

CAN VOLUNTARY PRICE DISCLOSURES FIX THE PAYDAY LENDING MARKET?

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I. Introduction

Eric J. Chang’s provocative article, *www.PayDayLoans.gov: A Solution for Restoring Price-Competition to Short-Term Credit Loans*, offers a simple, market-based solution to the fundamental problem in payday lending markets—high prices.¹ Chang’s core contribution in the article is to propose “creating a federally operated online exchange (Exchange) for payday lenders to post their rates and for borrowers to apply and receive payday loans.”² There is a lot to commend in his approach: it is low-cost, does not infringe on borrowers’ or lenders’ liberties, probably will not constrict small-dollar credit markets, and, perhaps most importantly, tackles the perennial problem of price competition in payday lending markets.

Texas provides evidence that Chang’s approach could be effective. Texas law requires lenders to post pricing information on their websites.³ Unlike other states, where payday loan prices aggregate near the highest legally permissible rate,⁴ Texas appears to

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¹ Eric J. Chang, *www.PayDayLoans.gov: A Solution for Restoring Price-Competition to Short-Term Credit Loans*, HARV. BUS. L. REV. ONLINE, <http://www.hblr.org/2015/12/www-paydayloans-gov-a-solution-for-restoring-price-competition-to-short-term-credit-loans/>; see Jim Hawkins, *Credit on Wheels: The Law and Business of Auto-Title Lending*, 69 WASH. & LEE L. REV. 535, 592 (2012) (arguing that “price is a powerful justification for banning title lending”).

² Chang, *supra* note 1, at 11.

³ Tex. Fin. Code § 393.222(a)(1)–(3) (2015).

⁴ SHEILA BAIR, UNIV. OF MASS. AT AMHERST, ISENBERG SCH. OF MGMT., LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES 29 (2005), <https://folio.iupui.edu/bitstream/handle/10244/101/FEs3622H334.pdf> (“The vendors we studied charged the maximum allowed in states where the product is permitted.”).

have significant price differentiation.⁵ If the federal government could establish a successful Exchange, Texas offers hope that disclosures could generate price competition.

This Response, however, offers some evidence from recent empirical research to suggest that an Exchange is unlikely to succeed in facilitating price competition. It also argues that lenders are unlikely to voluntarily participate in the Exchange and, even if they did, many borrowers are unlikely to use the Exchange.

II. It is Unlikely Payday Lenders Will Voluntarily Participate in a Website Focused on Price Disclosure.

Chang suggests that the law should not coerce lenders into participating in the Exchange.⁶ Indeed, a primary selling point of his suggestion to lenders and taxpayers is that “the Exchange imposes neither new laws nor legal regulations on any party . . . and taxpayers will be minimally burdened.”⁷ Instead of being forced into disclosing prices on the Exchange, Chang predicts that “payday lenders will voluntarily register with the Exchange in order to reach these potential customers.”⁸

This prediction seems implausible for several reasons. First, payday lenders historically have not voluntarily produced price information for borrowers in other contexts. In the case of payday and title lending storefronts in Houston, Texas, for example, a recent study demonstrated that outdoor advertising contained information about a variety of things: the speed of getting the loan, the loan amounts, and the simplicity of the application process.⁹ Even 15.24% of storefronts claimed to have low loan prices.¹⁰ However, not a single storefront portrayed price information in its advertisements that complied with federal law.¹¹

⁵ After several hours looking for prices in Houston one day, I found rates ranging from a 271% annual percentage rate (APR) to a 1,151% APR. Jim Hawkins, *Are Bigger Companies Better for Low-Income Borrowers?: Evidence from Payday and Title Loan Advertisements*, 11 J.L. ECON. & POL'Y 303, 315 (2015).

⁶ Chang, *supra* note 1, at 14.

⁷ *Id.*

⁸ Chang, *supra* note 1, at 11.

⁹ In the fall of 2014, I gathered information about the advertising outside 189 payday and title lending storefronts in Houston, Texas. Jim Hawkins, *Using Advertisements to Diagnose Behavioral Market Failure in the Payday Lending Market*, 51 WAKE FOREST L. REV. (forthcoming 2016) (manuscript at 20) (on file with author). Six research assistants took pictures of all the signs on or around the storefronts between September 14 and October 30, 2014, and we categorized the content of the advertisements. *Id.* at 19–21.

¹⁰ *Id.* at 30.

¹¹ *See id.* at 34 (“6.71% (n=11) of the storefronts we visited stated the price of the loan, and this

Payday lenders have also failed to comply with laws requiring posting price information on the Internet.¹² Texas law mandates that lenders post certain information on their website, including fees, contact information for the state agency that regulates payday loans, and a notice that the loans are intended to be short-term.¹³ Out of a sampling of 30 payday lending websites as of the fall of 2014, only 70% contained information about the regulator, 73.3% provided notice that the loans were short-term, and 80% had the required price information.¹⁴ The regulations implementing the law also require that the pricing information be displayed “immediately upon the consumer’s arrival at the credit access business’s website that includes information about a payday or auto title loan.”¹⁵ Shockingly, only 30% of the payday lending websites followed this rule.¹⁶ Thus, even when compelled by law to disclose price information, many payday lenders failed to do so, making the prospects of voluntary disclosure bleak.

Second, it seems unlikely payday lenders will voluntarily post pricing information because, as Chang recognizes,¹⁷ lenders do not think the Truth in Lending Act’s (TILA) APR disclosures fairly communicate price information for payday loans.¹⁸ Borrowers do not borrow money using payday loans for an entire year, even considering rollovers, so lenders understandably dislike using APRs as the baseline to measure the price of these loans.¹⁹ Because a federal website would require disclosures that comply with TILA, payday lenders would have to consciously choose to use what they consider to be a misleading measurement of price.²⁰ Given their failure to embrace this approach in other areas of business acquisition, it is hard to see them coming to the Exchange to do so.

That said, this problem seems easy enough to solve. The Consumer Financial Pro-

number includes 2 storefronts of a company that advertised ‘0% interest loans on select products,’ although this advertisement most likely is just a teaser rate. The remaining 9 storefronts were all with the same company, and the advertisement of the price stated an inaccurate price in large font with the correct price in extremely small font.”). Under the Truth in Lending Act, if a lender states the price of a loan in an advertisement, the lender must state the price in terms of an annual percentage rate. 15 U.S.C. § 1664(d) (2012) (requiring that, in any advertisement stating “the dollar amount of any finance charge,” the rate of the charge be “expressed as an annual percentage rate”).

¹² Hawkins, *supra* note 5, at 311.

¹³ Tex. Fin. Code § 393.222(a)(1)–(3) (2015).

¹⁴ Hawkins, *supra* note 5, at 311.

¹⁵ 7 Tex. Admin. Code § 83.6007(f) (2016).

¹⁶ Hawkins, *supra* note 5, at 311.

¹⁷ Chang, *supra* note 1, at 5 n.29.

¹⁸ Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. Rev. 855, 903–04 (2007).

¹⁹ *Id.*

²⁰ Because consumers think of these loans in terms of fees and not interest rates, laws should require lenders to advertise using dollar amounts, not APRs. *Id.*

tection Bureau (CFPB) could implement rules that make posting prices on the Exchange obligatory in order to obtain the price comparison benefits that Chang seeks. While some lenders likely would violate the law as they do in Texas, more would comply with a mandated disclosure regime than a voluntary one, especially if the consequences of noncompliance were substantial. Implementing the Exchange by force does undermine some of the benefits of Chang's proposal, but given lenders' aversion to coughing up price information voluntarily, it seems essential.

III. Many Borrowers Will Not Use a Web-Based Exchange.

In order to have any substantial positive effect, the Exchange would have to attract a significant portion of the overall payday lending market. A web-based platform, however, would be useless for all the consumers who access payday loans at storefronts. Only around one-third of payday loans are conducted purely online; the rest involve physical trips to storefronts.²¹ Thus, at best, Chang's proposal would enhance price competition for only this third of the market.

Chang anticipates this objection and argues that lenders will have to lower their rates to attract an informed minority of borrowers, so all payday lending customers will benefit.²² The problem, however, is that lenders could adapt by offering one price online and another price in the storefront.

If a substantial number of borrowers are still obtaining loans in person, lenders will still have to incur all the costs of maintaining storefronts, despite the existence of the Exchange. These continued costs will limit the downward pressure on prices that Chang anticipates.²³

Slightly tweaking Chang's proposal might solve this problem. The CFPB could require lenders to post their prices prominently on the outside of their storefronts, much like how gas stations post pricing information in large numbers visible from the road.²⁴ This complementary solution could reinforce the Exchange's price competition goals, although lenders' operating costs would remain relatively high.

²¹ Pew Charitable Trusts, *Fraud and Abuse Online: Harmful Practices in Internet Payday Lending* 3 (2014), http://www.pewtrusts.org/~media/Assets/2014/10/Payday-Lending-Report/Fraud_and_Abuse_Online_Harmful_Practices_in_Internet_Payday_Lending.pdf.

²² Chang, *supra* note 1, at 14–15.

²³ See Chang, *supra* note 1, at 16 (“As borrowers begin to use the Exchange as the ‘one-stop destination’ for payday loans, lenders will face less incentive to continue spending money on advertisements or expensive leases at busy locations.”).

²⁴ Mann & Hawkins, *supra* note 18.

IV. Conclusion

The idea of using the payday lending market to fix the payday lending market is extremely attractive. The problem, however, is that lenders have demonstrated a reluctance to disclose accurate price information even when compelled by law. While skepticism of the efficacy of the CFPB's proposed regulations in this market should be maintained,²⁵ more is needed than a purely voluntary regime. If the CFPB mandated disclosures on an Exchange like the one Chang envisions and required lenders to display the same pricing information prominently on storefront signs, Chang's market-based solution could potentially improve price competition in the payday lending market. As it stands, however, it seems clear that fixing payday lending markets will take more than relying on voluntary price disclosures.

²⁵ See generally, Jim Hawkins, *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress*, 86 IND. L.J. 1361, 1368 (2011).