# It's (Almost) My Money and I Need It Now: Facilitating Information to Encourage Competition in Tennessee's Payday Lending Markets

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## I. INTRODUCTION

Few small towns in the United States can claim to be the birthplace of a $1 billion industry—Cleveland, Tennessee is one of these towns. In 1993, Allan Jones started what was then referred to as a "check advance" store in his hometown of Cleveland.[1] Today, we call the common storefronts that imitate Jones's first store "payday lenders." Jones and his friend Toby McKenzie started the company that became Advance America Cash Advance, the biggest payday lender in the United States with revenues upwards of $650 million in 2010 and over 2,500 outlets.[2] The rapid growth of the payday-lender

1. *See generally* Gary Rivlin, *Payday Nation: How Lending to People Against Their Future Paychecks Went from a Single Shack to a Strip Mall Staple More Plentiful Than McDonald's*, BLOOMBERG BUSINESSWEEK, May 24–30, 2010, at 56, 56–59; *see also* Gary Rivlin, *Portrait of a Subprime Lender: Allan Jones, Payday King*, HUFFINGTON POST (June 6, 2010, 1:21 PM), http://www.huffingtonpost.com/gary-rivlin/portrait-of-a-subprime-le_b_602182.html ("As the first to spot (in 1993) the huge fortune that could be made making high-priced, small-denomination loans to the working poor, [Jones is] the closest thing the industry has to a founder.").

2. *Payday Lenders Fear Federal Regulations*, CHATTANOOGA TIMES FREE PRESS (June 21, 2010), http://www.timesfreepress.com/news/politics/national/story/2010/jun/21/payday-lenders-fear-federal-regulations/20879/. Jones is the also the founder of Check Into Cash, the third largest payday loan company in the country and the largest privately owned payday lender. Alex Green, *The Lord of Loans: How Cleveland Payday-Loan*

industry in Tennessee would reflect a similar pattern nationally: what began as few establishments in Cleveland and the nearby military base would turn into 850 stores statewide before the end of the 1990s.[3] The business model Jones created would turn into an industry with over 20,000 retail storefronts nationwide—more than all the McDonald's, Home Depot, and Walmart stores in the U.S. combined.[4]

Consumer advocates and government officials have attacked the payday loan industry over the "cycle of debt" it creates for borrowers.[5] Consumer advocates allege that the industry preys on the "financially illiterate," who would otherwise not take out such an expensive loan if they realized its true costs.[6] In contrast, industry leaders and their advocates point to the need for short-term credit and the proliferation of more harmful credit alternatives if the payday loan industry did not exist.[7]

Tennessee finds itself at the center of this debate, being one of the economic hubs of the industry and one of the states where low-income consumers depend on the industry most.[8] Today, Tennessee is

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*Pioneer Allan Jones Was Propelled to Fame and Fortune*, CHATTANOOGA TIMES FREE PRESS (Feb. 5, 2015), http://www.timesfreepress.com/news/business/aroundregion/story/2015/feb/05/lord-loans-how-clevelands-payday-loan-pioneer-allan-jones-was-propelled-fame-and-fortune/286693/. Along with Check Into Cash, Jones is also involved with other short-term credit services, such as Loan by Phone, U.S. Money Shops, Buy Here Pay Here USA, and LendingFrog.com, making him one of the wealthiest people in Tennessee. *Id.*

3. Sherry Davis Kasper, *Payday Lending: The Case of Tennessee*, 48 J. ECON. ISSUES 905, 908 (2014).

4. ADAM B. SUMMERS, REASON FOUND., POL'Y STUDY 420, PAYDAY LENDING: PROTECTING OR HARMING CONSUMERS? 3 (2013), http://reason.org/files/payday_lending_regulation.pdf.

5. *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 7, 55–56 (2002) [hereinafter Johnson, *Shrewd Business*] (arguing that payday loans often leave borrowers in a "debt treadmill").

6. Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases, and Payday Borrowing*, 66 J. FIN. 1865, 1865–66 (2011).

7. *See generally* SUMMERS, *supra* note 4, at 30–32 (explaining that, while fees for defaulting on a payday loan may be costly, it is still less costly then the alternatives, such as a bank overdraft or seeking a more predatory form of lending).

8. Richard Locker, *Tennessee Consumer Rights Group Backs Proposed Federal Regulation of Payday, Title Lenders*, KNOXVILLE NEWS SENTINEL (June 2, 2016), http://archive.knoxnews.com/news/politics/tennessee-consumer-rights-group-

one of only three states with over 1,000 payday lenders; the other two states, California and Texas, are the two geographically largest states in the country.[9] Tennesseans pay $400 million a year in payday loan and car title fees.[10] Additionally, "[t]he average Tennessee borrower pays $490 in fees to borrow $300 for five months."[11] While the Tennessee legislature has enacted some protections for consumers since the legitimization of the industry,[12] some opponents of payday lending urge further action.[13]

The payday loan certainly exhibits flaws, as evidenced by the abundance of literature critiquing the practice.[14] The consumers who

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backs-proposed-federal-regulation-of-payday-title-lenders-344f4a6b-f-381685221.html.

9. *See* James R. Barth et al., *Do State Regulations Affect Payday Lender Concentration?*, 84 J. ECON. & BUS. 14, 20 (2016).

10. *Federal Regulators Look to Severely Curb Payday Lending*, CHATTANOOGA TIMES FREE PRESS (June 3, 2016), http://www.timesfreepress.com/news/business/aroundregion/story/2016/jun/03/federal-regulators-look-severely-curb-payday/369158/.

11. Andy Sher, *Tennessee Consumer Advocates Say Proposed Federal Curbs on Payday Lenders a "Good Start"*, CHATTANOOGA TIMES FREE PRESS (June 2, 2016), http://www.timesfreepress.com/news/politics/state/story/2016/jun/02/tennessee-consumer-advocates-say-proposed-federal-curbs-payday-lenders-good-start/369090/.

12. *See infra* Section II.B.2.i.

13. For example, the Tennessee Citizen Action group has actively attempted to introduce bills into the Tennessee legislature with the aim of protecting consumers from payday lender abuses. *See* Stephanie Carson, *Bill Seeks to Enforce Existing Payday Lending Laws in TN*, PUB. NEWS SERV. (Feb. 11, 2016), http://www.publicnewsservice.org/2016-02-11/consumer-issues/bill-seeks-to-enforce-existing-payday-lending-laws-in-tn/a50318-1. See also *Archives for "Payday Loans"*, TENNESSEE CITIZENS ACTION, http://www.tnca.org/tag/payday-loans/ (last visited Feb. 4, 2018), for Tennessee Citizens Action's description of their policy goals regarding payday lending.

14. *See generally* Creola Johnson, *America's First Consumer Financial Watchdog Is on a Leash: Can the CFPB Use Its Authority to Declare Payday-Loan Practices Unfair, Abusive, and Deceptive?*, 61 CATH. U. L. REV. 381 (2012) (advocating that the CFPB use "its rulemaking authority to declare many payday loan practices as unfair, deceptive, abusive, and, consequently, unlawful"); Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. 649 (2012) (urging the CFPB release guidance and a policy statement regarding predatory lending practices); Johnson,

have fallen victim to a cycle of debt after taking out a loan remark that they did not realize the long-term ramifications of the transaction at the time of contracting.[15] The regulations that Tennessee's General Assembly and municipalities have enacted have done little to make the practice more competitive, and borrowers have found themselves with few options in deciding between one payday loan source versus another.[16] A payday loan, however, still has the potential to provide an informed borrower with the cash to make ends meet with fewer long-term ramifications.

To strike a proper balance in constructing efficient payday loan regulation, lawmakers should focus on fostering a competitive market in which borrowers can use information more easily to decide whether taking out this short-term loan is beneficial, and if so, from which lender. The success of the industry since its creation shows that there is a definite market demand for short-term credit. Indeed, payday loans can provide low-income consumers with access to short-term credit that would be otherwise unavailable to them through more traditional credit services, such as banks.[17] Because communities where payday

*Shrewd Business*, *supra* note 5 (concluding that a large number of payday lenders engage in predatory practices); Leah A. Plunkett & Ann Lucia Hortado, *Small-Dollar Loans, Big Problems: How States Protect Consumers from Abuses and How the Federal Government Can Help*, 44 SUFFOLK U. L. REV. 31 (2011) (urging the federal government to assist state's in their regulation of payday lending); Michael A. Satz, *How the Payday Predator Hides Among Us: The Predatory Nature of the Payday Loan Industry and Its Use of Consumer Arbitration to Further Discriminatory Lending Practices*, 20 TEMP. POL. & C.R. L. REV. 123, 123 (2010) (explaining "the predatory nature of the payday loan industry, the industry's specific discriminatory targeting of minorities, and the industry's use of consumer arbitration agreements to further its discriminatory lending practices"); Kelly J. Noyes, Comment, *Get Cash Until Payday! The Payday-Loan Problem in Wisconsin*, 2006 WIS. L. REV. 1627 (2006) (explaining how regulators could use local and statewide action to combat payday lending in Wisconsin).

15. *See* NICK BOURKE ET AL., PEW CHARITABLE TR. SAFE SMALL-DOLLAR LOANS RES. PROJECT, REPORT 2, PAYDAY LENDING IN AMERICA: HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 6 (2013), http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf ("Borrowers perceive the loans to be a reasonable short-term choice but express surprise and frustration at how long it takes to pay them back.").

16. *See infra* Part II.

17. *See infra* Section III.A.

lenders are successful are often underbanked,[18] a payday loan serves a market need.[19]

This Note diagnoses the problems in Tennessee's payday loan market and proposes solutions that will make the market more competitive by easing the consumer's burden in accessing information. Part II of this Note provides a brief overview of what payday loans are and the current federal and Tennessee efforts to regulate them. Part III shows how lawmakers can characterize Tennessee's market for payday lending as a market failure. These failures have arisen because consumers do not have information that is useful when borrowing. Further, zoning laws in Tennessee's largest cities also contribute to market failure because they force consumers looking for short-term credit to travel further than they otherwise would to find a lender with competitive rates, thereby increasing search costs and transaction costs. Despite the industry's problems, Part IV demonstrates why Tennessee should not follow the path that other states have taken and ban the industry or effectively regulate it out of existence. Lastly, Part V proposes solutions for the Tennessee legislature and localities to adopt. These solutions focus on fostering access to information through more effective disclosure requirements and enforcement mechanisms for state regulators, as well as using zoning ordinances that encourage competition, instead of hinder it. Part VI briefly concludes with a summary of the arguments presented.

## II. THE TYPICAL PAYDAY LOAN AND REGULATION OF THE INDUSTRY

This Part illustrates the typical payday loan transaction and provides an overview of the state and federal efforts to regulate the industry. Section A will describe what occurs during a typical payday loan transaction, as well as borrower and lender obligations that arise as a result. Section B.1 will cover the federal laws affecting payday loan transactions and the federal government's increased involvement in consumer credit transactions like payday loans. Section B.2 will cover the regulation of the industry by the state of Tennessee, including by its largest cities.

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18. Catherine Martin Christopher, *Mobile Banking: The Answer for the Unbanked in America?*, 65 CATH. U. L. REV. 221, 222 (2015).

19. *See infra* Section IV.A.

### *A. The Payday Loan Market Structure*

For consumers with poor or no credit, a traditional lending service may not offer a reasonable means for credit when unexpected financial obligations arise.[20] This is especially true when it comes to the need for short-term credit of small-dollar amounts, ranging from $50 to $1,000. Lack of credit access, coupled with the needs of unbanked and underbanked consumers, has created the rise of the payday lending industry.[21] A payday loan, however, has other characteristics that make it an attractive product for consumers. A payday loan is quick and easy. Borrowers must meet only minimal qualifications, and they can obtain a loan in a matter of minutes with little or no credit check.[22]

Despite the complexity of the state and federal laws regulating the practice, a payday loan transaction is relatively simple. The loans generally have three characteristics. First, the loan amounts tend to be under $1,000—for example, Tennessee caps an individual's loan amount at $500.[23] Second, borrowers have a relatively short amount of time to repay—in Tennessee, borrowers have 31 days.[24] Lastly, borrowers give lenders access to their deposit account, usually through a post-dated check payable on the borrower's next payday.[25]

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20. This is at least the perception many payday loan consumers have; evidence shows, however, that many subprime borrowers could qualify for prime credit. Michael Bertics, Note, *Fixing Payday Lending: The Potential for Greater Bank Involvement*, 9 N.C. BANKING INST. 133, 137 (2005) (citation omitted).

21. Christopher, *supra* note 18 ("People without bank accounts are considered 'unbanked.' Many more Americans are considered 'underbanked,' meaning they do have bank accounts, but they still use alternative financial service providers (such as prepaid cards, check cashers, and payday lenders) to meet their financial needs."). *See also* Terri Friedline & Mathieu Despard, *Life in a Banking Desert*, THE ATLANTIC (Mar. 13, 2016), https://www.theatlantic.com/business/archive/2016/03/banking-desert-ny-fed/473436/ (describing "banking deserts," or communities where traditional credit services are lacking that allow payday loans and other fringe banking services to fill the void).

22. Bertics, *supra* note 20, at 137–38.

23. TENN. CODE ANN. § 45-17-112(p) (2007).

24. *Id.* § 45-17-112(d) (2007).

25. CONSUMER FIN. PROT. BUREAU, EXAMINATION PROCEDURES: SHORT-TERM, SMALL-DOLLAR LENDING COMMONLY KNOWN AS PAYDAY LENDING 2 (2012), http://files.consumerfinance.gov/f/2012/01/Short-Term-Small-Dollar-Lending-Examination-Manual.pdf.

In a typical transaction, a borrower will enter a storefront seeking a loan ranging from $50 to $1000, depending on maximum loan regulations set by the state.[26] The lender will then verify that the borrower has a checking account and a job but will seek no other financial information, such as credit history.[27] In exchange for the borrower's promise to repay the amount borrowed, the lender extends a loan with an initial borrowing fee attached, such as a $15 to $20 borrowing fee for every $100 borrowed.[28] As the hypothetically perfect last step, the lender will attempt to cash the postdated check on the day specified unless the consumer repays the loan with the fee beforehand.[29]

This hypothetically perfect last step, however, often does not occur. When the lender attempts to cash the postdated check, problems can accumulate for a financially unstable borrower. If the borrower cannot pay the loan on the specified date, she will pay another fee (usually equal to the initial borrowing fee) to "roll over," or extend the loan's due date for two more weeks.[30] In states that ban rollovers, the borrower refinances the loan by paying a fee.[31] By refinancing, the borrower essentially takes out the new loan to cover the previous one.[32] If the buyer fails to do either, the check will bounce, potentially subjecting the borrower to an overdraft fee from her bank.[33]

If rollovers and loan refinances accumulate, borrowers fall into a "cycle of debt": if the borrower continues to fail to pay the loan principal and instead rolls over, rollover fees may accumulate and eclipse the principal balance, and subsequent payments go toward fees

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26. Johnson, *Shrewd Business*, *supra* note 5, at 9–10.

27. *See* Karen E. Francis, Note, *Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry*, 88 TEX. L. REV. 611, 615–16 (2010).

28. Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 861–62 (2007). While these amounts seem reasonable for an initial one-time transaction, the build-up of these fees translate to annual percentage rates ("APRs"), that range from 400% to 500% in some states. Tara Shinnick, *State Regulation of Payday Loans*, 29 A.L.R.6TH 461, 469 (2007); *see also infra* Section II.B.2.i. (describing Tennessee's maximum usury rates).

29. *See* Mann & Hawkins, *supra* note 28, at 861–62.

30. Johnson, *Shrewd Business*, *supra* note 5, at 10.

31. *Id.*

32. *See id.* at 10 n.41.

33. *See id.* at 10.

and not principal.[34] In these often-occurring, worst-case scenarios, the borrower will accumulate hundreds or potentially thousands in rollover fees.[35] The next Section will cover the state and federal laws and regulations that govern the practice and allow these structural flaws to occur.

### *B. Current Laws and Regulations*

This Section provides an overview of the contrasting roles that federal law, the Tennessee state legislature, and Tennessee cities play in regulating the payday loan industry. For the most part, the federal government has proposed and enacted regulations intended to protect consumers. Some commentators suggest that these regulations could kill the industry altogether.[36] In contrast, Tennessee has proposed new regulations to protect consumers since the enactment of the Deferred Presentment Services Act of 1997; the statute's amendments, however, have typically been industry-friendly.[37] This Note proposes that consumers benefit from policies that create a balance between providing access to short-term credit while encouraging consumers to stay away from more predatory credit alternatives. Therefore, it is important to explore why the current regulatory models fail to achieve this balance.

#### 1. Federal Laws Covering Payday Lending

Prior to the 2007 recession, state law overwhelmingly governed payday loans, and the federal Truth in Lending Act ("TILA") provided other protections.[38] Congress enacted this law to "assure a meaningful disclosure of credit terms" so consumers could more easily compare

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34. *Id.* at 11.

35. *See id.*

36. *See* Kelly Riddell, *Lending Businesses Fear Federal Regulations Will Threaten Their Existence*, WASH. TIMES (Aug. 30, 2015), http://www.washingtontimes.com/news/2015/aug/30/lending-businesses-fear-federal-regulations-will-t/ ("The industry says the bureau's approach is too heavy-handed and that it could force up to 70 percent of payday operators out of business and deny credit to millions of low-income people.").

37. *See infra* Section II.B.2.i.

38. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601–1693r (2012)).

competing terms and "avoid the uninformed use of credit."[39] In the context of payday loans, the law requires creditors to disclose APRs and finance charges "clearly and conspicuously," communicated in dollar amounts and percentages, during any consumer credit transaction.[40] The TILA does not require a lender to orally disclose the APR; if the lender chooses to respond to an oral inquiry about the loan's APR, however, the lender must disclose.[41] If the lender cannot determine the precise APR in advance (as the figure may vary depending on the size of the loan), the lender may state the APR for a sample transaction.[42] Tennessee's own Deferred Presentment Services Act requires lenders to adhere to the TILA in addition to the state's disclosure requirements.[43]

In the aftermath of the 2007 Recession, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), which created the Consumer Financial Protection Bureau ("CFPB").[44] The creation of the CFPB vastly expanded the

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39. 15 U.S.C. § 1601(a) (2012).

40. 15 U.S.C. § 1632(a) (2012 & Supp. 2016); Mann & Hawkins, *supra* note 28, at 871; *see also* Turner v. E-Z Check Cashing, Inc., 35 F. Supp. 2d 1042, 1050–51 (M.D. Tenn. 1999) (holding that documents a check cashing service gave to a consumer violated the TILA because it failed to disclose the following: the number, amount, and due dates of required payments; the true APR; the true finance charge; the availability of a rebate; a statement referring borrowers to a contract document for information regarding nonpayment, default, acceleration rights, prepayment rebates, and penalties). In addition, the documents in *Turner* used "the same typesize, font, and boldness in listing [the APR] and 'finance charge' as it does in listing other terms, data, and information." *Id.* at 1050.

41. Johnson, *Shrewd Business*, *supra* note 5, at 37.

42. *Id.* at 37–38.

43. *See* TENN. CODE ANN. § 45-17-112(g) (2007) ("The department of financial institutions shall promulgate rules requiring each licensee to issue a standardized consumer notification and disclosure form in compliance with federal truth-in-lending laws . . . ."); *see also* 18 TENN. JURIS. *Loans* § 10 (2018) ("Courts have generally construed the preemptive scope of the Truth-in-Lending Act (TILA) narrowly. The TILA's own preemptive provisions are narrowly worded and were intended to extend only to specific state requirements, in the interest of preserving uniform methods of disclosure.").

44. Pub. L. No. 111-23, 124 Stat. 1376 (2010) (codified as amended at 12 U.S.C. §§ 5301–5641 (2012)); 12 U.S.C. § 5491(a) (2012) ("There is established . . . the 'Bureau of Consumer Financial Protection', [sic] which shall regulate the offering

federal government's regulatory authority to provide heightened consumer protection for lending markets.[45] Payday lending is one of the industries that now fall within the CFPB's regulatory reach.[46] Under Dodd-Frank, the CFPB ensures that consumers have access to consumer financial products and services that are "fair, transparent, and competitive," regardless of whether a traditional bank offers the service.[47]

CFPB's statutory objectives focus on mitigating consumer deception by providing consumers with "timely and understandable information" to make reasonable decisions regarding their financial transactions.[48] The CFPB has the power to reach these objectives by issuing rules and guidance,[49] as well as the power to take enforcement

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and provision of consumer financial products or services under the Federal consumer financial laws.").

45. *See* Robert L. Clarke & Todd J. Kywicki, *Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau*, 33 REV. BANKING & FIN. L. 235, 236–37 (2013).

46. 12 U.S.C. § 5514(a)(1)(E) (2012).

47. *Id.* § 5511(a); *see also id.* § 5511(b)(4) ("Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition . . . ."). In the spirit of fostering fair competition, Dodd-Frank recognizes that unequal regulatory treatment of similar lending services, whether traditional or nontraditional, could lead consumers to choose a product based on its degree of regulation rather than the product's economic benefits. Clarke & Kywicki, *supra* note 45, at 237.

48. 12 U.S.C. § 5511(b)(1) (2012).

49. On October 5, 2017, the CFPB finalized a rule aimed at "stopping payday debt traps by requiring lenders to determine upfront whether people can afford to repay their loans." Press Release, CFPB, CFPB Finalizes Rule To Stop Payday Debt Traps (Oct. 5, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-rule-stop-payday-debt-traps/. Furthermore,

> [t]he CFPB rule aims to stop debt traps by putting in place strong ability-to-repay protections. These protections apply to loans that require consumers to repay all or most of the debt at once. Under the new rule, lenders must conduct a "full-payment test" to determine upfront that borrowers can afford to repay their loans without re-borrowing. For certain short-term loans, lenders can skip the full-payment test if they offer a "principal-payoff option" that allows borrowers to pay off the debt more gradually. The rule requires lenders to use credit reporting systems registered by the Bureau to report and obtain information on certain loans covered by the proposal. The rule allows less risky loan options, including

action if and when lenders violate these rules.[50] Section 5514 gives the CFPB the power to conduct general supervision of lenders, including supervision to avoid risky behavior, depending on the nature of the transaction.[51] In order to minimize the regulatory burden, the CFPB can coordinate its supervision activities with regulators at the state level.[52] Lastly, the Act gives the CFPB exclusive federal authority to enforce consumer financial law.[53]

Many commentators have speculated that the future of the CFPB may be in doubt after the election of President Trump.[54] The administration has not been publicly supportive of the new agency,[55]

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> certain loans typically offered by community banks and credit unions, to forgo the full-payment test. The new rule also includes a "debit attempt cutoff" for any short-term loan, balloon-payment loan, or longer-term loan with an annual percentage rate higher than 36 percent that includes authorization for the lender to access the borrower's checking or prepaid account.

*Id.* Critics emerged from both sides of the aisle to criticize this rule when it was still a proposal. *See* Jim Hawkins, *Using Advertisements to Diagnose Behavioral Market Failure in the Payday Lending Market*, 51 WAKE FOREST L. REV. 57, 95–100 (2016) (assailing the proposed rule and applying a new framework to evaluate its likely effects); Nick Bourke, *The CFPB's Proposed Payday Loan Regulations Would Leave Consumers Vulnerable*, PEW CHARITABLE TR. (Sept. 7, 2016), http://www.pewtrusts.org/en/research-and-analysis/analysis/2016/09/07/the-cfpbs-proposed-payday-loan-regulations-would-leave-consumers-vulnerable (analyzing the proposed rules vices along with its putative virtues); Veronique De Rugy, *Hurting the Poor Is No Way to Help Them: Payday Lending Rules Edition*, NAT'L REV. (June 2, 2016, 6:02 PM), http://www.nationalreview.com/corner/436155/payday-lending-restrictions-cfpbs-latest-crusade-against-poor-americans (arguing that the proposed rule would impose outsized costs on small-sum borrowers, the very people the rule purportedly helps).

50. *See generally* 12 U.S.C. § 5511(c) (2012).

51. *Id.* § 5514(b)(1)–(2).

52. *Id.* § 5514(b)(3).

53. *Id.* § 5514(c).

54. *See* Marcy Gordon, *Trump Administration Looks to Curb CFPB Powers, Change Bank Rules*, USA TODAY, https://www.usatoday.com/story/money/2017/06/12/trump-administration-looks-curb-cfpb-powers-change-bank-rules/102795120/ (last updated June 12, 2017, 7:45 PM).

55. Alan Rappeport & Matthew Goldstein, *Trump Administration Says Financial Watchdog Agency Should Be Defanged*, N.Y. TIMES (June 12, 2017),

but as of now, the agency's regulatory authority remains intact.[56] Traditionally, however, it has been the states that regulate these industries. This remains true in Tennessee.

2. Tennessee's Current Laws and Regulations

While state and federal laws largely control allowable lending terms, local Tennessee governments help structure the competitive atmosphere of an industry through zoning ordinances. Section II.B.2.i discusses state laws concerning payday lending, focusing on the disclosures that lenders must provide borrowers. Section II.B.2.ii will discuss the zoning regulations that specifically target financial services like payday loan stores that local governments in Tennessee's four largest cities promulgated.

*i. State-Wide Payday Lending Laws*

When the payday loan industry started in Cleveland, Tennessee (outside nearby Fort Campbell)[57] in the early 1990s, and it began spreading throughout the state, only the federal TILA governed

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https://www.nytimes.com/2017/06/12/business/banking-regulations-consumer-financial-protection.html.

56. Steve Eder et al., *Republicans Want to Sideline This Regulator. But It May Be Too Popular*, N.Y. TIMES (Aug. 31, 2017), https://www.nytimes.com/2017/08/31/business/consumer-financial-protection-bureau.html.

57. While not the focus of this Note, Congress has focused heavily on protecting military families from the predatory nature of payday loans and other types of fringe banking. Military families have relied heavily on payday loans since the birth of the industry, and its growth has heavily affected this demographic. *See generally* Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, 66 OHIO ST. L.J. 653 (2006). In 2006, Congress passed the Military Lending Act. *See* John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2266–69 (2006) (codified at 10 U.S.C. § 987 (2012)). The new law protects all active-duty military personnel, as well as their dependents, by capping interest rates on short term loans at 36% APR. 10 U.S.C. § 987(b) (2012). As a result of the Military Lending Act, the number of payday lending stores outside military bases has decreased. Stephen Dubner, *Are Payday Loans Really as Evil as People Say?*, FREAKONOMICS (Apr. 6, 2016), http://freakonomics.com/podcast/payday-loans/.

lending practices.[58] Since Tennessee payday lenders at this time were charging rates well above the state's usury laws,[59] they were technically engaged in illegal activity.[60] But the Tennessee Department of Financial Institutions—the state's financial regulator—did not have jurisdiction to enforce these usury laws.[61] In addition, district attorneys rarely prosecuted usury violations since they were misdemeanor offenses.[62] Given this minimal oversight, lenders were charging as much as $45 for a $100 loan,[63] which does not account for additional loan costs that consumers incurred from subsequent rollovers.

The Tennessee legislature responded with the Deferred Presentment Services Act of 1997 ("the 1997 Act"),[64] which effectively legalized the industry and put it in a regulatory class of its own.[65] It also conferred jurisdiction on the Tennessee Department of

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58. Kasper, *supra* note 3, at 909; *see infra* Section III.B.

59. "Usury is the taking of more interest for the use of money, or forbearance of a debt, than the law allows." 24 TENN. JURIS. *Usury* § 2 (2018). The elements of usury include: "(1) A loan or forbearance, either express or implied; (2) an understanding between the parties that the principal shall be repayable absolutely; (3) the exaction of a greater profit *than allowed by law*; and (4) an intention to violate the law." Jenkins v. Dugger, 96 F.2d 727, 729 (6th Cir. 1938) (emphasis added). Thus, compensation that meets the legal limit is interest, while excess compensation is usury. 24 TENN. JURIS. *Usury* § 2 (2018). The Tennessee Constitution empowers the General Assembly to define and regulate interest by setting maximum rates. TENN. CONST. art. XI, § 7. In the absence of an applicable statute, the effective interest rate shall not exceed ten percent per year. *Id.*; *accord* TENN. CODE ANN. § 47-14-103(3) (2013). Titles 45 (relating to banks and financial institutions) and 47 (relating to commercial instruments and transactions) contain general statutory provisions that govern usury and personal loans in Tennessee. There are other provisions, however, that deal with other types of lending arrangements (such as payday loans).

60. Kasper, *supra* note 3, at 909.

61. *Id.*

62. *Id.*

63. *Id.*

64. Deferred Presentment Services Act, 1997 Tenn. Pub. Acts 255 (codified as amended at TENN. CODE ANN. §§ 45-17-101 to -119 (2007 & Supp. 2017)).

65. Prior to the introduction of the bill in the 1997 session, the General Assembly appointed a study committee to develop the bill. Kasper, *supra* note 3, at 910. Simultaneously, members of the payday lending industry formed a lobbying group, the Tennessee Cash Advance Association, with the goal of enacting legislation that would "legitimize the industry" and provide for "effective regulation." *Id.* This

Financial Institutions to examine lender violations.[66] In addition to its enforcement power, the Department also provides consumers with a process for filing complaints.[67] The 1997 Act specifically exempts borrowing fees from the definition of "interest," thus escaping Tennessee's usury laws.[68]

The 1997 Act attempts to protect consumers from the abusive lending practices that existed prior to its enactment by limiting the amount lenders can charge and how many loans borrowers can obtain at a time. It restricts lenders to charge the no more than 15 percent the face-value of the loan,[69] with this fee converting into "an effective annual rate . . . of 391 percent."[70] It also provides a 31-day maximum allowable term for a loan[71] and a maximum loan amount of $500.[72]

The 1997 Act also imposes certain duties on lenders prior to the completion of a transaction. Before the transaction is complete, the lender must provide a written explanation "in clear, understandable

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group spent tens of thousands on political donations to legislators and the governor after it formed. *Id.* at 910.

66. *Id.* at 917.

67. *Id.*

68. TENN. CODE ANN. § 45-17-112(b) (2007 & Supp. 2017). The new legislation provided minimal requirements that payday lenders had to meet for a loan to be legal. Along with rules concerning proper transactional and operational practices, other provisions of the Act deal with store licensing, the Act's construction with other statutes, and the commissioner's power to investigate potential violations and enforce penalties for wrongdoing. *See id.* §§ 45-17-103 to -108 (provisions of the 2017 Act relating to lender licensing); *id.* § 45-17-118 (provision of 2017 Act relating to the Act's construction with other statutes); *id.* § 45-17-113 to -122 (provisions of the 2017 Act relating to the commissioner's power and other policing mechanisms).

69. *Id.* § 45-17-112(b).

70. Kasper, *supra* note 3, at 910. Due to its language, the 1997 Act does not consider this fee interest, it is not subject to the state-imposed 10% cap on interest; therefore, it is by definition not usury. *See* TENN. CODE ANN. § 47-14-103(3) (2013).

71. TENN. CODE ANN. § 45-17-112(d) (2007).

72. *Id.* § 45-17-112(p). This maximum loan amount is not limited to a single loan with a single lender. This aggregate amount includes up to three outstanding loans with different lenders. *Id.* In addition, the lender cannot renew or otherwise consolidate a loan with the proceeds of another loan it made to a borrower. *Id.* § 45-17-112(q). These transactions are void and unenforceable. *Id.*

language" of the fees she will charge and the date she will deposit or present the postdated check the borrower provides.[73]

The lender must also inquire whether the borrower has any outstanding checks with another payday lender.[74] The borrower must confirm in writing that he or she has no more than two outstanding checks with other lenders and that the aggregate face value of these outstanding checks does not exceed $500.[75] If the borrower confirms in writing that she has more than three checks outstanding, or that the aggregate sum of all outstanding checks equals or exceeds $500, the lender cannot accept another check until the borrower meets the requirements.[76] If a borrower does not tell the truth, however, the lender can still execute the transaction in good-faith reliance on the borrower's written confirmation.[77]

In response to widespread industry failure to follow the minimal requirements of the statute, the General Assembly extended the 1997 Act's reach in 1999[78] and provided more stringent lender disclosure requirements.[79] The Consumer Disclosure Rules promulgated by the

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73. *Id.* § 45-17-112(g).

74. *Id.* § 45-17-112(p).

75. *Id.*

76. *Id.*

77. *Id.* This lender-friendly reliance rule is not the only regulation favorable to lenders. In 2001, the state legislature passed a bill that would allow lenders to charge additional fees on their services, such as bad check fees, attorneys' fees, and court costs in the event that a borrower defaulted. TENN. CODE ANN. §§ 47-29-101 to -102 (2013). This came despite backlash from consumer advocacy groups, which argued that lenders should not be able to charge the additional fees because they accepted "high annualized rates" during negotiations in 1997 in lieu of fees. Kasper, *supra* note 3, 911–12. The Tennessee Cash Advance Association countered, painting lenders as victims who have no collateral in the case of a defaulted loan. *Id.* at 912.

78. The General Assembly designed the original 1997 Act to expire in 1999 unless the legislature extended it to correct for any negative, unintended consequences the law may have had. Kasper, *supra* note 3, at 911.

79. While the 1997 Act that legitimized the industry created sizable profits for firms and the operation of new firms, the Department of Financial Institutions complied a report on the industry and deducted violations of the statute in 53% of their examinations. Kasper, *supra* note 3, at 911. Problematic lender violations included:

> (i) failure to disclose the costs of loans in an understandable way; (ii) charging attorney's fees, late charges, court costs, or bad check fees for returned checks; (iii) failure to post licenses in public

Tennessee Department of Financial Institutions specify that the lender must provide the borrower with a "notification and disclosure" form containing the itemized and total amounts of all fees and other costs "that will or potentially could be imposed" as a result of the transaction agreement.[80] The regulation requires lenders to give borrowers "accurate and complete disclosure of all itemized and total amounts of all fees and other costs that will or potentially could be imposed as a result of [the] agreement."[81] The intent of this regulation is to "specify the style, content and method of executing the form of the disclosure" that a payday lender must provide to the consumer.[82] Further, these notification and disclosure forms must comply with the Federal TILA and Federal Reserve Board regulations.[83]

#### *ii. Local Zoning Laws Affecting Payday Loan Stores*

The U.S. Supreme Court's decision in *Village of Euclid v. Ambler Realty Co.*[84] gave localities broad power to control city organization through zoning ordinances. The Court held that, for a local zoning restriction to be unconstitutional, it must be "clearly arbitrary and unreasonable" and lack "substantial relation to the public health, safety, morals, or general welfare."[85] This decision gave localities broad power to control the proliferation of certain types of land use they "deemed harmful in some way to the local community."[86] Among the businesses that localities have justified regulating are those

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> viewing areas; (iv) applying rollovers to previous transactions; and (v) instances of loan splitting . . . in order to increase the amount of fees collected.

*Id.*

80. TENN. COMP. R. & REGS. 0180-28-.01(3)(a) (2017).

81. *Id.* at 0180-28-.01(1).

82. *Id.*

83. *Id.* at 0180-28-.01(3)(b); *see also* Section II.C (describing how the TILA affects payday loan transactions).

84. 272 U.S. 365 (1926).

85. *Id.* at 395 (citing, inter alia, Thomas Cusack Co. v. City of Chicago, 242 U.S. 526, 530–31 (1917)).

86. Sheila R. Foster, *Breaking Up Payday: Anti-Agglomeration Zoning and Consumer Welfare*, 75 OHIO ST. L.J. 57, 59–60 (2014).

deemed to be controversial or undesirable.[87] Because local governments lack the power to regulate payday loans directly (because the U.S. Constitution and state constitutions reserve this power to Congress and state legislatures, respectively),[88] land regulations are often the only tools localities possess to curtail the spread of payday lenders.[89]

Tennessee's largest cities, namely Nashville, Memphis, Knoxville, and Chattanooga, have enacted zoning laws to control the growth of payday lending storefronts.[90] For example, Nashville concluded that the "proliferation and clustering of 'Alternative Financial Services'" (which include payday loan stores) is harmful to property values and economic redevelopment.[91] Nashville's new zoning restrictions provide that

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87. *See id.* at 60 ("As land-use scholars have pointed out, local governments have long limited the siting and concentration of 'controversial' retail commercial establishments—including tattoo shops, marijuana-dispensing facilities, pawn shops, and adult businesses—to protect their residents and community character from the negative spillovers associated with these land uses.").

88. In Tennessee especially, localities' treatment of payday lenders often contradicts the state legislature's goals. *See supra* Section II.A.1 (recounting that the Tennessee legislature has consistently adopted measures favorable to the payday lending industry since the Deferred Presentment Services Act of 1997).

89. Foster, *supra* note 86, at 76.

90. *See* Megan Boehnke, *Knoxville City Council to Vote on Payday Loan Ordinance*, KNOXVILLE NEWS SENTINEL (July 5, 2016), http://archive.knoxnews.com/news/local/knoxville-city-council-to-vote-on-payday-loan-ordinance-36e4dae6-23f0-67ee-e053-0100007fdf75-385567671.html; Louie Brogdon, *Chattanooga Seeks to Limit Payday Lending and Title Pawns*, CHATTANOOGA TIMES FREE PRESS (Jan. 13, 2015), http://www.timesfreepress.com/news/local/story/2015/jan/13/city-seeks-limit-payday-lending-and-title-paw/282374/; Bill Dries, *Council Again Rejects Lee Legal Fees: Payday Lender Regulations Approved/Next Step in Fairgrounds Plan Charted*, MEMPHIS DAILY NEWS (Dec. 2, 2008), https://www.memphisdailynews.com/editorial/Article.aspx?id=39750; Joey Garrison, *Limits on Way for Nashville Pawnshops, Payday Loan Stores*, THE TENNESSEAN (Nov. 18, 2014), http://www.tennessean.com/story/news/politics/2014/11/18/limits-way-nashville-pawn-shops-payday-loan-stores/19252671/.

91. Nashville, Tenn., Ordinance BL2016-2017 (Mar. 16, 2016), http://www.nashville.gov/mc/ordinances/term_2015_2019/bl2016_117.htm; *accord* NASHVILLE, TENN., MUNICIPAL CODE § 17.16.050 (2006 & Supp. 2017).

> [n]o cash advance, check cashing, title loan, flex loan or installment loan establishment shall be located less than one thousand three hundred twenty (1,320) linear feet from the property line of another property upon which another cash advance, check cashing, title loan, flex loan or installment loan office is located.[92]

The ordinance also states that the above-named business offices in certain zoning districts "shall be limited to two thousand five hundred (2,500) square feet of gross floor area per establishment."[93] The other zoning ordinances in Tennessee's major cities have similar language.[94]

This Section shows that federal, state, and local governments have all attempted to curtail the negative effects of the payday lending. These efforts, however, fail to address one of the biggest problems plaguing the industry: the lack of competition. The next Section will show that this lack competition results, in part, from the burden consumers face in gathering information and the high search costs in finding competitive terms.

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92. Nashville, Tenn., Ordinance BL2016-2017 (Mar. 16, 2016), http://www.nashville.gov/mc/ordinances/term_2015_2019/bl2016_117.htm.

93. *Id.*

94. The Memphis and Shelby County Unified Development Code disallows payday loan storefronts if they violate the following provisions: "within 1,000 feet of any other establishment offering payday loans, title loans or flexible loan plans" or "within 1,320 feet from the boundary of a residential district or historic overlay district." MEMPHIS & SHELBY COUNTY UNIFIED DEV. CODE art. 2.6.3.M(1)–(2) (2010), http://www.shelbycountytn.gov/DocumentCenter/View/27740. Similarly, in Chattanooga, alternative financial services are not allowed within 1,320 feet of each other or within 500 feet of any residential zoned property. CHATTANOOGA, TENN. CODE § 38-529(4)(a)–(b) (1995 & Supp. 2017), http://www.chattanooga.gov/city-council-files/CityCode/38%20-%20Zoning.pdf. In Knoxville, the city council is mulling a restriction not allowing a payday loan store within 1,000 feet of another, but it has not yet been approved. KNOXVILLE, TENN. CODE app. B, art. V, § 26 (1991 & Supp. 2017); Megan Boehnke, *Law Director: Proposed Payday Loan Ordinance Could Cost City*, KNOXVILLE NEWS SENTINEL (June 30, 2016), http://archive.knoxnews.com/news/local/law-director-proposed-payday-loan-ordinance-could-cost-city-36871ffb-499c-2f9a-e053-0100007f4b65-385117721.html.

## III. INFORMATIONAL MARKET FAILURE IN TENNESSEE'S PAYDAY LENDING

There are certain conditions or industry characteristics that can make an industry ripe for failure. The term "market failure" refers to circumstances that produce undesirable results and cause deviations from what one might expect in an idealized, perfectly competitive market.[95] In writing about the payday lending market in New Mexico, a commentator explains market failure by first describing the idealized perfect market:

> Perfect markets are competitive. In the perfect market, many sellers offer substantially identical products, so it is easy to shop around and compare costs. There are also many buyers. All actors in the perfect market act to maximize their own financial well-being. There are no barriers to entry into the market by new sellers, and both buyers and sellers are well-informed. In a perfect market, supply and demand for products will level out and the price of goods will stabilize. The absence of any of these attributes is known as market failure.[96]

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95. *See* Francis M. Bator, *The Anatomy of Market Failure*, 72 Q.J. ECON. 351, 351 (1958) (defining "market failure" as "the failure of a more or less idealized system of price-market institutions to sustain 'desirable' activities or to estop 'undesirable' activities. The desirability of an activity, in turn, is evaluated relative to the solution values of some explicit or implied maximum-welfare problem"). Another commentator adds:

> The concept of market failure seems entrenched in the conventional wisdom of the economics discipline, if the conventional wisdom is most clearly revealed by what respected economists tell undergraduate students and government policy makers. The typical treatment proceeds as follows: the concept of Pareto-optimality is explained; the idea that competitive markets tend to allocate resources efficiently is developed; the notion that, under certain conditions prevalent in the real world, markets fail to perform efficiently is introduced; and the search for ameliorative measures, involving government as law-maker, tax collector, and/or regulator, is undertaken.

Alan Randall, *The Problem of Market Failure*, 23 NAT. RES. J. 131, 131 (1983).

96. Nathalie Martin, *1,000% Interest – Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 614 (2010) (citations

One factor that suggests the presence of market failure in payday lending is high borrowing fees. The industry has grown, and new competitors have entered the market, but increased competition has not exerted downward pressure on the costs of borrowing, which otherwise occurs in competitive markets.[97] While "[h]igh prices alone do not signify market failure," barriers may exist that make it more difficult for borrowers to search for more favorable loan terms through access to information.[98] This information asymmetry, in part, keeps prices high and uncompetitive.[99]

Tennessee, like the majority of states that allow payday lending, caps fees that lenders are allowed to charge borrowers for their service.[100] These caps addressed excessive fees that lenders were charging consumers prior to the 1997 Act.[101] Imposing a maximum fee, however, has done little to encourage more competitive behavior among lenders. Instead, the difference between the maximum fee lenders are allowed to charge and the average fee charged is

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omitted); *see also* Bertics, *supra* note 20, at 141 (describing an additional characteristic of a perfect market: "The return on capital for the seller in an efficient market for a particular good will be identical to the return on capital in every other efficient market once adjusted for risk. . . . The movement of sellers into and out of a market causes the return on capital in both markets to equalize.").

97. Kelly Noyes, Comment, *Get Cash Until Payday! The Payday-Loan Problem in Wisconsin*, 2006 WIS. L. REV. 1627, 1662 (2006) ("Studies show that, despite industry growth, payday-loan prices have increased or remained the same, and, in states with interest-rate limits, rates cluster around the highest legal interest rate.").

98. *See* Michael A. Garemko III, Note, *Texas's New Payday Lending Regulations: Effective Debiasing Entails More Than the Right Message*, 17 TEX. J. C.L. & C.R. 211, 220 (2012) ("[T]the lack of competition on price can show that price is either hard for consumers to ascertain or that there are collective action problems dis-incentivizing pro-consumer innovations.").

99. *See id.* at 220–22.

100. *See* TENN. CODE ANN. § 45-17-112(b) (2007 & Supp. 2017) (allowing the maximum fee amount of fifteen percent of the loan).

101. The 1997 Act was certainly successful in reducing the price paid for loans—along with the consumer protections it provides. APRs for fourteen-day loans were in the 1,000% range prior to the legislation and went down to 391% after it. Kasper, *supra* note 3, at 920. The fees in the 1,000% APR range are a good example of what results when this market operates without regulation.

minimal.[102] Some states, including Tennessee, have rate caps above the national average and are slightly more competitive than those states that have rates below the national average; the difference in price between that maximum-allowable rate and the average rate in those states is trivial.[103]

This Part will diagnose activity in the payday loan industry in Tennessee as an informational market failure. Due to the structural defects in the market that stifle the flow of relevant information to consumers, firms can largely avoid competing on price (the amount of fees they charge borrowers) and quality of service. Even taking into account transactional information that consumers actually have, payday lenders have no rational incentives to compete because the required disclosures are often unreliable or unhelpful to borrowers. Section A will discuss how local zoning laws aimed at reducing payday loan store clusters discourage and curtail competition. Section B will discuss how lenders can take advantage of the information asymmetry between borrower and lender and control consumers' access to information.

### *A. Local Zoning Ordinances Discourage Competition*

While local zoning ordinances strive to reduce consumer exposure to payday lending services and the decrease in property values that follow their proliferation,[104] zoning against the "clustering" of these services makes little sense in a market that already lacks

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102. *See* PEW CHARITABLE TRS., HOW STATE RATE LIMITS AFFECT PAYDAY LOAN PRICES 2 (2014), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf (showing that the maximum allowable charge for a $300 loan in Tennessee is $53, while the average charge imposed is $49).

103. Those states that have rate caps below the national average see the average charge to be the exact same as the maximum allowed. *See id.* However, only Missouri (with an astounding $225 allowable charge for a $300 loan) saw a bigger difference between allowable charge and average loan cost. *Id.* Those states with no rate caps all had higher average costs for a $300 loan compared to those states with rate caps. *Compare id.*, *with id.* at 3.

104. *See supra* Section II.B.ii.

competition.[105] Zoning ordinances like those in Tennessee's major cities are relatively common around the country.[106] One major justification of these "anti-agglomeration" zoning measures is that they are supposed to protect consumers by restricting their access to payday lending practices.[107] Restricting consumers' geographic access to these services, however, may have negative economic effects on consumer choice while filling lenders' pockets.[108]

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105. *See* PEW CHARITABLE TRS., *supra* note 102, at 2 (showing that the maximum allowable charge for a $300 loan in Tennessee is $53, while the average charge imposed is $49, thereby showing that most lenders merely charge close to the maximum allowable rate).

106. As one commentator observed,

> Because local governments are limited in their ability to regulate the terms of payday loans directly, they have turned to the one quintessential source of local authority that they possess—the power to regulate land within their boundaries—in order to address the spread of payday lenders in their communities. . . . Dozens of local governments have responded to the growth of the industry by imposing land-use restrictions on where payday lenders may locate.

Foster, *supra* note 86, at 76–77. *See also generally* Kelly Griffith et al., Controlling the Growth of Payday Lending Through Local Ordinances and Resolutions: A Guide for Advocacy Groups and Government Officials, Consumer Federation of America 17–35 (Oct. 2012) (unpublished manuscript), http://www.consumerfed.org/pdfs/Resources.PDL.LocalOrdinanceManual11.13.12.pdf (listing examples of zoning ordinances that take aim at payday lending services around the country).

107. Foster, *supra* note 86, at 59 ("Although the empirical evidence on the consumer-welfare impacts of payday lending is mixed, many local governments are convinced that payday lenders do more harm than good in their communities."). *See also, e.g.*, Nashville, Tenn., Ordinance BL2016-2017 (Mar. 16, 2016), http://www.nashville.gov/mc/ordinances/term_2015_2019/bl2016_117.htm (noting that the clustering of alternative financial services has a negative effect on property value and economic redevelopment).

108. In addition, questions remain as to whether restrictive zoning ordinances effectively drive payday lenders away from local consumers. In a California Department of Corporations study after the enactment of restrictive zoning laws similar to those in Tennessee, cities saw a reduction of new lenders entering the market—but the new laws did not drive away existing ones:

> While the number of new licenses has declined significantly in all municipalities, the industry has not disappeared, particularly in those cities with restrictive zoning ordinances. Thus, while these ordinances *arguably* have had some success in halting the further

When municipalities create zoning ordinances to prevent agglomeration, consumers face increased search costs as a result.[109] In a typical payday loan transaction, the lender has outsized bargaining power due to the borrower's low income and circumstances creating a cash shortfall, and thus borrowers pay presumptively high fees.[110] Because the cost of borrowing is already so high, many consumers cannot also afford to incur costs associated with searching for more favorable transaction terms that zoning creates.[111] When zoning spreads storefronts across a jurisdiction, firms do not have to compete as rigorously with each other as they would in an idealized market. Individual lenders with no competition immediately nearby can exploit information asymmetries about cost and service; indeed, they have a rational incentive to raise the payday loan initiation and rollover fees. Clustering firms can counterintuitively empower a borrower to compare and contrast terms in order to find the most favorable bargain.[112] A commentator provides a useful example to illustrate this point:

> [I]f seven lenders were all lined up in a row, each with clearly described prices, we might feel confident that debtors had a financial incentive to compare the prices of each lender, and in turn, each lender would have an incentive to price compete. But, if each lender were

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> concentration of payday lenders in California cities, they have not succeeded in preventing access by consumers to these business. New payday businesses continue to open, even in cities with restrictive zoning ordinances, and existing businesses continue to operate.

Foster, *supra* note 86, at 85. In addition, researchers conducted the study in the middle of the recession, suggesting that it might have played a role in the decline of lenders in California, regardless of the restrictive ordinances in effect. *Id.*

109. *See* Konrad Stahl, *Differentiated Products, Consumer Search, and Locational Oligopoly*, 31 J. INDUS. ECON. 97, 97 (1982) (noting that consumer search costs decline when sellers are located more closely together).

110. Joshua A.T. Fairfield, *The Search Interest in Contract*, 92 IOWA L. REV. 1237, 1242 (2007) ("Most costs in modern contracting do not involve negotiating an individualized agreement. Rather, most modern contracting costs involve the searcher finding someone she is willing to contract with in the first place.").

111. *Id.* at 1240–41.

112. Foster, *supra* note 86, at 88–89.

> spread out, one in each of the seven continents, no debtor would bear the cost of shopping at each location.[113]

These search costs are particularly important when considering that typical payday borrowers come from often of low- and middle-income populations;[114] they "own fewer automobiles per capita and are more dependent on public transportation" than higher-income persons.[115]

Internet-based payday loans illustrate how lowering search costs can improve price competition. After searching for "payday loans" on various internet search engines, Ronald J. Mann and Jim Hawkins found the dominant borrowing fee in the online market to be $10 per $100 loaned.[116] In comparison, the benchmark rate for the retail locations of large national providers was $15 per $100 loaned.[117] While one could explain lower rates in part by observing that online lenders have lower overhead costs than brick-and-mortar retail outlets, the significant difference in the dominant rates between these two markets with vastly differing search costs illustrates the competitive effect that ease of price comparison based on access to information can have on pricing.[118] Since first-time borrowers inevitably enter transactions with incomplete information,[119] reduced search costs enable borrowers to price shop, which in turn incentivizes price competition among storefronts.

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113. Chris Peterson, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 UTAH L. REV. 543, 573 (2001).

114. AMANDA LOGAN & CHRISTIAN E. WELLER, CTR. FOR AM. PROGRESS, WHO BORROWS FROM PAYDAY LENDERS? AN ANALYSIS OF NEWLY AVAILABLE DATA 8 (2009), https://cdn.americanprogress.org/wp-content/uploads/issues/2009/03/pdf/payday_lending.pdf (noting that that the median income of the payday loan borrower was $30,892, whereas the median income of the non-payday users was $48,397).

115. Foster, *supra* note 86, at 93.

116. Mann & Hawkins, *supra* note 28, at 869.

117. *Id.*

118. The authors also used these results to suggest the possibility that the market for payday loans is segmented between low-income customers that seek lenders based on convenience and location proximity and better-off customers that use the internet to find their lender of choice. *Id.* at 870.

119. *See infra* Section III.B.1.

The relationship between increased searched costs and consumer borrowing choices is even more meaningful when considering the importance that borrowers place on lender location. In a survey of New Mexico's payday loan borrowers, a commentator found that close to 80% of borrowers did not consider getting a loan from another payday lender.[120] Instead, borrowers pick lenders "based on convenience, location, and other factors."[121] Industry leaders from large national providers have also admitted that location is among the principal competitive factors for short-term loans.[122] The industry's emphasis on location makes sense considering the importance borrowers place on speed.[123] With limited time to shop for more desirable terms, borrowers find themselves picking a loan based on geographic proximity instead of price or favorable terms. Thus, when zoning ordinances forcibly separate competing stores, a single store can dominate the market in an area if it opens near employers or neighborhoods likely to have a high concentration of people fitting the demographics of a potential borrower.

Economic analysis shows that zoning restrictions limit where firms can locate,[124] but this depends on the types of limitations imposed. Where firms separate within a clustered space, there is a direct correlation between price competition and zoning controls.[125] The smaller and more concentrated the area in which firms can cluster, the stronger the correlation with lower prices.[126] In contrast, where

120. Martin, *supra* note 96, at 613. *But see* Thomas A. Durkin & Gregory Elliehausen, Assessing the Price of Short-Term Credit 20 (Nov. 6, 2013) (unpublished manuscript), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2402197 (noting 46% of payday loan customers reported that they considered another source before obtaining their most recent loan, thus concluding many customers exhibited some deliberation in their decision).

121. Martin, *supra* note 96, at 613; *see also* Mann & Hawkins, *supra* note 28, at 863 ("The industry depends heavily on retail-store locations, generally because of the sense that many customers will travel only to the store that is nearest their place of employment.").

122. Mann & Hawkins, *supra* note 28, 883 n.138.

123. *See infra* Section III.B.1.

124. Foster, *supra* note 86, at 87–92.

125. David B. Ridley et al., *Retail Zoning and Competition* 20–21 (Jan. 14, 2011) (Duke Univ., Working Paper), https://faculty.fuqua.duke.edu/~dbr1/research/zoning-competition.pdf.

126. *Id.*

zoning restrictions force more distance between the firms, the higher the prices tend to be.[127] In short, competition works. By forcibly spreading out storefronts, cities prevent consumers from comparing transaction terms,[128] which only further forces consumers to rely on store location—not borrowing terms—when choosing a lender. Therefore, anti-clustering ordinances have the unintended effect of harming consumers because they prevent more competitive lender behavior.[129]

### *B. Information Asymmetry Between Borrower and Lender*

Regardless of one's political or economic ideology, one cannot overstate the importance of consumer access to information when making financial decisions. In an ideal market, buyer and seller can make rational, mutually beneficial decisions because symmetry of information between the parties places them on equal footing.[130] A common criticism of the payday loan industry is that it thrives off borrowers that make borrowing decisions without considering the long-term consequences.[131] Further, those that turn to a payday loan

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127. *Id.*

128. As one commentator observes:

> Zoning regulations that restrict the entry of rival retailers or impose separation requirements that push firms farther apart risk a reduction in the positive agglomeration benefits that might accrue to firms and consumers. . . . Specifically, zoning which restricts firm location risks depriving consumers of the agglomeration benefits that competition between proximate firms can provide.

Foster, *supra* note 86, at 91–92.

129. *Id.*

130. *See* Martin, *supra* note 96, at 614 (citations omitted) (describing a perfect market).

131. This is a common criticism from consumer advocates who argue the industry thrives off trapping desperate borrowers in a cycle of debt. *See* Johnson, *Shrewd Business*, *supra* note 5, at 57 ("No matter what form a rollover takes, the results are the same: The customer steps onto the payday loan debt treadmill by making a stream of interest-only payments without reducing the principal and without obtaining additional cash."). Empirical evidence has shown, however, that a typical borrower is more likely to depend on their loan to pay typical, expected expenses, such as monthly bills. Martin, *supra* note 96, at 608 ("The majority of participants—indeed, 63%—reported using payday loans for regular, recurring monthly bills and expenses. . . . Initially, these respondents stated that the money was to cover 'bills,'

often do so because their community is underbanked or because they cannot qualify for a traditional loan.[132] One of the chief assumptions of neoclassical economic theory is that consumers "act rationally and do not make mistakes when it is at all costly to do so."[133] This model assumes that consumers seek to maximize "utility" by making choices that make them best off.[134] Thus, model, rational consumers possess the following characteristics: (1) they have access to relevant information; (2) they use information to make predictions; (3) they respond to incentives in the form of prices; and (4) they have "fixed, well-defined preferences" that are self-serving.[135] While behavioral economists have attacked this rational actor theory, a consumer's acquisition and use of information is still an important factor in analyzing rational consumer behavior.[136]

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but later elaborated that they meant rent, utilities, gas bills, cell phone bills, and so on.").

132. *See* Christopher, *supra* note 18; *see also* JAMES R. BARTH ET AL., MILKEN INST., WHERE BANKS ARE FEW, PAYDAY LENDERS THRIVE: WHAT CAN BE DONE ABOUT COSTLY LOANS (2013), http://assets1c.milkeninstitute.org/assets/Publication/ResearchReport/PDF/PaydayLenders.pdf (documenting the proliferation of payday lending services in underbanked California areas); Michael S. Barr, *Banking the Poor*, 21 YALE J. REG. 121, 124 (2004) ("Even those low-income persons who have a[] [bank] account may, in effect, be 'underbanked': They may rely on check cashers to cash their payroll checks; they may lack an institutionalized means to save, such as through payroll deduction plans; or they may not have, or may have tapped out, credit cards, and turn to relatively high cost forms of short-term credit, such as payday loans, to meet their liquidity needs.").

133. Kathryn Fritzdixon, Jim Hawkins & Paige Marta Skiba, *Dude, Where's My Car Title?: The Law, Behavior, and Economics of Title Lending Markets*, 2014 U. ILL. L. REV. ONLINE 1013, 1039 (2014). The rational actor model derives from "Chicago School" economic theories, which centers around "'free market' libertarianism" in crafting economic policy. *See* Maurice E. Stucke, *Money, Is That What I Want?: Competition Policy and the Role of Behavioral Economics*, 50 SANTA CLARA L. REV. 893, 896–97 (2010).

134. Fritzdixon, Hawkins & Skiba, *supra* note 133.

135. *Id.* at 1039–40. Under the rational actor model's assumptions, markets will "self-police," and government actors should wait for markets to "self-correct" before justifying intervention. Stucke, *supra* note 133, at 894. Commentators and government actors have critiqued this aspect of the rational actor model, particularly the idea that markets will "self-correct" in the name of profit maximization and thus lead to innovation and consumer welfare. *See id.*

136. *See* Fritzdixon, Hawks & Skiba, *supra* note 133, at 1040 (explaining that the field of behavioral economics "maintains . . . the primary elements of the rational

The use of information in borrower decision-making is why the lender's role in providing information prior to completing a transaction plays such an important role in a payday loan transaction. Seventy-eight percent of borrowers rely on the information they receive from the lender in assessing whether to take out a payday loan.[137] Due to this reliance, it is important that borrowers have accurate information about the nature of the transaction prior to entering it.

The next sections will explore how the distribution of information between borrower and lender can result in information asymmetry between the two parties. Section 1 will analyze the information that lenders use to attract potential borrowers and why this information does not assist borrower decision-making. Section 2 will show why Tennessee's current lender disclosure requirements, which focus primarily on the disclosure of fees, fail to assist borrowers in weighing the actual costs of a payday loan transaction.

### 1. Information That Lenders Provide Is Not Useful for Borrowers

The current distribution of information between borrower and lender shows a troubling trend of one party dominating the access to information. Because lenders "control" the flow of information during the transaction, it is important to explore the mechanisms lenders use to distribute it or conceal it. Even with minimal statutory disclosure requirements in place, lenders have little rational incentive, as long as rollover remains profitable, to go beyond minimal compliance.[138]

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actor model . . . but alters it to incorporate psychological evidence concerning how humans actually behave"). Relying on the principles of behavioral economics, the authors explain that the mode of presentation of certain decisions can affect consumer choice. *Id.* Further, the assumption of self-serving decision-making seeking to maximize utility is not always consistent. *Id.* at 1040–41 ("People are, of course, not purely self-interested, people procrastinate, people's preferences are often unstable and incoherent, and people misunderstand and miscalculate when thinking about probabilities and other complicated math problems required by utility maximization."). For a further critique of the rational actor model, see J. Thomas Rosch, Comm'r, FTC, Remarks at the New York Bar Association Annual Dinner: Implications of the Financial Meltdown for the FTC 2 (Jan. 29, 2009) (transcript available at http://ftc.gov/speeches/rosch/090129financialcrisisnybarspeech.pdf).

137. BOURKE ET AL., *supra* note 15.

138. For example,

Further, even if lenders follow the guidelines for proper disclosure, the way lenders present this information can affect borrower decision-making. Whether or not the lender intends to deceive the borrower, borrowers face an inherent disadvantage in obtaining information.[139]

Advertisements are an important informational source for borrowers seeking to learn more about a product. Professor Hawkins analyzed payday lenders' advertisements in Houston, Texas to assess market failure in the area, and he concluded that borrowers "deviate from the rational actor model."[140] Although the focus of Professor Hawkins's article is diagnosing the behavioral market failure, the study illustrates which characteristics of the payday loan transaction consumers consider important when making a borrowing decision.[141]

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> the APRs on payday loans far exceed those allowed for any other form of personal consumer credit. Payday lenders, therefore, possess a strong economic incentive to avoid disclosing their finance charges in a way that allows consumers to compare the cost of one credit transaction to another. The industry's creativity in characterizing payday loans as anything but credit extensions stems directly from this incentive.

Johnson, *Shrewd Business*, *supra* note 5, at 25.

139. Martin, *supra* note 96, at 615–16.

140. Hawkins, *supra* note 49, at 57. Professor Hawkins defines a behavioral market failure as one that occurs "when consumers' systematic mistakes about products or services cause them to misperceive the true cost or value of the product or service." *Id.* at 60. This definition stems from Oren Bar-Gill's description:

> We consumers are imperfectly rational, our decisions and choices influenced by bias and misperception. Moreover, the mistakes we make are systematic and predictable. Sellers respond to those mistakes. They design products, contracts, and pricing schemes to maximize not the true (net) benefit from their product, but the (net) benefit as perceived by the imperfectly rational consumer. Consumers are lured, by contract design, to purchase products and services that appear more attractive than they really are. This . . . results in behavioral market failure.

OREN BAR-GILL, SEDUCTION BY CONTRACT: LAW, ECONOMICS, AND PSYCHOLOGY IN CONSUMER MARKETS 2 (2012).

141. *See* Hawkins, *supra* note 49, at 65–66; *see also id.* at 59 ("Some advertisements contain information that rational actors would value. . . . But advertisements also contain material aimed at exploiting systematic mistake that consumers make when evaluating specific products, such as advertisements that focus consumers' attention on short-term gains as opposed to long-term costs."). Professor

The themes and information that lenders relay in advertising are, for the most part, consistent among the competing lenders that Professor Hawkins surveyed, showing uniformity in what competing lenders consider important for potential borrowers.[142] Advertisements tend to focus only on quick access to cash, the convenience of the transaction, and the lack of requirements borrowers need to qualify.[143] Of the advertised "themes," quick access to cash was the most heavily advertised attribute by a significant margin.[144] In addition, advertisements tend to focus on dollar prices, as opposed to APR.[145]

The emphasis on convenience is important because it is often the predominant factor—more so than competitive prices—that drives borrower choices.[146] While the advertisements on Houston storefronts included claims of low prices, they did not contain any support for the claim or any indication that their prices were lower than other competitors.[147] Further, while the advertisements relayed information that analysts and commentators considered informative,[148] the advertisements' "informative" content has little substance if it does not provide information to help a borrower pick between competing

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Hawkins concludes that "how firms advertise is a reliable guide to whether consumers are making mistakes." *Id.* at 59.

142. *See id.* at 65–66.

143. *See* Johnson, *Shrewd Business*, *supra* note 5, at 121 (stating that payday lenders "entice" customers through the promise of a quick loan without a credit check, not revealing the disproportionate APR rate until after the transaction has been finalized). *See also generally* Bertics, *supra* note 20, at 139 (describing advertisements as a means of deceiving borrowers that enable lenders to charge more).

144. Hawkins, *supra* note 49, at 72.

145. *Id.* at 68 (citations omitted).

146. Martin, *supra* note 96, at 615 (discussing that the location of the lending store is a more determinative factor for picking a lender than competitive prices).

147. *See* Hawkins, *supra* note 49, at 74–75.

148. Professors Hawkins makes this determination using the Resnick Stern fourteen prong rubric. *Id.* at 80. Based on this test, an advertisement is informative if it presents any information on one of the fourteen topics on the test. See Alan Resnik & Bruce L. Stern, *An Analysis of Information Content in Television Advertising*, 41 J. MARKETING 50, 51 (1977), for a listing of all fourteen topics. Topics relevant to payday loan advertisements include price or value, special offer, quality, availability, and content. Hawkins, *supra* note 49, at 80.

lenders.[149] Therefore, advertisements that focus on topics like speed, price, and convenience ("no credit check," for example) have little informative value for a rational actor because there are not substantial differences between competing lenders on these topics. Further, if stores advertise prices in a misleading or deceiving fashion that will likely confuse the borrower, the advertised price lacks informational value because the consumer cannot anticipate the true cost of the loan.[150]

Professor Hawkins's study also demonstrates how other cognitive issues outside the rational actor model factor into borrowing decisions and how lenders rely on these outside cognitive issues in the way they relay information to borrowers.[151] For example, the lack of advertisements containing information about the exact price of a loan was particularly problematic because borrowers could not compare competing lenders.[152] Here, the lender clearly holds the advantage by highlighting the desirable characteristics of the transaction—such as speed or convenience—while hiding the undesirable—how expensive the fees are.[153] By doing so, a lender can attract borrowers into her

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149. Here, Professor Hawkins defines the characteristics of an informative advertisement versus a persuasive one. Informative advertising helps guide intelligent buying decisions, such as providing price, quality, and availability of the product or service. Hawkins, *supra* note 49, at 79. Persuasive advertising "produces product differentiation where no real differences exist by, for example, creating brand loyalty where the brand is functionally irrelevant." *Id.* Based on these differing definitions, content deemed persuasive would not inform a purely rational consumer's decision-making. *Id.*

150. *See* Johnson, *Shrewd Business*, *supra* note 5, at 32–55 (describing the misleading tactics that payday lenders use before and at contract formation, based on a survey of lenders in Ohio).

151. *See* Hawkins, *supra* note 49, at 82–92 (analyzing the type of advertisements displayed and the cognitive factors that come into play for borrowers).

152. *Id.* at 88–90.

153. Professor Hawkins explains further:

> Behavioral economics offers a superior explanation for the absence of pricing information or for the deceptive pricing information. Gabaix and Laibson have shown that firms will shroud undesirable characteristics while highlighting desirable characteristics for customers. No scholarship argues that payday and title lending prices are low or that customers like paying these fees, so pricing information appears to be a prime candidate for shrouding. The

store through the promise of quick cash and the myth of an unspecified low price, only to reveal a high price in the middle of the transaction. In this scenario, the lender can attract potential customers who have no actual knowledge of a loan's terms or whether a competing lender can offer more favorable terms. This problematic scenario forces borrowers to consider terms for the first time when they enter a store and begin speaking to a lender. Considering the importance borrowers place on loan speed and lender location, and many borrowers' inability to incur additional search costs,[154] lenders can exploit borrowers by attracting them with irrelevant loan characteristics before they can shop around for more favorable terms.[155] For consumers who lack time or the ability to incur additional search costs, the first store that attracts their attention may well be the only store they visit.

Like the information potential borrowers get before entering a transaction, the information lenders must give to borrowers before closing the transaction is also of little use. The next subsection will demonstrate why current disclosure requirements do not assist borrowers in assessing long-term ramifications of their borrowing.

### 2. Lender Disclosure Requirements That Focus on Fees Do Not Provide the Borrower with the True Cost of the Transaction

Because borrowers' only means to access information about a loan may be through face-to-face encounters with lenders or advertisements lacking informative value, it is important that statutorily imposed disclosure requirements force lenders to reveal relevant information that affects borrowing behavior. In Tennessee, lenders must provide borrowers with a written explanation of all fees that it will charge in the transaction, as well as disclosure that complies with the TILA.[156] These disclosure requirements provide enough

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> near absolute absence of pricing information exemplifies Gabaix and Laibson's theoretical observation.

*Id.* at 89.

154. *See supra* Section III.A.

155. This type of borrower behavior reflects what economists call the "sunk cost fallacy." For a description of how the sunk cost fallacy can factor in borrower decision making, see Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 792 (2006).

156. TENN. CODE ANN. § 45-17-112(g) (2007 & Supp. 2017).

information for a hypothetically perfect transaction in which the borrower can pay off the loan and the fee at the date specified on the post-dated check. Minimal disclosure requirements that focus solely on fees and rates, however, ignore the reality of a typical payday loan transaction.

Disclosure requirements that focus on fees fail to fully inform consumers because these terms can be largely deceiving and confusing. For example, if a lender describes a loan in terms of the fee charged per $100 borrowed, many consumers may believe that the fee represents the APR, not the rate for two weeks.[157] This can be deceiving. The disclosure requirement, as written, permits a lender to show an otherwise high interest rate in a way that makes it seem low.[158] While the contract would display the APR (as required by TILA), unsophisticated borrowers may not know what this percentage describes, how to factor it in assessing the probability of paying off the loan, and whether they will later need to roll over.[159] This possibility of confusion stems from the general financial illiteracy from which Americans as a whole suffer.[160] Thus, disclosure requirements focusing solely on the cost of the transaction, filled with vocabulary with which an unsophisticated borrower may not be familiar, are of little value because the borrower cannot assess the true cost of the loan over time.[161]

While the fees of a payday loan transaction are for the most part transparent—for example, in Tennessee it costs a maximum of $15 dollars for a $100 loan—this transparency does not mean that borrowers comprehend the implication of this fee structure.[162]

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157. Martin, *supra* note 96, at 615–16.

158. *See* Chris Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1148–50 (2008) (discussing that high usury rates in the financial context were routinely expressed in a way to make them appear deceptively low).

159. *See* Martin, *supra* note 96, at 615–16

160. *Id.*

161. *Id.* at 617–18 ("Based upon the study described in this Article, the actual cost of payday loans over time is not easily translated into an annual percentage rate, making it difficult for consumers to compare the cost of credit.").

162. Bertrand & Morse, *supra* note 6, at 1876 ("For example, [borrowers] may not be aware of how a payday loan compares to other forms of credit in APR because of the emphasis in payday lending on fees rather than rate, or they may not go through

Disclosure requirements focusing solely on the first-time fee do not give borrowers a broad look at the true costs of a payday loan because it does not allow them to assess the cost of the loan over time. One way to determine what information affects borrowers' behavior is to analyze disclosure types that deter borrowers from borrowing or reduce the amount they borrow.[163] An economic study experimenting with different types of disclosure provided the following results:

> It appears, though, that getting consumers to think more broadly about the decision to take up a payday loan—by stressing how the fees accompanying a given loan add up over time, by presenting comparative cost information to increase evaluability, or to a lesser degree, by disclosing information on the typical repayment profile of payday borrowers—results in a reduction in the amount of payday borrowing.[164]

The experiment showed that this type of disclosure resulted in an 11% decrease in borrowing.[165] This demonstrates that borrowers respond to disclosures that accurately characterize the long-term and broad effects of the transaction instead of merely presenting the transaction as a one-time fee.

Despite the current flaws in the industry, however, Tennessee should not join the other states that have banned payday lending or effectively regulated it out of existence. Indeed, this next part will show why the negative effects that result from banning the industry are worse than the allowing the business to continue, albeit with reasonable regulation.

## IV. WHY TENNESSEE SHOULD NOT BAN PAYDAY LOANS

Given current structural problems in the payday loan market, one might ask why an outright ban on the service is not a viable option. Fourteen states and the District of Columbia have banned the

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the exercise of adding up the payday [fees] over periods of refinancing to make the dollar cost salient enough to warrant consideration.").

163. *See generally id.*

164. *Id.* at 1867.

165. *Id.* at 1868.

practice.[166] In addition, there are also numerous "hybrid states" that allow the practice, but have more exacting requirements than permissive states, such as lower limits on fees, loan usage, or longer payment periods.[167] Tennessee should not join with these states.

This section will provide two reasons why banning the industry altogether is not a viable alternative.[168] Section A will discuss the market need for short-term credit services and why regulation, instead of prohibition, is the best means of controlling the negative effects of the industry. Building from this idea, Section B will show that payday lending currently provides the best non-traditional financial service and that banning the industry will not necessarily produce better borrower behavior.

### *A. The Market Need for Short-Term Credit*

Given the reasons borrowers choose payday lending over traditional financial services that banks or credit unions provide, the high demand for payday loans is easy to understand. The U.S. Census Bureau surveyed payday loan borrowers and found that borrowers turn to payday lenders because of convenience and lack of small-dollar loan offerings at traditional banks.[169] These statistics show that borrowers

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166. PEW CHARITABLE TRS., STATE PAYDAY LOAN REGULATION AND USAGE RATES (2012), http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/state-payday-loan-regulation-and-usage-rates. It is also worth noting that states can effectively ban the industry.

167. *Id.*

168. In addition, the political landscape in Tennessee makes it unlikely. Since its founding in the early 1990s, the payday loan industry has been a major contributor to the campaigns of Tennessee lawmakers. *See* Steven Hale, *Payday Lenders Take from the Poor—And Give to Tennessee Candidates and Lawmakers*, NASHVILLE SCENE (July 31, 2014, 4:00 AM), http://www.nashvillescene.com/news/article/13054869/payday-lenders-take-from-the-poor-and-give-to-tennessee-candidates-and-lawmakers ("A scan of state financial disclosures reveals at least $66,750 in political donations from the payday lending industry so far this year, either given directly to candidates or funneled through political action committees."). *See generally* Kasper, *supra* note 3, at 913, 920 (noting the contributions by the industry to major players in Tennessee politics, such as Senator Bob Corker and former governor Don Sunquist).

169. U.S. CENSUS BUREAU, CURRENT POPULATION SURVEY, JUNE 2011: UNBANKED/UNDERBANKED SUPPLEMENT FILE (2011), http://www.nber.org/cps/cpsjun2011.pdf. The survey provided the most common

perceive payday loans as a means of obtaining a service that banks cannot offer.

While governments should certainly take steps to assure credit services harm consumers as little as possible, it is difficult to block consumer access to borrowing by eliminating a particular method of extending credit.[170] After banning a credit service, states have seen lenders use innovative means to work around usury statutes to offer essentially the same service.[171] In order to avoid these scenarios, states would need two things they often do not have: "both a broad and inclusive usury statute (so that lenders cannot easily switch to substitute transactions that are unregulated), and an aggressive enforcement regime (so that lenders cannot operate unlawfully below the radar)."[172]

One of the basic assumptions of economics explains the industry's proliferation: markets arise wherever there exists market demand.[173] A commentator analogizes the demand for alternative

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reasons regarding borrowers use payday loans instead of banks: "Easier and faster to qualify" (42.6%); "Banks do not give small-dollar loans" (20.7%); "Respondent does not qualify for bank loan" (15.8%); "More convenient hours or location" (12.4%); "Other" (7%); and "Feels more comfortable" (1.7%). Neil Bhutta, Jacob Goldin & Tatiana Homonoff, *Consumer Borrowing After Payday Loan Bans*, 59 J.L. & ECON. 225, 240 (2016).

170. Mann & Hawkins, *supra* note 28, at 887.

171. In Arizona, for example, payday lending was essentially made illegal after lenders were required to comply with the 36% state usury rate. Jim Hawkins, *The Federal Government in the Fringe Economy*, 15 CHAP. L. REV. 23, 74–75 (2011). For ten years prior, payday lenders were allowed to operate above the 36% cap. *Id.* The imposition of the new cap resulted in lenders offering what is essentially a payday loan disguised as a car title loan; a service that was not banned. *Id.* at 75.

> Lenders can offer payday-like loans to customers with cars by extending the loan based on the person's paycheck and taking a second-lien position on the car without ever intending to use the vehicle as collateral. If Arizona really intended to ban payday lending, it appears to have failed. To truly eliminate payday lending, the legislature will have to pass another law altering the title loan statute to prevent the conduct described here.

*Id.*

172. Mann & Hawkins, *supra* note 28, at 887.

173. *See* Charles M. Horn, *Regulation and Self-Policing Will Influence Consumers' Access to "Payday Loans,"* 12 LEGAL BACKGROUNDER 1 (Nov. 14, 2003), http://www.wlf.org/upload/111403LBHorn.pdf.

financial services to the demand for drugs.[174] While law enforcement focuses its efforts in the drug war on attempting to curtail the supply, the demand continues to exist.[175] Where demand exists, markets will arise. Thus, while police attack supply by taking one dealer off the street, another dealer has a rational incentive to take his place.[176] The same rationale allows alternative fringe credit markets to arise when the law bans one type or regulates it out of existence. While states may adopt regulations to restrict access to payday lending services, the demand will continue to exist and supply will follow, whether or not the market is legal.[177] As a worst case scenario, banning demanded credit services can result in borrowers going to credit sources of last resort.[178] In France, Germany, and the United Kingdom, stricter regulation of consumer credit—which reduces high-risk borrowers' access to legal credit—creates higher rates of illegal lending activity, such as loan sharking.[179] When policy makers consider the appropriateness of prohibition, they should accordingly consider the market-shifting consequences of prohibition.[180]

A statewide payday loan ban has little justification if it produces even more negative borrowing behavior from the industry's would-be consumers.[181] Restricting access to payday loans does not meaningfully reduce demand for other alternative financial services.[182] Consumers living in states that previously allowed payday lending, but have since banned the practice, illustrate the demand for short-term credit services. In states that ban or significantly restrict payday lending, borrowers turn to other alternative financial services to satisfy

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174. *See generally* Lance McMillian, *Drug Markets, Fringe Markets, and the Lessons of Hamsterdam*, 69 WASH. & LEE L. REV. 849 (2012).

175. *Id.* at 863–64.

176. *Id.* at 866–67.

177. *Id.* at 873.

178. Todd J. Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONSUMER L. REV. 425, 455 (2010).

179. *Id.* at 456.

180. McMillian, *supra* note 174, at 872.

181. Bhutta, Goldin & Homonoff, *supra* note 169, at 226 (2016) ("If payday-lending bans simply shift borrowing to other expensive forms of credit, attempts to deal with payday loans in isolation may be ineffective or even counterproductive.").

182. *Id.*

their demand for accessible albeit high-interest credit.[183] In addition, following the payday-loan restrictions, involuntary checking-account closures increase.[184] This suggests that some consumers are more likely to bounce checks and overdraw their bank accounts when they cannot avail themselves of payday loans by law.[185] Rather than reducing consumers' use of alternative financial services, restricted access to payday loans lads consumers seeking short-term credit to other sources.[186] Thus, when determining appropriate payday loan policy, it is important to determine whether payday loans are the worst available alternative for short-term credit.[187]

### *B. Alternative Short-Term Credit Options Are Less Effective*

Since would-be consumers of payday loans turn to other forms of alternative financial services when governments heavily regulate or

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183. Bhutta, Goldin, and Homonoff explain:

> Because we find that payday loan regulations are associated with a reduction in one type of AFS product (that is, payday loans), this result suggests that usage of a different AFS product must have increased in an offsetting way. . . . [P]ayday loan restrictions are associated with a positive and statistically significant effect on the use of pawnshop loans—the estimated effect is 1.6 percentage points, a 60 percent increase from the mean usage rate in states where payday loans are legal. This finding suggests that consumers turn to pawnshop loans as a substitute form of borrowing when payday loans are no longer available. In contrast, there is no such evidence of a shift to rent-to-own loans following payday loan bans. The difference may not be surprising since payday lenders and pawnshops both offer customers cash loans while rent-to-own outlets offer credit only for the purchase of specific items. If payday loan customers use their loans for reasons other than the purchase of electronics, appliances, or furniture, then a rent-to-own agreement will be an unlikely substitute.

*Id.* at 246.

184. *Id.* at 247.

185. *Id.* at 256.

186. *Id.* at 257.

187. *See id.* ("[O]ur analysis shows that it is important to determine whether [payday loans] are better or worse than the available alternatives. If policy makers conclude that payday loans are better than the available alternatives, restricting access to them (while not regulating other potential substitutes) may be counterproductive.").

ban the industry, it is important to determine whether these alternatives cause more harm than payday lending. Because markets exist wherever there is demand, policy makers must consider the reality of payday lending when determining the appropriate regulatory scheme for the industry to avoid its negative effects. CFPB Director Richard Cordray has admitted that, while it is important that the CFPB "recognize the need for emergency credit[,] . . . it is important that these products actually help consumers, rather than harm them."[188]

Pawnshops, one of the less attractive alternative-credit services, benefit from payday loan bans.[189] Pawnshops offer borrowers a loan in exchange for a possessory interest in a piece of personal property the borrower owns.[190] The possessory interest becomes an ownership interest if the borrower fails to repay the loan's principal and interest.[191] Borrowers in a pawn transaction risk not only accumulating interest on the principal loan but also forfeiting their personal property in the event of default.[192] Unlike a typical secured transaction, in which the creditor must return surplus value from selling the collateral in the event of borrower default, the borrower in a pawn transaction has no right to any surplus value the pawnbroker acquires through selling the borrower's personal property.[193] Thus, payday loans present more advantages to borrowers than pawnshop transactions because payday loan borrowers do not risk losing their personal property as part of their transaction.[194]

States like Georgia, North Carolina, and Virginia that have banned payday lending outright have seen the negative effects of the prohibition and the market-shifting consequences that result.[195] Georgians and North Carolinians have "bounced more checks,

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188. Richard Cordray, Dir., Consumer Fin. Prot. Bureau, Remarks at the Payday Loan Field Hearing in Birmingham, AL (Jan. 19, 2012), http://www.consumerfinance.gov/speeches//remarks-by-richard-cordray-at-the-payday-loan-field-hearing-in-birmingham-al/.

189. *See* Mann & Hawkins, *supra* note 28, at 891–93.

190. *Id*. at 891.

191. *Id.*

192. *Id.* at 891–92.

193. *Id.*

194. *Id.* at 892 ("Loans made by pawnbrokers generally have interest rates at least as high as, if not higher than, payday loans.").

195. McMillian, *supra* note 174, at 879–80.

complained more about lenders and debt collectors, and have filed for Chapter 7 ('no asset') bankruptcy at higher rates."[196] Are these alternatives more harmful than fees incurred through Tennessee's average APR of 391 percent? The corresponding APR on overdraft protection fees would range from 608 percent to 791 percent, while bounced check fees yield an APR between 487 percent and 730 percent.[197] Similarly, the payday-loan ban in Virginia resulted in the proliferation of the car-title lending industry.[198] Market-shifting that results when states ban payday lending does little to promote consumer welfare because, after a ban, consumers have fewer options from which to choose to fulfill their personal credit needs.[199]

## V. AN INFORMATIONAL APPROACH

Reducing the information costs of a loan should be the first step state governments take to mitigate the "cycle of debt." Lender control

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196. *Id.* at 880 (quoting DONALD P. MORGAN & MICHAEL R. STRAIN, FEDERAL RESERVE BANK OF NEW YORK, STAFF REPORT NO. 309, PAYDAY HOLIDAY: HOW HOUSEHOLDS FARE AFTER PAYDAY CREDIT BANS 26 (rev. 2008)).

197. SUMMERS, *supra* note 4, at 18 ("Applying the same APR calculations to bank account overdraft protection fees as to those for payday lending reveals that overdraft protection costs are even more 'usurious' than payday lending costs."). The report provides statistics from the Community Financial Services Association of America, which summarizes and compares the costs of payday loans with other short-term options. *Id.* at 19. While a $100 payday loan with a $15 fee has an APR of 391 percent, a $100 bounced check with $56 in non-sufficient funds and merchant fees is an APR of 1449 percent; a $100 credit card balance with a $37 late fee is an APR of 965 percent; and a $100 utility bill with $46 late/reconnect fees is an APR of 1203 percent. *Id.*

198. McMillian, *supra* note 174, at 880.

199. Professor Zywicki explains:

> [B]y pushing consumers to use credit that is less appropriate for their personal situation . . . banked consumers are more likely to run into financial collapse than they would be with a title loan. Unbanked consumers may see a reduction in credit availability, resulting in more bounced checks, more utility shutoffs, and more evictions stemming from an inability to pay rent. It is hard to see how this combination of consequences—greater use of pawnshops, more bounced checks, and more utility shutoffs—can improve consumer welfare.

Zywicki, *supra* note 178, at 448.

of information and the increased search costs that result from city zoning ordinances that spread storefronts across a jurisdiction both make consumer acquisition of information more burdensome. The ensuing information asymmetry allows lenders to keep prices high and terms uncompetitive.

This Part proposes a number of solutions that will allow consumers to make more informed borrowing decisions, which in turn will encourage competition among lenders. In Section A, I propose strengthening disclosure requirements in a way that allows consumers to obtain information that more accurately reflects the reality of payday loan transactions. Instead of disclosure focusing solely on fees, disclosure should also allow consumers to assess their probability of being able to pay the loan off in a reasonable amount of time. This information will not only allow borrowers to more easily determine the true costs of the loan, but will also allow borrowers to more easily compare price among competitors. In Section B, I propose that local zoning ordinances should not focus on preventing clusters. Instead, the ordinances should allow clustering in certain areas. This would encourage competition among nearby lenders by lowering consumer search costs.

### *A. Fostering Competition and Informed Borrowing Behavior Through Increased Disclosure Requirements and More Rigorous Enforcement*

Because lenders control the flow of information in a transaction, sound, statutorily imposed disclosure requirements would ease borrowers' burdens in comparing differing transaction terms, thereby encouraging competition among lenders.[200] What alternative disclosure requirements would allow borrowers to gather necessary information? After all, positive competitive changes in the industry will revolve around more competitive pricing.

While fees are important, it is equally important that borrowers leave payday loan stores with an understanding of the nature of the

200. Mann & Hawkins, *supra* note 28, at 902–03 ("If the product and its pricing can be made as simple as possible—so that there is a single fee—it increases the likelihood that borrowers accurately will understand (and compare) the cost of borrowing."). *But see supra* Section III.B.2 (discussing problems with fees as the centerpiece of a lender's required disclosure).

transaction and its true costs. Credit transactions can impose the most risk among all transactions a consumer can enter. Therefore, the goals of disclosure in a consumer credit transaction should be, first, improved consumer understanding of this unescapable risk and, second, the ability to find the offer with the least amount of long-term risk. This Note proposes several changes to Tennessee's statutory disclosure requirements that, if enacted, will give consumers access to necessary information about a transaction and encourage them to shop for the most favorable terms.

First, the law should require that lenders display fee amounts per $100 in stores in a manner that entrants can easily see. The current statute sets a maximum fee of "fifteen percent (15%) of the face amount of the check [that is, the amount loaned]."[201] Additionally, the current law only requires disclosure of this fee "before consummation of the deferred presentment agreement."[202] An optimal regulation would require lenders to display the total nominal fee charged per $100 loaned, per $200 loaned, etc., up to the maximum loan amount of $500.[203] This way, potential borrowers would know the total price of the loan before entering into a discussion with a lender. While this does not solve all information-distribution problems that arise in the transaction, it does lower the search costs that potential borrowers must incur to see a clear price. The proposal also allows potential borrowers to get an estimate of the loan's cost without having to talk to the lender. Storefront advertising currently does not provide an accurate description of the true cost of the loan and thus it is not a reliable source of information informing borrowing decisions.[204] Requiring storefronts to display accurate prices per $100 loaned would serve as an accurate informational source that current advertisements fail to supply.[205]

Many of the informational problems surrounding a typical transaction arise from the borrower's ignorance of how credit works,[206]

201. TENN. CODE ANN. § 45-17-112(b) (2007 & Supp. 2017).

202. *Id.* § 45-17-112(g).

203. *See id.* § 45-17-112(o)–(p).

204. *See generally* Hawkins, *supra* note 49.

205. *Id.* at 74–75 (noting that, while store advertisements made claims of low prices, they failed to back up this assertion by displaying actual price).

206. Martin, *supra* note 96, at 614–15 (discussing the general financial illiteracy from which most Americans suffer).

so second, the law should require lenders to provide borrowers with a Tennessee Department of Financial Institutions document outlining (a) how long a typical loan takes to pay, depending on loan size and borrowers' weekly earnings, (b) borrowers' legal rights against lenders, and (c) the requirements lenders must meet for the loan to be legal. In addition, disclosure based solely on fees fails to provide consumers with a broad overview of the potential consequences of taking out a loan.[207] Borrowers are less likely to take out of loan when they have information "stressing how the fees accompanying a given loan add up over time, by presenting comparative cost information to increase evaluability, or to a lesser degree, by disclosing information on the typical repayment profile of payday borrowers."[208] Because this type of disclosure resulted in a decrease in borrowing,[209] it is reasonable to assume that borrowers will use this additional information when assessing the risk of taking out a loan. If borrowers view the costs of a payday loan holistically, the risk of rollover (and the ensuing cycle of debt) may decrease because borrowers could more accurately assess the true cost of the loan and the risk the transaction presents. In addition to the complexity of a credit transaction, borrowers are not aware of their rights in the event of lender foul play.[210] While the current laws require lenders to disclose most of this information to borrowers,[211] it is unreasonable to assume the Tennessee Department of Financial Institutions has the manpower to enforce these requirements across a state with over 1,000 payday loan stores.[212] This proposal thus provides borrowers information about the

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

208. Bertrand & Morse, *supra* note 6, at 1867.

209. *Id.* at 1867–68 (noting that these types of disclosure requirements resulted in a 11% decrease in borrowing).

210. Empirical evidence shows that borrowers are unlikely to bring a civil suit in the event of disclosure or illegal lending practices. Johnson, *Shrewd Business*, *supra* note 5, at 80–82. This proposal will make borrowers aware that they have at least some legal rights.

211. *See* TENN. CODE ANN. § 45-17-112(g) (2007 & Supp. 2017).

212. Barth et al., *supra* note 9, at 20.

transaction from a more neutral third party, thereby allowing borrowers to rely less on lenders as their only source of information.[213]

Lastly, to encourage lender compliance through oversight, borrowers should complete a short Tennessee Department of Financial Institutions survey that asks various questions about the transaction. The questions should include when and how the lender disclosed the fee charged for the loan, whether the borrower is aware of their legal rights, and what information the lender provided to the borrower outside of the Tennessee Department of Financial Institutions informational document that this Note proposes. This way, state regulators can track lender violations more easily and, in the process, induce lenders to comply. While these proposals will not solve all the informational issues in a payday loan transaction, nor will they stop all lender violations, they will at least provide stronger incentives for safer lending practices.

### *B. Lift Zoning Laws That Increase Consumer Search Costs*

City councils in Tennessee have legitimate concerns about the effect payday lending stores can have on communities. The storefronts can be eyesores for neighborhoods and can potentially drag down property values.[214] Further, localities have the legal power to stop the proliferation of certain industries.[215] There is no denying that a market for this product exists, however, and states have failed to curtail the

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213. *Cf.* BOURKE ET AL., *supra* note 15, at 4 ("In deciding whether to borrow from a payday lender, more than 3 in 4 borrowers rely on lenders to provide accurate information about the product . . . .").

214. *See* NASHVILLE, TENN., METROPOLITAN ZONING CODE ch. 17.04, 17.08 (2016) ("WHEREAS, a study conducted by the Regional Planning Agency of Chattanooga-Hamilton County, Tennessee concluded that the proliferation and clustering of 'Alternative Financial Services' such as cash advance, check cashing, pawnshops, and title loan establishments can have a detrimental effect on local property values and economic redevelopment . . . .").

215. *See generally* Village of Euclid v. Ambler Realty Co., 272 U.S. 365 (1926) (holding that the Constitution does not prohibit municipalities from zoning jurisdictions according to planned uses to proactively mitigate nuisances, even where the zoning scheme may adversely affect property values); *see also* Patricia Salkin, *Regulating Controversial Land Uses*, 39 REAL EST. L.J. 526, 526 (2011) (noting localities general justifications for zoning restrictions on land uses deemed "controversial").

demand through regulation.[216] If city councils truly wish to protect city residents from what they deem "predatory" forms of credit, they should set forth ordinances that encourage competition. Location is one of the most important factors for consumers picking a lender.[217] With this in mind, future ordinances should strive to ease the consumer's ability to compare rates from competing lenders and keep search costs low. Accordingly, municipal ordinances should allow clustering of payday loan storefronts.

For example, cities can grant multiple store licenses in certain zoned areas, while outright denying the licenses in other areas. Payday lenders inevitably will seek to build stores in underbanked areas where people need the service.[218] Cities, however, can still protect certain uses that are ill-suited to be near payday loan stores (such as schools or residential areas), while not restricting benefits of geographic clustering. This way, city councils still retain some control to prevent the proliferation of storefronts in certain areas, while lowering search costs for consumers.[219] Under the current structure of the city ordinances, consumers face increased search costs to price shop between competing lenders, which encourages consumers to pick lenders based only on location.[220] While cities can take steps to encourage less dependence on payday loans, they should not take steps that require them to accept less competitive behavior from lenders. Retailers that are forced to be geographically closer together tend to react by increasing "format (or product) variety, without reducing firm

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216. *See supra* Section IV.A.

217. *See* Martin, *supra* note 96, at 611.

218. *See* SUMMERS, *supra* note 4, at 26–27 (concluding that while payday lenders are accused of "targeting" poor communities, this is not necessarily a harm because they are simply "tap[ing] an underserved market and satisfy[ing] the financial needs of those 'unbanked' and 'underbanked' consumers in areas that banks and credit unions have ignored").

219. While this could have the effect of making the zoned area further away for certain consumers, it would at least allow consumers to more easily compare the terms that competing lenders offer upon reaching the area. While the current ordinance structures may allow storefronts to be closer to certain consumers' homes, jobs, etc., it does not change the fact that this structure imposes search costs in finding other, more competitive rates.

220. Foster, *supra* note 86, at 92 ("[Z]oning which restricts firm location risks depriving consumers of the agglomeration benefits that competition between proximate firms can provide.").

entry."[221] Further, there is a correlation between zoning controls and price competition when cities use zoning controls to facilitate competitive firm agglomeration.[222] Simply put, location encourages competition, and competition works.

## VI. CONCLUSION

While payday lending is not the perfect form of short-term credit, the growth of the industry demonstrates a clear market need. When consumers lose access to payday lending, more predatory, alternative forms of short-term credit arise. These alternatives cause more harm to would-be payday loan borrowers.

As this Note demonstrates, the barriers that payday loan consumers face in obtaining reliable information, and the industry's lack of competition because of it, cause an informational market failure. The Tennessee General Assembly and Tennessean city councils, however, have the resources to make a payday loan transaction more efficient for consumers. They should begin by imposing disclosure requirements on lenders that provide reliable information for borrowers. In addition, municipalities should lift local zoning ordinances that prevent the clustering of payday loan stores in favor of ordinances that allow a degree of clustering. Through these proposals, payday loan borrowers will incur fewer search costs in their effort to find the most favorable transaction terms. When borrowers have access to reliable, neutral information that demonstrates the broad consequences of a loan, lenders will face a greater incentive to compete. This will result in a more efficient market in which a one-time loan does not become a years-long burden.

221. *Id.* at 90. "[C]ompeting retailers with heterogeneous formats gain additional customer traffic and consumers benefit from a more robust variety of products and shopping formats." *Id.*

222. *Id.* at 91 (citing Ridley et al., *supra* note 125).