Assignment 17

Payday Loans

Payday loans are one of the most contentious issues in consumer law. This is quite different from mortgage or automobile finance, where everyone agrees it should exist in its basic form and the focus is on curbing abuse. This blog post surveys the state of research on payday lending but opens with a fundamental policy point:

> Except for the ten to twelve million people who use them every year, just about everybody hates payday loans. Their detractors include many law professors, consumer advocates, members of the clergy, journalists, policymakers, and even the President!

Robert DeYoung, Ronald J. Mann, Donald P. Morgan, and Michael R. Strain, *Reframing the Debate about Payday Loans*, (Oct. 19, 2015), available at http://nyfed.org/291rCh2.

The coverage here has a couple of goals. First, the reality is that law students are drawn generally and on average from the upper end of the income spectrum. Few of them may have experiences with payday loans and the product itself is modestly complex. Second, this is an area where state legislation has struggled to curb the perceived abuses. It is hard to be effective without effectively ending the product. This point follows nicely on the problem about auto title lending that ended Assignment 16. Third, this is a place to revisit the idea of the vulnerable consumer and to debate what is sound policy in this area.

In June 2016, after the book was published, the CFPB issued proposed rules on payday, vehicle title and certain high-cost installment loans—collectively it calls these "alternative lending products." RIN 3170-AA40 (Docket No. CFPB-2016-0025). The prospects for enacting these rules look grim as of this writing in summer 2017. The proposed rules are still worth knowing, however, as they represent a recent "best effort" of a regulator. In a nutshell, leaving out all the nuances, here they are:

1. Lenders will be required to establish a borrower's ability to repay before extending the loan.
2. Individual loan payments per pay period must be limited to an amount that would not cause financial hardship to the borrower.
3. Payday lenders are not to allow consumers to reborrow immediately or carry more than one loan.
4. Lenders will be limited in how many times they can try to debit payments from a borrower's bank account if the initial effort results in an insufficient funds notice.

A group of law professors, including me, responded to these rules with general support and a few critiques. The most important of which is that the proposed rule would allow lenders to come up with their own measurements of borrower ability-to-repay. *See* Proposed 12 C.F.R. § 1041.5. Because the rule covers several kinds of products, it isn't clear to me that the CFPB should come up with a standard, such as the debt-to-income ratio and other features that are in use with mortgages, but certainly more could be done to require lenders to use reliable statistical data or measurable approaches in assessing ability to repay. The CFPB also proposed three exceptions to the ability-to-repay requirement, one for shorter-term loans not secured by vehicles, and two for longer-term loans. Up to six loans annually could be made at whatever cost is permitted by state law without an ability-to-repay determination. The rule does require amortization and a step-down in amount for such loans.

For those who want to go further and have the students compare an alternative approach, NCUA (National Credit Union Association) has had a "Payday Alternative Loan" model in place since 2010 and it contains more clear cost controls to protect borrowers from fees being moved from interest to origination. Another good reference—and comparison point—is the Colorado payday law passed in 2010. It is described in this article, which also is the most comprehensive look at the landscape of payday law that I could locate as of summer 2017. Nick Bourke et al., Pew Charitable Trusts, *A Year After CFPB Proposed A Rule For Small Loans Borrowers Still Await Reform,* (June 14, 2017) http://www.pewtrusts.org/en/research-and-analysis/analysis/2017/06/09/a-year-after-cfpb-proposed-a-rule-for-small-loans-borrowers-still-await-reform.

Problem 17.1. NOTA BENE: This problem sends students to the check cashing law, which arguably applies, but NOT to California's main payday law, which is Cal. Fin. Code §23000-23106. The result is not different because that law permits a maximum loan of $300, a max term of 31 days, and maximum fees and finance rate of 15% of the check. This loan checks out as legal under that statute. (I will send students directly to this law in the next version of the book; for now, you can mention the other statute and note what a patchwork of law there is on short-term loans.)

This problem is a chance to see the pricing of a payday loan and to wade into one of the statutes that regulates alternative lenders. Alba borrowed $300 for medical bills, so I have made her a sympathetic borrower. She also apparently has no prior loans, making her a somewhat unrealistic borrower given the repeat borrowers.

Start by having the students price the loan. The fees total $50, so her total cost will be $350 to borrow money for 20 days (when her next paycheck is due). (You can also calculate this as a $300 loan from which the $50 will be deducted, so that her loan proceeds are $255. This brings the APR to 365%.) The APR is shown as 260 percent; that is supposed to be accurate for the transaction, although if you want to wade into trying to calculate it and check my math, feel free. The Missouri AG used to have a sweet payday loan calculator, but as we now know, with each change in administration comes revised website content. I ran it through this calculator online, and it produces 304% or $270% (the former if the $5 background fee is included) and the latter if it is not. http://www.csgnetwork.com/apr4calc.html. Playing out the difference shows students how sensitive APR is to small changes in cost because the loan is short term.

The problem calls this a "deferred deposit transaction" rather than a payday loan. The point here is to familiarize students with the terminology and to raise the point that the label rarely matters.

The students are sent to the California Civil Code. It is entitled "check casher," but the definition in Cal. Civ. Code §1789.31 arguably covers anyone who engages in cashing checks in return for money *and* who is not a bank or similarly regulated entity. I think Money Madness fits under this section—although as noted at the start of the problem, the better fit is the payday/deferred deposit law itself in Cal. Fin. Code.

Section 1789.37 requires that Money Madness have a permit from the Department of Justice—in California, this is a reference to the Attorney General's office. It is also required to post a "complete, detailed, and unambiguous schedule of all fees." We need to look around the place to determine the loan's legality. And we should take a ruler—as the letters may not be less than one-half inch in height. Geez. This is what people warn about with the minutiae of regulation. You can segue here to whether consumers understand on a fundamental level that payday loans are expensive and borrow anyway. Is the problem with payday loans really one of disclosure? Why isn't the TILA disclosure enough?

Was the loan legal? The initial fee was less than $10. See Cal. Civ. Code §1789.35(b). But the fee for cashing a personal check cannot exceed 12% of the face value. For $300, that would limit the fee to $36 and $45 was charged here. You can announce this and see if the students see the problem with this analysis—it is that the limit in §1789.35(d) applies only to checks posted "for immediate deposit." Because this was a mutually agreed on deferred deposit, there appears to be no fee limit. Too bad because the remedies are pretty stout.

Section 1789.32 opens up a lawsuit under Cal. Civ. Code §17200 as an unfair business practice. Section 1789.35 brings in criminal law, making a "willful violation" a misdemeanor; it also creates a civil penalty not to exceed $2,000 that is enforceable by the Attorney General, and a private right of action with double or treble damages, and reasonable attorney's fees and costs. There are even punitives available for a willful breach, in the court's discretion.

As a segue to the next problem, you can also discuss how the modern equivalent of an actual paper check postdated is often an authorization to debit a bank account. One danger of the latter is that banks sometimes try to run the authorization multiple times, causing the consumer to incur multiple fees. If the check bounces, that is usually a one-time deal.

Problem 17.2. This problem asks the students to evaluate a leading payday "alternative," called a "direct deposit advance loan." The problem paints a picture of Staid Bank as an upstanding outfit—the heart of the community of Thayer and committed to help its customers.

In 2010 and beyond, when the major banks started rolling out these loans, there was a robust debate about whether they were meaningful improvements to payday loans. The banks noted that they were trying to help those who they serve with other "regular" banking services and that deposit advance loans carried lower interest rates. Critics countered that the lowered interest rate reflected reduced risk given the bank-consumer relationship—and that the loans were still expensive. Maya Jackson Randall & Alan Zibel, *Banks' Direct-Deposit Advances Spark Lending Debate*, WALL ST. J., (Aug 31, 2011) at https://www.wsj.com/articles/SB10001424053111904006104576502793158420916.

The Office of the Comptroller of the Currency—in true fashion in terms of visibly protecting consumers—flagged the loans as raising "operational and credit risks and supervisory concerns." At that time, the main concerns were making sure consumers were affirmatively choosing the deposit advances and disclosing fees. The OCC offered final supervisory guidance in late 2013, clamping down even further. Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products, 78 Fed. Reg. 70,264 (Nov. 26, 2013) at https://www.occ.gov/news-issuances/federal-register/78fr70624.pdf. The effect was to cause many banks, including Wells Fargo, to stop offering the product.

The problem sends the students to both federal and state law to evaluate the legality of the product. The Electronic Funds Transfer Act (EFTA) prohibits conditioning an advance on a right to collect by a preauthorized funds transfer, 12 C.F.R. §205.10(e)(1) but also suggests a potential workaround—if the deposit advance is an "overdraft credit plan" then it is exempt from that EFTA rule. *See* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 (2011), n. 257 (raising the EFTA violation and solution).

Staid Bank's product seems to trigger Massachusetts' small dollar loan statute. Mass. Gen. Laws ch. 140, §96. The first sentence prohibits making a loan of six thousand dollars or less "if the amount to be paid on any such loan for interest and expenses exceeds in the aggregate an amount equivalent to twelve per cent per annum upon the sum loaned" without obtaining a license from the commissioner. The rate is determined by regulation; Mass. Genl. Laws ch. 140, §100. As of summer 2017, the commissioner's regulation (which the students do not have) caps the maximum annual rate of interest at 23% with an annual administrative fee of $20. Only loans below this can receive licenses. The $19 per $100 will appear to the students to be below the 23% rate but this is another opportunity to drive home the difference between an "annual" rate of interest and what may appear at first blush to be the interest rate.

Problem 17.3. This problem offers three fruitful avenues for discussion. First, it mentions that FunFunds, a payday lender, is worried about CFPB regulations on payday loans, so you can discuss the proposed rules in detail (if you didn't in opening lecture). Second, the facts squarely invite a legal and policy discussion of one of the various workarounds (evasions?) to usury law. Finally, it is a counseling transactional problem, putting the students in a role they will often play as lawyers but rarely in the classroom—is this sale too risky? Or more precisely, what are the risks so that the client can make that decision?

This problem asks whether the Tribe is subject to—or could be in the upcoming years—any payday lending laws. If so, the transaction comes undone and the sellers of FunFund could be in a big mess. As background, the Wall Street Journal did a good piece on the "tribal model" of payday lending. Jessica Silver-Greenberg, *Payday Lenders Join with Indian Tribes*, WALL ST. J. (Feb. 10, 2011) at http://on.wsj.com/2963ai7.

You may have to go over with the students the basics of tribal sovereignty. If you make an analogy to casinos, most students immediately get the idea. The federal and state governments have no authority to intervene in tribal businesses. What happens on tribal land, stays on tribal land.

That raises the question though about just where these loans are occurring? The problem says that FunFunds are a national operation, but it does say whether it uses storefronts or operates online. (I will clarify in a future edition that it is online). Online payday lending is exploding. While they make up about one-third of the market, online lenders have a worse record with borrowers. A Pew Charitable Trust study found that consumers who borrow online are about twice as likely to experience overdrafts on their bank accounts than storefront borrowers, and that default rates are higher among online borrowers. Hunter Stuart, *Payday Lenders Are Using the Internet to Evade State Law*, Huffington Post, Jan. 12, 2015, at http://www.huffingtonpost.com/2015/01/12/payday-lenders_n_6443134.html.

Positing that it is an online lender, where does the loan occur? In the borrowers' home state? (Could be any state, including states where payday loans are prohibited). Where the owner of the business is located (the tribal land)? Where the actual operational nerve center of the business is (nearly always where the original business, in this case, FunFunds operate; it will continue to operate there after its sale to the Tribe)? State and federal regulators have argued that the borrower's location should control, while businesses plead that they cannot be responsible for determining from the ether of the Internet where someone is.

When internet lenders began to take heat from states issuing regulations or suing them in 2009 and thereafter, alleging that the borrowers' residence controlled, the "solution" of many internet lenders was to create tribal affiliations. Consumer attorneys argued these were largely "sham" relationships, where the payday lender was basically "renting" the tribe's name to avoid state law.

In November 2010, the Colorado Supreme Court ruled that payday lenders were protected from enforcement because they were arms of American Indian Tribes. But these relationships are under much more scrutiny as to their legitimacy. The CFPB sued CashCall, an Orange County, California online lender and won a court ruling that the true lender was CashCall, not Western Sky—which was affiliated with the Cheyenne River Sioux Tribe. The court noted that the entire monetary risk of the loan program was on CashCall, and that Western Sky was basically being paid a fee to "rent" its affiliation. The 2016 opinion is available here, https://www.mayerbrown.com/files/uploads/Documents/PDFs/2016/August/CFPB-v-CashCall-LRes.pdf. The decision also held that the borrowers' home states law applied to the agreements because the Cheyenne River Sioux Tribe had no substantial relationship to the parties in the transaction.

The decision was a big victory for consumer advocates protesting the "sovereign lender" model for online payday loans. It also upped the concern about the potential liability of parties that worked to "support" lending that may be illegal. The industry, however, struck back bigtime. In 2017, President Trump ended Operation Choke Point, a 2013 initiative that put pressure on FDIC-insured banks to not provide financing to payday lenders. http://www.politico.com/story/2017/08/17/trump-reverses-obama-operation-chokepoint-241767. The result may be to encourage banks to partner with legitimate platforms for online lending that use new technological models, such as Kabbage or Lending Club, that have met a reluctance by banks to incur the wrath of the federal government. Andy Peters & Paul Davis, *Banks Remain Wary of Online Lending, Despite the Lure*, American Banker, Oct. 5, 2015.