Georgetown Journal on Poverty Law and Policy
Volume XXXI, Number 2, Winter 2024

Lending Experimentalism: A New Regulatory Approach to Payday Loans

David Berman*

ABSTRACT

Payday loans entangle consumers with few alternatives in catastrophically harmful cycles of borrowing. But because of their design, payday loans are vexingly difficult to regulate effectively.

This article explains how the structure of regulatory oversight of payday lending abets lenders' evasion. In it, I focus on how dynamism, the financial sector's ability to quickly evolve, frustrates attempts to regulate payday lending in two ways: first, lenders employ a strategy of regulatory arbitrage to escape exacting state laws. Second, lenders take advantage of product innovation—what I call "recharacterization" — to circumvent state regulations by modifying loan attributes.

To overcome this dynamism, I argue regulators should consider an experimentalist approach to regulation. A regulatory structure of this kind would have three components: first, regulators must adopt a broad "ability-to-pay" standard, which centers the borrower's financial wellbeing. Second, regulators must find partners embedded in communities to license as lenders. Finally, regulators must conduct a holistic review of borrower financial health after receiving a loan.

I. INTRODUCTION 238
II. THE BACKGROUND: PAYDAY LENDING 240
III. POLICING PAYDAY LENDING: A CASE STUDY IN "WHACK-A-MOLE" REGULATION 243
A. Lessons from High Finance: Dynamism 243
B. Dynamism in Payday Lending 244

* Trial Attorney at the U.S. Department of Housing & Urban Development; J.D. 2021, Columbia Law School. The views expressed in this article are mine alone and do not reflect any affiliation with the U.S. Department of Housing & Urban Development. Thanks to Professor Charles F. Sabel for challenging me to think more creatively about the issue early in the writing process. I am also grateful to Tyler Ross, Austin King, and Ronald Mann for their feedback and suggestions, which undoubtedly made the article better, as well as the editors of the *Georgetown Journal of Poverty Law & Policy*. Finally, I would like to thank my family, particularly Sonali Mehta, for their love and support throughout this project. All errors are my own. © 2024, David Berman.

1. Regulatory Endogeneity: A Fifty-State Patchwork 244
a. Online Lending 250
b. Tribal Immunity 251
c. Arbitration 252
d. Rent-A-Bank 252
2. Innovation: The Legal Challenges of Characterization 255
a. Fees Versus Interest 255
b. Collateralized Loans 256
c. Loan Term 258
d. Loan Amount 258

IV. A Regulatory Solution 259
A. Existing Regulation 259
1. Usury Caps 259
2. Competition 260
3. Rollover Cap 261
4. Bans 262
5. Piecing Multiple Tools Together: Reform Efforts in Virginia and Colorado 262
6. Disadvantage of Existing Successful State Regulation 263

B. Experimentalist Regulation 265
C. An Experimentalist Regulatory Solution 268
1. Ability to Pay 268
2. Licensed, Community-Based Lending 269
3. Monitoring Holistic Borrower Outcomes 272

V. Conclusion 274

I. Introduction

As inequality grows,[1] and many struggle to pay for unexpected expenses,[2] payday loans play a prominent role in the American financial landscape. To some, they are a costly, short-term solution to urgent financial

1. *See* Thomas Piketty, Capital in the Twenty-First Century 31 (2017) (showing American income inequality reaching its highest level since the Great Depression); Joseph E. Stiglitz, The Price of Inequality: How Today's Divided Society Endangers Our Future 1–34 (2012) (describing how inequality in America is growing at an accelerating rate, leaving poor people behind).

2. *See* Bd. of Governors of the Fed. Reserve Sys., Rep. on the Economic Well-Being of U.S. Households in 2022 32 (2023), https://www.federalreserve.gov/publications/files/2022-report-economic-well-being-us-households-202305.pdf (reporting that 37% of Americans surveyed could not cover an unexpected $400 expense exclusively using cash, savings, or a credit card paid off at the next statement).

needs.[3] To others, they are the harbinger of long-term financial struggle—cycles of debt, loss, and bankruptcy.[4] In spite of these significant risks of catastrophic consumer harm, payday lenders across the country avoid regulation.

This Article grapples with the structure of regulatory oversight of the payday lending industry, and how it abets lenders' evasion. I draw comparisons with the difficulties of regulating high finance because of striking similarities with the strategies deployed by payday lenders to avoid regulation. This Article focuses on how dynamism frustrates attempts to regulate payday lending in two ways. First, lenders employ a strategy of regulatory arbitrage to escape exacting state laws. For example, they lend online, move to Indian reservations, compel private arbitration, or seek shelter with federally-chartered banks. Second, lenders take advantage of product innovation—what I call "recharacterization"—to circumvent state regulations by modifying loan attributes. Arbitrage, in combination with innovation, sabotages the regulatory process and frustrates its aims.

To overcome this dynamism, I argue that regulators must adopt an experimentalist approach, capable of moving quickly to provide oversight. This entails three steps: first, regulators must adopt a broad "ability-to-pay" standard, which centers the borrower's financial wellbeing. Second, regulators must find partners to license as lenders who are interested in the health of the community rather than merely their own financial gain. Finally, regulators must conduct a holistic review of loan outcomes, evaluating both lender success and borrower financial health. This combination escapes the persistent problem of dynamism, while also providing a credit lifeline to borrowers.

This Article proceeds in three parts. Section II provides background on payday lending, explaining why payday loans present a pervasive risk of harm to consumers. Section III explores what makes payday loans so difficult to regulate. It analogizes the regulation of payday lending to the regulation of high finance to identify the attributes of payday lending that make it most difficult to regulate. Section IV evaluates existing regulatory approaches, and explains why experimentalism presents a viable option for the regulation of payday lending.

---

3. *See* Ctr. for Responsible Lending, Sinking Feeling: Colorado Borrowers Describe Their Experiences with Payday Loans 3–7 (2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf; Megan Leonhardt, *Here's Why 1 in 3 College-Aged Americans Consider Payday Loans with Interest Rates of 400%*, CNBC (Aug. 1, 2018, 4:23 PM ET), https://www.cnbc.com/2018/08/01/1-in-3-college-age-americans-consider-payday-loans.html.

4. *See* Ctr. for Responsible Lending, *supra* note 3, at 12; Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* 21 (Vanderbilt Univ. Law Sch. Law & Economics, Working Paper No. 11–13, 2011) (finding that "barely approved" payday loan borrowers file for Chapter 13 bankruptcy at a higher rate than "barely rejected" payday loan applicants). *See generally* Katherine Porter, *The Damage of Debt*, 69 Wash. & Lee L. Rev. 979, 983 (2012) (describing the myriad non-financial harms that affect consumers with demandingly high debt loads).

II. The Background: Payday Lending

In recent years, payday lending has become a regular tool which low-income consumers use to address financial distress. Because it constitutes a high-cost option that can entrap borrowers in cycles of debt and hardship and is tempting only to those in desperate need of financial relief, payday loans are dangerous to borrowers.

Payday loans are identifiable by their short terms and high interest rates. According to the Consumer Financial Protection Bureau (CFPB), a typical payday loan is no more than a few hundred dollars over a two-week term.[5] Marketed as a means of helping people make it through unexpected financial difficulties between pay periods, payday loans carry interest rates often in excess of a 390% annual percentage rate (APR).[6] Loans typically require a balloon payment at maturity, meaning the borrower is responsible for repaying principal and interest all at once, rather than in small increments over time.[7]

Payday loans are also notable for how frequently borrowers are charged additional financing costs to extend their loan. Where borrowers cannot pay their initial loan in full, lenders offer them the ability to refinance with a second, new loan. This transaction, called a "rollover," is relatively common among borrowers: a 2014 study found that over 80% of payday loans are rolled over into another loan within 14 days.[8] The median borrower takes out ten loans over a twelve-month period.[9] At the more extreme end, over 10% of borrowers engaged in 20 such transactions over the course of a year.[10] Each time a borrower rolls over an existing loan, they rack up new financing charges, which can amount to more than the initial principal balance.[11] Borrowers that enter ten payday loan transactions over the course of a twelve-month period pay an average of $458 in fees.[12] In aggregate, loan rollovers cost borrowers an estimated $2.6 billion in fees annually.[13] The rollover loan isn't a bug; rather, it is one of the most profitable features of the payday

5. Consumer Fin. Prot. Bureau, Market Snapshot: Consumer use of State payday loan extended payment plans 2 (2022), https://files.consumerfinance.gov/f/documents/cfpb_market-snapshot-payday-loan-extended-payment-plan_report_2022-04.pdf.

6. Consumer Fin. Prot. Bureau, Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings 9 (2013) [hereinafter CFPB Payday Loans and Deposit Advance Products], https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

7. *Id.* at 6.

8. Consumer Fin. Prot. Bureau, CFPB Data Point: Payday Lending 4 (2014), https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

9. CFPB Payday Loans and Deposit Advance Products, *supra* note 6, at 22.

10. *Id.*

11. Bethany McLean, *Payday Lending: Will Anything Better Replace It?*, Atlantic (May 2016), https://www.theatlantic.com/magazine/archive/2016/05/payday-lending/476403/.

12. CFPB Payday Loans and Deposit Advance Products, *supra* note 6, at 22.

13. Susanna Montezemolo, Ctr. for Responsible Lending, Payday Lending Abuses and Predatory Practices 3 (2013), https://www.responsiblelending.org/sites/default/files/uploads/10-payday-loans.pdf.

lending business.[14] It perversely incentivizes payday lenders to find borrowers who can afford to pay an added fee at maturity, but not the full principal amount.[15]

Payday loans are aimed at society's most financially vulnerable. The median annual income for a payday loan customer is $26,167,[16] below the federal poverty line for a family of four.[17] This is particularly concerning because payday loans are also associated with a heightened risk of personal bankruptcy.[18] Even short of bankruptcy, loans can cause borrowers emotional harm, as they are often afflicted with feelings of guilt, shame, and hopelessness when they struggle to make ends meet.[19]

Also concerning is payday lending's disproportionate effect on people of color. Payday lenders are demonstrably more likely to be located in neighborhoods with higher concentrations of Black and Latino people.[20] Research shows that marketing materials published by payday loan companies are targeted to Black and Latino borrowers.[21] Black consumers are more than twice as likely to take out a payday loan compared to consumers of any other race.[22] This racial disparity persists even when one controls for income.[23] Similarly, two Native

---

14. *See* Leonhardt, *supra* note 3. The CEO of one payday lender even said that the purpose is to turn borrowers into repeat customers. McLean, *supra* note 11.

15. RICHARD CORDRAY, WATCHDOG: HOW PROTECTING CONSUMERS CAN SAVE OUR FAMILIES, OUR ECONOMY, AND OUR DEMOCRACY 202 (2020).

16. CFPB PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS, *supra* note 6, at 18.

17. U.S. Dept. of Health & Human Servs., *Poverty Guidelines* (Jan. 19, 2023), https://aspe.hhs.gov/poverty-guidelines (providing that the federal poverty line for a family of four is $30,000 as of January 2023).

18. Skiba & Tobacman, *supra* note 4, at 21.

19. *See* Elizabeth Sweet, Christopher W. Kuzawa & Thomas W. McDade, *Short-Term Lending: Payday Loans as Risk Factors for Anxiety, Inflammation and Poor Health*, 5 SSM – POP. HEALTH 114, 114 (2018) (finding an association between payday lending and a variety of negative health indicators); Pamela Foohey, *Debt's Emotional Encumbrances* 215, 221–23, EDWARD ELGAR RESEARCH HANDBOOK ON LAW AND EMOTION (2021) (surveying CFPB complaint narratives, and finding evidence of sadness and fear, including "discussions of how credit issues and disputes negatively impacted their personal well-being and harmed loved ones"); Deborah Thorne, *Women's Work, Women's Worry? Debt Management in Financially Distressed Families*, *in* BROKE: HOW DEBT BANKRUPTS THE MIDDLE CLASS 136, 136 (Katherine Porter ed., 2012) (highlighting the degree of stress that significant debts place on women in particular).

20. *See* WEI LI ET AL., CTR. FOR RESPONSIBLE LENDING, PREDATORY PROFILING: THE ROLE OF RACE AND ETHNICITY IN THE LOCATION OF PAYDAY LENDERS IN CALIFORNIA 2 (2009), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/predatory-profiling.pdf; URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, RACE MATTERS: CONCENTRATION OF PAYDAY LENDERS IN AFRICAN-AMERICAN NEIGHBORHOODS IN NORTH CAROLINA (2005), https://www.responsiblelending.org/research-publication/race-matters-concentration-payday-lenders-african-american-neighborhoods-0.

21. *See* Jim Hawkins & Tiffany C. Penner, *Advertising Injustices: Marketing Race and Credit in America*, 70 EMORY L.J. 1619, 1638–39 (2021); Ramenda Cyrus, *Predatory Lending's Prey of Color*, AM. PROSPECT (June 5, 2023), https://prospect.org/economy/2023-06-05-predatory-lendings-prey-of-color/ (describing how payday lending operations have come to "occupy a space left by traditional banking" by increasingly locating in underbanked Black and Latino neighborhoods).

22. MEHRSA BARADARAN, THE COLOR OF MONEY: BLACK BANKS AND THE RACIAL WEALTH GAP 261 (2017).

23. *See* PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 9 (Jul. 2012), https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf.

American writers have highlighted that, in New Mexico, payday lending stores are disproportionately located in close proximity to Reservations, "drain[ing] financial resources from individuals, families, and [their] communities, and caus[ing] great personal and financial turmoil."[24]

And yet, payday loans are poorly understood by their users. Borrowers do not comparison shop on the basis of price.[25] Consumers describe transactions in payday lending stores as disorienting and quick, giving them little time to consider their choice in the context of their budget; they note that their visits are devoid of processes usually used to determine whether a product is appropriate, such as credit checks or documentation requirements.[26] It is no wonder, then, that a recent study found that 40% of payday loan borrowers do not accurately assess their ability to pay back loans on time.[27]

Payday loans are a ubiquitous part of the consumer financial landscape. Small dollar lending was a mainstay of our financial system starting in the early 20th century, and has remained a tool for financially desperate people ever since.[28] But in light of historic levels of inequality, payday lending has taken on new significance: a 2022 Federal Reserve survey of American households found that 37% of Americans claimed that they would struggle to pay off an unexpected expense of $400, with 15% reporting that they would need to borrow or sell something to pay it.[29] Although only 2% of survey participants reported that they would cover an unexpected expense using a payday loan,[30] in practice, there are a massive number of payday loan borrowers: 19 million Americans borrow from payday lenders annually.[31] In 2018, there were around 23,000 payday lending stores open across America—nearly double the number of McDonald's franchises in operation across America.[32] Although there is some evidence of declining interest in payday loans,[33] consumer attraction to taking payday loans remains apparent.[34]

---

24. LaDonna Harris & Notah Begay III, Opinion, *Native Communities Need Legislative Action to End Predatory Lending*, CARLSBAD CURRENT ARGUS (Jan. 28, 2022), https://www.currentargus.com/story/opinion/columnists/2022/01/28/native-communities-need-legislative-action-end-predatory-lending/9257671002/.

25. McLean, *supra* note 11.

26. CTR. FOR RESPONSIBLE LENDING, *supra* note 3, at 8.

27. *See* Ronald Mann, *Assessing the Optimism of Payday Loan Borrowers*, 21 SUPP. CT. ECON. REV. 105, 129 (2014).

28. *See generally* ANNE FLEMING, CITY OF DEBTORS: A CENTURY OF FRINGE FINANCE (2018) (documenting the long history of payday lending in the New York area).

29. BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 2, at 31–33.

30. *Id.* at 33.

31. McLean, *supra* note 11.

32. Leonhardt, *supra* note 3.

33. FED. DEPOSIT INS. CORP., 2021 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 66 (Oct. 2022), https://www.fdic.gov/analysis/household-survey/2021report.pdf (showing that the percentage of both banked and unbanked households accessing payday loans has declined since 2017).

34. *See* Emily Stewart, *Americans are Falling Through the Safety Net. The Government is Helping Predatory Lenders Instead.*, VOX (Aug. 26, 2020, 10:00 AM), https://www.vox.com/policy-and-politics/2020/8/26/21401493/payday-loans-cfpb-occ-fdic-rent-bank-covid-19 (explaining how, as the federal

In spite of its risks, payday lending may very well continue to increase in scope and importance.[35] Under these circumstances, it is necessary to evaluate whether the payday lending regulatory system is working. The next section seeks to do just that.

III. Policing Payday Lending: A Case Study in "Whack-a-Mole" Regulation

Although several states have taken steps to limit the spread of payday lending, lenders themselves have found creative ways to frustrate states' efforts. This section explores how lenders are able to do this. First, this section looks towards high finance, highlighting the impact of dynamism—the financial system's fluidity and willingness to evolve in response to regulation. Then, this section explains how dynamism manifests itself in the payday loan industry to hamper regulatory efforts. The result is a frustrating game of regulatory "whack-a-mole," where lenders seek to avoid regulation by moving towards lightly-regulated jurisdictions and making small product modifications.[36]

A. Lessons from High Finance: Dynamism

To grasp why payday loans have proven so elusive to regulation, it is helpful to understand the concept of "dynamism" as it has been used to describe high finance. Although high finance is far-removed from payday lending, global financial regulatory failures shed light on the gaps in payday lending regulation by analogy. In their article, *Why Financial Regulation Keeps Falling Short*, Professors Daniel Awrey and Kathryn Judge explain why the immense effort expended on financial regulation has not quelled concerns about the financial system's systemic risk.[37] The authors highlight dynamism as one of the causes for regulatory failure.[38]

Dynamism refers to the fluidity of the financial system, and how it continues to evolve over time.[39] Awrey and Judge explore dynamism through a number of

---

government's emergency expansion of unemployment benefits phased out, Google searches for payday and installment loans increased, particularly in the American Southeast).

35. *See generally* California Dep't of Fin. Prot. & Innovation, 2022 Annual Rep. of Payday Lending Activity Under the California Deferred Deposit Transaction Law 6 (2023), https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/07/DFPI-Annual-Report-CDDTL-2022.pdf (showing that, although there was a dip in payday lending during the pandemic, the number of payday loans increased by more than 18% year-over-year in 2022 and are approaching pre-pandemic levels): *see also* Jody Godoy & Disha Raychaudhuri, *Californians Took Out 40% Fewer Payday Loans Amid Pandemic: Report*, Reuters (July 22, 2021), https://www.reuters.com/legal/transactional/californians-took-out-40-fewer-payday-loans-amid-pandemic-report-2021-07-22/ (highlighting that experts have suggested that lending could again increase after pandemic financial help from the federal government expires).

36. *See* Paul Kiel, *Whack-A-Mole: How Payday Lenders Bounce Back When States Crack Down*, ProPublica (Aug. 6, 2013, 9:00 AM) [hereinafter Kiel, *Whack-A-Mole*], https://www.propublica.org/article/how-payday-lenders-bounce-back-when-states-crack-down.

37. Dan Awrey & Kathryn Judge, *Why Financial Regulation Keeps Falling Short*, 61 B.C. L. Rev. 2295, 2299 (2020).

38. *See id.* at 2300–01.

39. *See id.* at 2302–03.

different lenses, but two are particularly noteworthy. One is "regulatory endogeneity," which refers to the way institutions constantly try to arbitrage regulation—either by sidestepping it or finding new locations with fewer regulatory burdens in which they can operate.[40] The other component of dynamism they identify is "innovation." This refers to how, through theoretical, technological, and market developments, finance accelerates product evolution.[41] The authors contrast regulatory endogeneity and innovation with the legislative process, which is slow and deliberative, ensuring that "finance moves faster than financial regulation."[42] Together, regulatory endogeneity and innovation ensure that efforts aimed at making the financial system safer often lead to pervasive regulatory arbitrage in a manner neither expected nor even contemplated by regulators.[43]

B. Dynamism in Payday Lending

While Awrey and Judge critique high finance and its regulation, payday loans are prone to the same type of dynamism that concerned them. As this section explores, dynamism in payday lending manifests itself through both regulatory endogeneity and innovation.

1. Regulatory Endogeneity: A Fifty-State Patchwork

The original sin of payday lending regulation is its decentralization. The Consumer Financial Protection Bureau (CFPB)—payday lending's natural regulator—is in a state of limbo caused by changes in presidential administrations and court challenges; no other agency has stepped up to the task. The lack of federal regulation pushes the onus of payday loan oversight onto the states, providing fertile ground for regulatory arbitrage.

As the federal agency empowered to protect consumers from potentially dangerous financial products, the CFPB is the ideal federal regulator for payday loans. The Bureau was created in the wake of the 2008 financial crisis and works "to ensure that existing consumer protection laws and regulations are comprehensive, fair, and vigorously enforced."[44] The CFPB's enabling legislation mandates that it "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."[45] In fact, the Consumer Financial Protection Act explicitly empowered the CFPB to supervise payday lenders.[46]

And the CFPB has already tried to convert this authority into action. In 2017, the Bureau promulgated a final rule, which was intended to regulate payday

40. *Id.* at 2304.

41. *Id.* at 2305–07.

42. *Id.* at 2321.

43. *See, e.g., id.* at 2329–37 (explaining the regulatory arbitrage in response to the Basel capital requirement regulations).

44. H.R. Rep. No. 111-517, at 874 (2010) (Conf. Rep. to Accompany H.R. 4173).

45. 12 U.S.C. § 5491.

46. *Id.* § 5514(a)(1)(E).

lending (the 2017 Rule).[47] In its preamble to the 2017 Rule, the CFPB highlights many of the problems identified in Section II: consumers overestimate their ability to repay, frequently re-borrow the loans, and default with high frequency.[48] To combat this problem, the CFPB used its authority under the Consumer Financial Protection Act to make it "an unfair and abusive practice for a lender to make covered short-term loans or covered longer-term balloon-payment loans without reasonably determining that the consumers will have the ability to repay the loans according to their terms."[49] Specifically, CFPB required that lenders must determine that consumers are able to make all loan payments, meet all major financial obligations, and pay for basic living expenses without needing to re-borrow over the ensuing thirty days.[50] The 2017 Rule also prohibited payday lenders from attempting to collect money from an account where two prior collection attempts have failed for insufficient funds, and provided for certain mandatory disclosures that must be made to the consumer when the loan is originated.[51]

However, changing political winds stopped this regulatory effort. After the CFPB finalized the 2017 Rule but before it was implemented, President Trump named Mick Mulvaney as interim head of the Bureau.[52] Shortly thereafter, Mulvaney joined an industry trade group's motion to stay implementation of the Bureau's 2017 Rule,[53] and a District Court in Texas obliged.[54] As a result, consumers never benefitted from its provisions. Then, in 2020 the CFPB promulgated a revision to the rule, revoking the portions of the 2017 Rule requiring lenders to assess borrowers' ability to repay the loan.[55]

---

47. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

48. *Id.* at 54554–55.

49. *Id.* at 54584, 54874 (providing the new text for 12 C.F.R. § 1041.4).

50. *Id.* at 54473; *see also id.* at 54875 (detailing the requirements of 12 C.F.R. § 1041.5).

51. *Id.* at 54473, 54882.

52. Chris Arnold, *Under Trump Appointee, Consumer Protection Agency Seen Helping Payday Lenders*, NPR (Jan. 24, 2018, 10:12 AM), https://www.npr.org/2018/01/24/579961808/under-trump-appointee-consumer-protection-agency-seen-helping-payday-lenders/.

53. Stacy Cowley, *Mulvaney Sides with Payday Lenders Asking Court to Block Restrictions*, N.Y. Times (June 5, 2018), https://www.nytimes.com/2018/06/05/business/cfpb-payday-lenders-mulvaney.html.

54. Cmty. Fin. Servs. Ass'n of Am., Ltd. v. Consumer Fin. Prot. Bureau, No. A-18-CV-0295-LY, 2018 WL 6252409 at *2 (W.D. Tex. Nov. 6, 2018).

55. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 85 Fed. Reg. 44382 (Jul. 22, 2020) (to be codified at 12 C.F.R. pt. 1041) ("[T]he Bureau is revoking provisions of those regulations that: Provide that it is an unfair and abusive practice for a lender to make a covered short-term or longer-term balloon-payment loan, including payday and vehicle title loans, without reasonably determining that consumers have the ability to repay those loans according to their terms; prescribe mandatory underwriting requirements for making the ability-to-repay determination; exempt certain loans from the mandatory underwriting requirements; and establish related definitions, reporting, recordkeeping, and compliance date requirements."). Note, however, that this effort was followed by whistleblower allegations of data manipulation and a lack of careful consideration, which provide fodder for the legal challenges to the repeal. *See* Nicholas Confessore & Stacy Cowley, *Trump Appointees Manipulated Payday Lending Research, Ex-Staffer Claims*, N.Y. Times (Apr. 29, 2020), https://www.nytimes.com/2020/04/29/business/cfpb-payday-loans-rules.html; Complaint for Declaratory and Injunctive Relief,

Although the Biden Administration was expected to revisit the rulemaking,[56] it is unclear whether and to what extent this will be possible. In 2021, the CFPB's leadership indicated its desire to revert to the 2017 standard.[57] But in 2022, the Fifth Circuit vacated what remained of the 2017 Rule in a challenge brought by a payday lending industry trade group on the grounds that the CFPB's structure violated the Constitution's Appropriations Clause.[58] The Fifth Circuit highlighted that the CFPB does not rely on periodic Congressional appropriations; rather it receives funding directly from the Federal Reserve, which then holds CFPB funding in its own account, outside the appropriations process. [59] This, the Court held, violated the Appropriations Clause of the Constitution, and the unconstitutional funding mechanism is what allowed the CFPB to promulgate the 2017 Rule.[60] As a result, the Fifth Circuit vacated the 2017 Rule.[61] The Supreme Court has granted certiorari to decide whether the Fifth Circuit properly invalidated and vacated the 2017 Rule in the October 2023 Term.[62] Until then, the CFPB's ability to enforce what remains of the 2017 Rule as well as any attempt to correct or tighten payday lending regulation, hangs precariously in the balance. Even if the CFPB successfully fends off this latest challenge, rulemaking is a lengthy process: the original payday lending rule took years to draft, after staff spent years on data collection.[63]

Nat'l Ass'n for Latino Comty. Asset Builders v. Consumer Fin. Prot. Bureau, 581 F. Supp. 3d 101 (D.D. C. 2022) (No. 1:20-cv-03122) (arguing that the repeal of the 2017 rule was arbitrary and capricious).

56. Greg Iacurci, *What a Biden Presidency May Mean for Consumer Protections*, CNBC (Nov. 10, 2020, 9:54 AM), https://www.cnbc.com/2020/11/10/what-a-biden-presidency-may-mean-for-consumer-protections.html ("A new CFPB director would likely . . . seek to rewrite certain rules like one around payday lending, according to consumer advocates."); Greg Iacurci & Annie Nova, *Covid, Payday Loans, Student Debt—Here are the Issues Biden's Consumer Bureau May Tackle*, CNBC (Jan 30, 2021, 10:25 AM), https://www.cnbc.com/2021/01/30/bidens-cfpb-priorities-covid-payday-loans-and-student-debt.html (former CFPB official Patricia McCoy explaining that she would be "shocked" if the Biden Administration did not get rid of the Trump-era payday lending rule changes); David Baumann, *CFPB Continuing Payday Rulemaking Despite Likely Biden Shakeup*, CREDIT UNION TIMES (Nov. 13, 2020, 12:57 PM), https://www.cutimes.com/2020/11/13/cfpb-continuing-payday-rulemaking-despite-likely-biden-shakeup/(noting that members of Biden's CFPB transition team criticized the payday lending rule).

57. *See* Dave Uejio, *Our Commitment to Protecting Vulnerable Borrowers*, CONSUMER FIN. PROT. BUREAU BLOG (Mar. 23, 2021), https://www.consumerfinance.gov/about-us/blog/our-commitment-to-protecting-vulnerable-borrowers/("The Bureau continues to believe that ability to repay is an important underwriting standard. To the extent small dollar lenders' business models continue to rely on consumers' inability to repay, those practices cause harm that must be addressed by the CFPB."); Katanga Johnson & Pete Schroeder, *U.S. Consumer Watchdog Eyeing Big Tech, Lending Competition as Recovery Unfolds—Testimony*, REUTERS (Oct. 26, 2021), https://www.reuters.com/business/us-consumer-watchdog-eyeing-big-tech-lending-competition-recovery-unfolds-2021-10-26/ ("Chopra's expansive agenda at the CFPB will also include revisiting several major rule easing ushered through under Republican leadership, particularly around . . . payday lending.").

58. Community Fin. Servs. Ass'n of Am. v. Consumer Fin. Prot. Bureau, 51 F.4th 616, 623 (5th Cir. 2022).

59. *Id.*

60. *Id.* at 635–642.

61. *Id.* at 643.

62. Consumer Fin. Prot. Bureau v. Community Fin. Servs. Ass'n of Am., No. 22-448 (S. Ct. Feb. 27, 2023).

63. CORDRAY, *supra* note 15, at 198–204.

And, whatever new payday lending rule results from CFPB rulemaking process started anew would likely be mired in litigation. Consequently, the slow pace of such efforts forecloses hopes of near-term relief.

The Federal Trade Commission (FTC), while capable of policing the payday lending business, plays a limited role in its regulation. The Commission is tasked with protecting consumers from "unfair or deceptive acts or practices in or affecting commerce."[64] The FTC shares jurisdiction to enforce key statutes affecting payday lending with the CFPB, such as the Fair Debt Collection Practices and Military Lending Acts.[65] In theory, this mandate could permit the Commission to engage in rulemaking.[66] But it is unclear whether the FTC has sufficient statutory authority to promulgate and enforce comprehensive payday lending regulation.[67] Instead, the FTC focuses on enforcement efforts related to illegal debt collection activity.[68] Often this mandate overlaps with payday lending, allowing the Commission to pursue lenders engaged in egregious collection activity[69] or propagating deceptive loan documentation.[70] While policing inadequate loan disclosures and illegal collection activity is undoubtedly necessary, it skirts the real problem with payday loans: their immiserating effect on poor consumers when they work as intended.

---

64. 15 U.S.C. § 45(a).

65. *See* Joseph J. Simons, Chairman, Fed. Trade Comm'n, & Kathleen L. Kraninger, Director, Consumer Fin. Prot. Bureau, *Memorandum of Understanding Between the Consumer Financial Protection Bureau and the Federal Trade Commission* (Feb. 25, 2019), https://www.ftc.gov/system/files/documents/cooperation_agreements/ftc-cfpb_mou_225_0.pdf.

66. *See* Trade Regulation Rule; Credit Practices, 49 Fed. Reg. 7740, 7789 (Mar. 1, 1984) (to be codified at 16 C.F.R. pt. 444) (a rule promulgated under FTC's unfair and deceptive practices authority, and last updated 40 years ago, prohibiting the use of certain terms in consumer credit contracts).

67. C*onsumer Credit and Debt: The Role of the Federal Trade Commission in Protecting the Public: Hearing Before the Subcomm. on Com., Trade, & Consumer Prot. of the H. Comm. on Energy & Com.*, 111th Cong. 63 (2009) (in response to the question, "Does the FTC have authority to crack down on pay-day lending practices such as rollover fees and the specific statutory language leading to direct the Commission to adequately deal with certain abusive payday lending features?" then-FTC Chairman Jon Leibowitz answered, "yes and no." He elaborated that the FTC had brought cases regarding hidden fee arrangements but asked for additional statutory authorization to "promulgate rules that would require better behavior by a lot of the pay-day lenders.").

68. *See Division of Financial Practices*, FED. TRADE COMM'N (last visited Jan. 15, 2024), https://www.ftc.gov/about-ftc/bureaus-offices/bureau-consumer-protection/our-divisions/division-financial-practices (highlighting the agency's efforts to curb deceptive, unfair, and abusive debt collection activity).

69. *See, e.g.,* Fed. Trade Comm'n v. Payday Fin. LLC, Complaint at ¶¶31–47, 989 F. Supp. 2d 799 (D.S.D. 2013) (alleging illegal wage garnishment); Fed. Trade Comm'n v. LoanPointe, LLC, No. 2:10–CV–225DAK, 2011 WL 4348304 *4–6 (D. Utah 2011), *aff'd*, 525 F. App'x 696, 698 (10th Cir. 2013) (alleging that the defendants were able to garnish wages without a court order).

70. *See* Fed. Trade Comm'n v. AMG Servs., Inc., 29 F. Supp.3d 1338, 1351 (D. Nev. 2014), *rev'd on other grounds*, 141 S. Ct. 1341 (2021) (finding that a lender's standard disclosure forms were deceptive to a borrower acting reasonably, in violation of the Federal Trade Commission Act); Fed. Trade Comm'n v. Direct Benefits Grp., LLC, No. 6:11–cv–1186–Orl–28TBS, 2013 WL 3771322 at *14–*18 (M.D. Fla. Jul. 18, 2013) (finding that a confusing payday loan contracting process was unfair and deceived consumers).

Even if the FTC were to more actively regulate payday lending, the Supreme Court has recently hemmed in its statutory enforcement powers, limiting its efficacy in preventing consumer harms. In *AMG Capital Management LLC v. FTC*, the Supreme Court held that § 13(b) of the FTC Act—which the Commission traditionally used to redress consumer harms—does not permit the Commission to seek equitable monetary relief such as disgorgement.[71] This result has very directly curtailed the Commission's ability to enforce the law and provide consumers with effective monetary relief.[72] Moreover, this ruling merely foreshadows more existential legal challenges for the FTC. In *Axon Enterprise, Inc. v. FTC*, the Supreme Court held that a district court had jurisdiction to hear a challenge to the constitutionality of the Commission's enforcement powers, even while the case was pending before an administrative law judge.[73] The decision portends future threats to the constitutionality of the FTC's enforcement program.[74] But even if the Commission is not entirely stripped of its power, the Court's decision could mire the Commission in pre-enforcement litigation.[75]

While the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of Currency (OCC), Federal Reserve Board of Governors (the Fed), and National Credit Union Administration (NCUA) are nominally consumer financial regulators, their ultimate responsibility is supervision of the banking system to ensure its safety and soundness.[76] Traditionally, payday loans are not originated by banks, which worry about the prospect of unwanted future regulatory

---

71. AMG Capital Management v. FTC, 141 S. Ct. 1341, 1344 (2021).

72. *See* Press Release, FTC Issues Annual Report on Refunds to Consumers; Agency Returned $392M in 2022 (June 6, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/06/ftc-issues-annual-report-refunds-consumers-agency-returned-392m-2022 (noting that in 2022, the money the FTC returned to consumers sharply declined relative to previous years and was likely to decline further once it finishes distributing consumer redress ordered before the *AMG* ruling).

73. Axon Enterprise, Inc. v. FTC, 598 U.S. ___ (2023).

74. Matthew Perlman, *FTC's Existential Threat Inches Closer to Reality*, LAW360 (Apr. 14, 2023, 9:44 AM), https://www.law360.com/articles/1597183/ftc-s-existential-threat-inches-closer-to-reality.

75. Ronald Mann, *Court Approves Early challenge to Agency Proceedings*, SCOTUSBLOG (Apr. 14, 2023, 6:05 PM), https://www.scotusblog.com/2023/04/supreme-court-approves-early-challenge-to-federal-agency-proceedings/.

76. *Mission, Vision, and Values*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/about/strategic/strategic/mission.html (last visited Apr 28, 2020) ("The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress to maintain stability and public confidence in the nation's financial system by . . . [e]xamining and supervising financial institutions for safety and soundness and consumer protection"); *Who We Are*, OFF. OF THE COMPTROLLER OF THE CURRENCY, https://www.occ.treas.gov/about/who-we-are/index-who-we-are.html (last visited Apr. 28, 2020) ("The OCC charters, regulates, and supervises all national banks, federal savings associations, and federal branches and agencies of foreign banks."); *About the Fed*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., https://www.federalreserve.gov/aboutthefed.htm (last visited June 19, 2023) (explaining that the Fed performs *five* functions, including 1) "promot[ing] the stability of the financial system and seeks to minimize and contain systemic risks"; 2) "promot[ing] the safety and soundness of individual financial institutions"; and 3) "promot[ing] consumer protection and community development through consumer-focused supervision and examination"); *Mission and Values*, NAT'L CREDIT UNION ADMIN., https://ncua.gov/about/mission-values (last visited June 19, 2023) (explaining that the NCUA's mission is "[p]rotecting the system of cooperative credit and its member-owners through effective chartering, supervision, regulation, and insurance").

attention.[77] There is some evidence this paradigm is shifting: a growing number of banks and credit unions are beginning to offer payday loan alternatives at lower prices than traditional payday lenders.[78] During the Trump Administration, national bank regulators were increasingly involved in policies that would remove regulation from payday lending.[79] Critics argue that this will not make consumers safer from predatory banking products as banking regulators are more interested in ensuring bank soundness than consumer safety.[80] Further, even if banks continue their foray into payday lending, a significant segment of the market are non-banks that lie outside of the banking regulators' jurisdiction. Consequently, national banking regulators are not likely to craft or enforce rules against payday lending.

In summary, payday lending exploits a hole in the federal government's regulatory system. While the CFPB may eventually return to fill the void, its absence leaves most regulation to the states.[81]

In this daunting regulatory task, states are not helpless—they can use a variety of tools to attempt to control payday loans. For example, states can impose usury laws, which cap the allowable interest rate on a loan. Indeed, such interest rate restrictions have biblical origins, and have been a part of American law since

---

77. *See* Claire Williams, *Regulators Weigh Opening Up Banks to Small-Dollar Lending Amid Pandemic*, MORNING CONSULT (Mar. 19, 2020 5:29 p.m.), https://morningconsult.com/2020/03/19/regulators-weigh-opening-up-banks-to-small-dollar-lending-amid-pandemic/.

78. *See* Megan Leonhardt, *Banks May Soon Offer Americans More Loan Options–Here's What Experts Say You Need to Know Before Borrowing*, CNBC (Mar. 27, 2020, 4:01 PM), https://www.cnbc.com/2020/03/27/americans-may-soon-have-more-loan-options-heres-what-to-know.html (explaining that in 2018, U.S. Bank began originating its "Simple Loan" product—a short term loan intended to compete with payday products); Alex Horowitz & Gabriel Kravitz, *Six of the Eight Largest Banks Now Offer Affordable Small Loans*, PEW CHARITABLE TRUSTS (Feb. 27, 2023), https://www.pewtrusts.org/en/research-and-analysis/articles/2023/01/24/six-of-the-eight-largest-banks-now-offer-affordable-small-loans (noting that banks comprising 23% of all branches in the United States offer short-term consumer loans at rates fifteen times lower than traditional payday lenders); Alex Horowitz & Chase Hatchett, *Credit Union Small-Dollar Loan Volume Hit New High in 2022*, PEW CHARITABLE TRUSTS (Apr. 7, 2023), https://www.pewtrusts.org/en/research-and-analysis/articles/2023/03/31/credit-union-small-dollar-loan-volume-hit-new-high-in-2022 (explaining that credit unions had originated $227 million in "payday alternative loans," a record high and a 30% increase over the previous record, which was set in 2019). *But see* Christopher K. Odinet, *Consumer Bitcredit and Fintech Lending*, 69 ALA. L. REV. 781, 801 (2018) (noting that the trend among banks of all sizes is to offer fewer consumer financial products at a higher price due to the cost of complying with the regulatory burdens of post-financial crisis legislation).

79. During the Trump administration, the FDIC and OCC seemed increasingly determined to promulgate rules that would have major impacts on the payday loan industry. *See infra* note 118.

80. *See, e.g.,* Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 330–31 (2013). *See also* Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 152–55 (2009) (noting that the OCC devoted relatively limited resources to consumer protection relative to the task of supervising banks for safety and soundness concerns).

81. *But see* 10 U.S.C. § 987(b) (The Military Lending Act capped the annual percentage rate chargeable to active-duty military, their spouses, and their dependents at 36%).

before the Constitution was ratified.[82] States can prohibit payday lending.[83] States can limit the number of times a borrower can rollover their loan.[84] They can also deregulate payday lending, in hopes that competition will lower prices.[85]

With such a variety of options at their disposal, state regulation of payday loans is inconsistent, ranging from comprehensive to almost nonexistent. Eighteen states plus the District of Columbia have enacted outright prohibitions on payday lending.[86] On the other hand, some states—Utah, for example—cap neither the loan amount nor the interest rate for payday loans.[87] This variability between states creates an opportunity for jurisdictional arbitrage: where one state attempts to restrict payday loans, lenders can successfully escape regulation by submitting themselves to a more permissive state's regulation. As explained in the following sections, lenders possess a variety of tools to successfully arbitrage the regulatory regime: they can move online, operate on Indian tribal lands, compel arbitration to shelter contracts from state court scrutiny, and partner with federally-regulated banks.

a. Online Lending

First, where state and local regulation forces physical stores to close or reduces their profit margins, lenders move online. Internet payday lenders do so by setting down a home base somewhere with permissive lending laws.[88] Then, they aggressively market their products to consumers in more highly regulated areas,[89] specifying that the lawfulness of the loan is governed by the lender's

---

82. Mehrsa Baradaran, *Credit, Morality, and the Small-Dollar Loan*, 55 HARV. C.R.–C.L. L. REV. 63, 69–71 (2020) (highlighting both the ancient origin of usury laws, and the early adoption of usury limits in American states).

83. *How Well Does Your State Protect Payday Loan Borrowers?*, PEW CHARITABLE TRUSTS (July 26, 2022), https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2022/how-well-does-your-state-protect-payday-loan-borrowers.

84. Paul Kiel, *How One State Succeeded in Restricting Payday Loans*, PROPUBLICA (Aug. 6, 2013, 9:00 AM) [hereinafter Kiel, *How One State Succeeded*], https://www.propublica.org/article/how-one-state-succeeded-in-restricting-payday-loans (highlighting that in the states of Washington and Delaware, borrowers are only permitted to reborrow their loans a certain number of times per year, which functions as a rollover cap).

85. *See How Well Does Your State Protect Payday Loan Borrowers?*, *supra* note 83.

86. *Id.* (noting that Arizona, Arkansas, Connecticut, Georgia, Illinois, Maryland, Massachusetts, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, Pennsylvania, South Dakota, Vermont, West Virginia, and the District of Columbia have all prohibited payday lending or set a low maximum interest rate).

87. Heather Morton, *Payday Lending State Statutes*, NAT'L CONF. OF STATE LEGISLATURES (Feb. 28, 2023), http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx. *See also How Well Does Your State Protect Payday Loan Borrowers?*, *supra* note 83.

88. Christopher K. Odinet, *Predatory Fintech and the Politics of Banking*, 106 IOWA L. REV. 1739, 1777-78 (2021).

89. *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54487 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041); JEAN ANN FOX & CATHERINE B. BOURKE, CONSUMER FED'N OF AM., SURVEY OF ONLINE PAYDAY LENDING WEBSITES 7 (Aug. 2011), https://consumerfed.org/pdfs/CFAsurveyInternetPaydayLoanWebsites.pdf. *See, e.g.*, Kiel, *Whack-A-Mole*, *supra* note 36 (discussing how payday lenders circumvented a Dallas ordinance through online marketing).

location.[90] A survey by the Consumer Federation of America revealed that borrowers sometimes pay an interest rate above the legal limit in their state of residence.[91] Beyond simply evading local payday lending restrictions, online lending also appeals to consumer preferences by using a social media aesthetic.[92] Especially when online lending is paired with a strategic banking partnership, payday lenders can reach consumers where their physical presence would be otherwise illegal.[93]

b. Tribal Immunity

Second, lenders sometimes move their operations to Indian reservations to claim tribal sovereign immunity. Common law immunity from suit is a core component of an Indian tribe's sovereignty.[94] Payday lenders capitalize on this, partnering with Indian tribes and attempting to cloak themselves in the tribes' immunity from civil liability.[95] Lenders then can use tribal immunity as a shield from suit under state usury law.[96] As of 2014, thirty tribes engaged in online payday lending, constituting a quarter of the payday loan industry.[97] Practically speaking, courts have greeted these arrangements skeptically, repeatedly refusing to grant lenders tribal immunity.[98] Most recently, in *Lac du Flambeau Bank of Lake Superior Chippewa Indians v. Coughlin*, the Supreme Court held that the Bankruptcy Code abrogates Indian tribes' sovereign immunity, allowing payday loan debtors to hold tribes accountable for attempting to collect a debt in violation of the automatic stay provided to them at the outset of their bankruptcy case.[99]

---

90. Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 854, 869 (2007).

91. JEAN ANN FOX & ANNA PETRINI, CONSUMER FED'N OF AM., INTERNET PAYDAY LENDING: HOW HIGH-PRICED LENDERS USE THE INTERNET TO MIRE BORROWERS IN DEBT AND EVADE STATE CONSUMER PROTECTIONS, 22 (Nov. 30, 2004), https://consumerfed.org/elements/www.consumerfed.org/file/finance/Internet_Payday_Lending113004.PDF.

92. Odinet, *Predatory Fintech*, *supra* note 88, at 1754.

93. Odinet, *Consumer Bitcredit*, *supra* note 78, at 790–92. *See also infra* Section III.B.1.d.

94. Michigan v. Bay Mills Indian Cmty., 572 U.S. 782, 788 (2014) (quoting Santa Clara Pueblo v. Martinez, 436 U.S. 49, 98 (1978)).

95. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54487 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041). *See, e.g.*, Gabrielle Crofford, *Selling Sovereignty: How Corporations Used Tribal Sovereign Immunity to Evade Regulation and Exploit Consumers*, [F] LAW (July, 29, 2022), https://theflaw.org/articles/selling-sovereignty-how-corporations-used-tribal-sovereign-immunity-to-evade-regulation-and-exploit-consumers/ (former Montana Office of Consumer Protection investigator describing how complaints directed to lenders would garner a response from tribes claiming immunity from local law and that the loans are governed "by all applicable federal law and the laws and lending codes enacted by the Tribe's Federally recognized sovereign government.").

96. FOX & BOURKE, *supra* note 89, at 4.

97. Julia Harte & Joanna Zuckerman Bernstein, *Payday Nation: When Tribes Team Up with Payday Lenders, Who Profits?*, AL JAZEERA AM. (June 17, 2014), http://projects.aljazeera.com/2014/payday-nation/.

98. *See, e.g.,* Gingras v. Think Finance, Inc., 922 F.3d 112, 124 (2d Cir. 2019); Consumer Fin. Prot. Bureau v. Great Plains Lending, LLC, 846 F.3d 1049, 1050 (9th Cir. 2017); Fed. Trade Comm'n v. AMG Servs., Inc. No. 2:12–CV–00536–GMN, 2013 WL 7870795 at *22–3 (D. Nev. Jul. 16, 2013). *But see* Williams v. Big Picture Loans, LLC, 929 F.3d 170, 174 (4th Cir. 2019) (granting a tribal lender sovereign immunity); Breakthrough Mgmt. v. Chukchansi Gold Casino & Resort, 629 F.3d 1173, 1177, 1186 (10th Cir. 2010).

99. 599 U.S. 382, 382–387 (2023).

But, this sovereign immunity argument provides payday lenders a plausible justification for skirting regulation, or at the very least, a means to mire consumers attempting to unravel the relationship between the tribe and the lender in litigation.[100]

c. Arbitration

Payday lenders also include clauses compelling arbitration in payday loan contracts, forcing consumers to adjudicate claims away from the watchful eyes of state courts. In arbitration, parties agree to settle disputes before a neutral third party rather than a court.[101] A CFPB study indicates that nearly all payday loans have arbitration clauses in their standard contracts.[102] Although the venue should not necessarily affect the outcome, CFPB data indicates that arbitrators seldom rule for consumers.[103] So, effectively, arbitration clauses prevent consumers from challenging payday lenders' malfeasance.[104] Courts have often refused to compel payday lenders' arbitration agreements.[105] But like tribal and online lending arrangements, arbitration clauses increase uncertainty about where a borrower can go to redress the harm caused by their payday loan and lenders can use them to evade state court review.

d. Rent-A-Bank

Finally, payday lenders partner with banks to originate loans in what has been called a "Rent-A-Bank" arrangement,[106] where payday lenders use federal preemption paired with strategic partnerships to their advantage. In *Marquette First National Bank of Minneapolis v. First of Omaha Service Corporation*, the Supreme Court found that the National Banking Act preempts state usury laws when applied to federally chartered banks.[107] Then, two years later, Congress

---

100. *See, e.g.,* Solomon v. Am. Web Loan, 375 F. Supp. 3d 638, 657 (E.D. Va. 2019) (highlighting the extensive legal process required to determine whether a tribe was entitled to sovereign immunity in a payday lending case).

101. Imre Stephen Szalai, *The Prevalence of Consumer Arbitration Agreements by America's Top Companies*, 52 U.C. Davis L. Rev. Online 233, 235 (2019).

102. Consumer Fin. Prot. Bureau, Arbitration Study § 2, at 22 (2015), https://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

103. *See id.* at 12 (highlighting that during a two-year period, of the 341 disputes resolved by an arbitrator with results that CFPB was able to ascertain, only 32 were decided in favor of consumers). *See also* Jessica Silver-Greenberg & Michael Corkey, *In Arbitration, a 'Privatization of the Justice System'*, N.Y. Times (Nov. 1, 2015), https://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html (describing cases where arbitrators found for a business despite overwhelming contrary evidence).

104. Comment, *Third Circuit Rules that Tribal Payday Lenders Cannot Compel Arbitration: Williams v. Medley Opportunity Fund II, LP, 965 F.3d 229 (3d Cir. 2020)*, 134 Harv. L. Rev. 2582, 2586 (2021).

105. *See, e.g.*, Williams v. Medley Opportunity Fund II, LP, 965 F.3d 229, 233 (3d Cir. 2020); Gingras v. Think Finance, Inc., 922 F.3d 112, 124 (2d Cir. 2019); Brewer v. Mo. Title Loans, Inc., 364 S.W.3d 486, 487 (Mo. 2012) (refusing to compel arbitration). *But see* Brice v. Haynes Investments, LLC, 13 F.4th 823, 825 (9th Cir. 2021) (compelling an arbitration of claims made by a payday loan borrower).

106. *See, e.g., The Rent-A-Bank Scheme,* Ctr. for Responsible Lending (Dec. 5, 2023), https://www.responsiblelending.org/research-publication/rent-bank-scheme.

107. 439 U.S. 299, 301 (1978).

passed the Depository Institutions Deregulation and Monetary Control Act, which allowed federally-insured state-chartered banks to export interest rates beyond state boundaries.[108] Collectively, these developments allow federally-chartered banks regulated by the OCC and federally-insured state-chartered banks regulated by the FDIC to locate in states without usury caps, and lend nationally without fear of local usury litigation.[109] They also allows banks to skirt a variety of other local lending regulations governing fees and non-real estate lending.[110]

Payday lenders take advantage of this legal landscape by partnering with banks: a bank nominally originates loans, even though the payday lender facilitates the transaction.[111] Then, the bank will sell the loan it just originated on the payday lender's behalf to the payday lender.[112] This arrangement gives payday lenders a federal preemption shelter from state usury caps.[113]

The legality of Rent-A-Bank is admittedly dubious. Federal law requires scrutinizing which entity holds an economic interest in the loan.[114] The FDIC, OCC, and state attorneys general brought enforcement actions against banks to disrupt Rent-A-Bank arrangements and enforce state usury laws in the early 2000s.[115] As recently as 2015, the FDIC updated its guidelines on payday lending in an expression of continued apprehension towards the practice.[116] A Second Circuit decision, *Madden v. Midland Funding, LLC*, further complicated such relationships, holding that when a national bank loan made above a state usury

108. Odinet, Predatory Fintech, *supra* note 88, at 1777.

109. *See, e.g.*, HERMA HILL KAY ET AL., CONFLICT OF LAWS: CASES – COMMENTS – QUESTIONS 113 (10th ed. 2018) (explaining that Citibank relocated its credit card business to South Dakota because the state had no usury cap).

110. *See* Levitin, *Hydraulic Regulation*, *supra* note 80, at 166 (describing the preemptive power of OCC regulations authorized under the National Banking Act while noting that the Supreme Court has not yet ruled on this matter).

111. *See, e.g.*, Cross-Complaint For: (1) Violation of the California Financing Law; (2) Violation of the California Consumer Financial Protection Law ¶¶ 2–6, Opportunity Fin., LLC v. Hewlett (Cal. Super. Ct. Sept. 30, 2022) (No. 22STCV08163), https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2022/04/1483000-1483486-civil-action-opportunity-financial-llc-cross-complaint.pdf (alleging that Opportunity Finance was responsible for marketing, underwriting, and servicing loans made to consumers from its website, but that all loans were funded by FinWise Bank, a Utah-chartered bank).

112. Alex Horowitz & Chase Hatchett, *Rent-a-Bank Payday Loans Have Highest Loss Rates in Banking System*, PEW CHARITABLE TRUSTS (June 23, 2022), https://www.pewtrusts.org/en/research-and-analysis/articles/2022/06/23/rent-a-bank-payday-loans-have-highest-loss-rates-in-banking-system.

113. Mann & Hawkins, *supra* note 90, at 872.

114. Levitin, *Hydraulic Regulation*, *supra* note 80, at 187–89 (demonstrating that courts analyzed the respective economic interests of the bank and non-bank entities to determine whether preemption was appropriate); Ctr. for Responsible Lending, *The OCC and FDIC Plan to Trample State Laws by Gutting the Longstanding "True Lender" Doctrine* (Aug. 10, 2020), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-gutting-true-lender-rule-10aug2020.pdf.

115. Mann & Hawkins, *supra* note 90, at 872-73; Levitin, *Hydraulic Regulation*, *supra* note 80, at 187–89*; see also* FLEMING, *supra* note 28, at 243.

116. *See* Fed. Deposit Ins. Corp., *Guidelines for Payday Lending* (Nov. 2015), https://www.fdic.gov/news/news/financial/2005/fil1405a.html.

cap is subsequently sold to a non-bank, it sheds the protection of federal banking law.[117] If left undisturbed,[118] *Madden* would threaten the viability of Rent-A-Bank arrangements in tightly-regulated jurisdictions.

Still, partnerships between payday lenders and banks continue. Several payday lenders are already considering or engaging in Rent-A-Bank relationships with federally regulated banks.[119] These arrangements appear to be crafted to avoid the preemption issues encountered by their predecessors in the early 2000s: payday lenders cede some marketing and underwriting control, and allow the banks to keep the loans on their books (even as the payday lenders purchase a 90% share in its economic risk).[120] Litigation over such partnerships will be the next test for efforts to stem jurisdictional arbitrage by payday lenders.[121]

Because there is no comprehensive federal payday lending regulation, each state must craft its own. This allows lenders to arbitrage state regulations by lending online, seeking partnerships with Indian tribes, compelling private arbitration, and partnering with federally-regulated banks. As in the world of high finance, regulatory arbitrage allows payday lenders to avoid compliance with the most demanding aspects of local regulation.

---

117. 786 F.3d 246, 247 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016).

118. The OCC has already tried to reverse *Madden*. Late in the Obama Administration, the OCC argued that *Madden* was wrongly decided. *See* Brief for the United States as Amicus Curiae at 6, Midland Funding LLC v. Madden, 136 S. Ct. 2505 (2016). The OCC then promulgated a rule during the Trump Administration that instructs courts to look at which entity is formally the lender in loan paperwork or funds the loan. *See* National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68742 (Oct. 30, 2020) (to be codified at 12 C.F.R. pt. 7). But Congress reversed the OCC's rule early in the Biden Administration using the Congressional Review Act. *See* Ken Sweet, *Congress Repeals Trump-Era Regulation on Payday Lenders*, AP NEWS (June 24, 2021), https://apnews.com/article/joe-biden-government-and-politics-business-820c0c14948d84deb274ff75da692345.

119. *See* NAT'L CONSUMER L. CTR., PAYDAY LENDERS PLAN TO EVADE CALIFORNIA'S NEW INTEREST RATE CAP THROUGH RENT-A-BANK SCHEMES (Oct. 2019), https://apnews.com/article/joe-biden-government-and-politics-business-820c0c14948d84deb274ff75da692345 (providing call transcripts showing that MetaBank, a FDIC-regulated state bank, discussing partnering with CURO Group Holdings Corp., a payday lender, to avoid compliance with California's newly-passed rate cap, and Elevate Credit, Inc. and Enova International, Inc. pursuing similar strategies). *See also* Jean Eaglesham et al., *'Rent-a-Banks' Defy States' Growing Efforts to Curb High-Cost Lending*, WALL ST. J. (Mar. 11, 2020, 5:30 AM), https://www.wsj.com/articles/rent-a-banks-defy-states-growing-efforts-to-curb-high-cost-lending-11583435510 (citing a similar strategy pursued by OppLoans in partnership with FinWise Bank to escape California's rate cap).

120. *See* Odinet, *Consumer Bitcredit*, *supra* note 88, at 1764–65 (highlighting the relationships between Elevate Credit, a fintech company originating high-interest payday loans, and Republic and FinWise Banks).

121. *See, e.g.*, Mindy Harris & Ronal K Vaske, *California DFPI is Wrong on Both Law and Facts, per OppFi*, BALLARD SPAHR LLP CONSUMER FIN. MONITOR (June 14, 2023), https://www.consumerfinancemonitor.com/2023/06/14/california-dfpi-is-wrong-on-both-law-and-facts-per-oppfi/ (detailing the complex litigation between the California Department of Financial Protection and Innovation and Opportunity Financial, LLC over whether Opportunity Financial's partnership with FinWise Bank permits it to make loans in excess of California's usury cap); Press Release, Colorado Attorney General's Office settles lawsuit against lenders for exceeding state interest rate limits on consumer loans (Aug. 18, 2020), https://coag.gov/press-releases/8-18-20/ (reaching settlements to disrupt two "rent-a-bank" partnerships based on their violation of Colorado state usury laws).

2. Innovation: The Legal Challenges of Characterization

Innovation presents another major challenge for successful payday loan regulation because loans are susceptible to recharacterization, allowing the lenders to skirt regulation by claiming that slight modifications result in totally different products. The result is what one journalist called regulatory "whack-a-mole."[122]

Loans are complex—consisting of a variety of contractually-prescribed features: terms, interest rates, origination fees, collateralization, and even insurance. Attempts to regulate loans must first describe their salient features. For payday loans, these include terms, loan amounts, and financing charges.[123] This creates another opportunity for lenders: changing any of these features allows them to recharacterize a loan as a totally different product-type that can no longer be regulated in the anticipated way. This is distinct from most other consumer products: removing two wheels does not make a car into a motorcycle. But intense litigation surrounds the determination of what kind of loan was originated (or if the product is a loan at all).[124] As such, payday lenders respond to local regulation by tweaking small features, while continuing to sell functionally the same product.

a. Fees Versus Interest

Payday lenders circumvent regulation by recharacterizing charges as "fees" rather than "interest." A common state regulatory approach is to set a maximum chargeable APR with a usury cap.[125] Payday lenders overcome this by blurring the line between "interest" and "fees" charged in the origination of their loans.

For example, some lenders tie additional products to their loans, increasing the aggregate cost to match the interest charged in the absence of regulation. In Ohio, for example, lenders add a "credit investigation fee" and an "application fee" to the cost of a short-term car loan.[126] Even though the stated interest rate is within the 28% APR legal boundary, these additional fees inflate loan costs so that the effective APR exceeds 350%.[127] Similarly, when interest rates were capped at 30% APR in Florida, auto-title lenders added insurance policies that nominally protected the lenders against damage to the car serving as collateral.[128]

---

122. Kiel, *Whack-A-Mole, supra* note 36.

123. *See* Morton, *supra* note 87.

124. *See, e.g.*, McLemore v. McLemore, 827 N.E.2d 1135, 1444 (Ind. Ct. App. 2005) (deciding whether a "contract-for-deed," an arrangement where a purchaser only gains title to the property after making the final installment payment, granted the borrower a security interest and entitled him to the procedural protections of foreclosure); *c.f.* Complaint at 1, New York v. Vision Prop. Mgmt., No. 19-CV-07191 (S.D.N.Y. 2019) (claiming that "lease agreements" marketed by the defendant were actually disguised mortgage loans).

125. Morton, *supra* note 87.

126. David Rothstein, Policy Matters, Keys for Collateral: How auto-title loans have become another vehicle for payday lending in Ohio 5 (Dec. 2012), http://www.policymattersohio.org/wp-content/uploads/2012/12/AutoTitle-Dec2012.pdf.

127. *See id.*

128. Paul Kiel, *Insta-Loophole: In Florida, High-Cost Lender Skirts the Law*, ProPublica (Jul. 25, 2014, 9:00 a.m.), https://www.propublica.org/article/insta-loophole-in-florida-high-cost-lender-skirts-the-law.

In practice, however, insurance merely brought the cost of the loan in line with what the same lenders charged in neighboring Georgia, which does not have the 30% cap.[129]

Taking this to an extreme, some payday lenders rebrand entirely as "credit repair organizations." Lenders in Ohio obtained licenses as a "Credit Service Organization" and partnered with a third-party lender, which actually extended the loan.[130] This arrangement allowed the "Credit Service Organization" to charge a "brokering fee" for performing credit repair services rather than interest.[131] But in reality, there is no evidence that the "Credit Service Organization" actually offered credit repair services; and the arrangement was used solely to evade Ohio's 28% rate cap.[132] In Texas, the state Attorney General claimed, and the Fifth Circuit Court of Appeals agreed, that state usury laws do not apply to companies acting as "Credit Services Organizations."[133] Consequently, Texas high-cost lenders extended payday and auto title loans for years until state legislators tightened the law.[134]

In each of these cases, payday lenders sidestep cost-oriented regulation by recharacterizing their charges as "fees" for services rather than "interest." Whatever lenders *call* their products, the *effect* is simply to extend the same credit products on the same terms without state regulatory oversight.

b. Collateralized Loans

Payday lenders also recharacterize their activity by shifting towards collateralized loans. Typically, a lender requests a security interest in a borrower's property to improve the safety of a loan. In practical terms, this means that if the borrower defaults on the loan, the lender has the right to seize and sell the borrower's asset in satisfaction of outstanding debt.[135] Payday loans are unsecured, so payday lenders lack a physical asset for recourse in the case of default. But in order to avoid payday loan regulation, they have tried to rebrand their products as more closely akin to secured loans like home mortgages or auto loans.

Car title loans are a prime example of this form of legal innovation. Though car title loans look different than payday loans on the surface, they are practically quite similar. Title loans have slightly longer terms—usually a month rather than

---

129. *Id.*

130. ROTHSTEIN, *supra* note 126, at 2–3.

131. *Id.*

132. *Id.* at 4.

133. Jim Hawkins, *Credit on Wheels: The Law and Business of Auto-Title Lending*, 69 WASH. & LEE L. REV. 535, 578 (2012) (citing Letter from Barry R. McBee, First Ass't. Att'y Gen., to Leslie Pettijohn, Comm'r, Office of the Consumer Credit Comm.) (Jan. 12, 2006); *see* Lovick v. Ritemoney, Ltd., 378 F.3d 433, 442–43 (5th Cir. 2004) (explaining that "Texas law does not construe . . . credit service fees as disguised interest").

134. Hawkins, *supra* note 133.

135. *See* RONALD J. MANN, COMMERCIAL FINANCE: A TRANSACTIONAL APPROACH 78–79 (1st ed. 2017).

a borrower's two-week pay period.[136] They also require customers to provide a lien on their car as collateral, allowing the lender to repossess it in the case of non-payment.[137] But in other ways the products bear a striking resemblance: they are similarly sized, have similarly high interest rates, and similarly high rollover rates.[138] The income profile of car title loan borrowers also closely resembles payday loan debtors.[139] Thus, if lenders are prevented from profitably making payday loans, shifting to car title lending allows them to reach the same population with virtually the same product.

Ohio's failed regulatory approach is proof of how such recharacterization can work effectively. In 2008, the state's legislature passed the Short-Term Lender Act (STLA), which established a 31-day minimum term, a $500 maximum principal amount, and a 28% APR cap.[140] Cash America, a payday lender with significant operations in Ohio, admitted that this regulation would make it difficult to continue doing business in the state.[141] So they and the other payday lenders shifted: even though the new law required a license to lend, not a single lender over the ensuing ten years actually acquired a license to make payday loans.[142] It is not that payday lending ended—as of 2012, there were still hundreds of payday lenders in operation.[143] Rather, they claimed that their loans were actually governed under the Mortgage Loan Act[144] or were auto title loans.[145] The Ohio Supreme Court endorsed this recharacterization, claiming that the language in the STLA was not specific enough to preclude "payday-style" loans from licensed mortgage lenders.[146]

The regulatory failure in Ohio shows the potency of this type of recharacterization. Lenders were able to make loans with the same exorbitant interest rates. But because they recharacterized these as "mortgages" and "auto title loans," they were able to escape compliance burdens. Consequently, the business of payday lending in Ohio continued "as if the STLA did not exist."[147]

---

136. CONSUMER FIN. PROT. BUREAU, SINGLE-PAYMENT VEHICLE TITLE LENDING 3 (May 2016), https://files.consumerfinance.gov/f/documents/201605_cfpb_single-payment-vehicle-title-lending.pdf.

137. *See id.*

138. *See id.* at 10–11.

139. PEW CHARITABLE TRUSTS, AUTO TITLE LOANS: MARKET PRACTICES AND BORROWERS' EXPERIENCES 5 (Mar. 2015), https://www.pewtrusts.org/~/media/assets/2015/03/autotitleloansreport.pdf?la=en.

140. Ohio Neighborhood Fin., Inc. v. Scott, 13 N.E.3d 1115, 1119 (Ohio 2014).

141. CASH AMERICA INTERNATIONAL, INC., ANNUAL REPORT (FORM 10-K) 2 (Feb. 27, 2009) (announcing that in response to the new law, the company was considering closing 139 Ohio locations and that the law "significantly reduced the revenue and profitability of that product in Ohio, effectively eliminating the Company's ability to offer that particular product in Ohio.").

142. 133 CARLA NAPOLITANO, OHIO LEG. SERV. COMM'N, PAYDAY LENDING IN OHIO 2 (Feb. 20, 2020), https://www.lsc.ohio.gov/documents/reference/current/membersonlybriefs/133Payday%20Lending%20in%20Ohio.pdf.

143. Kiel, *Whack-A-Mole supra* note 36.

144. CASH AMERICA INTERNATIONAL, INC., ANNUAL REPORT (FORM 10-K) 6 (Mar. 3, 2014).

145. *See* ROTHSTEIN, *supra* note 126, at 6.

146. Ohio Neighborhood Fin., Inc. v. Scott, 13 N.E.3d 1115, 1125 (Ohio 2014).

147. *Id.* at 1126 (Pfeifer, J., concurring).

c. Loan Term

Another way payday lenders adapt to regulation is by changing the loan term. Payday loans are normally characterized by a relatively short, definite term. By extending it, or making the term indefinite, payday lenders can circumvent existing state law restrictions.

Illinois and Kansas lenders provide good examples of how loan term modification allows lenders to skirt regulation. In 2005, the Illinois state legislature passed a law regulating "payday loans," which it defined as "loan[s] with a finance charge exceeding an annual percentage rate of 36% and with a term that does not exceed 120 days. . . ."[148] The new law capped payday loan interest rates and fees, and limited the outstanding credit of a borrower per month based on their income.[149] These regulations, while facially innocuous, led to lender adaptations; specifically, lenders shifted to making longer-term, higher-principal loans, which the state characterized as "installment loans." Even though such loans still carried high interest rates, by 2012 they significantly outstripped payday loans.[150] In an even more extreme case, Kansas-based auto title lenders adapted to regulation by structuring their loans as "open-ended credit," just like credit cards, which allows them to avoid rate caps.[151] By simply changing the loan term, lenders in Illinois and Kansas successfully recharacterized their lending activity, consequently avoiding burdensome regulation.

d. Loan Amount

Finally, lenders avoid payday loan regulations by lending just above dollar amount caps. Admittedly, increasing the loan amount changes the nature of the loan itself, but in certain cases, the loans appear clearly structured to avoid payday loan definitions and regulations. In California, interest rate caps limited interest rates on loans less than $2,500.[152] Lenders adapted, making an increasing number of loans between $2,500 and $4,999 at APRs in the triple digits.[153] Most brazenly, one car title lender advertised that its loans started at $2,501 to avoid the interest rate cap.[154] The California state legislature finally foreclosed this arbitrage opportunity in 2019,[155] more than 15 years after their last attempt to

148. 815 Ill. Comp. Stat. Ann. § 122/1-10 (amended March 23, 2021).

149. Morton, *supra* note 87.

150. VERITEC SOLUTIONS LLC, ILL. DEP'T OF FIN. AND PROF. REG, ILL. TRENDS REPORT ALL CONSUMER LOAN PRODUCTS THROUGH SEPT. 2012 7 (Apr. 17, 2013), https://web.archive.org/web/20220308054911/https://www.idfpr.com/News/DFI/IL_Trends_Report%20since%20Inception%20through%209-30-12%20final.pdf.

151. Hawkins, *supra* note 133, at 576.

152. CAL. FIN. CODE § 22303 (1994).

153. CAL. DEP'T OF BUS. OVERSIGHT, ANNUAL REPORT: OPERATION OF FINANCE COMPANIES LICENSED UNDER THE CALIFORNIA FINANCING LAW 2 (2019), https://dfpi.ca.gov/wp-content/uploads/sites/337/2019/08/CFL-Annual-Report-2018-FINAL-8-8-19.pdf.

154. Hawkins, *supra* note 133, at 578–79.

155. *See* Assem. B. 539, 2019–2020 Reg. Sess. (Cal. 2019) (enacted) (adding a new § 22304.5, which creates a new set of rules governing loans with principal amounts between $2,500 and $10,000).

regulate payday lending in 2003.[156]

The complexity of payday loan products lends itself to innovative recharacterization, allowing lenders to escape regulation. Where state regulators attempted to latch on to specific characteristics, lenders innovated. They recharacterized their charges, changed their loan terms, tweaked loan principal amounts, and went so far as to facially change the nature of their business entirely. But in reality, lenders continue to make high-cost loans to poor customers as they had in the absence of regulation.

As this section demonstrates, the observations made by Awrey and Judge about the difficulties of regulating dynamic financial markets extend to payday loans. Regulatory endogeneity allows lenders to dodge oversight by seeking friendlier regulators. Furthermore, innovation allows payday lenders to recharacterize contractual features and bring a credit contract beyond the reach of financial regulators. Together the two trends frustrate regulators' attempts to control payday lending.

IV. A Regulatory Solution

This section attempts to craft a better regulatory system with an eye towards the challenges described in Section III. First, it reviews the existing regulatory framework, attempting to explain that it cannot adequately address the dynamic problems presented by payday lending. Second, it introduces an experimentalist regulatory approach, explaining its comparative advantage in addressing complex problems. Finally, it proposes a three-part experimentalist approach: an "ability-to-pay" assessment combined with involvement from community-based lenders and a regime of performance monitoring.

A. Existing Regulation

While some state regulations fail to keep up with the dynamism the payday loan industry employs to evade them, others are more successful. This section explores the variety of regulatory solutions that states have tried and their efficacy. I argue that even the solutions that have proven successful are often too blunt due to the social welfare loss from their deployment.

1. Usury Caps

Usury laws represent a longstanding protection for borrowers against high-interest small-dollar loans. But such laws have been ineffective remedies for the problems posed by payday loans. Rate caps are vulnerable to the problem of

---

156. The California Deferred Deposit Transaction Law took effect on January 1, 2003. Cal. Dep't of Bus. Oversight, Annual Report and Industry Survey: Operation of Payday Lenders Licensed Under the California Deferred Deposit Transaction Law 1 (2019), https://dfpi.ca.gov/wp-content/uploads/sites/337/2019/08/CA-Payday-Loans-Annual-Report-2018-FINAL-8-8-19.pdf. *Compare* Cal. Fin. Code § 22251 (2000), *with* Cal. Fin. Code § 22251 (2020) (showing that rate caps newly established in § 22304.5 by the passage of California Assembly Bill 539 were the first revision to the payday lending rate cap provision in 20 years).

recharacterization, as lenders can easily avoid calling their charges "interest."[157] Similarly, the structure of state-level regulation facilitates the process of its evasion through tribal affiliation and rent-a-bank schemes.[158] But even where usury laws can be effective at controlling the total cost of a loan, there is a genuine question as to whether their benefits are outweighed by the consequent restrictions in capital available. I explore this perspective in greater depth below.[159]

2. Competition

Several states take market-based approaches, relying on consumer choice and competition to drive the price of payday lending down. Indeed, some academics and researchers have argued that competitive pressures in payday lending markets lead to better service and lower prices.[160] At least some empirical evidence suggests this is true: competition can improve the conditions faced by consumers in payday lending markets. For example, a recent study found that passage of a Texas law requiring disclosure of the costs of payday loans compared to alternative credit products led to a 13% decrease in loan use.[161] Additionally, the recent entry of credit unions and banks into the small-dollar lending market suggests that there might yet be room for robust competition.[162]

But competition is at best an incomplete solution. Many of the competition-based approaches rely on enhancing disclosure so that consumers can make informed choices. But empirical evidence suggests that consumers do not act

157. *See supra* Section III.B.2.

158. Baradaran, *supra* note 82, at 99–100 (explaining how state-level usury deregulation in the 1980s in combination with the regulatory arbitrage discussed above in Sections III.A created the current landscape of high-interest lending).

159. *See infra* Section IV.A.6.

160. *See*, *e.g.*, Victor Stango, *Are Payday Lending Markets Competitive?*, REGULATION 26, 26–27 (Fall 2012), https://www.cato.org/regulation/fall-2012/are-payday-lending-markets-competitive (arguing that payday lenders out-compete credit unions offering alternative products); THOMAS W. MILLER, JR. & TODD J. ZYWICKI, THE EFFECTS ON CONSUMERS FROM TWO STATE-LEVEL REGULATIONS OF THE PAYDAY LOAN MARKET 5 (Oct. 2, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3935920 (finding that payday loan amounts and interest rates do not cluster around the statutory maximum, "consistent with the notion that standard supply and demand characteristics could determine the market equilibrium"); Eric J. Chang, www.PaydayLoans.gov: *A Solution for Restoring Price-Competition for Short-Term Credit Loans*, 6 HARV. BUS. L. REV. ONLINE 3 (2015), https://journals.law.harvard.edu/hblr/2015/12/www-paydayloans-gov-a-solution-for-restoring-price-competition-to-short-term-credit-loans/ (arguing that a government-run payday lending exchange could increase pricing transparency and lower consumer transaction costs).

161. Jialan Wang & Kathleen Burke, *The Effects of Disclosure and Enforcement on Payday Lending in Texas*, 145 J. FIN. ECON. 489, 490 (2022).

162. *See* Alex Horowitz & Gabriel Kravitz, *Six of the Eight Largest Banks Now Offer Affordable Small Loans*, PEW CHARITABLE TRUSTS (Jan. 24, 2023), https://www.pewtrusts.org/en/research-and-analysis/articles/2023/01/24/six-of-the-eight-largest-banks-now-offer-affordable-small-loans; Alex Horowitz & Chase Hatchett, *Credit Union Small-Dollar Loan Volume Hit New High in 2022*, PEW CHARITABLE TRUSTS (Mar. 31, 2023), https://www.pewtrusts.org/en/research-and-analysis/articles/2023/03/31/credit-union-small-dollar-loan-volume-hit-new-high-in-2022.

rationally with respect to payday loan borrowing.[163] Even assuming that payday loan borrowers were rationally assessing disclosed information, lenders have historically mastered the ability to confound disclosure-oriented regulation.[164] Market-based approaches also ignore the fundamental differential in power between the average consumer and their lender. Payday loan borrowers are often desperate for financial relief and are rushed through the borrowing process.[165] A market solution places the onus on borrowers to understand the unusually complex products they purchase and then bear the cost of their cognitive errors.[166]

These shortcomings of competition are reflected in empirical data. Borrowing costs in Texas, one of the states that relies on a competition-based approach, remain among the highest in the country—an estimated 527% APR according to a 2022 report.[167] In sum, competition alone is not an effective regulatory response.

3. Rollover Cap

One of the more successful approaches, adopted by Washington and Delaware, limits the number of times a borrower can roll over their loan.[168] This limits the effect of a loan's most dangerous feature: the accumulation of additional fees and interest.[169] A rollover ban is easy to implement because it is difficult to recharacterize.[170] When an existing loan is rolled over, the borrower is effectively taking out a new loan to pay off the old. As discussed above, contractual features can be recharacterized as different products. The existence of a contract (or several contracts, for that matter) is more difficult to disguise. In Washington, this regulation successfully reduced payday lending volume.[171]

---

163. *See* Jim Hawkins, *Using Advertisements to Diagnose Behavioral Market Failure in the Payday Lending Market*, 51 WAKE FOREST L. REV. 57, 84–85, 92 (2016) (arguing that advertisements about the speed and price of payday loans indicate that borrowers are not acting rationally); Leandro Carvalho, Arna Olafsson, & Dan Silverman, *Misfortune and Mistake: The Financial Conditions and Decision-Making Ability of High-Cost Loan Borrowers* 5 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26328, 2020), http://www.nber.org/papers/w26328 (finding that a significant portion of payday loan borrowing was driven by cognitive mistake).

164. Lauren E. Willis, *Performance-Based Consumer Law*, 82 U. CHI. L. REV. 1309, 1322 (2015) (discussing how lenders have found ways to avoid the bite of disclosure-oriented regulation).

165. CTR. FOR RESPONSIBLE LENDING, *supra* note 3, at 8.

166. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law & Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1311 (2002).

167. Alex Horowitz, *Payday Loans Cost 4 Times More in States with Few Consumer Protections*, PEW CHARITABLE TRUSTS 5 (Apr. 5, 2022), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/04/payday-loans-cost-4-times-more-in-states-with-few-consumer-protections.

168. Kiel, *How One State Succeeded, supra* note 84.

169. *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 56 (2008).

170. Difficult does not mean impossible: one observer explains that payday lenders in Missouri can easily evade rollover caps by simply issuing another loan, highlighting that laws like this must still be enforced. *See* WALTER JOHNSON, THE BROKEN HEART OF AMERICA: ST. LOUIS AND THE VIOLENT HISTORY OF THE UNITED STATES 412–13 (2020).

171. Kiel, *How One State Succeeded, supra* note 84.

4. Bans

Payday lending bans are another potential regulatory approach. States like New York enacted usury caps so low as to render payday lending impractical—functionally acting as a ban.[172] New York pairs this with zealous enforcement, such that lenders are deterred from entry.[173] New York's insistence that there be no payday lending in the state differentiates it from states like Colorado or Ohio, where comprehensive regulations permit payday lending but under a strict licensure regime at a much lower cost.[174] Eighteen states plus the District of Columbia ban payday lending; many advocates from these states called for a nationwide ban as the CFPB considered its own regulation.[175] A ban likewise overcomes the recharacterization problem: lenders cannot effectuate tweaks when the entire realm of similar products is banned. While jurisdictional arbitrage like online payday lending may still be possible, rigorous enforcement can manage this problem.[176]

5. Piecing Multiple Tools Together: Reform Efforts in Virginia and Colorado

States like Colorado and Virginia demonstrate that piecing multiple regulatory strategies together can be a recipe for regulatory success. In 2010, Colorado passed a law requiring longer loan terms—six months instead of two weeks—and capping fees, amortizing them over time.[177] Colorado voters went even further, passing a ballot measure that capped permissible interest rates at an annual rate of 36%.[178] Virginia's 2020 Fairness in Lending Act took a very similar approach: lengthening the minimum loan term, capping the maximum interest rate and total fees, and requiring that loans be payable in amortizing installments.[179]

The results from these states have been striking. Immediately after Colorado's 2010 reform, the average annual percentage rates dropped dramatically, as did the rate of default on these loans.[180] The new law did so without reducing the average

---

172. Mann & Hawkins, *supra* note 90, at 879.

173. *Id.* at 880.

174. *See* Horowitz, *supra* note 167 (outlining the types of payday loan restrictions in more restrictive states); *see also infra* Section IV.A.5 (describing recently enacted comprehensive payday lending regulation).

175. *How Well Does Your State Protect Payday Loan Borrowers?*, PEW CHARITABLE TRUSTS (July 26, 2022), https://www.pewtrusts.org/en/research-and-analysis/data-visualizations/2022/how-well-does-your-state-protect-payday-loan-borrowers.

176. Mann & Hawkins, *supra* note 90, at 880.

177. PEW CHARITABLE TRUSTS, TRIAL, ERROR, AND SUCCESS IN COLORADO'S PAYDAY LENDING REFORM 4 (2014) [hereinafter PEW CHARITABLE TRUSTS, TRIAL, ERROR AND SUCCESS], https://www.pewtrusts.org/~/media/assets/2014/12/pew_co_payday_law_comparison_dec2014.pdf.

178. Pat Ferrier, *Colorado Election: Proposition 111, Capping Interest on Payday Loans, Passes*, COLORADOAN (Nov. 6, 2018, 8:37 PM), https://www.coloradoan.com/story/news/politics/elections/2018/11/06/colorado-election-proposition-111-passes-limits-interest-payday-loans/1890551002/.

179. *Virginia Fairness in Lending Act of 2020 Reforms Small Credit*, PEW CHARITABLE TRUSTS (Oct. 22, 2020), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2020/10/virginia-fairness-in-lending-act-of-2020-reforms-small-credit.

180. PEW CHARITABLE TRUSTS, TRIAL, ERROR AND SUCCESS, *supra* note 177, at 5.

size of a loan,[181] or reducing residents' access to payday loan products.[182] Similarly, the average cost of payday loans in Virginia declined significantly after the state's payday loan reform and is now *four times* less expensive than it was pre-reform.[183]

Still, the success of these reforms also demonstrates their shortcomings. First, credit still remains relatively expensive in both places. Even post-reform, the average APR for a payday loan in Colorado and Virginia exceeds 100%.[184] Additionally, these reforms remain susceptible to the same types of regulatory arbitrage experienced with usury laws. Colorado's changes in law led to an increase in regulatory arbitrage, forcing the Colorado state legislature to revisit lending regulation a little more than a decade after the law's initial passage.[185] In short, even though these reforms look promising, there is still an opportunity to search for a better solution.

6. Disadvantage of Existing Successful State Regulation

Even where state-level regulatory reforms have been successful, it is worth considering whether they adequately address the problem. Because the existing solutions do not center the people they are trying to help and produce socially sub-optimal results, there must be a better way to regulate payday loans.

First, these solutions center the product, rather than the problem it causes. Regulation focuses on payday loan attributes: whether the product is exceedingly expensive and how many times borrowers take them out. What these laws miss is the effect such products have on a consumer's financial well-being holistically. A better approach centers the consumer and tries to mitigate a loan's harmful consequences for them.

Second, bans and caps are blunt tools that restrict credit for poor people.[186] The evidence on rollover bans exemplifies this tradeoff. Evidence collected by

---

181. *Id.*

182. Letter from Nick Bourke, Director, Consumer Finance, Pew Charitable Trusts, *Technical Analysis of HB 2189, Pro-Consumer, Pro-Credit Small-Dollar Loan Reform* (Feb. 18, 2021), http://www.kslegislature.org/li_2022/b2021_22/committees/ctte_h_financial_institutions_and_rural_developm_1/documents/testimony/20210222_04.pdf (explaining that after the law passed, nearly the same percentage of people lived within 20 miles of a payday lending store).

183. *Id.* at 4.

184. *See* Alex Horowitz, *Payday Loans Cost 4 Times More in States With Few Consumer Protections*, PEW CHARITABLE TRUSTS (Jun. 3, 2022), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2022/04/payday-loans-cost-4-times-more-in-states-with-few-consumer-protections.

185. Seth Klamann, *After Colorado Voters Cracked Down on Payday Loans, Lenders Found Loopholes. A New Bill Would Try to Close Them.*, DENVER POST (Apr. 24, 2023, 6:00 a.m.), https://www.denverpost.com/2023/04/24/colorado-payday-loan-loophole-alternative-charge/.

186. *See, e.g.*, Engel & McCoy, *supra* note 166, at 1314; Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 302 (1995). *But see* CONSUMER FIN. PROT. BUREAU, SUPPLEMENTAL FINDINGS ON PAYDAY, PAYDAY INSTALLMENT, AND VEHICLE TITLE LOANS, AND DEPOSIT ADVANCE PRODUCTS 36–37 (Jun. 2016), https://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf (finding that, when banks discontinued high-cost credit in the form of deposit advance products, consumers did not substitute towards payday loans or other forms of high-cost credit); UNIV. OF N.C. CTR. FOR CMTY. CAPITAL,

the CFPB shows that where there are rollover bans in place, a significant percentage of payday loans—over 75% in many states—are reborrowed within two weeks.[187] This would seem to indicate that payday loan customers return to borrow because they need credit rather than because a rollover forestalls their need to pay back the loan in-full. Would a roll-over ban prevent some payday lenders from extracting disproportionate fees from a subset of consumers in severe financial distress? Almost certainly. But in the process, it would restrict a vital and necessary source of consumer credit for desperate borrowers.[188]

Perhaps one may argue that short-term, high-cost credit is more harmful than beneficial, and should not be seen as a component of the welfare state.[189] But if we accept that borrowers fundamentally need access to credit in order to meet payment shortfalls[190]—when they lose their jobs or encounter unexpected medical bills[191]—is the best answer really a moratorium on short-term, small-dollar lending? Is it optimal social policy to cut off a borrower's credit after three rollovers? Even if payday lending is predatory, and leaves some consumers worse-off, short-term credit is ultimately an essential service for poor people in order to make ends meet.[192] On this basis, it seems both challenging and irresponsible to ban payday lending without proposing an alternative.[193] Instead, as the next

---

N.C. CONSUMERS AFTER PAYDAY LENDING: ATTITUDES AND EXPERIENCES WITH CREDIT OPTIONS 1 (NOV. 2007), https://digital.ncdcr.gov/Documents/Detail/north-carolina-consumers-after-payday-lending-attitudes-and-experiences-with-credit-options/2601136 (finding that a payday loan ban resulted in no significant impact on the availability of credit for households in the state).

187. CONSUMER FIN. PROT. BUREAU, SUPPLEMENTAL FINDINGS ON PAYDAY, PAYDAY INSTALLMENT, AND VEHICLE TITLE LOANS, AND DEPOSIT ADVANCE PRODUCTS 108 (Jun. 2016), https://files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf.

188. *See also* Hawkins, *supra* note 133, at 589–92 (echoing this argument with respect to banning car title loans, which exhibit similar dynamics).

189. Deyanira Del Rio & Andy Morrison, Opinion, *Here's What Happens When Payday Loans are Banned*, WASH. POST (Jul. 5, 2016, 2:04 PM), https://www.washingtonpost.com/news/in-theory/wp/2016/07/05/heres-what-happens-when-payday-loans-are-banned/.

190. Mehrsa Baradaran, *Payday Lending Isn't Helping the Poor. Here's What Might.*, WASH. POST (June 28, 2016, 9:00 AM) [hereinafter Baradaran, *Payday Lending Isn't Helping the Poor*], https://www.washingtonpost.com/news/in-theory/wp/2016/06/28/payday-lending-isnt-helping-the-poor-heres-what-might/.

191. *See* Deborah Thorne, Pamela Foohey, Robert M. Lawless, & Katherine Porter, *Graying of U.S. Bankruptcy: Fallout from Life in a Risk Society*, 90 SOCIO. INQUIRY 682, 694 (2020) (highlighting that the leading causes of bankruptcy have long been loss of income and unexpected medical expenses).

192. *Id.* One could argue that this is a false narrative propagated by a myopic focus on market-based solutions to persistent economic shortfalls. *See* Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STANFORD L. REV. 1093, 1161 (2019). Using this lens, one could easily label payday loans as a form of "negative social insurance": they are a market-based solution to collective social conditions that make financial insecurity more profitable. *Cf.* TRESSIE MCMILLAN COTTOM, LOWER ED: THE TROUBLING RISE OF FOR-PROFIT COLLEGES IN THE NEW ECONOMY 181 (2017) (making a similar argument about the societal function of for-profit colleges). This critique is well-taken, but for the purpose of this article, I assume that the massive changes to the welfare state necessary to eliminate such market-based provision of social insurance is unlikely.

193. *But see* Alex Horowitz, *How to Reform State Payday Loan Laws*, PEW CHARITABLE TRUSTS (June 8, 2023), https://www.pewtrusts.org/en/research-and-analysis/articles/2023/06/08/how-to-reform-state-payday-loan-laws (explaining that in states where payday loans are banned, consumers choose other options such as negotiating with creditors, asking friends, or cutting expenses).

section suggests, we should seek to continue providing the service on socially optimal terms.

B. Experimentalist Regulation

With this understanding of the problems of payday lending, I now turn to one potential solution: Experimentalism. I explain why such an approach is the best way to overcome the problems posed by payday lending.

Experimentalism is an approach to regulatory design that pairs decentralized decision-making with centralized reporting, which informs future decisions. First, a central unit sets a goal for measuring local achievement, but then outsources program enactment to local actors.[194] This delegation empowers those with frontline exposure to craft a context-driven solution. However, the approach does not stop there: decentralization must be paired with an information-sharing and reporting regime. This allows the centralized decisionmaker to compare disparate outcomes and inform local units about which regulatory strategies have been most effective.[195] Flexibility is experimentalism's chief advantage: it is "manifestly impossible to write rules that cover the particulars of current circumstances in any sphere of activity."[196] Experimentalist approaches allows lower-level adaptation in light of this changing situation, provided that local units are willing to subject themselves to scrutiny.[197]

Experimentalism has been successfully applied across a broad variety of complicated regulatory systems, including environmental and civil rights law, health and safety regulation, and banking supervision.[198] For example, Professors Michael Dorf and Charles Sabel have written about how drug treatment court functions as an experimentalist institution.[199] Focusing on Brooklyn Treatment Court, Dorf and Sabel explain that, after an initial assessment, clients are placed in one of seven "treatment bands," which determines the frequency of drug testing, court appearance, and case management meetings.[200] Case managers are empowered to exercise discretion by rewarding milestones and punishing infractions within the framework of general program guidance.[201] In other words, case managers can use the context surrounding each client's case to make an informed decision about the most viable treatment practice. Then treatment courts evaluate

---

194. Charles F. Sabel & William H. Simon, *Minimalism and Experimentalism in the Administrative State*, 100 GEO. L.J. 53, 79 (2011).

195. *Id.*

196. Michael C. Dorf & Charles F. Sabel, *Drug Treatment Courts and Emergent Experimentalist Government*, 53 VAND. L. REV. 831, 837 (2000).

197. *Id.*

198. Daniel E. Ho, *Does Peer Review Work? An Experiment in Experimentalism*, 69 STANFORD L. REV. 1, 20 (2017).

199. Dorf & Sabel, *supra* note 196, at 841.

200. *Id.* at 847.

201. *Id.* at 847–49.

their overall performance compared to other responses to drug use.[202] Dorf and Sabel allow that there could be improvement monitoring service providers to treatment courts' clients—particularly treatment centers and other aftercare providers.[203] Still, the empowerment of street-level bureaucrats, coupled with constant monitoring of client successes, and adjustments to ensure positive outcomes, marks drug treatment court as an example of a functional experimentalist system in action.

In another striking example of success, Professor Daniel Ho crafted and applied a system of experimentalist peer reviews in the City of Seattle and King County Division of Public Health.[204] There he observed significant differences in the way that individual health inspectors conducted reviews of restaurants, leading to concerns about the quality, fairness, and consistency of the Agency's investigations.[205] To combat this, Professor Ho helped redesign the system: inspectors were paired to conduct independent reviews of restaurants.[206] Based on these evaluations, the entire food inspection team gathered to discuss common points of disagreement, clarifying how different violations should be scored.[207] This had all the makings of a successful experimentalist intervention: on-the-ground actors (health inspectors) were given control of implementing a centralized system (the health code). By regularly sharing inspection results and identifying the proper resolution to disagreements, the new system allowed inspectors to develop a more unified view of the correct Code application. Over time, this approach improved scoring consistency between inspectors.[208]

Consumer law experts have already gestured favorably towards this type of regulatory system, even if they have not designed an implementation-ready system for payday loans. In her article, *Performance Based Consumer Law*, Professor Lauren E. Willis discusses how a system very similar to experimentalism, what she calls "performance-based regulation," could be applied in consumer law.[209] Her article highlights problems similar to those discussed in this piece: firms have an incentive to create multiple variations on complex products and to change them quickly to evade regulation.[210] Professor Willis suggests using performance-based regulation—where regulators would set a "measurable standard closer to the regulator's ultimate goal and allows the regulated entity to choose how to meet that standard."[211] These standards would be paired with

202. *Id.* at 849.
203. *Id.* at 865–68.
204. Ho, *supra* note 198.
205. *Id.* at 45.
206. *Id.* at 51.
207. *Id.* at 54–59.
208. *Id.* at 68.
209. Willis, *supra* note 164, at 1309, 1311 (2015). Note that "performance-based" laws are a tool of implementing experimentalist systems. *See* Bradley C. Karkkainen et al., *After Backyard Environmentalism: Towards a Performance-Based Regime of Environmental Regulation*, 44 AM. BEHAV. SCIENTIST 691, 692 (2000).
210. Willis, *supra* note 164, at 1320, 1327–29.
211. *Id.* at 1330.

regular auditing and performance testing to ensure that consumer products meet the standards and firms do not evade performance benchmarks.[212] Professor Willis highlights several possible approaches, including *ex ante* suitability determinations, use of consumer decision aids, and outcome testing and measurement.[213] Professor Willis even contends that payday lending could be a particularly useful area for such an approach.[214]

Experimentalism can address the dynamic problems posed by payday lending more carefully than a ban or a rollover cap. Usury laws must be legislated, and present little opportunity to adjust outside of the slow process of passing new legislation. This is particularly apparent in the case of Ohio: though cracks in its regulatory system were almost immediately visible,[215] it took more than a decade for the state legislature to close the loopholes that allowed for rampant recharacterization.[216] Even the state's recent legislation does not appear to be a holistic fix: there is already evidence of substitution towards alternative forms of high-interest borrowing.[217] Experimentalist solutions allow regulators to be nimble—addressing arbitrage and recharacterization as they occur—while still focusing on the welfare concerns animating the law.

Professors Awrey and Judge express some apprehension towards an experimentalist approach in the financial context. First, they point out that it was deployed to limited success during the most recent financial crisis, with firms using an experimentalist approach to monitoring capital requirements faring worse than their competitors.[218] Second, the informational feedback collected there was, for the most part, not probative to the regulatory goal; Awrey and Judge explain that because financial regulation is so dynamic, it is difficult to identify the salient features that make certain bank assets "safer" than others.[219]

However, in the context of consumer financial regulation, these problems are easily addressed. First, partner firms can be selected by identifying their own commitment to helping poor people with their financial problems.[220] This way, regulatory design works to extend partner organizations' existing missions rather

---

212. *Id.* at 1330–35, 1393–95.

213. *Id.* at 1358–59.

214. *See id.* at 1392 (suggesting that a CFPB ability-to-pay rule could reduce payday loan rollovers).

215. *See* Section III.B.2.b, *supra*.

216. Jessie Balmert, *Gov. Kasich Signed Payday Lending Law. What it Might Mean for Your Loan.*, CINCINNATI ENQUIRER (Jul. 23, 2018, 10:13 PM), https://www.cincinnati.com/story/news/politics/2018/07/23/what-ohios-new-payday-lending-law-might-mean-your-loan/792591002/.

217. Natasha Frost, *Banning Payday Loans Sends Desperate Borrowers Running to Pawn Shops*, QUARTZ (Mar. 1, 2019), https://qz.com/1561643/ohios-ban-on-payday-loans-sent-people-running-to-pawn-shops/; *see also* Seth Klamann, *After Colorado Voters Cracked Down on Payday Loans, Lenders found Loopholes. A New bill Would Try to Close Them.*, DENVER POST (Apr. 24, 2023, 6:00 a.m.), https://www.denverpost.com/2023/04/24/colorado-payday-loan-loophole-alternative-charge/(highlighting that payday loan reform in Colorado spurred regulatory arbitrage).

218. Awrey & Judge, *supra* note 37, at 2349.

219. *Id.*

220. *See* Section IV.C.2, *infra*.

than to counteract them.[221] Second, while consumer financial products share the dynamism of high finance, the problem that payday lending regulation is intended to resolve—the immiserating effect of predatory financial products on poor people—is easier to pin down. For this reason, the next section suggests an experimentalist approach to regulating payday loans that starts with a goal of reducing the cost of financial products for poor people using a community-based financial institution as the conveyor of a better financial product.

C. An Experimentalist Regulatory Solution

An improved state-level experimentalist regulatory regime follows a three-fold path. It starts with the goal of reducing the cost of last-resort financial products on poor people. To enact this goal, it relies upon the CFPB's "ability-to-pay" concept from the Bureau's 2017 Rule. Second, it relies on partners that are both capable of and interested in implementing a rule that helps the communities they serve. For this, I suggest a licensing requirement, intended to keep out all but public banks with a community-oriented mission. Third, I propose that state financial regulators conduct ongoing monitoring, scrutinizing loan defaults and borrower welfare, then adjusting the lending mandate accordingly. These reforms collectively present the opportunity to make lending safer.

1. Ability to Pay

First, an experimentalist approach requires identifying the underlying problem.[222] Existing state-level payday lending regulation persistently fails at this threshold step of pinpointing the most problematic aspects of a payday loan.[223] But in an experimentalist system, the provision of goods and services must be tailored to the system's intended recipients.[224] Consequently, this regulatory solution appropriately centers payday loan *borrowers* rather than payday loan *products*.

For this reason, the CFPB's 2017 Rule, which demanded that lenders assess a borrower's ability to pay before making a loan, sets the correct baseline. The Rule required that lenders conduct a "full-payment test" to determine that borrowers can afford to repay their loans without re-borrowing.[225] This included investigating a prospective borrower's income to determine if repayment was feasible in the context of their life circumstances and competing financial

---

221. *See, e.g.*, Jerry L. Mashaw & David L. Harfst, *From Command and Control to Collaboration and Deference: The Transformation of Auto Safety Regulation*, 34 YALE J. ON REG. 167, 254 (2017) (noting the revitalization of the National Highway Traffic Safety Administration's rulemaking in cooperation with automakers, rather than in opposition).

222. Sabel & Simon, *supra* note 194, at 79.

223. *See supra* Section IV.A.

224. Sabel & Simon, *supra* note 194, at 90.

225. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54633 (Nov. 17, 2017) (to be codified at 12 C.F.R. pt. 1041).

obligations.[226] Several states have already adopted ability to repay rules with varying degrees of success.[227]

The advantage of this approach is that it addresses borrower harm by placing the burden of compliance on the least-cost avoider, the lender.[228] Most of the regulatory fixes attempt to cap the cost of a loan.[229] Although payday loans carry outrageous financing charges, the larger issue is the way lenders squeeze the most desperate without regard to their actual financial means. An "ability-to-pay" rule resolves this directly by forcing lenders to internalize the risk of a default for each borrower, rather than pass it off as a cost of doing business.[230]

This rule also resolves the issue of undue restriction of credit by ensuring that those in need who can actually afford credit retain access. Professor Willis explained that imposing suitability requirements, like an "ability-to-pay" assessment, functions as a "decision aid," providing an external audit for consumers about whether they can truly afford their loan.[231] While this outside perspective will deny the extension of credit to some consumers, it will also better tailor such denials based on likely harm.

2. Licensed, Community-Based Lending

Next, the state regulator must find viable partners for decentralized implementation.[232] These should be community stakeholders—organizations invested in the success of the community, rather than simple profit maximization. For this reason, regulators should erect a lending licensure regime, which allows the implementing state agencies to act as gatekeepers in ensuring that only lenders interested in the success of the community are giving loans. Such licensure has been a staple of recent state-level regulatory reform,[233] and could be used to exclude lenders indifferent to the welfare of the communities they enter. There are many possible community-oriented organizations that could be a part of such a licensing regime—the challenge is selecting the right ones that can be most responsive to the problem of payday loans.

In evaluating potential partners, existing financial institutions seem like a natural starting point. For example, Community Development Financial Institutions

---

226. *Id.* at 54633.

227. *See* UTAH CODE ANN. § 7-23-401(1)(g) (LexisNexis 2023) (requiring lenders to make an inquiry to determine whether a borrower has the ability to repay a loan); MO. REV. STAT. § 408.500(7) 2023 (same); MINN. STAT. § 47.603(3), (5) (2023). (Minnesota enacted a law requiring payday lenders to assess borrowers' ability to repay loans in 2023)*; see also* S.C. CODE ANN. § 37-3-413(3) (2023) (requiring the lender to investigate the ability of a consumer to repay in the car title lending context).

228. Engel & McCoy, *supra* note 166, at 1319.

229. *See supra* Section IV.A.

230. *See* Engel & McCoy, *supra* note 166, at 1319.

231. Willis, *supra* note 164, at 1358–59.

232. Sabel & Simon, *supra* note 194, at 79.

233. For example, Virginia included a lender licensure regime as part of its recent comprehensive reform. *Virginia Fairness in Lending Act of 2020 Reforms Small Credit*, PEW CHARITABLE TRUSTS (Oct. 22, 2020), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2020/10/virginia-fairness-in-lending-act-of-2020-reforms-small-credit.

(CDFIs) are "mission-driven financial institutions that create economic opportunity for individuals and small businesses, quality affordable housing, and essential community services in the United States."[234] CDFIs are already developing "an innovative approach to reach the unbanked customer market in [their] communities,"[235] and are entering partnerships with financial technology companies to reach borrowers most susceptible to payday lending's appeal.[236] Credit unions could similarly step into the breach: their core purpose is to provide people of modest means access to credit.[237] Institutions like Self-Help Federal Credit Union already provide an alternative to payday loans.[238] Recently, the National Credit Union Administration has increasingly blessed credit unions offering payday loan alternative products.[239] The evidence shows credit unions are moving rapidly into this market.[240]

The problem with these options is their location in the federalist financial regulatory structure. CDFIs and credit unions are both subjected to federal banking regulation, and as discussed above,[241] federal banking regulation largely preempts state usury laws. As a result, state regulation cannot exclude or license federally regulated institutions that refuse to participate in state aims, leaving the regulation open to arbitrage.[242] Even if states could easily pick and choose credit union and CDFI partners, they would remain primarily accountable to federal—rather than state—regulation and oversight. Relying on these types of institutions means that the primary lender will likely be more accountable to executive authority and administration aims than to local experimentalist designs and policies. And finally, relying on the traditional banking system presumes that it is capable of serving the population reliant on payday loans. In actuality, payday loans

---

234. Office of the Comptroller of the Currency, *Community Development Financial Institution (CDFI) and Community Development (CD) Bank Resource Directory*, https://www.occ.gov/topics/consumers-and-communities/community-affairs/resource-directories/cdfi-and-cd-bank/index-cdfi-and-cd-bank-resource-directory.html (last visited May 12, 2020).

235. This was Carver Federal, a CDFI located in New York. Carver Bancorp, Inc., Annual Report (Form 10-K) at 2–3 (Jun. 28, 2019).

236. Sunrise Banks, a Minneapolis-based CDFI, is one such example. *The Fintech Helping to Solve the Payday Loan Problem*, SUNRISE BANKS (July 18, 2020), https://sunrisebanks.com/stories/the-fintech-helping-to-solve-the-payday-loan-problem/.

237. Credit Union Membership Access Act, Public Law 105-219, section 2, 112 Stat. 913 (Aug. 7, 1998).

238. Debbie Nelson, *Self-Help Credit Union: Turning Around Upside Down Loans*, GREENVILLE BUS. MAG. (Jan. 3, 2020), https://www.greenvillebusinessmag.com/2020/01/03/294057/self-help-credit-union-turning-around-upside-down-loans.

239. *See Payday Alternative Loans*, 84 Fed. Reg. 51942 (Oct. 1, 2019) (to be codified at 12 C.F.R. pt. 701).

240. Alex Horowitz & Chase Hatchett, *Credit Union Small-Dollar Loan Volume Hit New High in 2022*, PEW CHARITABLE TRUSTS (Apr. 7, 2023), https://www.pewtrusts.org/en/research-and-analysis/articles/2023/03/31/credit-union-small-dollar-loan-volume-hit-new-high-in-2022.

241. *See supra* Section III.B.1.d.

242. *See* Odinet, Predatory Fintech, *supra* note 88, at 1777–78 (describing the legal structure of federal preemption that allows federally-chartered banks and federally-insured, state-chartered banks to avoid state usury caps)*; see also supra* Section III.B.1.d.

exist to serve a population starved of traditional banking and lending services.[243] A strategy focused on partnership with existing financial institutions risks missing precisely the population that is already underserved by traditional banks.

An alternative would focus on the creation and maintenance of a public option for banking services.[244] Some have argued that the Federal Reserve should provide a public option for bank accounts, which would ameliorate the need for payday loan products by providing faster access to money.[245] More directly, Professor Mehrsa Baradaran suggests the creation of a postal bank, an alternative employed internationally as well as in the United States during the early twentieth century, to provide basic banking services.[246] She explains that the U.S. Postal Service could feasibly offer small loans at lower interest rates than traditional payday lenders.[247]

To adapt a public option structure for a state-level regulatory regime, this Article focuses instead on proposals to create public banking options at the state level. Although the state of North Dakota has maintained a publicly-owned bank for over a century,[248] states and municipalities around the country are increasingly interested in creating their own public bank.[249] Of particular note, California passed a 2019 bill making it legal for cities and counties to establish public banks;[250] San Francisco and Los Angeles have moved forward with plans to create such banks.[251] Although advocacy on behalf of public banks appears to be primarily focused on their capacity to finance affordable housing and climate-oriented projects,[252] public banks could also be used in conjunction with a state regulatory regime to provide low-cost small dollar loans.

---

243. Mehrsa Baradaran, *Jim Crow Credit*, 9 U.C. IRVINE L. REV. 887, 910–11 (2019) (arguing that the disproportionate use of payday loan services in Black communities is directly related to the exit of traditional banks).

244. *See* Ganesh Sitiraman & Anne Alstott, Opinion, *There Should Be a Public Option for Everything*, N.Y. TIMES (July 6, 2019), https://www.nytimes.com/2019/07/06/opinion/sunday/public-option.html.

245. *See* John Crawford, Lev Menand, & Morgan Ricks, *FedAccounts: Digital Dollars*, 89 GEO. WASH. L. REV. 113, 125–29 (2021).

246. Baradaran, *Payday Lending Isn't Helping the Poor*, *supra* note 190.

247. Baradaran, *supra* note 82, at 124.

248. Bank of North Dakota, *History of BND*, https://bnd.nd.gov/history-of-bnd/(last visited July 16, 2023).

249. Oscar Perry Abello, *California's More Than Dreamin' About Public Banks*, NEXT CITY (Sept. 24, 2019), https://nextcity.org/urbanist-news/californias-more-than-dreamin-about-public-banks (highlighting campaigns for public banks in California, Washington State, New Mexico, Michigan, New Jersey, the District of Columbia, New York City, Philadelphia, Chicago, the Twin Cities, Portland, and Seattle).

250. *See* Public Banks, A.B. 857, 2019-2020 State Assemb., Reg. Sess., (Cal. 2019).

251. Charlotte Kramon, *After Years of Ups and Downs, Los Angeles Moves Forward on Creation of a Public Bank*, L.A. TIMES (July 6, 2023), https://www.latimes.com/california/story/2023-07-06/city-council-launches-process-in-creating-a-public-bank; Megan Rose Dickey, *How a Public Bank Could Work in San Francisco*, AXIOS S.F. (Feb. 24, 2023), https://www.axios.com/local/san-francisco/2023/02/24/public-bank-san-francisco-california-proposal.

252. *See* HR&A, SAN FRANCISCO PUBLIC BANK (PROPOSED) 2–7 (Feb. 2023), https://sfgov.org/lafco/sites/default/files/rwg021623_PublicBank-DRAFT.pdf (identifying the proposed priorities of a San

State and municipal public banks offer most of the same advantages as Professor Baradaran's postal banking public option. Local governments are accessible to everyone and have the financial resources to make loans at a lower interest rate than payday lenders. They can also be folded into the broader infrastructure of a state regulatory regime, allowing regulators to set underwriting criteria, ensure institutional compliance, and monitor outcomes. Although California does not presently allow public banks to offer retail banking services directly to consumers,[253] this supposed limitation creates an opportunity. Public banks are permitted to partner with CDFIs and credit unions already engaged in this type of lending,[254] setting an industry-wide baseline, learning from the experience of more seasoned community institutions, and limiting the threat of federal regulatory arbitrage. Ultimately, public banks present the greatest opportunity for an accountable state-level resource that responds directly to payday lending.

3. Monitoring Holistic Borrower Outcomes

Finally, for an experimentalist regulatory system to be effective, there must be a monitoring system, wherein the local units provide the central regulator performance data.[255] Successful experimentalist systems do this to evaluate social safety net interventions,[256] responses to operational failures,[257] and processing of facility improvements.[258] In each of these cases, reporting functions not just as a form of error-correction, but also as an opportunity to learn from success and implement new procedures to correct local failures—what the literature calls "learning by monitoring."[259]

Francisco public bank as 1) affordable housing; 2) small businesses; and 3) green investments); JAIN FAM. INST. & BERGGRUEN INST., WHAT A MUNICIPAL PUBLIC BANK CAN DO FOR LOS ANGELES AND ITS PEOPLE 4 (May 2023), https://jainfamilyinstitute.org/wp-content/uploads/2023/05/JFI-Berggruen_MBLA_Overview-Report_May-2023.pdf (proposing affordable housing, financial justice, and a climate transition as strategic priorities for Los Angeles's public bank).

253. A.B. 857 § 16 (adding Government Code § 57604(b), which provides, "a public bank shall conduct retail activities in partnership with local financial institutions and shall not compete with local financial institutions."). It is true that this law contains an extremely narrow exception allowing a public bank to "[e]ngage in retail activities without partnering with a local financial institution, if those retail activities are not offered or provided by local financial institutions in the jurisdiction of the local agency or agencies that own the public bank." Cal. Gov. Code § 57604(c)(2). However, even with this exception, close observers conclude that "the California Public Banking Act, AB 857, does not enable public banks to directly serve retail consumers." JAIN FAM. INST. & BERGGRUEN INST., *supra* note 252, at 30. Especially given that over 5 million payday loans were made to 900,334 customers within the state of California in 2022, the ubiquity of the service indicates that this exception would likely not apply to permit public banks to make small-dollar loans themselves. CALIFORNIA DEP'T OF FIN. PROT. & INNOVATION, *supra* note 35, at 6.

254. *Id.*

255. Sabel & Simon, *supra* note 194, at 79.

256. Dorf & Sabel, *supra* note 196, at 849–51.

257. JOSEPH V. REES, HOSTAGES OF EACH OTHER: THE TRANSFORMATION OF NUCLEAR SAFETY SINCE THREE MILE ISLAND 123–50, (1994).

258. John Paul MacDuffie, *The Road to "Root Cause": Shop-Floor Problem-Solving at Three Auto Assembly Plants*, 43 MGMT. SCI. 479, 491–95 (1997).

259. Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267, 287 (1998).

In the payday lending context, learning by monitoring requires collection of two different types of data. First, the lending institution must collect a variety of data on the cost of their products, as well as their respective success.[260] This helps regulators answer the most obvious question: has the regulatory intervention prevented excessive defaults? But the data collection efforts must go further. It is not enough to evaluate the program when it breaks. Rather, we must understand how it works when it is functioning well. This is particularly poignant in the consumer finance context, where many situations short of loan default are still disastrous for borrowers.[261] Any assessment of lending to a low-income population must also be understood in the context of their situation—whether the loan is actually more helpful than it is burdensome.

So, institutions should collect a second type of data: survey responses to monitor the financial and emotional health of payday loan borrowers before, during, and after a loan is made. This can be conducted as a regulator-driven quality survey, akin to the Quality Service Review diagnostic monitoring method used to survey child welfare in Alabama and Utah.[262] There, caseworkers conduct randomized case reviews, analyzing "child status and system performance" in the child welfare system.[263] Surveys like this allow the state to track the efficacy of the regulatory scheme over time, but may also provide an additional benefit: insight into a population on the fringes of financial insecurity, and how the state can intervene to most effectively serve them.

Academics already collect this type of data on financially-vulnerable people. For example, for the last forty years, a group of interdisciplinary academic researchers, known as the Consumer Bankruptcy Project, has been collecting a variety of data relying on a randomized national survey of bankruptcy filers, and analyzing the data to highlight problems in consumer bankruptcy as well as suggest policy changes.[264] Their data collection efforts have highlighted the rise in bankruptcy filers over the age of 65,[265] the persistence of medical debt

---

260. Note that the CFPB already attempts to collect these types of data in its supervisory role. *See* CFPB PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS, *supra* note 6, at 4.

261. Porter, *supra* note 4, at 983 ("Financial measures may not reveal when debt becomes harmful, and they certainly do not illuminate the nonfinancial harms of overindebtedness."); *see also* CTR. FOR RESPONSIBLE LENDING, *supra* note 3, at 10 (highlighting how, even though nearly every borrower surveyed repaid their loan, payday loan borrowers experienced financial hardship); Thorne, *supra* note 19, at 136 (highlighting the degree of stress that significant debts place on women).

262. Kathleen G. Noonan, Charles F. Sabel, William H. Simon, *Legal Accountability in the Service-Based Welfare State*, 34 L. & SOC. INQUIRY 523, 525, 542–48 (2009).

263. *Id.* at 542–44.

264. Pamela Foohey, Robert Lawless, & Deborah Thorne, *Portraits of Bankruptcy Filers*, 56 GA. L. REV. 573, 596–98 (2022) (explaining how the Consumer Bankruptcy Project has successfully collected data on a variety of financial and non-financial details of consumer bankruptcy filers' lives for over 40 years).

265. *See* Thorne, Foohey, Lawless, & Porter, *supra* note 191, at 685.

as a primary cause of bankruptcy filings,[266] and racial disparities in bankruptcy outcomes.[267] Evidence generated by the Consumer Bankruptcy Project has been cited by the American Bankruptcy Institute, a trade association for bankruptcy professionals, in its proposals to reform the consumer bankruptcy processes.[268] In other words, these types of data have been used to inform policy interventions in the bankruptcy arena; payday loans present no less suitable a terrain.[269]

Ultimately, evaluation and adaption are the most satisfying aspects of an experimentalist intervention: payday lending regulation is not an all-encompassing resolution to the issues affecting the financially-precarious. Like poverty, financial distress is inherently complex—deeply connected to a variety of noneconomic indicators.[270] While financial regulation cannot possibly hope to address each of these concerns, it provides regulators a window into the lives of poor people and some insight into how the welfare state can better serve them.

V. Conclusion

Payday lending is a pervasive and costly solution to sparse credit availability for consumers of limited means. While many accept that poor people must have credit access, the exorbitant cost presents policy makers with a quagmire: how do we protect poor people from a dangerous product without unduly restricting credit? This article attempts to resolve this question. First, I explain why regulatory oversight of payday lending is so difficult. I show how regulatory arbitrage and persistent recharacterization allow payday lenders to wriggle free of harsh regulation, and choose more favorable alternatives. Second, I evaluate the existing regulatory structure and explain why it is insufficient. Finally, I attempt to frame an experimentalist approach around the concept of "ability-to-pay," with intervention from community-based lending institutions, and monitoring more closely akin to that of a social welfare program than to a lending regime.

266. *See* David U. Himmelstein, Robert M. Lawless, Deborah Thorne, Pamela Foohey, & Steffie Woolhandler, *Medical Bankruptcy: Still Common Despite the Affordable Care Act*, 109 Am. J. of Pub. Health 431 (2019).

267. *See* Rory Van Loo, *A Tale of Two Debtors: Bankruptcy Disparities by Race*, 72 Alb. L. Rev. 231, 234 (2009).

268. Am. Bankr. Inst., Final Report of the American Bankruptcy Institute on Consumer Bankruptcy 160-64 (2019) (relying on Consumer Bankruptcy Project data and analysis to evaluate proposals for racial equity in Chapter 13 bankruptcy cases).

269. *See also* Dalié Jiménez et al., *Improving the Lives of Individuals in Financial Distress Using a Randomized Control Trial: A Research and Clinical Approach*, 20 Geo. J. on Poverty L. & Pol'y 449 (2013) (outlining another feasible empirical approach to studying debtor populations in financial distress).

270. *See* Porter, *supra* note 4, at 997–1003 (exploring the literature regarding the noneconomic effects of poverty).