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Can Local Governments Provide Protection to Vulnerable Communities in California, a State Which has Legalized Predatory Payday Lending and Failed to Pass Reform?

KRISTA R. GRANEN*

He was impressed. He was impressed that, first off, that payday lenders charged more than twice what a loan shark would charge. Of course, they don’t break knee caps if you don’t pay them back. But he just was impressed that they took their idea—the mob’s idea—and turned it into a multi-billion dollar industry.

-Gary Rivlin1

Introduction

In 2005, the state of North Carolina was preparing to effectively evict payday lenders from its borders.2 CBS correspondent Scott Pelly traveled to the state to report on the effort by interviewing

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several persons involved in the overarching lending industry, speaking with lenders and borrowers alike. During the course of these interviews, the CEO of the State Employee's Credit Union of North Carolina, Jim Blaine, told Pelly that if someone was considering borrowing a payday loan he would recommend that he or she see a loan shark instead because "[t]hey're cheaper" as they only charge "an [annual percentage rate] of around 150%." This backhanded endorsement for loan sharks is understandable in the context of the larger picture: in states without payday lending protections and even in states with only minor protections, payday lenders may charge two to three times as much as Blaine's hypothetical loan shark. Although payday lenders do not break the legs of their borrowers, their mere presence harms individual borrowers and the communities they reside in by trapping both in unnecessary and excessive debt, which lasts far longer than advertised. The cycle of debt perpetuated by payday lenders diminishes the resources that borrowers and communities are able to put toward meeting basic needs, and thus perpetuates poverty in the neighborhoods that these lenders target. As one of the many states that permit payday lenders to both charge astoundingly high annual percentage rates (hereinafter "APR") and prolong the repayment of debt through rollover loans, California has failed to protect its citizens from the dangers of payday lending.

In this Note, I will discuss various aspects of payday lending. In Part I, I will explain what a payday loan is; compare how the product is advertised to the reality; and how these loans impact individual borrowers and their communities. Part II provides the national context of payday lending at federal, state, and local government levels. Part II touches briefly on issues faced in California, but in Part III I will provide a more exhaustive treatment of the current state of California payday lending. In Part IV, I will suggest how California local governments can use targeted transparency disclosures to better inform their citizens as to the consequences of borrowing a payday loan in order to discourage the practice.

3. RIVLIN, supra note 2, at 227.
4. Id. at 228.
I. What is a Payday Loan?^5

In order to properly discuss why more stringent regulation of the payday lending industry is imperative to protecting the financial wellbeing of California residents, it is necessary to first explain what a payday loan is.

A. Marketing vs. Reality

As a society, we are generally aware that the manner in which a product is advertised can be drastically different from how it will function in reality. For example, television advertisements for wrinkle creams tend to show miraculous transitions from faces plagued with conspicuous wrinkles, to those devoid of any and all “blemishes” upon application of the advertised product. However, few to none believe such a product can actually get rid of wrinkles. Although such smoke and mirrors may be considered harmful, the difference between marketing and reality in the payday lending context is more insidious. The former may impact a user’s self-image, but the deception of payday lenders has a lasting impact on a person’s finances and primarily targets those who are already especially vulnerable.\(^6\)

Payday lending businesses advertise their product as a small dollar amount, short-term loan intended for unexpected expenses, “like a car repair or [an] emergency medical need.”^7 However, it is

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5. Throughout the time I have spent researching and writing this Note, I have discussed my topic—perhaps ad nauseam—with family, friends, fellow law students, professors, and practicing attorneys. At the least, all recognized the name of one of the biggest lenders in the industry, Check Into Cash. However, most had only a vague and negative impression of check cashing, and were unfamiliar with the concept of payday lending. With the exception of a few attorneys and a professor that specialize in consumer debt matters, and the professor that supervised this Note, no one I spoke with knew the specifics of what a payday loan was or why consumer advocacy groups consider these loans predatory. Unless you, reader, have watched John Oliver’s witty and scathing segment on the payday lending industry, it is likely you are similarly unfamiliar with this abusive practice. Last Week Tonight with John Oliver (HBO television broadcast Aug. 10, 2014), available at https://www.youtube.com/watch?v=PDylgzybWAw.


evident that "the payday lending market does not function as advertised." The Pew Charitable Trust found that although these short-term loans are marketed as two-week credit products, payday loan borrowers are more likely to be indebted to lenders for approximately five months of the year, taking out an average of eight loans during that period. Other estimates suggest that it may take much longer than five months for borrowers to repay loans taken from payday lenders. The Center for Responsible Lending found that the typical payday borrower remains in debt for 212 days of the year, or approximately seven months. Further indication of the true price borrowers pay is the fact that only 2% of borrowers pay their loan in full when it first comes due. The remaining 98% are repeat customers.

The success of the payday lender business model is largely dependent on return customers, so lenders structure their loans to ensure that a vast majority of borrowers become ensnared in a repeating cycle of debt. Several analysts, employed by payday lenders, have concluded that repeat customers, also known as "rollovers," are integral to generating a profit. In November 2013, the Consumer Financial Protection Bureau "issued a report... finding that four out of five payday loans are rolled over or renewed within the 14 days" that the loan comes due. A former manager of
Check 'n Go, a payday lender, noted that although she occasionally saw new customers enter her store, she spent most of her time giving loans to the same customers. These repeat borrowers often renew their loan multiple times because they are forced to borrow again in order to repay the initial loan that brought them to the lender in the first place, and the exorbitant interest it spawns. The same former Check 'n Go manager often saw customers “pinball” between the other payday lenders that began to crop up around her location. Although the manager did not directly witness her customers taking out loans at the neighboring payday lending stores, it is highly probable they were, because the terms of these loans often force borrowers to shuffle their debt from one payday lender to another, only deepening their debt and the need for a subsequent loan. Also contrary to advertisement, the primary reason borrowers take out the initial loan is to pay for basic necessities, rather than to cover the cost of an unexpected emergency.

Additionally, there is evidence suggesting that at least some payday lenders, “de-emphasize the importance of the annual percentage rate of the loan.” Although payday lenders may be required under state and federal law to provide borrowers with notices about fees and interest rates, California residents surveyed by the Center for Responsible Lending in 2009 either were unable to recall the APR of their loan or stated a dramatically lower APR closer to the 20 to 30% APR of a credit card. The notices required by California—despite requiring payday lenders list the triple-digit APR—downplay the consequence of the APR to the borrower.

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19. RIVLIN, supra note 2, at 194.
21. RIVLIN, supra note 2, at 193–94.
22. Id. at 194.
23. Id. at 195 (recounting how a customer confessed to borrowing from multiple places); Need to Know on PBS, supra note 1.
24. PEW CHARITABLE TRUSTS, supra note 7, at 5.
25. LI ET AL., supra note 6, at 23.
27. LI ET AL., supra note 6, at 23.
For example, see California’s notice requirement:

<table>
<thead>
<tr>
<th>Amount Provided</th>
<th>Fee</th>
<th>Amount of Check</th>
<th>14-day APR</th>
<th>30-day APR</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>XX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>$200</td>
<td>XX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

Since the California notice requirement does not obligate payday lenders to include APR based on the average time it takes a borrower to repay the loan—as explained earlier, this ranges between five to seven months—this notice furthers the payday lender’s false advertising efforts discussed above. By only requiring the payday lender to include APR for 14-day and 30-day loans, a California borrower may be more inclined to believe that what he or she is contracting for is in fact a short-term loan that can realistically be paid back in two weeks or, at the latest, a month, while still only incurring limited fees. Savvy payday lenders have also been known to manipulate the notice requirement by giving the appearance that the lender will charge the same amount for each loan despite how long it takes to repay, which they accomplish by basing their calculations on a hypothetical loan repaid in two weeks (and keeping that information in fine print). The result is that both the 14-day and 30-day loans have the same “fee amount,” or interest based cost, and the APR for the 30-day loan is deceptively reduced from 460% to 214.74%. This infers that, whether the borrower repays within 14 days or 30 days, the loan will cost the same. In reality, the longer a borrower takes to repay a loan, the more it will cost to repay because the interest continues to accumulate and drives the “fee amount” up.

Since Americans have generally poor financial literacy, and are more inclined to pay attention to dollar amounts than interest rates, a borrower may only look at the deceptively low fees given by the payday lender, which are listed in dollar amounts, and ignore what the APR implicates for failing to repay within 14 days. Accordingly, even if a borrower attempts to be fiscally responsible in determining the true cost before taking out the payday loan, he or she will likely

32. Id.
34. See CALIFORNIA CASH ADVANCES, supra note 31.
focus on the dollar amount of the fees listed, and assume it factors in
the APR and actual length of the loan. Therefore, the borrower is
highly unlikely to see the true cost of the loan and is therefore
unable to make an informed borrowing decision.

In states that have yet to pass interest rate caps, the APR of payday
loans is well within the triple digits. According to the Center for
Responsible Lending, the APR of a typical payday loan in America lies
between 391% to 521%. The average APR of these unregulated
payday loans is 400%. In a white paper the United States Post Office
(hereinafter “USPS”), relying on a study conducted by the Pew
Charitable Trust, placed the average APR slightly lower at 391%. Additionally, it takes an average of four and a half months for
Americans to repay the average payday loan of $375. During those
four and a half months, the borrower accumulates $520 in interest and
fees alone. Accordingly, the total cost of borrowing a $375 payday loan
with an APR of 391% is $895. This is almost 2.4 times the amount of the
original loan; the payments being exacted like blood from a stone when
the payee is in dire financial circumstances. The average APR for
California payday loans has been calculated to be between 459% and
460%. This means that California residents are paying more for their
“short-term” loans than the average American payday borrower.

By paying the exorbitant costs that naturally result from high
APR, borrowers are forced to redirect funds they would otherwise
use for necessities, such as childcare, groceries, and utilities. The
irony being that the primary reason borrowers take out payday
loans is to pay for those same necessities. Borrowers have proven

35. CTR. FOR RESPONSIBLE LENDING, supra note 11.
36. Id.
37. CTR. FOR RESPONSIBLE LENDING, supra note 7.
38. OFFICE OF INSPECTOR GEN., U. S. POSTAL SERV., PROVIDING NON-BANK
FINANCIAL SERVICES FOR THE UNDERSERVED 13 figure 6 (Jan. 27, 2014), available at
39. Id.
40. Id.
41. CTR. FOR RESPONSIBLE LENDING, supra note 7 (explaining that “[w]ith each loan
renewal or flip, borrowers become unable to both repay the lender and have enough money
left until the next payday arrives. The trap of recycled debt is also how billions are taken each
year from poor people.”).
42. CA Payday Overview, CTR. FOR RESPONSIBLE LENDING, http://www.responsible
lending.org/california/ca-payday (last visited Oct. 27, 2014).
43. Tim Lohrentz, Tools for Advocates of Limiting Payday Lending: How Your
Community Can Limit Payday Lending Through Municipal Land-Use and Other Ordinances,
INSIGHT CTR. FOR CMTY. ECON. DEV. 2 (June 2013).
44. CTR. FOR RESPONSIBLE LENDING, supra note 7.
45. PEW CHARITABLE TRUSTS, supra note 7, at 5.
themselves resourceful because, despite extreme financial hardship and having to forgo basic necessities, on average they are able to extricate themselves from payday debt for approximately half the year. However, this is unlikely to indicate an improvement in a borrower’s financial status. Rather, it is probably due to payday lending industry’s use of ruthless tactics to incentivize their past due borrowers to complete repayment.

For example, employees at the Check ‘n Go referenced earlier, as well as those in other Ohio locations, were instructed to call late borrowers at least three times a day in attempt to collect an outstanding loan balance. When that did not work, the employee would call the three people the borrower was required to list as references when he or she took out the loan. If the borrower was still late with payment, the employee started calling the borrowers’ workplace. Sometimes Check ‘n Go employees would even physically visit the borrower’s workplace. Next, an employee would visit the borrower’s home and, if the borrower was out or neglected to answer the door, the employee would leave a door hanger specifying the amount of the debt he or she owed Check ‘n Go. Sometimes the employee would even knock on neighbors’ doors asking when the borrower would be at home.

Chris Browning, a former Check ‘n Go manager who was required to make these calls during the course of her employment and testified about the realities of payday lending to the Ohio state legislature, described the collection practices as “torture” and “no holds barred.” According to her, the purpose of these practices was to embarrass borrowers into paying. Terrence Jent, a former regional director for Check ‘n Go, confirmed these practices when he testified to the Ohio State legislature about his four years in the industry, calling the methods harassing and embarrassing. Furthermore, Jent thought the goal behind the visits to borrowers’ homes was to show the borrower that the payday lender knew where they lived, which implies that payday lenders may also extort payment through intimidation.

46. CTR. FOR RESPONSIBLE LENDING, supra note 11.
47. RIVLIN, supra note 2, at 193.
48. Id.
49. Id.
50. Id. at 259.
51. Id. at 193, 259.
52. Id. at 193.
53. Id. at 257, 193.
54. Id. at 193.
55. Id. at 258–59.
56. Id. at 258.
Even after a borrower extricates him or herself from the cycle of payday loan debt, lenders continue to contact former customers with the purpose of trying to entice them into taking out a new loan.\(^{57}\) One of the owners of Check 'n Go, Jared Davis, admitted that it was company policy to contact former customers that had not visited a location in 60 days to attempt to convince him or her to come back and take out a new loan.\(^{58}\)

Such predatory tactics make it critical to protect the individuals and communities being targeted by payday lenders. When payday lenders incentivize individual borrowers to prolong the cycle of their debt, lenders also create an avenue to spread their product to the surrounding community. In addition to de-emphasizing the APR of the loan\(^ {59}\) and thereby prey on a borrower's lack of financial literacy and inability to adequately weigh the risks,\(^ {60}\) lenders further encourage borrowers deeper into a cycle of debt by offering the borrower discounts on future loans and other incentives for referring family and friends.\(^ {61}\) For payday lenders, this rewards system has the dual benefit, of aiding in the retention of rollover customers they continue to earn profit from,\(^ {62}\) as well as allowing the lender to insert themself into the borrower's internal network, and further expand their customer base.\(^ {63}\) Although a borrower's most common reason for picking a particular payday lending location is based on seeing the storefront,\(^ {64}\) it is probable a potential borrower would be persuaded to choose between locations and companies based upon a family member or friend's referral.

The industry practice of using aggressive debt collection methods to pressure borrowers into taking out subsequent loans persist today. On July 10, 2014, the Consumer Financial Protection Bureau (hereinafter “CFPB”) filed a consent order, fining ACE Cash Express, Inc. (hereinafter “ACE”) $10,000,000 for its “unfair, deceptive, and abusive” debt collection practices.\(^ {65}\) According to the consent order “ACE’s collections training manuals instructed its collectors to

\(^{57}\) Rivlin, supra note 2, at 196.

\(^{58}\) Id. at 197.

\(^{59}\) Li et al., supra note 6, at 23.


\(^{61}\) Li et al., supra note 6, at 23.

\(^{62}\) Id. at 25.

\(^{63}\) Id. at 23.

\(^{64}\) Id. at 7.

'create a sense of urgency' for consumers in default" and used that urgency to pressure borrowers to payoff the existing loan by taking out a new one.66 They did so by excessively calling homes, work, and cell numbers; disclosing the debt to non-liable third parties; and illegally failing to abide by consumer requests to cease collection activities.67 In-house collectors lied to borrowers about the consequences of letting accounts go to collections.68 Some in-house and third-party collectors threatened borrowers with lawsuits or criminal prosecution.69 The CFPB found that ACE's methods "took unreasonable advantage of the inability of consumers to protect their own interests in selecting or using a consumer financial product or service."70 It is doubtful that Check 'n Go and ACE are alone in their tactics. More likely, many (if not all) payday lenders use similar tactics to keep their borrowers in a cycle of industry-profiting debt.

In addition to being pressured by predatory tactics, borrowers may be tempted to return to payday lenders because they have been forced to forgo basic necessities in order to pay their loan along with its exorbitant rates and fees71 and need a new loan to cover their cost of living. Analogously, once inundated with payday loans, it is difficult to free a community from the grip of these institutions and their predatory tactics without completely banning payday lending. Unfortunately, and as I will discuss in more detail below, issues of preemption make it nearly impossible for California local governments to ban payday lenders within their borders.72

B. How to Calculate an Annual Percentage Rate

As shown above, the APR attached to a loan has a significant impact on the actual cost of a payday loan,73 especially since it is highly unlikely a borrower can repay the loan and its related costs within the two weeks advertised.74 Therefore, it can be helpful to understand how to calculate APR. Since this Note focuses on California payday loans, I will use the equation provided by Tim

67. Id. at 5.
68. Id. at 5-6.
69. Id. at 6.
70. Id. at 11.
71. Peterson, supra note 26, at 927–28; PEW CHARITABLE TRUSTS, supra note 7, at 5.
73. OFFICE OF INSPECTOR GEN., supra note 38, at 13 figure 6; CTR. FOR RESPONSIBLE LENDING, supra note 42; Lohrentz, supra note 43, at 2.
74. CTR. FOR RESPONSIBLE LENDING, supra note 11.
Lohrentz in his article on regulating California payday lenders through local government land-use ordinances:75

**BASIC EQUATION FOR APR:** simple interest X number of terms per year

**SIMPLE INTEREST:** $45 interest on $255 loan = 17.65% interest (45/225)

**TERMS PER YEAR:** 365.25 days per year by 14-day minimum term = 26.09 (365.25/14)

**CALIFORNIA APR:** simple interest (17.65%) X number of terms per year (26.09) = 460%.76

USPS provides a similar equation, resulting in a lower nationwide average APR of 390%.77 This may be due to factoring in the twenty states and the District of Columbia, which have instituted regulations—through legislative action and voter initiatives—that cap the APR payday lenders can charge.78

**C. Vulnerable Communities**

In its Civil Code, the Legislature of the State of California memorialized an acknowledgment that its low-income citizens are especially affected by payday loans. Their acknowledgment states that while "[t]he ability to obtain and use credit has become of great importance to consumers... [c]ertain advertising and business practices of some credit services organizations have worked financial hardship upon the people of this state, often those who are of limited economic means and inexperienced in credit matters."79

As inferred in the Civil Code above, low-income communities are especially vulnerable to payday lending institutions because a natural consequence of impoverishment is a lack of resources; bad credit can prevent people from opening a bank account with a traditional banking institution, which is more aggressively regulated than the payday lending industry, and therefore has more reasonable APRs and fees. Another important factor is that Americans in general have problems with financial literacy and assessing risk.80 As Professor Christopher Peterson noted in his law review article on payday lending and municipal ordinances, the Department of Education recently found in a national survey that 22% of American adults lack "even the most basic quantitative

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76. Id.
77. OFFICE OF INSPECTOR GEN., supra note 38, at 13 figure 6.
78. CTR. FOR RESPONSIBLE LENDING, supra note 11.
80. Fung et al., supra note 60, at 33; Peterson, supra note 26, at 911–12.
literacy skills."81 The lack of financial literacy is worsened by all consumers' general approach to weighing risks. Overall, people tend to overestimate the risks of unlikely events, like plane crashes, while underestimating the risks of common events that are more likely to affect them, like the risk of cancer inherent in smoking cigarettes and the risk of death or injury associated with speeding in an automobile.82

When a borrower initially takes out a loan, he or she is usually "hopelessly optimistic" about their ability to repay that loan, despite any past negative experiences.83 In general, when making risk-related decisions, people do not seek out additional information about the risks.84 Furthermore, consumers often underestimate or ignore the long-term drawbacks of risky ventures and prefer to focus on the present benefits.85 In the case of payday loans, potential borrowers are more likely to focus on their pressing need for the loan—which is usually purchased to pay for basic necessities— and understandably disregard the seemingly minor future risks and costs associated with repaying it. Adding the "abstract nature of financial pricing," like an APR, into the mix makes it even more difficult for consumers to assess risks and maintain control over their finances.87

Borrowers often do not accurately weigh the risks associated with payday loans because the consequences will take place in the future whereas the financial need is immediate.88 Payday lenders' own studies show that the industry relies on rollover loans to make a profit— "rollover" meaning when borrowers pay off a loan by rolling it into a subsequent one—which means the industry is inclined to encourage borrowers to underestimate or ignore the consequences of their borrowing decision.90 On the surface, it is easier for the borrower—especially those suffering from emotional distress (e.g., urgent financial concerns), embarrassment, desperation, or fear—to disregard the fact that the consequence of rolling over a loan is often a dramatic increase in debt.91 This

81. Peterson, supra note 26, at 916–17.
82. FUNG ET AL., supra note 60, at 33.
84. FUNG ET AL., supra note 60, at 33.
85. Peterson, supra note 26, at 913.
86. P E W CH A R I TA B L E TRUSTS, supra note 7, at 5.
88. Id. at 914.
89. RIVLIN, supra note 2, at 226.
90. Peterson, supra note 26, at 915.
91. RIVLIN, supra note 2, at 195 (former customer confessed to former Check 'n Go location manager about the enormity of his debt).
disregard exacerbates the borrowers’ inability to meaningfully weigh the consequences.92

The mere access to a payday lending institution increases the likelihood that a person will borrow a payday loan.93 In the study he published in the Quarterly Journal of Economics, Brian Melzer compared similarly composed families living in a state which had banned payday loans, but shared a border with a state that permitted them."94 Families that had access to payday loans because they were close to the neighboring state reported increased hardship.95 These families were 25% more likely to report having difficulty in paying their bills.96 Additionally, they reported having to skip meals, forego telephone access, and postpone medical care.97

The presence of payday lending institutions in a community has impacts beyond increasing a family’s financial hardships. Professor Peterson cites a study conducted in Seattle, which found that “a greater density of payday-lending locations causes an increase in local crime rates.”98 Tim Lohrentz also notes that research indicates that there is a correlation between the presence of payday loan institutions and higher crime rates.99 In a 2009 study, the Center for Responsible Lending found that the clustering of payday lending institutions in California was a significant drain on African-American and Latino communities’ economic resources. These California communities paid $247 million for payday loan fees alone instead of putting those resources toward supporting their basic needs.100 This drain on the local economies contributed to foreclosures, loss of equity, and diminished property values.101 Considering the increased financial hardship and higher crime rates associated with the presence of payday lending institutions, it is understandable that Professor Peterson concludes that although “the social science is by no means unanimous, the best evidence suggests that small, high-cost loans are harmful to their borrowers and

92. Peterson, supra note 26, at 915.
93. Id. at 927.
94. Id. at 927–28.
95. Id. at 928.
96. Id.
97. Id. at 927–28.
98. Id. at 929.
100. Li ET AL., supra note 6, at 24; RIVLIN, supra note 2, at 289 (An Ohio based non-profit was unable to find such a correlation); id. at 307–08 (Consumer advocate in Ohio firmly believed in the correlation due to seeing a remarkably higher amount of foreclosures in African-American neighborhoods, which were inundated with payday lending institutions); id. at 319 (Alan Greenspan acknowledged in 2002 that subprime lenders were targeting specific communities).
101. Li ET AL., supra note 6, at 25.
to their communities on balance.”

The Center for Responsible Lending found in a study it conducted in 2009 that these harmful effects are disproportionately felt in minority communities. African Americans and Latinos constituted over half of payday lending borrowers, despite making up about a third of California’s overall payday loan eligible adult population. Whites accounted for only 36% of payday loan borrowers, despite representing 44.5% of the payday loan eligible adult population. In fact, the presence of payday lenders in areas with the largest African-American and Latino populations is almost eight times greater than in White neighborhoods.

The payday lending industry claims that the reason its locations are more prominent in minority neighborhoods is to serve areas neglected by banks and credit unions. However, the Center for Responsible Lending’s study proved this underlying rationale false. The difference in presence of bank and credit union branches in African-American and Latino neighborhoods as compared to White neighborhoods is slight to the point of irrelevancy and most likely due to banks favoring commercial areas. Accordingly, the Center for Responsible Lending believes payday lenders have a less than altruistic motive for concentrating in minority neighborhoods. Instead of trying to serve communities ignored by banks and credit unions, payday lenders are “exploit[ing] the preferences and fears of underbanked” African-American and Latino households.” Their study noted that the underbanked — those who have checking accounts but regularly use payday loans— may be choosing payday loans over traditional banking products because: (1) the concentration of payday lending institutions makes them more conveniently located than banks and credit unions, (2) unlike traditional financial institutions, payday lenders approve loans for almost all applicants with checking accounts, and (3) payday loans have comparative “seemingly clear pricing.”

103. Li et al., supra note 6, at 4, 25.
104. Id. at 4.
105. Id.
106. Id. at 10.
107. Id. at 6.
108. Id. at 13.
109. Id. at 20.
110. Id. at 50 n.18 (defining “underbanked” as referring to someone who, despite having a checking account, “regularly use[s] alternative products and services such as check cashing and payday loans.”).
111. Id. at 6.
112. Id. at 23.
In addition to clustering in neighborhoods with higher minority populations, payday lenders are unsurprisingly also overwhelmingly located in low-income neighborhoods. Accordingly, it is probable that low-income communities with greater minority population are especially burdened by the clustering of payday lenders.

When crafting legislation to regulate payday lending, it is imperative that legislative drafters keep in mind which communities are most vulnerable—where payday lenders are most likely to cluster—so the drafters can afford these communities the protections needed. While it is probable that payday lenders presently target the same vulnerable communities, the Center for Responsible Lending’s study referenced earlier was published in 2009, it would be prudent for those drafting legislation to rely on more current data in their legislative efforts. As the non-profit organization “that has taken the lead against predatory lending in its various forms,” the Center for Responsible Lending may be the best place to start. Otherwise, drafters can rely on the sources used for the 2009 study: the State of California Department of Corporations, the Federal Deposit Insurance Corporation, and the United States Census.

II. Post-Deregulation and Subsequent Reform

After the incursion of payday lenders into the states that have deregulated their usury laws, there has been substantial reform at all levels of government: national, state, and local governments. In Part III of this Note, I will discuss California in detail, including the current laws that govern the State’s lending and attempts to reform its past deregulation of the State Constitution’s usury laws. To understand California’s past and possible future attempts at reform, it is important to view it in the broader federal context.

113. Li ET AL., supra note 6, at 13.
114. Li ET AL., supra note 6.
115. RIVLIN, supra note 2, at 50.
116. Li ET AL., supra note 6, at 4.
117. BLACK’S LAW DICTIONARY 1543 (7th ed. 2001) (explaining that in modern law the term “usury” refers to unlawful interest rates, which exceed maximums set by law).
119. CAL. CONST. art. XV, § 1; see infra Part III.
A. Federal


With few overarching federal laws regulating payday lenders, the task has largely fallen to the states and their usury laws. With consumer advocates in Congress, such as Senator Elizabeth Warren of Massachusetts, overarching federal regulation may not be as far off as it once seemed. Currently, there are few federal statutes that apply to the payday lending industry, but there is some growing federal agency regulation. One of the relevant federal statutes is the Truth in Lending Act, which imposes disclosure requirements regarding fees that states have incorporated into their laws.

The most clearly protective federal action to date took place on October 17, 2006. On that day Congress codified protections for members of the military against excessive payday loan rates, which were to take effect the subsequent year. This law became known as the Military Lending Act (hereinafter “MLA”). Subsequent amendments in 2013 added additional disclosure requirements, but the MLA has otherwise remained largely unaltered. The core protection afforded to members of the military by the MLA is a nationwide restriction on charging excessive interest rates: when a member of the military is extended credit, the “creditor . . . may not impose an annual percentage rate of interest greater than 36%” on the member or their dependents. This applies to various types of consumer loans, including payday loans. Congress has yet to extend this 36% cap on payday loan APRs to civilians.

The largest and most impactful federal statute since the enactment of the MLA was the passage of the Dodd-Frank Act in 2010. Professor Johnson recounted that when the MLA was passed “in the wake of the mortgage foreclosure crisis” it “create[d] a new federal agency . . . to focus on protecting consumers

122. 10 U.S.C. § 987 (2006); see also Editor’s and Reviser’s Notes for 10 U.S.C. § 987.
123. Johnson, supra note 118, at 649.
125. 10 U.S.C. § 987(a)-(b).
126. Johnson, supra note 118, at 649.
127. See generally, Johnson, supra note 118 (discussing how the Consumer Financial Protection Bureau has the authority to protect civilians in a manner similar to the MLA).
in the credit market place."\(^{129}\) The agency charged with protecting consumer credit was the CFPB.\(^{130}\) The CFPB's self-expressed mission "is to make markets for consumer financial products and services work for Americans—whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products."\(^{131}\) Along with educating the public\(^{132}\) and studying the financial market,\(^{133}\) the CFPB also "enforce[s] federal consumer financial laws."\(^{134}\) The enforcing arm of the CFPB enables the agency to bring lawsuits and administrative actions against illegal payday lending.\(^{135}\)

Due to matters of jurisdiction, the regulation of online payday lenders that are based in tribal territories is complicated, particularly with regard to who can sue and where the suit should take place. The CFPB and Federal Trade Commission (hereinafter "FTC") have both pursued actions against lenders based in tribal territories, and the resulting jurisdictional splits among District Courts show that this issue has yet to be conclusively resolved.\(^{136}\) Adam Mayle has already written an in depth analysis of tribal territory based payday lenders and the federal preemption issues this raises,\(^{137}\) so I will not attempt to elaborate further on this complex area.

\(^{129}\) Johnson, supra note 118, at 649 (emphasis removed).
\(^{130}\) 12 C.F.R. § 1002.1 (2011).
\(^{133}\) Herring, supra note 118.
\(^{134}\) CONSUMER FIN. PROT. BUREAU, supra note 131.
\(^{137}\) See generally Adam Mayle, Note, Usury on the Reservation: Regulation of Tribal-Affiliated Payday Lenders, 31 REV. BANKING & FIN. L. 1053, 1075-76 (2012) (discussing online payday lending in tribal territories and the federal preemption issues it raises).
2. Recent and Impactful Federal Agency Actions

Since November 2013 there have been three federal agency actions that have particularly impacted the future of payday lending. When the Center for Responsible Lending published its paper on the state of lending in September 2013, six major banks and credit unions were offering their own payday loan product with an APR "ranging from 225% to 300%." This product was marketed as a "direct deposit advance service." On November 21, 2013, the Federal Deposit Insurance Corporation (hereinafter "FDIC"), which oversees banks, issued a press release and guidance co-authored by the Office of the Comptroller of Currency (hereinafter "OCC"), which expressed the FDIC and OCC's concerns about direct deposit advance products and their intention to implement new supervision requirements. In the light of impending federal scrutiny, Regions Bank, which is actually regulated by the Federal Reserve, not the FDIC, announced it was discontinuing its payday loan program. Two days later Fifth Third Bank, also regulated by the Federal Reserve Board, made a similar announcement, and so did Wells Fargo and US Bank, who are both regulated by the FDIC and OCC. This does not appear to have had an immediate impact on traditional storefront payday lending or its online incarnation, but it does demonstrate that federal involvement is powerful, and when leveraged correctly, may be an effective tool in putting a halt to abusive lending practices.

The second potentially influential, as well as surprising, agency action is a proposal by USPS. For years, payday lenders have been justifying their high APR product as providing loans to high-risk customers who, due to bad credit, might not be able to borrow


139. Id. at 4.


elsewhere. Payday lenders bolster this argument with the fact that there are few to no alternatives to their product and claim that the high APR is necessary because lending to their target demographic of customers with bad credit presents a high risk. This is a valid concern, which USPS proposed a solution for in its recent white paper. USPS proposes that it could “offer non-bank financial services,” including “small loans that would help customers overcome unexpected expenses.” The paper provides a comparative breakdown of the national average costs of payday loans versus USPS’s suggested alternative program. For a $375 loan, an average payday lender attaches an APR of 391%, whereas USPS suggests a significantly lower APR of 28%. Relying on the Pew Charitable Trust, the Postal Service claims it takes an average of 4.5 months for a borrower to repay a loan from a payday lender and would take 5.5 months to repay its proposed alternative small-dollar loan. Taking the USPS’s figures at face value, this boils down to payday lenders charging $520 in interest and fees on top of the original $375 loan and the Postal Service charging only $48 in interest and fees. The proposal has garnered support from Senator Warren and the public at large, which may help push the payday alternative from the white paper into the green world of finance.

The most recent agency action is the CFPB’s administrative proceeding against ACE Cash Express, LLC. As discussed in Part I, the CFPB fined ACE for its unfair, deceptive, and abusive debt

143. Rivlin, supra note 2, at 30–31, 239.
144. S. 318, 2013 Leg. (Cal. 2013) (enacted); See also Need to Know on PBS, supra note 1 (Gary Rivlin discussing a payday loan alternative program in North Carolina).
145. See Rivlin, supra note 2, at 327–28 (Mike Loftin explaining that “[t]he underlying logic of subprime mortgagees and payday loans is the same: that the only way to expand credit to minorities and lower-income people is to dumb-down credit standards and charge them more for the added risk”).
146. See generally OFFICE OF INSPECTOR GEN., supra note 38.
147. Id. at ii.
148. Id. at 13 figure 6.
149. Id.
150. Id.
151. OFFICE OF INSPECTOR GEN., supra note 38 at 13 figure 6.
152. See Emily Swanson, Elizabeth Warren’s Postal Banking Idea Has Big Public Support, New Poll Finds, HUFFINGTON POST (Feb. 13, 2014), http://www.huffingtonpost.com/2014/02/13/post-office-banking-_n_4776767.html (finding that a plurality of Americans favor having the Postal Service offer basic financial services and that its “expansion into basic financial services would provide healthy competition”).
collection practices, and ordered ACE to change those practices.\textsuperscript{154} The risk of paying millions in fines will likely encourage other lenders to curb similar behavior. However, the consent order does not prevent ACE from keeping their delinquent borrowers in a continuing cycle of debt. Although ACE employees may not overtly encourage borrowers to pay off their loan with a new one, they can inform the borrower of the possibility if the borrower asks.\textsuperscript{155} Accordingly, while the CFPB has demonstrated its intention to hold payday lenders accountable for their debt collection practices, such litigation alone cannot grant borrowers the protections they need.

B. State and Local Governments

The Center for Responsible Lending recently testified to the CFPB that "[n]ot a single state has legalized payday lending since 2005."\textsuperscript{156} Additionally, there is a trend among states against payday lending, with 22 states prohibiting or restricting the payday lending industry.\textsuperscript{157} Some of those states with regulations in place still permit APRs in the triple digits or higher.\textsuperscript{158} For example, Washington State, which still permits high APRs,\textsuperscript{159} attempts to protect its consumers by limiting the dollar amount and length of the loan.\textsuperscript{160} The majority of the states regulating this type of lending have instituted caps on APRs, the lowest being 17%.\textsuperscript{161} Georgia explicitly prohibited payday lending and classified the practice as a violation of its racketeering laws.\textsuperscript{162} Others less explicitly prohibit the practice by repealing the laws created to authorize their presence or allowing those laws to sunset.\textsuperscript{163} Despite prohibiting payday lending, a state may experience difficulty in eradicating the practice because storefront lenders may continue to practice illegally within the state\textsuperscript{164} and this does not prevent non-traditional online lenders

\begin{itemize}
\item 155. Id. at 13–14.
\item 156. Herring, supra note 118.
\item 157. Id.
\item 159. Id.
\item 160. CTR. FOR RESPONSIBLE LENDING, supra note 7.
\item 161. CONSUMER FED’N OF AMERICA, supra note 158.
\item 162. Id.
\item 163. Id.; See also RIVLIN, supra note 2, 104-15 (providing a history of the beginning of the reform movement in North Carolina).
\item 164. RIVLIN, supra note 2, at 315-16 (observing it took five years before all storefront payday lenders left North Carolina).
\end{itemize}
from marketing their product to its citizens from payday lending friendly jurisdictions.  

When Christopher Peterson published his article, "Warning: Predatory Lender" - A Proposal for Candid Predatory Small Loan Ordinances," in 2012, "at least 135 local governments had attempted to restrict, regulate, or otherwise arrest the development of usurious lending within their boundaries." Local ordinances have resulted in varying degrees of success and failure because those creating the ordinances must take into consideration issues of federal and state preemption.  

For example, a Florida state trial court struck down the city of Jacksonville’s ordinance capping their APR at 36%, because the judge found the ordinance was preempted by the state’s own APR cap of 300%. The city of St. Ann, Missouri tried a different tactic by basing its ordinance in zoning laws as a way to completely ban the presence of payday lenders in its borders. The Supreme Court of Missouri struck down the ordinance also on preemption grounds, because the state permitted the presence of payday lenders and the ordinance would ban an activity allowed under state law. So far the city of Dallas, Texas has survived a preemption challenge to its penal ordinance, which includes the following protections: capping payday loans at 20% of a borrower’s income, limiting the number of rollovers, allowing installment payments, and fining lenders that violate the ordinance.

Typically, local governments rely on “their well-accepted power to adopt zoning ordinances to stem the tide of payday ... lending within their jurisdictions.” According to Professor Peterson, local governments typically implement three types of ordinances: “(1)
restrictions on the location where predatory lenders can operate; (2) discretional permits that restrict who may obtain licenses to engage in predatory lending; and (3) permanent or temporary limits on the number of predatory lending locations within a jurisdiction.  

Along with explaining how each type of ordinance operates, Professor Peterson notes their specific weaknesses. He states that the distance limits (e.g., requiring payday lenders stay a specific distance from schools), although "cosmetically appealing," are "too small to impede the basic business model" of the payday lenders and ironically "force" them to locate "in the poor, often minority neighborhoods and strip malls that they wanted to operate in anyway." Furthermore, all three types of ordinances "provide political cover for leaders who do not want to risk offending the powerful predatory lobby" and are highly unlikely to help statewide reform campaigns.

The weakness Professor Peterson believes applies to all three types of measures is that they "[provide] too little protection too late," because by the time the measures are passed the jurisdictions are saturated with payday lenders and the grandfather clauses that most local governments feel compelled to create allow existing payday lenders to stay in place. Permitting existing locations to remain "cements the unsatisfactory development patterns in place for the long term."

III. Current State of Payday Lending in California

As previously stated in Part I, the average APR for a California payday loan has been calculated to be between 459% to 460%. As a result borrowers in California "lose more than $450 million every year just to pay the fees on their . . . payday loans." In 2009, the Center for Responsible Lending found that $247 million of the $450 million came from the African-American and Latino communities payday lenders prefer to cluster in. As discussed in Part I.C., payday lenders are overrepresented and tend to cluster in California communities with

174. Peterson, supra note 26, at 937.
175. Id. at 937-40.
176. Id. at 939-40.
177. Id. at 940; See generally Lohrentz, supra note 43 (proposing local government ordinances can be used to bolster larger reform efforts).
178. Peterson, supra note 26, at 939.
179. Id.
181. CTR. FOR RESPONSIBLE LENDING, supra note 42.
182. Li ET AL., supra note 6, at 24.
higher percentages of minority and low-income populations. Therefore, it is predictable that these same communities are also vulnerable to the California payday lending industry.

A. Reform Efforts

In April 2013, the California State Legislature considered Senate Bill 515, which proposed to reform the payday lending industry within the state. The bill, introduced by Senator Jackson on February 21, 2013, acknowledged that "the high price of a payday loan" and the requirement "that it must be paid off in one lump sum after only two weeks, virtually ensures that cash-strapped borrowers will be unable to repay the loan and have enough left over to meet their other basic needs." This "debt trap" effectively forced the majority of borrowers to "re-borrow before their next pay period to make ends meet." The bill proposed to better protect California consumers by limiting individual borrowers to four loans per year; giving borrowers 30 instead of just 14 days to repay; requiring payday lenders to assess the borrower’s ability to repay; allowing borrowers to enter into installment repayment plans; and requiring that payday lenders produce additional information to the California Department of Corporations. Despite not requiring a cap on the state’s triple-digit APR, the bill still failed. After the payday industry’s success one of their lobbyists commented: "I do feel bad that people have to go to the payday lending industry...but the fact of the matter is, they help a lot of people in the state of California." To the best of my knowledge, at the time this Note went to print, no new reform measures had been enacted.

The California State Legislature has authorized the creation of small dollar loan pilot programs on at least two occasions. Yet, considering how much California residents still spend on payday lending, the existence of these pilot programs does not appear to have had a significant impact on payday lending in California. The

183. Li ET AL., supra note 6, at 13.
186. Id.
187. Id.
189. Id.
190. S. 318, 2013 Leg. (Cal. 2013) (enacted); S. 1146, 2010 Leg. (Cal. 2010).
ineffectiveness of these pilot programs may be due to management issues, lack of publicity, the larger presence of payday lenders throughout the state, or a combination thereof.

A recent and promising reform measure is the passage of Senate Bill 896, which will be codified in the California Financial Code as sections 22066 and 22067. Although the law has been approved by Governor Brown it does not appear to have fully taken effect. Once the law does take effect, specially licensed non-profits will be able to provide small dollar loans at 0% interest for a fixed set of reasonable fees. The law is intended to help borrowers establish and build their credit history, so the non-profit lenders understandably will be required to provide the borrowers with credit education before distributing the loan. After the law takes effect, non-profit lenders will be able to provide a healthier alternative to payday loans. The sustainability of the program and its effectiveness in diverting borrowers from payday loans remains to be seen.

B. Overarching State Laws

The California Constitution has set usury laws. It sets per annum interest rates to 7% for “loan[s] or forbearance[s] of any money, goods, or things in action, or on accounts after demands” and caps those interest rates at a maximum of 10% per annum. Despite the additional language that “[n]o person, association, copartnership or corporation shall . . . receive from a borrower more than the interest authorized by this section” and that “[t]he provisions of this section shall supersede all provisions of this Constitution and laws enacted thereunder in conflict therewith,” these State Constitutional protections have been interpreted to not apply to payday lenders.

Instead, “[s]ections 23000-23106 of the California Financial Code . . . also known as the California Deferred Deposit Transaction

192. Id.
193. Id. at §§ 22066 (c), (c)(6)(G), (c)(6)(C)(i)-(iii).
194. Id. at § 22066 (a), (c)(7).
195. CAL. CONST. art. XV, § 1 (1879).
196. Id.
197. Id. at § 1(1)–(2).
198. Id. at § 1(2).
199. Lohrentz, supra note 43, at 17 (stating that “Article XV of the California Constitution . . . does not apply to deferred deposit (payday) lenders.”).
Law, govern the conduct of check cashers and payday lenders."\textsuperscript{200} Section 23036 articulates that a payday lender’s “fee for a deferred deposition transaction shall not exceed 15% of the face amount of the check."\textsuperscript{201} Unlike Article 15 of the State Constitution, the text in section 23036 does not say “per annum” so the 15% is \textit{simple} interest, which translates into the 459% to 460% APR discussed previously.\textsuperscript{202} This section also allows payday lenders to tack on an additional $15 charge if a borrower’s check bounces,\textsuperscript{203} which is almost inevitable considering the majority of borrowers are unable to repay the loan when it comes due after 14 days.\textsuperscript{204}

Payday lenders operating in California are required to make various financial disclosures to borrowers regarding their fees, some of which are imported from the federal Truth in Lending Act.\textsuperscript{205} The most visually apparent disclosure is to be posted “clearly and conspicuously in the unobstructed view of the public” at each payday lending institution “in letters not less than one-half inch in height” along with a disclosure informing borrowers that they cannot be criminally prosecuted for any potential debt.\textsuperscript{206} Furthermore, payday lenders are required to provide a fee schedule.\textsuperscript{207} The suggested format is:

<table>
<thead>
<tr>
<th>Amount Provided</th>
<th>Fee</th>
<th>Amount of Check</th>
<th>14-day APR</th>
<th>30-day APR</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>XX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>$200</td>
<td>XX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

As discussed in Part I.A., although this format initially appears helpful, payday lenders have found a way to manipulate the disclosure in their favor and belie the actual cost of their product. For example, the portion of Check Into Cash’s website regarding its California stores, the “Fee Amount”—essentially the cost of the accumulated interest—of a $100 loan remains $17.65 whether its borrowed for 14 or 30 days.\textsuperscript{208} Similarly, the fees for a $200 loan

\textsuperscript{200} Lohrentz, \textit{supra} note 43, at 17.
\textsuperscript{201} Cal. Fin. Code § 23036(a) (2004).
\textsuperscript{202} See \textit{supra} Part I.B. (providing a formula to calculate APR and simple interest).
\textsuperscript{204} CTR. FOR RESPONSIBLE LENDING, \textit{supra} note 11.
\textsuperscript{205} Cal. Fin. Code § 23035(c)-(f) (2004).
\textsuperscript{206} \textit{Id.} at § 23035(d).
\textsuperscript{207} \textit{Id.} at § 23035(d)(2).
\textsuperscript{208} \textit{Check Into Cash, supra} note 31.
remain at $35.30 for the same time periods. This static fee amount and the mysterious drop in the APR, which calculates to 460.16% for a 14-day term and lowers to 214.74% for a 30-day term, allows borrowers to conclude Check Into Cash charges a flat fee. It is only after looking at the duller-colored fine print below stating that all of their calculations are “[b]ased on a fourteen (14) day advance with one (1) payment,” that the deception becomes apparent: The real APR for the alleged 30-day term loan is 460% and there is no flat fee. In order to keep the cost at $17.65, the loan must be repaid within the 14-day term, otherwise the interest will build to envelope the borrower in unexpected debt.

C. California Local Government Efforts

As we have seen, protective ordinances bear the risk of being overturned due to preemption. Accordingly, local governments are unable to pass the interest rate caps that would grant their citizens the most protection. California local governments looking to protect their citizenry from payday lending institutions located within their jurisdictions could be well served to take the state laws discussed in Part III, section B, into consideration.

To circumvent preemption concerns, many counties and cities in California have instead passed land use ordinances, which are considered within the purview of local governments and not the state. These types of ordinances include: short moratoriums on new or relocating payday lenders while the local government assesses the situation; bans on new institutions entering the jurisdiction or specific neighborhoods; caps on the amount of payday lenders in the jurisdiction; requirements that payday lenders stay a specific distance from other payday lenders or “other sensitive uses” such as schools and liquor stores; performance measures such as hours of operation; conditional use permits; and zoning code verification certificates. These ordinances are prospective, and typically have little to no effect on existing payday lending locations. Even those that ban payday lenders from specific neighborhoods

210. CHECK INTO CASH, supra note 31.
211. Id.
212. CTR. FOR RESPONSIBLE LENDING, supra note 42.
213. Peterson, supra note 26, at 934–36.
214. Lohrentz, supra note 43, at 21–22 (providing a table summarizing the ordinances implemented by local governments in California to regulate payday lending).
215. Id. at 17 (stating that “local land use is a police power granted to local governments rather than to states”).
216. Id. at 17–18.
have little immediate effect, because the statutory scheme will often include a problematic grandfather clause that allows the existing institutions to remain.\textsuperscript{217} Accordingly, it is debatable how effective land use ordinances are at protecting citizens, especially if the area covered by the ordinance is already inundated with payday lenders, which "has typically served as the political impetus for the ordinance in the first place."\textsuperscript{218}

**IV. Warning Signs and Targeted Transparency**

A. Peterson's Proposed Warning Sign

In light of the inadequacy of land use ordinances, Professor Peterson has proposed that local governments create ordinances requiring payday lenders bear a "cautionary message on signs at [their] businesses" when they "[offer] credit at annual percentage rates exceeding 45%."\textsuperscript{219} An example of suggested language for the ordinance is included in his Appendix A.\textsuperscript{220} He suggested the following language for his cautionary message: "City of Anywhere Warning: Predatory Lender."\textsuperscript{221} The message would be required on all of the payday lender’s exterior signs, covering one-third of the space, and in black text on a white background.\textsuperscript{222} The placement on all exterior signs is an attempt to discourage payday lenders from advertising their locations as well as to put potential borrowers on alert.\textsuperscript{223}

Furthermore, Professor Peterson proposes the cautionary message also be placed on the payday lender’s door with an “additional explanation indicating: that the city or county in question has determined that the facility displaying the sign engages in predatory lending; that the local government requires predatory lending warnings on displayed signs under a consumer protection law; that the lender offers loans at interest rates above 45%; and, that “[t]hese loans can cause bounced checks, penalty fees, repossessions lawsuits, and severe financial hardship.”\textsuperscript{224} Permit fees would cover the cost of enforcing the proposed ordinance.\textsuperscript{225} Both the local government and

\begin{footnotesize}
\begin{itemize}
  \item 217. Lohrentz, supra note 43, 17-18.
  \item 218. Peterson, supra note 26, at 939.
  \item 219. Id. at 941.
  \item 220. Id. at 969-70.
  \item 221. Id. at 941.
  \item 222. Id.
  \item 223. Id.
  \item 224. Id. at 941-42.
  \item 225. Id. at 942.
\end{itemize}
\end{footnotesize}
borrowers could bring enforcement actions against violators.\textsuperscript{226}

Peterson argues that his proposal does not trigger issues of preemption because local governments are granted "all powers not expressly denied by state statute" and most of the states that require enumerated powers "have expressly granted local governments the broad authority to enact any laws or regulations that are 'reasonably related' to the promotion of 'health, safety, morals, peace, or general welfare.'"\textsuperscript{227} Additionally, a local government's authority to regulate the general welfare of its citizens has been consistently held to include the authority to regulate consumer finances, such as payday lending.\textsuperscript{228} He bolsters his claim that states have not fully occupied the field of payday lender regulation by pointing to the existence of the numerous zoning ordinances that blatantly target the industry.\textsuperscript{229} Specifically, the cautionary message is unlikely to contradict any express provisions codified in state consumer protection statutes.\textsuperscript{230} Nor should it violate the United States Constitution.\textsuperscript{231}

If Peterson's preemption analysis is correct, local governments in California should be able to pass cautionary message ordinances without preemption concerns.\textsuperscript{232} The California Financial Code does not specify limits on the abilities of its local governments to regulate payday lenders' storefronts.\textsuperscript{233} The disclosure requirements articulated in section 23035, including those incorporated from the federal Truth in Lending Act, do not mention storefront signs or provide limitations on the information that can be disseminated in disclosures.\textsuperscript{234} Rather, it establishes a minimum standard for payday lenders to meet.

\textbf{B. Targeted Transparency}

Although Professor Peterson's proposed warning sign is a good start, especially because the placement on exterior signage and doors means consumers are presented with the risk information at the time

\textsuperscript{226} Peterson, supra note 26, at 942.
\textsuperscript{227} Id. at 947–48.
\textsuperscript{228} Id. at 948.
\textsuperscript{229} Id. at 951.
\textsuperscript{230} Id.
\textsuperscript{231} Id. at 952–68 (analyzing how the cautionary message is acceptable under the First Amendment either under the Government Speech Doctrine or Compelled Commercial Speech).
\textsuperscript{232} See supra Part IV.A.
\textsuperscript{234} Id. at § 23035 (2004).
and place they would make a borrowing decision,235 it may not be enough to effectuate a significant change in consumer practices and would doubtfully stop the most financially vulnerable from falling victim to this poverty-perpetuating product. The authors of the legislative transparency book Full Disclosure explain that providing “[j]ust the facts” (i.e., this location is a predatory lender that charges above 45% APR, which can lead to consequences, such as bounced checks and severe financial hardship) might be inadequate, because such an approach “fail[s] to recognize that potential users may not respond in ways that models of rational behavior predict.”236

In a rational world, a cautionary message similar to the one Professor Peterson suggests should put borrowers on notice to inquire about the realistic consequences of taking out a payday loan, especially those with limited income. However, the apprehension that the warning is meant to evoke is not likely to manifest as “[p]eople do not seek or use information about risks even when making risk-related purchases”237 like payday loans. Even those that might heed the sign and attempt to evaluate the risk will likely assess their individual risk incorrectly because “[p]eople tend to substantially overestimate risks associated with unlikely events . . . (such as chemical accidents or airplane crashes)” and “underestimate the risks posed by events in which they perceive themselves as having greater control (such as smoking, eating high-fat foods, or speeding on the highway).”238 The act of borrowing a payday loan likely falls into the latter category, as borrowers exert some sense of agency in initiating the agreement by entering a storefront or filling out an application online. Furthermore, the times when people are more likely to attempt to reduce their risk is when the consequences are described in “graphic (rather than clinical) terms.”239 When contrasted to anti-smoking campaigns that emphasize personal stories and images of those negatively affected by smoking, it is clear that Professor Peterson’s cautionary sign is “clinical” rather than “graphic.” The phrase “predatory lender” is a complicated term of art and the list of consequences Professor Peterson proposes—bounced checks and severe financial hardship240—come across as theoretical. So theoretical that they can be dismissed as easily as the carcinogen warning signs that seem to be present in every commercial location in

235. FUNG ET AL., supra note 60, at 57.
236. Id. at 34.
237. Id. at 33.
238. Id. at 33.
239. Id.
240. Peterson, supra note 26, at 942.
California, which state that entering the premises exposes a person to carcinogens, but fails to give the probabilities of contracting an illness or other negative effects.

For a transparency measure to be effective and reach the consumer it needs to be "embedded," meaning: (1) the consumer must perceive it as valuable in achieving his or her goals, (2) it must be compatible with his or her decision-making process, and (3) it must be comprehensible. Municipal measures like the County of Los Angeles' restaurant hygiene grading system are held in high regard as an example of effective transparency, because the grades "have become highly embedded in customers'... existing decision making process." Each restaurant receives a letter grade with a corresponding vivid color, or a grey number if the score falls below 70. The grades are successful because they are available where and when needed—on the storefront and viewable before entering the restaurant—convey useful information in a comprehensible format about the cleanliness, and therefore the potential health risks of eating there. After implementing the mandatory grading system, the county experienced a 5.3% increase in hygiene quality and a 13.1% decrease in hospitalizations due to food-borne diseases, a decrease that persisted in subsequent years. The continued existence of restaurant grading systems, which vary in local jurisdictions, demonstrate that these measures are under the local government jurisdiction and do not pose any issues of preemption, at least none that have been challenged thus far.

C. Grading Payday Lenders Through Targeted Transparency

Considering its level of success in conveying information and improving the health of its citizenry, California local governments who want to effectively inform their citizens about the dangers of payday lending and discourage the use of these loans should adopt measures that emulate Los Angeles County's restaurant hygiene grading system. A highly visual grade or star rating system coupled with an easy-to-understand breakdown of the real financial consequences could help

241. FUNG ET AL., supra note 60, at 55.
242. Id. at 82.
244. FUNG ET AL., supra note 60, at 83.
245. Id. at 93.
potential borrowers accurately assess the risk and make an informed decision. The grade should be based on a variety of factors, including: the APR; the average length of time it takes to repay the loan; the average interest and fees incurred by borrowers; the percentage of customers that borrow repeatedly; how often the payday lender contacts the borrower, family, and friends to collect; and additional important factors. The accompanying easy-to-understand financial breakdown should clearly state the dollar amount of the average loan (or perhaps also the highest amount allowed under state law), the average time it takes to repay that loan, the corresponding APR, the corresponding amount of fees and costs associated with it, and the average total cost of the product. This should be stated in dollar amounts as there is evidence that "although people do not understand APR disclosures, they do understand... [disclosures given in] a dollar amount."247 Similar to the restaurant hygiene grades, the payday lending grade and accompanying easy-to-understand financial breakdown should be placed on the storefront where potential borrowers can review it before entering the location. As Peterson suggested for his cautionary message, permit fees could fund the implementation of a grading and financial disclosure measure, which might require inspectors similar to health inspectors to ensure accuracy. Additionally, if it is explained as arising out of the need to care for its citizens' general welfare, the measure should remain in the local government's jurisdiction without courting any issues of preemption.

Such a measure would easily meet the compatibility and comprehension factors discussed in "Full Disclosure."248 The grade and supplemental information would be available at the time and place potential borrowers are considering whether to borrow the payday loan, making it relatable to the decision. The information would be immediately digestible, as normative signs and visual graphics, such as letter grades, are considered an effective way to distill and communicate complex data.249 The supplemental information gives more interested potential borrowers quick access to more detailed information, but does not overburden them.

The crux is that potential borrowers may not consider the grading and financial breakdown valuable if they "believe they have few meaningful choices to make."250 There are few alternatives available to those that take out payday loans and potential borrowers may perceive

248. FUNG ET AL., supra note 60, at 55.
249. Id. at 57, 59, 61.
250. Id. at 56.
even fewer alternatives if they fear a bank or alternative source will refuse to lend to them due to bad credit. This can only be alleviated by educating the community on available alternatives. When California's SB 896, which is aimed at improving financial health and literacy, takes effect, or if the aforementioned USPS's proposal comes to fruition, then reasonable alternatives may come to the forefront and increase the value of the proposed measure. Once borrowers use payday "grades" in determining whether to take out a payday loan, payday lenders are more likely to incorporate that consumer response into their business model.\textsuperscript{251} This could lead to self-regulation in a manner similar to the restaurant industry in Los Angeles,\textsuperscript{252} and result in a lowered APR and a cleaning-up of other egregious practices in an effort to obtain a better grade.

Conclusion

The payday lending industry is detrimental to the citizens of California and all the states that permit its presence. These businesses use deceptive advertising and financial information to target vulnerable potential borrowers, especially those in neighborhoods with a high proportion of low-income minorities. This entices people into long cycles of debt, which exacerbates poverty by dramatically depleting resources that would otherwise go toward basic needs. Local governments in California can discourage the practice and lessen its negative impact by implementing measures that emulate the Los Angeles County restaurant hygiene grading system to accurately and effectively inform potential borrowers about the actual consequences of taking out a payday loan. Local governments can support their measures by providing an assessment on the vulnerability of its citizens. These assessments could be accomplished by consulting the California Department of Corporations and the advocacy group the Center for Responsible Lending, or other similarly situated organizations.

However, due to limited alternatives and the lived experience of negotiating conditions of poverty, even if grading measures are successfully implemented and enforced it is likely that many California residents will still feel pressured into take out payday loans and incur severe financial hardship. In order to protect those that will either

\textsuperscript{251} Fung et al., supra note 60, at 65 (stating that "[c]hanges in information users' behavior usually are not enough to make transparency policy effective. Information disclosers must also alter their decisions and actions. When disclosers incorporate user responses to information into their decision calculus, we say that new information has become embedded in discloser decision-making process.").

\textsuperscript{252} Id. at 50.
ignore the measures or believe they have no feasible alternative, California should pass substantial statewide reform that caps payday loan APR at a reasonable rate and include the other regulatory measures stated in the unsuccessful SB 515 proposed in February 2013. A statewide measure would also mean California could better protect its citizens from online payday lenders by giving the state grounds to bring actions against those that sell payday products exceeding the new maximum APR.

Even if reform is successfully passed, it is clear there is a need for reasonable alternative small-dollar loan programs. The current pilot programs in California do not appear effective, but this could change once substantive reform is passed. USPS’s recent proposal to provide small-dollar loans at a reasonable APR may provide a model solution. As a non-profit organization USPS does not need to charge the high APR that keeps payday loan borrowers in a long-term cycle of debt. This program would simultaneously help increase borrowers' financial stability and decrease poverty overall by permitting low-income communities to direct their limited resources to meeting their basic needs. California’s recent passage of SB 896—perhaps inspired by USPS’s proposal—which will allow local non-profits to provide a zero-APR alternative to payday loans, is the most promising statewide change. However, it remains to be seen how successful this alternative will be against well-established and entrenched payday lending institutions. For California to truly protect its low-income communities of color, it is imperative that it pass comprehensive statewide payday lending regulation.

253. CTR. FOR RESPONSIBLE LENDING, supra note 7.