after receiving threats from his payday lender, a sailor overwhelmed by payday loan debt went to his commanding officer, who then helped him find a lawyer and obtain credit counseling).

124. See 52 CONG. REC. H7979 (daily ed. Sept. 29, 2006) (statement of Rep. Drake).

125. See *id.* at H7980 (daily ed. Sept. 29, 2006) (statement of Rep. Drake).

As explained further below, if one accepts the argument that payday loans turn into a debt trap for military families, one should be able to accept the same argument for civilians given that they lack a strong social safety net. Below is a comparison and contrast of military families and civilian families that demonstrate that military families enjoy benefits that exceed the private sector. The discussion about the huge disparity in benefits is not intended to downplay the sacrifices of military personnel. It is, however, intended to show that civilians should be afforded protection from payday lenders because, while military personnel may face other forms of hardship, the average civilian is financially worse off than those in the military;¹²⁶ consequently, many civilians will obtain payday loans and get trapped in debt.

The employment benefits enjoyed by active-duty military members vastly differ from those available to civilian families. The first of these benefits is relatively good compensation with job security. The Congressional Budget Office reported that, with cash allowances and associated tax advantages, regular military compensation for the average enlisted soldier exceeds the 75th percentile of civilian earnings.¹²⁷ In addition to being well-paid, members of the military have the option to retain their jobs and receive scheduled across-the-board pay increases.¹²⁸ Soldiers also receive free training to improve their skills and, as a result, become qualified for higher-skilled and higher-paid positions.¹²⁹ Furthermore, they can receive free or largely subsidized college education.¹³⁰ As of August 2009, service members with at least three years of active duty service can attend any public college at government expense or apply for a subsidy payment toward tuition at a private university.¹³¹ In addition to benefits related to further career advancement, active-duty military personnel, eligible

126. CONG. BUDGET OFFICE, *ASSESSING PAY AND BENEFITS FOR MILITARY PERSONNEL* (2007), available at <http://www.cbo.gov/doc.cfm?index=8550&type=0> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

127. *Id.*

128. *Id.*

129. *Id.*

130. Lizette Alvarez, *More Americans Joining Military as Jobs Dwindle*, N.Y. TIMES, Jan. 19, 2009, at A1, available at <http://www.nytimes.com/2009/01/19/us/19recruits.html>.

131. *Id.*

military retirees, and dependents of both groups receive highly-subsidized health care through the Military Health Services System.¹³² Besides healthcare, housing cost is another large expense soldiers are primarily relieved of paying. They can live on base for free or they and their family can live off base and receive a monthly housing subsidy to cover housing cost.¹³³ Soldiers also can go to on-base commissaries and post exchanges to buy groceries at or near cost and do not pay sales tax on them.¹³⁴ Soldiers also receive free legal representation that is guaranteed and is an important benefit, especially when facing a legal battle with a payday lender.¹³⁵ Finally, bankruptcy filings are easier to accomplish as result of laws passed to protect troops in need of bankruptcy relief due to insurmountable debt, such as payday loan debt.¹³⁶

Civilians, who are largely unprotected from payday loans,¹³⁷ are facing persistent unemployment¹³⁸ and have very few benefits in comparison to military families.¹³⁹ In the midst of the current

132. See JOHN V. LUND, MILITARY PAY, BENEFITS AND RETIREMENT 41 (2004) (stating that healthcare services are mostly free but members may be responsible for small per diem costs for hospital stays).

133. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-02-935, MILITARY PERSONNEL: ACTIVE DUTY BENEFITS REFLECT CHANGING DEMOGRAPHICS, BUT OPPORTUNITIES EXIST TO IMPROVE 47–48 (2002).

134. *Id.* at 42.

135. *Id.* at 50.

136. *Military Families Accomplish Mission of Reducing Debt*, PROVIDENCE J. BULL. (R.I.), Dec. 15, 2008, at 11, available at 2008 WLNR 24019139 (explaining the National Guard and Reservists Debt Relief Act of 2008, Pub. L. 110-438, § 3197, 122 Stat. 5000).

137. Unless they are poor enough to qualify for free legal aid, civilian Americans have to pay for their own legal counsel. Moreover, unlike soldiers, civilians do not have federal laws making it easier to file bankruptcy. Additionally, nonbank payday lenders are flagrantly disregarding state laws aimed at curbing payday lending. See Johnson, *supra* note 119, at 31 and accompanying text (citing data that suggests payday lenders are evading state usury limits).

138. U.S. BUREAU OF LABOR STATISTICS, USDL-11-1691, THE EMPLOYMENT SITUATION—NOVEMBER 2011 2 (2011), available at http://www.bls.gov/news.release/archives/empst_12022011.pdf (stating that as of November 2011, the number of long-term unemployed, i.e., those jobless for twenty-seven weeks and over, stood at 5.7 million).

139. CONG. BUDGET OFFICE, ASSESSING PAY AND BENEFITS FOR MILITARY PERSONNEL 5 (2007), available at <http://www.cbo.gov/doc.cfm?index=8550&type=0>.

economic crisis, the unemployment rate remains high.¹⁴⁰ In 2008, 2.6 million jobs were lost—the highest loss since 1945.¹⁴¹ In January 2009, 598,000 jobs were lost.¹⁴² This unemployment trend has continued with the unemployment rate jumping from 5.8% in 2008 to 9.6% in 2010, and in 2011, it hovered around 9.1%.¹⁴³ Studies demonstrate that job losses have affected minorities disproportionately more than Caucasian Americans.¹⁴⁴ The current unemployment rate for African-Americans is 15.8% and for Latinos is 11.0% while it is only 7.5% for Caucasians.¹⁴⁵ This racial disparity is important because research shows African-Americans and Latinos are disproportionately more likely to obtain payday loans than Caucasians.¹⁴⁶ This is not surprising, considering data showing the concentration of payday lenders in minority communities and, as one study found, these lenders are three times more prevalent in African-American neighborhoods than Caucasian ones, even when it controlled for other factors.¹⁴⁷

140. See Liz Wolgemuth, *What's in a Number?*, U.S. NEWS & WORLD REP., July 1, 2009, at 46 (discussing what happens during a recession, including rising unemployment).

141. *Id.*

142. *Id.*

143. U.S. BUREAU OF LABOR STATISTICS, LABOR STATISTICS FROM THE CURRENT POPULATION SURVEY 194, <http://www.bls.gov/cps/cpsaat1.pdf>; see also *Rep. Clarke Issues Statement on May's Job Report*, U.S. FED. NEWS, June 3, 2011.

144. Patrick McGeehan & Mathew R. Warren, *Black-White Gap in Jobless Rate Widens in City*, N.Y. TIMES, Jul. 13, 2009, at A1, available at <http://www.nytimes.com/2009/07/13/nyregion/13unemployment.html?scp=1&sq=Job%20Losses%20Show%20Wider%20Racial%20Gap&st=cse>. By the end of March 2009, there were about 80,000 more unemployed blacks than whites, even though there are roughly 1.5 million more whites than blacks in New York City. *Id.* Because of the disproportionate number of blacks unemployed than whites, the military could be an attractive option for black youths. *Id.*

145. U.S. BUREAU OF LABOR STATISTICS, EMPLOYMENT SITUATION SUMMARY (December 2011), <http://www.bls.gov/news.release/empst.nr0.htm> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

146. See, e.g., PANAMEÑO & CORBETT, *supra* note 99, at 2; WEI LI ET AL., *supra* note 96, at 2 (noting in its report that African-Americans and Latinos make up a disproportionate share of payday loan borrowers in California).

147. URIAH KING ET AL., RACE MATTERS: THE CONCENTRATION OF PAYDAY LENDERS IN AFRICAN-AMERICAN NEIGHBORHOODS IN NORTH CAROLINA, CTR. FOR RESPONSIBLE LENDING 11 (Mar. 22, 2005), available at http://www.responsiblelending.org/north-carolina/nc-payday/research-analysis/racematters/rr006-Race_Matters_Payday_in_NC-0305.pdf.

Instead of an increase in well-paying jobs, low-to-moderate income civilian workers can expect stagnant wages and “automation, outsourcing, and the march of workers toward jobs in the [low-paying] service sector.”¹⁴⁸ After adjusting for inflation, wages for most workers have been stagnant for the last few years.¹⁴⁹ That means that those who are fortunate to receive pay increases in this Great Recession are most likely earning wages that do not actually keep pace with the cost of living. An estimated three million jobs have been outsourced to China alone¹⁵⁰ and thousands of jobs have gone to other low-income countries such as India.¹⁵¹ Given these bleak statistics, many Americans will remain unemployed or under-employed.¹⁵² For those civilians fortunate enough to have decent jobs, some will face financial difficulties due to an ever-shrinking compensation and benefits package.¹⁵³

Opportunities for job training, career advancement, and higher education are substantially less for civilians in comparison to military members.¹⁵⁴ The training a civilian does receive is specific

148. Liz Wolgemuth, *Workers Do the Shuffle: The Labor Force Is Shifting Toward Science and Health*, U.S. NEWS AND WORLD REP., July 1, 2009, at 38, available at 2009 WLNR 11671360.

149. See JARED BERNSTEIN & LAWRENCE MISHEL, ECONOMY'S GAINS FAIL TO REACH MOST WORKERS' PAYCHECKS, ECON. POL'Y INST. 1 (Aug. 30, 2007), available at <http://www.epi.org/publication/bp195/>.

150. See ROBERT E. SCOTT, UNFAIR CHINA TRADE COSTS LOCAL JOBS, ECON. POL'Y INST. 1 (Mar. 23, 2010), available at <http://www.epi.org/publication/bp260/> (reporting that between 2001 and 2008, 2.4 million jobs were lost or displaced due to a growing trade imbalance between the United States and China).

151. See Kimberley Blanton, *An Honest Disturbing Look At Outsourcing*, BOSTON GLOBE, July 10, 2005, at D2, available at 2005 WLNR 10872874 (providing statistics on several U.S. corporations hiring in India); see also J. Bonasia, *Outsourcing, for Good or Ill, Comes of Age Putting India on the Map*, INVESTOR'S BUS. DAILY, Dec. 3, 2010, at A04, available at 2010 WLNR 23970044 (quoting a study that found “[m]ore than 1.3 million additional Western jobs will vanish by 2014 due to ‘accelerated movement of work to India and other offshore locations’”).

152. See generally U.S. BUREAU OF LABOR STATISTICS, USDL-11-1691, THE EMPLOYMENT SITUATION—NOVEMBER 2011 (2011), available at http://www.bls.gov/news.release/archives/empisit_12022011.pdf.

153. See *supra* note 134 and accompanying text.

154. See Chas Sisk, *Funds for Training Cut as Job Losses Increase*, TENNESSEAN (Nashville), Dec. 14, 2008, available at 2008 WLNR 26407099 (reporting that job training programs have suffered from budget cuts as the recession has deepened).

to the job at hand, and generally inapplicable to other fields.¹⁵⁵ In order to pursue significant advancement or change in career, a civilian usually must go back to school to gain the proper credentials at his or her own expense.¹⁵⁶ Post-secondary education comes at no small cost.¹⁵⁷ The majority of civilians will not be fortunate enough to receive scholarships along the way and, therefore, will be responsible for the entire cost of higher education, which has been steadily rising for the last two decades.¹⁵⁸

Besides lack of free higher education, most civilian workers and their family members do not get free healthcare, subsidized housing, discounted groceries, or free legal aid. Even if civilians are able to take advantage of move-in specials for housing, scholarships for higher education, coupons for groceries, and discounts for special offers, these potential savings cannot compare to free healthcare services, free public higher education, subsidized housing, and other benefits provided to active-duty military families.

Without these numerous benefits awarded to military families, average civilian families are even more vulnerable to economic hardship and, therefore, likely to rely on payday loans.¹⁵⁹ Without the legal protection afforded to military personnel, many civilian families who obtain payday loans will get caught in a cycle of debt and some will even have to file bankruptcy to get out of this debt.¹⁶⁰

IV. Efforts to Afford Civilians Protections from Payday Lending

Some federal lawmakers have tried but have been unsuccessful in passing legislation to curb payday lending to protect ordinary

155. See Steven Greenhouse, *Learning Curves on the Career Path*, N.Y. TIMES, Aug. 26, 2010, at F1, available at <http://www.nytimes.com/2010/08/26/education/26JOBS.html?pagewanted=all> (attributing different technology in various fields as a stimulus for retraining).

156. *Id.*

157. See U.S. DEPT OF EDUC., TRENDS IN STUDENT FINANCING OF UNDERGRADUATE EDUCATION: SELECTED YEARS, 1995–96 TO 2007–08, tbl. 1.1 (Jan. 2011), available at <http://nces.ed.gov/pubs2011/2011218.pdf>.

158. *Id.*

159. See *supra* notes 126–36 and accompanying text.

160. See Mitchell Schnurman, *Big Print Is a Big Step Toward Reigning in Payday Loan Fees*, STAR-TELEGRAM (Jan. 12, 2012) <http://www.star-telegram.com/2012/01/11/3653488/big-print-is-a-big-step-toward.html> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

Americans.¹⁶¹ While several states have enacted laws to restrict payday lending, payday lenders are either ignoring the laws outright or finding clever ways to get around them.¹⁶²

A. Federal Lawmakers Have Been Unable to Muster Bipartisan Support to Protect Civilians

The United States Congress acted bipartisanly in 2006 to protect *only* active duty soldiers and their families from payday loans;¹⁶³ however, since that time, Congress has had inertia when it comes to passing legislation that would extend protection to all Americans.

In 2009, U.S. Representative Luis Gutierrez (D-Ill.), then head of the House Financial Services Subcommittee on Financial Institutions and Consumer Credit, introduced a bill entitled the “Payday Loan Reform Act of 2009.”¹⁶⁴ The proposed bill would have required lenders to provide specific disclosures to payday loan customers¹⁶⁵ and purported to extend protections of the MLA to all Americans.¹⁶⁶ However, because the bill would not have capped APRs on payday loans or offered many protections already required

161. See, e.g., Payday Loan Reform Act of 2009, H.R. 1214, 111th Cong. (1st Sess. 2009).

162. See Creola Johnson, *America’s First Consumer Financial Watchdog Is on a Leash: Can the CFPB Use Its Authority to Declare Payday Loan Practices Unfair, Abusive, and Deceptive?*, 61 CATHOLIC UNIV. L. REV. (forthcoming 2012).

163. See Warner National Defense Act, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2266–69 (2006).

164. The proposed bill would require lenders to provide specific disclosures to payday loan customers and purports to extend protections of the Military Lending Act to all Americans. It would require payday lenders to post notices in English and Spanish, and offer extended repayment plans if consumers cannot make due dates. Lenders would also be prohibited from threatening criminal prosecution or taking a security interest in property against people who can’t repay on time. Payday Loan Reform Act of 2009, H.R. 1214, 111th Cong. (1st Sess. 2009). Because the Gutierrez bill actually protects payday lenders and legalizes predatory lending, consumer advocates have labeled it the “Payday Lender Protection Act.” See “*Payday Loan Reform Act*” *Doesn’t Contain Much Reform*, AMERICANS FOR FAIRNESS IN LENDING (Apr. 10, 2009), <http://americansforfairnessinlending.wordpress.com/2009/04/10/“payday-loan-reform-act”-doesn’t-contain-much-reform/> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

165. Payday Loan Reform Act of 2009, H.R. 1214, 111th Cong. (2009).

166. *Id.*

under state law, critics rightfully argued that the Gutierrez bill would have in effect given Congressional approval to lenders that charge triple-digit-interest rates for payday loans.¹⁶⁷

In the same year the Gutierrez bill was introduced, Senator Richard J. Durbin (D-Ill.) introduced a bill called the Protecting Consumers from Unreasonable Credit Rates Act of 2009 in order to establish “a national usury rate for consumer credit transactions.”¹⁶⁸ Like the MLA, Durbin’s bill would have capped the APR on payday loans at 36%.¹⁶⁹ The 36% interest rate cap was arguably fair to consumers and would have given payday lenders a reasonable profit.¹⁷⁰ Durbin’s bill, however, fell short of providing needed consumer protection because it had “tolerances” or exceptions that payday lenders would have used to skirt the usury cap.¹⁷¹

167. The Gutierrez bill provides that: “It shall be unlawful for a payday lender to require a consumer to pay interest and fees that, combined, total more than 15 cents for every dollar loaned in connection with a payday loan.” *Id.* Americans for Fairness in Lending contends that the rate of charging interest at fifteen cents for every dollar translates into an APR of 390% for two weeks or 780% APR for one week. See “*Payday Loan Reform Act*” *Doesn’t Contain Much Reform*, *supra* note 164. Thus, Gutierrez’s bill is “an ersatz reform that would allow payday lenders to charge at what amounts to an annual percentage rate of 391 percent.” Editorial, *391 Percent Payday Loan*, N.Y. TIMES, Apr. 13, 2009, at A20, available at <http://www.nytimes.com/2009/04/13/opinion/13mon2.html?scp=1&sq=391%20Percent%20Payday%20Loan&st=cse>.

168. S. 500, 111th Cong. (1st Sess. 2009).

169. Because of the lack of a federal usury cap on interest rates, consumers pay as much as \$8,600,000,000 annually in fees for payday loans. Protecting Consumers from Unreasonable Credit Rates Act of 2009, S. 500, 111th Cong. (2009). Unlike the Gutierrez bill, consumer protection proponents support Durbin’s bill. See *Payday Loan Reform Act Does Not Contain Much Reform*, *supra* note 164 (stating that the consumer groups that support Durbin’s Bill and oppose Gutierrez’s bill include ACORN, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, National Consumer Law Center, National Fair Housing Alliance, National Community Reinvestment Coalition, and U.S. PIRG). See Protecting Consumers from Unreasonable Credit Rates Act of 2009 § 141(a).

170. See FDIC, *The FDICs Small Dollar Loan Pilot Program: A Case Study After One Year*, 3 FDIC QUARTERLY, 2009, at 29, 34, available at http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_2/SmallDollar.pdf (discussing a pilot program demonstrating the profitability of short-term loans with APRs less than 36%).

171. For example, section 141(b)(2) of the bill provides that the definition of fee and interest rate does not include a “credit obligation that is payable in at least 3 fully amortizing installments over at least 90 days.” S.500, 111th Cong. (1st Sess. 2009). For loans of \$300 or more, lenders can charge additional fees, including origination fees of no more than \$30, and late fees of either \$20 or a

In 2010, Senator Kay Hagan (D-NC) introduced a bill that was weaker than Durbin's bill because it contained no usury cap and would have only required payday lenders to offer customers an extended repayment plan upon their default and would have allowed payday lenders to issue up to six loans to an individual borrower in a twelve-month period.¹⁷² Senator Hagan also introduced the text of this bill as an amendment to the bill that eventually became the Dodd–Frank Act.¹⁷³ The amendment failed due in part to the lobbying efforts of nonbank payday lenders.¹⁷⁴ In response to her proposed amendment, some of these lenders told their customers that the bill would put payday lenders out of business and would deny their customers the ability to receive loans.¹⁷⁵ Some payday lenders even provided their customers with scripts and letters to contact their lawmakers in an effort to begin a “grass-roots” campaign to stop the amendment.¹⁷⁶

In summary, none of the foregoing proposed bills would have required lenders to offer reasonably priced loans to all Americans or would have imposed reasonable restrictions on payday lending practices; therefore, these bills were not worth passing.¹⁷⁷

While federal lawmakers have been unsuccessful in getting any bills passed to protect civilians, several states have passed legislation to protect their civilian residents from payday lending.¹⁷⁸ Due to reasonable publishing constraints, the author is unable to discuss numerous schemes employed by payday lenders to

fee authorized by state law. *Id.* For example, if the loan is payable in three installments and has a 90-day maturity, lenders will be allowed to charge origination fees between \$30 and \$120 on loans of \$300 or more. *See Johnson, supra* note 162 (discussing numerous ways in which nonbank payday lenders skirt state laws).

172. Payday Lending Limitation Act of 2010, S. 3425, 111th Cong. (2009).

173. Restoring American Financial Stability Act, S. 3245, 111th Cong. (2010).

174. Clarence Page, *Small Loans, Big Business*, MERCED SUN-STAR (Cal.), Jun. 23, 2010, available at <http://www.mercedsunstar.com/2010/06/23/1469969/clarence-page-small-loans-big.html>.

175. David Lazarus, *Payday Lenders Sink Loan Limits*, L.A. TIMES, May 21, 2010, at B1, available at <http://articles.latimes.com/2010/may/21/business/la-fi-lazarus-20100521>.

176. *Id.*

177. *See Johnson, supra* note 162.

178. *Id.*

circumvent state laws. These schemes are, however, fully expounded in a forthcoming article¹⁷⁹ to demonstrate why federal regulation from the CFPB is necessary to curb payday lending.

*B. Mainstream Financial Institutions Alone Cannot Be
Trusted to Protect Civilians*

Before proposing specific recommendations that the CFPB could consider implementing, this Article addresses why the CFPB cannot just leave it solely to traditional banks and credit unions to offer nationwide low-cost loans to civilian consumers, and thereby obviate the need for the CFPB to act.

Credit unions are perceived by millions to be a trustworthy source for low-interest mortgage and auto loans, and recently adopted regulations seek to continue that perception. The National Credit Union Administration (NCUA) amended in 2010 its lending rules concerning short-term, small-dollar loans¹⁸⁰ to make it easier for a federal credit union (FCU) to offer short-term, small-amount loans as an alternative to payday loans.¹⁸¹ Under the new rules, the APR for such loans is capped at 28% and FCUs are prohibited from charging application fees in excess of \$20 or issuing loan amounts in excess of \$1,000.¹⁸² Note that this amendment raised the allowable rate from 18% to 28%,¹⁸³ thereby allowing FCUs to create slightly more expensive loans. The NCUA requires that the loans have a minimum maturity date of one month and prohibits rollovers.¹⁸⁴

Despite the promise offered by the NCUA rules, the media has reported that some credit unions are offering high-cost loans similar

179. *Id.*

180. Short-Term, Small Loan Amounts, 12 C.F.R. § 701.21(c)(7)(iii) (2011).

181. *See* Short-Term, Small Amount Loans, 75 Fed. Reg. 58285 (Sept. 24, 2010) (codified at 12 C.F.R. § 701) (stating that “[t]he amendment permits FCUs to charge a higher interest rate for an STS loan than is permitted under the general lending rule, but imposes limitations on the permissible term, amount and fees associated with an STS loan”).

182. *Id.*

183. *Id.* Prior to the rule change, federal credit unions were limited to a maximum lending rate of 18%. *See* Letter from Nat’l Credit Union Admin., to Federal Credit Unions (Apr. 2011), *available at* <http://www.ncua.gov/Resources/Documents/LFCU2011-04.pdf>.

184. *Id.*

to traditional payday loans.¹⁸⁵ Critics argue that the amendments have enabled, rather than curbed, the conduct of such rogue credit unions.¹⁸⁶ One specific criticism is that because of a \$20 application fee for each loan, the cost to borrow \$200 for two months translates into an APR of more than 100% and even greater since some credit unions are charging application fees far above the \$20 cap.¹⁸⁷ For example, Kinecta Federal Credit Union reportedly charges an application fee of \$39.95.¹⁸⁸ This practice is clearly in violation of NCUA rules which require that FCUs charge an application fee that reflects the actual costs associated with processing an application for a short-term, small-dollar loan.¹⁸⁹ There are also allegations that some credit unions have found inventive ways of circumventing these rules, including selling loans in exchange for a commission by third-party payday companies.¹⁹⁰ Although the NCUA rules are an important starting point, they are meaningless and ineffective if member credit unions can circumvent them without fear of enforcement actions from the NCUA. Debbie Matz, Chairman of the NCUA, responded to the media reports about these credit unions by strongly condemning such practices but did not announce any plans to investigate possible violators and bring enforcement action against them.¹⁹¹

185. See Ben Hallman, *Credit Unions Remake Themselves in Image of Payday Lenders*, iWATCH NEWS (May 27, 2011 2:00 AM), <http://www.iwatchnews.org/2011/05/27/4754/credit-unions-remake-themselves-image-payday-lenders> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

186. *Id.*

187. *Id.*

188. *Id.*

189. See Short-Term, Small Amount Loans, 75 Fed. Reg. 58285 (Sept. 24, 2010) (noting that “Reg Z limits application fees to the recovery of costs associated with processing applications for credit that charged to all consumers who apply, regardless if credit is actually extended”). If FCU undertakes a more limited application process with repeat borrowers, there is no justification for charging the same application fee each time the borrower applied. *Id.*

190. *Id.* Some CUs, such as Mountain America, the second biggest credit union in Utah, are partnering with Capital Finance LLC, a payday lender, to offer high-cost loans. *Payday-loan Limits Among Laws Taking Effect Tuesday*, PAYDAY LOAN ADVOCATE (Oct. 20, 2011 5:42 PM), <http://www.paydayloanadvocate.com/information/payday-loan-limits-among-laws-taking-effect-tuesday/> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

191. See Debbie Matz, Editorial, *Alternatives to Payday Loans*, WASH. POST, June 6, 2011, at A16, available at <http://www.washingtonpost.com/opinions/>

Along with credit unions, traditional banks cannot be relied upon to self-regulate and offer widespread low-cost loans to consumers. Albert Kelly, CEO of SpiritBank in Oklahoma and chairman-elect of the American Bankers' Association, gave congressional testimony where he claimed "[b]anks are working hard every day to make credit available," and argued that "the [CFPB] should focus its energies on supervision and examination of nonbank financial providers."¹⁹² He urged "Congress to ensure that this focus on nonbanks is a priority of the [CFPB]."¹⁹³ Such comments ignore the fact that part of the blame for the rapid expansion of payday lending by nonbanks is due to the scarcity of traditional banks in neighborhoods that rely on payday loans.¹⁹⁴ All types of predatory high-cost credit establishments are ubiquitous in urban neighborhoods while traditional banks are difficult to find.¹⁹⁵ Mr. Kelly's comments also assume only nonbanks are guilty of predatory lending; however, as explained further below, some banks now issue payday loans that are arguably more predatory than the typical payday loan.

Major banks, such as U.S. Bancorp, Wells Fargo, and Fifth Third Bancorp—all three recipients of taxpayer bailout funds¹⁹⁶—have been stealthily creating their own payday loan products,¹⁹⁷ with clever labels such as "direct deposit advances."¹⁹⁸ For example,

alternatives-to-high-interest-payday-loans/2011/06/02/AGJbZmJH_story.html.

192. See, e.g., *Rep. Shelley Moore Capito Holds a Hearing on Dodd-Frank Impact on Community Banks*, CQ CAP. TRANSCRIPTS, Mar. 2, 2011, available at 2011 WLNR 4165390. Albert Kelly, CEO of SpiritBank in Bristow, Oklahoma and chairman-elect of the American Bankers Association failed to explain to whom are the banks "working hard" to extend credit and for what type of loan transactions. *Id.*

193. *Id.*

194. See Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 149–50 (2004) (referring to a 1997 Federal Reserve Board study that found fewer banks per capita in lower income central city neighborhoods when compared to higher income neighborhoods outside the central city).

195. See *id.*

196. *Where Is the Money? Eye on the Bailout—Bailout Recipients*, *supra* note 20.

197. See Serres, *supra* note 21, at 1D.

198. LEAH A. PLUNKETT AND MARGOT FREEMAN SAUNDERS, NAT'L CONSUMER LAW CTR., RUNAWAY BANDWAGON: HOW THE GOVERNMENT'S PUSH FOR DIRECT DEPOSIT OF SOCIAL SECURITY LOANS EXPOSES SENIORS TO PREDATORY BANK LOANS 14–15 (2010), available at <http://www.nclc.org/images/pdf/pr-reports/runaway-bandwagon.pdf>; JEAN ANN FOX, CONSUMER FED'N OF AMERICA, BANK PAYDAY

some Fifth Third Bank branches have signs posted on their drive-through windows that state: "I CAN HELP YOU ACCESS YOUR DIRECT DEPOSIT EARLY[.] ASK ME HOW."¹⁹⁹ When the teller explains the "early access program," she or he is careful not to use the word "loan" but, instead, describes it as a "service" offered to customers with direct deposit, thereby implying that these customers are especially valued.²⁰⁰ Fees for the "service" are not mentioned unless the customer asks and the APR is never mentioned. A comparison of Fifth Third's loan product to the typical payday loan demonstrates that many of these bank-provided short-term loans are nothing more than payday loans.

LOAN PRODUCTS 1 (2009), available at <http://www.stoppaydaypredators.org/CFA%20-%20Bank%20Direct%20Deposit%20Payday%20Loan%20Products,%20Aug.%203,%202009.pdf>.

199. Creola Johnson, Untitled Photograph of Fifth Third Sign (Jan. 29, 2010) (on file with the Washington and Lee Law Review). Midway on the sign was a clipart image of the horn of plenty. *Id.*

200. The author has been a Fifth Third customer for twelve years. She regularly goes into a Fifth Third bank branch for service and is, therefore, describing what she has observed firsthand about the Early Access Loan. Almost every time the author enters a Fifth Third branch for service, a bank employee tries to get her to sign up for this loan program. The author has gotten into arguments with bank employees for refusing to admit that this "early access program" is nothing more than a loan! The author can only assume that the employees are instructed to never use the word "loan." See generally Johnson, *supra* note 119, at 15–19 (stating that when nonbank payday lenders fail to state the APR when asked, they are violating the Truth in Lending Act).

Loan Process and Features	Fifth Third's Early Access Loan ²⁰¹	Typical Payday Loan ²⁰²
Application	None required	Short Application
Direct Deposit	Required	Not Required
Term of Loan	As short as one day and up to thirty-five days depending on when the next direct deposit of borrower's income check occurs.	Usually two-week loan but could be shorter if borrower's payday is sooner than two weeks.
Fee/Interest Rate	Finance charge \$10 for every \$100 borrowed. Fifth Third states this is an APR of 120%.	Finance charge of \$15 to \$20 per \$100 for a two-week loan, with a resulting APR of 390% to 520%.
Repayment Process	Repayment on the loan <i>automatically</i> occurs when the borrower's next direct deposit of at least \$100 goes into the checking account, or else the bank will withdraw the amount due at the end of thirty-five days if no direct deposit transpires.	Repayment occurs when the borrower pays in person on the due date or when the lender debits the borrower's bank account for repayment of entire loan or for a rollover fee if the balance is too low.

Although Fifth Third claims its fee translates into a 120% APR, experts demonstrate that the actual APR is 520% for a one-week loan or 260.71% for a two-week loan.²⁰³ One could hardly call Fifth Third's Early Access Loan a reasonable alternative to payday loans, especially given that the bank will automatically offset the loan against the next direct deposit, and thereby cause the bank to be paid ahead of all other creditors, including the borrower's landlord.²⁰⁴ By doing this, the bank can cause the borrower's account to be overdrawn and incur multiple NSF fees. One could easily see then how a Fifth Third loan could set the borrower on a course of indebtedness just like any other payday loan.

These bank-provided payday loans can be worse for the consumer than nonbank payday loans. By requiring direct deposit

201. See Fifth Third Bank, Brochure, *Fifth Third Early Access Loan* (on file with the Washington and Lee Law Review).

202. See Johnson, *supra* note 119, at 11 (discussing the basic structure of a payday loan); see also *Bank Payday Loans . . . They're Baaaaaaack*, NAT'L CONSUMER LAW CENTER (June 2009), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/pr_prepaid_payday_loans.pdf [hereinafter *Bank Payday Loans*] (same).

203. See *Bank Payday Loans*, *supra* note 202; see also E-mail from Ron Elwood, Staff Attorney, Mid-Minnesota Legal Assistance, to Creola Johnson (Jan. 27, 2010 15:56 EST) (on file with the Washington and Lee Law Review).

204. See *Bank Payday Loans*, *supra* note 202.

and using their automated technology to cause payment immediately when the deposit hits the account, banks are depriving the borrower of using the funds for necessities such as food, and banks are evading garnishment laws that protect a certain amount of income and certain income sources (e.g., social security checks) from creditors.²⁰⁵ The bank's direct deposit requirement was not implemented to benefit the consumer but to assure the bank of an easy way of facilitating payment of itself ahead of all other creditors via technology and automated processes. In contrast, nonbank payday lenders will have to continue their practices of using manpower to attempt multiple bank-account debits to collect and to harass borrowers with insufficient balances into repaying the loans or paying rollover fees.²⁰⁶

Ironically, payday lenders, who have a track record of circumventing state laws, are complaining that banks like Fifth Third are ignoring interest rate caps imposed under state payday lending statutes.²⁰⁷ However, these national banks can ignore state law because federal banking laws protect them from state laws capping interest rates.²⁰⁸ The Office of the Comptroller of the Currency (OCC) recently announced proposed guidelines on safe and sound banking practices in connection with deposit-related consumer credit products, which would include direct deposit advance programs, which are really the banks' version of a payday loan.²⁰⁹ These guidelines are merely suggestions for banks to follow and lack any serious restraints on bank-issued payday loans; therefore, these guidelines would likely have an inconsequential effect on the supply of such loans and are not worth discussing.²¹⁰

Although a few banks and credit unions are offering to civilians short-term loans with effective APRs below 36%, too many of these mainstream institutions are eagerly offering an increasing number of

205. *Id.*

206. *See supra* notes 115–20 and accompanying text (discussing the various methods employed by payday lenders to harass customers who have been unable to repay loans).

207. *See Bank Payday Loans, supra* note 202 (stating that payday lenders are contending that Fifth Third is “ignoring Ohio’s 28% payday loan cap”).

208. *See Johnson, supra* note 119, at 107–08.

209. *See* Guidance On Deposit-Related Credit Products, 76 Fed. Reg. 33409 (June 8, 2011) (proposing guidance and requesting comments).

210. *See id.*

higher-priced loans. For example, according to a trade magazine for banks, Wells Fargo's direct deposit advance loans, which carry APRs ranging from 120% to 1,200%, are offered in twenty-six states, and the bank had allegedly "planned to use its status as a federally regulated bank to get around [New York's] usury cap" to expand its loan business in New York.²¹¹

In summary, there is no groundswell of mainstream financial institutions offering low-cost loans to civilians. Consequently, the CFPB has to rise to the occasion to change the small-dollar, short-term loan industry to protect civilians from high-cost loans.

V. The Consumer Financial Protection Bureau (CFPB) Has Authority to Protect Civilians

The CFPB's intervention is critical and necessary in addressing the plight of the civilian borrower. The U.S. Department of Defense, numerous military organizations, and politicians from jurisdictions with large military installations combined forces to ensure that military families receive protection from predatory lenders.²¹² In other words, these combined forces became a very powerful voice that captured the ear of Congress to act on behalf of military borrowers. Civilian borrowers, on the other hand, have had a very difficult time getting the attention of Congress to afford them similar protections from payday lending, and this is due in part to the strong lobbying efforts of the payday loan industry.²¹³ Consequently, civilians' cries for protection from payday lending have largely fallen on deaf ears.

The nascent CFPB now has the chance to act on the cries of civilians and afford them basic protections. The author has, in another article, described in detail how Richard Cordray, the first director of the CFPB, can use its rulemaking authority to declare many payday loan practices deceptive, unfair, and abusive and, therefore, prohibit them.²¹⁴ However, because various forces are hard

211. Alex Ulam, *Consumer Groups Call N.Y. Plan an Invitation to Usury*, AM. BANKER, Jun. 2, 2011, at 7, available at 2011 WLNR 10957959.

212. See *supra* Parts II, III.

213. See *supra* Part IV.

214. See Johnson, *supra* note 162; David Nakamura & Felicia Sonmez, *Obama Defies Senate, Puts Cordray in Consumer Post*, WASH. POST, Jan. 5, 2012, at A1.

at work to substantially limit the CFPB's rulemaking authority,²¹⁵ the author has to confront the real possibility that the CFPB may be unable to adopt rules prohibiting many common payday loan practices. This Article, therefore, sets forth a road map for the CFPB to consider following to get providers of payday loans to *voluntarily* make substantial improvements of their loans to consumers.

This section asserts that, in order to decrease the supply of payday loans and expand the availability of low-cost loans with reasonable terms to civilian consumers, the CFPB has to seek to accomplish three major tasks. The first major task for the CFPB is to use its guideline-making authority to make clear (1) that high-cost, short-term consumer loans offered by nonbank and mainstream financial institutions are subject to regulations; (2) that entities disguising their operations or their versions of payday loans are "covered persons" subject to regulations;²¹⁶ and (3) that typical payday loan practices are considered unfair, deceptive, and abusive. The second major task for the CFPB to accomplish is to use its authority to issue policy statements to signal to the market place the characteristics of affordable loans to provide a safe harbor for financial institutions offering such loans and desiring to be promoted by the CFPB. The third major task is for the CFPB to use its educational mandate to develop innovative ways of disseminating information about safe affordable loans and make it easy for consumers to locate lenders offering these loans.

A. The CFPB Should Issue Guidelines Identifying Many Payday Loan Practices as Deceptive

The first step in decreasing the supply of the typical payday loan is for the CFPB to use its authority to issue a guideline identifying as abusive, deceptive, and unfair several payday loan practices. The

215. See Johnson, *supra* note 162 (describing various bills introduced to limit the CFPB'S effectiveness by reducing its funding and restricting its ability to adopt regulations).

216. See Johnson, *supra* note 162; Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 983–95 (2008) (describing how payday lenders are reorganizing as "credit service organizations" to avoid regulation). The definition of "covered persons" needs to also be expanded to include companies acting as brokers for payday lenders because they are known for predatory behavior as well.

Dodd–Frank Act transfers to the CFPB various FTC powers, including the authority to issue guidelines,²¹⁷ and grants to the CFPB itself the power to issue guidelines.²¹⁸ FTC guides (also known as guidelines and guidance) are statements of interpretation about what practices are considered unlawful and are intended to promote voluntary compliance among industry participants.²¹⁹ FTC guides provide “the basis for voluntary and simultaneous abandonment of unlawful practices by members of industry.”²²⁰

The CFPB’s issuance of a guide covering payday loans has several advantages. Although a guide would not have the force of law like a promulgated rule, courts and state laws can accord to the guide deference in deciding which practices are unlawful under state consumer statutes.²²¹ Moreover, an industry participant’s actions that are inconsistent with the guide may subject the participant to corrective action by the FTC, and now the CFPB.²²² A guide may be introduced as evidence of the FTC’s “interpretation as to the appropriate standard of conduct and measure of fairness concerning a particular method, act, or practice.”²²³ By issuing a guide, the CFPB would not have to follow the lengthy process of promulgating a rule because it can publish a guide on its own in the Federal Register after giving interested parties a time period to

217. See Dodd–Frank Act, Pub. L. No. 111-203, § 1061(b)(5)(B)(i), 124 Stat. 1376, 2037 (2010) (“The Bureau shall have all powers and duties under the enumerated consumer laws to prescribe rules, issue guidelines, or to conduct studies or issue reports mandated by such laws, that were vested in the Federal Trade Commission on the day before the designated transfer date.”).

218. See *id.* § 1012(a)(10), 124 Stat. at 1965 (authorizing the CFPB to “implement[]the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions”); see also *id.* § 1021(c)(5), 124 Stat. at 1980 (stating that one of the primary functions of the CFPB is “issuing rules, orders, and guidance implementing Federal consumer financial law”).

219. See 16 C.F.R. § 1.5 (2011).

220. *Id.*

221. See 16 C.F.R. § 1.3(c) (2011). *But cf.* *Jeanty v. Washington Mutual Bank F.A.*, 305 F. Supp. 2d 962, 964 (E.D. Wis. 2004) (presenting official staff commentary by the Federal Reserve staff concerning meaning of regulation was entitled to binding effect on courts unless found to be clearly irrational).

222. See *supra* notes 194–95 and accompanying text.

223. See FED. TRADE COMM’N, FTC OPERATING MANUAL § 8.3.2, at 2 [hereinafter FTC OPERATING MANUAL], available at www.ftc.gov/foia/ch08industryguidance.pdf.

submit comments.²²⁴ If the FTC's track record is any indication regarding the length of the rulemaking process, it could take the CFPB nearly ten years to finalize a rule regulating payday lending.²²⁵ Given the ever-changing political winds, the CFPB probably will not have that kind of time to take effective action. Another advantage of issuing a guide is that it would not be subject to the veto power of the Financial Stability Oversight Council, which can veto, by a two-thirds majority vote, any rule adopted by CFPB if it would threaten the safety and soundness of the banking system or the stability of America's financial system.²²⁶ Nothing in the Dodd–Frank Act requires the CFPB to make certain findings or conclusions before issuing a guide about questionable acts or practices by providers of consumer financial products or services.²²⁷ Consequently, the CFPB should issue a guide to quickly signal to the market place what types of payday loan practices are considered unlawful.

The CFPB has examples of FTC guides that it can consider in formulating a guide for payday loan providers. Some FTC guides are applicable to several industries because they are of general application, such as its Guides for the Use of Environmental Marketing Claims, commonly known as Green Guides, which are considered successful in establishing standards for truthful and substantiated environmental claims in advertising.²²⁸ Other FTC

224. See 1 Fed. Trade Comm'n § 2:17 (2011) (stating that FTC publishes in the Federal Register its trade rules, advisory opinions, and industry guides); 16 C.F.R. § 1.6 (2011) (“Industry guides are promulgated by the Commission on its own initiative or pursuant to petition filed with the Secretary or upon informal application therefor, by any interested person or group.”).

225. See Jennifer L. Pomeranz, *Television Food Marketing to Children Revisited: The Federal Trade Commission has the Constitutional and Statutory Authority to Regulate*, 38 J.L. MED. & ETHICS 98, 101 (2010) (stating that FTC's rulemaking process “is quite onerous and time-consuming” and it took the FTC almost ten years to get a rule finalized); Annemarie Ellig & Rebecca Lanctot, *A Decision Looms: How Passage of the United States Arbitration Fairness Act of 2007 Would Contradict Principles Underlying the New York Convention and Affect the United States' Role in International Commerce*, 12 VJ 249, 262 n.88 (2008) (stating the FTC's rulemaking process for revising a franchise rule took ten years).

226. See Dodd–Frank Act, Pub. L. No. 111-203, § 1023(a), 124 Stat. 1376, 1985 (2010) (describing the process by which a CFPB rule can be set aside).

227. See generally Dodd–Frank Act.

228. See Roscoe B. Starek, III, Comm'r, Fed. Trade Comm., *The Federal Trade Commission's Green Guides: A Success Story*, Prepared Remarks at the

Guides are directed toward particular industries,²²⁹ such as the Guides for Private Vocational and Distance Education Schools (FTC Guide for For-Profit Schools), which was adopted to address deceptive practices by “private vocational or distance education schools.”²³⁰

Since the CFPB has its own authority to issue a guide as well as the FTC’s authority to do so, it should issue a guide for financial institutions offering payday loans (CFPB’s Guide for Payday Loan Providers) to deter their proliferation. An FTC guide for particular industries typically consists of sections identifying a list of the entities covered by the guide, a number of definitions, and a list of practices the FTC considers deceptive and misleading.²³¹ Using as an example the FTC Guide for For-Profit Schools, the CFPB should first identify the entities that are providers of payday loans. A broad list is necessary to cover (1) banks offering their own versions of payday loans but calling them something else, (2) nonbank lenders claiming to be an entity other than a payday lender to circumvent state laws imposing APR caps on payday loans, and (3) tribal members in nominal partnerships with nonbank lenders claiming tribal sovereign immunity to charge usurious interest rates. The CFPB’s Guide for Payday Loan Providers should also broadly define “payday loan” to cover transactions disguised to look like something else. For example, both nonbank payday lenders and banks offering short-term unsecured consumer loans claim their financial products

Alliance for Beverage Cartons and the Environment Symposium (Dec. 4, 1996), available at <http://www.ftc.gov/speeches/starek/egstarek.shtm>; see also U.S. FED. TRADE COMM’N, 1996 ANNUAL REPORT 19 (1996) [hereinafter FTC 1996 ANNUAL REPORT], available at <http://www.ftc.gov/os/annualreports/ar1996.pdf> (finding in its first review of the Green Guides that they were “effective in preventing deception and encouraging truthful claims”). In 2010, the FTC proposed revisions to the Green Guides. Press Release, Fed. Trade Comm’n, Federal Trade Commission Proposes Revised “Green Guides” (Oct. 6, 2010), <http://www.ftc.gov/opa/2010/10/greenguide.shtm> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

229. See 16 C.F.R. § 20.0 (2011). This section sets out guides for the “manufacture, sale, distribution, marketing, and advertising (including advertising in electronic format, such as on the Internet) of used parts and assemblies containing used parts designed for use in automobiles, trucks, motorcycles, tractors, or similar self-propelled vehicles whether or not such parts or assemblies have been reconstructed in any way.” *Id.*

230. 16 C.F.R. § 254.0(b) (2011).

231. See, e.g., *id.* § 254.2.

are equity lines of credit when in reality they function just like regular payday loans.

In addition to identifying covered entities and defining payday loans, the CFPB's Guide for Payday Loan Providers should identify the practices that are considered deceptive, abusive, and unfair. As stated previously, the CFPB has the FTC's power to issue a guide interpreting an act or practice as deceptive or unfair and has its own power to issue a guide interpreting an act or practice as abusive, in addition to unfair and deceptive.²³² The CFPB has several bases on which to issue a guideline interpreting as unfair, abusive, or deceptive several payday loan practices. For example, in the 2006 DOD Report that pre-dated passage of the MLA, the Department of Defense identified payday loans as predatory, defined predatory to include a loan that is unfair or abusive, and urged passage of federal and state laws "to protect Service members from unfair, deceptive lending practices and usurious interest rates."²³³

The author categorizes common payday loan practices into the following two groups that the CFPB's guide should address: debt entrapment practices and debt treadmill practices. Debt entrapment practices ensure that the borrower will not be able to repay the loan by the initial due date and will eventually default or have to do something to extend the life of the loan.²³⁴ Debt treadmill practices are designed to ensure the lender of receiving a continuing stream of fee payments from the borrower, who continues to remain on the hook for the original principal loan amount.²³⁵

1. The Guide Needs to Warn Lenders About Their Debt Entrapment Practices

The CFPB's Guide for Payday Loan Providers needs to identify the following debt entrapment practices as unfair or deceptive: (1) triple-digit interest rates, (2) minimal credit checks, (3) large

232. See *supra* notes 217–18 and accompanying text.

233. See DOD REPORT, *supra* note 46, at 50.

234. See *Nine Signs of a Predatory Loan*, CTR. FOR RESPONSIBLE LENDING, <http://www.responsiblelending.org/payday-lending/tools-resources/ninesigns.html> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

235. *Id.*

principal amounts, (4) single balloon payments, and (5) short loan due dates.

The first debt entrapment practice that the CFPB's Guide for Payday Loan Providers needs to address is the lending practice of habitually charging interest rates in violation of applicable laws. The MLA caps the APR on payday loans to covered military families at 36%, and all financial institutions, not just nonbanks, must comply with this APR cap.²³⁶ Moreover, a federal rule subjects payday loans offered by federal credit unions to an APR cap of 28%,²³⁷ and several state statutes subject payday loans by nonbanks to APR caps of 36% or less.²³⁸ Accordingly, a large number of federal and state lawmakers believe a triple-digit interest rate is usurious and, therefore, unfair.²³⁹

Lenders that charge APRs in excess of applicable laws are engaged in a deceptive practice because even if they make accurate APR disclosures, as required by the Truth in Lending Act,²⁴⁰ they will mislead consumers into believing the APR is legal when it is not. Unfortunately, the CFPB is prohibited from establishing a national usury limit;²⁴¹ consequently, it cannot assert that *all* payday loans with APRs exceeding 36% are unfair, deceptive, or abusive. It can, however, place in its Guide for Payday Loan Providers a provision stating that it is unfair and deceptive for a lender to charge an APR that is in excess of the interest rate permitted under applicable state and federal laws.²⁴² CFPB's Guide for Payday Loan Providers could then state, as an example, that a federal credit union or a nonbank lender would be engaging in an unfair or deceptive practice if it charged an Ohio civilian resident an APR greater than 28% because both institutions are subject to this APR cap.²⁴³ With such an advisory interpretation, lenders that

236. 10 U.S.C. § 987(h)(5)–(6) (2006).

237. 12 C.F.R. § 701.21(c)(7)(iii) (2011).

238. See DOD REPORT, *supra* note 46, at 50–51.

239. See 152 CONG. REC. S6405, S6406 (daily ed. June 22, 2006) (statement of Rep. Drake) (noting that the 36% APR was necessary to promote fairness).

240. See *supra* note 54.

241. Dodd–Frank Act, Pub. L. No. 111-203, § 1027(o), 124 Stat. 1376, 2003 (2010).

242. See *supra* notes 217–29 and accompanying text (discussing the CFPB's exclusive rulemaking authority).

243. See *supra* note 237 and accompanying text; OHIO REV. CODE ANN.

disregard the applicable interest-rate caps would be on notice that they are subject to the CFPB's corrective action and risk imposition of liability in states with strong consumer protection statutes that accord deference to FTC rules and guidelines.

Besides usurious interest rates, the lending practice of doing minimal credit checks is the next debt entrapment practice that needs to be addressed. Payday lenders advertise that consumers can get a loan within minutes without undergoing a credit check.²⁴⁴ However, the author discovered years ago that payday lenders use Teletrack, a company that was recently fined \$1.8 million in civil penalties²⁴⁵ and that provides credit reporting services to payday lenders, rent-to-own stores, and other nonbank companies that extend credit to cash-strapped consumers.²⁴⁶ If Teletrack reports that a consumer has recently defaulted on one of these subprime transactions, the payday lender will decide that the consumer is ineligible for a loan.²⁴⁷ When payday lenders claim they do not conduct credit checks, not only are they falsely advertising, but what they are really revealing is that they do no assessment of the consumer's ability to repay the loan. This practice is in violation of some state laws²⁴⁸ and is identified in the DOD Report and by

§ 1321.40(A) (West 2011). If the CFPB defines payday loans broadly as proposed herein, banks would be in violation of the CFPB if they issued open-end loans with APRs exceeding 36% to military personnel covered under the MLA. See *supra* notes 161, 225 and accompanying text (explaining how national banks are subject to the MLA but can circumvent application of the MLA by claiming their loan products are open-end credit).

244. Johnson, *supra* note 119, at 32–33.

245. See Press Release, Fed. Trade Comm'n, Consumer Reporting Agency to Pay \$1.8 Million for Fair Credit Reporting Act Violations (June 27, 2011), <http://www.ftc.gov/opa/2011/06/teletrack.shtm> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review). Teletrack recently entered a consent agreement with the FTC to pay \$1.8 million in civil penalties for violating the Fair Credit Reporting Act by creating and selling to numerous entities lists of consumers who had applied for payday loans. *Id.*

246. Johnson, *supra* note 119, at 61–62 (uncovering in a study of payday lenders in central Ohio that they use Teletrack in deciding whether to issue a payday loan to a consumer).

247. *Id.*

248. See, e.g., MO. ANN. STAT. § 408.500 (West 2011) (“When making or negotiating loans, a licensee shall consider the financial ability of the borrower to reasonably repay the loan in the time and manner specified in the loan contract.”).

federal regulators as a predatory lending practice.²⁴⁹ By advertising that they will not perform credit checks, by refusing to assess a consumer's loan repayment ability, and by issuing loans based on minimal documentation, lenders knowingly mislead consumers into a loan product where they are destined to default, i.e., be unable to pay by the initial due date. Consequently, the CFPB's Guide for Payday Loan Providers should identify this lack of repayment-ability assessment as a deceptive practice.

Connected to the lenders' lack of repayment-ability assessment is the debt entrapment practice of issuing loans with large principal amounts. Payday lenders are known for issuing loans that are large in comparison to the consumer's gross income as well as their disposable income.²⁵⁰ The author also discovered in her survey of payday lenders that they usually encourage the consumer to borrow the maximum amount allowed under law even when a lower loan amount is requested.²⁵¹ That is why several states, in addition to capping the maximum amount of the loan, restrict the loan amount at 30% or less of the borrower's income.²⁵² Similarly, the regulator for federal credit unions requires them to limit the loan amount in relation to the consumer's wealth and to do some type of assessment of the consumer's ability to repay the loan.²⁵³ Therefore, the CFPB's Guide for Payday Loan Providers should identify as deceptive a

249. See DOD REPORT, *supra* note 46, at 4–5.

250. See Johnson, *supra* note 119, at 58.

251. *Id.* at 74–75.

252. See, e.g., WASH. REV. CODE ANN. § 31.45.073(2) (West 2011) (capping the total loan amount at the lesser of \$700 or 30% of the borrower's monthly income); IND. CODE ANN. § 24-4.5-7-402 (West 2011) (prohibiting a lender from issuing a loan where "the total of . . . the principal amount and finance charges . . . plus [] any other small loan balances that the borrower has outstanding with any lender [] exceeds twenty percent (20%) of the borrower's monthly gross income"); OHIO REV. CODE ANN. § 1321.41(E) (West 2011) (prohibiting payday lenders from issuing loans that exceed 25% of the borrower's gross monthly income).

253. 12 C.F.R. § 701.21(c)(7)(iii)(8) (2011)

The Federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of loans made under this section of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.

See, e.g., FDIC Pilot Program, *infra* note 302, at 28.

lender's practice of issuing loans with large principal amounts relative to the borrower's income.

Single balloon payments and short maturity dates are the next two debt entrapment practices that should be addressed in the CFPB's Guide for Payday Loan Providers. Banks, as well as nonbank lenders, do not allow payday borrowers to make partial payments but require them to repay the loan in a single payment and in a very short time period, typically two weeks or less.²⁵⁴ Because the majority of Americans live paycheck to paycheck,²⁵⁵ it should not be surprising that the majority of payday loan borrowers are unable to repay the loan in a lump sum and in a short period.²⁵⁶ The DOD Report found that "75% of payday customers are unable to repay [the entire] loan within two weeks and are forced to get a loan 'rollover' at additional cost."²⁵⁷ Again, by requiring the borrower to repay a high-cost loan in a short period of time and in a single payment, the lender's practice is unfair and deceptive because it knows at the outset that the majority of consumers are obtaining loans that the lender knows the consumer cannot repay. A few states require payday lenders to offer consumers an extended payment plan if it is requested before the loan's due date. For instance, in Ohio, the loan contract not only must inform the borrower of an optional extended payment plan, but the lender must verbally inform the borrower that this plan option may be invoked by the borrower any time before the loan's due date and without costing the borrower additional fees.²⁵⁸ This is meant to force the industry to follow its so-called best practice of offering extended payment plans.

254. See Johnson, *supra* note 119.

255. See Mark Coindreau, *More Americans Living Paycheck to Paycheck*, REUTERS (Sept. 15, 2008 3:37 PM), <http://www.reuters.com/article/pressRelease/idUS194666+15-Sep-2008+PRN20080915> (last visited Apr. 6, 2012) (reporting that 71% of Americans reported living "paycheck to paycheck," defined as being unable to meet or having difficulty meeting their current financial obligations if their paychecks were delayed for only one week) (on file with the Washington and Lee Law Review).

256. Barr, *supra* note 194, at 156–57.

257. See DOD REPORT, *supra* note 46, at 14.

258. See OHIO REV. CODE ANN. § 1321.39(D) (West 2011) (stating that the borrower must be given at least sixty days from the original maturity date to repay the loan under the extended payment plan).

As for arguments that the consumer should bear the burden of financially unwise decisions, it is noteworthy that consumer protection laws are about protecting the least sophisticated consumer. Because financial literacy education is not mandatory in most of America's K-12 schools, very few consumers obtain such education prior to leaving high school.²⁵⁹ That means they are ill-prepared to negotiate with cunning and often highly educated business people offering complex financial products and services. Moreover, when it comes to consumer credit, behavioral research shows consumers often process complex information in ways that lead to systematic errors in judgment.²⁶⁰ Furthermore, consumers tend to place heavy weight on the immediate consequences of a decision, and thereby tend to borrow too much. One should also keep in mind that America's current economic crisis that began in 2008 arose from mortgage lending practices that destined homeowners to fail.²⁶¹ By passing the Dodd–Frank Act, Congress has made it clear that irresponsible lending practices are unacceptable. Accordingly, the CFPB's Guide for Payday Loan Providers needs to identify the following debt entrapment practices as unfair or deceptive: minimal credit checks, large principal loan amounts, usurious interest rates, single balloon payments, and short loan due dates. These practices put borrowers in the position of defaulting or entering the debt treadmill and both options are economically harmful to the consumer.

259. Tara Seigel Bernard, *Working Financial Literacy in With the Three R's*, N.Y. TIMES, Apr. 10, 2011, at B1, available at <http://www.nytimes.com/2010/04/10/your-money/10money.html?pagewanted=all> (last visited Apr. 6, 2012) (stating that “[j]ust 13 states require students to take a personal finance course or include the subject in an economics course before they graduate from high school”).

260. REN S. ESSENE & WILLIAM APGAR, JOINT CTR. FOR HOUSING STUDIES AT HARVARD UNIV., UNDERSTANDING MORTGAGE MARKET BEHAVIOR: CREATING GOOD MORTGAGE OPTIONS FOR ALL AMERICANS 11 (Apr. 25, 2007), available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/mm07-1_mortgage_market_behavior.pdf.

261. MARK JICKLING, CONG. RESEARCH SERV., CAUSES OF THE FINANCIAL CRISIS 5 (Apr. 9, 2010), available at <http://www.au.af.mil/au/awc/awcgate/crs/r40173.pdf> (stating that relaxed mortgage lending practices led to rising rates of defaults which delivered a blow to U.S. financial institutions). More precisely, in his congressional report, Mark Jickling states that the financial crisis “spread and gathered intensity” in 2008, but financial stability became “the Federal Reserve’s chief concern” in August 2007, and the “roots of the crisis go back [even] further.” *Id.* at 3.

*2. The Guide Needs to Warn Lenders About Their Debt
Treadmill Practices*

In addition to the debt entrapment practices, the proposed Guide for Payday Loan Providers needs to address the following debt treadmill practices: (1) multiple rollovers, (2) multiple back-to-back loans, (3) rapacious electronic debits, (4) illegal garnishments, and (5) criminal prosecution threats.

As found in the DOD Report and many other studies, the majority of payday borrowers cannot pay the loan by its initial due date and have to resort to multiple rollover payments, which do not reduce the loan's principal.²⁶² In states where there is no ban or limitation on the number of rollovers, payday lenders require borrowers to pay rollover fees to extend the loan's due date for another two weeks, and this leads to a cycle of rollovers.²⁶³ For example, a study conducted by the Indiana Department of Financial Institutions revealed that the payday loan borrower "rolls over" his or her loan an average of ten times, so that the loan is actually outstanding for five to six months.²⁶⁴ Because lenders do not permit partial payments, the rollover fees do not count towards reducing the principal; therefore, the cycle of rollovers can lead to the borrower paying rollover fees that are several times the original loan amount.²⁶⁵ Because the rollover cycle is considered very harmful to consumers, the MLA, NCUA rule, and many state laws ban rollovers.²⁶⁶ Therefore, the CFPB's guide should warn banks and nonbanks that rollovers are considered a deceptive practice.

262. See DOD REPORT, *supra* note 46, at 39–44 (listing situations where service members were trapped in high interest loans).

263. See Johnson, *supra* note 119, at 54–64 (discussing the practices of rollover and refinancing a loan). Even if there is an applicable law regarding rollovers, many payday lenders routinely ignore legal restrictions on rollovers. *Id.* at 66.

264. See JEAN ANN FOX & EDMUND MIERZWINSKI, RENT-A-BANK PAYDAY LENDING, HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS, THE 2001 CFA AND PIRG PAYDAY LENDER SURVEY AND REPORT 7 (Nov. 2001), available at <http://budgetchallenge.com/Resources/Rent%20a%20Bank%20-%20PayDayLending.pdf> (providing a chart comparing the average number of times a customer rolls over).

265. See Graves & Peterson, *supra* note 4, at 663 (citing studies demonstrating the long-term frequency of rollovers).

266. See, e.g., 32 C.F.R. § 232.8(a)(1) (2011). The MLA makes it unlawful if a lender "rolls over, renews, repays, refinances, or consolidates any consumer

In states where rollovers are banned, payday lenders issue multiple “touch and go” or back-to-back loans, which are transactions where the borrower repays the payday loan in full and then the lender immediately (within a few hours or days) issues another loan for the same amount.²⁶⁷ Some lenders structure the back-to-back loans in a manner to circumvent a few state statutes that require cooling-off periods between loans.²⁶⁸ In states that have databases to track payday lending, one can determine that consumers are in a cycle of debt even though the lenders claim these repeat borrowers are successful.²⁶⁹ For example, in one state with a tracking database, 49% of all subsequent loans were obtained within 24 hours of the previous loan being repaid and almost 90% of all subsequent loans were obtained within the two-week pay period of the previous loan being repaid.²⁷⁰ Unfortunately, although several states ban rollovers, these states are silent about multiple outstanding or back-to-back loans, which some advocates claim are the most frequently used lending practice to keep the borrower indebted to the payday lender.²⁷¹

Some states attempt to ban or limit multiple successive and concurrent payday loans.²⁷² However, advocates claim they are ineffective in the absence of an electronic database to track payday lending.²⁷³ Both banks and nonbanks are accused of issuing

credit extended to the covered borrower by the same creditor with the proceeds of other consumer credit extended by that creditor to the same covered borrower, unless the new transaction results in more favorable terms to the covered borrower.” *Id.*; see also 12 C.F.R. § 701.21(c)(7)(iii)(4) (2011) (“The Federal credit union must not roll-over any STS [short-term small] loan.”); OHIO REV. CODE ANN. § 1321.41(G) (West 2011).

267. See Johnson, *supra* note 119, at 54–64 (discussing the practices of rollover and refinancing a loan).

268. See *id.* at 64–69 (describing how lenders get around statutes attempting to limit rollovers or refinancing).

269. See *id.* at 62–63 (describing the use of Teletrack, a credit reporting agency for sub-prime borrowers).

270. See *id.* at 61–64 (explaining results of a research assistant applying for multiple payday loans in a day).

271. See *id.* at 64–65 (pointing out that states which allow multiple outstanding loans are effectively allowing lenders to practice rollovers when it is illegal).

272. See, e.g., N.M. STAT. ANN. § 58-15-36 (West 2011).

273. See *Payday Loan Reform Act of 2009: Hearing on H.R. 1214, H.R. 1608, and H.R. 2871 Before the Subcomm. on Fin. Inst. and Consumer Credit, 111th Cong. 57–58 (2009)* (testimony of Jean Ann Fox, Dir., Consumer Fed’n of Am.).

multiple loans. This practice serves to generate additional fees just like multiple refinancing in the residential mortgage market served to increase the revenues of mortgage brokers and lenders. Because the issuance of various forms of multiple successive and concurrent payday loans allows lenders to perpetuate consumer indebtedness and skirt state law, the CFPB's guide should advise that it considers this practice deceptive. If the borrower cannot repay, the lender should be trying to work out an extended repayment plan, not dupe the borrower into getting multiple loans.

Besides the practice of issuing multiple successive or concurrent payday loans, the CFPB's Guide for Payday Loan Providers has to deal with the practice of lenders raiding consumers' bank accounts via electronic debits. Payday loan contracts by banks and nonbanks usually contain a provision authorizing the lender to debit the consumer's bank account to facilitate repayment of the loan or rollover/refinancing fees.²⁷⁴ Horror stories abound where lenders have used electronic debits to withdraw far more than the outstanding loan. For example, in one California case involving a payday lender claiming immunity due to a tribal affiliation, the consumer alleges that after borrowing \$300, the Internet lender, over the next five months, debited her bank account for rollover fees totaling \$977, and then informed her that she still owed \$430.²⁷⁵ This lender's absurd position arises from payday lenders not allowing partial payment; therefore, these extra fees are due to multiple rollovers or refinancing.

If the consumer does not have money in the account to cover these rollover fees, the withdrawals dramatically worsen the consumer's financial situation because the consumer's bank will charge the consumer bounced check fees for these attempted debits.²⁷⁶ Prior to passage of the MLA, a military service member

274. See E-mail from Dana Wiggins, Coordinator, VPLC/VaPERL, to Creola Johnson (Nov. 16, 2011 15:44 EST) (on file with the Washington and Lee Law Review) (noting that according to information obtained from payday loan customers, electronic debit accounts seem to be the only payment option for borrowers from the beginning).

275. Michael Hudson & David Heath, *Fights over Tribal Payday Lenders Show Challenges of Financial Reform*, IWATCH (Feb. 7, 2011 11:00 AM), <http://www.iwatchnews.org/2011/02/07/2151/fights-over-tribal-payday-lenders-show-challenges-financial-reform> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

276. See Chessin, *supra* note 41, at 410–15; E-mail from Dana Wiggins,

sued a payday lender after it debited his bank account eleven times in a single day and, thereby, caused him to incur hundreds of dollars in bounced check fees from his bank as well as additional fees from the payday lender due to the unsatisfied debits.²⁷⁷ The rapacious debiting of the consumer's bank account has worsened recently because banks are now complicit in the debiting by prohibiting the consumer from revoking the debit authorization previously given to the payday lender.²⁷⁸ Even after consumers believe they have closed the bank account to stop the debits, some banks re-open the accounts allowing them to be overdrawn and generate more fees for the bank and the payday lender.²⁷⁹ Such a bank account is now known as a "zombie bank account," because, try as hard as she can, the borrower cannot seem to permanently close the bank account.²⁸⁰

supra note 42 and accompanying text.

277. See *Unfair or Abusive Loans, Credit Sales Transactions, and Collections Practices that Are Particularly Harmful to Service Members as It Undermines Military Readiness and Harms Troop Morale: Hearing Before the Comm. on Banking, Housing, and Urban Affairs*, 109th Cong. 176 (2006) (statement of Lynn Drysdale, staff attorney, Jacksonville Area Legal Aid) (urging the committee to adopt the DOD Report's recommended statutory changes).

278. See *Creating a Consumer Fin. Prot. Agency: A Cornerstone of Am. New Econ. Found.: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. 38–39 (2009) (statement of Travis B. Plunkett, Legis. Dir. of Consumer Fed'n of Am.), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_senate_hearings&docid=f:54789.wais.pdf (documenting that lenders create "demand drafts" based on language in loan contracts and that these drafts are used to circumvent the borrower's attempt to revoke a previous debit authorization and thereby allow the lender to continue to electronically withdraw money from the bank account); see, e.g., Dan Sorenson, *Unregulated Online Lenders Can Mean Stress, Frustration*, ARIZ. DAILY STAR, Mar. 14, 2010, at D1, available at 2010 WLNR 6597873 (describing a borrower's numerous attempts to stop the payday lender's debiting of her account). The debits continued for months because the borrower could not get her bank to honor her request to cancel her debit authorization to the lender. *Id.*

279. See, e.g., Email from Claudia Wilner to author (Apr. 7, 2011 9:39 AM EST) (stating that the borrower, a resident of a state where payday lending is illegal, closed her bank account to stop debits by an online payday lender located in Costa Rica) (on file with the Washington and Lee Law Review). The lender continued to debit the closed account, and upon each debit, Bank of America reopened her account, paid the lender, and then charged the borrower an overdraft fee plus a \$35 NSF fee. *Id.*

280. See *id.* Claudia Wilner, Senior Staff Attorney at Neighborhood Economic Development Advocacy Project, was the first to use the term "zombie bank account" in reference to a payday lender's rapacious access to a borrower's bank account and since that time several consumer advocates use the term. For use of the term "zombified," see Laura Northrup, *Zombie Wells Fargo Account*

Some payday lenders are even raiding new bank accounts opened in the borrower's name.²⁸¹

Consumers obtaining bank-issued payday loans may likewise have their bank accounts raided and incur hefty bounced check fees. For example, an elderly Social Security recipient who obtained a loan from Wells Fargo wound up obtaining twenty-four successive loans in a thirty-nine-month period, paid \$1,200 in finance charges, and paid \$676 in overdraft fees on loans marketed as a means of avoiding such fees.²⁸² Clearly, no consumer would grant a lender a debit authorization if he or she knew ahead of time that rapacious electronic debits, such as the examples described above, would follow. Such abuse of debit authorizations was considered unfair to military families, and, therefore, the MLA bans lenders from using

Rises from Dead, Collects Overdraft Fees, CONSUMERIST (Mar. 29, 2011 11:45 AM), <http://consumerist.com/2011/03/zombie-wells-fargo-account-rises-from-dead-collects-overdraft-fees.html> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

When some forgotten auto-payments hit [Leigh's closed] account, . . . instead of rejecting the payments, the bank zombified the account, brought it back to life, and charged Leigh and her husband a \$35 overdraft fee for each item that hit their account. Wells Fargo put them on a payment plan to repay their balance, then turned around and sent the account to collections less than a month into the agreed-upon payment plan. Now they've been flagged as overdrafters in the Chexsystems database, and are still watching the account to make sure that no erroneous auto-payments hit it and trigger more overdrafts.

Id.

281. See, e.g., Email from Dana Wiggins, Coordinator, VPLC/VaPERL, to author (Apr. 4, 2011 4:32 PM EST) (on file with the Washington and Lee Law Review). For example, one payday borrower closed her bank account and opened a new one at a different bank, but when she went to withdraw funds to pay her rent and utility bills, she discovered it was empty. *Id.* After making inquiries, she learned that one of the Internet lenders that she borrowed money from had raided her new bank account. *Id.* The lender's agent told her that he was able to accomplish this by "using a database to search using her social security number to find out the numbers for all her bank accounts." *Id.*

282. See Letter from Adam Rust, Research Director, Cmty. Reinvestment Assoc. of N.C., to the Office of the Comptroller of the Currency 6 (July 14, 2011) [hereinafter Rust Letter to OCC] (providing comments by the Community Reinvestment Association of North Carolina in opposition to the OCC's proposed guidance on direct deposit advances and describing how the banks' direct deposit advances have the same characteristics as payday loans and leading to a cycle of debt just like any regular payday loan) (on file with the Washington and Lee Law Review).

electric debits unless the loan meets certain conditions, including the APR being capped at 36% or less and no rollovers being allowed.²⁸³ Consequently, the CFPB's Guide for Payday Loan Providers should warn lenders that debiting a consumer's bank account more than once to facilitate loan repayment is deceptive unless it has received explicit future consent in writing to any subsequent debit. Zombie bank account practices should be identified as deceptive as well.²⁸⁴ The Guide for Payday Loan Providers should encourage lenders to create, at no additional cost, an extended payment plan to borrowers who have defaulted on the initial payment.

Along with multiple successive debits, the CFPB's guide should warn lenders that illegal garnishments of consumers' bank accounts and paychecks are considered deceptive practices. To illustrate this problem consider the following examples. The FTC recently filed a complaint against Martin Webb, a Native American member of the Cheyenne River Sioux Tribe, and several of his online payday loan companies for illegal garnishment practices.²⁸⁵ When Webb and his companies were unsuccessful in collecting repayment of payday loans from the consumers directly, they would send bogus official-looking documents to the consumers' employers in an attempt to garnish wages.²⁸⁶ The defendants simply chose to ignore state law requirements such as actually getting a judgment against the consumers and following procedural requirements for garnishments.²⁸⁷ Similarly, MetaBank offered its version of a payday loan called an iAdvance until it agreed to pay a \$400,000 civil penalty to the Office of Thrift Supervision to settle claims that the bank engaged in unfair and deceptive practices in the marketing of its iAdvance loan.²⁸⁸ After the settlement, consumer advocates

283. See Warner National Defense Act, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2266 (2010) (codified at 10 U.S.C. § 987(6)).

284. See *supra* notes 279–80 and accompanying text (explaining zombie bank account practices).

285. Press Release, Fed. Trade Comm'n, FTC Action Halts Allegedly Illegal Tactics of Payday Lending Operation that Attempted to Garnish Consumers' Paychecks (Sept. 12, 2011), <http://www.ftc.gov/opa/2011/09/payday.shtm> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

286. *Id.*

287. *Id.*

288. See Rust Letter to OCC, *supra* note 282 (reporting several consumer complaints, including: "MetaBank today garnished my Social Security Deposit

uncovered consumer complaints suggesting that MetaBank had engaged in a pattern of illegal garnishments against protected income sources, such as social security benefits.²⁸⁹ These stories of illegal garnishments are not isolated incidents.²⁹⁰ It is considered so problematic that the U.S. Department of the Treasury is making efforts to prohibit direct deposit of government benefits into bank accounts that have payday loan debit authorizations attached to them.²⁹¹ As a result of actions taken by the FTC and OTS and expected action by the Treasury Department, the CFPB has sound reasons for warning banks and nonbanks that illegal garnishments of bank accounts and paychecks are deceptive acts and may subject the wrongdoers to corrective action.

Last in the long list of debt treadmill practices that the CFPB's guide should address is the lender's practice of threatening consumers with criminal prosecution or threatening to take any other action it cannot legally take or has no intention of taking.²⁹² Despite legal advocates making it clear for over a decade that payday lenders have no legal basis for threatening borrowers with being arrested or criminally prosecuted for failing to repay a loan, payday lenders continue to scare consumers into repaying out of

for my loan payment in full after giving me little time to make alternate arrangements. I am now risking eviction and becoming homeless"); *Idaho Issues Cease and Desist Order Against Online Payday Lender, Alleges Garnishing of Wages Violating Law*, IDAHO STATESMAN, Dec. 21, 2010, available at 2010 WLNR 25167059 (reporting that the Idaho Department of Finance banned Flobridge group from engaging in payday lending in Idaho because it never obtained a license from the department and was doing illegal garnishments).

289. Rust Letter to OCC, *supra* note 282.

290. See, e.g., *Minnesota AG Sues Five Short-Term Loan Companies*, PAYMENTSOURCE, Sept. 7, 2011, available at 2011 WLNR 17678071 (reporting Minnesota Attorney General is suing several online payday lenders for numerous violations, including illegally garnishing consumer's paychecks).

291. See 31 C.F.R. pt. 208 (2011) (presenting new rules issued by the Department of Treasury that limit creditors' ability to seize funds from Social Security, Supplemental Security Income (SSI), VA, and other federal benefits held in bank accounts in favor of direct deposit or prepaid cards).

292. See Dodd-Frank Act, Pub. L. No. 111-203, § 1012(a)(10), 124 Stat. 1376, 1965 (2010) (authorizing the CFPB to "implement the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions"); *id.* § 1021(c)(5), 124 Stat. at 1980 (stating that one of the primary functions of the CFPB is "issuing rules, orders, and guidance implementing Federal consumer financial law").

fear of going to jail for passing bad checks.²⁹³ In September 2011, Minnesota Attorney General Lori Swanson sued five Internet payday lenders for various violations of state law, including using illegal debt collection tactics, such as threatening arrest or criminal prosecution.²⁹⁴ Some victims had not actually obtained payday loans but were hounded by scam artists who obtained their information when the consumers submitted information online to a purported lender.²⁹⁵ While the Fair Debt Collection Practices Act can reach some violators making unlawful threats, it cannot reach lenders attempting to collect their own debts.²⁹⁶ Therefore, it is important that the CFPB's Guide for Payday Loan Providers warn all lenders issuing payday loans that threats to prosecute and to take any action they cannot legally take, or have no intention of taking, are considered deceptive practices.

In summary, the proposed Guide for Payday Loan Providers needs to warn bank and nonbank lenders that the debt entrapment and debt treadmill practices discussed above are considered deceptive, unfair or abusive.

B. The CFPB Should Issue a Policy Statement Granting Responsible Lenders a Safe Harbor

Along with issuing guidelines identifying the payday loan practices the CFPB considers deceptive, unfair, or abusive, the CFPB should issue a policy statement regarding characteristics of safe, affordable loans. The Dodd–Frank Act transfers to the CFPB various FTC powers, including the authority to issue policy statements,²⁹⁷ and also grants to the CFPB itself the power to issue policy statements.²⁹⁸ Some lenders, particularly credit unions,

293. *Minnesota AG Sues Five Short-Term Loan Companies*, *supra* note 290.

294. *Id.*

295. *Id.*

296. See 15 U.S.C. §1692a(6)(A) (2006) (providing that the FDCPA does not apply to a creditor collecting its own debt).

297. See Dodd–Frank Act § 1061(b)(5)(B)(i), 124 Stat. at 2037 (“The Bureau shall have all powers and duties under the enumerated consumer laws to prescribe rules, issue guidelines, or to conduct studies or issue reports mandated by such laws, that were vested in the Federal Trade Commission on the day before the designated transfer date.”).

298. See Dodd–Frank Act § 1012(a)(10), 124 Stat. at 1965 (authorizing the

already offer safe, affordable, short-term unsecured loans to consumers.²⁹⁹ Therefore, the CFPB can balance lender concerns over the breadth of the proposed Guide for Payday Loan Providers by issuing a policy statement indicating what type of loan products will not subject the lender to enforcement action. The CFPB can look to prior policy statements issued by the FTC as an example for issuing policy statements that contain safe harbor provisions for certain actors. For example, in 1993 the FTC and the Department of Justice jointly issued six policy statements containing “safety zones” that exempted from antitrust enforcement action certain hospital mergers, physician network ventures, and other cooperative arrangements among hospitals, doctors, and other healthcare providers.³⁰⁰

1. The CFPB Could Consider the FDIC’s Guidelines for Its Pilot Loan Program

Before issuing a policy statement regarding a safe harbor for affordable loans, the CFPB could consider the guidelines issued by the Federal Deposit Insurance Corporation (FDIC) for its two-year pilot program for member banks participating in a program offering small-dollar, short-term consumer loans.³⁰¹ The main purpose of the program was to demonstrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit

CFPB to “implement[]the Federal consumer financial laws through rules, orders, guidance, interpretations, statements of policy, examinations, and enforcement actions”); *id.* § 1021(c)(5), 124 Stat. at 1980 (stating that one of the primary functions of the CFPB is “issuing rules, orders, and guidance implementing Federal consumer financial law”).

299. See Hallman, *supra* note 185 (noting that some viable solutions exist to reduce risk exposure for credit unions wishing to profitably provide affordable small dollar loans.) For example, fifty credit unions in Michigan and Ohio banded together to collect annual fees from subprime borrowers of \$35 or \$70 (for a \$250 or a \$500 loan). *Id.* The fees go in a central fund to backstop losses at participating credit unions. *Id.*

300. See DEP’T OF JUSTICE & FED. TRADE COMM’N ANTITRUST ENFORCEMENT POLICY STATEMENTS IN THE HEALTH CARE AREA, 4 Trade Reg. Rep. (CCH) ¶ 13, 150–51 (Sept. 15, 1993) (including, for example, a safety zone for hospital mergers where one of the hospitals is small and other conditions are met).

301. Press Release, FDIC, Affordable Small Loan Guidelines (Nov. 4, 2006) <http://www.fdic.gov/news/news/press/2006/pr06107a.html> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

products, such as payday loans and fee-based overdraft programs.³⁰² According to the Affordable Small-Dollar Loan Guidelines (FDIC Guidelines), banks offering small dollar loans had to (1) charge reasonable interest rates, (2) encourage principal reduction, (3) streamline the underwriting of loans, (4) maximize their automated and technology processes, (5) consider offering loan repayment programs that have a savings component, and (6) collaborate with for-profit and non-profit institutions in developing small-dollar loan programs and financial literacy education.³⁰³

A full discussion of the results of the pilot program is beyond the scope of this Article; however, the results show that the participating banks met or exceeded the FDIC Guidelines for charging reasonable interest rates and encouraging principal reduction. The average interest rate for all types of loans ranged from 13% to 16%; however, the most common interest rate charged was 18%.³⁰⁴ The average origination fees amounted to \$31 for small dollar loans (SDLs) and \$46 for nearly-small dollar loans (NSDLs).³⁰⁵ Even when these fees were factored into the interest rate calculation, all participating banks had effective APRs that were at or below the suggested 36% cap.³⁰⁶ The FDIC Guidelines suggested a minimum maturity period of ninety days and an unspecified payment plan to reduce principal and interest.³⁰⁷ The results of the FDIC's two-year pilot program demonstrated that the average loan amount for SDLs was approximately \$700 and allowed payments over an average loan term of ten to twelve months.³⁰⁸ The

302. See *A Template for Success: The FDIC's Small-Dollar Loan Pilot Program*, 4 FDIC QUARTERLY, 2010, at 28, 28, available at http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf [hereinafter FDIC Pilot Program]. The parameters of the program required a loan amount of \$2,500 or less, a loan term of at least ninety days, and an annual percentage rate no higher than 36%; the pilot began with thirty-one banks and concluded with twenty-eight banks ranging in size from \$28 million to nearly \$10 billion. *Id.*

303. *Id.*

304. *Id.*

305. *Id.*

306. *Id.*

307. *Id.*

308. *Id.* at 30.

average loan amount for NSDLs was \$1,700 and allowed payments over an average loan term of fourteen to sixteen months.³⁰⁹

The loan performance for the FDIC's pilot program is encouraging. Overall, the delinquency rate—an indication of the borrower's ability to make payments on time—for both SDLs and NSDLs was higher than for general unsecured consumer loans.³¹⁰ However, the participating consumers' default rate—failure to pay back the loan—was very similar to consumers in the general population with unsecured debt.³¹¹

The pilot program provided some valuable lessons for participating banks. The most important key to success of the banks' loan programs was affording consumers longer periods to pay off the loans.³¹² Another lesson was that “small-dollar loans were a useful business strategy for developing or retaining long-term relationships with consumers.”³¹³ While short-term profitability was rare, banks participating in the pilot program were able to achieve long-term profitability through volume and cross-selling of other products.³¹⁴ One of the elements linked to program feasibility was location.³¹⁵ Bank offices in communities with large populations of low- and moderate-income, military or immigrant households tend to benefit from greater demand for small-dollar loan products.³¹⁶ Based on the foregoing, low-cost loans with reasonable terms are not only profitable in the long run but the overwhelming majority of consumers obtain a loan product they can successfully repay.

309. *Id.*

310. *See id.* at 30–31. The delinquency rate for SDLs climbed to 11% for the fourth quarter of 2009 from a stable rate of 9% for much of 2009. *Id.* The increase is attributed largely to adverse economic conditions. *Id.* The delinquency rate for NSDLs was 9.4% in the fourth quarter of 2009. *Id.*

311. *See id.* at 32 (comparing charge-offs for pilot program loans to charge-offs for credit cards and stating “[p]erformance statistics of loans originated during the pilot show that while small-dollar loan borrowers are more likely to have trouble paying loans on time, they have a default risk similar to those in the general population”).

312. *Id.* at 28.

313. *Id.* at 32.

314. *Id.*

315. *Id.*

316. *Id.*

*2. The Policy Statement Can Create a Safety Zone for Affordable
Low-Cost Loans*

While the FDIC Guidelines for its pilot program led to positive results, they cannot be adopted wholesale in a policy statement by the CFPB for a safe harbor for lenders. The FDIC Guidelines are insufficient because they do not address several practices such as rollovers, which are prohibited under the MLA and many state statutes.³¹⁷ Bank-issued payday loans can also lead to rollovers or back-to-back transactions.³¹⁸ Although the Office of the Comptroller of the Currency (OCC) has issued proposed guidelines for banks offering direct deposit advances,³¹⁹ these guidelines are less substantive than the FDIC Guidelines and have been heavily criticized as nothing more than the OCC's approval of bank-issued payday loans.³²⁰ Given that some banks have ignored the FDIC Guidelines³²¹ and that the OCC's proposed guidance is not substantive, the CFPB should develop its own criteria in issuing a policy statement regarding a safe harbor for affordable loans.

As several reports and studies have shown, the majority of payday borrowers fall into a cycle of indebtedness due to debt entrapment practices, such as usurious interest rates, short maturity dates, and single balloon payments,³²² and debt treadmill practices, such as multiple rollover and refinancing fees, and repetitive bank account debits.³²³ Assuming the CFPB has, at a

317. See *supra* notes 51–57 and accompanying text (explaining the function and applicability of the MLA); *supra* notes 228–45 and accompanying text (providing guidelines the CFPB can use to interpret unfair or deceptive payday loan practices).

318. See Ulam, *supra* note 211 (discussing how banks get around their own policy of banning rollovers by using back-to-back loan transactions and stating that “a Wells Fargo insider has admitted, ‘[m]any [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken’”).

319. See *Guidance on Deposit-Related Consumer Credit Products*, 76 Fed. Reg. 33409 (June 8, 2011).

320. See Rust Letter to OCC, *supra* note 282 (providing comments by the Community Reinvestment Association of North Carolina in opposition to the OCC's proposed guidance on direct deposit advances and describing how the banks' direct deposit advances have the same characteristics as payday loans and lead to a cycle of debt just like any regular payday loan).

321. See *supra* note 302 and accompanying text

322. See Johnson, *supra* note 119 and accompanying text.

323. See DEP'T OF DEFENSE, REPORT ON IMPLEMENTATION OF LIMITATIONS ON

minimum, issued guidelines warning lenders that these practices are considered deceptive, unfair, and abusive, the CFPB can use these guidelines for establishing a policy statement regarding a zone of safety for lenders offering loans that meet or exceed a base-line set of criteria for safe, low-cost loans (Policy Statement for Safe Low-Cost Loans). By using the label “Safe Low-Cost Loan,” the author wants the CFPB to eschew the term “payday loan” as it is synonymous with predatory lending and is considered one of the worst forms of consumer credit.³²⁴ Furthermore, by issuing the Policy Statement for Safe Low-Cost Loans, the CFPB could, as explained later, make it easy for consumers in the market place to find such loans.

The author’s proposed Policy Statement for Safe Low-Cost Loans is based on her analyses of actions taken (1) by Congress in passing the MLA to protect military families, (2) by state legislatures in passing statutes restricting payday lending, and (3) by prudential regulators in establishing standards for low-cost loans offered by financial institutions. As previously discussed, legislative and regulatory actions as well as programmatic measures make clear that common payday loan practices do not comport with responsible lending practices. Besides imposing APR caps, the MLA, NCUA, and several states ban rollovers and other fee-generating tactics as well as ban payday lenders from issuing a consumer more than one outstanding loan.³²⁵ The NCUA and several states also limit the number of loans a lender can issue to a consumer within a twelve-month period.³²⁶ Some states impose cooling off periods

TERMS OF CONSUMER CREDIT EXTENDED TO SERVICE MEMBERS AND DEPENDENTS 18–19 (July 22, 2008), <http://www.dcuc.org/PDF%20Files/Senate%20Report%20Final.pdf> (discussing the high cost of short-term predatory loans and how restrictions on them have not made access to credit unavailable).

324. See, e.g., 151 CONG. REC. E1386 (daily ed. June 28, 2005) (statement of Rep. Gutierrez) (noting that in calling for passage of the Military Lending Act, one congressman stated, “[t]hose who claim to support the troops should agree to restrict the worst financial product out there”).

325. See, e.g., 12 C.F.R. § 701.21(c)(7)(iii)(4) (2011); OHIO REV. CODE ANN. § 1321.41(E) (West 2011) (prohibiting a licensed lender from “[m]ak[ing] a short-term loan to a borrower if there exists an outstanding loan between the licensee and that borrower”).

326. See OHIO REV. CODE ANN. § 1321.41(E) (West 2011); FDIC Pilot Program, *supra* note 302; DOD REPORT, *supra* note 46; see also Johnson, *supra* note 119 and accompanying text.

between loans.³²⁷ Moreover, regulations and guidelines exist to require the lender to do some type of assessment of the prospective borrower's ability to repay, afford the debtor a longer maturity date than the typical payday loan,³²⁸ and afford the debtor the option to pay off the loan in installments.³²⁹ Finally, the MLA restricts a lender's ability to access the consumer's bank account to facilitate repayment of the loan³³⁰ and makes mandatory arbitration clauses unlawful.³³¹

As a result of the above actions taken by federal and state lawmakers as well as prudential regulators, the author proposes that to prevent debt entrapment, the CFPB's Policy Statement for Safe Low-Cost Loans establishes a zone of safety if a lender's loan has the following features: (1) contains an effective APR at 36% or less as required by applicable law where the consumer resides,³³² (2) contains a repayment plan period greater than ninety days, (3) allows repayment of the loan in partial payments of at least four installments, and (4) contains no penalties for paying off the loan early. Besides these features, a lender that wants to be in the zone of safety from enforcement should also have procedures in place that demonstrate an adherence to the following practices: (1) applying reasonable criteria to assess consumers' ability to pay, (2) disallowing any practice (including rollovers) that serves only to generate fees for the lender to extend the loan's due date, (3) limiting the number of times the lender can electronically access consumers' bank accounts, (4) offering classes or having partnerships with organizations that teach consumers budgeting

327. See, e.g., OHIO REV. CODE ANN. § 1321.41(E) (West 2011) (prohibiting “[m]ak[ing] a short-term loan to a borrower if there exists an outstanding loan between the licensee and that borrower”).

328. See, e.g., N.M. STAT. ANN. § 58-15-35(B), (C) (West 2011) (requiring that the installment payment plan allow for relatively equal installments over a minimum period of 130 days at no additional cost to the borrower).

329. See, e.g., N.M. STAT. ANN. § 58-15-35(A) (West 2011) (stating that the lender must offer borrowers “opportunity to enter into an unsecured payment plan for any unpaid administrative fees and principal balance [owed on] . . . the payday loan”).

330. See 32 C.F.R. § 232.8(a)(5) (2011).

331. *Id.* § 232.8(a)(3).

332. This 36% APR cap must include in the interest rate calculation any origination and application fees. See *supra* notes 52–53 (discussing MLA where APR calculation is very broad to cover origination fees and any other fees that are disguised finance charges).

and debt management skills, and (5) refusing to threaten consumers with criminal prosecution or unlawful debt collection practices.

Potential critics of the CFPB's Policy Statement for Safe Low-Cost Loans may argue that such loans are not profitable and result in lower availability of short-term loans to people that need them. This contention is without merit. The widespread increase in loans to military families by mainstream institutions at effective APRs at or below 36% is proof that such loans are profitable, especially when part of a program focused on long-term profitability and not with an eye on high short-term profits through irresponsible lending practices.³³³ Moreover, the FDIC pilot program demonstrated that the default rate among participating borrowers was very close to the default rate in the general population.³³⁴ Consequently, the CFPB's Policy Statement for Safe Low-Cost Loans will afford lenders that are actually committed to responsible lending practices a zone of safety from enforcement action.

C. The CFPB Can Use Its Educational Mandate to Foster Expansion of Affordable Low-Cost Loans

One of the mandated objectives of the CFPB is to provide consumers "with timely and understandable information to make responsible decisions about financial transactions."³³⁵ The CFPB can accomplish this objective through its Office of Financial Education, which is authorized to develop and implement mechanisms to improve consumer knowledge and awareness to educate the public in order to improve consumer financial decisions.³³⁶ Leadership at the CFPB and the Office of Financial Education need to be cognizant of inside and outside forces that could render a consumer awareness campaign ineffective. An awareness campaign cannot be predicated on the leadership's assumption that the consumers with

333. See *supra* notes 59–70 and accompanying text.

334. See *supra* note 253 and accompanying text.

335. See Dodd–Frank Act, Pub. L. No. 111-203, § 1021(b)(1), 124 Stat. 1376, 1980 (2010).

336. See *id.* §1013(d), 124 Stat. at 1970. To protect sub-groups of the population, the CFPB also has an Office of Service Member Affairs, *id.* § 1013(e), 124 Stat. at 1972, as well as Office of Financial Protection for Older Americans, *id.* § 1013(g), 124 Stat. at 1972–73.

the greatest need for a safe affordable loan have home computers with unlimited high-speed internet access or that consumers know how to navigate through the ocean of online loan information, much of which is biased, misleading, and false.³³⁷ Moreover, external forces are at work to greatly limit the CFPB's funding and effectiveness.³³⁸ If they are successful, the CFPB will have to be extremely careful in deciding the best way to use a portion of its funding for education. The CFPB, therefore, needs to take a cue from corporate America, which maximizes its advertising dollars by increasingly using social networking sites and allowing consumers to generate advertising to increase product awareness.³³⁹

A six-step strategy is proposed as an example for the CFPB to consider implementing for increasing consumer understanding about and awareness of safe affordable loans. Every component of the strategy is at play in the efforts by corporate America to increase branding and customer loyalty and should be considered by the CFPB's Office of Financial Education.

Under the author's proposed six-step strategy, the CFPB needs to (1) increase the number of fans it has on social networking sites, (2) conduct a contest for the creation of consumer-generated advertising, (3) utilize crowdsourcing to select the best advertisements, (4) secure the commitment of banks and credit unions nationwide to supply safe affordable loans, (5) start a public service announcement campaign to increase consumer awareness, and (6) take advantage of cell phone app technology to develop an easy way for consumers to find these loans. Such a strategy implemented via the CFPB's Office of Financial Education would

337. See *supra* note 99–100 and accompanying text (discussing how payday lenders target low-income individuals). See *Survey Shows Widespread Enthusiasm for High Technology*, NPR ONLINE, <http://www.npr.org/programs/specials/poll/technology/> (last visited on Apr. 6, 2012) (providing results from a 1999 survey which showed that individuals making less than \$30,000 per year are less likely to use a computer than those in a higher income bracket) (on file with the Washington and Lee Law Review).

338. See, e.g., 112th CONG. REC. H5325 (daily ed. July 21, 2011) (statement of Rep. Hirono) (opposing the bill limiting the “independence and effectiveness of the CFPB”).

339. See Christopher Hosford, *Twitter Drives Traffic, Leads, Conversions at Mongoose Metrics*, B TO B, Jun. 13, 2011, at 14, available at 2011 WLNR 12049003.

harness the power of social media, consumer-generated advertising, and wireless technology.

1. Social Media Networks Would be an Effective, Low-Cost Way to Educate Consumers

The first step is to increase the number of fans on the CFPB's social networking page and specifically create a webpage for the Office of Financial Education. At this writing, the Office of Financial Education does not have its own webpage and the CFPB has recruited a mere 8,174 Facebook fans³⁴⁰ and about 6,000 Twitter followers.³⁴¹ These numbers are abysmal when one considers that the total number of Twitter users is 200 million³⁴² and Facebook users is 750 million.³⁴³ Corporate America has spent years trying to increase the number of customers visiting their websites but is now reaching out to potential customers by increasingly using social networking sites.³⁴⁴ One cannot simply create a Facebook page like the CFPB has already done, but must also actively develop creative ways to recruit new fans and keep current fans interested by posting relevant information.³⁴⁵ Such active engagement can cause the number of fans and followers to grow exponentially in a very short period of time and increase the use of the CFPB's website by consumers to obtain important information.³⁴⁶ The CFPB does not

340. FACEBOOK, <http://www.facebook.com/CFPB?sk=info> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

341. TWITTER, <http://twitter.com/#!/search/cfpb> (last visited July 20, 2011) (on file with the Washington and Lee Law Review).

342. Charlie White, *Reaching 200 Million Accounts: Twitter's Explosive Growth*, YAHOO! NEWS (July 16, 2011 6:01 AM), <http://news.yahoo.com/reaching-200-million-accounts-twitters-explosive-growth-infographic-183959702.html> (last visited Jan. 8, 2012) (on file with the Washington and Lee Law Review).

343. FACEBOOK, <http://www.facebook.com/press/info.php?statistics> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

344. *Social Media a Crucial Jobs Tool*, STAR PRESS (Muncie, Ind.), Mar. 6, 2011, available at 2011 WLNR 4387108.

345. Ross Johnston, *Facebook and Customer Acquisitions: Strategy and Dedication Needed to Recruit Fans*, 26 ALASKA BUS. MONTHLY, Dec. 1, 2010, at 80, available at 2010 WLNR 25774880.

346. See, e.g., *CW Network Is Now Making Digital Dollars, Said Dawn . . .*, COMM. DAILY, Jan. 19, 2011, available at 2011 WLNR 1315148 (reporting that the CW network has in excess of 30 million Facebook fans and 100,000 Twitter followers and that "unique viewers to cwtv.com increased 77 percent over a year

need to be deterred by concerns that their message needs more than a thirty-second sound bite.³⁴⁷ Companies that have to educate consumers about the nature of their services have found effective ways to use social networking to spread the word about their services and to get their influential fans to continue spreading the message on their own independent sites.³⁴⁸

A key to increasing the number of fans may be for the CFPB to seek free endorsements from influential figures, bloggers, or celebrities on Facebook and Twitter to promote the CFPB's education materials.³⁴⁹ High-profile figures, such as Oprah and Lady Gaga, have millions of followers on Twitter and Facebook.³⁵⁰ Product endorsements by Oprah lead to record sales,³⁵¹ and Lady Gaga is recognized as a superstar with "monster influence."³⁵² With

ago, and viewers are watching 59 percent more episodic video on the site than last year").

347. See Kate Davidson, *In War Over CFPB, Democrats See Political Advantage*, MORTGAGE PROFESSIONALS OF AMERICA (Dec. 8, 2011 5:42 PM), <http://blog.mpofa.org/2011/12/in-war-over-cfpb-democrats-see-political-advantage/> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

348. See, e.g., Hosford, *supra* note 339, at 14 (reporting that Mongoose Metrics, a company that operates a phone call tracking service, considered its Twitter campaign a success by relying heavily on providing links to its website offering white papers and research materials explaining its services, and another company re-tweeted the information on its website). "Mongoose saw its own tweets retweeted 1,248 times, for a total retweet reach of 2.9 million eyeballs." *Id.*

349. See, e.g., *id.* (reporting how retweets from fans of a phone-call tracking company greatly expanded its reach of people finding out about its services).

350. FACEBOOK, <http://www.facebook.com/ladygaga> (last visited on Jan. 24, 2012) (on file with the Washington and Lee Law Review); FACEBOOK, <http://www.facebook.com/oprahwinfrey> (last visited on Apr. 6, 2012) (on file with the Washington and Lee Law Review); TWITTER, <http://twitter.com/ladygaga> (last visited on Jan. 24, 2012) (on file with the Washington and Lee Law Review); TWITTER, <http://twitter.com/Oprah> (last visited on Apr. 6, 2012) (on file with the Washington and Lee Law Review).

351. *Oprah's Endorsement Lifts 'A New Earth' to Record Sales*, HUFFINGTON POST (Feb. 28, 2008 8:58 PM), http://www.huffingtonpost.com/2008/02/28/oprahs-endorsement-lifts-_n_88938.html (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

352. Lisa Respers France, *Lady Gaga's Monster Influence*, CNN (Jan. 20, 2011 1:59 PM), <http://edition.cnn.com/2011/SHOWBIZ/celebrity.news.gossip/01/20/lady.gaga.career/index.html?hpt=Mid> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review). Lady Gaga not only has a proven track record for selling brands, but she also actively communicates about causes she believes in with her fans using social media. See Gil Kaufman, *Lady Gaga*,

help from celebrities with mass appeal and an army of fans, the CFPB's social media sites can benefit immensely and increase the number of people accessing them.

2. The CFPB Needs to Engage Consumers by Hosting a User-Generated Advertisement Competition

After expanding its presence in social media, the CFPB's next step is to create a contest inviting the public to create a user-generated advertisement with a catchy slogan related to consumers' avoiding payday loans and selecting safe loans. The contest should have guidelines for submissions and must be announced through the social networking sites and offer prizes large enough to create an incentive for numerous people to enter the contest. Using such a strategy will not only dramatically decrease advertising cost but, more importantly, will greatly expand the number of consumers learning about affordable loan options through the social media buzz generated by the contest.

Consider the success of Pepsico, the owner of the Doritos product, in creating numerous contests that strengthened brand loyalty and increased the number of new customers. In 2007, Pepsico had its first "Crash the Super Bowl" contest where contestants had to create a Doritos commercial to be aired during the next Super Bowl game.³⁵³ Two amateur filmmakers won the contest and collected one million dollars as the prize.³⁵⁴ The company considered the contest so successful that it has done it every year since then and now receives thousands of submissions for the contest.³⁵⁵ To further the expansion of the Dorito brand, Pepsico has launched other contests, including the "Doritos Crash Course"

Linkin Park Urge Fans to Help Japan Earthquake Victims: Park's Mike Shinoda Has Designed T-Shirts to Benefit the Relief Effort, MTV (Mar. 14, 2011 11:24 AM), <http://www.mtv.com/news/articles/1659807/lady-gaga-japan-earthquake.jhtml> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

353. Lisa Arthur, *Three Lessons from Pepsi's Super Bowl XLV Ad Campaign*, FORBES MAGAZINE (Feb. 1, 2011 4:36 PM), <http://www.forbes.com/sites/lisaarthur/2011/02/01/three-lessons-from-pepsis-super-bowl-xlv-ad-campaign/> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

354. *Id.*

355. *Id.*

contest, where contestants had to create a game designed for the Xbox 360.³⁵⁶ In 2010, a twenty-eight-year old copy center employee at Staples beat out 1,500 contestants to become one of two finalists.³⁵⁷ Contests that use consumer-generated advertising and consumer voting to select the winner are not done solely for marketing purposes.³⁵⁸ Traditional advertising has become less effective.³⁵⁹ However, consumer contests coupled with social media result in the contest fostering a continuing engagement about the product among fans.³⁶⁰ For example, a study of more than 50,000 discussions on social networking sites found that Doritos was one of the most discussed products advertised during the Super Bowl.³⁶¹ By the CFPB taking advantage of this type of marketing strategy, it would not only cost far less than hiring a professional advertising firm, but can result in a successful campaign about safe, low-cost loans and can ultimately help spread the word about the CFPB and its mission.³⁶²

356. See John Murawski, *Raleigh Woman Wins \$50,000 for Game Design*, NEWS & OBSERVER (Raleigh, N.C.), Dec. 31, 2010, available at 2010 WLNR 25662004.

357. *Id.* (reporting that consumer voters chose her game over the other finalist and that she won \$50,000).

358. See Erika D. Smith, *'09 Doritos Ad Winners Work on Social Networking Buzz for Contest*, INDIANAPOLIS STAR, Feb. 6, 2010, at A10, available at 2010 WLNR 2655533.

359. *Id.*

360. *Id.*

361. *Id.*

362. Other brand companies, such as Pepsico, utilized the user-generated marketing strategy to have consumers create and market new flavors through the “Dewmocracy campaign,” along with Doritos creating successful advertisements with its user-generated Super Bowl ads. See Natalie Zmuda, *Pass or Fail, Pepsi’s Refresh Will Be Case for Marketing Textbooks: Rest of Industry Eyeing Bold Social-Media Experiment*, ADVERTISING AGE, Feb. 8, 2010, at 1, available at 2010 WLNR 2878042. A user-generated content strategy made substantial big contributions to deepening the connection with consumers, building ongoing relationships, and obtaining their loyal support for the brands, while saving costs. *Id.* For Old Spice, having consumers generate and upload parodies and clips amassed eighty million views for its “Responses” campaign, with Revlon seeing sales reach a two-year high as a result of its YouTube contest. See Andrew Hampp, *Your Digital Questions Answered: How to Make Your Branded Video Go Truly Viral*, ADVERTISING AGE, Feb. 28, 2011, at 46, available at 2011 WLNR 4175689. Revlon’s campaign received 150 submissions and over 3 million views. *Id.* Converse’s successful campaign received 1,500 submissions of user-generated contents and created a buzz. See Julie Bosman, *Advertising; Chevy Tries a Write-Your-Own-Ad Approach, and the Potshots Fly*,

3. *Crowd Sourcing Is a Productive Avenue for the CFPB to Interact with and Inform Consumers*

In addition to conducting a consumer-generated advertising contest, the CFPB should use crowdsourcing to select finalists and a winner as means of keeping consumers informed and engaged with the CFPB. Crowdsourcing is the practice whereby an organization enlists a variety of people to accomplish a specific task or solve a specific problem.³⁶³ Crowdsourcing is an increasingly popular marketing tool that can be as simple as allowing the public to vote on the winner in consumer-generated advertising contests, or be as elaborate as allowing consumers to develop product lines and designs.³⁶⁴ For instance, after initially conducting consumer-generated advertising contests and allowing consumers to vote for the winner, the makers of Mountain Dew fully embraced crowdsourcing to allow consumers to develop new flavors and credited crowdsourcing as a reason for its continued growth.³⁶⁵ The company reported that the “Dewmocracy” campaign attracted new customers to its fan base.³⁶⁶ The CFPB can use a crowdsourcing strategy that allows for mixture of input from professional firms as well as consumers. For example, personnel within the Office of Financial Education or a professional firm hired by the CFPB could select ten finalists with videos that best capture the CFPB’s message about safe, low-cost loans and then use a consumer voting process via social media to select the first-place winner.³⁶⁷ Of course,

N.Y. TIMES, Apr. 4, 2006, at C1, *available at* 2006 WLNR 5615601.

363. See Barbara Wallraff, “Word of The Year” Worth Roundup, ALBANY TIMES UNION (ALB.), Jan. 9, 2011, at 13, *available at* 2011 WLNR 1037527 (providing a description of crowdsourcing); see also *Ms. Adverthinker Reports From SXSW: Day Two*, TALK BUSINESS, Mar. 14, 2010, at 21, *available at* 2010 WLNR 5351561.

364. Eleftheria Parpis, *Crowd Control: Is Turning to the Masses for Creative Input a Quick Fix or the Way of the Future?*, 19 MEDIA WEEK, Nov. 2, 2009, at 21, *available at* 2009 WLNR 22771474. While critics have claimed this to be too “gimmicky,” that it “encourages low-quality creative,” and “eschews strategic thinking and relationship management,” marketers see the value in the strategy for adding “a consumer-engagement punch” to a company’s marketing efforts. *Id.*

365. Natalie Zmuda, *New Pepsi ‘Dewmocracy’ Push Threatens to Crowd Out Shops*, ADVERTISING AGE, Nov. 2, 2009, at 1, *available at* 2009 WLNR 25072439.

366. *Id.*

367. See, e.g., Jed Gottlieb, *Doritos Hopes Winner Scores Big With Fans*,

members of the CFPB should use all forms of free media opportunities to spread the word about the contest-entry phase as well as the voting phase.

4. The CFPB Needs to Secure Commitments from Banks and Credit Unions to Offer Safe Low-Cost Loans

Along with the consumer-generated advertising strategy, the CFPB should also implement a strategy that secures the commitment of banks and credit unions in every state to promise to set aside and use funds for issuing short-term consumer loans that meet the safe harbor provisions of the CFPB's Policy Statement for Safe Low-Cost Loans. This would counter the trend among some banks and credit unions to offer high-priced loans rather than safe, low-interest loan products. Recognizing that mainstream financial institutions need continuing incentives to offer safe, low-cost loan products, Congress also included Title XII in the Dodd–Frank Act.³⁶⁸ Title XII is entitled the Improving Access to Mainstream Financial Institution Act of 2010, and its purpose is “to encourage initiatives for financial products and services that are appropriate and accessible for millions of Americans who are not fully incorporated into the financial mainstream.”³⁶⁹ Title XII also authorizes the Secretary of the Treasury to establish programs to encourage low-cost alternatives to high-cost small-dollar loans, such as payday loans.³⁷⁰ An earlier draft of § 1205 of Title XII actually used the words “Low-cost alternatives to payday loans,”³⁷¹ but the words “payday loans” were removed, probably as result of lobbying by the

BOSTON HERALD, Feb. 1, 2008, at E05, *available at* 2008 WLNR 1955116 (discussing a Dorito contest where consumers created an ad with a one-minute music video and “a panel of music industry heavies picked 10 finalists out of thousands of homemade videos”). Consumers voted online for three finalists, one of which would be announced during the Super Bowl Game. *Id.*

368. *See Title XII—Improving Access for the Non-Banked and Under-Banked*, MILLER & MARTIN PLLC, <http://www.millermartin.com/financial-reform-monitor/title-xii-%E2%80%93improving-access-non-banked-and-under-banked> (last visited Apr. 6, 2011) (explaining the purpose and effect of Title XII) (on file with the Washington and Lee Law Review).

369. *See id.*

370. *See id.*

371. *See* H.R. 4173 111th Cong. § 1205 (2010).

payday loan industry. Despite the removal of the words “payday loans,” these loan products remain the elephant in the room. The CFPB, which is housed in the Federal Reserve System, should work with the Secretary of the Treasury to expand the availability of mainstream financial institutions offering low-cost loans by establishing a loan-loss reserve fund. This fund would defray the costs of mainstream financial institutions establishing loan programs to comply with the CFPB’s Policy Statement for Safe Low-Cost Loans criteria.

Even in the absence of the creation of programs establishing a loan-loss reserve fund, the CFPB needs to work with the prudential regulators to secure written agreements from banks and credit unions promising to offer loans in accordance with safe harbor provisions of the CFPB’s Policy Statement for Safe Low-Cost Loans. Such efforts will increase the supply of affordable short-term loans. Without such a supply, an advertising campaign may prove disastrous when consumers show up at mainstream financial institutions and are told no such loans are available. Consider what happened to KFC as a horrible example of a campaign failing to increase consumer use due to unpreparedness. KFC, the largest fast-food chicken restaurant, launched a campaign offering free pieces of its new grilled chicken product.³⁷² The company enlisted Oprah to promote the campaign and, consequently, generated an overwhelming number of consumers visiting its website to download the free chicken coupons.³⁷³ Not only was KFC unable to fulfill its promise from the sheer volume of demand, the event led to negative results after its failure was widely reported in the media.³⁷⁴

The lesson from the KFC advertising disaster is that for the marketing of and education about safe, affordable loans to succeed, a substantial number of banks and credit unions must be committed already to providing such loans to consumers who lack high credit scores but are nevertheless creditworthy. Before completion of the consumer-generated advertising contest promoting safe affordable loans, the CFPB must ensure that participating banks and credit unions in major cities in every state are prepared to issue such loans and that a

372. Emily Bryson York, *KFC’s Stunts Make Nightly News, But Do Nothing to Stop Sales Slide*, 81 ADVERTISING AGE, Apr. 19, 2010, at 2, available at 2010 WLNR 8452274.

373. *Id.*

374. *Id.*

list of these institutions is easily available at the CFPB's website. The CFPB could also solicit input from these financial institutions in creating disclosure forms for such loans as part of its "Know Before You Owe" campaign.³⁷⁵ Currently, the CFPB is fine-tuning a new, simplified disclosure form for consumers shopping for mortgage loans³⁷⁶ and recently introduced a prototype "financial aid shopping sheet" for student loans.³⁷⁷ By using the Know Before You Owe campaign to develop an effective simplified disclosure form for consumers in need of short-term loans, the CFPB will fulfill its mandate to make disclosure forms more comprehensible and simultaneously involve responsible lenders in the process.³⁷⁸

5. Partnership with the Ad Council Would Lead to the Dissemination of the CFPB's Message Through PSAs

After securing the commitment of mainstream financial institutions, the CFPB should implement step five, which is to partner

375. CFPB, *Student Loans, Know Before You Owe*, <http://www.consumerfinance.gov/knowbeforeyouowe/> (last visited Apr. 6, 2012) (on file with the Washington and Lee Law Review).

376. See Press Release, CFPB, Consumer Financial Protection Bureau Announces Initiative to Combine Mortgage Loan Disclosures (May 18, 2011), <http://www.consumerfinance.gov/pressrelease/consumer-financial-protection-bureau-announces-initiative-to-combine-mortgage-loan-disclosures/> (last visited Apr. 6, 2012) (stating that in May 2011, the CFPB introduced its "Know Before You Owe" Project, which "combine[s] two federally required mortgage disclosures into a single, simpler form that makes the costs and risks of the loan clear and allows consumers to comparison shop for the best offer") (on file with the Washington and Lee Law Review). The combination of the two forms was mandated by the Dodd–Frank Act, and the Bureau is required to "issue proposed forms and implement regulations by July 2012." *Id.* The CFPB has been testing the prototype disclosure forms through interviews with consumers, bankers, and brokers. *Id.* The testing and feedback process will inform the CFPB's formal rulemaking process. *Id.*

377. See CFPB, *Know Before You Owe*, <http://www.consumerfinance.gov/students/knowbeforeyouowe/> (last visited Apr. 6, 2012) (stating that the sample financial aid shopping sheet is to help schools improve the information they present to prospective students and their families about educational costs) (on file with the Washington and Lee Law Review).

378. See Dodd–Frank Act, Pub. L. No. 111-203, § 1012(a)(10), 124 Stat. 1376, 1965 (2010) (enabling the CFPB to make rules in order to ensure the features of consumer financial products and services are "fully, accurately and effectively" disclosed to consumers, including the power to create model disclosures).

with the Ad Council to turn the winning consumer-generated amateur ad into a public service announcement (PSA) to disseminate the CFPB's message about safe affordable loans. This strategic step is important if efforts to dramatically reduce the funding of the CFPB are successful.³⁷⁹ The reader may recall the Ad Council is responsible for several successful PSA ads; therefore, the CFPB can work with an organization with a proven track record of getting consumers to modify their behavior in accordance with the action urged in the ad.

The Ad Council's PSA campaigns are produced pro bono by advertising agencies that donate their services to create professionally done PSA ads.³⁸⁰ Each PSA campaign is sponsored by a non-profit organization or federal government agency, like the CFPB, which is then responsible for paying the production and distribution costs.³⁸¹ The production and distribution costs for an ad are roughly \$950,000 each year, totaling \$2.8 million over a three-year campaign period.³⁸² After the campaign ad is produced, the Ad Council distributes the PSAs via a nationwide network of over 33,000 media outlets that donate space on TV and radio stations, in print sources (e.g., newspapers and magazines), in outdoor venues (e.g., billboards), and on internet sites (e.g., web banners).³⁸³ The value of the donated air time and space amounts to \$30 million each year in free advertising and totals \$90 million for the typical three-year campaign.³⁸⁴ In addition, the Ad Council uses social media technologies, such as Facebook, texting, video email, and satellite radio to further an advertising campaign.³⁸⁵ The foregoing demonstrates that the CFPB, working in conjunction with the Ad Council, would sow very little to reap so much—\$2.8 million

379. See Randall, *supra* note 35 and accompanying text.

380. The Ad Council, *Frequently Asked Questions*, <http://www.adcouncil.org/About-Us/Frequently-Asked-Questions> (last visited Apr. 6, 2011) (on file with the Washington and Lee Law Review).

381. See *id.*

382. Telephone Interview with Sr. Vice President, The Advertising Council (July 25, 2011).

383. See The Ad Council, *supra* note 380.

384. Telephone Interview with Sr. Vice President, The Advertising Council (July 25, 2011).

385. See The Ad Council, *supra* note 380.

compared to \$90 million—in a national campaign that would steer thousands of consumers to safe affordable loans.³⁸⁶

6. The CFPB Should Create “Apps” to Provide Easy Access to Affordable Loans from CFPB-Approved Financial Institutions

The final step in the author’s proposed strategy is for the CFPB to create a free Facebook and cell phone app that consumers can download to quickly and easily locate institutions offering safe low-interest loans in their area. The CFPB could use a consumer-generated app contest to accomplish this. The app phenomenon, triggered by the “Facebook Class,” has become known as the “new wave of technology innovation.”³⁸⁷ Stanford University students enrolled in the Facebook Class were given the task to devise free apps for Facebook in the fall of 2007, and, after doing so, they acquired millions of users and helped pioneer a new model of entrepreneurship.³⁸⁸ One group of seventy-five students collectively had 16 million users within ten weeks of creating the apps and then used them to generate millions in revenue from companies willing to sponsor the apps.³⁸⁹ Apps have now become wildly popular on social networking sites and have transitioned to Android and iPhones, with thousands of them being available to customers.³⁹⁰ Additionally, apps are not costly or time consuming to create.³⁹¹ One popular app was created in only five hours by two students.³⁹² Consequently, the CFPB could easily create an app for Facebook and smartphone users to find institutions identified by the CFPB as offering low-cost loans within the CFPB’s guidelines. This final

386. The Ad Council has done reports documenting the economic success of its ad campaigns. *See, e.g.*, THE AD COUNCIL, PUBLIC SERVICE ADVERTISING THAT CHANGED A NATION, available at <http://www.adcouncil.org/content/download/1283/11304/file/advertising-that-changed-a-nation.pdf>.

387. Miguel Helft, *The Class That Built Apps, and Fortunes*, N.Y. TIMES, May 8, 2011, at BU1, available at <http://www.nytimes.com/2011/05/08/technology/08class.html?pagewanted=all>.

388. *Id.*

389. *Id.*

390. *See id.*

391. *Id.*

392. *Id.*

strategy would keep the CFPB from merely having a webpage where only a few consumers visit.

Professor Elizabeth Warren recently stated that the CFPB's Office of Financial Education is to be "a 21st-century resource for consumers who are looking to better understand how different products and services work, and . . . will provide access to tools and information that can help consumers select the products that are best for them."³⁹³ However, without using twenty-first century social media, technologies, and advertising, the CFPB's website, no matter how much information it provides, will fall under the radar for the majority of civilian consumers in need of short-term loans.

VI. Conclusion

Several years ago, Congress decided that payday loans were predatory and passed legislation to severely curtail payday loans issued to active-duty military families. By all accounts, payday lending to military families has been drastically reduced. Banks and credit unions, after urging from politicians and military leaders, began offering nationwide low-cost loans to military families.

Civilian families, on the other hand, have not only continued receiving predatory payday loans from nonbanks but are now being targeted with such loans from mainstream financial institutions. The newly created CFPB has the opportunity to do what many federal politicians have been unwilling to do—protect civilian consumers from payday lending. This Article provided a three-step roadmap that the CFPB can use to increase the supply of safe, low-cost loans and to place community banks and credit unions with a track record of offering such loans at a competitive advantage. First, by issuing guidelines identifying the common payday loan practices it considers unfair, deceptive, and abusive, the CFPB can influence

393. Elizabeth Warren, Warren Outlines Goals for New Consumer Agency, Prepared Remarks at the University of California (Oct. 28, 2011), *in* AM. BANKR. INST. J., Dec.–Jan. 2011, at 10, 101, available at <http://www.abiworld.org/AM/Template.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=62550>. In 2010, President Obama named Elizabeth Warren as the Assistant to the President and Special Adviser to the Secretary of the Treasury on setting up the CFPB. Professor Warren was the first to argue for the creation of a consumer financial protection agency, and she is responsible for helping to set up the CFPB.

some lenders to voluntarily cease such practices to avoid enforcement action by the CFPB and other regulators. Second, by issuing a policy statement establishing a safety zone for lenders desiring approval of their loan products, the CFPB will encourage some lenders to offer low-cost, affordable loans meeting the criteria in the policy statement. Third, by following a multi-faceted strategy that harnesses the power of social media and uses a national public service announcement campaign, the CFPB can make it easy for consumers to access lenders that offer safe affordable loans.

Professor Warren has described the CFPB as the “cop on the beat.”³⁹⁴ Police officers do not just enforce the law. They also create programs, such as gun surrender programs for limited amnesty, to get wrongdoers to voluntarily change their behavior. As the nation’s first cop for consumers, the CFPB should use every available tool to get lenders to stop issuing payday loans and instead offer safe, low-cost loans to civilian consumers.

394. *Id.* at 101 (stating that the CFPB will engage in enforcement actions “as the cop on the beat watching huge credit card companies, local payday lenders and others in between”).