Report on the Status of Payday Lending in California

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A MESSAGE FROM SILICON VALLEY COMMUNITY FOUNDATION

At a time when more individuals and families began to lose their homes or jobs, Silicon Valley Community Foundation determined that building economic security would fulfill a critical need for many residents in San Mateo and Santa Clara counties.

We knew that those caught in the foreclosure crisis needed housing counseling and legal help. We knew that supporting financial education and asset building would help low-wage earners create a better future. And we had anecdotal information that those who lacked access to traditional banking and lending services had few choices but to turn to payday lenders who charge interest rates that can be as high as 400 percent.

To better inform our understanding of how these practices came about, and to have factual and documented information upon which to act, we asked the Public Interest Law Firm to research the history of payday lending and the existing laws and regulations governing the industry. The resulting report provides a thorough analysis of current policies and proposals and suggests steps for policy makers, funders and others interested in curbing these abusive lending practices.

What they found surprised and shocked us. It also helped us to see how payday lending in its current form contributes to creating a growing circle of debt that is difficult for people to escape.

We hope this report will raise awareness and build understanding about the negative impact of payday lending on our communities. We also hope it will prompt interest in public policies to restrict excessive interest and service fees.

The corrosive effects of predatory lending are hurting families and communities in our region. At Silicon Valley Community Foundation, we look forward to building partnerships with government, banking and financial institutions, and nonprofit organizations who want to change that.

Emmett D. Carson

Emmett D. Carson, Ph.D.
CEO and President
Silicon Valley Community Foundation

<u>Table of Contents</u>

Executive Summary

Payday lending, the practice by which a lender makes a relatively small, short-term loan to a borrower, using a post-dated check as security, drains wealth from low-income communities and communities of color.

- Payday lending began in California in the 1990's as an extension of the check cashing industry.
- The usual repayment period for a payday loan is two weeks. At the end of that term, the entire loan amount plus the finance charge must be paid in full.
- Because payday lenders charge extremely high interest rates—an average of 400 % on a two-week loan—the typical borrower in California pays $800 for a $300 loan.
- Payday lenders are disproportionately concentrated in predominately African American and Latino neighborhoods. They are also more prevalent in communities where low- and very low-income families live.
- In California, nearly half of borrowers take out payday loans at least once a month, and more than one third have taken out loans from multiple payday lenders simultaneously.

While state and federal laws impose some restrictions on payday lending practices, payday lenders are currently largely unregulated. Because a nationwide lending cap does not appear to be imminent, we believe:

- State and local policy changes should be considered;
- Access to credit and banking resources and non-predatory alternatives should be increased; and
- Consumers should be educated about payday lending and its consequences.

Introduction

The purpose of this report is to provide an update to policymakers and stakeholders interested in consumer protection in California — both on a state and local level — regarding the status of the payday lending laws and practices in the state.

Payday loans are lending transactions in which a borrower provides a lender with a post-dated check and receives immediate cash from the lender. The borrower's check includes not only the principal loan amount, but also any interest and fees charged by the lender. The lender then cashes the borrower's check on the borrower's next payday. Payday loans, sometimes called deferred deposit transactions or cash advances, comprise one corner of a larger universe of "alternative financial services," which also include check cashing services, pawn brokers, and rent-to-own stores.[1] In California, these loans are typically small — between $100 and $300 — and are capped at $300.[2] According to Consumers Union, the "fees for payday loans are extremely high: up to $17.50 for every $100 borrowed."[3] The average annual percentage rate (APR) in 2006 for such loans was a staggering 429%, according to the California Department of Corporations.[4] All of this means that the cost of these small loans quickly balloons to a staggering amount.[5]

By surveying the many research studies and reports that have been published in recent years addressing payday lending, this report: 1) examines the negative effects of payday lending on individuals; 2) discusses the unfortunate reality that many low-income families use check-cashing and payday lending outlets as their primary means of financial management because their neighborhoods have inadequate banking choices but high concentrations of these outlets; 3) summarizes efforts in California, in other states, federally, and, most recently, locally, to address and try to prevent these negative effects by regulating the industry; and 4) provides recommendations for policymakers and stakeholders about the potential policy changes that could alleviate this problem as well as barriers to accomplishing these changes.

The Predatory Nature of Payday Lending in California

Store-front Payday Lending

Payday lending is widespread in California. In 2006, approximately 1 million Californians were issued payday loans (at an average of 10 loans per borrower).[6] The Department of Corporations estimated that there were approximately 2,500 payday lending stores by the end of 2006.[7]

Not surprisingly, representatives of the payday lending industry contend that they offer a useful product that responds to consumer demand for this type of loan. The industry's national association, the Community Financial Services Association of America, portrays a payday loan as a convenient and beneficial product if it is used for short-term needs, saying:

> A payday advance is a small, unsecured, short-term loan that is usually repaid on the borrower's next payday. Typically, a customer uses a payday advance to cover small, unexpected, expenses between paydays to avoid expensive bounced-check fees, late bill payment penalties, and other less desirable short-term credit options. . . .
>
> The payday advance application process is fast and simple. It usually requires only a few supporting documents, including proof of a regular income, a personal checking account and identification.[8]

According to the California Department of Corporations, payday loans have some positive aspects:

> Payday loans provide an immediate source of short-term credit to meet emergency cash needs of consumers that may not have access to traditional sources of credit or elect not to use other sources of credit available to them. Payday loan stores are located in close proximity to the customers. Many times, the transaction can be completed in 15 minutes or less. Payday lenders rarely perform time-consuming credit checks or evaluate the borrower's ability to repay the loan on the due date. Instead, the borrowers are required to provide information easily available to them, such as identification, proof of residence, recent pay stub and checking account information.[9]

Consumer advocates acknowledge that payday loans are easy to obtain and that, by obtaining such a loan, some borrowers can avoid the damage to their credit scores that a delinquent payment to, say, a credit card can cause.[10] However, payday loans, as they are currently structured and permitted in California, harm families and certain fragile communities in ways that outweigh the benefits of the product.

First, payday loans are exceedingly expensive. In California, a 14-day loan has an average annual percentage rate of more than 400%.[11] According to a 2008 issue brief by the Center for Responsible Lending, the typical payday loan borrower ultimately has to pay $800 for a $300 loan.[12] The Center for American Progress explains that these loans are so costly because:

> . . . many borrowers are unable to pay off their loan plus lender fees in full when they are due and still have enough money left to cover their expenses until their next payday. This means they begin a cycle of borrowing . . . that lasts much longer and costs much more than they had originally anticipated.[13]

Payday lending costs Californians an estimated $757 million annually in finance charges.[14]

Moreover, payday loans encourage those who are already struggling to make ends meet to further compromise their financial health. As the California Budget Project has stated,

"Payday loans encourage chronic borrowing."[15] Payday loans carry a very short repayment term, usually only until the next payday — or about two weeks — at which point the full amount of the loan and the finance charge must be paid at once.[16] Since most borrowers take out payday loans to cover a chronic shortage of income over expenses, rather than to cover emergencies,[17] many cash-strapped borrowers experience another shortfall after their first loan. That shortfall is compounded by the finance charge. Payday lenders do not determine the ability of borrowers to repay the balloon payment that becomes due on their next payday. Although "roll-over" loans — where a borrower can renew the loan and pay another fee — are prohibited in California, neither taking out "back-to-back" loans nor taking out payday loans from multiple sources is prohibited. As a result, nearly half of California borrowers take out payday loans at least once a month and more than one third of borrowers have taken out loans from multiple payday lending companies at the same time.[18]

The profoundly negative consequences of borrowers' reliance on payday loans are well documented. A March 2009 letter from the National Consumer Law Center to the Chairman of the National Credit Union Administration provided a short summary of recent research-based findings about the downstream harms of payday lending. For example, researchers recently showed that payday borrowers are twice as likely to file for bankruptcy in the two years after first getting a payday loan as applicants whose applications for a payday loan are rejected.[19] These findings "are consistent with the interpretation that payday loans and interest payments on them might be sufficient to tip the balance into bankruptcy for a population that is already severely financially stressed."[20] Other researchers have found that the use of payday loans increases the incidence of involuntary closure of bank accounts.[21] Still others determined that consumers who use payday loans encounter more hardship and have trouble paying other bills, getting health care, and staying in their home or apartment.[22]

According to an FDIC press release in 2005:

> When used frequently or for long periods, the costs [of a payday loan] can rapidly exceed the amount borrowed and can create a serious hardship for the borrower. The FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending.[23]

While these negative consequences are harmful to all sectors of society, they are even more troubling because they disproportionately affect already vulnerable and disadvantaged families and communities. In two separate reports issued in March 2009, the Center for American Progress and the Center for Responsible Lending identified common characteristics of payday borrowers. Up until the issuance of these reports, the understanding that payday borrowers tended to be low income was based largely on anecdotal information.[24] The Center for American Progress' report "Who Borrows from Payday Lenders? An Analysis of Newly Available Data," analyzes recently released data from the Federal Reserve Board and confirms that payday borrowers tend to have less income, lower wealth, fewer assets, and less debt than families without payday loans.[25] The report made these additional findings:

- “Families who borrowed from a payday lender in the past year were more likely to be minorities and single women than their counterparts. They also tended to be younger and had less educational attainment.”
- “Approximately 4 out of 10 families who borrowed from a payday lender within the past year owned their own home, while nearly 7 out of 10 families who had not taken out a payday loan were homeowners.”
- “Roughly one-quarter of families who had borrowed from a payday lender within the past year identified themselves as savers, compared to nearly half of families who did not withdraw a payday loan.”
- “Payday loans are taken out primarily for convenience, to cover an emergency, and to pay for basic consumption needs, such as gas and food.”[26]

The California Budget Project recently produced maps of payday lender locations for each of California’s legislative districts. The maps set out a vivid portrait of California’s two-tier finance system by clearly demonstrating that, while high-income communities in California house very few payday lenders, low-income communities attract them. In Santa Clara County, for example, Assembly Member Ira Ruskin’s District 21 is categorized almost entirely as “high income” or “moderate income” territory and houses only 4 payday lenders.[27] Assembly Member Jim Beall’s District 24, however, has several “low” and “very low” income areas and is home to 25 payday lenders.[28]

In addition to income, studies have shown that race plays a strong and disturbing role in the location of payday lending. A new analysis by the Center for Responsible Lending finds that California’s payday lenders are overwhelmingly located in African American and Latino neighborhoods, even after controlling factors such as household income.[29] Strikingly, Center for Responsible Lending found that the racial and ethnic composition of a particular neighborhood is actually the primary predictor of payday lending locations.[30] African Americans and Latinos make up a disproportionate share of payday loan borrowers in California.[31] The Center’s specific findings include:

- “Payday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods, draining nearly $247 million in fees per year from these communities.”[32]
- “Even after controlling for income and a variety of other factors, payday lenders are 2.4 times more concentrated in African American and Latino communities. On average, controlling for a variety of relevant factors, the nearest payday lender is almost twice as close to the center of an African American or Latino neighborhood as a largely white neighborhood.”[33]
- “Race and ethnicity play a far less prominent role in the location of mainstream financial institutions, such as bank branches. While race and ethnicity account for over half of the variation in payday lender location explained by neighborhood factors, they explain only one percent of the variation in bank branch locations.”[34]

Payday lending should also be considered in context with the pricing of other household amenities and financial products in lower-income and minority neighborhoods. In its 2006 report "From Poverty, Opportunity: Putting the Market to Work for Lower Income Families," the Brookings Institution found that lower-income families pay higher prices for a wide array of basic household necessities and financial products — including short-term credit — than higher income households do for the same or similar products.[35] According to the Brookings Institution's survey and findings, high-priced alternative financial services, such as payday lenders, check cashers, and pawnshops, tend to be more densely concentrated in lower-income areas.[36] The report pointed to 1) lack of banks and credit unions in lower-income neighborhoods; 2) unscrupulous business practices and the failure of states to regulate the "astronomical rates" of these products; and 3) consumer misinformation as the factors that cause lower-income customers to buy such high-priced products.[37]

The macroeconomic harm of the clustering of payday lending in lower-income and minority communities is clear. Payday lending has drained an estimated $247 million in fees from African American and Latino households in California.[38] As the Center for Responsible Lending points out, "[t]he funds drained from these communities by payday lending could be saved or better spent on food, car repairs, medicine, housing, child care, education or other needs."[39]

Internet Payday Lending

Payday lending has expanded from check cashing outlets, pawn shops and payday loan outlets to the Internet. In fact, one estimate pegs the volume of online lending in 2008 at $7.1 billion, almost 20 percent of the volume of traditional outlets.[40] Taking out a payday loan over the Internet exposes borrowers to all the same predatory practices they would face if they took out a payday loan from a traditional store-front lender. In addition, these borrowers are even more at risk of harm due to the ever-changing and largely unregulated nature of the Internet itself. Even a lobbyist for the payday industry referred to Internet payday lending as "the Wild West."[41]

No single federal law addresses the practice of Internet payday lending, creating a sizeable hole in the regulation of such loans. As the Consumer Federation of America points out, the lack of any federal law governing Internet payday lending exposes borrowers of Internet payday loans to greater risk.[42] However, several states have created laws to address the practice; some have limited or barred Internet payday lending, while others have allowed it to take place with few restrictions.[43] The regulatory inconsistencies created by the differing state laws have allowed Internet payday lenders to thwart state efforts to regulate their practices by registering in the states with few or no restrictions and selling their product to people throughout the country, regardless of the protections in place in the state in which the borrower resides.[44]

Some Internet payday lenders even operate without any state licensure or by basing the company outside of the United States. In California, Internet payday lending operations have

been able to thwart state laws regulating in-state payday lenders by claiming to be owned by Indian tribes in Oklahoma or Nebraska and thus not subject to state law.[45] Unfortunately, even after years of efforts by the California Department of Corporations, these online-only lenders continue to operate under loose federal law, leaving consumers without state-law protections.[46]

Further, Internet payday lenders may claim to be licensed, but offer no proof of licensure on the site to allow consumers the assurance that they are dealing with a legitimate vendor. Unfortunately, there does not appear to be any consistent oversight or regulation of websites that claim to be licensed. To complicate matters even further, many Internet payday lenders are licensed under one business name, but operate under a different domain name.[47] This practice, combined with the series of referral sites that a borrower may click through before actually taking out a loan, creates confusion as to who the lender is and, therefore, who borrowers should contact with complaints or requests for changes to their loans.[48]

The process of taking out an Internet payday loan is fairly simple. According to the Consumer Federation of America:

> The typical Internet payday loan involves an online or faxed application in which the borrower provides extensive personal and financial information, direct deposit of the loan proceeds into the borrower's bank account through the Automated Clearing House system on the same or next day, and an agreement to permit the payday lender to withdraw the loan and finance charge electronically from the consumer's bank account on his/her next payday.[49]

Unfortunately, this process exposes borrowers to many additional risks that they would not encounter at a traditional payday loan store. For example, because borrowers submit applications for payday loans online, their personal financial information is vulnerable to identity theft and other Internet scams.[50] Claims that a site is secure and private may be false, and borrowers do not have a way of verifying that a site is secure.[51]

In addition to increased security risks, Internet payday lenders may not properly disclose the finance charges associated with taking out one of their loans. While the Federal Truth in Lending Act requires lenders to post the annual percentage rate (APR) for loans offered through their websites, Internet payday lenders do not always comply.[52] Consequently, many borrowers have no idea that their payday loan may carry an APR over 500%, as is frequently the case with such loans. In addition to the interest and finance charge on Internet payday loan, borrowers are charged overdraft fees, also known as NSF fees, if the funds are not available in their checking account when the borrower's account is debited on payday.[53] These fees vary greatly and are often not disclosed by the lenders.[54]

Finally, Internet payday borrowers can more easily be trapped in the cycle of debt that is a feature of all payday loans than those who use more traditional means to take out loans.[55] Some Internet payday lenders create loan agreements that are automatically set to refinance the

loan at the end of the loan period; these loans will do so unless the borrower reads the fine print and changes the setting.[56] Borrowers may not notice this detail until their loan is rolled over and they have incurred the additional finance fees.

Why Borrowers Obtain Payday Loans

With such well documented, negative impacts, a natural question is why people utilize such expensive, problematic products in the first place. According to the Center for American Progress, people take out payday loans for three main reasons: convenience, emergency expenses, and to cover basic consumption needs.[57] The Federal Reserve's triennial Survey of Consumer Finances found that 34% of payday loan borrowers chose a payday loan for "the convenience factor."[58] In a survey of payday customers in California, the main reason the customer chose a particular payday lending outlet was because the customer "saw a payday location and went in."[59] Most borrowers take out payday loans to cover regular bills or groceries.[60] Contrary to the assertions of the payday lending industry, only 10.3% of borrowers obtained such loans for an emergency.[61]

The greatest market for payday loans appears to be prior borrowers who are unable to pay off their previous loans. One study found that 90% of payday lenders' business is generated by individuals who take out at least five loans per year; 60% of their business comes from borrowers averaging at least one payday loan per month.[62] Despite payday lending industry claims that the product they offer is meant to be a last resort in times of emergency, the reality is that low-income borrowers obtain these loans repeatedly to cover both their basic needs and the increasing debt created by their prior payday loans.

Payday loans are prevalent in low-income communities largely because these communities tend to have fewer affordable credit options than do their wealthier counterparts.[63] In unbanked or under-banked communities, individuals may not be aware that more affordable loan products are available and, in turn, may not realize the relative costs of payday loans in comparison.[64] For individuals who lack experience with banks or who have bad credit, the time-consuming and complex process of applying for more mainstream forms of credit can be daunting.[65] This discomfort, compared with the prospect of getting a fast loan in a convenient location, often steers individuals who might qualify for more affordable financing into expensive payday loans.[66] Even low-income individuals who do use mainstream banks may obtain payday loans because their banks do not offer smaller, short-term loan products or because the process of obtaining such products is too cumbersome.[67]

Additionally, many low-income individuals obtain payday loans as a response to variable or unreliable earnings. Unlike the predictable salaried employment held by many upper- or middle-class individuals, low-wage jobs often vary in income from week to week or month to month.[68] Low-wage jobs also carry with them a greater risk of outright job loss than do their higher paid counterparts, increasing the likelihood that low-income, less educated individuals will find themselves suddenly unemployed.[69] This income instability, coupled with a greater

likelihood of instability in residence and family composition, exacerbates the financial challenges facing low-income households.[70] As such, low-income households are unlikely to have savings to tide them over during times of job loss or wage reduction, forcing them to turn to payday loans and similar products to cover their basic necessities.

Finally, language or cultural issues may also contribute to low-income households obtaining payday loans as opposed to other types of loan products.[71] Anecdotal evidence suggests that, relative to the general population, immigrants often assume that they will not be able to obtain loans. This misimpression, in turn, makes it less likely that they will apply for a bank account and begin to establish a credit history, which is the key to obtaining mainstream credit.[72] Having limited proficiency in English may also increase borrowers' reluctance to use mainstream banks, making them more likely to use payday loans and other alternative sources of financing; these language barriers may also prevent borrowers from understanding the terms of the loans they obtain.[73] And banks in many immigrants' home countries are not always trustworthy places for low-income people to put their money (shown by, for example, Mexico's 1990s bank crisis), making it still less likely for them to access the mainstream financial system.[74]

California Legislative Responses to Payday Lending

Given these profoundly negative consequences of payday loans and the well-documented disparate impact of those consequences on low-income and minority communities, it is not surprising that the state of California has taken steps to address its pernicious effects. However, as discussed below, these efforts have not significantly reformed the problematic practices of payday lenders; indeed, California is regarded by national advocates as significantly failing to enact meaningful consumer protections.

Payday lending began in California in the 1990s as an extension of the burgeoning check cashing industry.[75] Because payday lending was a new practice, California law did not govern the practice of payday lending specifically. Indeed, the check cashers who offered payday loans argued that they were not subject to the California Finance Lenders Law because they were merely deferring deposit of a check, not making a loan.[76]

The lenders law strictly regulates the interest rate that consumer finance lenders may charge for installment loans under $2,500.[77] The interest rate limits provided by that law are: 2.5% per month on amounts up to $224; 2% per month on amounts between $226 and $900; 1.5% per month on amounts between $901 and $1650; and 1% per month on amounts between $1651 and $2500.[78]

Senate Bill 1959 (Calderon)

As a result of the lobbying efforts of the check cashing industry, California resolved the ambiguity surrounding the lenders law's applicability to payday loans in the industry's favor,

becoming one of 35 states that specifically permit payday lending. In 1996, the California Legislature passed SB 1959 (Calderon), which essentially exempted payday lenders from the lenders law.[79] The assumption that "many individuals face an occasional emergency [need] for small amounts of money for a short term" was used as justification for the passage of this bill.[80]

However, SB 1959 did establish limited restrictions on payday lending, including a $300 limits on the loan amount and 15% limit on fees as well as procedural protections for borrowers.[81]

California Deferred Deposit Transaction Law

After these products became legal in 1997 under SB 1959, the industry boomed: by 2002, some estimates were that over one million deferred deposit transactions per month were completed in California.[82] However, with this growth came controversy. As noted by the Legislature, numerous consumer groups "have long argued that deferred deposits involve excessive charges and fees and too often exacerbate the debt treadmill or 'cycle of debt' confronting many consumers who use deferred deposits."[83]

These concerns led to the passage of the California Deferred Deposit Transaction Law, which became effective in 2003. This statute is currently the primary law governing the practice of payday lending in California.[84]

Passage of the statute (introduced as SB 898 [Perata]) was tremendously hard-fought and contentious as consumer advocates and payday lending industry lobbyists battled over the terms of the bill. This description of the debate was supplied in the Senate Floor Analysis:

> Following the [Assembly Business and Professions] committee's informational hearing, the committee chair initiated negotiations with all stakeholders, including representatives of the author's office, consumer groups, deferred deposit businesses, regulatory agencies, and committee staff. These complex negotiations have been underway for approximately eight months; the result is the current version of this bill. All parties involved in the negotiations made serious and good faith efforts to resolve issues, and there were significant concessions.[85]

The statute established both licensure and regulation of persons making deferred deposit transactions ("licensees").[86] The licensure provisions are rather extensive, requiring, among other things: applications for licensure; surety bonds; submission and maintenance of financial records and statements; fingerprinting of customers and key personnel; fees and assessments for applications, licensure, and administration of oversight; records examination and net worth requirements; advertisement disclosures; and posting of fee information.[87] The statute also established oversight by the Department of Corporations persons engaged in the business of making deferred deposit transactions.[88]

The regulatory features of the statute, however, are not significantly broader than those established by SB 1959. The law made changes to the existing regulatory requirements, including requiring that licensees inform borrowers regarding charges and fees, of the fact that the borrower cannot be prosecuted for returned check in connection with the transaction, and of the prohibition against licensees' demanding collateral. [89] The law also requires licensees to provide borrowers with the Department of Corporations' toll-free number.[90] In addition, the law allows licensees to defer the deposit of a customer's personal check for up to 31 days (rather than 30 days as previously allowed),[91] and allows them to extend the repayment period or to create a payment plan, so long as additional fees are not charged.[92] The law does not, however, limit the number of payday loans a payday lender may make to a borrower in any given period of time.[93]

During the negotiations concerning SB 898, the payday lending/check cashing industry representatives were quick to point out that the new law would subject deferred deposit businesses "to substantially higher charges and fees compared to the [then-] current annual $50 fee."[94] As explained in the Senate Floor Analysis:

> These new charges and fees include an initial non-refundable fee of $100 for investigating the application, plus $200 as an application fee, plus the cost of fingerprint processing, plus an annual assessment, as determined by the Department of Corporations, of the pro rata share of all costs and expenses reasonably incurred in the administration of the provisions of this bill, plus the costs of being periodically audited by DOC.[95]

These concessions by the industry were cited—juxtaposed with concessions by consumer advocates regarding fees and installment plans—as evidence that this bill embodied a compromise that all parties could live with. But, as set out below, this compromise has not fulfilled its promise.

Efforts to Reform Payday Lending in California

Unfortunately, despite the tremendous efforts put into reaching the compromises embodied in the California Deferred Deposit Transaction Law, it has fallen short as a consumer protection measure. For one thing, it leaves California significantly behind some states' protections against some of the worst aspects of payday loans. Other states respond to payday lending in one of three ways:

- "[Enforcing] an interest rate cap at or around 36% on small loans, inclusive of payday lending;"[96]
- "[Allowing] payday lenders to charge interest rates in the hundreds of percent while making some restrictions on lending practices and licensure requirements;"[97] or
- "[Allowing] payday lenders to operate with virtually no legal restrictions."[98]

As of the March 2009, fifteen states and the District of Columbia require payday lenders to comply with an annual interest rate cap of 36%.[99] If Arizona's exclusion for payday lenders from its 36% cap expires in 2010, it will be the sixteenth state to adopt a rate cap.

California falls in the third category of largely ineffectual regulation on the margins. Three consumer advocacy organizations recently graded California an "F" in their "Small Dollar Loan Product Scorecard," based on, among other things, the staggering 460% APR allowed under California law on 2-week payday loans.[100] In contrast, in recent years, Arizona, Arkansas, Georgia, New Hampshire, North Carolina, Ohio, and Oregon have passed usury caps or prohibitions on payday loans.

And the Department of Corporations' reports on the statute's performance make clear that at least one of the most pernicious aspects of payday loans — that they trap repeat borrowers in a lengthy cycle of debt — is still very much a feature of these products.[101] The Department of Corporations found that repeat borrowers make up 73% of payday borrowers statewide.[102]

California legislators have introduced several bills that would have increased regulation of and limits on deferred deposit transactions and/or the payday lending industry. However, despite these attempts, and despite pressure from consumer advocacy organizations for California — and other states — to adopt a "Model Deferred Deposit Loan Act,"[103] most of the legislation has stalled or failed, as detailed below.

Changes to California payday lending law since the passage of the California Deferred Deposit Transaction Law include increasing regulators' reporting requirements regarding advertising,[104] requiring payday lenders to comply with federal law regarding loans to military personnel,[105] and exempting auto dealers from coverage.[106]

Proposed changes that failed include efforts to limit APR to 36%,[107] to lower the fee cap,[108] to ease the burden of payday lenders' collection practices on military personnel beyond federal requirements,[109] and to require regulators to create a comprehensive report on the demand for payday lending.[110] Three bills in the current legislative session appear to be stuck in committees and unlikely to pass until next year, if at all; these bills would consolidate regulatory agencies,[111] legalize Internet payday loans,[112] and authorize payday lenders to receive specified information regarding would-be borrowers' payday loan history.[113]

In short, no significant changes to regulation of the payday lending industry have occurred since passage of the California Deferred Deposit Transaction Law in 2002.[114]

Current Federal Law Related to Payday Lending

Historically, states have borne the responsibility for regulating payday lenders. However, some federal laws that speak to loans and other consumer transactions, generally, apply to payday lending practices and provide some level of uniform protection for consumers.

Additionally, the federal government has established a 36% rate cap for a variety of loan products — including payday loans — when those products are offered to military service members and their dependents. A brief discussion of these federal law protections follows.

Truth in Lending Act

The federal Truth in Lending Act seeks to ensure that consumers receive accurate information about credit products.[115] With respect to payday lending, the Truth in Lending Act and its implementing regulation, "Reg Z," require lenders to disclose finance charges and APRs to consumers "clearly and conspicuously in writing" at or before the time of the transaction.[116] Likewise, Truth in Lending prohibits lenders from utilizing incorrect or incomplete information about the terms of the loan product in order to entice consumers; advertisements must accurately describe the loan product available and must make certain disclosures regarding the loan terms.[117] If a payday lender — or any other lender — fails to meet the technical requirements of this law, the consumer may be entitled to money damages, as well as attorney fees and costs.[118] A lender who knowingly misleads consumers by failing to make the required disclosures may also be subject to criminal liability.[119] A bank financing a loan will be subject to Truth in Lending Act liability even if the loan was provided through a third-party agreement.[120] The Act does not, however, cover state-regulated financial institutions where the state has a parallel statute, underscoring the importance of ensuring that states enact laws that are equally or more protective of credit consumers' right to receive accurate and complete information about the loan products they obtain.[121]

Military Lending Act of 2006

The Military Lending Act of 2006 provides specific protections to military personnel in credit transactions, including payday loans.[122] Specifically, the Act caps the APR of loans offered to service members or their dependents after October 1, 2007, at 36%.[123] Prior to providing the loan, the lender must disclose the APR, the payment obligations, of the borrower, and any other information required by the Truth in Lending Act, in writing.[124]

Community Reinvestment Act

Congress passed the Community Reinvestment Act in 1977 to prevent redlining and to encourage financial institutions to help meet the credit needs of their communities, including the needs of low- and moderate-income neighborhoods.[125] Congress has reauthorized and revised the Act several times since 1977, and the FDIC, the Federal Reserve Board, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency share the responsibility of implementing and enforcing the Act.[126] The federal agency that regulates a particular bank will conduct a Community Reinvestment Act Public Performance Evaluation of that bank on a cycle determined by the applicable regulations.[127] While only illegal credit practices adversely affect a bank's Community Reinvestment Act rating, payday lending activities that are "questionable" (as opposed to strictly illegal) suggest that the bank is not best meeting the credit needs of its

community; this may impact the bank's Public Performance Evaluation, and will be included in the bank's public file.[128]

Additional Federal Protections for Consumers

Federal laws such as the Fair Debt Collection Practices Act,[129] the Federal Trade Commission Act,[130] and the Fair Credit Reporting Act[131] also protect consumers in credit transactions, including payday loans. These laws limit the ways in which a creditor may seek to collect on a loan and provide remedies for both consumers and the general public when lenders engage in behavior that is deceptive, harassing, or otherwise abusive. Along the same lines, the Electronic Funds Transfer Act provides limited protection to consumers obtaining payday loans via the Internet or otherwise utilizing electronic funds transfers.[132] Finally, federal privacy laws, such as the Gramm-Leach-Bliley Act, help protect consumers' personal and financial information.[133]

<u>Federal Agency Regulation of Payday Lending Practices</u>

With the exception of the above-referenced statutes, the federal government has largely refrained from regulating payday lending. However, to the extent that mainstream banks, thrifts, credit unions, or other federally chartered financial institutions may become involved in payday lending, the federal regulatory bodies that oversee those institutions can exert control over those institutions' payday lending practices.

Because federal law allows federally and state chartered institutions to "export" favorable interest rates to borrowers in states other than the state where they are located, and because states cannot effectively regulate federally chartered banks due to federal pre-emption issues, many payday lenders used "rent-a-bank" partnerships with mainstream lending institutions to circumvent state restrictions on loan amounts and interest rates.[134] This practice was especially prevalent in the 1990's.[135] However, in 2000, federal regulatory agencies began to tighten controls on the extent to which the institutions they oversee can engage in payday lending.

In 2000, the Federal Reserve published a rule clarifying that Reg Z, the implementing regulation of the Truth in Lending Act, applies to payday lenders.[136] Soon thereafter, the Office of the Comptroller of the Currency and the Office of Thrift Supervision issued advisory letters regarding the participation of national banks and national and state chartered thrifts in payday lending.[137] These agencies cautioned institutions against the inherent risks of participating in short-term, unsecured, high-interest lending and cautioned banks and thrifts against aligning themselves with less reputable payday lenders, who might be engaging in illegal collections activities or otherwise abusing consumers.[138] Since issuing this guidance, both agencies have taken enforcement actions to stop institutions from engaging in abusive payday lending practices and deterred numerous others.[139]

Although actions by the two agencies effectively limited the participation by federally chartered banks and thrifts in payday lending, state chartered banks remained involved until the FDIC revised its guidance in 2005. The FDIC, which insures both federally chartered and state-chartered banks, recognized the significant risks that payday lending poses to financial institutions.[140] The FDIC's primary concern in issuing this guidance was to guarantee that the banks it insures do not engage in unacceptably risky lending practices either directly or through third-party affiliates.[141] Payday loans are unsecured and often made to individuals who lack the financial resources to repay them; though usually small in amount when made, these loans represent a very tangible risk for lending institutions.[142] As such, the FDIC has noted that payday lending threatens, not only the stability of the individual institution that engages in it, but also the reputation of the banking industry generally. Through its guidance, the FDIC was able to influence the behavior of both federally chartered banks and state-chartered banks, even though it does not regulate state-chartered banks directly.[143]

As with the subprime mortgage lending industry, mainstream banks have often engaged in payday lending through their affiliates; in some instances, payday lending subsidiaries belong to the same corporate structure as does the mainstream bank itself.[144] In its 2005 guidance the FDIC confirmed that a bank's board of directors and management are responsible for the bank's payday lending practices, even if those practices are conducted through a third party.[145] FDIC examiners are instructed to review, not only the arrangements between banks and third-party lending agencies, but also the practices of the third parties themselves.[146] Examiners include these inherently risky loans when evaluating whether banks have sufficient capital to absorb the potential losses associated with payday lending.[147] Additionally, because payday lending practices often raise consumer protection issues and attract the attention of consumer advocates, participation in payday lending exposes banks to potential litigation.[148] By explicitly considering these factors as it evaluates financial institutions for insurance, the FDIC actively discourages mainstream banks from participating in payday lending.

However, as mainstream banks have ceased payday lending activities, credit unions have begun to fill that gap, and consumer organizations have petitioned the National Credit Union Administration, the federal body that oversees credit unions, follow the lead of FDIC and other federal agencies in restricting the ability of credit unions to engage in such practices.[149] Credit unions have long been a resource for low-income and minority communities to obtain more affordable alternatives to payday loans.[150] Many credit unions provide small loans with reasonable interest rates and payment terms. However, credit unions have recently become involved in payday lending.[151] Some credit unions have begun to make payday loans themselves, while others operate through affiliated credit union service organizations or other third parties.[152] Although federal credit unions are subject to an 18% usury cap, meaning they cannot charge more than 18% APR, some credit unions have circumvented this limit by referring to the costs of the loan as "application fees" or "participation fees."[153] Protective federal regulation could help to curb these practices — hopefully without deterring federally chartered credit unions from offering more affordable small loans to their customers — and parallel state regulation could have the same effect on state-chartered credit unions.

Pending Federal Legislation Related to Payday Lending

The Pay Day Loan Reform Act of 2009, H.R. 1214, was introduced to Congress by Representative Luis Gutierrez (D-Ill.) in February 2009.[154] This bill would expand payday lenders' duty to make certain disclosures to consumers beyond what is now required by the Truth in Lending Act.[155] It would require payday lenders to offer "extended" repayment plans involving a minimum of 6 payments spaced at least 13 days apart.[156] It would limit fees and charges to 15 cents on the dollar and would limit the types of actions the lender can take to collect the loan.[157] However, while Congressman Gutierrez was instrumental in the passage of the Military Lending Act of 2006, and while the purported purpose of the bill is to protect consumers, leading consumer advocacy organizations have expressed their strong opposition to the bill.[158] Consumer advocates point out that the bill would essentially give the federal government's seal of approval to payday lenders' charging triple-digit interest rates: 290% APR for a two-week repayment arrangement or 780% APR for one week.[159] Additionally, while the bill requires payday lenders to offer extended repayment plans only twice a year, the typical payday borrower takes out nine loans per year, making the extended payment plan provisions largely ineffective.[160] While the bill would not compromise any states' more protective interest rate caps, it would preempt state statutes regarding extended payment plans.[161]

Two additional bills — The Consumer Lending Education and Reform Act (H.R. 1846)[162] and the Payday Lending Reform Act of 2009 (H.R. 2563)[163] — also purport to add protections for consumers in payday loan transactions, but these bills would actually offer fewer protections than would H.R. 1214, discussed above. Both would endorse triple-digit interest rates, and both have less generous repayment plan provisions than does H.R. 1214.[164]

As discussed further below, many consumer advocates argue that, short of outlawing deferred deposit lending altogether, the only way to prevent predatory payday lending activities is to cap the allowable APR at 36% nationwide, just as the Military Lending Act did for military personnel.[165] A competing Senate Bill, Protecting Consumers from Unreasonable Credit Rates Act of 2009, S. 500, better addresses these concerns.[166] This bill would cap the allowable APR at 36%, as well as clarifying which types of fees and costs are included in that limit.[167] Over one hundred consumer protection organizations across the country have endorsed this bill.[168]

The following pending federal bills could also impact payday lending practices if passed:

- Interest Rate Reduction Act (S. 582), which would require an 15% APR cap on all forms of credit for banks, state credit unions, and other lenders;[169]
- Consumer Credit Fairness Act (S. 257), which would disallow claims in bankruptcy court for debts arising from "high cost consumer credit transactions," including any transaction whose APR exceeds 36%;[170]

- Financial Product Safety Commission Act (S. 566), which would create a federal Financial Product Safely Commission (FPSC) that would ensure the fairness, safety, and sustainability of credit and payment products;[171]
- Consumer Financial Protection Agency Act (H.R. 3126), which would create a federal Consumer Financial Protection Agency to regulate the provision of consumer financial products and services;[172]
- Improving Access to Mainstream Financial Institutions Act (S. 786), which would establish grants to federally insured depository institutions and other entities to create banking options (including payday loan alternatives) for previously unbanked low- and moderate-income individuals.[173]

Recommendations

The following three strategies for addressing the problem of payday lending are discussed in greater detail below:

- **Policy approach:** adopting legal limits on payday lending at the local, state, and/or federal level;
- **Banking access approach:** creating alternative credit and/or banking products that are more accessible to payday lending customers or assisting customers in transitioning to the mainstream banking or credit industries; and
- **Consumer education approach:** teaching potential payday lending customers how to avoid the debt trap of payday lending and how to utilize other alternatives.

Policy Approach

Policy Reform Approaches in California Laws Regarding Payday Lending

In late 2008, the Center for Responsible Lending issued its report, "Springing the Debt Trap: Rate caps are the only proven payday lending reform," which makes an extremely persuasive case for the adoption of 36% interest rate caps for all small loans as the only effective solution to the payday lending problem.[174] The report sets forth the experience of state-law reform efforts, demonstrating that any reforms short of such a cap are ineffective in preventing the debt trap. In states which attempted reforms but did not impose a cap, 90% of payday loans still went to consumers who were taking five or more loans per year.[175] These ineffective reforms of payday lending included:

- Loan renewal bans or "cooling-off" periods;
- Limits on the number of loans outstanding;
- Requiring payment plans to be offered;
- Loan amount caps based on borrower's income;
- Database tracking of borrowing; and
- Limits on payday lending that don't extend to other loan products.[176]

As discussed in the report, an experience with reinstating a 36% rate cap in North Carolina confirmed the beneficial effects of enforcing such an interest rate cap on small loans.[177] North Carolina had previously permitted payday lending by exempting payday lenders from its extant 36% interest rate cap; that exemption had a four-year sunset provision so that lawmakers could analyze the impact of payday lending before reauthorizing the exemption.[178] After seeing the documented effects of payday lending on residents, legislators declined to reauthorize the exemption.[179] From 2002-2006, after the exemption expired, the number of consumer finance loans made for $600 or less increased by 37%, demonstrating that the market would develop other non-payday lending options to help cash-strapped families.[180] As the report describes, in place of payday loans, "small loans from consumer finance companies, credit unions, and other financial institutions have flourished while charging rates at or below the rate cap."[181]

Similarly, after the passage of the Military Lending Act of 2006, the Department of Defense found that "affordable loan options to the military increased after the cap and that military debt relief societies were able to reduce assistance given to indebted members of the military because of the reduction in payday loan usage."[182]

A small loan cap of 36% has a long history in the United States; most states adopted a small loan cap of 36% in the mid-twentieth century to respond to loan-sharking.[183] As of March 2009, fifteen states and the District of Columbia require payday lenders to comply with an annual interest rate cap of 36%.[184] As explained in greater detail above, in 2006, Congress enacted a similar 36% cap for lending to members of the military and their dependents.

Voters across the country appear to support two-digit rate caps. The Center for Responsible Lending conducted a nationwide telephone survey between March 19 and 22, 2009, and found that three quarters of Americans who stated an opinion believe that Congress should cap interest rates, while 72% think that the interest rate cap should be no higher than 36% annually.[185] The survey results are consistent with the outcomes of two ballot measures, in Ohio and Arizona, in last November's election.[186] In Ohio, voters confirmed, by 3 to 1, a 28% rate cap passed by the state legislature.[187] In Arizona, voters rejected, by 3 to 2, a payday lending industry-backed ballot measure that would have made 391% interest rates legal.[188]

The National Consumer Law Center has developed a "Model Deferred Deposit Loan Act" for states to adopt.[189] This Model Act was introduced in the California Senate by Senator Perata as SB 834 in 1999 but failed to pass.[190] This Model Act seeks to provide broad protections for consumers in a range of deferred deposit loan transactions.[191]

The Model Act would apply not only to lenders, but also to other individuals or organizations that facilitate the making of deferred deposit loans, ensuring that payday lenders do not flout the law by enlisting the assistance of out-of-state banks or other financial institutions that might be exempt from other payday lending protections.[192] The Model Act requires licensure and bonding of deferred deposit lenders, in turn creating administrative oversight over such businesses.[193] The licensing process would include both an inquiry of whether the applicant

has been convicted of a crime and an opportunity for public hearing and comment.[194] As such, community members would have a voice in determining whether a deferred deposit lender would be located in their neighborhood.

The Model Act would limit the amount, nature, and terms of deferred deposit loans to prevent unscrupulous lenders from making loans with usurious or abusive terms. First, the Model Act would require that the term of a loan be at least two weeks for every $50 and would cap the total deferred deposit loan amount at $300.[195] The Model Act would also require more thorough written disclosures of the loan's terms, as well as the consequences of non-payment, than does the federal Truth in Lending Act.[196] The Model Act would clarify that each of these written disclosures must be made to borrowers in both English and in the language in which the loan was negotiated.[197]

Most significantly, the Model Act would limit the charges to borrowers, including a 36% APR cap and a cap on how much the lender can charge for a bounced check.[198] The Model Act would also prohibit a variety of other practices by lenders, including using the proceeds of one deferred deposit loan to pay off another earlier loan, threatening debtors with criminal process for failure to repay loans, and engaging in various other unfair or deceptive acts.[199]

Finally, the Model Act would establish administrative, civil, and criminal remedies for violations. Since lenders would be subject to licensing and administrative oversight, consumers would have the right to file licensing complaints, as well as to access information about complaints made by other members of the public.[200]

In addition to the rate cap, the Center for Responsible Lending also recommends that states adopt:

- Caps on the number of loans a borrower can receive annually to ensure that payday loans are only used occasionally in the short-term;
- Bans on the holding of a check or bank access as collateral or security for a loan to prevent the payday loan taking precedence over all other debts and basic needs; and
- Increased incentives for small loans and emergency savings.[201]

With respect to Internet payday lending, the Consumer Federation recommends that states strengthen state usury laws and/or small loan rate caps and prohibit loans based on electronic access to consumers' bank accounts.[202] Short of an outright ban on such loans, the Consumer Federation advises that states should amend small loan and payday loan laws to apply to Internet-based loans; prohibit choice-of-law provisions that make the laws of other countries or states applicable to loans issued to borrowers within that state; and require state credit regulators to investigate the Internet payday loan industry to enforce state credit laws and interest rate limits.[203]

Despite concurrence among consumer advocates that a rate cap is the most effective legislative remedy for payday lending, efforts to adopt such a rate cap in California have not be successful and appear to have stalled. AB 2845 — a rate cap bill proposed by Assemblyman Dave Jones in the 2007-2008 Session — is currently inactive and faced strenuous and well-funded opposition by the California Financial Services Association. As a result of the anemic response of California legislators to enact meaningful payday lending reform, at least one California-based advocacy organization has largely re-directed its limited resources over the past year or so to work towards the adoption of local ordinances that would restrict the location or proliferation of payday lending outlets — discussed further below.[204]

<u>Policy Reform Approaches in Federal Law Regarding Payday Lending</u>

Three pending federal bills would create additional protections for consumers in payday lending transactions.[205] Many of the policy reforms discussed for statewide implementation above could be effective on the federal level as well.[206] With respect to Internet payday lending, the Electronic Fund Transfers Act could be updated to extend consumer protections to credit transactions not envisioned when the law was enacted.[207] However, passage of any of the pending federal bills or any other payday lending reforms is in no way guaranteed, and additional advocacy will likely be needed in coming years to ensure nationwide, comprehensive protection for consumers in small loan transactions.

Consumer advocates at the national level believe that there is work to be done to build on the surprisingly successful federal legislative effort to pass the Military Lending Act; for instance, advocates point out that there has been no comprehensive study — either nationally or looking only at bases in a state with no statewide rate cap — to examine the effects of the Act.[208] Such a study could certainly bolster efforts to pass a federal rate cap; however, it does not appear that this type of study is currently being undertaken.

Another important element on the federal scene is the new President's stated support of a federal rate cap. Barack Obama and Joe Biden have publicly stated that they believe that the protection extended to the military by the Military Lending Act must be extended to all Americans, "because predatory lending continues to be a major problem for low and middle income families alike."[209]

Additionally, opportunities remain for existing federal regulatory bodies, such as the National Credit Union Administration, to protect consumers and to discourage the entities they oversee from engaging in predatory payday lending practices. For Internet-based payday lending, the Consumer Federation of America recommends that the Federal Trade Commission investigate the Internet payday loan industry to enforce federal credit and financial privacy laws.[210] However, any regulatory action should be taken with an eye toward preserving affordable small loans for the consumers who need them, where possible.

Possible Changes in Local Laws Regarding Payday Lending

Local governments also have the power to restrict payday lending through zoning ordinances. In "Controlling the Growth of Payday Lending through Local Ordinances and Resolutions: A Guide for Advocacy Groups and Government Officials,"[211] consumer advocates suggest the following types of local ordinances designed to reduce or stamp out the presence of predatory payday lending within a city's borders:

- **Moratorium during Study Period.** Such a temporary moratorium could be enacted to prevent new payday lenders from setting up shop while the local government evaluates other, more permanent options.[212]
- **Permanent Moratorium.** Cities may enact a permanent moratorium. They can choose to grandfather in existing stores or make a plan for phasing those stores out.[213]
- **Limits on Density and/or Distance.** Cities may limit the number of payday lending outlets in a geographic area either based on distance or population density.[214]
- **Special Zoning**. Cities can "limit payday lending outlets to special zoning districts or a limited number of existing zoning districts."[215]
- **Special Permits**. Cities may require payday lenders to obtain conditional use permits, or other special permits.[216] Cities should ensure that such permits are subject to a public notice and comment period.

Many cities have used one or more of these methods to address predatory payday loan practices in their communities.[217] In the Bay Area, both San Francisco and Oakland have passed ordinances restricting payday lending activities. Oakland requires a special use permit for check cashers and payday lenders and sets minimum distances between such establishments, as well as a minimum distance between these businesses and schools, banks, credit unions, churches, community centers, and liquor stores.[218] San Francisco first enacted a temporary moratorium on check cashing and payday lending businesses in 2006 and has since enacted permanent controls, including a ban on all new payday lending outlets in certain districts and a requirement that, anywhere in the city, a new payday loan outlet may not locate within a quarter mile of an existing one (or of another "fringe financial service," such as a check cashing store).[219]

The City of Sacramento recently adopted an ordinance limiting the activity of check cashers and payday lenders. Although the ordinance, which became effective April 27, 2009, will not close existing stores, it places restrictions on new stores.[220] Check cashers and payday lenders must now obtain conditional use permits before opening any new stores.[221] Additionally, these types of business may not open within 1000 feet from a church, school, bank, or credit union; nor may they open within 500 feet of a residentially zoned area.[222]

Sacramento first instituted a moratorium on new payday lending and check cashing stores in October 2007 in order to explore strategies for addressing these types of business and the problems they cause for the communities where they locate.[223] Sacramento currently has 55 payday lending stores, most of which are located in predominantly African American or Latino

neighborhoods.[224] The new ordinance ends the moratorium but includes provisions to help ensure that payday lenders and check cashers who do locate in Sacramento conform to certain requirements, including a "'good neighbor policy' and . . . other specifications around lighting, signs and security."[225] The City Council passed the ordinance unanimously on March 3, 2009, following a long battle between consumer advocates and the payday lending industry.[226] A broad coalition of local community organizations, including Sacramento ACORN, the Sacramento Housing Alliance, Villa San Juan Owners Association, the Interfaith Service Bureau, the Sacramento Central Labor Council, along with the California Reinvestment Coalition, advocated for the ordinance and were instrumental in its passage.[227]

Advocates in other cities — such as Los Angeles, San Diego, Bakersfield, and San Jose — that have large numbers of payday loan locations should consider mounting similar efforts.[228] Of course, the payday lending industry is likely to mount political or legal challenges — or both — to any proposed zoning ordinance that limits its ability to do business in a given community.[229] Preparations for these potential challenges should involve an array of community groups and strategies. Politically, advocates can encourage payday borrowers who have suffered from predatory practices to testify before their local government body about their experiences; advocates should also help mobilize voters to tell their elected officials that they support regulation of payday lenders.[230] Legal services organizations can also play a role in advising the city or county about potential legal challenges, as well as responses to those challenges.

Local governments can also combat payday lending indirectly by supporting policies that decrease the market for payday loans. Cities can fund financial education programs to help low-income families learn about their credit options, as well as the consequences of accruing consumer debt. They can also support programs that make food and healthcare more accessible to the working poor, including campaigns to educate families about public assistance programs such as the Supplemental Nutrition Assistance Program (formerly Food Stamps) and Medicaid (Medi-Cal, in California). Cities and counties can also provide funding for free or low-cost health care to low-income families to help them avoid taking out payday loans to cover medical expenses.[231] While local governments cannot — and should not — force poor families to pursue these alternatives to payday loans, making these options available will help to ensure that families do not resort to payday lenders because they have no other choice. City and county governments can pass resolutions supporting state and federal reforms of payday lending laws.[232]

Banking Access Approach

Many borrowers take out payday loans because of lack of access to or familiarity with mainstream banking products. In many neighborhoods, payday lending establishments see little to no competition from mainstream banks.[233] A number of authors have noted the barriers that mainstream financial businesses face in reaching lower-income customers, as well as the importance of removing those barriers.[234] The recommendations below provide a guide for how lending institutions could attract would-be payday loan consumers by offering alternative and

affordable finance products and tailoring business practices to the needs of low-income populations.

In order to successfully serve low-income and minority communities, lending institutions must be accessible and usable to the customers who live in those communities. Mainstream banks should consider the following strategies to attract and maintain currently unbanked communities:

- **Bilingual bank workers.**[235] Banks should employ bilingual bankers fluent in the languages most spoken within a given community; in communities with a high percentage of non-native English speakers, banks should consider hiring additional bilingual workers.
- **Specialized customer service training.** Reports show that some payday loan consumers opt for a payday loan because they feel welcomed, rather than intimidated, by payday lending stores.[236] Banks and credit unions should train employees to relate with customers in a culturally appropriate way, and to be welcoming and conscious of potential fears and concerns that customers may have.

Mainstream lending institutions can also compete with payday lenders by providing banking products that better meet the needs of potential borrowers. They should develop a range of alternative finance products, in addition to the traditional finance products.

- **Small consumer loans (a.k.a. small dollar loans).**[237] These loans are around $1,000 or less, with interest rates capped at 36% or lower, without prepayment penalties. These loans should also have an automatic savings component, limited maintenance fees and an extended repayment period of up to 36 months.[238]
- **Credit union installment loans.**[239] Many credit unions offer unsecured installment loans with 18% APR or less. These loans are generally structured so that the principal and interest are repaid in equal installments at fixed intervals (usually once a month).
- **Low-cost check-cashing (a.k.a. "ethical" check-cashing).**[240] Would prohibit financial institutions from charging exorbitant fees to cash personal checks, even if the customer does not have an account at that bank.
- **No-minimum-balance debit accounts that do not allow overdrafts.**[241]

Many different variations on the basic checking account exist and banks can offer accounts with any of the following components: initial deposit requirement, monthly account maintenance charge, minimum account balance requirement, overdraft protection, limit on the number of withdrawals per month, limits on the number of transactions per month, etc.[242] In order to attract lower-income customers, banks and credit unions should offer banking products that have limited or no fees or charges and that have combined checking and savings components.[243]

Often, would-be borrowers do not have the credentials (i.e., credit history, property for collateral, etc.) necessary to access the finance products available at mainstream banks. As such, many organizations and programs working to pull low-income populations out of the cycle of debt have developed tools to prepare low-income people to access traditional finance products. The following is a list of recommendations for transitioning low-income people from the informal economy to participation in mainstream banking arena, as well as for non-predatory alternatives to mainstream banking.

- **Lending circles.**[244] These lending arrangements solve the problem of unmet banking needs in low-income communities through the informal economy. Participants contribute an amount of money to the "pool" and then each contributor can borrow from it when necessary; over time, each person repays the amount that they borrowed.
- **Alternative credit reporting.**[245] Community organizations should develop ways to incorporate non-traditional credit references and scoring for borrowers with little or no credit history into credit reports in order to enable creditors to more accurately assess a person's credit history and decide whether to qualify that person for a loan or credit card. Such non-traditional credit could be built through lending circles or other non-traditional credit sources.
- **"Starter" Bank Account.** These accounts, often provided through mainstream banks, are designed to help account-holders build personal savings and establish a credit history in order to be prepared to access more affordable credit sources later.[246]
- **Financial services pre-paid debit cards.** With these cards, the cardholder determines the quantity of money to add or reload onto the card, which can be equipped with direct deposit, automatic bill pay and automatic savings features, in order to enable the cardholder to easily manage finances. These types of cards have very few restrictions.[247]

Both mainstream banks and community groups have already begun to implement some of the above strategies. "Bank on San Francisco," a program pooling the efforts of local government agencies, key non-profits, banks and credit unions, works to connect new, lower-income customers with banks and mainstream financial products. Key components of Bank on San Francisco's model include: working with financial institutions to make more "starter" bank accounts available; educating consumers—especially low-income people—about finance management, the benefits of bank accounts and how to open a starter bank account; and discouraging new check cashing and payday lending stores from opening.[248]

In 2008, the success of Bank on San Francisco led Governor Schwarzenegger to launch Bank on California, a program aimed to provide low-income Californians with "starter" bank accounts through collaborative relationships with banks, community financial organizations and local governments. Bank on San Jose is a pilot program of the Bank on California initiative. Currently, Bank on San Jose is working with seven banking partners and one credit union partner on key priorities of the program, such as connecting unbanked people with starter bank accounts

and providing "second chance" bank accounts in conjunction with financial education for people who have mismanaged accounts in the past.[249] Additionally, Bank on San Jose is working with financial institution partners to begin a practice of accepting alternative forms of identification from customers interested in opening a new bank account.[250]

Local community groups have also sought creative ways to build credit in low-income and minority neighborhoods. For example, in 2005, the Mission Asset Fund was created when the Levi Strauss & Company donated $1 million for the "economic development" of San Francisco's Mission neighborhood. In deciding on a strategy for using the funds, a steering committee comprised mostly of community leaders first assessed the needs and desires of the community through community outreach and interviewing, then developed a mission and structure that was tailored to the community's expressed needs. The Mission Asset Fund now connects Mission neighborhood residents with alternative financial products and provides financial education in order to help build wealth and personal assets that make those residents more financially secure.[251] Currently, Mission Asset Fund is partnering with One California Bank to house and track payments into lending circles in order to allow community member participants to establish and develop credit ratings.[252]

Consumer Education Approach

Incentives to mainstream financial business to enter lower-income neighborhoods and to offer appropriate products should be made in tandem with efforts to educate consumers "to dispel myths and misperceptions" about these business.[253] And as many have suggested, consumers should be provided with information and tools to make the best financial choices they can.[254] Presumably, an increased understanding about financial and banking options could help would-be payday loan consumers to make a different, perhaps less expensive, choice when faced with the question of how to cover an emergency expense.[255]

For example, adjusting the amount of income tax withheld from a paycheck temporarily could provide additional income for an emergency. Educating people about the logistics of making an income tax change, especially the potential benefits and consequences of that change, equips them with one more option to consider when assessing finances. Increased accessibility of information about banking and finance options available to people would likely increase the likelihood that they will make good decisions about how to manage their money, including whether or not to accept a payday loan.[256]

The Brookings Institution noted that the need for financial education for lower-income consumers comes at a time when numerous entities, such as "banks, employers, public schools, community colleges, faith-based groups, community groups, and the military," are providing financial education services.[257] An abundance of financial education information designed for lower-income families can be found online — Brookings cites to www.beehive.org — and most states have recently considered legislation related to financial education.[258]

It should be noted that the effectiveness of financial literacy programs has been questioned,[259] apparently due to the difficulty in creating a sound methodology for assessing them.[260] It is also important to recognize that some experts in financial literacy programs believe that such programs are of limited value without incentives for participants, which are "as important as program content and structure in attracting students and in influencing their behavior."[261]

However, there is certainly support for the thesis that financial education is beneficial.[262] Brookings recommends that community leaders can improve the availability and quality of financial education to help lower-income families avoid "unscrupulous business that charge higher-than-necessary prices" by:

- Finding and analyzing the gaps, both in delivery and quality, in consumer financial education delivery in specified jurisdictions;
- Researching and publicizing the best practices in consumer financial education that will best fill those gaps; and
- Ascertaining a methodology for setting outcome goals to measure the impact of financial education efforts, both in general financial education programs and in those that are targeted towards a particular consumer purchase.[263]

Another Brookings author agreed that "well-evaluated demonstration programs would greatly advance our knowledge of best practices around financial education."[264] Locally, adding the strategies described above — including a research component and/or an outcome-measurement element — to existing Bank on San Jose efforts, described above, would be useful and advisable.

Conclusion

Payday lenders have capitalized on low-income communities' demand for small-dollar credit products that respond to emergency needs or day-to-day income shortfalls. Recent years have seen a marked increase in the amount of information available about payday lending patterns, as well as the ways in which the payday lending industry strips wealth from families and communities by creating a cycle of escalating debt.

Although information about the effectiveness of various strategies to combat predatory payday lending practices is less plentiful, a multi-faceted approach seems warranted. Efforts should continue to develop policies at the federal, state, and local level to impose rate caps or other controls to protect consumers. However, given the challenges of mounting these policy efforts against strong and well-funded industry opposition, these policies should be complimented by on-the-ground efforts to create more affordable credit products that meet the same needs as payday loans. Since the need of low-income families for readily available small loans is not likely to abate, creating and sustaining non-predatory alternatives to payday lending — whether from mainstream banks or from less "traditional" sources like lending circles — is

imperative. Further, education and organizing efforts can help empower members of low-income and minority communities to make informed financial decisions, to build wealth in their neighborhoods, and to participate in policymaking.

Appendix: Legislative Efforts to Reform Payday Lending in California, 2003-2009

2003-2004 Legislative Session

- AB 2156 (Reyes): Requires the Commissioner of Corporations' report regarding the implementation of the California Deferred Deposit Transaction Law to include specified information on the advertising practices of payday lenders and recommendations regarding additional regulation of those practices.[265]

2005-2006 Legislative Session

- AB 207 (Dymally): Would have: (1) prohibited fees on payday loans from exceeding an effective annual rate of 10%; (2) required that a post-dated check written in exchange for a payday loan be made out to the licensed payday lender; and (3) rendered void any check held by the lender for longer than 31 days.[266]

- AB 1965 (Lieu): Would have (1) authorized service members and reservists, and their spouses, to defer payments on payday loans; (2) prohibited payday lenders from garnishing wages or contacting military superiors for collection on a payday loan; and (3) required payday lenders to honor repayment agreements made through negotiation.[267]

2007-2008 Legislative Session

- AB 7 (Lieu): Requires payday lenders to comply with the federal law relating to terms of consumer credit extended to armed services members and dependents of armed services members as required by the Military Lending Act.[268]

- AB 634 (Calderon): Redefines "deferred deposition transaction" to exempt auto dealers from coverage when they accept checks as deposits.[269]

- AB 1534 (Nunez): Would have required an additional report to be provided to the Governor and the Legislature by December 1, 2008. The report would have included specified information on payday loan consumers and the advertising practices of payday lenders.[270]

- AB 2845 (Jones): Would 1) prohibit the interest on a payday loan from exceeding an annual percentage rate of 36%; 2) require the informational notice and written agreement for a payday loan to include a notification of the interest rate limit; and, 3) prohibit a payday lender from acting to evade these requirements.[271]

2009-2010 Legislative Session

- AB 33 (Nava): Would consolidate portions of three existing state departments to create a single operations and licensing framework that would cover licensing and regulation of finance lenders, among other entities.[272]

- AB 377 (Mendoza): Would make amendments to the California Deferred Deposit Transaction Law related to advertising regulations for licensed payday lenders.[273] This bill would also legalize Internet payday loans made to Californians and would offer Californians who borrow Internet payday loans only one repayment plan option, forcing them to pay additional finance fees as a result.

- AB 545 (Salas): Would authorize the Commissioner of Corporations to develop and implement a system that would enable a payday lender to receive specified information regarding a consumer's history with payday loans.[274]

ENDNOTES:

[1] *See, e.g.*, Sharon Hermanson and George Gaberlavage, "The Alternative Financial Services Industry," AARP Public Policy Institute (Aug. 2001), available at http://www.aarp.org/research/credit-debt/credit/aresearch-import-198-IB51.html. The San Francisco Municipal Code also uses the term "fringe financial services" to refer to these types of establishments. San Francisco Muni. Code § 790.111.
[2] Consumers Union, "Fact Sheet on Payday Loans" (1999), available at http://www.consumersunion.org/finance/paydayfact.htm.
[3] *Ibid.*
[4] California Department of Corporations, "Report to the Governor and the Legislature: California Deferred Deposit Transaction Law" (Dec. 2007), 6, available at http://www.corp.ca.gov/pub/pdf/CDDTL07_Report.pdf.
[5] Center for Responsible Lending, "Wealth-stripping payday loans trouble communities of color," CRL Issue Brief (Oct. 2008), available at http://www.responsiblelending.org/pdfs/az-payday-communities-of-color-10-2-final.pdf, *cited by* Logan and Weller, *infra* note 10 at 3.
[6] California Budget Project, "Payday Loans: Taking the Pay out of Payday" (Sept. 2008), 5, available at http://www.cbp.org/pdfs/2008/080926_paydaychartbook.pdf.
[7] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 19.
[8] Community Financial Services Association of America, "About the Payday Advance Service," http://www.cfsa.net/about_payday_advance_product.html.
[9] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 5.
[10] Amanda Logan and Christian E. Weller, "Who Borrows From Payday Lenders? An Analysis of Newly Available Data," Center for American Progress (Mar. 2009), 2, available at http://www.americanprogress.org/issues/2009/03/pdf/payday_lending.pdf
[11] California Budget Project, *supra* note 6 at 5. Consumers Union makes the following argument that such high fees are unnecessary:

> The industry claims its extremely high fees are necessary on account of the risk being taken and its high loss ratio. In fact, in Colorado, one of the few places in the country that collects actual data from the industry, **payday lenders charge-off only 3%** of the loans made from 1996-1997, while their loans had an average APR of 485.26%. **Conversely, California banks charged off 2.7% of credit card debt** in those same years, while having an APR of 15-22%. Thus, the payday loan industry's claim of risk and loss simply does not stand up to close scrutiny and does not justify the high rates charged.

Consumers Union, "Fact Sheet on Payday Loans," *supra* note 2 (citations omitted) (emphasis in original).
[12] Center for Responsible Lending, "Wealth-stripping payday loans trouble communities of color," CRL Issue Brief (Oct. 2008), available at http://www.responsiblelending.org/pdfs/az-payday-communities-of-color-10-2-final.pdf, *cited by* Logan and Weller, *supra* note 10 at 3.
[13] Logan and Weller, *supra* note 10 at 3.
[14] California Reinvestment Coalition, "The Financial Divide: An Uneven Playing Field, Bank Financing of Check Cashers and Payday Lenders in California Communities" (Mar. 2005), 2, available at http://www.calreinvest.org/system/assets/17.pdf.
[15] California Budget Project, *supra* note 6 at 5.
[16] *Id.* at 7. In 2006, the average repayment period in California was just 16 days, even though state law allows a repayment period of up to 31 days. *Id.* at 10.
[17] A 2007 survey of California borrowers found that only 10.3% used payday loans to cover financial emergencies. *Id.* at 25. However, the Federal Reserve's 2007 Survey of Consumer Finance Services found that 29% of borrowers took out payday loans for emergencies. *See* Logan and Weller, *supra* note 10 at 11 (citation omitted). This discrepancy may be a result from the survey sample, the definition of "emergency" used by surveyors, or other differences in survey methodologies.
[18] California Budget Project, *supra* note 6 at 5.
[19] Paige Marta Skiba and Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy?" (Oct. 2008), http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221, *cited*

in Letter from Lauren K. Saunders, Managing Attorney, National Consumer Law Center, to Michael E. Fryzel, Chairman, National Credit Union Administration (Jan. 29, 2009), 2.

[20] Skiba and Tobacman, *supra* note 19 at 3.

[21] Dennis Campbell, *et al.*, "Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures" (June 2008) (paper presented at the Federal Reserve Bank of Boston Summer Workshop, Consumer Behavior and Payment Choice, July 2008), available at www.box.frb.org/economic/eprg/conferences/payments2008/campbell_jerez_tufano.pdf, cited in letter from Lauren K. Saunders, *supra* note 19 at 2.

[22] Bart J. Wilson, *et al.*, "An Experimental Analysis of the Demand for Payday Loans," (April 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796; Brian T. Melzer, "The Real Costs of Credit Access: Evidence from the Payday Lending Market" (Nov. 2007), available at http://home.uchicago.edu/~bmelzer/RealCosts_Melzer.pdf, cited in letter from Lauren K. Saunders, *supra* note 19 at 2.

[23] FDIC Press Release, "FDIC Revises Payday Lending Guidance" (Mar. 2005), available at http://www.fdic.gov/news/news/press/2005/pr1905.html.

[24] Brookings Institution, "From Poverty, Opportunity: Putting the Market to Work for Lower Income Families," (2006), available at http://www.brookings.edu/reports/2006/07poverty_fellowes.aspx.

[25] Logan and Weller, *supra* note 10 at 1.

[26] *Ibid.*

[27] Available at http://www.cbp.org/pdfs/2008/PaydayMaps/AD%2021.pdf.

[28] Available at http://www.cbp.org/pdfs/2008/PaydayMaps/AD%2021.pdf. Ninety-one payday lending stores operate in Santa Clara and San Mateo Counties, with just over half of those stores are located in San Jose—the most populated city in the Bay Area with 939,889 residents. California Department of Corporations, "2007 Payday Loan Study" (December 2007; updated June 2008), 31-32, available at http://www.corp.ca.gov/pub/pdf/PDLStudy07.pdf.

[29] Wei Li, *et al.*, "Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California," Center for Responsible Lending (Mar. 26, 2009), 25, available at http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf.

[30] *Ibid.*

[31] *Ibid.*

[32] *Id.* at 10.

[33] *Id.* at 14.

[34] *Id.* at 20.

[35] *See* Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 20-24. Other high-priced "alternative financial services" include car title lenders, pawnshops, and remittance sellers.

[36] *Id.* at 26.

[37] *Id.* at 4-7.

[38] Li, *et al.*, *supra* note 29 at 12.

[39] *Id.* at 24.

[40] Arthur Delaney, "Online Loan Sharks Trap People into Debt — Then Disappear," Huffington Post, May 21, 2009 (available at http://www.huffingtonpost.com/2009/05/21/online-loan-sharks-trap-p_n_205832.html), *citing* Consumer Federation of America, "Payday Loan Consumer Information — Facts" (available at http://www.paydayloaninfo.org/facts.cfm).

[41] *Ibid.*

[42] Jean Ann Fox and Anna Petrini, "Internet Payday Lending: How High-priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections," Consumer Federation of America (Nov. 30, 2004), 5, available at http://www.consumerfed.org/pdfs/Internet_Payday_Lending113004.PDF.

[43] *Id.* at 9-13; see also "Pennsylvania to Require Licenses For Internet Payday Lenders," July 29, 2008 (describing state's effort to bring Internet payday lenders under its credit laws) (available at http://www.consumeraffairs.com/news04/2008/07/payday_lending_internet.html); Jim Siegel, "Payday-lending bill advances," The Columbus Dispatch, May 1, 2008 (describing Ohio House passage of HB 545, a bill banning Internet payday lending) (available at http://www.dispatchpolitics.com/live/content/local_news/stories/2008/05/01/payday01.ART_ART_05-01-08_B1_TQA32FU.html?sid=101).

[44] See Fox and Petrini, *supra* note 42.

[45] Marc Lifsher, "Internet payday lenders with ties to Indians dodge California regulators," Los Angeles Times (April 13, 2009), available at http://articles.latimes.com/2009/apr/13/business/fi-internet-loans13?pg=1
[46] *Ibid.*
[47] Fox and Petrini, *supra* note 42 at 12.
[48] *Ibid.*; *see also* Delaney, *supra* note 40 (describing futile effort of attorney representing online payday consumer who was subjected to thousands of dollars in illegal fees to track down individuals behind payday lending sites).
[49] Fox and Petrini, *supra* note 42 at 13.
[50] *See id.* at 25-6, 30-1.
[51] *See id.* at 31.
[52] *See id.* at 23.
[53] *See id.* at 28-30.
[54] *See* id. at 29.
[55] *See id.* at 26-30.
[56] *See id.* at 27-8.
[57] Logan and Weller, *supra* note 10.
[58] *See, e.g.*, Li, *et al.*, *supra* note 29 at 23.
[59] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 7.
[60] California Budget Project, *supra* note 15 at 25.
[61] *Ibid. But see* Logan and Weller, *supra* note 10 at 11 (citation omitted) (citing to the Federal Reserve's Survey of Consumer Finance, which found that 29% of those borrowers surveyed used payday loans for emergencies).
[62] Li, *et al.*, *supra* note 29 at 2.
[63] *See, e.g.*, Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 34.
[64] *See, e.g.*, Rebecca M. Blank, "Public Policies to Alter the Use of Alternative Financial Services among Low-Income Households," Brookings Institution and University of Michigan (2008), 2, available at http://www.brookings.edu/papers/2008/0416_low_income_blank.aspx.
[65] Li, *et al*, *supra* note 29 at 23.
[66] *Ibid.*
[67] Blank, *supra* note 64 at 2.
[68] *Id.* at 4.
[69] *Ibid.*
[70] *Ibid.*
[71] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 7.
[72] Anna Paulson, *et al.*, "Financial Access for Immigrants: Lessons from Diverse Perspectives," Brookings Institution (May 2006), 22, available at http://www.brookings.edu/reports/2006/05demographics_paulson.aspx.
[73] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 7.
[74] Paulson, *supra* note 69 at 18-19.
[75] California Budget Project, *supra* note 6 at 8.
[76] *Ibid.*
[77] Cal. Fin. Code § 22303.
[78] *Ibid.*
[79] SB 1959, 1995-96 Leg. Sess. (Cal. 1996).
[80] SB 1959, Assembly Floor Analysis (Aug. 1996).
[81] SB 1959, *supra* note 62.
[82] *See* SB 898, 2001-2002 Leg. Sess. (Cal. 2002), Senate Floor Analysis (Aug. 2002).
[83] *Ibid.*
[84] *See* Cal. Fin. Code §§ 2300-23106; 10 Cal. Code Regs §§ 2020, et seq. (regulations under the CDDTL). Note that the CDDTL does not address, or even mention, Internet payday lending per se.
[85] SB 898 Senate Floor Analysis, *supra* note 82.
[86] *See* Cal. Fin. Code §§ 23000-23106.
[87] *See* California Department of Corporations, "California Deferred Deposit Transaction Law," available at http://www.corp.ca.gov/FSD/CDDTL.asp, for a summary of some of the licensure requirements of the CDDTL.
[88] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 4.
[89] Cal. Fin. Code §§ 23035(c).
[90] *Ibid.*
[91] Cal. Fin. Code §§ 23035(a).

[92] Cal. Fin. Code §§ 23036(b).
[93] Cal. Fin. Code §§ 23000-23106.
[94] SB 898, Senate Floor Analysis, *supra* note 82.
[95] *Ibid.*
[96] Uriah King and Leslie Parish, "Springing the Debt Trap: Rate caps are only proven payday lending reform," Center for Responsible Lending (Dec. 2007), available at http://www.responsiblelending.org/pdfs/springing-the-debt-trap.pdf.
[97] *Ibid.*
[98] *Ibid.*
[99] Li, *et al.*, *supra* note 29 at 3.
[100] Consumers Union, National Consumer Law Center, and Consumer Federation of America, "Small Dollar Loan Products Scorecard" (*last updated* August 2008), available at http://www.consumerfed.org/pdfs/small_loan_scorecard_08.pdf.
[101] California Budget Project, "Recent Reports on Payday Lending in California Should Be Used with Caution" (May 1, 2008), 1, available at http://www.cbp.org/pdfs/2008/080501_PaydayReportCautionMemo.pdf.
[102] *Id.* at 3. Indeed, as consumer groups have noted, "[d]ue to a major factual error and a methodological flaw, . . . [DOC's] report highlights data that understate the number of Californians who repeatedly use payday loans. In addition, the DOC report understates the average number of payday loans per borrower." *Id.* at 4.
[103] See National Consumer Law Center, "Model Deferred Deposit Loan Act," available at http://www.consumerlaw.org/initiatives/payday_loans/paydayac.shtml.
[104] AB 2156, 2003-2004 Leg. Sess. (Cal. 2004); Cal. Fin. Code § 23057.
[105] AB 7, 2008-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 1241; Cal. Fin. Code § 14960; Cal. Fin. Code § 22345; Cal. Fin. Code § 23038; Cal. Mil. & Vet. Code § 394.
[106] AB 634, 2007-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 23001.
[107] AB 2854, 2007-2008 Leg. Sess. (Cal.), would amend Cal. Fin. Code §§ 23001; 23005; 23035; 23036; 23039.
[108] AB 207, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code §§ 23038-23042.
[109] AB 1965, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code § 23038.
[110] AB 1534, 2007-2008 Leg. Sess. (Cal.), would have amended Cal. Fin. Code § 23057.
[111] AB 33, 2009-2010 Leg. Sess. (Cal.), would amend various sections of Cal. Bus. & Prof. Code, Corp. Code, and Gov't Code.
[112] AB 377, 2009-2010 Leg. Sess. (Cal.), would amend Cal. Fin Code §§ 23001, 23027, and 23035, and add Cal. Fin. Code §§ 23005.5, 23010.5, and 23036.5.
[113] AB 545, 2009-2010 Leg. Sess. (Cal), would add Cal. Fin. Code § 23024.5.
[114] For more detail regarding these changes and attempted changes to state law, see Appendix, "Legislative Efforts to Reform Payday Lending in California, 2003-2009."
[115] 15 U.S.C. § 1601. The Truth in Lending Act may be found at 42 U.S.C. §§ 1601 et seq., and its implementing regulation ("Reg Z") is located at 12 C.F.R. § 226.
[116] 12 C.F.R. § 226.5.
[117] 12 C.F.R. § 226.16.
[118] 15 U.S.C. § 1640.
[119] 15 U.S.C. § 16.11.
[120] FDIC, "Guidelines for Payday Lending," FDIC Financial Institution Letters, FIL-14-2005 (Mar. 2005), available at http://wwww.fdic.gov/news/news/financial/2005/fil1405a.html.
[121] 15 U.S.C. § 1633.
[122] 10 U.S.C. § 987.
[123] 10 U.S.C. § 987 (b).
[124] *Ibid.*
[125] Office of the Comptroller of the Currency, "Community Reinvestment Act Information," available at http://www.occ.treas.gov/crainfo.htm. The Community Reinvestment Act may be found at 12 U.S.C. §§ 2901 et seq.
[126] FDIC, "Guidelines for Payday Lending," *supra* note 119.
[127] 12 U.S.C. §§ 2901(b), 2903; 12 C.F.R. § 228.21.
[128] FDIC, "Guidelines for Payday Lending," *supra* note 119.
[129] 15 U.S.C. §§ 1692 et seq.
[130] 15 U.S.C. §§ 41-58.

[131] 15 U.S.C. §§ 1681 et seq.
[132] 15 U.S.C. § 1601. The Electronic Funds Transfer Act regulates transactions where the consumer allows the other party to the transaction access to the consumer's bank account, such as through debit card or direct deposit transactions. While neither the Act nor its implementing regulation, "Reg E," was designed with Internet payday loans in mind, both pertain to arrangements where the borrower provides a check or other account information to the lender as a source document, but, rather than cashing the check (as happens in in-person payday lending) the lender uses the bank account information to access the account directly.
[133] *See, e.g.*, 15 U.S.C. §§ 6801-6809; Federal Trade Commission, "The Gramm-Leach Bliley Act," available at http://www.ftc.gov/privacy/privacyinitiatives/glbact.html.
[134] *See, e.g.*, Jean Ann Fox and Edmund Mierzwinski, "Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," Consumer Federation of America and U.S. Public Interest Research Group (Nov. 2001), available at http://www.consumerfed.org/pdfs/paydayreport.pdf; Pauline Smale, "Payday Loans: Federal Regulatory Initiatives," CRS Report for Congress (May 2005), 3-4, available at http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-9204:1.
[135] Smale, *supra* note 134 at 3.
[136] *Ibid.* (citation omitted).
[137] *See* Office of the Comptroller of the Currency, OCC Advisory Letter AL 2000-10 (Nov. 27, 2000) available at http://www.ffiec.gov/ffiecinfobase/resources/retail/occ-al-2000-10_payday_lending.pdf; Office of Thrift Supervision, "Agencies Urge Banks and Thrifts to Evaluate Risks with Vendors Engaged in Practices Viewed as Abusive to Customers" (Nov. 27, 2000), available at http://files.ots.treas.gov//77099.html.
[138] *See, e.g.,* OCC Advisory Letter AL 2000-10, *supra* note 137.
[139] Smale, *supra* note 134.
[140] FDIC, "Guidelines for Payday Lending," *supra* note 120 at 1-2.
[141] *Id.* at 2.
[142] *Id.* at 5.
[143] Letter from Lauren K. Saunders, *supra* note 19 at 13.
[144] California Reinvestment Coalition, "The Financial Divide," *supra* note 14.
[145] FDIC, "Guidelines for Payday Lending," *supra* note 120 at 4.
[146] *Ibid.*
[147] *Id.* at 4.
[148] *Id.* at 6.
[149] *See* letter from Lauren K. Saunders, *supra* at note 19.
[150] *See, e.g.*, Hon. Johann Johnson, Chairman, National Credit Union Administration, "Financial Services for Disadvantaged Communities" (statement before the Appropriations Subcommittee on Financial Services and General Government, U.S. House of Representatives, Mar. 1, 2007), 12, available at http://www.ncua.gov/news/speeches/2007/Johnson/Testimony07-0301.doc.
[151] Letter from Lauren K. Saunders, *supra* note 19 at 1.
[152] *Ibid.*
[153] *Id.* at 1-3.
[154] H.R. 1214, 111th Cong. (2009).
[155] *Id.* at § 2 (a).
[156] *Id. at* § 2 (b).
[157] *Ibid.*
[158] ACORN, Americans for Fairness in Lending, Consumer Action, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, National Consumer Law Center, National Fair Housing Alliance, National Community Reinvestment Coalition, and U.S. PIRG signed a joint statement opposing the bill on March 23, 2009. ACORN, *et al.*, "Please Don't Co-Sponsor or Support HR 1214, 'Payday Lender Protection Act,'" (Mar. 23, 2009) available at http://www.affil.org/uploads/pI/Nw/pINwPM5OS3qeu0gZh8WV0A/Oppose-HR-1214-23march09.pdf. To view the April 2, 2009, testimony before the House Committee on Financial Services, go to http://www.house.gov/apps/list/hearing/financialsvcs_dem/HR04022009.shtml.
[159] ACORN, *et al.*, "Please Don't Co-Sponsor or Support H.R. 1214," *supra* note 158.
[160] *Ibid.*
[161] *Ibid.*
[162] H.R. 1846, 111th Cong. (2009).
[163] H.R. 2563, 111th Cong. (2009).

[164] *See* H.R. 1846, *supra* note 162 at §§ 2(a)(3), 2(b)(1), 2(b)(5); H.R. 2563, *supra* note 163 at §§ 2(a)(3), 2(b)(3), 2(b)(4)(A).
[165] *See, e.g.*, King and Parrish, *supra* note 98 at 22.
[166] S. 500, 111th Cong. (2009), was introduced in the Senate by Sen. Richard Durbin (D-Ill.) in February 2009. A companion bill, H.R. 1608, 111th Cong. (2009), was introduced in the House of Representatives by Jackie Speier (D-Cal.) in March.
[167] S. 500, *supra* note 166 at § 3.
[168] Letter from Jean Ann Fox, Consumer Federation of America, *et al.*, to Senator Richard Durbin (Mar. 2, 2009), available at http://www.consumersunion.org/pub/core_financial_services/009581.html.
[169] S. 582, 111th Cong. (2009). A companion bill, H.R. 1640, 111th Cong. (2009), has been introduced in the House of Representatives.
[170] S. 257, 111th Cong. (2009).
[171] S. 566, 111th Cong. (2009). A companion bill, H.R. 1705, 111th Cong. (2009), has been introduced in the House of Representatives.
[172] H.R. 3126, 111th Cong. (2009).
[173] S. 786, 111th Cong. (2009).
[174] King and Parrish, *supra* note 98.
[175] *Id.* at 9.
[176] *Id.* at 12.
[177] *Id.* at 20.
[178] *Ibid.*
[179] *Ibid.*
[180] *Ibid.*
[181] *Ibid.*
[182] Li, *et al.*, *supra* note 29 at 26, *citing* United States Department of Defense, "Report on the Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and their Dependents," (July 2008). Consumer advocates have noted that insufficient data to fully document the benefits of the Military Lending Act was available at the time this report was generated. Telephone interview, Jean Ann Fox, Consumer Federation of America (May 6, 2009).
[183] "Small Dollar Loan Products Scorecard," *supra* note 100, citing "The Cost of Credit: Regulation, Preemption, and Industry Abuses" § 2.3.3.2 (3d ed. 2005).
[184] Li, *et al.*, *supra* note 29.
[185] Center for Responsible Lending, "Congress Should Cap Interest Rates" (Mar. 2009), available at http://www.responsiblelending.org/issues/payday/reports/interest-rate-survey.html.
[186] Center for Responsible Lending, "Voters Reject 400 percent interest payday loans" (Nov. 7, 2008), available at http://www.responsiblelending.org/media-center/press-releases/archives/voters-reject-400-percent-interest-payday-loans.html.
[187] *Ibid.*
[188] *Ibid.*
[189] NCLC, "Model Deferred Deposit Loan Act," *supra* note 102.
[190] SB 834, 1999-2000 Leg. Sess. (Cal.).
[191] NCLC, "Model Deferred Deposit Loan Act," *supra* note 102.
[192] *Id.* at §§ 1-2.
[193] *Id.* at § 4.
[194] *Ibid.*
[195] *Id.* at § 6 (c).
[196] *Id.* at § 7 (b).
[197] *Ibid.*
[198] *Id.* at § 8.
[199] *Id.* at § 6.
[200] *Id.* at § 4.
[201] King and Parrish, *supra* note 98 at 22-23.
[202] Fox and Petrini, *supra* note 42 at 37.
[203] *Ibid.*
[204] Telephone interview, Liana Molina, California Reinvestment Coalition (Apr. 30 & May 5, 2009).

[205] *See* H.R. 1214, *supra* note 153; S. 500, *supra* note 166; H.R. 1608 *supra* note 166.
[206] Specifically, federal policy makers and regulatory bodies could cap the number of loans a borrower can receive annually, ban the use of bank account access for loan collateral, and create incentives for federally chartered banks and credit unions to engage in non-predatory small loans as an alternative to payday lending. King and Parrish, *supra* note 98 at 22-23.
[207] Fox and Petrini, *supra* note 42 at 37.
[208] Fox interview, *supra* note 182; telephone interview, Lauren Saunders, National Consumer Law Center (May 5, 2009).
[209] Organizing for America, "Plan to Stimulate Urban Prosperity," available at http://www.barackobama.com/issues/urban_policy/index_campaign.php.
[210] Fox and Petrini, *supra* note 42 at 37.
[211] Kelly Griffith, *et al.*, "Controlling the Growth of Payday Lending through Local Ordinances and Resolutions: A Guide for Advocacy Groups and Government Officials" (Nov. 2007), available at http://www.consumerfed.org/pdfs/PDL%20Local%20Ordinance%20Handbook%2012%2007%20Final.pdf. Local efforts have largely focused on nuisance-type issues presented by payday lending outlets in order to avoid possible state or federal pre-emption issues.
[212] *Id.* at 10.
[213] *Ibid.*
[214] *Ibid.*
[215] *Ibid.*
[216] *Ibid.*
[217] *See, e.g., id.*.; Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 61.
[218] Oakland Planning Code § 17.102.430.
[219] *See* San Francisco Planning Code § 249.35; Office of Treasurer and Tax Collector, "San Francisco Supervisors Unanimously Pass 45-day Moratorium on Check Cashing and Pay Day Lending Businesses" (Jan. 10, 2006), available at http://www.sfgov.org/site/treasurer_page.asp?id=36902.
[220] City of Sacramento Ord. 2009-017.
[221] *Ibid.*
[222] *Ibid.*
[223] City of Sacramento Ord. 2007-080, available at http://cityofsacramento.org/dsd/planning/zoning/ordinances/check-cashing-moratorium.cfm. This ordinance created a 45-day moratorium, which was extended by Ord. 2007-089 and Ord. 2008-048.
[224] Bill Lindelof, "Sacramento council looks to limit quick cash stores," *The Sacramento Bee* (Mar. 27, 2009), available at http://www.sacbee.com/government/story/1732962.html.
[225] California Reinvestment Coalition, "Victory in the Fight against Predatory Payday Lending," The CRC Blog (Apr. 6, 2009), http://www.calreinvest.org/blog#blog-entry-66.
[226] *Ibid.*
[227] *Ibid.*
[228] See California Department of Corporations, "2007 Payday Loan Study," *supra* note 28 at 31.
[229] *See* Griffith, *et al.*, *supra* note 211 at 11.
[230] *Ibid.*
[231] Blank, *supra* note 64 at 11.
[232] Griffith, *et al.*, *supra* note 211 at 12.
[233] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 24.
[234] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 53.
[235] Inter-American Dialogue Taskforce on Remittances Report, "Making the Most of Family Remittances" (May 2007), 10, available at http://www.fdic.gov/about/comein/handout1.pdf.
[236] Blank, *supra* note 64 at 3.
[237] FDIC, "Small Dollar Loan Pilot Program" (May 2009), available at http://www.fdic.gov/smalldollarloans.
[238] In telephone interviews, Alan Fisher of the California Reinvestment Coalition and Carolina Reid of the Federal Reserve Bank of San Francisco both emphasized the need for these finance products as alternatives to payday loans.
[239] California Budget Project, *supra* note 6.
[240] Blank, *supra* note 64 at 6.
[241] *Ibid.*

[242] State of New York Banking Department, "Basic Banking Accounts," available at http://www.banking.state.ny.us/brbba.htm.
[243] Telephone interview with Jim Dale, Bank on San Jose (Apr. 29, 2009).
[244] Alexandra Hernandez, "MAF launches innovative Cestas Populares," Mission Asset Fund (October 8, 2008), available at http://missionassetfund.org/node/112.
[245] Telephone interview with Haydee Moreno, Self-Help Credit Union (Apr. 30, 2009).
[246] *See, e.g.*, Bank on California, http://www.bankoncalifornia.ca.gov.
[247] FDIC, "Alternative Financial Services: A Primer" Vol. 3, No. 1 FDIC Quarterly 43 (2009), available at http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/FDIC140_QuarterlyVol3No1_AFS_FINAL.pdf.
[248] Anne Stuhldreher, "Traditional Lending Goes Mainstream," San Francisco Chronicle (Apr. 8, 2009), available at http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/04/07/EDHI16UMQH.DTL.
[249] Dale interview, *supra* note 243.
[250] *Ibid.*
[251] Mission Asset Fund, "How can we help low-income Mission residents build a more secure economic future for themselves and their families?", available at http://missionassetfund.org/ourstory.
[252] Stuhldreher, *supra* note 248.
[253] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 53-54.
[254] *Id.* at 54.
[255] Dale interview, *supra* note 243.
[256] In its recent report, the California Budget Project provides a compendium of alternatives to payday lending that should be considered as potential content for a financial education course designed to help consumers avoid payday borrowing. *See* California Budget Project, *supra* note 6 at 41-47.
[257] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 69.
[258] *Ibid.*
[259] Blank, *supra* note 64 at 10, citing John P. Caskey, "Can Personal Financial Management Education Promote Asset Accumulation by the Poor?" Networks Financial Institute Policy Brief #2006-PB-06 (2006).
[260] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 76, n.141.
[261] Katy Jacob, et al., "Tools for Survival: An Analysis of Financial Literacy Programs for Lower-Income Families," Woodstock Institute, 50 (2000) (available at http://www.woodstockinst.org/publications/download/tools-for-survival%3a-an-analysis-of-financial-literacy-programs-for-lower%11income-families). For example, Individual Development Accounts ("IDAs") offer low-income families a powerful incentive to save (*id.* at 54-57), which should reduce their reliance on high-cost forms of credit like payday loans. *See, e.g.*, Pearl Chin, "Payday Loans: The Case for Federal Legislation," 2004 U. Ill. L.R. 752, Nov. 19, 2004 (stating that "[b]y focusing on asset accumulation rather than short-term cash needs, IDAs address the underlying conditions that create reliance on payday cash outlets and other predatory lenders") (available at http://lawreview.law.uiuc.edu/publications/2000s/2004/2004_3/Chin.pdf).
[262] *Id.* at 69, citing Elizabeth Bell and Robert I. Lerman, "Can Financial Literacy Enhance Asset Building?" The Urban Institute, Opportunity and Ownership Project, No. 6 (2005) and Saundra Braunstein and Carolyn Welch "Financial Literacy: An Overview of Practice, Research, and Policy" (2002).
[263] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 69, 76, n.146, citing Douglas B. Bernhein, *et al.*, "Education and Savings: The Long Term Effects of High School Financial Curriculum Mandates," Journal of Public Economics, Vol. 80 (2001), 435-65.
[264] Blank, *supra* note 64 at 10. Given that this Brookings paper dates back over a year, conducting an updated survey of the current literature about the effectiveness of financial education with respect to payday lending is warranted for policy-makers and funders seeking to address the payday lending problem, but is beyond the scope of this report.
[265] AB 2156, 2003-2004 Leg. Sess. (Cal. 2004); Cal. Fin. Code § 23057.
[266] AB 207, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code §§ 23038-23042.
[267] AB 1965, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code § 23038.
[268] AB 7, 2008-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 1241; Cal. Fin. Code § 14960; Cal. Fin. Code § 22345; Cal. Fin. Code § 23038; Cal. Mil. & Vet. Code § 394.
[269] AB 634, 2007-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 23001.
[270] AB 1534, 2007-2008 Leg. Sess. (Cal.), would have amended Cal. Fin. Code § 23057.
[271] AB 2854, 2007-2008 Leg. Sess. (Cal.), would amend Cal. Fin. Code §§ 23001; 23005; 23035; 23036; 23039.

[272] AB 33, 2009-2010 Leg. Sess. (Cal.), would amend various sections of Cal. Bus. & Prof. Code, Corp. Code, and Gov't Code.
[273] AB 377, 2009-2010 Leg. Sess. (Cal.), would amend Cal. Fin Code §§ 23001, 23027, and 23035, and add Cal. Fin. Code §§ 23005.5, 23010.5, and 23036.5.
[274] AB 545, 2009-2010 Leg. Sess. (Cal), would add Cal. Fin. Code § 23024.5.

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