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The Federal Government in the Fringe Economy

Jim Hawkins*

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

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

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

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

¹ Federal Deposit Insurance Corporation, FDIC National Survey of Unbanked and Underbanked Households 10 (2009) [hereinafter FDIC Survey] (reporting that 7.7 percent of American households, or nine million people, are unbanked, and 17.9 percent of households, or twenty-one million people, are underbanked).


³ Id.


⁶ FDIC Survey, supra note 1, at 10.
Indeed, almost no federal laws are aimed directly at fringe banking.\(^7\) Although many states have implemented measures to protect consumers, the federal government has largely sat on the sidelines—until now.

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

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

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

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

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

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

A. Coverage Generally

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

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10 Dodd-Frank § 1002(4).
11 Dodd-Frank § 1002(5).
12 See, e.g., Todd J. Zywicki, Consumer Use and Government Regulation of Title Pledge Lending, 22 LOY. CONS. L. REV. 425, 449 (2010) (asserting that around twenty-five to thirty percent of auto-title loans are taken out by small businesses).
who think that the Bureau’s regulations will prevent small businesses from accessing credit.\footnote{See id. at 425–26 (expressing concern that the creation of the Consumer Financial Protection Bureau could eliminate auto title lending which would “create hardship for many Americans who rely on auto title lending [such as unbanked consumers and independent small businesses] to meet urgent short-term expenses for utilities, housing and home repairs, and business expenses”).}

The definition for financial products and services reveals the lion’s share of what the Act covers. The Act offers a list of transactions that it defines as financial products or services. Most significantly, the term includes “extending credit and servicing loans, including acquiring, purchasing, selling, brokering, or other extensions of credit.” Credit is given the same expansive definition as debt is in the Fair Debt Collection Practices Act\footnote{15 U.S.C. § 1692a(5) (2006) (“The term ‘debt’ means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.”).} and is given a more expansive definition than in the Truth in Lending Act.\footnote{15 U.S.C. § 1602(e) (2006); 12 C.F.R. § 226.2(14) (2010) (“Credit means the right to defer payment of debt or to incur debt and defer its payment.”).} Credit means “the right granted by a person to a consumer to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for such purchase.”

Based on this provision alone, the bulk of fringe banking transactions fall within the scope of the Act. In payday loans, auto-title loans, secured credit cards, and pawn loans, the lender generally directly extends credit to consumers. This definition encompasses the activity of payday and auto-title lenders who act as credit service organizations and merely charge a fee for connecting customers with lenders\footnote{For a discussion of how payday lenders operate as credit service organizations, see Mary Spector, Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences, 57 DePaul L. Rev. 961, 983–95 (2008).} because it includes firms that broker extensions of credit.\footnote{Dodd-Frank § 1002(7).}
In some cases, the statute even specifies that fringe banking transactions are governed by the Bureau. For instance, check cashing is defined as a financial service.\textsuperscript{20} Also, one section empowering the Bureau to obtain reports and conduct examinations of a limited number of non-depository entities specifically gives the Bureau such powers over anyone who “offers or provides to a consumer a payday loan.”\textsuperscript{21} Thus, it is clear that the Act is intended to cover payday loans.

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

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

\textsuperscript{20} Dodd-Frank § 1002(15)(A)(vi).
\textsuperscript{21} Dodd-Frank § 1024(a)(1)(E).
\textsuperscript{22} Dodd-Frank § 1027(d).
\textsuperscript{23} Dodd-Frank § 1027(d)(2)(B) (“For purposes of this subsection, extending or brokering credit is not a customary and usual accounting activity, or incidental thereto.”).
\textsuperscript{24} For an account of the controversy, see Appelbaum, supra note 8.
\textsuperscript{25} Dodd-Frank § 1029(a) (“Except as permitted in subsection (b), the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both.”).
\textsuperscript{26} Dodd-Frank § 1029(b)(2)(B) (“Subsection (a) shall not apply to any person, to the extent that such person . . . operates a line of business . . . in which . . . the extension of retail credit or retail leases are provided directly to consumers; and . . . the contract governing such extension of retail credit or retail leases is not routinely assigned to an unaffiliated third party finance or leasing source . . . “).
\textsuperscript{27} Dodd-Frank § 1022(b)(3).
\textsuperscript{28} Dodd-Frank § 1022(b)(5)(B).
most likely possibility because they are declining in number and they are extensively regulated by every state.  

Finally, the Act has built into it a mechanism to prevent lenders from circumventing regulation by disguising credit sales as sales of other products or services. Reports indicate some fringe bankers have created such schemes in attempt to avoid state interest rate limits. To prevent this strategic behavior, the Act clarifies that although the Bureau does not have authority to regulate a “merchant, retailer, or seller of any nonfinancial good or service,” this exemption does not apply to any credit transaction or collection of debt... in which the credit extended significantly exceeds the market value of the nonfinancial good or service provided, or the Bureau otherwise finds that the sale of the nonfinancial good or service is done as a subterfuge, so as to evade or circumvent the provisions of this title.

B. Pawnshops as Exchange Facilitators?

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

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

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

29 See John Caskey, Fringe Banking and the Rise of Payday Lending, in Credit Markets for the Poor 26 (Patrick Bolton & Howard Rosenthal eds., 2005) (noting that the growth in pawnbroking stopped around 1997 and in “many states, the number of pawnshops actually declined between 2000 and 2002”).
30 See generally Oeltjen, supra note 5 (discussing the effect of state regulations on the pawnshop industry).
32 Dodd-Frank § 1027(a)(1).
33 Dodd-Frank § 1027(a)(2)(B).
35 Dodd-Frank § 1079.
36 FERNHOLZ, supra note 34, at 9.
facilitates, for a fee, an exchange of like kind property by entering into an agreement with a taxpayer by which the exchange facilitator acquires from the taxpayer the contractual rights to sell the taxpayer’s relinquished property and transfers a replacement property to the taxpayer as a qualified intermediary (within the meaning of Treasury Regulations section 1.1031(k)-1(g)(4)) or enters into an agreement with the taxpayer to take title to a property as an exchange accommodation titleholder (within the meaning of Revenue Procedure 2000-37) or enters into an agreement with a taxpayer to act as a qualified trustee or qualified escrow holder (within the meaning of Treasury Regulations section 1.1031(k)-1(g)(3)).

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

C. Rent-to-Own

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

37 Dodd-Frank § 1079(d)(1).
39 See Ezra Klein, Digging Into Finance’s Pay Dirt, WASH. POST, July 25, 2010, at G1 (‘Sometimes this spring, Democrats stopped calling Sen. Chris Dodd’s bill ‘financial reform’ and started calling it ‘Wall Street reform.’ Most of the headlines and news releases on the sweeping legislation focused on the well-heeled, white-collar, upper crust of finance—investment banks, private-equity firms and hedge funds. But the bill President Obama signed into law Thursday will have a lot to say about payday lenders and check cashers and rent-to-own furniture stores—the blue-collar, far-off-Main Street joints.”); Jonathan D. Epstein, Financial Reforms Mean Big Changes, BUFFALO NEWS, July 4, 2010, at C1 (“The new consumer financial protection bureau would have extensive power to make and enforce regulations, even over industries previously subject to little federal regulation. It will have authority over traditional products such as mortgage, credit card, student and other consumer loans, as well as non-banks like check-cashers, pawn shops, payday lenders and rent-to-own stores.”); Jessica Machetta, New Federal Oversight Bureau to Crack Down on Payday Lenders, MISSOURINET, Nov. 23, 2010, http://www.missourinet.com/2010/11/23/new-federal-oversight-bureau-to-crack-down-on-payday-lenders/ (“Brenda Procter of the University of Missouri believes this new step of hiring a director to oversee non-depository institutions such as payday lenders and rent-to-own stores will give some focused attention to the issues that consumer advocates have requested for years.”).
rent-to-own is covered by the Act. Some consumer advocates have noted it is unclear whether rent-to-own falls within the Act’s control,41 and some industry sources have similarly expressed concern over whether the Bureau will regulate rent-to-own.42

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

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

consumer financial products or services, including taking deposits; extending credit; servicing loans; leasing or brokering leases of real or personal property on a rent-to-own basis . . . .”); Sutherland, New Whistleblower Protections for Financial Service Employees 1 (2010), http://www.sutherland.com (follow “Alerts+Publications” hyperlink, search “new whistleblower protections”) (“The whistleblower must be in the employ of a ‘covered person’ (or a service provider assisting such covered person). A covered person is defined by Title X as any individual or incorporated entity that provides ‘consumer financial products or services,’ defined broadly to include lending (including payday lending), loan servicing, ‘rent-to-own’ leasing . . . .”); Richard P. Hackett & Frank H. Bishop Jr., Pierce Atwood LLP, Working Summary of the Consumer Financial Protection Act of 2010 9 n.26 (2010), http://pierceatwood.com/files/811_workingSummaryoftheConsumerFinancialProtectionActof2010.pdf (“This exclusion does not apply if: (i) the person assigns, sells, or otherwise conveys non-delinquent debt (i.e., sells the consumer obligation); (ii) the credit extended significantly exceeds the market value of the non-financial good or service provided (e.g., rent-to-own); or (iii) the person regularly extends such credit and the credit is subject to a finance charge.”) (emphasis added).


42 Consumer Protection Agency Passes Key Committee, Targeted News Service, Oct. 22, 2009, available at http://www.tns.com/02826spro-consumer-protection-agency-passes-key-committee.html (“The U.S. House Financial Services Committee today approved creation of a controversial Consumer Financial Protection Agency (CFPA), charged with writing rules for mortgage and credit card lenders and other financial service providers which could include rent-to-own.”); Rent-A-Center Inc. Outlook Revised To Stable; ‘BB’ Corporate Credit, All Other Ratings Affirmed, Market News Publishing, Nov. 10, 2009 (“The outlook revision to stable from positive reflects our reassessment of the probability of a ratings upgrade over the near term, and not any recent substantial unfavorable developments with respect to potential future RTO industry regulation under the proposed Consumer Financial Protection Agency Act of 2009 (CFPA). The reassessment reflects uncertainty surrounding whether the CFPA will be passed, what industries (including RTO) may be regulated by the act, and the impact of any such regulation. If we had greater assurance that Rent-A-Center would not be substantially negatively impacted by CFPA regulation, we would give consideration to a ratings upgrade.”).
would have explicitly excluded rent-to-own, and this effort failed, potentially signaling that the Act includes rent-to-own. Some Senators balked at the idea of exempting rent-to-own from the Act’s coverage. On the other hand, Charles Schumer attempted to insert language into the Act to ensure the Act covered rent-to-own and failed to get this language passed into law, suggesting the opposite conclusion, that rent-to-own is not covered.

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

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

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

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

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

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

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

46 House/Senate Conference Committee Holds a Meeting on the Wall Street Reform and Consumer Protection Act, FD (FAIR DISCLOSURE) WIRE, June 22, 2010.
Testimony from people supporting the Act also assumes rent-to-own is covered. For instance, in support of an amendment to the Act regarding military families, Senator Jack Reed stated:

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

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

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

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

47 Senator Jack Reed, Floor Statement Introducing Joint Amendment to Strengthen Consumer Protection for Military Families, STATES NEWS SERVICE, May 7, 2010. See also Media Conference Call with Senator Richard Durbin (D-IL); Senator Jack Reed (D-RI); And Holly Petraeus, Director, Better Business Bureau Military Line; Subject: Protection for Military Families Against Abusive Lending Practices, FEDERAL NEWS SERVICE, May 12, 2010 (“They’re numerous. They’re legion. And, you know, we’ve got Marine squad leaders who need to do a lot more than, you know, take care of consumer activities of their Marines. This is something that should be done systematically by a consumer protection agency. Our families, our military families are vulnerable not just to auto dealers. They’ve [sic] vulnerable to pay-day loans who offer up to—interest rates up to 800 percent. You know, back where I come from, you know, that’s—that would be frowned on by people who, you know, aren’t legitimate businessmen and women. Rent-to-own loans, two to three times the price of the goods. We could go on and on and on.”).
49 Dodd-Frank § 1002(15)(A)(ii).
contracts are almost universally for less than 90 days, causing them to fall outside the Act. On the other hand, if rent-to-own is considered an extension of credit, it will fall within the basic definition of a financial product or service.

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

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

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

50 See generally Jim Hawkins, Renting the Good Life, 49 WM. & MARY L. REV. 2041 (2008) (discussing the rent-to-own industry and examining arguments for regulating it).
51 Id.
52 Id. at 2048 (collecting arguments for both sides).
53 Id. at 2051.
54 Id. at 2050.
55 Dodd-Frank § 1002(15)(A)(xi).
56 See, e.g., CAL. CIV. CODE § 1812.622(d) (West 2010) (“Rental-purchase agreement” means an agreement between a lessor and a consumer pursuant to which the lessor rents or leases, for valuable consideration, personal property for use by a consumer for personal, family, or household purposes for an initial term not exceeding four months that may be renewed or otherwise extended, if, under the terms of the agreement the consumer acquires an option or other legally enforceable right to become owner of the property.”).
unlikely because the Bureau or any court interpreting the Act will have to look to the Act’s definition of credit, not any individual state’s definition of credit. The Act sets out a definition of credit. It does not defer to states’ definitions of credit, so courts will have to analyze transactions in light of the Act’s definition regardless of state law. In similar contexts, courts look only to the federal statute’s definition of a term to determine its meaning. For example, in determining whether rent-to-own transactions are credit within the meaning of the Truth in Lending Act, courts do not consider state law but instead just evaluate the definition of credit in the Truth in Lending Act statute.

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

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

58 Dodd-Frank § 1002(7).
59 See Ortiz v. Rental Mgmt., Inc., 65 F.3d 335, 341 (3d Cir. 1995) (determining rent-to-own is not “credit” based on the definition in the statute and the Regulations promulgated to implement it and the federal commentary on the statute); Starks v. Rent-A-Center, No. 3-89-0786, 1990 U.S. Dist. LEXIS 20099 (D. Minn. May 16, 1990) (concluding that rent-to-own contracts are not extensions of credit under TILA even though the court found that rent-to-own contracts were credit sales under Minnesota law); In re Crawford, No. 90-50066, 1992 Bankr. LEXIS 2515 (E.D. Bankr. Ky. 1992) (assessing whether rent-to-own was a credit sale under TILA completely separately from assessing rent-to-own’s status under Kentucky law).
60 Dodd-Frank § 1002(7).
62 Even cases finding that rent-to-own agreements are credit sales state that rent-to-own does not entail accumulating debt. See Miller, 518 N.W.2d at 549.
63 See, e.g., 16 U.S.C. § 3372(c)(2) (2006) (“It is deemed to be a purchase of fish or wildlife in violation of this Act for a person to obtain for money or other consideration . . . (A) guiding, outfitting, or other services; or (B) a hunting or fishing license or permit . . . .”); U.C.C. § 1-201(29) (2007) (“Purchase’ means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift,
payments for renting are due before the rental period begins, rent-to-own does not entail deferring payment for purchasing even the right to possess the goods during the rental period. Also, the consumer must pay in advance to actually acquire ownership of the goods, so purchasing the title of the goods is not deferred. The only way rent-to-own involves a purchase under common definitions of that term is if it is a disguised deferred purchase—i.e., the consumer really purchases title of the goods at the start of the first rental period but defers payment for the title until the end of the rental agreement.

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

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

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

or any other voluntary transaction creating an interest in property.

64 Dodd-Frank § 1002(15)(A)(ii).
65 Expressio unius is the principle of statutory interpretation which states that the expression of one thing means the exclusion of another. Chevron U.S.A. v. Echazabel, 536 U.S. 73, 80 (2002).
66 Dodd-Frank § 1002(15)(A)(ii) (emphasis added).
II. THE CONSUMER FINANCIAL PROTECTION ACT'S SUBSTANTIAL POWER TO REGULATE FRINGE CREDIT

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

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

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

A. Research

A major focus of the Bureau will be research,\(^\text{71}\) and the Act instructs the Bureau’s Director to create a research unit.\(^\text{72}\)

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

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

\(^{69}\) Dodd-Frank § 1014(b).

\(^{70}\) Dodd-Frank § 1073(c).

\(^{71}\) Dodd-Frank § 1021(c)(3) (stating a primary function of the Bureau will be “collecting, researching, monitoring, and publishing information relevant to the
Remarkably, three of the six foci of the research unit directly relate to fringe banking, and the other three are indirectly related to it.

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

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

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

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

72 Dodd-Frank § 1013(b)(1).
73 Dodd-Frank § 1013(b)(1)(A).
74 Dodd-Frank § 1013(b)(1)(B).
75 Dodd-Frank § 1013(b)(1)(F).
76 Dodd-Frank § 1013(b)(1)(C)--(E).
draw: information obtained directly from fringe banking firms through the Bureau’s supervision powers.

B. Monitoring and Supervision

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

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

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

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

78 Dodd-Frank § 1024(b).
79 Dodd-Frank § 1022(c)(1).
80 Dodd-Frank § 1022(c)(2)(E).
81 Dodd-Frank § 1022(c)(4)(B)(i).
82 Dodd-Frank § 1022(c)(5) (“In order to assess whether a nondepository is a covered person, as defined in section 1002, the Bureau may require such nondepository to file with the Bureau, under oath or otherwise, in such form and within such reasonable period of time as the Bureau may prescribe by rule or order, annual or special reports, or answers in writing to specific questions.”).
83 Dodd-Frank § 1022(c)(7)(A).
85 Dodd-Frank § 1022(c)(7)(C).
Second, in addition to monitoring, the Act empowers the Bureau to supervise some fringe lenders. The Act specifically empowers the Bureau to supervise just three types of lenders: (1) mortgage originators, brokers, and servicers; (2) those offering education loans; and (3) payday lenders. The specific language of the section granting supervisory power over payday lenders is broad enough to include payday lenders operating in a variety of business models because it is not limited to companies that provide payday loans—it includes anyone who even offers them. Thus, the Bureau will supervise payday lenders who operate as Credit Service Organizations that merely connect borrowers with third-party lenders.

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

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

86 Dodd-Frank § 1024(a)(1)(A), (D), (E).
87 Dodd-Frank § 1024(a)(1)(E) (granting power to supervise a person who “offers or provides to a consumer a payday loan”).
88 Spector, supra note 18, at 983–95.
89 Dodd-Frank § 1024(a)(1)(B).
90 Cash America International, Inc. is a pawnshop traded on the New York Stock Exchange listed under the symbol “CSH.”
91 EZ Corp. offers title loans and is traded on NASDAQ under the symbol “EZPW.”
92 Advance America is one of the largest payday lenders and is traded on the New York Stock Exchange under the symbol “AEA.”
93 Dodd-Frank § 1024(a)(1)(C).
94 Dodd-Frank § 1024(b)(1).
95 Dodd-Frank § 1024(b)(7)(C).
96 Id.
Bureau can perform its supervisory function.\textsuperscript{97} These requirements could have a variety of effects in fringe markets. For instance, if only payday lenders are supervised, it could put other fringe lenders in a better competitive position because they will be able to avoid the costs payday lenders are paying for compliance. More generally, capital requirements and substantial reporting requirements could favor larger firms and drive mom and pop shops out of business.

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

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

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

C. Rulemaking

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

\begin{flushright}
97 Dodd-Frank § 1024(b)(7)(B).
99 Dodd-Frank § 1021(c)(5) (“The primary functions of the Bureau are… issuing rules, orders, and guidance implementing Federal consumer financial law.”); § 1022(a) (“The Bureau is authorized to exercise its authorities under Federal consumer financial law to administer, enforce, and otherwise implement the provisions of Federal consumer financial law.”).
100 Dodd-Frank § 1031(b).
\end{flushright}
On the other hand, the Act’s instruction to create rules to regulate “unfair, deceptive, or abusive acts”\textsuperscript{101} has much more potential to affect fringe lenders. None of these terms are explicitly defined by the Act. The Act does give some indication of when the Bureau can define a practice as unfair and abusive, but it gives no guidance concerning defining acts as deceptive.

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

1. materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
2. takes unreasonable advantage of—
   
   (A) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
   
   (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
   
   (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.\textsuperscript{103}

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

\begin{footnotesize}
\begin{enumerate}
\item Id.
\item Dodd-Frank § 1031(c)(1).
\item Dodd-Frank § 1031(d)(1)&(2).
\item See 15 U.S.C. § 45(a) (2006) (using the same language as the Consumer Financial Protection Act when empowering the FTC to prevent unfair and deceptive acts or practices but omitting “abusive”).
\item 15 U.S.C. § 45(a)(2) (“The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.”).
\item See 15 U.S.C. § 57a(a)(1)(B) (2006) (“[T]he Commission may prescribe . . . rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce (within the meaning of section 45(a)(1) of this title), except that the Commission shall not develop or promulgate any trade rule or regulation with regard to the regulation of the development and utilization of the standards and certification activities pursuant to this section. Rules under this subparagraph may
\end{enumerate}
\end{footnotesize}
unfair and deceptive conduct may help predict what conduct the Bureau will define as unfair and deceptive.

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

i. Unfair Acts or Practices

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

111 49 Fed. Reg. 7740, 7744 (Mar. 1, 1984). See also Unfair or Deceptive Acts or Practices, 74 Fed. Reg. 5498, 5503 (Jan. 29, 2009) (“An injury is not reasonably avoidable when consumers are prevented from effectively making their own decisions about whether to incur that injury . . . . The test is not whether the consumer could have made a wiser decision but whether an act or practice unreasonably creates or takes advantage of an obstacle to the consumer’s ability to make that decision freely.”).
112 H.R. REP. NO. 98-156 (1983); FTC Policy Statement on Unfairness, (Dec. 17, 1980), available at http://www.ftc.gov/bcp/policystmt/ad-unfair.htm (“Normally we expect the marketplace to be self-correcting, and we rely on consumer choice—the ability of individual consumers to make their own private purchasing decisions without regulatory intervention—to govern the market. We anticipate that consumers will survey the available alternatives, choose those that are most desirable and avoid those that are inadequate or unsatisfactory. However, it has long been recognized that certain types of sales techniques may prevent consumers from effectively making their own decisions, and that corrective action may then become necessary. Most of the Commission’s unfairness matters are brought under these circumstances. They are brought, not to second-guess the wisdom of particular consumer decisions, but rather to halt some form of seller behavior that unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decisionmaking. Sellers may adopt a number of practices that unjustifiably
has come to the initially surprising conclusion that unfairness in consumer contracts means gross inefficiency."

Under the statute and its policy statement, the FTC will only take action when the benefits of further regulation outweigh the costs to consumers and competition.

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

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


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

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

*Id. at 945.*

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

*Id. at 945–48.*
While the consumers knew that their monthly payment was being allocated in prescribed percentages, that fact would have been meaningless to a reasonable consumer and would not have alerted the consumer of what was to come. While the ERA said that the obligation to make monthly payments was unconditional, the consumers could not have reasonably anticipated that, to use Justice Cardozo’s phrase, “the doom of mere sterility was on the [transaction] from the beginning,” and that it was a virtual certainty, not merely a possibility inherent in any comparable transaction, that its contracted for telecommunications services would cease and they would be on the hook to an assignee. Having no reason to anticipate the harm that was certain to befall them, there was no occasion for the consumers even to consider taking steps to avoid it.\(^{120}\)

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

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

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

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\(^{120}\) Id. at 948.

\(^{121}\) See KARGER, supra note 4, at 6 (reporting the United States has more payday lending and check cashing stores than McDonald’s, Burger King, Target, Sears, J.C. Penney, and Wal-Mart locations combined).

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

\(^{123}\) Ann Sanner, White House Consumer Adviser Gathers Input in Ohio, DAILY CALLER (Oct. 14, 2010), http://dailycaller.com/2010/10/14/obama-consumer-adviser-gathers-input-in-ohio/ (“Warren told reporters before the round-table that payday lending would be a ‘high priority’ for the agency. People should have access to small-dollar loans for emergencies, she said, but ‘a model that is designed to keep those families in a revolving door of debt is not good for families—and ultimately not good for the economy.’ Warren said federal regulators would look at the business models used in payday lending, the costs to consumers and the actions states have taken to regulate it.”).
address credit cards and mortgages. Some payday lenders think the Bureau will address payday lending first because it is low hanging fruit and an easy early win for the Bureau. In any case, given the emphasis on payday lending in the Act itself and news stories about the Act, it is highly likely the Bureau will make rules about it.

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

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


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


129 See Sanner, supra note 123 (quoting Warren as saying: “[A] model that is designed
power to eliminate rollovers.\textsuperscript{130} The Bureau could argue that rollovers are expensive for individual payday lending customers\textsuperscript{131} and could use evidence that rollovers are common to establish that many consumers are affected by the practice.\textsuperscript{132} Many people claim that consumers do not anticipate rolling over their loans when they take them out, suggesting a market failure,\textsuperscript{133} which implies consumers could not reasonably avoid the injury.

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

One industry attorney, Hilary Miller, is tentatively skeptical that the Bureau could take action against payday loans under either the unfairness or deceptive prongs of the Act.\textsuperscript{135} Because the FTC already has had the authority to prevent unfair and deceptive acts but has never found payday lending to fall within these categories, Miller argues that the Bureau cannot use these prongs against the industry: “To my mind, this argument entirely disposes of two of the three ‘bad conduct’ badges in the Act . . . . The FTC Act and Title X of Dodd-Frank are manifestly in pari materia, and chaos would result if they were interpreted differently.”\textsuperscript{136}
The problem with the argument, however, is that the FTC has never affirmatively found payday lending to be fair or not deceptive. It just has not taken action either way. It is possible to read this as an affirmation of the industry, but it is more likely that the FTC has never acted because it does not have infinite resources. As Jeff Soverr has argued, the FTC lacks the resources to bring even cases it considers worthwhile. Thus, the Bureau could rule that rollovers or some other aspect of a fringe credit transaction are unfair despite the fact the FTC has never pursued a suit against this conduct on the theory that the FTC’s past actions just reflect scarce resources, not a judgment about all consumer credit practices that currently exist in the market. Moreover, because the Bureau was created out of a sense that other agencies were not actually protecting consumers, it is likely the Bureau will take a more aggressive stance than the FTC on many issues. Also, the Bureau will have a much easier time promulgating rules than the FTC. The FTC has a burdensome rulemaking procedure compared to the Bureau’s procedure, which is relatively straightforward. For instance, from 1980 to 2000, the FTC did not create a single rule related to unfair acts or practices. This difference may result in the Bureau having an easier time creating rules for fringe creditors. Finally, the language defining unfairness in the FTC Act is not exactly the same as the language in the Dodd-Frank Act, suggesting the Bureau has a new chance to define unfairness.

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


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

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

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

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

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

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142 Sovern, supra note 137, at 444.
146 Id. at 15–16.
147 FTC v. IFC Credit Corp., 543 F. Supp. 2d 925, 941 (N.D. Ill. 2008) (observing that deception cases “usually involve advertisements made by the defendant to induce consumers into purchasing the defendant’s products or services” and giving as examples FTC v. Bay Area Bus. Council, Inc., 423 F.3d 627, 635 (7th Cir. 2005), which found that “defendants misled consumers with bad credit into believing they were buying credit cards when in fact they were buying worthless ‘ChexCards,'” and F.T.C. v. World Travel Vacation Brokers, Inc., 861 F.2d 1020, 1029 (7th Cir. 1988), which found that “defendants misrepresented the cost of vacation packages to Hawaii”).
150 Id. at 296.
151 Id. at 297.
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deceptive within the meaning of the FTC Act because “they convey a misleading impression.”\textsuperscript{152} They implied that the study found that vegetable pills could reduce the risk of cancer when the study did not explicitly find that; in fact, the study specifically expressed doubts about whether processed vegetables could have the same salutary effects as fresh ones.\textsuperscript{153}

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

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

iii. Abusive Acts or Practices

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

\begin{itemize}
  \item \textsuperscript{152} \textit{Id.} at 301.
  \item \textsuperscript{153} \textit{Id.} at 302.
  \item \textsuperscript{155} See Hawkins, \textit{supra} note 50, at 2045.
  \item \textsuperscript{156} Michael A. Benoit, \textit{The Birth of a New Financial Services Regulator}, BUS. L. TODAY (Nov. 22, 2010), http://www.abanet.org/buslaw/blt/content/2010/11/article-benoit.shtml (last visited Nov. 30, 2010) (“While we have years of jurisprudence from which providers may glean what acts or practices may be unfair or deceptive, the standard for ‘abusive’ practices is new and untested.”).  
\end{itemize}
mortgage financing abusive.\textsuperscript{157} The Federal Reserve, however, rarely exercises that power, leaving us with little understanding of the term.\textsuperscript{158} Also, the FTC has the power to regulate abusive telemarketing acts or practices,\textsuperscript{159} and it has promulgated regulations under this statute, but the regulations do not provide a meaningful parallel to the Bureau’s power. The term “abusive” is not defined in the Telemarketing and Consumer Fraud and Abuse Prevention statute,\textsuperscript{160} but the statute and regulations give examples of abusive acts,\textsuperscript{161} and courts have deemed some conduct abusive under the statute.\textsuperscript{162} Unfortunately, however, very little of the FTC’s power in this area relates to credit,\textsuperscript{163} so it is difficult to extrapolate what abusive means from the regulations in this statute.

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


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


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

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

\textsuperscript{163} The only regulation related to initiating credit relationships (and not debt settlement) is in section 310.4(a)(4) which states that it is abusive to “[r]equest[] or receive[] payment of any fee or consideration in advance of obtaining a loan or other extension of credit when the seller or telemarketer has guaranteed or represented a high likelihood of success in obtaining or arranging a loan or other extension of credit for a person.” 16 C.F.R. § 310.4(a)(4).
pass any rule because the standard is “whatever the bureau director says it is,” and is likely impossible for businesses to comply with because “the term is so broad and the definition is so broad” and the standard is “very subjective.”

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

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


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

166 Dodd-Frank § 1031(d).

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

168 Compare Dodd-Frank § 1031(c)(1) (stating the Bureau can only declare an act unfair if “the Bureau has a reasonable basis to conclude that . . . the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers . . . and such substantial injury is not outweighed by countervailing benefits to consumers or to competition”), with Dodd-Frank § 1031(d)(2)(B) (stating that the Bureau can define an act as abusive if it “takes unreasonable advantage of . . . the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service”).
the ability to declare acts abusive without substantial injury really gives the Bureau any new authority.

The only truly new part of the standard is the Bureau’s ability to declare an act abusive if it “takes unreasonable advantage of...the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.”

One commentator has suggested that businesses will be able to protect themselves from problems under this part of the standard by disclosing to consumers that they should not rely on the business to protect their interests in the transaction. Such statements have been effective to negate reliance under state consumer protection laws. In Texas, if a consumer signs a contract that states the consumer is purchasing a good or property “as is” and without reliance on the seller’s representations, the consumer cannot claim that she relied on the seller’s representations. The Texas Supreme Court explained in a seminal case that:

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

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

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

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

170 Benoit, supra note 156.

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

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

173 See e.g., U.C.C. § 1-304 (2007) (requiring parties to use good faith in performing and enforcing contracts but not in negotiating them).
falsely communicate to the consumer that it will act in the consumer’s interest.

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

D. Enforcement

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

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

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

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

\textsuperscript{175} Dodd-Frank § 1052.

\textsuperscript{176} Dodd-Frank § 1053(b).

\textsuperscript{177} Dodd-Frank § 1054(a).

\textsuperscript{178} Dodd-Frank § 1055(a)(3).

\textsuperscript{179} Dodd-Frank § 1055(a)(2)&(b).

\textsuperscript{180} Dodd-Frank § 1055(c)(2).

\textsuperscript{181} Id.
violating federal consumer protection law. A primary function of the Bureau is “collecting, investigating, and responding to consumer complaints.” One mechanism the Bureau will have for learning about violations is a consumer hotline for complaints established by the Act. In her work establishing the Bureau, Warren has pledged to use new technologies, such as crowdsourcing, to enhance the amount of information that the Bureau gathers from consumers. After gathering this information, the Bureau will establish procedures to “provide a timely response to consumers...to complaints against...a covered person...” Both the powers to gather information and to act on that information give the Bureau the power to take definite action to affect fringe lenders who violate federal rules and statutes.

E. The Act’s Relation to State Law

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

182 Dodd-Frank § 1021(c)(2).
183 Dodd-Frank § 1013(b)(3)(A).
185 Eileen Ambrose, Elizabeth Warren: Three Top Goals for New Consumer Protection Agency, CONSUMING INTERESTS (Nov. 10, 2010, 2:22 PM), http://weblogs.baltimoresun.com/business/consuminginterests/blog/2010/11/elizabeth_warren_three_top.goa.html (noting that one of Warren’s top three priorities of the Bureau is “using technology to tap into the experience of millions of consumers so the bureau can develop a rapid response to problems”); Bill Swindell, Warren Outlines Sweeping New Approach to Consumer Financial Protection, NATIONAL J. (Oct. 26, 2010), http://www.nationaljournal.com/daily/warren-outlines-sweeping-new-financial-protection-approach-20101026 (“In an interview on Tuesday with National Journal, Warren said new techniques like crowd-sourcing—scaled-up variations on Wikipedia—make it possible to collect valuable information from millions of ordinary consumers who report problems as they arise. Using new systems to organize and find patterns in all that information, Warren said, the bureau could be able to spot new enforcement targets in a matter of days—an unheard-of response time for traditional regulators.... Under her vision, Warren imagines a subset of Americans reporting on a specific problem, such as extraneous fine print included in a bank’s checking account statement, documenting it through use of a camera phone, and then emailing it to the bureau within seconds. The bureau would use such data to target its enforcement.”).
186 Dodd-Frank § 1034(a).
Bureau will only add regulations to fringe credit markets, not take any away.

i. The Effect of Existing State Laws on Rulemaking

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

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

ii. Coordination

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

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187 See, e.g., Dodd-Frank § 1022(b)(3) (instructing the Bureau to consider the extent of state regulation when determining if an industry should be exempt from its rules).
188 Dodd-Frank § 1024(b)(2)(D).
190 For instance, New Mexico sanctions small dollar loans and does not place a cap on the interest lenders can charge either in the small loan statute or general state law. See generally N.M. Stat. Ann. § 58-15-17 (2010). Section 56-8-3 sets out that interest rates in the state generally “in the absence of a written contract fixing a different rate, shall be not more than fifteen percent annually,” but it does not prevent the parties agreeing in a written contract to a higher interest rate. N.M. Stat. Ann. § 56-8-3 (2010). The end result is that title lenders have restrictions on the interest rate they can charge, and title borrowers have no specific protections beyond those afforded to borrowers generally in the Uniform Commercial Code.
persons . . . and requirements regarding reports to be submitted by such persons.” 191 Additionally, in setting capital requirements for supervised nondepositories “the Bureau shall consult with State agencies regarding requirements or systems (including coordinated or combined systems for registration), where appropriate.” 192 Finally, the Act mandates that the Bureau coordinate with states when setting up registration requirements for all business it monitors. 193 To the extent this coordination is successful, it will obviously reduce demands on fringe banking firms, but it is again questionable how the Bureau will be able to coordinate with states that have different requirements. While it might be simple to harmonize the federal requirements with a single state, it seems impossible to do so with several states that have different registration requirements, for example.

iii. Powers Given to State Governments

The Act actually confers some powers on state regulators. First, states can prompt the Bureau to consider proposing a rule if a majority of states enact a resolution supporting a rule. 194 Second, in addition to clarifying that states still have the authority to enforce their own consumer protection laws, 195 the Act empowers states to file suits in consultation with the Bureau 196 to enforce Bureau regulations, 197 except against national banks and federal savings associations. 198 These provisions should increase the potential that fringe banking businesses will face enforcement actions of the Bureau’s rules—even beyond the augmentation of general enforcement powers

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191 Dodd-Frank § 1024(b)(3).
192 Dodd-Frank § 1024(b)(7)(D).
193 Dodd-Frank § 1022(c)(7)(C).
194 Dodd-Frank § 1041(c)(1) (“The Bureau shall issue a notice of proposed rulemaking whenever a majority of the States has enacted a resolution in support of the establishment or modification of a consumer protection regulation by the Bureau.”).
195 Dodd-Frank § 1042(d)(1).
196 Dodd-Frank § 1042(b).
197 Dodd-Frank § 1042(a)(1) (“The attorney general (or the equivalent thereof) of any State may bring a civil action . . . to enforce provisions of this title or regulations issued under this title, and to secure remedies under provisions of this title or remedies otherwise provided under other law. A State regulator may bring a civil action or other appropriate proceeding to enforce the provisions of this title or regulations issued under this title with respect to any entity that is State-chartered, incorporated, licensed, or otherwise authorized to do business under State law . . . and to secure remedies under provisions of this title or remedies otherwise provided under other provisions of law with respect to such an entity.”). States are limited from enforcing the Bureau’s rules against exempt merchants, just as the Bureau cannot enforce those rules. Dodd-Frank § 1027(a)(2)(E) (“To the extent that the Bureau may not exercise authority under this subsection with respect to a merchant, retailer, or seller of nonfinancial goods or services, no action by a State attorney general or State regulator with respect to a claim made under this title may be brought under subsection 1042(a) . . . .”).
198 Dodd-Frank § 1042(a)(2).
discussed above—because state attorneys general will have a new tool to combat what they perceive to be sharp practices.

iv. Preemption

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

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

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

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199 Dodd-Frank § 1041(a)(1).
200 Dodd-Frank § 1041(a)(2).
201 See 12 U.S.C. § 2616 (2006) (“The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.”); 15 U.S.C. § 1692n (2006) (“For purposes of this section, a State law is not inconsistent with this subchapter if the protection such law affords any consumer is greater than the protection provided by this subchapter.”); 15 U.S.C. § 1691d(f) (2006) (“The Board may not determine that any State law is inconsistent with any provision of this subchapter if the Board determines that such law gives greater protection to the applicant.”); 12 U.S.C. § 2805(a) (2006) (“The Board may not determine that any such law is inconsistent with any provision of this chapter if the Board determines that such law requires the maintenance of records with greater geographic or other detail than is required under this chapter, or that such law otherwise provides greater disclosure than is required under this chapter.”).
supported a federal law on rent-to-own called the Consumer Rental Purchase Agreement Act. This law sets out a variety of rules for rent-to-own and even includes similar language to the Consumer Financial Protection Act regarding state laws that provide greater protection for consumers. But, the bill clarifies that no state law can regulate rent-to-own as a credit sale or require businesses to disclose interest rates. These two rules have historically been of overwhelming importance to rent-to-own companies, so the passage of the bill would be a major victory because it would prevent states from enacting these disfavored regulations. The new Consumer Financial Protection Act as written, however, does not bring this benefit, it only adds restrictions onto fringe lenders’ conduct. As with the other substantive provisions on fringe banking, the sections discussing preemption reveal a profound new power the federal government now has to govern the fringe economy. The next part asks a more basic question: Is this power justified?

III. THE RATIONALES BEHIND THE BUREAU REGULATING FRINGE BANKING

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

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

This part takes up that inquiry.

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204 See Consumer Rental Purchase Agreement Act § 1018(a)(3).
205 Consumer Rental Purchase Agreement Act § 1018(b).
206 See Hawkins, supra note 50, at 2101–09.
207 SKEEL, supra note 98, at 113.
In order to assess the rationales offered for the Bureau regulating fringe credit, it is important to group different rationales into categories. This part categorizes the diverse reasons that popular press, government officials, and academics have proffered to justify the Bureau’s control over fringe banking products. To describe the rationales, I draw primarily on two of Elizabeth Warren’s articles proposing the Bureau. Although these two articles are not the only academic works advocating for the Bureau, they are significant because the President appointed Warren as a special advisor to oversee the creation of the Bureau and these two articles are widely considered the academic work that propelled the Bureau into existence.

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

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


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

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

I say we read virtually every article that appeared in this database because during the time we performed the study (September 2010–November 2010), the number of results from the search jumped from 1520 to 1560 as additional articles were added. This change in the number of results combined with the fact multiple people were working on different sections of the result led to twenty-four results being coded twice and twenty-four not being coded at all. I eliminated the twenty-four results that were coded twice from the database because it only represented 1.5% of the total results. In the end, we reviewed 1496 stories instead of the 1520 that were originally generated by the search.
(2) the extent of the coverage (provides no coverage, merely mentions the Bureau and fringe banking, merely explains the law, or offers justifications for the Bureau regulating fringe banking); and (3) the justification, if any, offered for the Bureau governing fringe banking. The coding information was imputed into a custom-designed Microsoft Excel database. Each researcher underwent a training class and received detailed written coding protocols about how to code the results, and we met periodically to ensure we were uniformly carrying out the coding protocol. I reviewed each researcher's data to lessen the chance of a coding error.

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

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

<table>
<thead>
<tr>
<th>Prominence of Justifications for the Bureau Regulating Fringe Banking</th>
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<tbody>
<tr>
<td>Percent of Articles Discussing This Justification</td>
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<tr>
<td>Fringe Banking Relies on Deception</td>
</tr>
<tr>
<td>Fringe Banking Is Too Costly</td>
</tr>
<tr>
<td>Fringe Banking Causes Financial Distress</td>
</tr>
<tr>
<td>Fringe Banking Is Unregulated</td>
</tr>
<tr>
<td>Fringe Banking is Abusive or Predatory</td>
</tr>
</tbody>
</table>

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

A. Deception

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

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

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

$^{215}$ For instance, a search for “(tricks w/3 traps) and consumer-financial-protection” in LexisNexis “News, All” source yielded 379 results on October 24, 2010.
percent (n=46) of the stories provided deception as a reason the Bureau should regulate fringe credit. Some of the sources noted that payday loan documents are “incomprehensible” and hide terms in fine print, while others simply stated the Bureau will be able to prevent deceptive payday loans. This section discusses the two ways supporters of the Bureau claim credit contracts are deceptive: the terms of the contracts themselves and the credit products’ designs.

i. Tricks and Traps in Contracts

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

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

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

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

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

217 Tomasky, supra note 210.

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

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

220 Warren, supra note 208, at 11–12.

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

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

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

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

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

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

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222 Warren, supra note 208, at 10.
223 Id. at 13.
225 In exchange for me using its contract, the company asked it not be identified in my paper.
other rental agreement I discussed, Rent-A-Center’s agreement
discloses all costs on the first page of the contract and is written
at a similar level of complexity. Rent-A-Center is currently
rewriting its rental agreement in New York because of recent
changes in the law, and the General Counsel is explicitly
attempting to write the contract at a seventh grade reading
level.\textsuperscript{226}

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

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

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

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

\textsuperscript{226} Telephone Interview with Ron Demoss, General Counsel, Rent-A-Center, Nov. 13,
2010.
\textsuperscript{227} A+ PAWN SHOP, \url{http://apluspawnshop.com/} (last visited Mar. 22, 2011).
\textsuperscript{228} SPEEDY CASH, Store Locations, \url{http://www.speedycash.com/payday-loan-store/}
\textsuperscript{229} I also reviewed the contract from California, which is similar to the Kansas
contract.
agreement. One thousand three hundred twenty of the words of the contract are definitions and various terms.\textsuperscript{230} In addition to payday lending, Speedy Cash also does auto-title loans. Its auto-title loan documents are similar to its payday loan contracts but they have a single additional paragraph relating to the vehicle as collateral for the loan.\textsuperscript{231}

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

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

\textsuperscript{230} The following paragraph is representative of the level of complexity:

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

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

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

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

\textsuperscript{234} 15 U.S.C. § 1632(c).
reports because it was in a block of fee disclosures, but a court in Tennessee found it violated the TILA because “EZ’s disclosure document uses the same typesize, font, and boldness in listing the terms ‘annual percentage rate’ and ‘finance charge’ as it does in listing other terms, data, and information; thus these terms are no more conspicuous than others.”

Similarly, in a case involving a contract very similar to the one Warren reports, the court held a pawn ticket violated the TILA because the term “APR” was “contained in the middle of a paragraph in the smallest print on the pawn ticket” and because “this section is similar in appearance to a section entitled ‘Customer Information’ and is less conspicuous than the section setting forth information on the vehicle used for collateral which is outlined in a box.”

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

ii. Tricks and Traps in Product Design

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

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

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

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

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

239 FDIC Survey, supra note 1, at 31.
243 Id. at 11–13.
244 Id. at 33–35.
245 Id. at 9.
Despite these limitations, the case for intervening in payday lending markets because of mistakes people make about rollovers is slightly more persuasive than the case for deceptive contracts because at least some studies have documented high numbers of rollovers in payday lending markets. But, direct evidence of over optimism in payday lending markets simply does not exist at this point, so it is troubling to think that the Bureau would act on mere speculation about how borrowers use payday loans.

B. Cost

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

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246 See Graves & Peterson, supra note 240, at 663.
247 Administration Takes Aim at Fine Print, Lewiston Morning Tribune (Idaho), July 1, 2009, at 3A (“The agency would be dedicated to protecting consumers when buying mortgages, using credit cards and taking out high-rate ‘payday loans.’”).
252 Regulatory Restructuring: Enhancing Consumer Financial Products Regulation: Hearing Before the Comm. on Fin. Servs., 111th Cong. 48–49 (2009) (statement of Luis V. Gutierrez, H. Comm. on Fin. Servs., State of Ill.) (“So I just wanted to say to Professor Warren, Ms. Seidman, and others, I would like to put a floor on payday lending, a national one, so that at least we have some minimum standard. I would like for the remitters to have somebody nationally, you know a federal regulator. I would like to see people maybe not buy an $800 TV and 3 years later pay $2,400 for it, or people to kind of, I don’t know, escape to installment loans at 500 and 600 percent. Some people might be surprised that happens. It happens.”).
254 Elizabeth Palmberg, Ground Rules: Troubled Assets on Main Street, Sojourners
Warren’s work exhibits a general concern that trusting lenders can cause consumers to pay a high price. She points to payday lending specifically as a product with abusive pricing, citing several examples of individuals who paid a lot to service payday loans, and concluding, “In total, the cost to American families of payday lending is estimated to be $4.2 billion a year” and “each year, predatory payday lending practices cost U.S. families $3.4 billion in excess fees and charges.” More significant than just pointing out the high cost of payday loans, however, is Warren’s forecast that the Bureau would allow people to get short-term, small-dollar loans for lower costs. With the Bureau in place, Warren predicted, “An older person who needed a little cash to make it until her Social Security check arrived would have a manageable loan, not one that would escalate into thousands of dollars in fees.”

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

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

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255 Warren, supra note 208, at 9.
256 Id. at 13.
257 Bar-Gill & Warren, supra note 128, at 56–57; Warren, supra note 208.
258 Warren, supra note 208 at 19.
259 Id. at 19.
260 Compare Aaron Huckstep, Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?, 12 FORDHAM J. CORP. & FIN. L. 203, 230–31 (2007) (concluding payday lenders’ profits are not highly profitable), with Nathalie Martin, 1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions, 52 ARIZ. L. REV. 563, 571 (2010) (“While some scholars have questioned the profitability of the industry and the industry sometimes denies that its returns are excessive, the mere existence of such a large number of lenders belies the conclusion that these loans are not highly profitable.”).
261 I have argued elsewhere that high prices alone are a poor reason to regulate fringe credit. See Hawkins, supra note 50, at 2041.
262 Dodd-Frank § 1024(o).
reports suggest this provision was added under pressure from payday lenders.  

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

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

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

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


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

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

268 *See Small-Dollar Loan Pilot Program*, FDIC, http://www.fdic.gov/smalldollarloans/ (last visited Mar. 22, 2011) (noting the program was "designed to illustrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products, such as payday loans").
as a flop and consumer advocates judging the experiment to be a success. To the extent that the Bureau can lower the cost of credit by matching borrowers with less expensive alternatives, it will add significant value to the welfare of borrowers, but it will be a long time before we know if this feat is possible.

C. Financial Distress

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

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

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

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

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

272 Green, supra note 251.

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


275 Warren, supra note 208, at 13.
explaining that payday loans with individuals can impose costs on third parties:

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

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

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

D. Unregulated Markets

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

276 Bar-Gill & Warren, supra note 128, at 3.
277 Id. at 44.
278 Warren, supra note 208, at 19.
280 Id. (manuscript at 33–35).
281 Id.
unregulated. In the results from our study of rationales for the Bureau governing fringe banking, we repeatedly found claims that fringe banking is currently unregulated. Forty-nine percent (n=118) of the results presenting arguments for the Bureau claimed that fringe banking transactions currently operate under little regulation. Some sources contended that fringe lenders have escaped regulation entirely or that they operate in the Wild West of financial services with little oversight. Other sources noted the inconsistency in state regulations that left some consumers completely unprotected, and others asserted that no federal regulator governed fringe credit before the Bureau.

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

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

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

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


287 Warren, supra note 208, at 14.

288 Id. at 9.

289 Bar-Gill & Warren, supra note 128, at 6. Another argument Warren makes to support the claim that credit markets are insufficiently regulated is that states lack the
arguments have been made by others as well, who point out that current federal regulation of credit markets fall to seven different regulators, none of whom have consumers as their central focus. 290 Having divided missions resulted in agencies, like the Federal Reserve, neglecting consumer protection: “It never made sense to simply include consumer protection among the Fed’s other tasks, for instance, since the Fed’s primary concern is maintaining the stability of the banking system, which stands in considerable tension with consumer protection.” 291

The common claim that fringe banking operates in a regulatory vacuum is easy to dismiss as a faulty reason for the Bureau regulating fringe credit. In every state and under federal law, lending activity is subject to some general regulations, such as the Truth in Lending Act. 292 Moreover, for many fringe credit transactions, state statutes aimed specifically at that type of transaction govern fringe credit. 293

Warren’s claim that state and federal regulations are not effective at countering innovative creditor malfeasance is much more applicable to fringe banking markets. Many commentators have noted how adept fringe creditors are at avoiding restrictive regulations. 294 The recent change in the payday lending law in Arizona provides an example. In Arizona, a specific statute enabled payday lenders to operate above the thirty-six percent usury cap in the state for ten years, but in 2010, that statute

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

290 Levitin, supra note 138, at 3.
291 Skeel, supra note 98, at 15.
293 See, e.g., MASS. GEN. LAWS ch. 140D (2010).
294 Proof of this claim would result in an article-long footnote, but for a few examples, see LA. R.S. 37:1801(D) (2010) (“Under no circumstances shall the practice commonly referred to as motor vehicle ‘title only’ pawn transactions be allowed in this state.”); Martin, supra note 260, at 564 (noting payday lending is legal in only thirty-five states); ALA. CODE § 5-19A-3 (West 2010) (requiring pawn tickets to contain extensive amounts of information); OHIO REV. CODE ANN. § 1351.05(A) (West 2010) (requiring rent-to-own dealers to reinstate rental agreements even after default).
295 Johnson, supra note 31, at 18–21.
sunrise, effectively making payday lending illegal. In response to the rate cap, some payday lenders are operating as they did before the sunset, but are now essentially offering payday loans disguised as auto-title loans, which remain legal in the state. Before the law even sunset, 200 payday lenders filed for licenses to operate as title lenders, and the Attorney General of Arizona believed that “a lot of people are [getting] ready by telling their customers to shift to auto-title loans, even if they don’t have a car.” Lenders can offer payday-like loans to customers with cars by extending the loan based on the person’s paycheck and taking a second-lien position on the car without ever intending to use the vehicle as collateral. If Arizona really intended to ban payday lending, it appears to have failed. To truly eliminate payday lending, the legislature will have to pass another law altering the title loan statute to prevent the conduct described here.

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

297 A similar thing happened in Virginia when it banned payday lending. See Korey Clark, States Put Brakes on Auto Title Lending, STATE NET CAPITOL J., July 26, 2010, at 6 (“In fact, industry lobbyists and consumer groups in Arizona expect payday lenders to switch to car title lending as a result of the ban imposed on payday lending this past spring, because that’s exactly what has happened in Virginia since it restricted payday lending. ‘They moved to the car title model because they realized there were hardly any requirements,’ said Dana Wiggins of the Virginia Poverty Law Center, an advocacy group for low-income people that pushed for the payday lending restrictions. ‘It was kind of like a newfound treasure trove. You saw all of these folks who used to have payday loans were being moved into car title loans by payday lenders.”).
299 Dale Quinn, Industry Shifting to New Services as Payday Lending Becomes Illegal, ARIZ. DAILY STAR, June 27, 2010, at A1 (“Auto-title loans should be given only to the owner of the vehicle being used as collateral. If a lender says ownership of the vehicle and its value are not important, the borrower should proceed with caution and consider contacting the Attorney General’s Office, said Goddard, who is running for governor.”).
regulation, the Bureau has an important opportunity to ensure lenders actually comply with federal regulations.

E. Predatory and Abusive Lending

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

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

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

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


308 The only instance I found was Warren’s claim that the change in law protecting military personnel from payday lending “will protect military families from payday lenders, but it will leave all other families subject to the same predatory practices.” Warren, supra note 208, at 14. This assertion, however, is probably just a summary of the other arguments she had already made against payday loans and not a stand-alone point.
reflection, it is unlikely these blanket assertions will have any influence on its behavior. Because this category is merely a rehash of earlier rationales, I do not discuss it in further detail here.

CONCLUSION

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

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

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