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THE FED OF THE FUTURE: A FRAMEWORK TO OPTIMIZE SHORT-TERM LENDING PRACTICES

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ABSTRACT

Underbanked individuals currently face significant risk when accessing short-term credit. While payday loans are the least expensive short-term credit option when compared to alternatives like overdraft fees, they can also have an extraordinarily high cost of borrowing. Unable to pay the cost of the loan, borrowers often find themselves in a vicious cycle that drives them further into debt. This Note sets forth a proposal as to how payday loans can be better regulated to create affordable access to short-term credit. Specifically, this Note advocates for congressional and Federal Reserve intervention in the payday lending market.

This Note first analyzes the current regulatory environment for payday loans. It concludes that the CFPB's attempts to regulate payday loans at the federal level have largely fallen short, while state attempts to regulate payday loans are threatened by recent OCC rulemaking. Without intervention, underbanked consumers' access to short-term credit may be threatened by usurious payday lenders.

The potential for an unregulated market has created a need for federal intervention. On this basis, the second half of this Note argues that congressional intervention in setting a federal usury rate is not only justified, but necessary. This approach is not without its difficulties; a congressional usury rate may drive existing lenders out of the payday lending market for want of profit. Thus, to preserve efficient access to short-term credit, this Note proposes that the Federal Reserve create a short-term lending framework through the layered use of FedAccounts and FedNow.

TABLE OF CONTENTS

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INTRODUCTION

The United States' antiquated check settlement system has created a banking crisis for Americans who live paycheck to paycheck.[1] The United States uses an "automated clearing house settlement process," which can take three or four days to clear a check.[2] For Americans without savings, this processing lag can be devastating.[3] The current system is designed to "clear the money coming out of an account before the money that's coming into it," which can result in "overdrafts and charged fees."[4] Consumers left in the lurch because of slow processing speed must choose the lesser of three evils: overdraft fees, reduction of necessary consumption and expenditure, or payday loans.[5]

Payday loans are a type of financial service that provide fast cash to individuals who need emergency funding to cover unexpected expenses, or to help pay expenses in between paychecks.[6] These loans are offered across the nation on a state-by-state basis and, while they

1. *See* Aaron Klein, *Why Don't Checks Clear Instantly? Ask the Fed*, BROOKINGS (Sept. 29, 2016), https://www.brookings.edu/opinions/why-dont-checks-clear-instantly-ask-the-fed/ [https://perma.cc/MPY6-K9CM].

2. Katie Deighton, *The Dark Truth Behind America's Payments Lag*, RACONTEUR (Mar. 26, 2020), https://www.raconteur.net/finance/payments/payment-modes-usa [https://perma.cc/AXG7-WVQ5].

3. *See* Ted Knutson, *Nielsen: Even Many High Earners Live Paycheck to Paycheck*, FINANCIAL ADVISOR (Aug. 6, 2015), https://www.fa-mag.com/news/nielsen—even-many-high-earners-live-paycheck-to-paycheck-22704.html [https://perma.cc/Z8GD-MDT8] (explaining that one in four families making $150,000 a year lives paycheck to paycheck, while one in every two families earning below $50,000 lives paycheck to paycheck).

4. Deighton, *supra* note 2.

5. *See id*.

6. Jeannette N. Bennett, *Fast Cash and Payday Loans*, FED. RSRV. BANK OF ST. LOUIS (Apr. 2019), https://research.stlouisfed.org/publications/page1-econ/2019/04/10/fast-cash-and-payday-loans [https://perma.cc/JM8Q-96TE].

provide access to cash to underbanked populations, they are also synonymous with alarming costs and predatory behavior.[7]

On average, payday loans are made for less than $500.[8] The loans come due within two to four weeks, with repayment generally coming due on the borrower's next payday.[9] To secure a payday loan, an individual does not need a qualifying credit score or collateral. Rather, the requirements are simple: a borrower must be at least eighteen years old and have a valid ID, proof or verification of income, and either a bank account, credit union account, or prepaid card account.[10] An estimated twelve million Americans are thought to use payday loans each year.[11] Perhaps unsurprisingly, the loans are used disproportionately by underbanked individuals.[12] The typical payday loan borrower earns $30,000 per year, and fifty-eight percent of payday loan borrowers have difficulty meeting basic monthly expenses.[13] This gap in financing leads borrowers to use payday loans outside of their marketed scope as a means of stopgap financing, with funds being spent on recurring expenses like rent.[14]

Payday loans work differently in theory than in practice.[15] In theory, the loan is used as a stopgap and is promptly repaid once the borrower receives their next paycheck. However, borrowers are often unable to repay the loan and meet basic monthly expenses.[16] This imbalance between monthly expenses and assets creates a vicious cycle: borrowers must keep borrowing to meet their basic expenses, creating dependency on payday loans. As a result, the cost of payday loans is staggering. Most payday loan borrowers receive less principal than they repay in fees.[17] To illustrate, the average payday loan borrower "spend[s] an average of $520 in fees to repeatedly borrow $375."[18] Seventy-five

7. Melissa Horton, *Payday Loan Statistics*, LENDEDU (Jan. 15, 2020), https://lendedu.com/blog/payday-loan-statistics/ [https://perma.cc/RB2L-P9D3].

8. Bennett, *supra* note 6.

9. *Id.*

10. *What Do I Need to Qualify for a Payday Loan?*, CFPB (June 2, 2017), https://www.consumerfinance.gov/ask-cfpb/what-do-i-need-to-qualify-for-a-payday-loan-en-1593 [https://perma.cc/CH3E-R5PZ].

11. Horton, *supra* note 7.

12. Bennett, *supra* note 6.

13. *Payday Loan Facts and the CFPB's Impact*, PEW TRUSTS (Jan. 14, 2016), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2016/01/payday-loan-facts-and-the-cfpbs-impact [https://perma.cc/BE6L-BHQ5].

14. *See id.*

15. Kelly Anne Smith, *CFPB Revokes Payday Lending Restrictions Meant to Protect Borrowers*, FORBES (July 7, 2020), https://www.forbes.com/sites/advisor/2020/07/07/cfpb-revokes-payday-lending-restrictions-meant-to-protect-borrowers/?sh=2008f79632be [https://perma.cc/W3PQ-HRR8].

16. *Id.*

17. PEW TRUSTS, *supra* note 13.

18. *Id.*

percent of payday loans are borrowed by consumers who borrow eleven or more loans in a year.[19]

While the high cost of borrowing is certainly a concern for critics, the widespread use of payday loans suggests that many consumers rely heavily on the product.[20] Millions of American consumers have limited options for short-term loans, and payday loans can provide critical short-term funding for wage earners with steady employment.[21] Further, payday loans are frequently less expensive than other options available to underbanked individuals, including bank overdraft protection and informal lenders like pawn shops.[22] In the current market, payday loans can fill the funding gaps for individuals without access to traditional lenders.

The idea, however, that payday loans must remain unchanged to meet the demand for short-term credit is erroneous.[23] The imagined binary between the status quo and a complete lack of short-term credit fails to consider several options for extending more favorable credit to underbanked consumers. The failure to consider these alternatives disproportionately impacts groups who are more likely to experience harm from payday loans, including the financially vulnerable, the elderly, the less educated, and the poor.[24] While some legislative efforts, like the Military Lending Act, have protected vulnerable groups against usurious lenders, there has been no successful comprehensive short-term lending reform.[25]

Part I of this Note addresses the attempts of the Consumer Financial Protection Bureau (CFPB or "the Bureau") to regulate the payday loan industry and subsequent attacks on these efforts from opposition groups and the Bureau itself. Part II predicts that litigation over the constitutionality of the Bureau's actions will continue, potentially negatively impacting underbanked consumers' access to short-term credit. Part III offers a two-part solution in which Congress works in tandem with the Federal Reserve to create a more favorable lending environment and product for under- and unbanked consumers.

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19. Smith, *supra* note 15.

20. Bennett, *supra* note 6.

21. *See* Todd Zywicki, *The Case Against New Restrictions on Payday Lending* 1–2 (Mercatus Ctr. Geo. Wash. Univ., Working Paper No. 09-28, 2009).

22. *Id.* at 2.

23. *See, e.g.*, *id.*

24. Press Release, Consumer Fed'n of Am., CFPB Rolls back Payday Loan Rule Just When Consumers Need More, Not Less, Protection (July 7, 2020), [https://perma.cc/3VRY-XSYB]; *see also* Nat'l Ass'n of Consumer Advocs., *Predatory Lending* (2019), https://www.consumeradvocates.org/for-consumers/predatory-lending [https://perma.cc/Y7SM-PEMW].

25. FDIC, CONSUMER COMPLIANCE EXAMINATION MANUAL V-13.1 (Sept. 2016), https://www.fdic.gov/resources/supervision-and-examinations/consumer-compliance-examination-manual/documents/5/v-13-1.pdf [https://perma.cc/FX7T-PG8G].

I. THE RISE AND FALL OF THE 2017 PAYDAY LENDING RULE

One of the most recent attempts at comprehensive short-term lending reform was the CFPB's 2017 Payday Lending Rule. Understanding the history of the 2017 Payday Lending Rule is crucial in order to understand the gravity of the consumer protections at risk. Moreover, when reviewing the history of the rule and its related litigation, past is prelude. Landmark cases like *Seila Law v. Consumer Financial Protection Bureau* inform this Note's predictions about the outcome of ongoing litigation against the CFPB.

The organization of Part I proceeds as follows: Section I.A details the history of the 2017 Payday Lending Rule, which was originally anticipated to diminish high-interest payday loans,[26] and reviews the Rule's three provisions, only one of which survives. Section I.B outlines the existing threats to the Payday Lending Rule, with a focus on the ongoing federal court case, *Community Financial Services Association of America v. CFPB*.[27] Finally, Section I.C details the CFPB's response to the current litigation and evaluates the case's status.

A. *The History of the 2017 Payday Lending Rule*

Under former director Richard Cordray, the CFPB found that the debt traps created by payday loans forced consumers to choose between "defaulting, re-borrowing, or skipping other financial obligations like rent or basic living expenses such as buying food or obtaining medical care."[28] In response to these concerns, the CFPB aimed to eliminate debt traps by putting in place strong consumer-oriented protections and, on October 5, 2017, the CFPB finalized the 2017 Payday Lending Rule (the 2017 Rule).[29] The rule covers certain types of closed-end or open-end credit,[30] the most contentious being (1) loans whose costs

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26. *See* Stacey Cowley, *Payday Lending Faces Tough New Restrictions by Consumer Agency*, N.Y. TIMES (Oct. 5, 2017), https://www.nytimes.com/2017/10/05/business/payday-loans-cfpb.html [https://perma.cc/N7W2-CZVT] (articulating that the CFPB anticipated that the number of loans with an annual percentage rate (APR) greater than thirty-six percent would fall by nearly fifty-five percent).

27. *See generally* Brief of Appellees, *Cmty. Fin. Servs. Ass'n of Am. v. Consumer Fin. Prot. Bureau*, Case No. 21-50826 (5th Cir. Dec. 15, 2021).

28. *CFPB Finalizes Rule to Stop Payday Debt Traps*, CONSUMER FIN. PROT. BUREAU (Oct. 5, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-rule-stop-payday-debt-traps/ [https://perma.cc/DER7-76HL].

29. *Id.*

30. *See* 12 C.F.R. § 1041.3(b) (2020). This Note defines closed-end credit as a loan where the borrower receives an upfront sum and is required to pay back the loan at the end of a set time frame. Open-end credit is a pre-approved lending limit, with no fixed time for lapse.

exceed thirty-six percent per annum[31] and (2) loans that grant the lender a leveraged payment mechanism, which allow the lender to unilaterally initiate the transfer of money.[32] The CFPB claimed that the rule prevented "loans . . . marketed heavily to financially vulnerable consumers" from "plagu[ing] communities across the country."[33] The original 2017 Rule contained three sets of obligations imposed on lenders: underwriting standards, reporting requirements, and the Payments Provisions.[34]

The first set of obligations, the underwriting standards, required lenders to ensure that a borrower had the ability to repay a covered loan before the lender issued the loan. The CFPB identified lenders' failure to reasonably determine that a consumer had the ability to repay the loan as an unfair and abusive practice.[35] Further, the underwriting standards mandated that lenders obtain verification of a consumer's income and a report from a national consumer reporting agency.[36] After advancing the covered loan to the consumer, the lender was then required to submit information concerning the loan to a Registered Information System, thereby fulfilling the second set of obligations, the reporting requirements.[37]

The Payments Provisions—the only full set of obligations that remain—stipulate that when a loan falls within the scope of the 2017 Rule, a lender cannot attempt to withdraw payment from a consumer's account after a second failed withdrawal attempt; doing so constitutes an unfair and abusive practice.[38] Further, lenders are required to provide consumers with a "payment notice" before making the first transfer attempt and a "consumer rights notice" after two consecutive failed transfer attempts.

Amid an ongoing political struggle for control of the CFPB, President Trump appointed Mick Mulvaney as the interim head of the agency in January 2018.[39] As a congressman, Mulvaney "received tens of

31. *See* 12 C.F.R. § 1041.3(b)(3); *see also* 12 C.F.R. § 1041.3(b)(1)–(2) (explaining other covered loans).

32. 12 C.F.R. § 1041.3(c). This regulation explains that a lender has obtained a leveraged payment mechanism if it has the right to initiate a transfer of money, through any means, from a consumer's account to satisfy an obligation on a loan. *Id.* A lender initiating a single immediate payment transfer at the consumer's request has not obtained a leveraged payment mechanism. *Id.*

33. CONSUMER FIN. PROT. BUREAU, *supra* note 28.

34. *See* Payday, Vehicle Title and Certain High-Cost Installment Loans, 12 C.F.R. § 1041.4–.5 (2017).

35. 12 C.F.R. § 1041.4 (2017).

36. 12 C.F.R. § 1041.5 (2017).

37. 12 C.F.R. § 1041.10 (2020).

38. 12 C.F.R. § 1041.7 (2017).

39. Chris Arnold, *Under Trump Appointee, Consumer Protection Agency Seen Helping Payday Lenders*, NPR (Jan. 24, 2018), https://www.npr.org/2018/01/24/579961808/under-trump-appointee-consumer-protection-agency-seen-helping-payday-lenders#:~:text=Under%20Trump%20Appointee

thousands of dollars in political donations from the payday lending industry," suggesting a close connection to the industry.[40] On January 16, 2018, the CFPB announced that it intended to "engage in a rulemaking process so that the Bureau may reconsider the Payday Rule."[41] Subsequently, under Director Kathy Kraninger, the CFPB released notices of proposed rulemaking indicating an intent to rescind the underwriting and associated reporting requirements. The CFPB justified its decision by arguing that rescinding these requirements would increase consumer access to credit.[42] The majority of the 2017 Rule has indeed been jettisoned through agency rulemaking, increasing the importance and scrutiny of the Payments Provisions of the 2017 Rule.

After issuing a final rule to delay the compliance date for the under writing provisions and reporting requirements in June 2019, the CFPB issued the Revocation Rule in July 2020. The Revocation Rule removed three provisions of the 2017 Rule, including the underwriting standards and reporting requirements. The discarded provisions included, first, the obligation stipulating that lenders must confirm a consumer has the ability to repay their loans before making the loan;[43] second, the requirement that lenders verify the consumer's income before a loan transaction;[44] and third, the mandate that lenders furnish information about the covered loan to the Registered Information System.[45] In issuing the Revocation Rule, the CFPB withdrew its two previous determinations that (1) under an individualized-risk standard, "consumers do not understand the material risks, costs, or conditions of covered loans," and (2) "consumers do not have the ability to protect their interests in selecting or using covered loans."[46] The Revocation Rule became effective on October 20, 2020.[47] Although the Revocation Rule repealed significant elements of the 2017 Rule, the Payments

%20Mulvaney%2C%20CFPB%20Seen%20Helping%20Payday%20Lenders%20As,delayed%20implementing%20payday%20lending%20rules [https://perma.cc/2WXN-PRC6].

40. Ken Sweet, *Financial Watchdog to Gut Most of Its Payday Lending Rules*, ASSOCIATED PRESS (Feb. 6, 2019), https://apnews.com/article/north-america-us-news-business-ap-top-news-2a095cc99a07432aba3f62bfb6bfe47d [https://perma.cc/2JUX-5UGL].

41. *CFPB Statement on Payday Rule*, CONSUMER FIN. PROT. BUREAU (Jan. 16, 2018), https://www.consumerfinance.gov/about-us/newsroom/cfpb-statement-payday-rule/ [https://perma.cc/F8RJ-87JZ].

42. *Consumer Financial Protection Bureau Releases Notices of Proposed Rulemaking on Payday Lending*, CONSUMER FIN. PROT. BUREAU (Feb. 6, 2019), https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-releases-notices-proposed-rulemaking-payday-lending/ [https://perma.cc/3AQD-7QXW].

43. *See* Payday, Vehicle Title and Certain High-Cost Installment Loans, 12 C.F.R. § 1041 (2020).

44. *Id.*

45. *Id.*

46. *Id.* (citing 12 U.S.C. § 5331 (d)(2)(A)).

47. *Id.*

Provisions remain intact,[48] allowing payday lending to persist in the consumer financial market with few safeguards.[49]

B. Seila Law *Places the Payments Provisions in Limbo*

While the Payments Provisions have thus far survived the CFPB's rollback of the 2017 Rule, they remain threatened by the Supreme Court's holding in *Seila Law v. Consumer Financial Protection Bureau*. *Seila Law* centers on the refusal of Seila Law LLC, a debt-relief services organization, to respond to several interrogatories pursuant to a CFPB investigation because, Seila Law LLC contended, the CFPB was unconstitutionally structured.[50]

Seila Law presented two questions for the Court: first, whether the structure of the CFPB, an independent agency led by a single director, violated the separation of powers; and second, if the structure of the CFPB was found unconstitutional, whether the provision codifying it, 12 U.S.C. § 5491(c)(3), could be severed from the Dodd-Frank Act.[51] Director Kraninger announced that the agency itself had adopted the legal stance that "the for-cause removal provision of the Consumer Financial Protection Act of 2010 . . . [was] unconstitutional."[52] The Court held that, while the "CFPB's leadership by a single individual removable only for inefficiency, neglect, or malfeasance" was unconstitutional because it violated the separation of powers, the removal provision was "severable from the other statutory provisions bearing on the CFPB's authority."[53]

Although *Seila Law* resolved the question of whether the structure of the CFPB was constitutional, it raised other questions surrounding the legality of the agency's past actions and the impact of those actions on regulated entities.[54] The CFPB has been proactive in affirming and ratifying the 2017 Rule's Payments Provisions,[55] which was intended to

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48. 12 C.F.R. § 1041.9 (2021).

49. Lawrence Kaplan, Sara Weed, Jason Cabral, Quinn Dang & Karin Thrasher, *CFPB Issues Final Rule Rescinding Payday Loan Mandatory Underwriting Requirements*, PAUL HASTINGS (July 15, 2020), https://www.paulhastings.com/insights/client-alerts/cfpb-issues-final-rule-rescinding-payday-loan-mandatory-underwriting-requirements [https://perma.cc/6BG4-YQ6H].

50. Seila L. LLC v. Consumer Fin. Prot. Bureau, 140 S. Ct. 2183, 2188 (2020).

51. *Id.* at 2183.

52. Letter from Kathleen L. Kraninger, Consumer Fin. Prot. Bureau Dir., to Nancy Pelosi, Speaker, House of Reps. 1 (Sept. 17, 2019), https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2019/09/Pelosi-letter.pdf [https://perma.cc/C9CQ-T5VM].

53. *Seila*, 140 S. Ct. at 2192.

54. Eric Goldberg, William Heller & Thomas Kearney, *Impact of Supreme Court's Decision in "*Seila Law, LLC v. CFPB,*"* JDSUPRA (July 17, 2020), https://www.jdsupra.com/legalnews/impact-of-supreme-court-s-decision-in-31036/ [https://perma.cc/TG2G-UZ86].

55. Payday, Vehicle Title and Certain High-Cost Installment Loans, 12 C.F.R. § 1041 (2020); *see also* David Stein & Andrew Rubin, *CFPB Finalizes Amendments to Payday Lending Rule*, COVINGTON

preserve the remnants of the 2017 Rule in light of the *Seila Law* holding.[56] However, regulated entities have since questioned the validity of the ratification.[57]

Despite the agency's commitment to staving off attacks, the Payments Provisions are currently the subject of ongoing litigation in *Community Financial Services Ass'n of America v. CFPB* (*CFSA v. CFPB*).[58] If plaintiffs are ultimately successful in that case, the 2017 Rule will be all but demolished, leaving little substantive federal law in place to regulate payday loans or the conduct of lenders in this realm.

C. *Community Financial Services Ass'n of America* v. *Consumer Financial Protection Bureau (CFSA* v. *CFPB)*

The organization responsible for the suit against the CFPB is the CFSA, an advocacy group that seeks to "protect consumers while preserving access to credit options and to support and encourage responsible practices within the short-term loan industry."[59] The CFSA alleges that restricting payday loans would "hurt consumers' financial well-being."[60] Further, the CFSA takes the position that, instead of protecting these invaluable consumer financial tools, the CFPB "virtually eliminate[d]" payday lending through the 2017 Rule.[61] In its amended complaint, CFSA argues that the Payments Provisions violate both the Administrative Procedure Act (APA) and the U.S. Constitution.[62]

CFSA sets forth two arguments against the Payments Provisions and expressly reserves the right to renew their challenges to the underwriting provisions should the Revocation Rule be set aside for any

& BURLING LLP (July 7, 2020), https://www.covfinancialservices.com/2020/07/cfpb-finalizes-amendments-to-payday-lending-rule/ [https://perma.cc/MUS6-886D].

56. Alan S. Kaplinsky & Jeremy T. Rosenblum, *CFPB Issues Final Rule Rescinding Payday Loan Rule Ability to Repay Provisions and Ratifies Rule's Payments Provisions*, BALLARD SPAHR LLP (July 7, 2020), https://www.consumerfinancemonitor.com/2020/07/07/cfpb-issues-final-rules-rescinding-payday-loan-rule-ability-to-repay-provisions-and-ratifies-rules-payment-provisions/ [https://perma.cc/7XQG-UYZS].

57. *See* Defendants' Motion for Judgment on the Pleadings at 7, CFPB v. Navient Corp., No. 17-cv-00101, 2020 WL 4454932 (M.D. Pa. July 10, 2020) (arguing that in the context of litigation, absent a legally sufficient ratification, the CFPB's prior action's must be dismissed because an unconstitutionally structured agency lacks authority).

58. Cmty. Fin. Servs. Ass'n of Am. v. Consumer Fin. Prot. Bureau, No. 18-cv-00295, 2021 WL 4132272 (W.D. Tex. Aug. 31, 2021).

59. *About CFSA*, CMTY. FIN. SERVS. ASS'N OF AM., https://www.cfsaa.com/about-cfsa [https://perma.cc/LH92-9K2Z].

60. Amended Complaint ¶ 1, *Cmty. Fin. Servs. Ass'n of Am.*, No. 18-cv-00295, 2021 WL 4132272.

61. *Id.* ¶ 2.

62. *Id.* ¶ 16.

reason.[63] These arguments may represent a credible and "powerful attack on the payment provisions of the rule"[64] and thus should be analyzed with the presumption of appeal, regardless of the District Court ruling.

First, the CFSA argues that the CFPB arbitrarily and capriciously declined to repeal the Payments Provisions simultaneously with the repeal of the mandatory underwriting provisions.[65] The CFSA contends that the initial promulgation of the Payments Provisions was based on the same unfair, deceptive, or abusive acts or practices (UDAAP) theory as the underwriting provisions.[66] When reconsidering the underwriting provisions, the CFPB acknowledged flaws in the original 2017 Rule, including evidence that the prior CFPB director had misinterpreted the proper scope of UDAAP authority when issuing the 2017 Rule.[67] The CFSA alleges that the Payment Provisions "rested on the very same UDAAP standards that the Bureau had just rejected in revoking the underwriting provisions."[68] Accordingly, the CFSA argues that relying on the same disallowed test should be deemed "arbitrary [and] capricious" under the APA.[69]

Second, the CFSA argues that the post-*Seila Law* ratification of the Payments Provisions is legally insufficient to cure the constitutional defects of the 2017 Rule.[70] The CFSA argues that the 2017 Rule should be presumed to have constitutional defects because it was created by a structurally invalid agency.[71] After all, as the CFSA contends, "an invalid agency cannot promulgate valid legislative rules. . . . [and] [t]he Bureau's notice of ratification, promulgated without notice-and-comment rulemaking, did not and could not cure this constitutional defect."[72] Thus, the CFSA argues, the CFPB must promulgate the Payments Provisions under a new "valid rulemaking process, which only a validly constituted agency can undertake."[73] In summary, the CFSA posits that without a new rulemaking process, the CFPB's ratification of the Payments Provisions violates the Constitution because it gives "retroactive legal force to the promulgation of [an invalid] legislative

63. *Id.* ¶ 56.
64. Jeremy T. Rosenblum, *Trade Groups File Amended Complaint in Texas Lawsuit Challenging CFPB Payday Loan Rule*, CONSUMER FIN. MONITOR (Aug. 31, 2020), https://www.consumerfinancemonitor.com/2020/08/31/trade-groups-file-amended-complaint-in-texas-lawsuit-challenging-cfpb-payday-loan-rule/ [https://perma.cc/JBP3-UXKW].
65. Amended Complaint, *supra* note 60, ¶ 6.
66. *Id.* ¶ 6.
67. 12 C.F.R. § 1041, *supra* note 55.
68. Amended Complaint, *supra* note 60, ¶ 106.
69. *Id.* ¶ 101; *see also* 5 U.S.C. § 706(2)(A).
70. Amended Complaint, *supra* note 60, ¶ 11.
71. *Id.*
72. *Id.* ¶¶ 95–96.
73. *Id.* ¶ 11.

rule."[74] The CFSA concedes that the Bureau may be able to ratify enforcement actions, but asserts that a legislative rule cannot be held to the same standard.[75]

D. *The CFPB's Response*

The Bureau maintains that both of the CFSA's primary arguments are erroneous. First, the Bureau argues that any initial problem of an invalid agency declaring a valid rule was cured when "a Director fully accountable to the President ratified them."[76] In order to support this proposition, the Bureau cites several cases in which various appellate courts have held that "ratification by an official unaffected by any constitutional problem can 'cure any Article II deficiencies.'"[77] Further, if the District Court were to agree with the CFSA and invalidate the ratified provisions, the decision would undermine, not fortify, Article II executive power.[78] To bolster the argument that the ratification was constitutional, the CFPB relies on agency theory to assert that the Bureau itself "validly ratified the Provisions when its valid agent . . . approved them."[79]

The Bureau's response to the CFSA includes several more avenues of support for its position. One compelling rebuttal addresses the CFSA's statement that the Bureau acted arbitrarily and capriciously in ratifying the Payments Provisions while simultaneously repealing the underwriting provisions. The Bureau argues that the "repeal of the [u]nderwriting [p]rovisions did not give rise to an 'inconsistency' in the 2017 Rule's discussion of the [p]ayment [p]rovisions' benefits and costs."[80] Rather, the repeal of the underwriting provisions did not impact the Bureau's consideration of the Payments Provisions.

In order to make a distinction between the underwriting provisions and the Payments Provisions, the Bureau relies on two distinct interpretations of its UDAAP authority.[81] In issuing the Revocation Rule, the Bureau contends that it now rejects the individualized-risk standard that the underwriting provisions were based on, but continues

74. *Id.* ¶ 97.

75. *Id.* ¶ 96.

76. Defendants' Combined Cross-Motion for Summary Judgment and Opposition to Plaintiffs' Motion for Summary Judgment at 9, Cmty. Fin. Servs. Ass'n of Am. v. Consumer Fin. Prot. Bureau, No. 18-cv-00295, 2021 WL 4132272 (W.D. Tex. Aug. 31, 2021) [hereinafter Cross-Motion].

77. *Id.* at 10 (citation and brackets omitted).

78. *Id.* at 11.

79. *Id.* at 14.

80. *Id.* at 22.

81. *Id.* at 24.

to back the generalized-risk standard that supports the Payments Provisions.[82] When drafting the 2017 Payments Provisions, the Bureau was concerned that consumers were not aware of the risk of multiple failed withdrawal attempts. This premise relies on the generalized-risk standard as opposed to the individualized-risk standard, which was later rescinded by the Revocation Rule. Because the underwriting provisions and Payments Provisions were based on different UDAAP authorities, the Bureau argues that revocation of one and ratification of another is not arbitrary or capricious.[83]

In summary, both the CFSA and CFPB rely on differing interpretations of the proper process for ratifying an agency action that has been undermined by a court opinion. As a result, the CFSA and CFPB disagree on the validity of the Payments Provisions in light of *Seila Law* and the revocation of the underwriting provisions.

II. THE ANTICIPATED IMPACT OF *CFSA v. CFPB* ON PAYDAY LENDING POLICY

The controversy between the CFSA and CFPB embodies the tension between the benefits generated from providing short-term credit to consumers and the harms of maintaining the status quo. Both the CFPB and CFSA have valid arguments. Although the District Court ruled in favor of the CFPB by granting the CFPB's motion for summary judgment, a longer-term legal battle and appeal is now on its way to the Fifth Circuit. In the interim, it is worth considering how the case's outcome may affect consumers. Section II.A details the impact on consumers of the court-ordered stay of the 2017 Rule, which lasted throughout the District Court litigation (and has been extended through the CFSA's appeal to the Fifth Circuit).[84] Section II.B outlines the Bureau's options should the CFSA prevail on the merits in the Fifth Circuit. At best, the Bureau could start afresh with the creation of a new, duly constituted version of the Payments Provisions; at worst, the Bureau could be blocked from enacting such provisions altogether.

A. *The Effect of the Court-Ordered Stay of the 2017 Rule*

First, the Payments Provisions, which limit the ability of the lender to make subsequent withdrawal attempts after an initial failed attempt,

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82. *Id.*
83. *Id.* at 26.
84. *See* Evan Weinberger, *Court Delays CFPB Payday Rule as Industry Challenge Continues*, BLOOMBERG LAW (Oct. 15, 2021), https://new.bloomberglaw.com/banking-law/court-delays-cfpb-payday-rule-while-industry-challenge-continues.

remain in limbo due to a court-ordered stay of the entire 2017 Rule in November 2018.[85] After ratifying the 2017 Rule, the Bureau stated that it would seek to have the Payments Provisions "go into effect with a reasonable period for entities to come into compliance."[86] This was a compromise that some critics viewed as necessary in light of the indefinite stay;[87] without such a grace period, lender advocates argued, creditors could be put in the "untenable position" of being deemed out of compliance with the Payments Provisions once the stay is lifted.[88] However, the Bureau has since clarified that, in its view, the reasonable period for entities to come into compliance with the Payments Provisions ended in August 2019.[89] Specifically, the Bureau argued in its brief supporting its motion for summary judgment that:

> [B]ecause of the stay entered in this case, companies did not actually have to comply by the Rule's original compliance date (and do not have to comply yet)—but that leaves companies with more time to come into compliance, not less. If some lenders put preparations on hold in hopes that the Payment Provisions would be invalidated before the Court ever lifted the stay, that was a gamble they took.[90]

If the CFPB prevails after the Fifth Circuit's decision, covered lenders who bet on a complete overhaul of the 2017 Rule will be forced to execute an accelerated plan to bring themselves into compliance with the Payments Provisions. This could result in "extensive programming and operational changes" that may not be easily implemented.[91]

Given the CFPB's contentious reputation over the past decade, it is unsurprising that the court-imposed stay will be held throughout the appeal to the Fifth Circuit. This means that, for the foreseeable future, consumers are borrowing within the status quo—namely, in a regulatory field devoid of the Payments Provisions.

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85. Cross Motion *supra* note 76. at 7.

86. *Consumer Financial Protection Bureau Issues Final Rule on Small Dollar Lending*, CONSUMER FIN. PROT. BUREAU (July 7, 2020), https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-final-rule-small-dollar-lending/ [https://perma.cc/L6XE-SLEZ].

87. *See* Jeremy T. Rosenblum, *CFPB Does Not Seek Lifting of Compliance Date for Payday Loan Rule's Payment Provisions in New Status Report Filed in Trade Groups' Lawsuit*, CONSUMER FIN. MONITOR (Mar. 11, 2019), https://www.consumerfinancemonitor.com/2019/03/11/cfpb-does-not-seek-lifting-of-stay-of-compliance-date-for-payday-loan-rules-payment-provisions-in-new-status-report-filed-in-trade-groups-lawsuit/ [https://perma.cc/94LF-BHAF].

88. *Id.*

89. CONSUMER FIN. PROT. BUREAU, UNOFFICIAL REDLINE TO THE REVOCATION RULE'S AMENDMENTS TO THE PAYDAY LENDING RULE § 1041.15(c) (2020).

90. Cross-Motion, *supra* note 76, at 22.

91. *See* Rosenblum, *supra* note 87.

The stay affects consumers in three ways. First, consumers continue to be subject to practices that facilitate patterns of long-term borrowing and cyclical debt. Lenders are "first in line" to collect on their loans directly from consumers' accounts and attempt withdrawals repeatedly with impunity.[92]

Second, individuals who borrow payday loans more frequently are disproportionately impacted by the absence of the Payments Provisions. For example, staying the Payments Provisions disproportionately affects Black Americans, who are 105% more likely to take out payday loans than other races and ethnicities.[93] Without the Payments Provisions, historically excluded communities cannot decide for themselves how to repay their loans.[94] Without these safeguards in place, short-term lenders continue to remove paychecks directly from consumers' bank accounts when they least expect it.

Finally, leaving the Payments Provisions in limbo disproportionately burdens vulnerable consumers during unprecedented market contractions, such as the economic downturn during the COVID-19 pandemic, by giving predatory lenders more leverage over the unemployed.[95] With annual interest rates as high as 400% continuing unabated,[96] the impact on low-income consumers of nullifying the Payments Provisions cannot be overstated.

B. *The Bureau's Options upon Defeat*

In the Fifth Circuit, the CFSA could plausibly prevail on any of their legal arguments and all but eviscerate the 2017 Rule. If this happens, the Bureau has several options. First, if the Payments Provisions are struck down on constitutional grounds, the Bureau could reinstate them now that the CFPB is considered a "validly constituted" agency under *Seila Law*.[97] But this avenue is not without its drawbacks. The road to

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92. SUSANNA MONTEZEMOLO, CTR. FOR RESPONSIBLE LENDING, PAYDAY LENDING ABUSES AND PREDATORY PRACTICES 2 (2013), https://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf [https://perma.cc/6BHJ-KLCU].

93. Pew Charitable Trusts, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 9 (2012) [hereinafter PAYDAY LENDING IN AMERICA].

94. *Proposal to Dismantle Payday Loan Rule Would Harm Millions*, PEW TRUSTS (Feb. 6, 2019), https://www.pewtrusts.org/en/about/news-room/press-releases-and-statements/2019/02/06/pew-proposal-to-dismantle-payday-loan-rule-would-harm-millions [https://perma.cc/8X5Q-EFD5].

95. *See* Yuka Hayashi, *Rollback of Payday Loan Proposal Decried by Consumer Groups, Welcomed by Banks*, WALL STREET J. (July 8, 2020), https://www.wsj.com/articles/rollback-of-payday-loan-proposal-decried-by-consumer-groups-welcomed-by-banks-11594238239 [https://perma.cc/A5F8-MEYV].

96. *Id.*

97. Amended Complaint, *supra* note 60, ¶ 11.

regulation is often hard-fought and time-consuming. A brief overview of the CFPB's rulemaking process underscores this point.

To initiate rulemaking, the CFPB must conduct research on the issue in question. That research must be informed by "public input, including field hearings, consumer and industry roundtables, advisory bodies, and in some cases, small business review panels."[98] It is tempting to think that this process could be expedited since the 2017 Rule already underwent this extensive vetting process. However, due to public pushback on the CFPB's prior research methods concerning the 2017 Rule in general and the Payments Provisions in particular,[99] it seems likely that the Bureau would start this process from scratch to avoid any appearance of impropriety.

After the research component is complete, the newly proposed rule would be vetted during a notice and comment period. This process alone takes at least sixty days and is prone to extensions.[100] Even if the newly proposed rule makes it this far, the CFSA could prevent its enactment on alternative grounds. Such additional legal challenges would only extend an already drawn-out process.

Alternatively, if the Fifth Circuit is convinced that the Payments Provisions are arbitrary and capricious under the APA, that would put the final nail in the coffin for payday lending protections under the Bureau's UDAAP powers.[101] If this were to occur, the CFPB would be compelled to develop an alternate explanation of why the acts and practices covered by the Payments Provisions are unfair, deceptive, or abusive. Given the preexisting controversy surrounding the meaning of "abusive," and the exhaustion in this scenario of "unfair" under the revocation rule, the Bureau may be hard pressed to construe a compelling explanation.[102]

In either scenario, taxpaying consumers would be forced to fund an expensive legal battle designed to eliminate short-term lending protections. Currently, the CFPB is fighting to salvage the remnants of the 2017 Rule and what once was an expansive framework for fortifying consumer access to credit. Even if the agency succeeds in the long-term, preserving the Payments Provisions will not alleviate the

98. *Rules and Policy*, CONSUMER FIN. PROT. BUREAU (2020), https://www.consumerfinance.gov/rules-policy/ [https://perma.cc/8SBW-ZVXE].

99. *See* Amended Complaint, *supra* note 60, ¶ 3.

100. STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 116TH CONG., ABUSES OF THE FEDERAL NOTICE-AND-COMMENT RULEMAKING PROCESS 11 (Oct. 24, 2019), https://www.hsgac.senate.gov/imo/media/doc/2019-10-24%20PSI%20Staff%20Report%20-%20Abuses%20of%20the%20Federal%20Notice-and-Comment%20Rulemaking%20Process.pdf [https://perma.cc/35PK-B6XV].

101. Or, at least signal the exhaustion of the possibility of such a CFPB rule based on UDAAP authority.

102. *CFPB Symposium: Abusive Acts or Practices*, CONSUMER FIN. PROT. BUREAU (June 25, 2019), https://www.consumerfinance.gov/about-us/events/archive-past-events/cfpb-symposium-abusive-acts-or-practices/ [https://perma.cc/2VJV-6KLP].

immediate distress that low-income consumers are facing today. The need for accessible, short-term credit is particularly acute given the financial impact of the COVID-19 pandemic, the aftereffects of which will be felt for years to come. The clear distress in the short-term lending market has created an urgent need for reform.

III. BUILDING A NEW FRAMEWORK: BEYOND HARM AVOIDANCE, TOWARD FINANCIAL INCLUSION

The Payments Provisions of the 2017 Rule were intended to "increase consumer protections from harm associated with lenders' payment practices."[103] This is a modest aim. One might expect a loftier goal than harm avoidance from an institution that purports to "make consumer financial markets work for consumers."[104] This is not to say that agencies like the CFPB play a trivial role in regulating practices that may harm consumers, but it *is* to say that an effective consumer framework requires more than just harm prevention.

This Note posits harm prevention as the first step in a two-part framework of consumer protection from payday lending. The second—and thus far missing—component requires confirmatory proactive action to create financially inclusive lending options for consumers. This second step fills the void left by usurious payday lenders and negates one of the main counterarguments to the Payment Provisions: namely, that to "target[] a critical form of credit for millions of borrowers who are in dire need of it, the [practice of regulating payday lending] would . . . severely injure[] the very consumers the Bureau is charged with protecting."[105] There are other ways to provide short-term credit to underbanked consumers without saddling them with contemptible loans, as this Part explores.

Part III proceeds as follows. Section III.A identifies an alternative means of "harm prevention" analogous to the Payments Provisions and, indeed, the 2017 Rule as a whole. This Section then argues that Congress should exercise its authority to set a federal usury rate for payday lending. Section III.B proposes an affirmative step toward financial inclusion for under- and unbanked consumers who require the services of payday loans. Here, this Note builds upon the proposed FedAccounts feature of the Federal Reserve and offers a more beneficent version of existing payday loans. These proposed loans (what this Note refers to as "FedLoans") would be facilitated through

103. CONSUMER FIN. PROT. BUREAU, *supra* note 86.

104. *The Bureau*, CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/about-us/the-bureau/ [https://perma.cc/M48M-4M3E].

105. *See* Amended Complaint, *supra* note 60, ¶ 3.

FedAccounts and would have three defining features: (1) they would be "real-time payments"[106] that are readily available for timely disbursal; (2) they would maintain a competitive interest rate tied to the prime rate; and (3) they would be available to all American residents, including non-citizens and undocumented immigrants.

A. *Congressional Usury Rates for Payday Lending*

Currently, payday lending is primarily regulated by state annual interest rate caps. Recent developments in case law and rulemaking, however, highlight that Congress must act immediately to set a federal usury rate for payday lending. *Madden v. Midland Funding, LLC* has had a particularly profound impact on the anticipated regulation of payday lenders. In *Madden*, the Second Circuit held that a loan that was valid when it was originated by a national bank could become usurious under state law if it was sold or assigned to a non-bank because federal preemption would no longer apply upon assignment.[107] Further, *Madden* supported the proposition that payday lenders were not entitled to protection from state-law usury claims under the National Bank Act (NBA).[108] Finally, *Madden* held that state law usury claims are not preempted under the NBA when the lending party is neither a "national bank nor a subsidiary or agent of a national bank" and when "application of the state law . . . would not significantly interfere with any national bank's ability to exercise its powers under the NBA."[109] Thus, under this framework, a payday lender is neither a national bank nor an agent of a national bank and, as such, cannot use the NBA to evade the state interest rate caps that regulate payday loans.

The *Madden* framework, however, is threatened by the Office of the Comptroller of the Currency's (OCC's) December 2020 rule, "National Banks and Federal Savings Associations as Lenders."[110] Under this proposal, a bank will be deemed to have made a loan for the purpose of the NBA if "as of the date of origination . . . [the bank] [i]s named as the lender in the loan agreement . . . or [f]unds the loan."[111] The OCC promulgated this rule to clarify which entity is making the loans, and

106. *See generally* Letter from Aaron Klein, Fellow in Econ. Stud., Brookings Inst., to Ann Misback, Secretary, Bd. of Governors of Fed. Rsrv. Sys. (Dec. 14, 2018), https://www.federalreserve.gov/SECRS/2018/December/20181221/OP-1625/OP-1625_121418_133277_428769914666_1.pdf [https://perma.cc/QEV4-WZ7U].

107. Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015).

108. *Id.* at 250.

109. *Id.* at 247.

110. 12 C.F.R. § 7.1031(b)(1)– (2) (2020). The OCC ensures that national banks and federal savings associations operate safely.

111. *Id.*

therefore what laws apply to the loans.[112] However, this rule may override the fact-intensive balancing test that courts currently use to determine which party is the true lender and what regulations should apply.[113] In the context of payday lending, this rule will eviscerate states' power to regulate payday loan interest rates; payday lenders will turn to rent-a-bank schemes in order to reap the interest rate exportation benefit of the NBA.[114] Under the OCC rule, the lending party would be the national bank and, as such, state law usury claims would be preempted under the NBA.[115]

The new OCC rule, which expands payday lenders' powers and reduces their regulation, could be mitigated by a new presidential administration. Indeed, the OCC is not immune from partisanship; academics correctly predicted that Brian Brooks, the former acting comptroller of the OCC, would be "out if Biden takes office."[116] The new comptroller has yet to be named. Although the Biden administration might amend or revoke the December 2020 rule, the political pendulum will continue to swing, and it is prudent to proactively combat regulatory gaps whenever they arise.

The possibility that payday lenders will soon operate without even state law restrictions underscores the urgent need for federal congressional intervention. Congress must implement a federal usury rate for payday lending to avoid the least-favored outcome of no state or federal limitations on usurious lenders. By proactively establishing a federal usury rate for payday lending, Congress can preempt rent-a-bank schemes while ensuring short-term credit access for underbanked consumers.

Consumer advocates have already begun asking Congress to pass a thirty-six percent federal interest rate cap for non-bank lenders in response to recent rulemaking efforts by the OCC and the Federal

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112. *Id.*

113. *Id.* § 6. Currently under the true lender doctrine, courts look at a multitude of factors such as "(1) how long the entity named as the lender holds the loan before selling it to the third party, (2) whether the third-party advances money that the named lender draws on to make loans, (3) whether the third party guarantees minimum payments or fees to the named lender." National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 44223, 44224 (proposed July 22, 2020).

114. *See* Jan Kruse & Lauren Saunders, *OCC Proposal Would Turn State Interest Rate Limits into a "Dead Letter," Causing Explosion of Rent-a-Bank Payday Lending That Will Devastate Struggling Families*, NAT'L CONSUMER L. CTR. (July 20, 2020), https://www.nclc.org/media-center/occ-proposal-would-turn-state-interest-rate-limits-into-a-dead-letter-causing-explosion-of-rent-a-bank-payday-lending-that-will-devastate-struggling-families.html [https://perma.cc/DY3L-NC5Z].

115. *See* Beneficial Nat'l Bank v. Anderson, 539 U.S. 1, 11 (2003) ("[T]here is . . . no such thing as a state-law claim of usury against a national bank.").

116. *See* Anna Hrushka, *Election 2020: What Should the Banking Industry Expect from Biden or Trump?*, BANKINGDIVE (Oct. 22, 2020), https://www.bankingdive.com/news/election-2020-biden-trump-tax-cfpb-marijuana-cabinet/587489/ [https://perma.cc/9FPC-2BMN].

Deposit Insurance Corporation (FDIC).[117] Congress is well within its power to do so. Notably, under the Military Lending Act, Congress has already established a thirty-six percent usury cap for certain consumer loans.[118] Additionally, in late 2019, Illinois Representative Jesús García introduced a bipartisan bill, the Veterans and Consumers Fair Credit Act, which sought to extend the consumer credit protections provided in the Military Lending Act, including the thirty-six percent usury rate cap, to all consumers. [119] The proposal would not preempt stricter state usury rates.[120] While Congress has expanded consumer lending protections by changing federal usury rates, Senator Bernie Sanders and Representative Alexandria Ocasio-Cortez have suggested even more expansive reforms in their proposed legislation, the Loan Shark Prevention Act.[121] Under the Loan Shark approach, payday lenders cannot charge an annual percentage rate that exceeds the lesser of fifteen percent and the maximum rate permitted by state law.[122]

These actions underscore an important point: state usury rates are no longer an efficient means of regulating payday lending. Under the OCC rule, payday lenders can circumvent maximum state usury laws and take advantage of interest rate exportation. By setting a national maximum interest rate, Congress could prevent payday lenders from creating the rent-a-bank schemes that the OCC rule enables.

Congress could set a federal payday lending usury rate without preempting state usury rates. Federal law can preempt inconsistent state laws, as well as laws that impede federal aims.[123] However, given the variety of payday lending usury rates set by states, not all state laws will be more permissive than the federal law. If Congress sets a maximum usury rate, states that elect to set a lower usury rate would not be interfering with the federal government's exercise of its powers and, thus, would not be in violation of the Supremacy Clause.[124] In drafting the proposed rate, Congress could use the language of Sanders' Loan

117. MEMORANDUM FROM COMM. ON FIN. SERVS. MAJORITY STAFF TO MEMBERS, COMM. ON FIN. SERVS., RENT-A-BANK SCHEMES AND NEW DEBT TRAPS: ASSESSING EFFORTS TO EVADE STATE CONSUMER PROTECTIONS AND INTEREST RATE CAPS (Jan. 31, 2020), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-20200205-sd002-u1.pdf [https://perma.cc/9PNV-3QFQ] [hereinafter RENT-A-BANK SCHEMES AND NEW DEBT TRAPS]. The FDIC is "an independent agency created by the Congress to maintain stability and public confidence in the nation's financial system. The FDIC insures deposits; exaines and supervises financial institutions for safety, soundness, and consumer protection; makes large and complex financial institutions resolvable; and manages receiverships." *About FDIC*, FDIC, https://www.fdic.gov [https://perma.cc/44X6-9Y7Z].

118. *See* 10 U.S.C. § 987(b).

119. Veterans and Consumers Fair Credit Act, H.R. 5050, 116th Cong. (2019).

120. RENT-A-BANK SCHEMES AND NEW DEBT TRAPS, *supra* note 117, at 5.

121. *See* Loan Shark Prevention Act, S. 1389, 116th Cong. (2019).

122. *Id.*

123. RENT-A-BANK SCHEMES AND NEW DEBT TRAPS, *supra* note 117 (citing Barnett Bank of Marion Cnty., N.A. v. Nelson, 517 U.S. 25, 33 (1996)).

124. *See* U.S. CONST. art. VI, cl. 2.

Shark Prevention Act to ensure that states maintain the right to eradicate payday lending and consumers remain adequately protected from egregious usury rates.[125]

Finally, a congressional solution to predatory lending is practical for two reasons. First, the variation among state payday lending regulations creates uncertainty for consumers, which is difficult to navigate. A Pew Research study on payday loans currently identifies twenty-seven "permissive" states that allow single-repayment loans with APRs of 391% or higher.[126] In contrast, fifteen "restrictive" states have no payday loan storefronts at all.[127] Each of these circumstances is problematic. Together, they evoke the old maxim: "pick your poison." Should consumers be forced to live without the option of payday loans[128] or attempt to tread water in a regulatory environment that permits an annual interest rate of 391%? A federal usury rate would provide the first step in regulating these extremes.

Second, courts oversee payday lending practices with a light touch and tend to intervene in only the most egregious instances.[129] In fact, far from vindicating consumer interests, state courts frequently function as a mechanism to maintain the stranglehold that high-interest loan companies have on vulnerable consumers. Savvy lenders have started using small claims courts to their advantage, using the levers of the law to arrest borrowers in default and recoup the money they are owed—plus interest.[130] Although it is illegal to jail a consumer for an unpaid debt, predatory lenders have fettered out a workaround in which debtors are arrested for missing a court date or for failure to respond to a court summons.[131] The predatory cycle is completed with the aid of state laws,

125. *See* Loan Shark Prevention Act, S. 1389, 116th Cong. (2019) ("Nothing in this section may be construed to preempt any provision of State law that provides greater protection to consumers than is provided in this section.").

126. *See* PEW CHARITABLE TRUSTS, STATE PAYDAY LOAN REGULATION AND USAGE RATES 1 (2012), https://www.pewtrusts.org/-/media/data-visualizations/interactives/2014/state-payday-loan-regulation-and-usage-rates/report/state_payday_loan_regulation_and_usage_rates.pdf [https://perma.cc/6E7H-8CWE] [hereinafter STATE PAYDAY LOAN REGULATION AND USAGE RATES].

127. *Id.* The remaining eight states are classified as "hybrid" states which "[h]ave payday loan storefronts, but maintain more exacting requirements, such as lower limits on fees or loan usage, or longer repayment periods." PAYDAY LENDING IN AMERICA, *supra* note 93, at 21.

128. *But see After Payday Loans: How Do Consumers Fare When States Restrict High-Cost Loans?*, NAT'L CONSUMER L. CTR. (Oct. 2018), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/ib_how-consumers-fare-restrict-high-cost-loans-oct2018.pdf [https://perma.cc/AE2V-M6MR].

129. *See, e.g.*, McGhee v. Ark. State Bd. of Collection Agencies, 289 S.W.3d 18 (Ark. 2008) (holding that a state law permitting payday lenders to offer short-term loans with rates exceeding 300% violated a state constitutional provision limiting annual interest percentage rates on consumer loans to 17%); De La Torre v. CashCall, Inc., 422 P.3d 1004 (Cal. 2018).

130. *See, e.g.*, Anjali Tsui, *They Loan You Money. Then They Get a Warrant for Your Arrest.*, PROPUBLICA (Dec. 3, 2019, 5:00 AM), https://www.propublica.org/article/they-loan-you-money-then-they-get-a-warrant-for-your-arrest [https://perma.cc/67ZKYY9X].

131. *See id.*

such as Utah's, which permit creditors to recoup cash posted for an individual's bail in civil cases.[132] The current lack of judicial intervention further highlights the need for a proactive solution.

B. *FedAccounts: Introducing FedLoans*

With a federal usury rate in place, consumers will receive better protections from payday lenders who are hawking high-interest, predatory loans. But this is only half the battle. Payday lenders are motivated to issue risky loans because they offer the probability of a big payday upon consumer default. A federal cap on short-term interest rates will significantly diminish the probability of such payouts for lenders. As a result, it seems likely that, upon enactment of the proposed federal legislation, a number of payday lenders will exit the business for want of profits.[133] This exodus will leave a significant number of low-income consumers who currently depend on such loans in the lurch as they try to bridge the gap between wage payments. Thus, a comprehensive solution to payday lending must not only prohibit usurious lending rates, but also provide consumers with a viable alternative to payday lending.

Enter the prospect of fast, low-interest loans through FedAccounts. FedAccounts, first suggested by Professors John Crawford, Lev Menand, and Morgan Ricks, are consumer accounts for public use that are held at the Federal Reserve.[134] The proposed system would permit American consumers to use "government-issued digital currenc[ies] . . . in the form of central bank accounts," a system that would be "seamlessly interoperable with the mainstream payment system, relying on technologies that the Federal Reserve has used for decades."[135] Although such accounts are currently a privilege reserved for commercial entities,[136] the Federal Reserve is already taking steps to make its services available to the general public. In August 2020, the Fed announced a new interbank settlement service christened "FedNow."[137] While the service stops short of permitting consumers to bank directly with the Federal Reserve, it is touted as "catalyz[ing]

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132. *See* S.B. 159, 2014 Leg., Gen. Sess. (Utah 2014).

133. For example, within Arkansas (classified as a "restrictive" state with respect to payday loans) no payday lenders operate under the state law. *See* STATE PAYDAY LOAN REGULATION AND USAGE RATES, *supra* note 126.

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

135. *Id.* at 113.

136. *See id.* at 116.

137. *See* Service Details on Federal Reserve Actions to Support Interbank Settlement of Instant Payments, 85 Fed. Reg. 48522, 48525 (Aug. 11, 2020).

fundamental improvements in the nation's payment system," allowing "individuals and businesses to conduct and complete payments almost immediately, around the clock, every day of the year and provide a receiver with access to funds in seconds."[138]

This Note's proposed solution would require a layering of technological innovation. With the realization of FedAccounts, the operational advantages of FedNow could be applied to consumer accounts.[139] The FedAccounts program itself could offset certain conditions that cause consumers to turn to payday loans in the first place.[140] Real-time payment clearances would eliminate the delays that force consumers to borrow high-interest funds to support themselves between paychecks.[141] The program could also lessen reliance on prepaid debit cards and their accompanying fees and service interruptions, factors that also lead to the use of payday loans.[142] Finally, the FedAccounts program could be used to facilitate real-time, low-interest loans to fill the gap created by the existing payday lending framework.

Layering FedAccounts with FedNow to create FedLoans would effectively leverage technology to better serve consumers in need of short-term loans. This solution is different from proposals for a public postal banking option.[143] Importantly, this Note's proposal envisions FedLoans as a gap-filling measure designed to mitigate the potential negative impacts of limiting usury, not as a public option designed to compete with private companies. Further, a United States Postal Service bank would enter a financial services environment characterized by digitalization and proficiency.[144] Focusing on a brick-and-mortar solution may miss demographics that are early adopters of technology, including forty percent of unbanked individuals.[145] Besides

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138. *Id.* at 48522–23.

139. Crawford, Menand, and Ricks also suggest this eventuality within their proposal, advocating for real time payments between FedAccount holders. *See* Crawford et al., *supra* note 134, at 122–23, 125–130.

140. *See infra* Introduction.

141. *See* Aaron Klein, *Understanding Non-Prime Borrowers and the Need to Regulate Small Dollar and "Payday" Loans*, BROOKINGS (May 19, 2016), https://www.brookings.edu/research/understanding-non-prime-borrowers-and-the-need-to-regulate-small-dollar-and-payday-loans/ [https://perma.cc/4PYD-EMU9]; *see also* Crawford et al., *supra* note 134, at 122–23.

142. Crawford et al., *supra* note 134, at 126.

143. *See* Mehrsa Baradaran, *Credit, Morality, and the Small-Dollar Loan*, 55 HARV. C.R.-C.L. L. REV. 64, 112 (2020).

144. Marc Joffe, *Progressive 'Postal Banking' Proposal: A Solution in Search of a Problem*, NAT'L REV. (May 6, 2021, 6:30 AM), https://www.nationalreview.com/2021/05/progressive-proposal-for-postal-banking-a-solution-in-search-of-a-problem/ [https://perma.cc/Y92X-74LW].

145. *See* Peter Conti-Brown, *Why the Next Big Bank Shouldn't Be the USPS*, BROOKINGS (May 31, 2018); BD. OF GOVERNORS OF THE FED. RSRV. SYS., CONSUMERS AND MOBILE FINANCIAL SERVICES 2016 (2016), https://www.federalreserve.gov/econresdata/consumers-and-mobile-financial-services-report-201603.pdf [https://perma.cc/DRM2-FLFL].

lagging in technology, a public postal banking option would "put the livelihoods of many [financially vulnerable] Americans in the hands of a government agency with zero experience in underwriting loans and that cannot even balance its own books while putting taxpayers at risk."[146] While leveraging the Postal Service's expansive network to provide a public banking option is a worthy goal, FedAccounts' ability to offer financial stability, speedy and efficient payment, monetary policy transmission, and regulatory streamlining makes FedLoans a more modern, efficient solution.

Our proposal also departs from the FedAccounts scheme envisioned by Crawford, Menand, and Ricks, which does not entail the provision of loans. As noted at the outset of their proposal, "FedAccount would not be a *lending* program. The Fed would not provide credit directly to individuals or businesses."[147]

The rest of this Section defends this Note's divergence from the original FedAccounts proposal. Instead of merely integrating FedAccounts with a consumer lending program, this Note advocates for the inclusion of a lending framework within the Federal Reserve. Three necessary components comprise this framework: first, payments would have to be distributed in "real time"[148] and be readily available for timely disbursal; second, loans would be required to maintain a competitive interest rate tied to the prime rate; and third, loans would have to be available to all American residents, including non-citizens and undocumented immigrants.

1. FedAccounts as a Lending Program

The iteration of FedAccounts proposed by Professors Crawford, Menand, and Ricks does not function as a lending program. The authors readily acknowledge the limitations of their proposed program's ability to ameliorate the consumer liquidity crisis, noting that "FedAccount, in and of itself, admittedly is not a robust response to these household credit needs."[149] The authors' solution to payday lending is instead an integrated system of postal banking, whereby the FedAccount program could host the branch services of postal banking, but the small-dollar loans would be made through a service separate and apart from the central bank.[150] In sum, the authors envision

146. Rebeca Romero Rainey, *Postal Banking Should Be a Dead Letter*, AM. BANKER (May 7, 2018, 9:58 AM), https://www.americanbanker.com/opinion/postal-banking-should-be-a-dead-letter [https://perma.cc/8KWF-HEBT].

147. Crawford et al., *supra* note 134, at 123.

148. *See generally* Letter from Aaron Klein, *supra* note 106.

149. Crawford et al., *supra* note 134, at 159.

150. *Id.* at 158–59.

FedAccount not as a consumer lending program, but as operationally and "philosophically harmonious" with such initiatives.[151] The authors present a number of reasons for this separation of powers; this Note addresses their strongest points and other reasonable objections to the FedLoans program.

First, the authors note: "[We have] reservations about putting government agencies, whether the Fed or the postal service, in the small-dollar debt collection business. . . . [T]here are strong reasons for outsourcing individualized portfolio allocation decisions in lending markets to member banks."[152] The authors go on to argue that this outsourcing does not necessarily entail a loss of control and that the Federal Reserve could impose certain conditions on banks' membership in the FedAccount program, such as compliance with credit distribution requirements.[153]

Relying on commercial banks to provide small-dollar payday loans is technically feasible, but it does not guarantee that consumers will be protected from predatory lending. In fact, this arrangement has already been tested. Before OCC and FDIC regulations put a stop to the practice in 2013, certain banks did double-duty as payday lenders, albeit with more reliable methods of ensuring a return on their loans.[154] At the "peak" of the practice in 2013, six banks were making short-term loans with APRs between 225% and 300%.[155] Banks' methods of ensuring that loans were repaid mimicked payday lenders' approach to recouping their cash—the only difference was that the banks could intercept clients' wages before their paychecks hit their accounts.[156] When OCC and FDIC guidance limited the most predatory aspects of the practice in 2013, the banks abandoned their role as payday lenders.[157]

With the elimination of non-bank payday lenders, commercial banks would have to voluntarily fill the void. This presents numerous problems. First, issuing short-term loans to low-income customers is a high-risk, low-reward practice.[158] The reputational risks, fears of customer default, and limits on interest rates make commercial banks

151. *Id.* at 158.

152. *Id.* at 159–60.

153. *Id.* at 160.

154. Such banks included Wells Fargo, US Bank, Regions Bank, Fifth Third Bank, the Bank of Oklahoma, and Guaranty Bank. Rebecca Borné, *Been There; Done That: Banks Should Stay Out of Payday Lending*, CTR. FOR RESPONSIBLE LENDING 2 (July 2017), https://www.responsiblelending.org/sites/dfault/files/nodes/files/research-publication/crl-bank-payday-issue-jul2017.pdf [https://perma.cc/DY8T-MNQA].

155. *Id.* at 1.

156. *Id.*

157. *See id.*

158. *See* Sarah Connelly, *Why Don't Banks Offer Payday Loans?*, CASHFLOAT (Dec. 15, 2021), https://www.cashfloat.co.uk/blog/money-borrowing/banks-payday-loans/ [https://perma.cc/A23H-MPFK].

apprehensive to offer these services.[159] This is one reason why public banks are better equipped than private commercial banks to furnish short-term loans. Second, when commercial banks do choose to provide such loans, consumers with low or no credit scores are frequently deemed ineligible.[160] This is undesirable, as it is exactly these consumers who are most in need of the short-term loans.[161] Finally, this model is inefficient. Even assuming that commercial banks and credit unions do decide to issue short-term loans, the banks' financial products will need to be developed and then approved by the OCC, FDIC, and National Credit Union Administration (NCUA)[162]—and approval of such programs is just the beginning of the process. These programs would require continuous oversight to ensure banks are complying with the law and treating customers equitably. A better approach is to centralize the public lending process using the FedAccount model, with the Fed serving as the loan originator.

Critics may raise additional concerns with a program such as FedLoans. If the Fed lends directly to consumers, it must eventually collect on those loans. This raises the prospect of the Fed appearing in court to recoup outstanding principal and interest payments and being directly susceptible to a high rate of consumer default.[163] One may contend that this impermissibly broadens the mandate of the Fed and that it is precisely these commercial activities which are best left to private actors and the market.

These objections are well-noted and conform with the traditional conception of the Fed and its duties. However, recent practices underpinned by economic theory demonstrate that the Fed is gradually moving away from this conventional construction and embracing a new, consumer-oriented role within the U.S. economy. FedNow, in providing

159. *Id.*; *see also Standards Needed for Safe Small Installment Loans from Banks, Credit Unions*, PEW TRUSTS (Feb. 15, 2018), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2018/02/standards-needed-for-safe-small-installment-loans-from-banks-credit-unions [https://perma.cc/23BL-JZ5H]. *But see* Ann Carrns, *Banks Urged to Take on Payday Lenders with Small, Lower-Cost Loans*, N.Y. TIMES: YOUR MONEY (Feb. 16, 2018), https://www.nytimes.com/2018/02/16/your-money/banks-payday-loans.html [https://perma.cc/TY9E-546V].

160. *See Standards Needed for Safe Small Installment Loans from Banks, Credit Unions*, *supra* note 159.

161. Kirsten Wysen, *Why Credit Scores and Payday Lending Matter for Health*, OPEN SOURCE SOLS. (Oct. 2019), https://www.frbsf.org/community-development/files/credit-scores-payday-lending-matter-to-health.pdf [https://perma.cc/4CYN-VAWE].

162. *Standards Needed for Safe Small Installment Loans from Banks, Credit Unions*, *supra* note 159.

163. *See generally* Susanna Montezemolo & Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, CTR. FOR RESPONSIBLE LENDING (Mar. 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2605972. Montezemolo and Wolff explain that nearly half of payday loan borrowers default within two years. *Id.* While eliminating predatory usury rates may lower this figure, it is prudent to expect short-term lending to continue to create some level of litigation risk. *Id.*

consumers and businesses access to an instant payment infrastructure,[164] is one way that the Fed acts as an agent of monetary policy. Moreover, the 2020 pandemic has underscored the Fed's willingness to provide critical payments to U.S. households using appropriated federal funds.[165] Further, in a March 2020 emergency action, the Fed established a lending facility to "unclog" the short-term lending market: businesses were permitted to issue commercial paper—what some economists describe as an "IOU" to the Fed—to cover short-term commercial costs such as payroll.[166] These actions show the Fed's clear willingness to embrace a consumer-oriented role.

Further, some critics are also concerned that the FedLoans program will increase the national debt. When a nation's economy is performing well, so the argument goes, the government has a greater opportunity to "pay down the national debt, cut taxes, shore up entitlements or pursue new spending programs."[167] In contrast, national debt is frequently viewed as impeding economic growth and weakening the economy.[168] Proponents of this view might, in turn, position FedLoans as an expensive drain on government resources that heightens the risk of hyperinflation.

However, apprehension concerning FedLoans' contribution to the national debt is misplaced, as this Note demonstrates in theory and practice. First, as posited by Modern Monetary Theory (MMT), increased government debt from the FedLoans program will not cause the economy to collapse, as some critics fear.[169] MMT instead positions national debt merely as "money the government put into the economy

164. Lael Brainard, Member, Bd. of Governors of the Fed. Rsrv. Sys., The Future of Retail Payments in the United States at the FedNow Service Webinar, Washington D.C. (Aug. 6, 2020), https://www.bis.org/review/r200807a.pdf [https://perma.cc/M5FA-2MQ4].

165. *See id.*; Andrew T. Budreika, Julia Frost-Davies & Ian M. Wenniger, *CARES Act and Federal Reserve Offer Economic Assistance to Stabilize US Economy*, MORGAN LEWIS: LAWFLASH (July 29, 2020), https://www.morganlewis.com/pubs/2020/07/cares-act-and-federal-reserve-offer-economic-assistance-to-stabilize-us-economy-cv19-lf [https://perma.cc/75WJ-UELY].

166. Associated Press, *Fed Will Buy Short-Term Loans to Try to Ease Flow of Credit*, L.A. TIMES (Mar. 17, 2020, 9:28 AM), https://www.latimes.com/world-nation/story/2020-03-17/fed-will-buy-short-term-loans-to-try-to-ease-flow-of-credit [https://perma.cc/5SE2-PBN8].

167. Dylan Matthews, *Modern Monetary Theory Is an Unconventional Take on Economic Strategy*, WASH. POST (Feb. 28, 2012), https://www.washingtonpost.com/business/modern-monetary-theory-is-an-unconventional-take-on-economic-strategy/2012/02/15/gIQAR8uPMR_story.html.

168. Hans G. Despain, *Book Review: The Deficit Myth: Modern Monetary Theory and the Birth of the People's Economy by Stephanie Kelton*, LONDON SCH. ECON. (June 22, 2020), https://blogs.lse.ac.uk/lsereviewofbooks/2020/06/22/book-review-the-deficit-myth-modern-monetary-theory-and-the-birth-of-the-peoples-economy-by-stephanie-kelton/ [https://perma.cc/KWE5-YUTN].

169. *See The Fiscal & Economic Impact*, PETER G. PETERSON FOUND. https://www.pgpf.org/the-fiscal-and-economic-challenge/fiscal-and-economic-impact [https://perma.cc/CG36-3RQZ] (describing concerns about the negative impact of increased government debt). For an extensive discussion dispelling the myths surrounding the dangers of national deficits, see STEPHANIE KELTON, THE DEFICIT MYTH (2020).

and didn't tax back."[170] This comports with recent recession trends. For example, scholars such as Atif Mian and Amir Sufi have convincingly argued that the Great Recession was caused by the uneven accretion of household debt between 2000 and 2006.[171] When the housing bubble popped, the debt was disproportionately distributed to economically unstable communities which subsequently cut back on spending en masse.[172] Mian and Sufi posit that had the distribution of debt been allocated more evenly across the economy, the decrease in consumer spending and subsequent recession would have been less devastating.[173] They further argue that the government could end the boom-and-bust cycle by moving away from policies that encourage the accumulation of national consumer debt.[174] By providing consumers with the means to pay off their debts, the FedLoans program may not only end the cycle of consumer debt but also reduce the severity of recessions.

Second, recent experimentation with vast federal spending and lending programs should dispel concerns surrounding FedLoans' contributions to the national deficit. One need only turn to the federal programs created in response to the COVID-19 pandemic. The $2.2 trillion poured into the U.S. economy by such programs—including those that allowed for partially or fully forgivable loans[175]—did not instigate "runaway inflation," as some critics feared.[176] Instead, programs like the CARES Act have had an overwhelmingly positive impact on many aspects of the U.S. economy. For example, such programs have increased consumer spending for low-income families and in low-income neighborhoods;[177] helped increase GDP growth to 33.1% (in contrast to the Survey of Professional Forecasters' median prediction of 19.1% growth); limited unemployment rates and temporary layoffs; and helped keep

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170. Deborah D'Souza, *Modern Monetary Theory (MMT)*, INVESTOPEDIA (Feb. 23, 2021), https://www.investopedia.com/modern-monetary-theory-mmt-4588060 [https://perma.cc/FKH8-FRR8].

171. *See generally* ATIF MIAN & AMIR SUFI, HOUSE OF DEBT: HOW THEY (AND YOU) CAUSED THE GREAT RECESSION, AND HOW WE CAN PREVENT IT FROM HAPPENING AGAIN 84–88, 91–93 (2014).

172. *See generally id.*

173. *Id.* at 88; *see also* Heather Boushey, *It Wasn't Household Debt That Caused the Great Recession*, ATLANTIC (May 21, 2014), https://www.theatlantic.com/business/archive/2014/05/house-of-debt/371282/ [https://perma.cc/4NPY-NLTK].

174. MIAN & SUFI, *supra* note 171, at 85–93.

175. *See, e.g.*, *CARES Act Stimulus for Small Businesses*, THOMSON REUTERS (Aug. 10, 2020), https://www.thomsonreuters.com/en/resources/covid-19-small-business-resources/cares-act-stimulus-for-small-business.html [https://perma.cc/KN95-HWG9].

176. James K. Galbraith, *Who's Afraid of MMT?*, PROJECT SYNDICATE (Dec. 23, 2020), https://www.project-syndicate.org/commentary/why-central-bankers-fear-modern-monetary-theory-by-james-k-galbraith-2020-12 [https://perma.cc/XX5Z-9UA9].

177. Kenan Insight, *Who CARES? Assessing the Impact of the CARES Act*, KENAN INST. PRIVATE ENTERPRISE (July 15, 2020), https://kenaninstitute.unc.edu/kenan-insight/who-cares-assessing-the-impact-of-the-cares-act [perma.cc/8Z5S-6Db6].

commercial bankruptcy filings below pre-pandemic levels.[178] The achievements of the CARES Act prove what MMT posits: federal programs that contribute to national deficits are not intrinsically undesirable. Rather, such programs' contributions to economic stability and the national debt balance each other out. With the right programs, deficits, such as the potential deficit created by FedLoans, can be enormously helpful for both sustaining a national economy and improving the lives of those within it.

2. Features of the FedLoans Program

The implementation of a federal program for short-term loans from the Federal Reserve would be an enormously technical feat and require extensive economic analyses. These considerations are valid yet beyond the scope of this proposal. Instead, this Note lays the groundwork for such a program and identifies key features which will fill the gap created by the elimination of usurious payday loans. Three components characterize a successful program: real-time payments; an interest rate tied to the prime rate; and availability to all American residents, including non-citizens and undocumented immigrants.

The distribution of payments in real-time imitates one of the most attractive features of payday loans themselves. Whereas payday loans can be processed in thirty minutes or less, a personal loan can take days to process.[179] This is often too long for individuals who need to bridge a cash-flow shortage immediately or are otherwise living paycheck-to-paycheck.[180] Moreover, FedLoans should allow for fourteen-day principal rollovers (or taking out a new loan).[181] The CFPB's research suggests that loan renewal rates are markedly consistent across states, with consumers renewing eighty-two percent of payday loans within fourteen days.[182] To avoid rampant abuse, the Fed could follow the practice that many states have already adopted. This practice restricts loan rollover to a limited time period after procuring the first loan, reducing the possibility of vicious cyclical debt.[183]

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178. Michael R. Strain, *Washington's Stimulus Triumph Remains Underrated*, BLOOMBERG OP. (Nov. 24, 2020), https://www.washingtonpost.com/business/on-small-business/washingtons-stimulus-triumph-remains-underrated/2020/11/24/f138bac8-2e50-11eb-9dd6-2d0179981719_story.html [perma.cc/Q7FV-GLD4].

179. Zina Kumok, *Payday Loans vs. Personal Loans: What's the Difference?*, EARNEST (Mar. 31, 2020), https://www.earnest.com/blog/payday-loans-vs-personal-loans/ [https://perma.cc/59L3-EFWT].

180. *See generally* KATHLEEN BURKE, JONATHAN LANNING, JESSE LEARY & JIALAN WANG, CFPB OFF. OF RSCH., CFPB DATA POINT: PAYDAY LENDING (2014), https://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf [https://perma.cc/G2U7-HP6X] [hereinafter CFPB DATA POINT].

181. *See id.*

182. *See id.* at 9.

183. *See id.* at 7.

The second key feature of the proposed FedLoans program is a competitive interest rate tied to the prime rate, the index used to determine interest rates for consumer loans.[184] Restricting interest rates on FedLoans would ensure that consumers do not pay more in fees than they receive in principal. Research shows that consumers' payday loan sequences progressively increase in dollar amount, in part to cover the predatory interest rates associated with payday loans.[185] Each renewal incurs higher fees.[186] Maintaining a competitive interest rate tied to the prime rate not only eases dependence on payday loans, but also guarantees that consumers are getting a fair rate that corresponds with economic conditions.[187] For example, because the federal rate fluctuates based on the economy, low-income individuals who are likely to be hit hardest during recessions—such as the economic downturn caused by the COVID-19 pandemic—will be able to receive fast, low-interest loans when they need them most. A 2015 study by the Federal Reserve exploring how it might provide fixed rate loans indicates that most of the costs associated with financing small personal loans are fixed.[188] The study concludes that private payday loan companies may charge high interest rates "to provide sufficient revenue to cover the costs of providing such loans."[189] Because the Fed already absorbs the overhead costs of financing loans and subsequent charges are "not sensitive to loan amount,"[190] the Fed has little incentive to set high interest rates. Finally, tying the interest rate to the prime rate could eliminate what is left of the "loan shark problem."[191] If the Fed sets a competitive interest rate that is rarely available to payday loans users, the high demand will preempt reliance on high-interest commercial lenders.

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184. For a detailed explanation of the prime rate, see James Chen, *Prime Rate*, INVESTOPEDIA (June 30, 2020), https://www.investopedia.com/terms/p/primerate.asp [perma.cc/62ZY-3E98] ("The prime rate is the interest rate that commercial banks charge their most creditworthy corporate customers. The federal funds overnight rate serves as the basis for the prime rate, and prime serves as the starting point for most other interest rates.").

185. *See* CFPB DATA POINT, *supra* note 180, at 16.

186. *Payday Loans, Auto Title Loans, and High-Cost Installment Loans: Highlights from CFPB Research*, CONSUMER FIN. PROT. BUREAU (June 2, 2016), https://files.consumerfinance.gov/f/documents/Payday_Loans_Highlights_From_CFPB_Research.pdf [https://perma.cc/MK5E-3YNR].

187. Alexandria White, *How the Prime Rate Works and How It Affects You*, CNBC (Sept. 30, 2021), https://www.cnbc.com/select/prime-interest-rates/ [https://perma.cc/E9VU-N22E].

188. *See* Lisa Chen & Gregory Elliehausen, *The Cost Structure of Consumer Finance Companies and Its Implications for Interest Rates: Evidence from the Federal Reserve Board's 2015 Survey of Finance Companies*, BD. OF GOVERNORS OF FED. RSRV. (Aug. 12, 2020), https://www.federalreserve.gov/econres/notes/feds-notes/the-cost-structure-of-consumer-finance-companies-and-its-implications-for-interest-rates-20200812.htm [https://perma.cc/U8WM-2MGY].

189. *Id.*

190. *Id.*

191. *See id.*

The final key component of the proposed FedLoans program is widespread availability. Undocumented immigrants are frequently targeted by payday lenders and often rely on alternative financing.[192] Like the typical payday loan customer, undocumented immigrants are, on average, employed but have low to moderate incomes.[193] Further, undocumented immigrants are unlikely to seek legal protection for fear of deportation.[194] These factors combine to make undocumented immigrants attractive customers for payday lenders. Cities across the United States have recognized this problem and created "alternative ID" for non-U.S. citizens and undocumented immigrants to facilitate their participation in the traditional financial sector.[195] Although such programs have achieved measurable levels of success, they have yet to be implemented nationwide. Enabling widespread access to FedLoans could balance non-U.S. citizens' need for financial security with the Fed's interest in certifying consumers' identification. Perhaps most importantly, a FedLoans program could help the United States' most financially underserved population overcome financial impediments to their full participation in society.[196]

CONCLUSION

Payday loans provide important access to short-term credit that is otherwise unavailable to under- and unbanked consumers. The widespread use of payday loans suggests that there is demand for the product, or for a similar product in the market. In fact, payday loans are often less expensive than alternatives such as pawn shops or bank overdraft fees. However, the current structure of payday loans is indefensible. Borrowers often find themselves unable to meet basic monthly expenses while simultaneously paying off the principal and interest of the loan. This imbalance between assets and liabilities generates a brutal cycle, as consumers repeatedly borrow at extraordinarily high interest rates to make ends meet.

In an attempt to retain the benefits of short-term credit while minimizing the damage caused by usurious interest rates and other harmful practices of the payday loan industry, the CFPB proffered the

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192. *See generally* Katherine Houren, *Achieving the American Dream in Debt? Why the USA Patriot Act Puts Undocumented Immigrants at Risk for Abuse by the Payday Loan Industry*, 15 WASH. & LEE J. CIV. RTS. & SOC. JUST. 561 (2009).

193. *Id.* at 572.

194. *Id.* at 573.

195. *Municipal ID Cards Help Undocumented Residents, Boost Local Economies,* POLICYLINK, https://www.policylink.org/blog/municipal-id-cards [https://perma.cc/2KK6-ST47].

196. *See* Nathalie Martin, *Giving Credit Where Credit Is Due: What We Can Learn from the Banking and Credit Habits of Undocumented Immigrants*, 2015 MICH. STATE L. REV. 989 (2015).

2017 Rule. This Rule aimed to prevent creditors from lending to consumers who could not afford to repay the loan and to limit lenders' ability to make repeated attempts to withdraw repayment from borrowers' accounts. As discussed throughout this Note, the 2017 Rule has barely survived an onslaught of attacks, with the remaining Payments Provisions currently under scrutiny in the Fifth Circuit.

Ordinarily, the CFPB's failure would leave regulation up to each individual state. But recent developments in court and at federal agencies may make states unable to effectively regulate payday loans. Unsupervised and unconstrained payday lenders may represent the worst possible outcome for consumers. To compete in the short-term credit market, payday lenders need only be the best of bad options for consumers; as long as payday loans continue to dominate the alternatives in the short-term lending market, the market is unlikely to yield favorable outcomes for underbanked consumers.

The federal government must act both to prevent harm to existing consumers and to proactively protect consumer access to short-term credit. First, Congress should enact a federal usury rate for payday loans. Second, to avoid a gap in services, the Federal Reserve should use the layered technology of FedNow and FedAccounts to offer real-time, low-interest, short-term loans directly to consumers.

Preserving access to short-term credit is vital to moving individuals who historically have been excluded from traditional banking services toward financial inclusion. Our proposal not only facilitates access to short-term credit but improves the status quo. By treating payday loans as a public service provided by the Federal Reserve, all U.S. residents will be able to access real-time payments to help make ends meet, without the fear of exploitative interest rates or harmful practices. In turn, a short-term credit option at the federal level may work to break the vicious cycle of debt that many underbanked consumers currently face. In an environment where federal attempts fail and state regulations are in danger, harm prevention is not enough. We must capitalize on every tool possible to reduce consumer debt.