Texas's New Payday Lending Regulations: Effective Debiasing Entails More Than the Right Message

Michael A. Garemko III*

* J.D., University of Texas, 2012; Editor-in-Chief, Texas Journal on Civil Liberties & Civil Rights, 2011–12; B A./M.A., Emory University, 2003. The author thanks Angela Littwin, William Sage, Ann Baddour, and Don Baylor for their input and suggestions; and the editors and staff for their revisions.

I. INTRODUCTION

Like the proverbial tree falling in the woods, the message of a consumer disclosure must land close to a person to be heard. This Note evaluates recently-adopted Texas payday lending laws and their resulting regulations. It reaches two conclusions: (1) the statutes contained sufficient powers to enable regulators to provide consumers with important cautionary advice; and (2) the resulting regulations do not exercise those statutory powers effectively by failing to ensure that consumers actually hear the advice.

In 2011, the Texas legislature passed two bills seeking to regulate the practice of payday lending, H.B. 2592 and H.B. 2594,[1] both by Representative Vicki Truitt, Chair of the House Committee on Pensions, Investments, and Financial Services (PIFS). The statutory framework adopts both licensing and disclosure requirements, with delegations of rulemaking authority to the Finance Commission of Texas. The bills took effect on January 1, 2012, and a set of regulations has also been issued. This Note pays careful attention to the final language in the new laws

[1] *See* Act of May 23, 2011, 82d Leg., R.S., ch. 1301, 2011 Tex. Gen. Laws 3717 (codified at TEX. FIN. CODE ANN. §§ 393.221–.224 (West Supp. 2012)), *available at* http://www.capitol.state.tx.us/tlodocs/82R/billtext/html/HB02592F.htm; Act of May 23, 2011, 82d Leg., R.S., ch. 1302, 2011 Tex. Gen. Laws 3719 (codified as amendments to TEX. FIN CODE ANN. ch. 14 (West 1998), ch 393 (West 2006 & Supp. 2012)), *available at* http.//www.capitol.state.tx.us/tlodocs/82R/billtext/html/HB02594F.htm. *See also* 7 TEX. ADMIN. CODE §§ 83.1001–.5002 (2011), §§ 83 6001–.6008 (2012) (Fin. Comm'n of Tex., Rules for Credit Access Businesses) (regulations adopted under the authority of H.B. 2592 and H.B. 2594).

and argues that the laws gave the finance commission the power to create an innovative regulatory approach to payday lending. An innovative approach would have drawn upon recent experiences from other states in order to write rules aiming to help consumers make better choices when deciding whether to take out a payday loan. The Note concludes that the finance commission did not design such an innovative program. This Note's examination of the choices that could have been made in Texas may help consumer advocates develop effective strategies in other states.

Generally, a payday loan is a loan for a small amount of money, secured by the next paycheck (either through an actual post-dated check or a direct draw on the consumer's account). The term of the loan is typically for the amount of the anticipated paycheck due two weeks later. The loan has an interest rate and associated fees. Together, the fees and interest typically produce actual annual percentage rates (APRs) above 400%.[2]

The only way for a consumer to get out of paying the full amount (including all fees and interest) at the end of the loan is to renew the loan (sometimes called a rollover), which comes in the form of another two-week advance, usually under the same terms. A consumer who cannot repay the full amount essentially only has the option of fully paying off the loan or making an interest-only payment—there is no way to reach the principal by way of a partial payment.[3]

According to Karen Francis, "[p]ayday loans are generally short-term loans of small amounts offered at extremely high effective interest rates to consumers who have impaired credit histories."[4] Nathalie Martin has empirically found that the transaction can take many forms, and the industry is capable of innovating around formal definitions.[5] Despite the industry's potential for innovation to avoid regulation, Texas law defines a payday loan, or a "deferred presentment transaction," narrowly. A deferred presentment transaction has three components: (1) "a cash advance in whole or part is made in exchange for a personal check or authorization to debit a deposit account;" (2) "the amount of the check or

---

[2] Robert W. Snarr, *No Cash 'til Payday: The Payday Lending Industry*, COMPLIANCE CORNER: FED. RESERVE BANK OF PHILADELPHIA, First Quarter 2002, at CC1, *available at* http://www.philadelphiafed.org/bank-resources/publications/compliance-corner/2002/first-quarter/q1cc_02.pdf. The author's conversation with a Texas consumer advocate provides reason to believe that the average rates in Texas are considerably higher. *See* E-mail from Ann Baddour, Senior Policy Analyst, Texas Appleseed (May14, 2012, 10:15 CST) (on file with author) (concluding that "[i]n Texas common rates are more in the range of 500 to 700%, with 533% ($20 per $100 per 2 weeks plus the 10% annualized interest) [being] a common rate").

[3] *But see* E-mail from Ann Baddour, Senior Policy Analyst, Texas Appleseed (May14, 2012, 10:15 CST) (on file with author) (explaining that "[t]his practice appears to be changing—a number of companies now do accept partial principal payments. However, because of the high fees, most borrowers do not make much headway towards principal repayment unless they pay a significant amount of money over the fee payment amount, the equivalent.").

[4] Karen E. Francis, Note, *Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry*, 88 TEX. L. REV. 611, 611 (2010).

[5] *See* Nathalie Martin, *1000% Interest-Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 598–614 (2010).

authorized debit equals the amount of the advance plus a fee;" and (3) "the person making the advance agrees that the check will not be cashed or deposited or the authorized debit will not be made until a designated future date," usually two weeks from the date of the transaction.[6] Under the new law, the "definition does not preclude repayment in more than one installment."[7] The Note will show that the rigidity of Texas law can have negative consequences for consumers.

The payday loan industry grew rapidly during the 1990s, after the easing of state usury restrictions.[8] State usury laws were gradually weakened or abandoned after a 1978 Supreme Court decision allowed national banks to "import" high interest rates from states with no usury caps into states with caps.[9] After the industry's rapid growth, governments at the federal and state level have been pushed to reinstitute usury restrictions in the fringe lending context, particularly in payday loans.

Whether payday loans are net positive or negative in terms of consumer welfare is debated. Advocates defend payday loans as being better than the alternatives.[10] Low-income, cash-constrained people have a need for more money, but have limited access to traditional credit. Thus, the choice is not between payday lending and austerity, but between payday lending or bank overdraft fees, criminal loan sharks, pawning one's possessions, etc. Under this view, high interest rates are justified by the very high risk of default. In the end, the system is efficient because the loans are the optimal way to give this credit-constrained population the credit it demands.

Critics charge payday lenders with a number of predatory behaviors: exploiting consumer cognitive biases;[11] extracting high

---

[6] TEX. FIN. CODE ANN. § 341.001 (West 2006). This definition is incorporated by cross-reference in a provision of H.B. 2594 adding § 393.601 to the Finance Code. H.B. 2594 at § 2.

[7] *Id.*

[8] *See generally*, Snarr, *supra* note 2.

[9] *See* Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp. 439 U.S. 299 (1978).

[10] *See, e.g.*, DONALD P. MORGAN & MICHAEL R. STRAIN, FED. RES. BANK OF N.Y., STAFF REPORT NO. 309, PAYDAY HOLIDAY: HOW HOUSEHOLDS FARE AFTER PAYDAY CREDIT BANS (2007) (revised Feb. 2008), http://www.newyorkfed.org/research/staff_reports/sr309.pdf; Kelly D. Edmiston, *Could Restrictions of Payday Lending Hurt Consumers?*, Econ. Rev., First Quarter 2011, at 63, *available at* http://www.kansascityfed.org/publicat/econrev/pdf/11q1Edmiston.pdf. Some of these views can also be found among the proponents of regulation. *See, e.g.*, Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. Rev. 855 (2007).

[11] For example, payday lenders may withhold information about pricing until after a loan has been approved. In practice this means that employers have been alerted to the consumer's seeking of the payday loan. Since it would be embarrassing to have the employer contacted for verification a second or third time, consumers may not shop around when this practice occurs. In addition, required disclosures may be verbally downplayed, or withheld until after the loan has been signed. Examples include refusing to show the consumer a copy of the contract or disclose APR until the contract is signed. *See* Christopher Peterson, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 UTAH L. REV. 543, 573 (2001) (discussing Utah's payday lending and noting that 65% of Utah payday lenders engage in the practice of loan approval before discussing price).

payments from those in desperate circumstances;[12] and precipitating and encouraging a debt-trap whereby payday lenders do not assess a customer's ability to repay because it would be less profitable.[13] There are many more arguments on both sides of the debate, but these are enough to introduce some key issues.

Before moving to an in-depth discussion of the justifications for regulation, however, it is necessary to introduce three groups with an interest in payday lending regulation.

II. INTERESTED GROUPS

A. Consumers

There are three types of people who borrow in the consumer market: (1) those who borrow the optimal amount; (2) those who borrow too much; and (3) those who borrow too little.[14] The "right" amount is determined by an amount of borrowing that does not cause the borrower's life to "go significantly less well than [it] otherwise would."[15] Excessive borrowing (borrowing above the right amount) can have this effect by providing people with an ability to buy items that contribute little to their welfare, but saddle them with welfare-decreasing debt obligations.[16] Insufficient borrowing, perhaps as a result of a person being "unduly fearful of debt," can have a similar effect by preventing people from borrowing when it would benefit them.[17] Any regulation of payday lending must grapple with the fact that the interests of these three groups of consumers do not always align. A government action privileging one group over the other will need to be justified to be legitimate.

---

[12] *Id.*

[13] *See, e.g.*, LESLIE PARRISH & URIAH KING, CTR. FOR RESPONSIBLE LENDING, PHANTOM DEMAND: SHORT-TERM DUE DATE GENERATES NEED FOR REPEAT PAYDAY LOANS, ACCOUNTING FOR 76% OF TOTAL VOLUME (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

[14] Cass R. Sunstein, *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249, 249 (2006) [hereinafter Sunstein, *Boundedly Rational Borrowing*]. *See also* Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 200 (2006) (discussing "attempting to help people either to reduce or to eliminate" cognitive biases). Sunstein would evaluate the "too much" and "too little" amounts both from an ex ante and ex post perspective, meaning an examination both of what people might not know before going into a transaction and what benefits and detriments the transaction actually produces in terms of their overall wellbeing. Sunstein, *Boundedly Rational Borrowing*, *supra*, at 250.

[15] *Id.*

[16] *Id.*

[17] *Id.* This risk is real in the payday lending context, where it has been demonstrated that some people choose payday loans because they are actually afraid of credit card debt. *See* Martin, *supra* note 5, at 605–06.

Nathalie Martin recently surveyed payday borrowers in New Mexico and analyzed how they behave in payday loan transactions.[18] First, they frequently borrow, and the loans are not actually used short-term.[19] Second, payday loans are used for recurring, not emergency, expenses.[20] These two facts indicate that if consumers were aware that they could get a better deal with alternatives, they might take it because their need for credit is ongoing. Third, borrowers often choose payday loans because of location and convenience, not price.[21] Fourth, other credit options are available to nearly half of payday borrowers, but the ubiquity of stores makes it much easier to take out a payday loan.[22] Finally, borrowers do not generally shop around to compare prices of payday loans available to them.[23] Consumer cognitive biases, a different set of behaviors, will be addressed as a form of market failure below.

B. Payday Lenders

There are two key aspects of the behavior of payday lenders that are important for this discussion. First, payday lenders try to undermine a consumer's access to important information at the point of sale. Nathalie Martin found that borrowers often do not understand how the loan works, and therefore do not understand why they are paying so much.[24] Her survey indicated that common practice in the industry is to try to keep the details obscure, with some businesses even handing contracts to customers in sealed envelopes to discourage reading.[25]

Second, the payday loan industry seeks to evade regulations rather than submit to them. Martin's study showed that lending restrictions that targeted payday loans were avoided by slightly changing the transaction in order to avoid the reach of the statute.[26] Therefore, any consumer disclosure requirements that actually seek to have an impact on

---

[18] Martin, *supra* note 5, at 598–614.

[19] *Id.* at 598.

[20] *Id.* at 608. *See also* URIAH KING & LESLIE PARRISH, CENTER FOR RESPONSIBLE LENDING, PAYDAY LOANS, INC.: SHORT ON CREDIT, LONG ON DEBT (2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf (discussing how consumers typically use payday loans for long-term expenses).

[21] Martin, *supra* note 5, at 610–11. *See also* CENTER FOR RESPONSIBLE LENDING, PREDATORY PROFILING (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.html (discussing how payday lenders set up shop in minority communities).

[22] Martin, *supra* note 5, at 611–13.

[23] Martin suggests a federal rate cap based on the ineffectiveness of the language of many statutes. *See id.* at 619. This Note takes the Texas statutes as a given, examines the power of the agency to regulate in particular areas.

[24] *Id.*

[25] *Id.* at 599.

[26] *Id.* at 590.

consumers must deal in some way with the gatekeeper of that information—the payday lender himself.

C. Government Actors

With any government intervention, it is important to remember that two significant risks of error are present. First, government actors, like consumers, have cognitive biases that can cause them to make unwise policy choices.[27] In particular, government actors are often under the pressure of powerful interest groups, which can acutely cloud their judgment, especially in situations affecting powerful interests.[28] Second, government actors may have a difficult time distinguishing between the kinds of consumers outlined above, and may not be able to tell if people have a conscious "taste" for consumption at high interest, or are alternatively suffering from unconscious cognitive biases.[29]

Payday loans might be good for some, but not all, of the people who use them. Consumer protection groups are often behind the push for regulation, and payday lenders have bad reputations as predatory lenders. Because there are welfare and efficiency concerns on both sides of the question of whether regulating the industry is wise,[30] it is useful to have a brief overview of the justifications for regulating the payday lending industry. This Note does not seek to settle the debate. Rather, the Note evaluates the efficacy of the regulatory framework in light of the stated goals and the powers delegated to the agency.

III. JUSTIFICATIONS FOR REGULATION

A. Liberty

A central debate in considering payday lending restrictions is their impact on freedom. When the debate occurs at this level, it is perhaps at its most abstract because of its moral basis. It is common for the political faction aligned with the industry to invoke freedom and personal

---

[27] Sunstein, *Boundedly Rational Borrowing*, *supra* note 14, at 255.

[28] *Id.*

[29] *Id.* at 254–55. Sunstein also points out that individual choice is important to preserve. First, people who suffer harm from bad debt choices have an incentive to learn and improve behavior. Second, regulations with no opt-out can solidify some relationships that may be good for most, but not for all. Weaker forms of intervention can be "technology-forcing" and cause innovations that better serve consumers over time. *See id.* at 255.

[30] Edmiston, *supra* note 10.

responsibility in criticizing restrictions.[31] Industry supporters typically focus on the freedom of choice of consumers, rather than payday lenders' freedom to operate.[32]

Although freedom tends to be a pro-industry justification for maintaining the status quo in political debates, reform advocates argue that the status quo itself implicates liberty. For some commentators, the business practices of the industry are so injurious that they produce exploitation, leaving consumers worse off than before transacting, without any gain. Citing the demographic makeup of payday loan consumers as being credit-constrained and out of options,[33] Creola Johnson has argued that "[t]he demographic data . . . suggest why the principles of freedom of contract and free enterprise fail to empower these consumers in any meaningful way. The data demonstrate why a largely unregulated free market has led to what is best characterized . . . as economic *exploitation* rather than *efficiency*."[34] Because freedom of contract rests on notions of efficiency and mutual bargain, industry practices that harm a consumer's ability to make well-informed, reasonable financial decisions undermine the idea that an unregulated payday lending market is desirable on liberty grounds. They are neither efficient nor neutral.[35] Put another way, "freedom of contract shifts from a system to enhance consumer welfare, and social welfare more generally, to a tool used by more sophisticated parties to take consumers' money without giving value in return."[36] Thus, the level of harm the contract produces for the vulnerable borrower impacts the strength of the justification for leaving people free to enter into such a transaction in the first place. This argument has long roots; a version of it reaches back to traditional libertarian and religious principles, which helped justify traditional usury laws—removing lending at interest from the universe of legal contracts.[37]

---

[31] For example, one of the authors of a Georgia bill that would have rolled back a strong ban on payday lending, which had passed earlier in the decade, argued that citizens should practice personal responsibility and promote their own freedom. Christopher T. Conway & Nicola M. Pasquarelli, *Crimes and Offences*, 24 GA. ST. U. L. REV. 37, 43 (2007) (citing Video Recording of House Floor Debate, Mar. 20, 2007 at 3 hr., 27 min., 27 sec. (remarks by Rep. Earl Ehrhart (D-36th)) ("Representative Ehrhart, one of the authors of the bill, maintained that the representatives should 'trust the citizens of Georgia to promote their own freedom' by limiting the government and allowing Georgians to 'exercise their own personal responsibility.'").

[32] Richard J. Thomas, Note, *Rolling Over Borrowers: Preventing Excessive Refinancing and Other Necessary Changes in the Payday Loan Industry*, 48 WM. & MARY L. REV. 2401, 2424–25 (2007) ("At least one industry supporter has even gone so far as to allege that those seeking elimination of the industry 'are dictating which types of financial services we should use' and thus threaten the '[c]onsumer freedom [that] is the very core of American democracy.'").

[33] Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 102 (2002) ("Thus, the data demonstrate a lack of access to traditional credit and provide a rational explanation as to why these consumers resort to using extremely high-interest loans.").

[34] *Id.* at 98.

[35] *Id.* at 118.

[36] Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7 (2008).

[37] Christopher Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1117–22 (2008) (discussing

For other commentators, participation in the consumer credit market can implicate freedom even if a person does not begin transacting from a desperate position. Mechele Dickerson concludes that unregulated access to credit means that "financial freedom is vanishing and . . . giving people the power to go into debt gives them the illusion of freedom, but . . . the temporary illusion of financial freedom causes people to make unwise spending decisions that ultimately strip them of control over their finances."[38] In this formulation, the initial credit, not the borrower's initial position, causes the harm by creating a false feeling that exacerbates consumers' cognitive failures and ends up curtailing freedom.

In sum, the freedom debate is between the freedom of individuals (and enterprises) to contract in the service of their own perceived self-interests, and the prevention of malicious harm that both calls into question whether an individual's choice to transact is actually free in the first place and also whether the transaction eventually curtails individual freedom to an extreme degree. When the market fails to deliver value and leaves consumers worse off, it may be the result of a violation of freedom in the form of taking advantage of an unsophisticated party's desperate starting position, or from a foreseeable result of extending credit in an unregulated market.

B. Market Failure

1. No Price Competition; Collective Action Problems

Nathalie Martin explains the concept of a market failure, which occurs when a market fails to display the characteristics of competition:

> Perfect markets are competitive. In the perfect market, many sellers offer substantially identical products, so it is easy to shop around and compare costs. There are also many buyers. All actors in the perfect market act to maximize their own financial well-being. There are no barriers to entry into the market by new sellers, and both buyers and sellers are well-informed. In a perfect market, supply and demand for products will level out and the price of goods will stabilize. The absence of any of these attributes is known as market failure.[39]

---

early American views on usury and early incarnations of fringe credit).

[38] Mechele Dickerson, *Vanishing Financial Freedom*, 61 ALA. L. REV. 1079, 1080 (2010).

[39] Martin, *supra* note 5, at 614 (citations omitted).

Payday lending markets experience problems with at least three of these attributes, because (1) comparing costs is futile or difficult; (2) consumers may be making non-economic or irrational decisions that do not improve their financial well-being; and (3) consumers suffer from a lack of information at a number of points in the course of a transaction.

First, payday lenders generally compete on the basis of convenience, not price.[40] Prices of payday loans remain high no matter how many entrants into the market there are.[41] High prices alone do not signify market failure, but the lack of competition on price can show that price is either hard for consumers to ascertain or that there are collective action problems dis-incentivizing pro-consumer innovations.[42] In particular, because of the dire circumstances of most payday borrowers, consumers are not willing to go to multiple locations and shop around when time and money are tight.[43]

Second, collective action problems can prevent consumers from educating themselves about financial products, and can prevent creditors from offering safer products. Elizabeth Warren and Oren Bar-Gill have addressed these issues in the context of the credit card market.[44] Unlike, for example, car manufacturers, who may have an incentive to develop new safety features in order to attract more customers, there is little incentive among payday lenders to be the first to offer a product that is safer for consumers.[45] There is a free-loader problem that is especially

---

[40] Benjamin D. Faller, Note, *Payday Loan Solutions: Slaying the Hydra (And Keeping It Dead)*, 59 CASE W. RES. L. REV. 125, 139 (2008).

[41] *Id. See also* Martin, *supra* note 5, at 614 ("The payday lending and other short-term lending industries are classic failed markets. The industry is young, having developed primarily in the 1990s. Thus, price competition is not yet necessary to create a strong market share. Rather, most lenders charge similar amounts for the same loan, typically the largest amount permitted by law.").

[42] Michael Kenneth, *Payday Lending. Can 'Reputable' Banks End Cycles of Debt?*, 42 U.S.F. L. REV. 659, 689–690 (2008) ("Another basis for criticizing the industry is the utter lack of price competition among payday lenders. Those who urge greater regulation often cite to this as evidence of a basic market failure that demands legislation to protect the consumer. For example, after Colorado passed an industry-approved bill regulating payday loans, over 89% of payday loan lenders charged a finance fee of the exact maximum amount allowed under the law, and that percentage increased to almost 93% in two years. FDIC also conducted a nationwide survey that found that most payday lenders offered prices at or near the statutory limit."). *See also* Kelly Noyes, Comment, *Get Cash Until Payday! The Payday-Loan Problem in Wisconsin*, 2006 WIS. L. REV. 1627, 1662 (2006) ("Scholars argue that payday-loan legislation should limit interest rates because there is market failure in the payday-loan industry Many payday-loan consumers do not base their borrowing decisions on price. Consumers may not understand the true cost of the loans and may focus instead on the low monthly payments, speed, or convenience. Payday lenders principally compete based on location, speed, promotions or specials, and name recognition instead of price. Further, many lenders discourage price shopping by refusing to disclose the interest rate and other loan terms until after the consumer applies for the loan Because payday-loan consumers often do not have complete information, most cannot price shop and create price competition. Due to this market failure, increased competition between lenders has failed to lower payday-loan interest rates. Studies show that, despite industry growth, payday-loan prices have increased or remained the same, and, in states with interest-rate limits, rates cluster around the highest legal interest rate. Therefore, interest-rate caps could correct this market failure.").

[43] Peterson, *supra* note 11, at 571–72.

[44] Bar-Gill & Warren, *supra* note 36, at 15–22.

[45] *Id.* at 18.

acute in financial products—they are easy to copy quickly.[46] Thus, the research that goes into developing consumer friendly market innovation is not rewarded with higher prices and more business.[47] On a related note, financial products can be difficult to explain.[48] If a company cannot adequately make the case that a product saves consumers money, then the resources expended on developing it go to waste.[49]

Finally, a collective action problem may explain why consumers are reluctant to press their rights in the context of consumer credit contracts. An individual loss is often quite small and not worth the hassle of filing a complaint or litigation.[50] When the whole consumer credit economy tends toward the same inaction, creditors are able to mistreat consumers continuously—little by little—while suffering few consequences.

2. *Information Problems*

There are two important kinds of information failures at work in the payday lending context: information asymmetry and consumer cognitive errors. Ronald Mann and Jim Hawkins observe that no rational consumer would pay 400% interest and have a loan outstanding for weeks or a year, and thus concludes that the market taxes cognitive failures.[51]

Information asymmetry in the payday loan market stems from a highly sophisticated industry, which knows its customers well, interacting with a customer base that is not nearly as sophisticated. As some commentators have shown, numbers can be highly deceiving in the financial context. Christopher Peterson studied usury statutes in the states and found that high numbers were routinely expressed in a way to make them appear low. For instance, an interest rate cap that bans payday loan prices in excess of $10 per $100 is not a prohibition on interest rates exceeding 10%; it is actually a cap allowing APRs of a few-hundred percent.

Information asymmetry combines with the desperate circumstances of some consumers to cause rational breakdowns which can alter a consumer's priorities.[52] Even though a mother may know a payday loan is ultimately a bad deal, she may feel forced to take one out in order to ensure that her children eat. In such a circumstance, rationality gives way to what may be "altruistic or other non-economic decision making

---

[46] *Id.* at 19.
[47] *Id.*
[48] *Id.* at 19–20.
[49] *Id.*
[50] *See id.* at 21–22.
[51] Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 884 (2007).
[52] Peterson, *supra* note 11, at 573.

procedures."[53]

Consumers in Nathalie Martin's surveys did not have a handle on basic information, or could not effectively process it when it was available. Overall, borrowers do not know what APR describes, nor can they accurately predict the total cost of their loans.[54] Borrowers are not able to compare the cost of alternatives; specifically, they do not understand how the costs of payday loans and credit cards compare.[55]

Consumers also suffer from cognitive biases. Cass Sunstein outlines five general cognitive problems that consumer borrowers face when deciding to borrow money.[56] Because Sunstein discusses these biases in the credit card context, the Note draws distinctions between that market and the payday loan market where necessary.

The first cognitive problem is unrealistic optimism, or the consumer's belief in his ability to pay back the debt, even if it is unlikely.[57] This bias, at work when young smokers assume they will not be smoking in a few years, can be present when consumers incur large expenditures.[58] In the payday loan context, this bias is probably present when consumers who are short of cash today think they will be able to pay back the full amount of a loan plus a high rate of interest in only a couple of weeks. Consumers who make this assumption are not always wrong, but many are.

The second problem is myopia, or the failure of self-control, which is often operative if a consumer makes short-term choices that cause long-term harm.[59] This kind of behavior can be a rational matter of taste (for example, someone who prefers to live in the moment might choose to behave in this way). When "a day's welfare produces long-term distress," however, Sunstein says excessive borrowing is the result of similar psychological mechanisms as those that contribute to excessive smoking and drinking.[60] In the payday loan context, this behavior is not always present. Some people may use payday loans to consume, some may use them for emergency expenses, and still others may use them for recurring expenses. When used for consumption and for recurring expenses, however, this bias is likely at work.

The third problem is "miswanting," which is when people want things that are not good for them and do not want things that are good for them.[61] Consumers are often in competition with each other to "keep up

---

[53] *Id.*

[54] Martin, *supra* note 5, at 598–605.

[55] *Id.* at 605–08.

[56] Sunstein, *Boundedly Rational Borrowing*, *supra* note 14, at 251–53.

[57] *Id.* at 252.

[58] *Id.*

[59] *Id.*

[60] *Id.* at 252.

[61] Sunstein, *Boundedly Rational Borrowing*, *supra* note 14, at 253.

with the Joneses."[62] This competition does not help consumers as a group, so if easy borrowing contributes to its acceleration, it can "produce a great deal of harm" in the form of debt obligations without producing much value for consumers.[63] In the payday loan context, miswanting may be keeping consumers from shopping around based on price, asking relatives for money, or reducing other consumption, which are all usually less costly than payday loans.

The fourth problem is "cumulative cost neglect," or a tendency to treat with less caution small costs that add up over time than if the same effect occurred as a single, one-time cost.[64] For example, people are more cautious about borrowing $20,000 at a high rate of interest, but less so about borrowing small amounts at a time that end up creating the same effect.[65] In credit card transactions, swiping the card multiple times per day likely implicates this problem. It may be at work in the payday lending market as well because the loans are advertised as short-term loans, so a high yearly interest rate may not be in the consumer's mind as the actual interest rate. But, even with rollovers of payday loans, the consumer's decision to incur more debt likely occurs more infrequently than for credit cards.

The fifth problem is procrastination, which can cause the accumulation of late fees and charges.[66] It is less likely that this consumer behavior is a problem with respect to payday loans. Procrastination will generally not cause late fees, but a full-on default leading to seizure of the full principal. If consumers are putting anything off, it is this result. Consumers generally rollover the loan before it is due in order to avoid paying, a practice that has been called the cycle of debt.

Finally, information problems are exacerbated in the payday lending context due to the industry practice of marketing to consumers in a way that triggers these and other cognitive impairments. Some commentators have discussed practices that increase "shopping costs" for consumers who otherwise might be willing to shop around based on price. In particular, payday lenders may withhold information about pricing until after a loan has been approved. Because loan approval processes often entail employment verification, in practice this means that employers have been alerted to the consumer's seeking of the payday loan. Because it can be embarrassing to have the employer contacted for verification a second or third time, consumers may not shop around when this practice occurs.[67] In addition, required disclosures may be verbally downplayed or withheld until after the loan has been

---

[62] *Id.*

[63] *Id.*

[64] *Id.* at 251.

[65] *Id.*

[66] Sunstein, *Boundedly Rational Borrowing*, *supra* note 14, at 251–52.

[67] Peterson, *supra* note 11, at 573 (discussing Utah and noting that 65% of Utah payday lenders engage in this practice).

signed. An example is a payday lender refusing to show a copy of the contract or disclose the APR until the contract is signed.[68]

3. *Externalities*

When consumers become extended beyond their means, it harms not only the lender, but others who are outside the transaction. This is the problem of externalities. As commentators have pointed out, consumers who have debt problems also often have family members who are harmed by the consequences of their loan transactions, for example children and spouses.[69]

An additional external cost may be carried by a consumer's lower-interest creditors.[70] Because a credit-constrained consumer has a limited paycheck, a substantial portion of it may end up going to pay the high-interest creditor first.[71] This decreases the potential that the lower-risk creditors will be paid and puts economic pressure on the providers of lower-risk credit.[72] This might have the effect of constraining credit further throughout the consumer economy.[73] At least one commentator has pointed out that the external costs alone justify intervening in the consumer credit market in light of the low value that emergency credit provides to consumers, citing increased bankruptcies, court costs, strains on welfare programs, and low consumer savings.[74]

IV. WHAT A DEBIASING DISCLOSURE MESSAGE SHOULD AIM TO DO

Now that the actors have been introduced, and the justifications for regulation described, the Note introduces Sunstein's regulatory framework. The framework helps to situate evaluations this Note makes about the specific Texas rules at issue. Sunstein has described the basic methods of regulating the consumer credit market in an article about excessive borrowing with credit cards.[75] The credit card market is

---

[68] Johnson, *supra* note 33, at 32.

[69] *Id.* at 571–72. *See also* Bar-Gill & Warren, *supra* note 36, at 59–62.

[70] Diane Hellwig, Note, *Exposing the Loansharks in Sheep's Clothing: Why Re-regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567, 1578 (2005). *See also* Bar-Gill & Warren, *supra* note 36, at 63.

[71] Hellwig, *supra* note 70, at 1578.

[72] *Id.*

[73] *See id.* at 1578–80.

[74] *Id.* at 1567, 1578–80 ("This Note argues that the protection of society from these externalities justifies government intervention, even in the rare case where consumers understand the full implications of their decisions.").

[75] *See* Sunstein, *Boundedly Rational Borrowing*, *supra* note 14. *See also* Christine Jolls & Cass R.

distinct from the payday loan market, but Sunstein's discussion of the motivations of borrowing behavior; the effects of borrowing behavior; and the appropriate categories of legal responses is useful for evaluating what Texas has done.[76] Understanding the framework does not alone reveal the proper legal responses to choose (if any) from the framework. Empirical findings are necessary to make those evaluations in full. But understanding the framework can help a commentator understand whether a particular legal regime should be considered adequate to advance the policy goal it adopts.

Regulations can be strongly or weakly paternalistic.[77] Strongly paternalistic regulations remove some contracts from the realm of possible agreements on the grounds that they "produce little short-term gain but significant long-term harm."[78] If the aggregate benefits of banning the contract exceed the aggregate harms, then the ban is justified.[79] In the consumer credit context, industry practices that seek to exploit the natural cognitive limitations of the target audience, which can inflict great injury on consumers, could be candidates for these types of strongly paternalistic regulations.[80] This Note will not go into more detail on strongly paternalistic regulations, however, because Texas has not chosen to adopt that type of scheme.[81]

Weakly paternalistic regulations, on the other hand, preserve consumer choice while also leading people to choose welfare-enhancing options.[82] Sunstein identifies three types of weakly paternalistic regulations. The first, asymmetrical paternalism, inflicts a small harm on rational consumers, but greatly helps irrational consumers.[83] An example is a "cooling off" period before marriage: people who have thought it out will not be bothered much by a waiting period, but those who have not thought it out may be given the proper time to reconsider.[84] The second

---

Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 200 (2006) (discussing "attempting to help people either to reduce or to eliminate" cognitive biases).

[76] *See* Sunstein, *Boundedly Rational Borrowing*, *supra* note 14, at 250 (discussing the aim of the article as "to provide a kind of regulator's guide . . . a general outline of the reasons that boundedly rational borrowing might occur and the possible legal remedies. My hope is that the discussion will be applicable to a wide range of situations in which bounded rationality is a potential problem . . . . Evaluation of the relevant mechanisms and remedies would require detailed empirical investigation").

[77] Sunstein thinks some paternalism is inevitable because the status quo itself counts as a "default rule" that may or may not promote the interests of parties, but he allows that particular weakly paternalistic regulatory choices are not inevitable and must be justified with reference to empirical reality. *Id.* at 258–59.

[78] *Id.* at 267.

[79] *Id.*

[80] *Id.*

[81] But, information regulations do not exist in a vacuum. Action is necessary on the part of the government, industry, and consumer in order to ensure that a desired message is received by a consumer. Thus, there is a necessary element of government policing of behavior even in purely informational regulation.

[82] Sunstein, *Boundedly Rational Borrowing*, *supra* note 14, at 256.

[83] *Id.*

[84] *Id.*

type of weakly paternalistic regulations is libertarian paternalism, which sets default rules where the government wants consumer choice to be, but allows consumers to freely opt for a different path.[85] The example is automatic enrollment (with an option for opting out) in employee savings plans. People tend to stay in the plan, and savings rates improve.[86] Finally, government "debiasing" efforts are the weakest form of weakly paternalistic regulations.[87] Debiasing regulations counteract the effects of cognitive problems that some consumers face when deciding to make a purchase.[88] An example is anti-smoking warnings on packs of cigarettes.[89] Debiasing is persuasive information regulation.

By adopting a system of mandatory consumer disclosures, Texas has primarily opted for the debiasing strategy. The debiasing strategy, when properly employed, will persuade consumers to counteract their biases by prompting them to think more cautiously about the payday loan transaction. The Note now addresses what Texas has done; what Texas has not done; and what Texas should do. This discussion begins with how the payday lending industry and the law evolved in Texas.

V. EVOLUTION OF THE TEXAS PAYDAY LENDING INDUSTRY

A. Texas Authorizes Payday Lending Within Limits

Texas formally regulates payday lending,[90] but commentators have noted that Texas does not do so in a way that actually limits the industry's practices.[91] The "payday loan" was born rather recently as a

---

[85] *Id.*

[86] *Id.* at 256.

[87] See Sunstein, *Boundedly Rational Borrowing, supra* note 14, at 257–58.

[88] *Id.*

[89] *Id.* at 258, n.27.

[90] In 2000, the Texas finance commission issued regulations under their rulemaking authority. 25 Tex. Reg. 6316 (originally codified at TEX. ADMIN. CODE § 1.605) (June 30, 2000); JEAN ANN FOX, CONSUMER FED'N OF AM., UNSAFE AND UNSOUND· PAYDAY LENDERS HIDE BEHIND FDIC BANK CHARTERS TO PEDDLE USURY, 33 (2004), *available at* http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/pdlrentabankreport.pdf. The regulations first appeared as 7 TEX. ADMIN. CODE § 1.605 (2000). Through notice and comment in the *Texas Register*, the Texas finance commission moved those regulations to a new section, where it was updated in 2010. 31 Tex Reg. 6568 (August 25, 2006) (proposing repeal of the old section and soliciting public comment); 31 Tex. Reg. 8984 (November 3, 2006) (adopting the repeal of the old section); 31 Tex. Reg. 6578 (August 25, 2006) (proposing new section and clean up changes); 31 Tex. Reg. 8992 (November 3, 2006) (adopting the new section); 35 Tex. Reg. 9698 (October 29, 2010) (providing for online payday lending outlets).

[91] *See* Deena Reynolds, *A Look at Payday Loans & Current Regulation in Texas*, 8 TEX. TECH. ADMIN. L.J. 321 (2007). *See also* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 884 (2007); Benjamin D. Faller, Note, *Payday Loan Solutions: Slaying the Hydra (And Keeping It Dead)*, 59 CASE W. RES. L. REV. 125, 139 (2008).

new product of check-cashing businesses and pawnshops.[92] Texas first addressed the product when the finance commission promulgated rules in 2000.[93] The regulations are still in place,[94] but Texas payday lenders no longer operate in ways captured by the formal regulations.[95] The circumvention of this first attempt at regulation places the most recent legislation in context.

The regulation governs the transaction, the ongoing relationship with the customer, and disclosure requirements. As a threshold matter, the finance commission defines a "[p]ayday loan or deferred presentment transaction" narrowly to include three elements: "(i) a cash advance in whole or part is made in exchange for a personal check or authorization to debit a deposit account; (ii) the amount of the check or authorized debit equals the amount of the advance plus a fee; and (iii) the person making the advance agrees that the check will not be cashed or deposited or the authorized debit will not be made until a designated future date."[96] Limiting the definition to check transactions alone does not necessarily capture all that payday lending could entail, as Nathalie Martin has shown occurred in New Mexico.[97] It is conceivable that the second element could also be circumvented by simply requiring two payments. Yet, the law also instructs courts to look beyond the form of the transaction to consider substance.[98]

The regulation caps finance charges and prohibits the charging of additional fees, unless they are authorized in statute.[99] It provides consumers with a right to prepay the loan before the term ends, along with a right to a credit for any unused finance charge.[100] Finally, it provides a minimum term of seven days and requires deposit of the check after a maximum of thirty-one days.[101]

In regulating the ongoing relationship of the customer and lender, the rules allow rollovers of the loan without limiting the number of

---

[92] Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 975 (2008).

[93] Reynolds, *supra* note 91, at 329.

[94] 7 TEX. ADMIN. CODE § 83.604 (2006) (Fin. Comm'n of Tex., Rules for Regulated Lenders).

[95] *See, e.g.*, Lawrence Meyers, *Payday Lenders Strike Back*, THE MOTLEY FOOL (July 29, 2005) *available at* http://www.fool.com/investing/small-cap/2005/07/29/payday-lenders-strike-back.aspx (discussing the big payday companies' response to new FDIC rules limiting their ability to import interest rates from outside of Texas, namely, to register as CSOs and guarantee repayment of loans with a third party lender).

[96] 7 TEX. ADMIN. CODE § 83.604.

[97] Martin, *supra* note 5, at 578 n.78.

[98] *See* TEX. FIN. CODE ANN. §§ 342 007, 342.008 (West 2006) (authorizing the finance commission to make rules about deferred presentment transactions; and prohibiting attempted evasion "by use of any device, subterfuge, or pretense."). Note, § 342.008 could have provided the hook to rein in CSO/payday lending activities in Lovick v. Ritemoney, 378 F.3d 433 (5th Cir. 2004), *infra*.

[99] 7 TEX. ADMIN. CODE 83.604(b) (2012). *See also* TEX. FIN. CODE ANN. § 342.251–342.259 (West 2006) (setting maximum finance charges and restricting allowed fees).

[100] 7 TEX. ADMIN. CODE § 83.604(e)(4).

[101] *Id.* § 83.604(d), (e)(5).

rollovers.[102] But, a loan that rolls over cannot result in the lender making more money than what would have been earned if the original loan had simply been for a longer term.[103] Finally, the regulation specifies that a payday loan is a credit relationship and that the lender can pursue "all legally available civil means" to collect in the event of a default.[104] But, lenders must comply with Texas collection regulations.

As for disclosure requirements, the regulation requires the price term to be expressed as an annual percentage rate (APR) in addition to a sum of money.[105] It requires the lender to "provide a notice" that "reads" this way: "This cash advance is not intended to meet long-term financial needs. This loan should only be used to meet immediate short-term cash needs. Renewing the loan rather than paying the debt in full when due will require the payment of additional charges."[106] Additionally, the agreement must contain "notice" of the "name and address of the Office of Consumer Credit Commissioner and the telephone number of the consumer helpline."[107] The lender must "post a notice" of the allowed fee schedule.[108] Finally, the lender must make a "good faith" effort to determine whether a borrower has the ability to repay the loan on its terms.[109]

Added together, the limitations on charges are quite generous, allowing loans between $100 and $350 to incur interest that works out to approximately 309% APR for a two week period.[110] When federal regulations made it difficult to "import" interest rates, the payday loan industry searched for another way to structure their stores to evade the new regulations, and in the process evaded the state legal structure.[111]

B. The CSO Business Model Is Created

In 1987, the Texas legislature passed a credit services organization (CSO) statute. Many states and the federal government adopted CSO statutes in the late 1980s to combat deceptive practices in the debt repair industry. In particular, bad actors in these companies encouraged people to lie on their credit applications and to "borrow" other people's cleaner credit reports for a fee.

---

[102] *Id.* § 83.604(f)(1).
[103] *Id. See also*, Reynolds, *supra* note 91, at 330.
[104] 7 TEX. ADMIN. CODE § 83.604(f)(2).
[105] *Id.* § 83.604(e)(2)(D).
[106] *Id.* § 83.604(e)(3).
[107] *Id.*
[108] *Id.* § 83.604(e)(6).
[109] 7 TEX. ADMIN. CODE § 83.604(f)(3).
[110] *See* FOX, *supra* note 82, at 13.
[111] FED. DEPOSIT INS. CORP., DEP'T OF THE TREAS., FINANCIAL INSTITUTION LETTER FIL-14-2005, PAYDAY LENDING PROGRAMS REVISED EXAMINATION GUIDANCE (2005).

Under the Texas statute, a CSO includes a person that advises a consumer on how to get; assists a consumer in getting; or provides a consumer with an extension of consumer credit from a third party.[112] CSOs must file with the Secretary of State and post a $10,000 surety bond to be used to pay damages to the state or consumers in the event of a statutory violation. The statute allows civil and criminal penalties for a violation, including punitive damages. The statute includes a consumer right of rescission of a debt service contract within three days after signing.

There are a number of disclosure requirements in the statute that primarily relate to remedying the problem of dishonest debt repair. One of the required disclosures is a complete description of the services to be provided in exchange for the fees charged, but there is no limit to the amount of the fees.[113]

After 2005, when the FDIC cracked down[114] on a model of payday lending called "rent-a-bank," Texas payday lenders en masse began registering and operating as CSOs. The way this works in payday lending[115] is that the storefront sets up as a CSO, separate from a non-bank lender (the third party).[116] The CSO provides brokerage services and usually provides a letter of credit guaranteeing the payment of the customer's loan.[117] The lender lends the money to an approved consumer

---

[112] TEX. FIN. CODE ANN. § 393.001 (West 2006) (defining CSO as "a person who provides, or represents that the person can or will provide . . . [a] service[ ]obtaining an extension of consumer credit [by others] for a consumer"; or "provid[es] advice or assistance to a consumer" regarding such an extension by others).

[113] *See id.* at §393.105 (requiring a CSO to disclose the following to a consumer: "(1) a complete and detailed description of the services to be performed by the organization for the consumer and the total cost of those services; (2) an explanation of the consumer's right to proceed against the surety bond or account obtained under Section 393.302; (3) the name and address of the surety company that issued the surety bond or the name and address of the depository and the trustee and the account number of the surety account, as appropriate, (4) a complete and accurate statement of the consumer's right to review information on the consumer maintained in a file by a consumer reporting agency, as provided by the Fair Credit Reporting Act (15 U.S.C. Section 1681 et seq.); (5) a statement that information in the consumer's file is available for review: (A) without charge on request made to the consumer reporting agency not later than the 30th day after the date on which the agency receives notice the consumer has been denied credit; and (B) for a minimal charge at any other time; (6) a complete and accurate statement of the consumer's right to dispute directly with a consumer reporting agency the completeness or accuracy of an item contained in the consumer's file maintained by the agency; (7) a statement that accurate information cannot be permanently removed from the files of a consumer reporting agency; (8) a complete and accurate statement explaining: (A) when consumer information becomes obsolete; and (B) that a consumer reporting agency is prevented from issuing a report containing obsolete information; and (9) a complete and accurate statement of the availability of nonprofit credit counseling services").

[114] FED. DEPOSIT INS. CORP., *supra* note 111.

[115] A useful document for more information on the CSO model is a short memo written by a lawyer for the Payday Loan Bar Association. *See* Memorandum from J. Scott Sheehan, Greenberg and Taurig, to Payday Loan Bar Association, "Re: Payday Loan Bar Association – Update and Materials on CSO Model" (Nov. 13, 2006), http://pdlba.com/images/GT_--_Payday_Loan_Bar_--_Update_on_CSO_Model_11-13-06_.doc.

[116] *Id.* at 1.

[117] *Id*

at the default 10% usury cap rate.[118] But, the CSO runs up unregulated fees for the "services" it provides in helping the consumer get the loan.[119]

Regardless of one's opinion of the justifications for regulating the price of credit offered by payday lenders, it is important to recognize the operation of payday lenders as CSOs as the exploitation of a legal reality that allows the escape of targeted payday lending regulations. The industry has reacted similarly to regulations in other states. For example, the closing of a CSO loophole in Oklahoma led the payday lenders to seek their own law allowing the higher interest rates for payday loans. Michigan and New Mexico have also recently dealt with attempts by payday lenders to avoid narrowly-drafted regulatory caps.

In Texas, the prospect of operating without the regulation required under state law made the CSO statute a natural home for payday lenders. The practice was challenged and in a crucial respect upheld in a 2004 federal case (which was later endorsed by the Texas Attorney General), discussed next.

C. *Lovick v. Ritemoney, Ltd.* and Its Impacts

The question in *Lovick*[120] was whether the fees that payday lenders, acting as legal brokers, charged to the consumers should be considered interest for the purposes of usury law. The door was open in the *Lovick* case for the court to say that Texas law prohibits the CSO model as a pretextual attempt to evade the usury restrictions, but the court declined. Instead, it reasoned that the payday restrictions were restrictions on lending, whereas the legislature had intended brokers to be governed by the separate CSO statute. As a result, the third-party lenders, by complying with the caps were behaving appropriately, and the brokers, by being independent of the lenders were also acting appropriately, provided that the two were not sharing fees. The court also held that common law devices used to find violations of usury laws despite formal compliance had been superseded by the legislature's use of statutes to govern the relationship between brokers and lenders.

In response to the *Lovick* decision, the Texas Attorney General and state regulators clarified and accepted this interpretation of Texas law.[121] Reliance on this authority is sufficient under Texas law to shield a payday lender from liability; even if a court later rules that the *Lovick*

---

[118] *Id.*at 3.

[119] *Id.* at 6. *See also* Spector, *supra* note 92.

[120] Lovick v. Ritemoney, Ltd., 378 F.3d 433, 438–39 (5th Cir. 2004).

[121] *See* Ann Baddour, *Why Texas' Small-Dollar Lending Market Matters*, E-PERSPECTIVES, (Vol. 12, Issue 2, 2012), www.dallasfed.org/microsites/cd/epersp/2012/2-2cfm (citing unpublished Letter from Barry R. McBee, First Assistant Attorney General, Office of the Attorney General of Texas, to Leslie Pettijohn, Consumer Credit Comm'r, Jan 12, 2006).

interpretation was faulty.[122]

Whether or not a regulation is justified, the industry seeks ways to offer money to customers at unlimited rates and will seek loopholes to do so.

VI. LEGISLATION CONSIDERED OR PASSED IN 2011

The Note now discusses the legislative history of the bills that passed, and did not pass, in the 2011 legislative session. While a number of bills were filed to address the CSO model of payday lenders in Texas, there were only two competing approaches. The first approach, offered by Representatives Tom Craddick and Eddie Rodriguez and embodied in H.B. 410, would have overturned *Lovick*, and opened the door for an interest rate cap. Representative Vicki Truitt's approach was more permissive, and a version of it passed.

A. Craddick/Rodriguez Approach

H.B. 410 would have amended two sections of the Texas Finance Code: (1) Chapter 302, which sets a limit of ten percent for interest rates that are not specifically addressed in other statutes; and (2) Chapter 393, which is the credit service organization statute defining CSOs and governing their operations.[123]

H.B. 410's changes to Chapter 393 would have banned CSOs from providing consumers with credit or helping consumers get credit. The change to Chapter 302 would have added Section 302.003, a "prohibition on third-party fees to arrange or guarantee certain extensions of consumer credit." Under subsection (a), the extensions of consumer credit for which a third party could not get a fee for helping to arrange are those for which "the proceeds . . . are used for personal, family, or household purposes."[124] This change would have swept up most

[122] *About Attorney General Opinions*, TEX. STATE LIBRARY & ARCHIVES COMM'N, https://www.tsl.state.tx.us/ld/pubs/liblaws/aboutag html (last visited Aug. 16, 2012) ("Although the courts have generally ruled that opinions are 'advisory in nature,' persons who reasonably rely on Attorney General Opinions may be protected from civil and criminal liability, even if the Attorney General has erred in his interpretation. Conversely, the failure to follow the authoritative advice of the Attorney General may be evidence of a lack of good faith.").

[123] Tex. H.B. 410, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/ billtext/html/HB00410I.htm.

[124] *Id.* The only excluded category of credit is a purchase money security interest (PMSI) in personal property, which arises when the loan is for the purpose of purchasing the collateral used to secure the loan. An example of a PMSI is a car-buying transaction, where the consumer is lent the money to drive the car off the lot and must repay it in installments at interest.

practitioners of the CSO model. Because the CSO statute would no longer be a vehicle for assisting a consumer in getting consumer credit, the change to Section 302 would have been a broad change applicable to all arrangements where the person in the storefront is not the actual lender.

In addition to banning fees to third parties, subsection (b) would have also directed courts to apply the usury laws: "The amount of a fee contracted for, charged, or received in violation of Subsection (a) is considered interest for usury purposes under state law."[125] Thus, it would be a violation of the law to charge the fees, and a potential violation of usury laws if the fees brought a lender over the cap.

It appears that H.B. 410 would have gutted the *Lovick* holding in a number of ways. First, it probably rejected a line of reasoning in the case which argues that usury statutes supplanted common law doctrines that had managed the broker/lender relationship, because the statutes were passed after those doctrines were elucidated. The phrase "usury purposes under state law" is not restricted to statutory law, nor statutory actions, but all usury "purposes" under the law. Whether the argument would be successful in reviving any of the doctrines that *Lovick* said were overruled by implication,[126] the bill analysis for the senate version of H.B. 410, S.B. 251 authored by Royce West, names *Lovick* as the root of the loophole allowing the circumvention of usury laws.[127] The bill was meant to overrule the court, and this likely would have had the effect of broadening the usury statutes to once again include courts looking to the substance of transactions rather than the form.

Second, the bill would not have allowed a CSO to help a consumer obtain an extension of credit. Such a change would reject the line of reasoning in *Lovick* that the CSO statute was meant to govern brokers' fees by reuniting the analysis of fees with the other sections of the finance code that deal with lending. Under the bill, it would not have mattered how the broker is registered because the behavior affected would have been the charging of a fee.

Third, it impliedly rejected the reasoning in *Lovick* that the CSO statute and usury statute work in harmony for the purpose of determining whether fees are interest. Instead, the bill would have barred CSOs from engaging in the activity that the *Lovick* decision said they were designed for. H.B. 410 would have given Chapter 393 no role in a future usury analysis.

---

[125] *Id.*

[126] Lovick v. Ritemoney, Ltd., 378 F.3d 433, 442 (5th Cir. 2004) ("The codification of Texas usury law and the enactment of CSOA governing loan brokers as credit services organizations (CSOs) has overruled by implication those cases interpreting brokerage fees of the type alleged here as potentially usurious interest. Again, *Lovick* cites no post-enactment cases. In the light of Texas' more recent usury statutes and CSOA, the complaint fails to state a claim.").

[127] *See* S. Comm. on Bus. & Commerce, Bill Analysis, Tex. S.B. 251, 82d Leg., R.S., (2011) *available at* http://www.legis.state.tx.us/tlodocs/82R/analysis/html/SB00251I.htm.

Finally, the statute would have brought payday lenders back under the purview of the previous restrictions, outlined above, and the administrative control of the finance commission.[128]

H.B. 410 was referred to the House Committee on Pensions, Investments, and Financial Services (PIFS), but was left pending after a public hearing.[129] Representative Vicki Truitt, Chair of the PIFS Committee, carried more permissive bills on the subject, intent on striking the final deal.

B. Truitt Approach

The Truitt approach is the product of three bills. For the purpose of this Note, I understand the filing of the three bills together to mean that each of them is intended to pass and that, together, they make up the full policy. Legislative skepticism, however, would demand noticing that three separate bills were filed to address parts of the same problem. Three bills allows the possibility of strategic ordering of the voting process so that certain reforms pass while others do not. This possibility is especially present when the chair of the committee is authoring the bills.

1. H.B. 2593, the Rollover and Rate Regulation Bill

H.B. 2593 included Truitt's proposed limitations on loan amounts, fees, and renewals for payday loans and auto-title loans, but did not pass.[130] The bill would have amended the section of code governing deferred presentment transactions to add a new Section 342.607, Finance Code. The new section would have limited the amount that a lender could advance to either $2000 or "35 percent of the borrower's gross

---

[128] There would have been potential problems with the language in the amendment to Chapter 302. First, it leaves open the possibility that fees could be charged that are not "in connection" with the extension of consumer credit. Stronger language would have conveyed that it is not the *connection* with extending credit that the law should govern, but the conditioning of the credit upon the payment of a fee. It is possible to imagine that a new species of third party crops up that conditions access to loans on additional services that are formally unrelated to the credit. Second, because the bill seems to require the threshold finding of a "violation" of the fee restriction, the bill could conceivably make enforcement difficult. If courts fashion "in connection" exceptions, then the availability of the usury laws ceases. The bill could be broadened to say that the kinds of fees in subsection (a) are also included in any usury calculations.

[129] H.J. of Tex., 82d Leg., R.S. 400 (2011) (reading H.B. 410 first time before the house and referring H.B. 410 to PIFS Committee). *See* House Comm. on Pensions, Investments, and Financial Servs. Minutes, 82d Leg., R.S. (Mar. 22, 2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/minutes/html/C3952011032208001.htm.

[130] Tex. H.B. 2593, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02593I.htm.

monthly income," whichever measure is less. Under then-current law, this new section would have applied to the lenders, not the store-front "brokers."

If this provision had been adopted, it would have effectively set no limit on how much may be advanced, even though it posed as a limit. For example, a consumer who makes $24,000 each year, has a gross monthly income of $2000, thus the cap is set at a $700 advance. But it is unusual for payday loan principals to be so high.[131]

Next, in a new Section 342.608, the bill would have limited rollovers to three "consecutive reauthorizations," or "transaction[s] in which a borrower refinances or pays all or part of the finance charges and advance of a deferred presentment transaction with a new deferred presentment transaction." Under the regulation scheme set up before the shift to CSOs, the rollovers were unlimited, but capped at the value of the original advancement plus the interest rate, as if the original loan had been for the extended length of time. The result would be that the principle would finally be reached and the loan paid off. Even though Truitt's definition accurately described what a rollover is under current industry practice, the law would have been easy to evade by simply extending credit for a payment without a deferred presentment transaction. Then, a new deferred presentment transaction could have been done without falling under the definition. This type of approach has been used to evade the New Mexico payday lending reforms.[132]

Next, a lender would have been required to accept partial payment of an amount owed and to apply the payment to the principal. When a borrower has paid twenty-five percent of the principle, neither the lender nor the CSO would have been able to charge any additional "fees or other charges related to the transaction." The language was again limited to transactions "in the form of a deferred presentment transaction." Any innovation that fell outside of this language could have evaded the reach of the statute.

After a less stringent substitute[133] was voted out of committee,[134] H.B. 2593 died on the house floor, possibly as a result of a sustainable question of order called by Representative Jodie Laubenberg.[135] Laubenberg, who according to a report by Texans for Public Justice actually did not take considerable campaign contributions from the payday lending lobby, acted as the main parliamentary obstacle to

---

[131] *See, e.g.*, KING & PARRISH, *supra* note 20, at 1; John Sandman, *Is the Payday Loan Business on the Ropes?*, REUTERS (Sept. 21, 2012), http://blogs.reuters.com/great-debate/2012/09/21/is-the-payday-loan-business-on-the-ropes/.

[132] *See* Martin, *supra* note 5.

[133] *See* House Comm. Report version of Tex. H.B. 2593, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02593H.htm.

[134] House Comm. on Pensions, Investments and Financial Servs. Minutes, 82d Leg., R.S. (April 7, 2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/minutes/html/C3952011040700001.htm.

[135] *See* H.J. of Tex., 82d Leg., R.S. 3716 (2011) (postponing bill while point of order pending, but failing to call it back up). *See also* H. Chamber Broadcast, May 12, 2011 at video position 5:27:59.

Truitt's efforts.[136] Because there was no vote on the house floor on this bill, it is an open question what the failure of H.B. 2593 means for legislative intent purposes. Craddick has said that he could have passed his rate cap bill on the house floor if it had been voted out of committee.[137] Craddick did not offer his bill as an amendment to Truitt's H.B. 2593, but nor did he have the time to do so before the point of order was called.[138] Both Truitt and Senator John Carona (the senate sponsor of the payday lending bills) have said that the industry agreed in principle to the goal of breaking the cycle of debt in H.B. 2593.[139] As will be shown below, there were enough votes to pass Truitt's other two bills through both chambers, but it is unclear whether that would have been the case had H.B. 2593 come up for a floor vote.

The failure of H.B. 2593 is potentially significant because if the agency tried to regulate the practices covered in H.B. 2593 by using rulemaking authority granted in the other two bills, there would be a debate as to whether the agency has that authority. It would be an issue for the courts whether the legislature intended to provide a back door to that authority over opposition from either the industry or from a majority of the legislature itself.

2. *H.B. 2592, the Posting and Disclosure Bill*

H.B. 2592 is currently law.[140] The law includes new disclosure requirements for all CSOs, including CSOs offering deferred presentment transactions.[141] The introduced version of the bill included a bifurcated disclosure scheme; some disclosures would be through posting required notice "in a conspicuous location in an area of the organization accessible to consumers," while others would be through providing

---

[136] *See* TEXANS FOR PUBLIC JUSTICE, *Loan-Shark-Financed Campaigns Threaten Payday-Loan Reform*, http://info.tpj.org/reports/pdf/PaydayReport.mar2011.pdf (discussing payday loan money in the legislature). *See also* Brandi Grissom & Matt Stiles, *Payday Lenders Give Big Money to Lawmakers*, THE TEXAS TRIBUNE, Nov. 20, 2009, http://www.texastribune.org/texas-issues/predatory-lenders/payday-lenders-give-big-money-to-lawmakers.

[137] *See* Melissa Del Bosque, *Payday Reform: Could it Finally Pass?*, THE TEXAS OBSERVER (May 19, 2011), *available at* http://www.texasobserver.org/lalinea/payday-reform-could-it-finally-pass.

[138] H.J. of Tex., 82d Leg., R.S. 3713–14 (2011) (floor action on H.B. 2593). *See also* H. Chamber Broadcast, May 12, 2011 at video position 5:27:59.

[139] *See* Del Bosque, *supra* note 136 (quoting Truitt defending H.B. 2593 on the floor: "Are you aware[, Rep. Elkins]...do you understand that the language in these bills was negotiated between the industry and advocates?"); S. Comm. on Bus. & Commerce, broadcast of May 18, 2011 at video position 12:00.

[140] *See* Act of May 23, 2011, 82d Leg. R.S., ch. 1301, 2011 Tex. Gen. Laws 3717 (codified at TEX. FIN. CODE ANN. §§ 393.221–.224 (West Supp. 2012)), *available at* http://www.capitol.state.tx.us/tlodocs/82R/billtext/html/HB02592F.htm.

[141] *See id.* The bill also applies to CSOs that offer auto title loans, which I do not address in this Note.

information to consumers.[142]

As for posting, CSOs would be required to post the following: (1) a schedule of "all fees to be charged" for CSO services, including, those "in connection with" payday loans; (2) contact information for the state regulatory authority, including the "consumer helpline"; and (3) a statutory notice informing the consumer that payday loans are for short-term purposes and that "renewing the loan" will cost more.[143]

As for providing notices to consumers, CSOs would be required to provide the following: (1) a comparison of the APR of the loan (including "all interest and fees") with the APR charged on "other similar financial products"; (2) a comparison of the "amount of accumulated fees a consumer would incur" if the consumer kept a $300 payday loan outstanding for two weeks, one month, two months, and three months versus if the consumer carried the same balance on a credit card for those same intervals; and (3) "information regarding the typical profile of repayment" of payday loans.[144]

The finance commission would be given the authority to adopt rules "to implement" the disclosures required in these two additional sections.[145]

The version of H.B. 2592 voted out of committee is more limited in a number of ways.[146] First, it limits its disclosure requirements only to CSOs that offer consumers extensions of credit "in the form of []deferred presentment transaction[s]," labeling these CSOs as "credit access business[es]" (CABs).[147] It keeps the same bifurcated approach, requiring some postings and some notices to consumers.[148] The committee substitute only requires disclosure of a CAB's fees charged "in connection with" a payday loan.[149] It also alters the language of the required posted disclosure about the purpose of payday loans.[150] The committee substitute notice would warn consumers of the consequences of "refinancing the loan,"—a more confusing term that might not intuitively include payment of a rollover fee.[151]

The requirement to provide information to consumers, however,

---

[142] *See* Introduced version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592I.htm (including § 3 adding TEX. FIN. CODE. ANN. §§ 393.107 and 393.108).
[143] *Id.*
[144] *Id.*
[145] *Id.*
[146] *See* House Comm. Report version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592H.htm. Note, the house committee report also makes similar changes to the auto title loan provisions.
[147] *Id.*
[148] *Id.*
[149] *Id.*
[150] *Id.*
[151] *See* House Comm. Report version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592H.htm.

was strengthened. First, a new provision required CABs to provide required disclosures to consumers before the loan processing services are performed.[152] Under the previous language, there was no mandate to provide the information before the fees were accumulated.[153] A CSO could have held the disclosure until after the customer had agreed to the loan. Second, the committee substitute strengthened required disclosures.[154] According to the substitute, a CAB would have to disclose the interest, fees, and APRs of payday loans in specific comparison to (1) "alternative financial products that a consumer might consider, such as credit card finance charges or pawn service charges"; and (2) "late charge fees or other typical costs that a consumer considering a [payday loan] may otherwise incur," including bank overdraft fees and utility late fees.[155] Additionally, the committee substitute expanded the disclosure requirement comparing outstanding payday loan balances at different intervals to the same balances on credit cards beyond the one example of a $300 balance.[156] The committee substitute requires that this comparison be "in various sample amounts."[157]

Finally, the substitute changes the requirement to disclose the "typical profile of repayment" to the "typical pattern of repayment" of a payday loan. It is unclear whether or not the profile/pattern change strengthens or weakens the disclosure. It might be helpful for people to know what the profile of a payday loan borrower is, since a potential customer might think the typical borrower is worse off, or somehow less capable of repaying than the potential customer is. But, profile information alone, without some discussion of the typical results from the typical customer, or the "pattern" of repayment, may also be ineffective at combatting consumer misconceptions. Choosing "profile" over "pattern" raises the possibility that patterns could not be included in a final regulatory scheme.

The committee substitute gave the finance commission the option to adopt rules "to implement" the posting requirements, but required it to adopt rules to implement the consumer disclosures.[158]

There was a significant floor fight during the debate on H.B. 2592.[159] Two floor amendments were added: one strengthened the bill,

---

[152] *Id.* Note that the house committee report also makes similar changes to the auto title loan provisions.

[153] *See* House Comm. on Pensions, Investments, & Financial Servs., Bill Analysis, Tex. H.B. 2592, Comparison of Original to Substitute, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/analysis/pdf/H.B.02592H.pdf#navpanes=0.

[154] *See* House Comm. Report version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592H.htm.

[155] *Id.*

[156] *Id.*

[157] *Id.*

[158] *Id.*

[159] *See* H.J of Tex., 82d Leg., R.S. 3585-87 (2011); House Chamber Broadcast, May 11, 2011 at video position 1:46.

and one weakened it. The amendment offered by Representative Burt Solomons strengthened the bill by allowing the consumer credit commissioner to assess administrative penalties for CABs that "knowingly and willfully" violate the provisions of the bill or rules adopted by the rulemaking authority it grants.[160] The amendment offered by Representative Elkins, himself an operator of payday lending stores, gutted the consumer notice disclosure requirements to only require disclosure of "interest, fees, and [APRs] . . . to be charged on a deferred presentment transaction."[161] Truitt lost her motion to table, the amendment was adopted, and the bill passed.[162]

In the Senate Business and Commerce Committee, Senator John Carona, Chair of the committee, added back some of the consumer disclosures that were stripped in the house. Carona's version of H.B. 2592 was ultimately enacted into law.[163] The final version of H.B. 2592 preserves the requirements that the finance commission adopt rules to implement the disclosures, and that the disclosures are provided before the extension of credit.[164] It also requires three disclosures. First, CABs have to disclose interest, fees, and APRs to be charged on the payday loan "in comparison to [the same] to be charged on other alternative forms of debt," which probably encompasses more than the original bill's comparisons to "other similar financial products."[165] Second, CABs would also have to disclose "the amount of accumulated fees a consumer would incur by renewing or refinancing a [payday loan] that remains outstanding" for three intervals of time.[166] There are no requirements for specific dollar amounts as examples or multiple dollar amounts as examples, as there were in the previous versions of the bill.[167] Finally, just as in the committee substitute, CABs must disclose the "typical pattern of repayment" of a payday loan.[168]

The success of Elkins's amendment raises questions concerning legislative intent. Some of the more specific required disclosures that

---

[160] *See* H.J. of Tex., 82d Leg., R.S. 3585 (2011) (Amendment 2 by Solomons); Engrossed version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592E.htm.

[161] *See* H.J. of Tex., 82d Leg., R.S. 3586–87 (2011) (Amendment 3 by Elkins); Engrossed version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592E.htm.

[162] *Id*

[163] *Compare* Engrossed version of Tex. H.B 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592F.htm, *with* Senate Amendments version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/senateamend/pdf/HB02592A.pdf#navpanes=0

[164] *Compare* Engrossed version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592E.htm, *with* Enrolled version of Tex. H.B. 2592, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592F.htm.

[165] *Id.*

[166] *Id.*

[167] *Id*

[168] *Id.*

came close to demonstrating to consumers how much the loans cost over the long term and how they compare with other relevant choices did not make their way back into the bill. The fact that the house voted to strip that language could be used as a legislative intent argument that the finance commission cannot go as far in rulemaking as those disclosures would have required. On the other hand, it is not clear that Elkins's amendment was necessary for passage of the bill. In that light, the senate's re-expansion of the disclosures, and subsequent passage through the house, could show that the legislature intended for disclosures to be in the bill and to be effective.

Comparing H.B. 2593 to H.B. 2592, it is clear that Truitt decided at the introduction of these bills that the overall scheme would include relatively more regulatory power over disclosure requirements than over interest rates and loan fees (price).[169] Because no statutory limitations on loan fees were enacted, however, an amendment added to H.B. 2594 could potentially open the door to some indirect regulation of CSO behavior surrounding these fees. The possibility is discussed in further detail below.

3. *H.B. 2594, the Licensing Bill*

H.B. 2594 is also currently law. The law includes new licensing requirements for payday lenders.[170] The bill was amended at several stages of the legislative process. This Note's discussion of the bill will be confined to the provisions that appear to have regulatory importance.

The introduced version of H.B. 2594 only required CSOs that are assisting consumers to get credit "in the form of" payday loans to register with the consumer credit commissioner.[171] A registration application is required, and the commissioner is given the authority to require additional "information . . . as the commissioner determines necessary." The commissioner may deny an application if a principal in the CSO has been previously convicted of a crime or found civilly liable for "an offense involving moral turpitude"; the CSO's registration has been previously revoked or suspended; or the commissioner "based on specific evidence" makes a finding that the "applicant does not warrant the belief that the business will be operated lawfully and fairly within the

---

[169] *Compare* Introduced version of Tex. H.B. 2593, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02593I.htm, *with* Introduced version of Tex. H.B. 2592, 82d Leg., R.S. (2011) *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02592I.htm. H.B. 2593 has no rulemaking authority; H.B. 2592 does.

[170] Act of May 23, 2011, 82d Leg., R.S., ch. 1302, 2011 Tex. Gen. Laws 3719 (codified as amendments to TEX. FIN. CODE ANN. ch. 14 (West 1998), ch 393 (West 2006 & Supp. 2012)), *available at* http://www.capitol.state.tx.us/tlodocs/82R/billtext/html/HB02594F.htm.

[171] *See* Introduced version of Tex. H.B. 2594, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594I.htm.

provisions and purposes" of Chapter 393. The commissioner also has the power to revoke registration for a number of reasons, including discovery of facts that "would have been grounds for denying registration"; violations of Chapter 393; or "fail[ure] to warrant the belief" that the business will operate within the purposes of Chapter 393.[172]

In addition to the registration requirements, the introduced version of the bill would have also required the submission of an annual report about payday loans that the organization has helped a consumer secure. In addition to a list of required information, the bill included a catch-all provision that would have allowed the commissioner to require reporting "any related information the commissioner determines necessary."[173]

The committee substitute to H.B. 2594 made several important changes.[174] For brevity, the Note also discusses how the provisions in the committee substitute compare to the final version of the bill.

First, two important provisions were added to the applicability section. The *Lovick* holding was likely codified by the following provision: "In connection with a determination of usury, the fees charged by a credit access business do not constitute interest."[175] If there was any question that *Lovick* accurately states Texas law, this provision would probably end it. But, an amendment was added in the senate that changed the language of this provision. Instead of referencing a determination of usury and interest, the final language says that a CAB "may assess fees for its services as agreed to between parties."[176] Thus, there may be a good argument that the legislature did not mean to codify *Lovick*'s holding, leaving the question open as to whether these fees could be considered interest in a future case.

Additionally, a provision was added that had the potential to widen the scope of the bill: "a person may not use a device, subterfuge, or pretense to evade the application" of the law.[177] An amendment was added on the house floor and survived in the senate, however, that limits the potential. The amendment makes clear that "a lawful transaction governed under another statute . . . may not be considered a device, subterfuge, or pretense."[178]

Second, the committee substitute changes the registration process to

---

[172] *Id.*

[173] *Id.*

[174] *See* House Committee Report version of Tex. H.B. 2594, 82d Leg., R S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594H.htm.

[175] *Id.*

[176] *See* Enrolled version of Tex. H.B. 2594, 82d Leg., Reg .Sess. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594F.htm.

[177] *Id.*

[178] *See* H.J. of Tex., 82d Leg., R.S. 3765 (2011) (Amendment 5 by Elkins); Enrolled version of Tex. H.B. 2594, 82d Leg., R.S. (2011) (reflecting amendment), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594F.htm.

require a CAB to apply for a license for "each location" where it provides payday loans.[179] Like the introduced version, it allows the commissioner to require additional "relevant information."[180] The committee substitute also conditions the license on the commissioner's affirmative findings not only that the CAB "warrant[s] the belief" that the CAB will comply with the letter and purpose of Chapter 393, but also that "character, and general fitness" of the CAB "are sufficient to . . . command the confidence of the public."[181]

Third, the commissioner was given authority to revoke a CAB's license if the CAB "knowingly or without the exercise of due care" violates Chapter 393, or rules adopted by the agency under it.[182] Additionally, the commissioner is given the power to suspend the licenses of all of a company's locations if five or more CABs operated by that company have their licenses revoked within a three year period.[183]

Fourth, the committee version grants rulemaking authority to the commissioner to require the CAB to report its relationship with the lender.[184] Additionally, the house committee included a specific provision that "the finance commission may not establish limits on the fees charged by a credit access business."[185] This provision was changed in the senate, and the final version says that "nothing in [the provisions added by the bill] grants authority to the finance commission . . . to establish a limit on the fees charged by a credit access business."[186] As a point of legislative history, the removal of the prohibition on establishing limits on fees may allow the commission by rule or practice to scrutinize CABs that charge fees at a particular level, or in a particular way, that brings a CAB's practice within the commission's relatively broad licensing authority. In other words, if there is a "grant of authority" in the other provisions of the bill that could justify a practice of scrutinizing fees, then the legislature clearly removed a specific ban on that type of regulation. The criticism that the bills do not allow the commissioner to establish limits on fees might be open for debate if the commissioner were a creative regulator.

Finally, the house committee version and the final version set up the Texas Financial Education Endowment by way of an annual assessment on each license holder paid to the finance commission. The

---

[179] *See* House Committee Report version of Tex. H.B. 2594, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594H.htm.

[180] *Id.*

[181] *Id*

[182] *Id.*

[183] *Id.*

[184] *See* House Committee Report version of Tex. H.B. 2594, 82d Leg., R.S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594H.htm.

[185] *Id.*

[186] *See* Enrolled version of Tex. H.B. 2594, 82d Leg., R. S. (2011), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594F.htm.

fund is only to be used to raise financial literacy, but allows the finance commission to produce and disseminate materials at license locations, including advertising and marketing materials. The finance commission could expand its control over consumer debiasing through this provision because it is also given rulemaking authority to implement the fund.[187]

VII. SUMMARY OF OPPORTUNITIES FOR AGENCY CREATIVITY

Through the creative use of rulemaking authority, the finance commission could potentially undertake a strong program of debiasing at the point-of-sale of payday loans. One potential avenue would be requiring CSOs to show a customer a video produced by the finance commission, presumably under its financial education fund powers, that discusses the market for payday loans and the cheaper alternatives. Video may be an attractive regulatory tool in this field because the accumulation of paper disclosures does not seem to help consumers make better choices, as Martin's work suggests. If the finance commission chose to take the job of debiasing seriously, there is also enough rulemaking authority to make the law applicable to new product innovations, through the addition of the subterfuge language, although the legal bases of that expansion, as shown earlier, might be relatively weak.

Additionally, the licensing powers could provide the finance commission with enough of a stick to target rates as a consideration for renewing or granting licenses. While there is no authority to cap rates, the language of the new law simply says what the law does not grant, removing a specific prohibition in the process. Aggressive regulators would try to take advantage of that legislative history.

The finance commission is justified, and would be on solid empirical ground, to look into a strong disclosure regime aimed at educating consumers about the market in which they are participating. Proper information might help to ensure that payday loans are less predatory in the future, but as the Note will show, the agency has taken a timid approach.

VIII. WHAT TEXAS HAS DONE: DESIGNED A DISCLOSURE WITH THE RIGHT MESSAGES

The finance commission, through the Office of Consumer Credit Commissioner (OCCC), has adopted required consumer disclosures for

---

[187] *Id.*

CABs.[188] The disclosures target the most important consumer misconceptions.[189] Disclosures are required to fit on two sides of a single sheet of paper.[190] The disclosures seek to convey nine messages, but only five of them are consequential for debiasing purposes.[191] This Note will summarize each of the five important messages and describe how the disclosures graphically represent those messages. Later, the Note will assess whether the messages are likely to counteract consumer biases.

A. The Messages[192]

The first message discusses the borrower's right to consider other options. The message reads: "After reviewing the terms of the loan, you are not required to choose that loan, and may consider other borrowing options, including those shown on Page 2 of this document." The text is featured prominently at the top of the first page in a blue box with large white print.

The second message discusses the total cost (principal, fees, and interest) of a hypothetical two-week, $500 loan and how the amount would grow at different time intervals. The message is divided into two boxes. One box breaks down and totals the borrowed amount (principal),

---

[188] 7 TEX. ADMIN. CODE §§ 83.6001–83.6008 (2012) (Fin. Comm'n of Tex., Rules for Credit Access Businesses, Consumer Disclosures and Notices). Some notes about citations in Part VIII follow. the disclosure sheets are available in pdf form on OCCC's website. 7 TEX. ADMIN. CODE § 83.6007(a), *available at* http://info.sos.state.tx.us/fids/201105659-1.pdf. This link is for the required disclosure for "single payment" payday loans, but the messages are not significantly different for the "multiple payment" types of loans that are also addressed in the regulations. Additionally, the stakeholder comments are available at http://www.occc.state.tx.us/pages/Legal/ANPR/Aug2011Stakeholders Meetings.html. In Part VIII, all references to the disclosures or stakeholder interests are to these online locations, unless otherwise specified.

[189] Note, there was also a requirement for wall postings in each payday lending retail store. While the posting requirement raises some interesting regulatory issues as well, this Note does not deal with them for the sake of brevity. Based on the weakness of the proposed rules, the posting will probably not be relevant to the debiasing issues discussed in the rest of the Note.

[190] *Id.* § 83.6006(c).

[191] 7 TEX. ADMIN. CODE § 83.6007(a) (containing the sixth message, defining payday loans as "cash advances provided to a borrower to meet financial needs," tells borrowers that they will be required to sign "a loan agreement," and introduces the kinds of terms a borrower will see in his contract. The final statement of this message states plainly: "Payday loans may be one of the more expensive borrowing options available to you." This message is displayed in print underneath the fifth message (at the middle of the second page). The seventh message is a similar column discussing other important considerations for borrowers. There are three of these in bullet points: (1) "Borrowers may be required to write checks . . . to cover payments for the loan"; (2) "Borrowers can compare all loan options available and select the option that is best for them"; (3) "Borrowers can avoid extra fees and loan renewal costs by not missing payments and by paying loans on time." The eighth message directs borrowers "[l]ooking for information on budgeting, personal savings, credit card management, or other personal money management skills" to OCCC's "Financial Literacy Resource" website. This box is set off by borders and is in large print. Finally, the ninth message provides information on how to get answers to general questions and to file or convey consumer complaints to OCCC. This is also a box set off from the others.).

[192] 7 TEX. ADMIN. CODE § 83.6007(a).

fees, interest charges, and total payment amount assuming the loan is paid back as agreed. The other box displays what happens to the total cost if a borrower decides to renew the loan. The disclosure shows the total cost at intervals of two weeks, one month, two months, and three months. The rollover box has a column titled "If I pay the loan in . . ." and the other titled "I will have to pay. . . ." The box also prominently displays a caveat that the sample amounts may not reflect the actual charges.

The third message discusses how long it typically takes to pay back a payday loan. This box displays in large font the words "[o]f 10 people who take out a new payday loan" followed by a breakdown of how many of those ten people would pay back a loan at a particular time interval. Stick figures are used to indicate how many people out of the ten would be in each of the following categories: people who pay off the loan in one payment; renew one or two times; renew three or four times; and renew five or more times. This message also contains a less prominent disclaimer that the information is from a 2008 national survey, so "repayment patterns may be different."

The fourth message is a column urging potential borrowers to ask themselves some questions. The words "Ask Yourself. . ." are at the top of the column with the following five questions (in order) underneath in bullet points: (1) "Is it necessary for me to borrow the money?"; (2) "Can I afford to pay the loan back in full in 2 weeks?"; (3) "Will I be able to pay my regular bills and repay this loan?"; (4) "Can I afford the extra charges, interest, and fees that may be applied if I miss or fail to make payment?"; (5) "Are other credit options available to me at this time?" The fourth message is the last message on the first page of the disclosure.

The fifth message is a box that prompts consumers to compare the cost of different types of credit that might be available by asking at the top "How does a payday loan compare to other options?" Within the box is another loan calculation box (based on the same hypothetical $500, 2-week loan) that restates the cash advance/borrowed amount; interest payment amount; total of fees amount; and total of payments amount. The smaller box contains an additional piece of information, the annual percentage rate (APR), listed as 664.30%. Under that box is a graphic comparing payday loans to other forms of credit to show that a payday loan is among the most expensive forms of credit.

The graphic has two bars that look like thermometers. The bars are hotter on the right side of the graphic, which is labeled as "Most Expensive;" and cooler on the left side of the graphic, labeled "Least Expensive." One bar represents APRs and the other represents "[a]verage amount of interest and fees . . . per $100 borrowed over 2 weeks." On both bars, payday loans are plotted the farthest to the right. The options that are listed as being cheaper are (from cheaper to cheapest): auto title loans, pawn loans, signature loans, secured loans, and credit cards.

B. Evaluating the Messages in Light of the Five Biases

This section will look at Sunstein's biases and Martin's payday-borrower behavior findings and preliminarily analyze whether these disclosures are likely to solve those problems.

First, the OCCC disclosures combat a consumer's unrealistic optimism about her ability to repay by conveying the third and fourth messages. The third message attempts to show that very few people are able to pay back the loan without paying additional fees, and that most end up renewing the loan more than three times. The fourth message prompts the consumer to question whether she really has the ability to repay the loan. Consumer groups[193] wanted this information to be framed in a clearer way: instead of showing how many times the loan is usually "renewed," they would have expressed it as the typical dollar amount a person pays on the same hypothetical $500, 2-week loan. They would also have added another sentence that states: "Most borrowers pay $900 or more to pay off this . . . loan." One consumer group would have included in this statement a reiteration of the average number of weeks a borrower would have a balance.[194] The OCCC disclosures seek to convey the right kind of information to counteract optimism bias.

Second, the disclosures combat a consumer's myopia and self-control problems. As noted above, many people use payday loans to pay for recurring expenses. If cheaper credit options are available, then myopia/self-control issues might account for the persistently bad choice. The OCCC disclosures work to counteract this behavior in the first, fourth, and fifth messages by prompting borrowers to compare the payday loan to other choices; to ask themselves what they are getting the loan for, and whether it will hurt their ability to pay those same recurring expenses; and to look at the difference in interest rates and price. Consumer advocates wanted credit cards in the disclosure, which may help consumers who already have credit cards, as well as those who erroneously think that credit cards are bad debt and payday loans are conservative.[195] Payday lenders,[196] on the other hand, wanted

---

[193] *See* Memorandum from Ann Baddour, Senior Policy Analyst, Tex. Appleseed, to OCCC (Aug. 26, 2011), at 8, (Response to Advanced Notice of Proposed Rulemaking to Implement Disclosure Provisions in H.B. 2592 and H.B. 2594), *available at* http://www.occc.state.tx.us/pages/Legal/ANPR/CAB_disclosure/CABs%20ANPR2%20Cmt%20Baddour_TX%20Appleseed%208_26_11.pdf.

[194] Memorandum from Stephen Reeves, Legislative Counsel, Tex. Baptist Christian Life Comm'n, to OCCC, (Aug. 26, 2011) (Advance Notice of Proposed Rulemaking, Response to Questions, regarding: H.B. 2592 - Credit Access Businesses – Consumer Notice and Disclosures), *available at* http://www.occc.state.tx.us/pages/Legal/ANPR/CAB_disclosure/CABs%20ANPR2%20Cmt%20Reeves_TX%20Baptist%20Christian%20Life%20Cmmn%208_26_11.pdf.

[195] *Id.* at 2.

[196] *See* Memorandum from J. Scott Sheehan, Consumer Serv. Alliance of Tex., to OCCC (Aug. 26, 2011) (Texas Finance Code, Subchapter 393 – Notice and Disclosure Requirements CSAT Pre-Comments Regarding Office of the Consumer Credit Commissioner 8-18-11 Advance Notice of

comparisons to overdraft fees, and credit card penalties for exceeding the credit limit, which they did not get in this form. Overall, the disclosures might be useful for a person who is already caught in a cycle of payday loan debt to examine alternative credit sources.

Third, the disclosures might counteract miswanting. To the extent that consumers use payday loans to buy unnecessary consumer goods, the disclosures attempt to dissuade that type of borrowing by focusing on the costs and prompting the question of whether the loan is necessary or will interfere with other obligations. Martin's empirical study did not turn up much of this type of behavior in securing the loan, but the sensitivity to "keeping up with the Joneses" might be at work in the tendency of consumers not to seek out alternatives. It could keep them from taking on credit card debt because they do not want to think of themselves as fiscally irresponsible. Or it could keep them from borrowing from friends or family out of pride or social standing. The OCCC disclosures prompt necessary questions and comparisons to combat this bias.

Finally, the disclosures combat both cumulative cost neglect and procrastination. Because borrowers are not actually borrowing short-term, but continuing to pay interest without reaching the principle (so each time a loan is opened or renewed, the consumer pays less than if she had paid off the full amount), they may be discounting the cumulative cost of the loan. The OCCC disclosures, particularly the second and third messages, discuss how quickly the interest/fees accumulate and how unlikely it is that the borrower will be able to pay off the loan. Seeing these cumulative costs up front can help the consumer correct myopia. The consumer advocates wanted to be stronger in this area by adding language about the impossibility of making interest-only payments and still paying the loan off. The advocates also wanted to add language about how much the typical borrower spends on an example loan.[197] The OCCC forms only discuss how often people renew the loans (without defining what a renewal is). Nonetheless, the form does considerable work to point out the total dollar amount that customers are incurring.

The OCCC disclosures mention that paying on time will keep costs under control, and their charts show how quickly loans grow. These disclosures will help to avert the procrastination problem, to the extent that it exists in the payday loan market. All in all, the messages OCCC chose to convey were the right messages. But, as we will see below, having the right message does not do much if potential consumers do not hear it.

Proposed Rulemaking), at 5, *available at* http://www.occc.state.tx.us/pages/Legal/ANPR/CAB_disclosure/CABs%20ANPR2%20Cmt%20Sheehan_CSAT%208_26_11.pdf.

[197] *See* Baddour, *supra* note 192, at 7.

IX. WHAT TEXAS HAS NOT DONE: ENSURED CONSUMERS WILL HEAR THE MESSAGES

The payday-loan industry does not have an interest in cooperating to debias consumers. The legal scholarship has not discussed this incentive not to be cooperative in the debiasing context as much as it has in the context of strongly paternalistic regulation. Usually, the argument is used to justify why we need to limit payday lending contracts, but it is an important issue in debiasing as well. A way to describe what is happening at the point of sale is as a conversation between the consumer, the industry, and the government. The only person who is not actually in the room for the conversation is the government. At minimum, this means the consumer and industry will be able to talk, while the government's message will be relegated to a sheet of paper. There are a few places where OCCC has not decided to issue rules (even though it could through express rulemaking authority). By leaving power on the table, OCCC may have unnecessarily reduced the government's persuasive voice.

First, OCCC has not established a mechanism for updating disclosures based on the types of products a company offers. As Martin has shown, industry innovation to change the transaction in order to fall outside its formal definition is almost certain. When the inevitable innovations occur, OCCC will not be in a position to respond effectively. When making rules for the licensing bill, OCCC declined to require payday loan companies to submit sample contracts along with their licensing application.[198] Disclosures must be tailored to the types of transactions offered, otherwise they lose their force.[199] This is especially true because the government cannot chime in when the payday lender downplays the disclosure form. In short, there will likely emerge a new category of payday loans that fall outside the reach of the deferred presentment transaction. Without the power to review contracts, the government will only be able to learn very slowly. In a similar way, the agency did not take the opportunity to regulate rates through the licensing process.

Second, for the regular payday loans, OCCC has still not developed rules regarding who, how, and when to give the disclosure to consumers.[200] The regulations only require the disclosure "to be provided to a consumer before a credit application is provided or before a financial evaluation occurs in conjunction with a [payday loan]."[201] It is unknown

---

[198] *See* 36 Tex. Reg. 7521 (2011) (Fin. Comm'n of Tex.) (OCCC, in official comments, declining to require contract submission).
[199] *See* Baddour, *supra* note 192.
[200] *Id.*
[201] 7 TEX. ADMIN. CODE § 83.6007(a).

what "provided" means: is it sufficient to make it available in a stack of papers; must it be physically placed in a customer's hand, etc.? In addition, even assuming that "provided" ensures that a consumer sees the disclosure both before a credit application is provided and before a financial evaluation occurs, anything that payday lenders do to persuade customers that a loan is a good idea can occur before giving the disclosure without running afoul of the rule. The payday lender could, for example, verify employment status and request documents or information necessary for the credit application or for a financial evaluation without actually performing either act. Without clearer guidelines, the consumer is again at the mercy of the way the payday lender will characterize her product—reliably in the most favorable light possible.

X. WHAT TEXAS SHOULD DO

Texas should consider joining the conversation between the consumer and the payday lender more effectively. Instead of requiring a piece of paper, OCCC could require the viewing of a DVD or web movie. This method could come close to matching the in-person sales with in-person disclosure. The video would not have to be long; it simply needs to convey the crucial messages with a real person.

OCCC likely has the statutory authority to require a more aggressive disclosure method. H.B. 2592 says the following: "[A] credit access business must provide to a consumer a disclosure adopted by rule of the Finance Commission of Texas[,] . . . in a form prescribed by the commission."[202] The disclosure could be in the *form* of a video presentation.

There was also a provision in H.B. 2594, the licensing bill, which gave the OCCC some interesting power.[203] The bill sets up Texas Financial Education Endowment by way of an annual assessment on each license-holder paid to the finance commission. The fund is only to be used to raise financial literacy, but includes a power given to the finance commission to produce and disseminate materials at license locations, including ad/marketing materials. The finance commission could likely expand its control over consumer debiasing through this provision, because it is also given rulemaking authority to implement the fund.

---

[202] Act of May 23, 2011, 82d Leg., R.S., ch. 1301, § 1, 2011 Tex. Gen. Laws 3717, 3718 (codified at TEX. FIN. CODE ANN. §§ 393.221-.224 (West Supp. 2012)), *available at* http://www.capitol.state.tx.us/tlodocs/82R/billtext/html/HB02592F.htm

[203] Act of May 23, 2011, 82d Leg., R.S., ch. 1302, § 2, 2011 Tex. Gen. Laws 3719, 3724 (codified at TEX. FIN. CODE ANN. §§ 393.628 (West Supp. 2012)), *available at* http://www.legis.state.tx.us/tlodocs/82R/billtext/html/HB02594F.htm.

If OCCC did propose more persuasive debiasing at the point of sale, an interesting free speech issue could be lurking in the background. Recently, a federal district court granted a preliminary injunction for tobacco companies against the FDA on the grounds that a new debiasing campaign that shows graphic, smoking-caused illnesses on pictures that take up half of a cigarette pack likely violates the First Amendment as compelled speech not falling into the commercial exception.[204] When debiasing seeks to eradicate a legal commercial practice, the strategy may have constitutional limitations.

XI. CONCLUSION

In conclusion, the OCCC rulemaking process has produced a set of potentially effective disclosures. The clear messages seek to counteract cognitive biases that lead some consumers to harm themselves. But, so far, OCCC has not taken the necessary steps to make sure that the government's voice is heard at the point of sale. For that reason, these rules do not go as far as they could to protect consumers.

---

[204] R.J. Reynolds Tobacco Co. v. FDA, 11-cv-01482-RJL (D.D.C. Nov. 7, 2011) (memo op.). *See also* Jonathan Stempel, *Cigarette Makers Sue FDA Over New Labeling Rules*, REUTERS (Aug. 17, 2011), http://www.reuters.com/article/2011/08/17/us-cigarettes-advertising-lawsuit-idUSTRE77G05V20110817.