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Short-Term Emergency Lending: Examining Usury Law in the United States and Canada

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Short-Term Emergency Lending: Examining Usury Law in the United States and Canada

Abstract
We have chosen to discuss the regulatory framework surrounding the "payday lending" industry in North America and ultimately propose that further consumer protection and usury laws are necessary. In particular, we suggest that existing regulatory frameworks do not adequately safeguard low-income consumers who often rely on the alternative consumer credit market as their sole means of credit making them particularly susceptible to usurious lending practices. We believe this to be a particularly timely issue that has, of yet, received limited scholarly coverage adopting an international approach.

Keywords
Short-Term Emergency Lending, Payday Loans, Consumer Credit Protection, Usury, Comparative Law

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SHORT-TERM EMERGENCY LENDING: EXAMINING USURY AND CONSUMER CREDIT PROTECTION LAW IN THE UNITED STATES AND CANADA

JESSE BELLAM & AIDEN TALAI*

I. INTRODUCTION

Over the last decade the short-term emergency, or "payday", lending industry has grown steadily into a multi-billion dollar business. Payday loans are small, short-term cash advances used for a variety of reasons ranging from "covering unforeseen emergencies such as car repairs, to simply trying to make ends meet between paycheques."[1] The industry functions as an alternative to traditional consumer credit and operates outside the safeguards of the mainstream banking sector. This seemingly innocuous credit structure has been a lightning rod for criticism based on two central and connected elements: (1) the interest rates charged to borrowers, and (2) the tendency for these loans to ensnare borrowers in a "cycle of debt."[2] However, despite these issues, the payday lending industry remains largely unregulated, especially when compared to the broader financial services industry.[3] In particular, the consumer protection laws and regulations designed to monitor mainstream financial institutions are not readily applicable to payday lenders. Therefore, there is a need for new laws and regulatory measures aimed specifically at payday lenders.

Before reforming these consumer protection standards, however, legislatures must first account for the distinct challenges posed by the payday lending industry. In particular, regulators must reconcile the tension between disapproval of payday lending practices and the belief that payday loans serve a useful purpose for society. The latter perspective is that payday lending provides more than mere convenience; it serves low-income consumers who have limited access to traditional banks with an alternative means of credit. Accordingly, shuttering the industry without first providing a feasible alternative to payday loans is a problematic solution, as it is likely to leave an entire

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[1] Consumer Measures Committee, "Alternative Consumer Credit Market Consultation" (December 31, 2004), online: Industry Canada <http://www.ic.gc.ca/eic/site/cmc-cmc.nsf/eng/fe00085.html>.

[2] Bart J Wilson et al, "An Experimental Analysis of the Demand for Payday Loans" (2010) 10:1 The B.E. Journal of Economic Analysis & Policy at 2.

[3] See *Sarbanes–Oxley Act of 2002*, Pub L No 107-204, 116 Stat 74; *Bank Act*, SC 1991, c 46; etc.

class of consumers without access to credit. Even worse, it may unintentionally "force this vulnerable group to turn to loan sharks and more criminal lenders."[4] Therefore, in the absence of a workable alternative, regulators may have to consider new public policy that permits low-income borrowers to access these loans while simultaneously providing them with the consumer protection safeguards available to mainstream borrowers.

This paper is divided into four sections. The first and second sections provide a general overview of payday lending regulation across the United States and Canada. The third section highlights the enforcement difficulties associated with the existing laws, which have allowed the payday lending industry to thrive notwithstanding its arguably predatory, misleading and abusive lending practices. In the fourth section we suggest that a viable consumer protection regime should include a federal interest rate ceiling, along with with an industry code of best practices and a complementary enforcement scheme.

II. THE UNITED STATES REGULATORY SCHEME

A. Federal Oversight

Borrowing has increasingly come to define American economic practices and, in lockstep with this trend, the payday loans industry has grown explosively throughout the United States. It now has more American storefront locations than McDonald's and Starbucks combined.[5] While payday lending in the United States is a multi-billion dollar industry, it is not subject to any significant federal regulatory oversight. In particular, there is no federal licensing regime for payday lenders similar to that in place for chartered banks, nor is there a federally mandated interest rate ceiling.[6] The recent passing of the Talent-Nelson amendment[7], which imposes a 36 percent interest rate cap on certain types of loans to military personnel and their dependents, gave some "prominence to the possibility that federal law might someday limit the operations of payday lenders," but federal oversight is nevertheless still limited, ineffectual and, in some cases, unintentionally facilitates the circumvention of usury law.[8]

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[4] Stephanie Ben-Ishai, "Regulating Payday Lender in Canada: Drawing on American Lessons" (2008) 4:3 CLPE 3 at 6 [Ben-Ishai].

[5] Paige Marta Skiba & Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy?" (2009) Vanderbilt Law and Economics Research Paper No 11-13 at 1, online: SSRN <http://ssrn.com/abstract=1266215>.

[6] Pearl Chin, "Payday Loans: The Case for Federal Legislation" (2004) 3 University of Illinois Law Review 723 at 732–33.

[7] *Talent-Nelson amend*, 10 USCA § 987 (West 2000 & Supp 2007) in HR 5122: John Warner National Defense Authorization Act for Fiscal Year 2007.

[8] Ronald J Mann & Jim Hawkins, "Just Until Payday" (2007) 54:4 UCLA L Rev 855 at 871 [Mann & Hawkins]. For more information on the payday practices that spurred legislation against high interest lending targeted at military personnel in the United States, see Stephen M Graves & Christopher L

The federal *Consumer Credit Protection Act* ("CCPA"), more specifically the section entitled *Truth in Lending Act* ("TILA"), requires that lenders disclose upfront the costs of a consumer loan.[9] Unfortunately, TILA has been unsuccessful in providing adequate protection to consumers.[10] Moreover, other federal regulatory initiatives have incidentally afforded payday lenders with avenues to displace and escape state usury limits. For instance, following the United States Supreme Court ruling in *Marquette National Bank of Minneapolis v First of Omaha Service Corp* (1978), s 85 of the federal *National Bank Act* has been interpreted to permit national banks to charge interest rates as high as the maximum rate allowable in the state where the bank was headquartered.[11] In turn, national banks headquartered in states without usury limits, such as South Dakota or Delaware, began renting their operating licenses to payday lenders, effectively allowing them to lend under their corporate umbrella and lawfully charge whatever interest rates they desired.[12] While this "rent-a-bank" phenomenon has never been directly proscribed by state or federal statute, the Federal Deposit Insurance Corporation ("FDIC"), for practical purposes, ended these partnerships in 2005, when it imposed what were ostensibly prohibitive capital requirements on lenders and also restricted "the number and frequency of extensions, deferrals [and] renewals" available to lending institutions.[13] Notwithstanding the FDIC's intervention, however, payday lenders continue to operate healthily. They now simply charge rates that are nominally lower than they previously could under the "rent-a-bank" model, but that remain exceedingly high when compared to the rates levied by mainstream lenders.

B. State Regulation

With the federal government having taken a relatively hands-off approach to payday lending, states are basically free to handle the issue in whatever manner they deem most appropriate. Unfortunately, a lack of uniformity has created a complex national scheme with radical deviations in lending standards. For the sake of convenience, however, state regulations can be said to be the product of one of three general legislative archetypes: (1) explicit tolerance; (2) under-enforced prohibition, and; (3) true prohibition.[14]

Peterson, "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns" (2005) 66 Ohio State Law Journal 4 [Graves & Peterson].

[9] *Truth in Lending Act* 12 CFR § 226.1(b) (2003) [TILA].

[10] Chin, *supra* note 6 at 730–32.

[11] *Ibid* at 732–33; *Marquette Nat Bank v First of Omaha SVC Corp*, 439 US 299 (1978).

[12] Christopher L Peterson, "Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits" (2008) 92 Minn L Rev 1110 at 1120-21.

[13] Mann & Hawkins, *supra* note 8 at 872–73.

[14] *Ibid* at 874.

The most common regulatory regime adopted by state legislatures, such as those in Tennessee and Michigan, explicitly tolerates payday-lending practices.[15] Many of these jurisdictions have adopted their payday-lending statutes based on the legislative model suggested by the Community Financial Services Association (CFSA), a lobbying arm of the payday lending industry.[16] These states typically require payday lenders to meet only modest regulatory thresholds, such as token capitalization requirements. These states also tend to provide payday lenders with broad exceptions to usury limits and allow for high borrowing limits, which can often result in annual percentage rates (APR) of over 400 percent.[17]

An alternative approach, producing similar results, can be found in formal prohibition states that tacitly implement usury limits and yet continue to allow the industry to operate unfettered by those limits. In many of these states the payday lending industry initially sprung from the "rent-a-bank" loophole to usury limits and, notwithstanding federal initiatives to ban that phenomenon, deficient state funding coupled with a lack of social and political impetus has resulted in inaction by the authorities. A noteworthy example is Texas, where the maximum interest rate on a loan of under $250,000 is set at 24 percent APR and yet nearly every major payday lender continues to charge rates in excess of that cap.[18]

Conversely, there are states that unqualifiedly prohibit payday lending and enforce the prohibition. For instance, in Georgia, payday lending has been explicitly included in the definition of racketeering and can bring up to five years in prison or a penalty of up to $10,000.[19] In New York State, interest rates are capped at 16 percent per annum, while traditional collaterally backed loans, such as mortgages, are strictly capped at six percent per annum.[20] Much like Texas, New York was until recently subject to usury import laws that allowed payday lenders to circumvent state laws and establish a strong foothold. However, the distinction here is that once the FDIC 2005 guidelines came into effect, regulators aggressively pursued payday lenders operating in

[15] *Ibid*; *Deferred Presentment Service Transactions Act PA 244*, MCL 487.2121 (2005).
[16] Mann & Hawkins, *supra* note 8 at 874.
[17] Adair Morse, "Payday Lenders: Heroes or Villains" (2009) University of Chicago, Booth School of Business, Working Paper Series at 25, online: SSRN <http://ssrn.com/abstract=1344397>.
[18] Mann & Hawkins, *supra* note 8 at 877–879.
[19] See Ga SB 157, Act 440, signed 4/14/2004, effective 5/1/2004, online: Georgia General Assembly <http://www1.legis.ga.gov/legis/2003_04/fulltext/sb157.htm>; Petru S Stoianovici & Michael T Maloney, "Restrictions on Credit: A Public Policy Analysis of Payday Lending" (2008) Working Paper Series at 3, online; SSRN <http://ssrn.com/abstract=1291278>.
[20] *New York Banking Law* § 14-a(1), online: Findlaw <http://codes.lp.findlaw.com/nycode/BNK/2/14-a>; *New York State General Obligations Law* § 5-501(3) (2006), online: Justia <http://law.justia.com/codes/new-york/2010/gob/article-5/title-5/5-501/>.

violation of the state's usury limits.[21] The net result has been nothing short of striking: no major payday lender operates a location in the state of New York.[22]

Each of these regimes is problematic, albeit for different reasons. The model applied in Tennessee and Michigan is disconcerting for an obvious reason. Not only does it allow payday lenders to legally operate in circumvention of otherwise binding consumer protection standards, but in the process it also confers legitimacy to what some consider abusive lending practices. The model adopted in states like Texas is likewise problematic because it provides consumers with the assurance that payday lending practices are government regulated when, for all intents and purposes, they are not. Finally, the prohibition enforced in New York is also distressing insofar as it leaves many low-income borrowers without access to credit. Altogether the experiences of these states suggest that handing off payday lending regulation to state legislatures has resulted in a patchwork of consumer protection laws, none of which work particularly well.

III. THE CANADIAN REGULATORY SCHEME

Payday lending is also a relatively new phenomenon in Canada, but the business has grown rapidly: the industry operated approximately 1,200 payday loan stores in Canada, as of 2004, generating an estimated annual profit of $1 billion.[23] It emerged much in the same way as it did in the United States, as an offshoot of the check-cashing industry. It is therefore somewhat unsurprising that the criticisms leveled against payday lenders in Canada are typically the same as those aimed at their American counterparts: they charge too much money, target the poor, and lie to their customers.[24] The regulatory scheme governing payday lenders in Canada, however, is somewhat different. In Canada, the principal legislation governing payday lenders is s 347 of the *Criminal Code*, which is a federal prohibition against lending agreements that set the payment of interest at a criminal rate, defined as anything higher than a 60 percent APR.[25] However, s 347 has never been used to prosecute payday lenders who levy

[21] Graves & Peterson, *supra* note 8 at 766. Former Attorney General of New York Elliot Spitzer was particularly vigilant in prosecuting usury violations, stating: "Payday lending can be the modern equivalent of loan sharking and is illegal in New York…. [M]y office will continue to take aggressive action to stop payday lenders from victimizing New York consumers." (quoted in "Payday Lender to Forgive Loans and Provide Refunds" (22 November 2004) online: New York State Office of the Attorney General <http://www.ag.ny.gov/press-release/payday-lender-forgive-loans-and-provide-refunds>).
[22] Mann & Hawkins, *supra* note 8 at 879–880.
[23] Andrew Kitching & Sheena Starky, "Legislative Summary (PRB 05-81E) Payday Loan Companies in Canada: Determining the Public Interest" *Parliamentary Information and Research Service* (26 January 2006), online: Parliament of Canada <http://www.publications.gc.ca/site/eng/weeklyChecklist/issues/2006/06-33-full.html> at 4 [Kitching & Starky]; Ben-Ishai, *supra* note 4 at 8.
[24] Ben-Ishai, *supra* note 4 at 1.
[25] *Criminal Code*, RSC 1985, c C-46, s 347.

interest charges in excess of the proscribed rate because it was "drafted to aid police in prosecutions of loan sharks, rather than as consumer protection legislation," any irony notwithstanding.[26] For this reason, the 1998 Supreme Court of Canada *Garland v Consumers' Gas Co* decision noted that s 347 "is a deeply problematic law" insofar as "some of its terms are most comfortably understood in the narrow context of street-level sharking, while others compel a much broader application" such as to consumer and commercial transactions.[27] Accordingly, in its holding**,** the Court effectively urged Parliament to take the required remedial action and clarify the underlying impetus for the provision.[28]

In response**,** Parliament drafted Bill C-26, which amended the *Criminal Code*'s statute on criminal interest rates and came into force in 2007.[29] The amendment expands the scope of s 347 to payday loans, which it defines as "an advancement of money in exchange for a post-dated cheque, a preauthorized debit or a future payment of a similar nature but for any guarantee, suretyship, overdraft protection or security on property and not through a margin loan, pawnbroking, a line of credit or a credit card."[30] However, the amendment also exempts payday loans, of less than $1,500 and for fewer than 62 days, from the reach of the *Criminal Code*.

Bill C-26 also leaves the regulation of these loans to the provinces.[31] The amendment does provide guidance to provincial regulation to the extent that it "requires a licensing or other type of authorization system for lenders, the establishment of limits on the total cost of borrowing, and a framework of protections for consumers."[32] However, the amendment does leave the provinces with significant legislative discretion in how they do this. The result is that while most of the provinces comply with the amendment's guidelines insofar as they have adopted interest rate caps, cancellation protection, rollover prohibitions, and so on, there is nevertheless significant variation in how this is done and, where regulations exist, APR remain in usurious ranges from 517 percent in Manitoba to 943 percent in Nova Scotia.[33] As an illustration,

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[26] Ben-Ishai, *supra* note 4 at 11.
[27] *Garland v Consumers' Gas Co*, [1998] 3 SCR 112 at 52.
[28] *Ibid*.
[29] Bill C-26, *An Act to Amend the Criminal Code (criminal interest rate),* 1st Sess, 39th Parl, 2007 (assented to 3 May 2007), amending RSC 1985, c C-46.
[30] *Criminal Code*, *supra* note 25.
[31] Ben-Ishai, *supra* note 4 at 11; Andrew Kitching, Sheena Starky & Philippe Bergevin, "Legislative Summary (LS-541E): Bill C-26: An Act to amend the Criminal Code (criminal interest rate)" *Parliamentary Information and Research Service* (28 Sept 2007), online: Parliament of Canada <http://www.parl.gc.ca/About/Parliament/LegislativeSummaries/Bills_ls.asp?ls=c26&Parl=39&Ses=1> at 3 [Kitching, Starky & Bergevin].
[32] Ben-Ishai, *supra* note 4 at 12.
[33] While there are significant variations in provincial payday legislation, all permit for usurious levels of interest when calculated by APR as opposed to by 12-day loan cycle. Nova Scotia permits 31 percent interest or 943 percent APR: *Nova Scotia Utility and Review Board Decision* (NSUARB-PD-07-001); British Columbia permits 23 percent interest or 700 percent APR: *Payday Loans Regulation* (BC Reg

in Ontario a 2009 provincial law caps the cost of borrowing from payday loan companies at 21 dollars per 100 dollars advanced.[34] However, the governing legislation does not include language that prohibits other fees from being applied to the loan. As a result, a number of payday loan companies require borrowers to access their loans through a debit card, which can only be accessed once an activation fee is paid;[35] furthermore, the legislated rate can soar up to an effective APR of 639 percent when renewed over the course of a year.[36] Consequently, when the activation fee is pooled with the interest already being charged, the resulting APR easily exceeds both the federal and advertised provincial usury caps.[37]

IV. THE EFFECTS OF LIMITED FEDERAL OVERSIGHT

A. Usury Limits

The antecedents to modern usury law can be traced all the way back to the Babylonian code of Hammurabi, the Book of Deuteronomy of the Old Testament, and the Koran.[38] The breadth and significance of these sources demonstrates a remarkably universal moral and social condemnation of excessive interest rates. In the modern financial landscape, usury law remains important and, as mentioned above, is regulated by state and provincial governments that maintain interest rate caps varying between 16 percent (New York) to 23 percent (British Columbia) per annum on traditional loans.[39]

57/2009); Alberta permits for 23 percent or 700 percent APR: (Alta Reg 157/2009, s 7); Manitoba permits 17 percent interest or 517 percent APR: *Payday Loans Regulation* (Amendment to 99/2007 (50/2010)); Saskatchewan permits 23 percent interest or 700 percent APR: *An Act respecting Payday Loan Agreements, Payday Lenders and Borrowers* (2007 Chapter P-4.3). Newfoundland and Labrador, Prince Edward Island, New Brunswick, the Northwest Territories, Nunavut, and Yukon have not yet regulated payday lending. *See* Government of Newfoundland and Labrador, News Release, "Provincial Government Will Not Regulate Payday Loan Companies" (16 June 2010), online: Government of Newfoundland and Labrador <http://www.releases.gov.nl.ca/releases/2010/gs/0616n11.htm>; "Payday loan firms thrive in N.W.T.", *CBC News* (28 September 2010), online: CBC News <http://www.cbc.ca/news/canada/north/story/2010/09/28/nwt-payday-loans.html>; "No payday with high-risk loans, says NDP", *Yukon News* (15 August 2008), online: Yukon News <http://yukon-news.com/news/9723/>. See also Nunavut *Consumer Protection Act*, RSNWT 1988, c C-17, s 5.

[34] *Payday Loans Act, 2008*, SO 2008, c 9, s 23; Ontario Ministry of Consumer Services, Media Release, "Cost of Payday Loans Capped – McGuinty Government Enhances Protections for Borrowers" (15 December 2009), online: Ontario Ministry of Consumer Services <http://www.sse.gov.on.ca/mcs/en/Pages/News_15Dec2009.aspx>.

[35] "Payday lenders skirt loan charge limits", *CBC News* (June 14, 2011), online: <http://www.cbc.ca/news/canada/toronto/story/2011/06/13/tor-payday-loan-fees.html>.

[36] "New Payday Loans Rates and Rules Proclaimed" Canadian Payday Loan Association (1 May 2010), online: <http://www.cpla-acps.ca/english/pr_2010_05.php>.

[37] *Ibid*.

[38] Rudolph Blitz & Millard Long, "The Economics of Usury Regulation" (1965) 73:6 Journal of Political Economy 608 at 608.

[39] *New York State General Obligations Law* § 5- 501[2] (2006); *New York Banking Law* § 14-a [*1*]; *Payday Loans Regulation* BC Reg 57/2009, s 17.

However, the payday lending industry has skirted these usury limits by exploiting gaps in usury statutes and defining thinly veiled interest rates as finance fees. The resulting transactions can often border on the absurd. For example, a common payday lending rate on a loan of $300 is $50 in bi-weekly fees, which results in a 434 percent APR.[40] Shockingly, this is a conservative payday lending rate, given that some lending chains charge in excess of 600 percent APR.[41] To put these lending rates in perspective, illegal Las Vegas loan sharks commonly charge a 5 percent weekly interest rate, which amounts to a 260 percent APR.[42] This makes it abundantly clear that usurious interest rates are the foremost problem with the institution of payday lending and highlights further why it is essential for regulators to either curb these excessive rates or provide low-income borrowers with the possibility of borrowing from traditional financial institutions that can often be quite literally twenty times cheaper.

B. Debt Cycle

One of the most problematic characteristics of the payday lending industry is that it actively encourages borrowers to defer payments, which can lead to a cycle of dependency and compounding fees.[43] A survey of payday borrowers in the United States found that, on average, a borrower will renew their loan ten to twelve times per year, while a similar study conducted in Canada "estimated that first-time borrowers end up taking out an average of fifteen loans."[44] The 'debt trap', as it has become commonly known, refers to the exponential rise in fees each time a borrower rolls over a loan. For example, suppose a borrower must pay an initial $15 finance charge to facilitate a $100 payday loan. In order to roll that loan over another two-week period, the fee jumps to $30 and to $60 after that. The end result is that borrowers quite often find themselves in the precarious situation of having to pay off many times the principal in fees before beginning to affect the principal balance itself. For instance, in a recent United States congressional forum on payday lending, the head of the American Consumer Protection Council recounted the story of a woman from Kentucky who paid over $1,000 in fees on a $150 loan over a six-month period without paying off any of the principal.[45]

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[40] Calculation used: APR = $50 * (365/ 14 days) / $300 = 4.3452 = 434.52%.
[41] Chin, *supra* note 6 at 724.
[42] *Ibid* at 729.
[43] Patrick Hayes, "A Noose Around the Neck: Preventing Abusive Payday Lending Practice" (2009) 35:3 William Mitchell L Rev 1134 at 1143 [Hayes].
[44] *Ibid* at 1143. Hayes cites statistics compiled by the Illinois Department of Financial Institutions, which found an average of thirteen contract rollovers per customer during a typical six-month period, while the average number of rollovers per twelve months in Iowa and North Carolina were 12.5 and 7 respectively; Ben-Ishai, *supra* note 4 at 9.
[45] Chin, *supra* note 6 at 729.

C. Predatory Lending

Payday lenders typically defend their lending practices by insisting that they provide a valuable service to astute borrowers, who they maintain are predominantly middle-class homeowners. Accordingly, payday lenders further submit that, with collateral in hand and only after extensive comparison-shopping, these discerning borrowers intelligently select the payday-lending model in lieu of other credit alternatives. The evidence suggests, however, that payday lenders almost exclusively target vulnerable consumers with low incomes and insufficient collateral to borrow from a bank. Moreover, "many customers of payday loans feel that they have nowhere else to go" including "families with little savings or no credit cards" and particularly those who have already been refused.[46] For instance, the Wisconsin Department of Financial Institutions recently conducted a survey that found the average annual income of payday borrowers was $18,675 and that 78 percent of borrowers did not own a home.[47] Moreover, recently uncovered internal documents from a large payday lender described one "fertile market" for payday lenders as "minority [groups] with a household income of less than $25,000, a high school or GED education or less, ages ranging from 18-59 years and female heads of household with dependents […] and welfare recipients".[48] Accordingly, the typical borrower is not selecting the payday-lending model in lieu of alternatives; rather it is their only option for securing such credit.

D. Lack of Transparency

In the United States, TILA was designed and implemented to "promote the informed use of consumer credit by requiring disclosures about its terms and cost."[49] TILA does not, however, control credit rates. Accordingly, it protects consumers from misleading pricing models by requiring lenders to adhere to a uniform set of disclosure rules. For instance, TILA's key provisions require creditors to calculate interest rates as an annual percentage, disclose the total dollar amount of the finance fee, and display the total costs conspicuously.[50] In this sense, TILA provides federal regulators with a legislative instrument through which they can protect borrowers, insofar as it ensures that borrowers have access to accurate terms of credit, which in turn allows for a more informed borrowing decision. The reality, however, is that TILA has proven largely unsuccessful in the context of payday lending, as compliance and enforcement remain a serious concern. For instance, a nationwide survey of payday lenders found that only 32

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[46] Hayes, *supra* note 43 at 1139–1141; Ben- Ishai, *supra* note 4 at 5–6.
[47] Chin, *supra* note 6 at 728.
[48] *Ibid*; Dory Rand, "Using the Community Reinvestment Act to Promote Checking Accounts for Low-Income People" (1999) 33 Clearinghouse Review Journal of Poverty Law.
[49] TILA, *supra* note 9, § 226.1(b).
[50] *Ibid*, §§ 226.18(e), 226.18(d), 226.17(a)(2).

percent of payday storefronts disclose the correct APR on their materials and signage.[51] The same study also discovered that a mere 22 percent correctly disclose both the finance fee and APR, while of the remaining stores, only 21 percent of them had employees who were willing or capable to verbally disclose the APR upon request.[52]

A separate survey conducted in Ohio found three common types of TILA violations.[53] Firs, payday-lending employees typically fail to abide by TILA's uniform disclosure rules. When borrowers inquire about the cost of credit, TILA requires lenders to provide the borrower with the applicable APR.[54] In the Ohio study, however, only 32 percent of payday employees accurately relayed the APR, while another 32 percent of employees denied the loan had an APR and the remaining 16 percent did not know one way or the other.[55] Second, payday lenders regularly advertise an APR that is inconsistent with the finance fees they levy on the borrower. The Ohio study found that over 85 percent of lenders failed to disclose the accurate APR on their in-store fee schedules.[56] Finally, payday lenders consistently neglect to abide by TILA's in-writing disclosure requirements, which require creditors to disclose in "[clear] and [conspicuous] writing, in a form that the consumer may keep" the terms of the agreement "before the consummation of the transaction."[57] Accordingly, during the Ohio study, over 77 percent of payday lending company employees refused to allow borrowers to take home a copy of their prospective contract prior to signing the lending agreement.[58]

In Canada, a recent study evaluated the extent to which provincial consumer protection disclosure requirements for payday lenders are respected. The study sent student researchers to four Toronto payday lenders and, at each location, the students asked a series of questions designed to evaluate the lenders' compliance with s 61.1(4) of Ontario's *Consumer Protection Act*, which requires lenders to unambiguously disclose and explain the total costs of borrowing to the borrower.[59] Through the course of the study, the students "found it very difficult to determine how much the loan would ultimately cost [them]."[60] For instance, when students asked, "how much does it cost to borrow?" the payday lending representatives generally pointed to a disclosure poster indicating the advertised rates and read from it. When the students then asked for more

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[51] Jean Ann Fox & Edmund Mierzwinski, "Rent-a-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections" (2001) Consumer Federation of America & US Public Interest Research Group at 14, online: <http://www.consumerfed.org>.
[52] *Ibid*.
[53] Chin, *supra* note 6 at 731.
[54] *Consumer Credit Cost Disclosure* 15 USC § 1665a (2000); TILA, *supra* note 9, § 226.26(b).
[55] Chin, *supra* note 6 at 731.
[56] *Ibid*.
[57] TILA, *supra* note 9, §§ 225.17(a), 226.17(b).
[58] Chin, *supra* note 6 at 731.
[59] Ben-Ishai, *supra* note 4 at 22–24.
[60] *Ibid* at 28.

specific information, such as "what the terms 'cost of borrowing' and 'total to repay' meant, the lenders declined to answer."[61] Moreover, while the Canadian Payday Loan Association, the national industry association representing payday lenders, advertises on its website that it prohibits rollovers under its model of "Best Practices", when the students asked, "what if I can't pay the loan back?" the lenders explained that they could apply for a "back-to-back" loan. While a back-to-back loan is "not technically a rollover, the risk of debt spiral would still be present."[62] For instance, if the students "pursued back-to-back loans for one year (26 loans) on a principal amount of $300 [they] would pay roughly $60 in interest every two weeks" which would amount to over $1,560 in interest (or a 520 percent APR), for a $300 loan.[63] The study concluded that the "average payday loan consumer may not know how much they are paying for their loan when they sign the agreement, nor are they fully capable of 'shopping-around' to find the best deal."[64]

V. RECOMMENDATIONS AND CHALLENGES

As mentioned above, the challenge for legislators is to provide substantive regulations that can effectively curb predatory and usurious practices that have come to define payday lending and ultimately transform the industry from fringe lenders to responsible and legitimate financial institutions.

The piecemeal status of existing legislation has clearly failed to provide the necessary consumer protections. Accordingly, the time is ripe for legislatures to introduce a federal payday loan statute that addresses the most pressing concerns surrounding the industry. This initiative should rest on five central pillars. The first is a federal usury interest rate ceiling.[65] Understandably such a provision may stir up concerns over federalism, particularly in Canada where "[t]he federal government has jurisdiction over interest rates, but the day-to-day regulation and licensing of payday lender most likely falls under provincial jurisdiction, as part of their power over property and civil rights."[66] However, in order to establish any semblance of meaningful national payday standards there must be some legislative mechanism in place to prevent significant legal interest rate disparities between peer state and provincial governments. Moreover, a rate cap would act as a high-bar for interest rates, allowing room for state and provincial governments to legislate lower rates at their discretion. The second pillar

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[61] *Ibid* at 25.
[62] *Ibid* at 27–28. According to one study, "25% of insolvent consumer debtors owed more than 25% of their monthly income to payday lenders"; see Janis P Sarra, "Economic Rehabilitation: Understanding the Growth in Consumer Proposals under Canadian Insolvency Legislation" (2009) UBC Faculty of Law, Working Series Paper at 44, online: SSRN <http://ssrn.com/abstract=1399610>.
[63] Ben-Ishai, *supra* note 4 at 28.
[64] *Ibid*.
[65] Chin, *supra* note 6 at 749.
[66] Kitching & Starky, *supra* note 23 at 11.

is a limit on the total amount a customer can borrow.[67] The payday lending industry justifies its fee structure based on the distinction that it provides a unique service: short-term emergency cash loans. Accordingly, the industry should be held to this credo and borrowers should be limited to a fixed monthly or yearly sum to ensure that the service is being used as an emergency buffer rather than as a regular paycheck cashing service. The third pillar is a limit on the numbers of permitted rollovers on each loan.[68] Payday lenders charge tremendously high fees to access their service, but it is rollovers that contribute most directly to borrower indebtedness. A cap of two rollovers per loan, for instance, would allow customers the option of incurring additional fees to carry debt until their next paycheck without falling into a dangerous spiral of insurmountable debt. The fourth pillar is strict disclosure requirements, perhaps shaped around something akin to TILA.[69] Given that payday lenders habitually mislead borrowers, such provisions are an absolute necessity. Logistically, disclosure can be tied to a mandatory lender licence that can be revoked, or to specific fines. The fifth pillar is a codified private right of action that vests liability in the lender for damages to consumers resulting from the failure to adhere to federal law.[70] Enforcement has proven to be a major issue in regulating the behaviour of payday lenders. The spectre of private action may provide a useful tool to further disincentivize illegal payday lending practices. There is already some evidence to suggest that this approach to enforcement may prove effective. For instance, while the issue has yet to be fully litigated in Canada, "it is notable that a number of class actions have been recently certified based on restitutionary claims arising from the alleged charging of criminal rates of interest (under the earlier version of s 347 of the *Criminal Code*) on payday loans."[71]

Implementing this initiative, however, may pose a difficult challenge. In general, industry-lobbying pressure tends to bear tremendous influence over the legislative process. The situation is, for all intents and purposes, no different in the context of payday lending, as the industry has often flexed its political muscle by contributing heavily to political campaigns. For instance, an analysis of Washington State Public Disclosure data shows that "political contributions by payday loan companies, owners and employees jumped dramatically […] from just over $21,000 in 2000 to more than

[67] Chin, *supra* note 6 at 749.
[68] *Ibid*.
[69] *Ibid*.
[70] *Ibid*.
[71] See *McCutcheon v The Cash Store Inc*, 2006 ONCJ 1860; *Smith v National Money Mart Co*, 2007 ONCJ 46; *Kilroy v A OK Payday Loans Inc*, [2006] BCJ No 1885 (SC); *Bodnar v Payroll Loans Ltd*, [2006] BCJ No 1705 (SC); *Tracy v Instaloans Financial Solutions Centres (BC) Ltd*, 2006 BCSC 1639; *Bodnar v The Cash Store Inc*, [2005] BCJ No 1904 (SC); and *Ayrton v PRL Financial (Alta) Ltd*, [2006] AJ No 296 (CA) as cited in Ben-Ishai, *supra* note 4 at 5.

$162,000 [in 2005] […], an increase of more than 650 percent."[72] Moreover, further analysis of those political contributions reveals that they were made principally to members of the state Senate Financial Institutions Committee, "including the three lawmakers who have questioned the basis for many of […] proposed payday restrictions."[73]

If the desired effect of the Washington political contributions was industry deregulation, it seems to have finally taken hold. The state's House of Representatives is at present considering House Bill 1678, a controversial initiative that "could roll back some rules designed to protect people from predatory payday lenders."[74] In particular, the bill would jettison a 2009 law that capped rollovers and the total amount a customer could borrow in an effort to curb debt spiral. The bill's sponsors maintain that repealing the caps is "necessary to prevent flight to riskier [loans]," such as unregulated Internet lenders and loan sharks.[75] However, consumer protection advocates maintain that the 2009 law is working because it curbs debt spiral. They cite data from the state Department of Financial Institutions that payday loans were down to about one million total loans in 2010, from three million before the law went into effect.[76] As for the issue of lenders turning to riskier outfits, these consumer protection advocates argue that the legislature should build on the debt-cycle–reducing benefits of the existing law by focusing on "borrower education and stronger regulation of internet lenders [and loan sharks]" rather than addressing the issue through deregulation, which might respond to the issue of consumer flight to riskier loans, but would likely perpetuate debt spiral.[77] However, the bill's principal sponsor, Tacoma Representative Steve Kirby, is confident it will pass on the House floor. While Kirby endorsed the 2009 law, he now maintains that the legislature cannot run the risk of sending customers into "the wild west" of unlicensed and criminal lenders.[78] According to Public Disclosure Commission data, Kirby received campaign contributions from groups representing lenders in the state in his 2010 election run.[79]

The situation in Washington State is indicative of the broader problem faced by consumer protection advocates, namely, the countervailing influence of industry

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[72] Eric Engleman, "Payday politics: Contributions on the rise", *Puget Sound Business Journal* (20 February 2005), online: The Business Journals Digital Network <http://www.bizjournals.com/seattle/stories/2005/02/21/story4.html?page=all>.
[73] *Ibid*.
[74] Katie Schmidt, "Repeal payday loan limit?", *The News Tribune* (5 February 2011), online: The News Tribune <http://www.thenewstribune.com/2011/02/05/1531492/repeal-payday-loan-limit.html>.
[75] *Ibid*.
[76] *Ibid*.
[77] *Ibid*.
[78] *Ibid*.
[79] *Ibid*.

lobbying on the legislative process.[80] For instance, where policymakers rely heavily on private donors to finance political campaigns there is always a risk that they will unqualifiedly support the industry position. This is particularly easy in the context of payday lending, because policymakers like Representative Kirby can always justify deregulation on the basis that it provides refuge from riskier lenders, notwithstanding the irony that the rates charged by supposedly more respectable payday lenders often exceed those levied by illicit lenders.

VI. CONCLUSION

This article was conceived as a natural extension and comparative analysis of the available academic literature on payday lending both Canada and the United States. Perhaps the most salient revelations from these sources are the detrimental consequences of the respective federal legislatures passing the responsibility of regulating this industry to their state and provincial counterparts. We echo our predecessors in concluding that this tendency has led to a patchwork of legislation throughout the United States that has had problematic consequences for low-income borrowers. For some, this emphasis on the United States is perhaps not altogether surprising, given the deluge of negative public, media, and scholarly attention the United States has garnered for the handling of its money lending industry. Our research however, sounds an alarm that the Canadian regulatory regime with respect to payday lending is equally worrisome. Unlike their American counterparts, who have implicitly shifted the regulatory burden to the state level, the Canadian model gives the dangerous illusion that there is in fact a federal ceiling on interest rates. Instead, the reality is that the federal usury cap in s 347 of the *Criminal Code* provides little in the way of consumer protection, insofar as Bill C-26 delegates the interpretation and enforcement of that provision to the provinces, where consumer protection priorities are not uniform. This is particularly problematic because it gives the impression that there is nothing left to regulate, when in fact the overall regulatory regime governing payday lending in Canada is as diffuse and worrisome in result as that in the United States.

The goal of this article has been to shed further light on this legal fiction and emphasize that national legislatures, both Canadian and American, need to take the initiative in regulating the payday loan industry by passing effective legislation that imposes a federal interest rate cap on payday loans, prohibits excessive rollovers, and institutes potent new enforcement mechanisms. With a federal payday loan statute, both national governments can legitimize the payday industry and ensure that it operates ethically and equitably in its rightful role as a secondary financial services provider.

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[80] Peter Lewis, "Payday lenders hire ex-regulators to lobby for them", *The Seattle Times* (7 March 2005), online: <http://seattletimes.nwsource.com/html/localnews/2002199293_payday07m.html>.

The payday loan industry is built on what some have called willfully exploitative and unethical business practices.[81] Despite staggering economic success, the industry seems poised to continue to circumvent, both legally and illegally, state and provincial, as well as federal usury and consumer protection laws. It is our hope that Canadian and American policy-makers live up to the same high standards of consumer protection afforded to mainstream borrowers and introduce this safeguard into the each country's payday lending industry to protect a particularly vulnerable and currently exploited class of borrowers.

[81] See generally Robert Mayer, "Payday Loans and Exploitation" (2003) 17:3 Public Affairs Quarterly 197; Mark Flannery & Katherine Samolyk, "Payday Lending: Do the Costs Justify the Price?" (2005) FDIC Center for Financial Research Working Paper, online: SSRN <http://ssrn.com/abstract=771624>; Donald P Morgan, "Defining and Detecting Predatory Lending" (2007) Federal Reserve Bank of New York Staff Report no 273, online: <http://www.newyorkfed.org/research/staff_reports/sr273.html>; Dean Beeby, "Feds hunt for 'payday' loan alternatives", *The Globe and Mail* (10 January 2011), online: <http://www.theglobeandmail.com/globe-investor/personal-finance/feds-hunt-for-payday-loan-alternatives/article1864037>.