ENFORCING VERMONT'S CONSUMER LENDING LAWS: A NEEDED MODEL FOR OTHER STATES

> Those who hold, and those who are without property, have ever formed distinct interests in society. Those who are creditors, and those who are debtors, fall under a like discrimination . . . . The regulation of these various and interfering interests forms the principal task of modern Legislation . . . .

—James Madison, Federalist No. 10[1]

1. THE FEDERALIST NO. 10, at 59 (James Madison) (Jacob E. Cooke ed., 1961).

INTRODUCTION

Predatory consumer lending undermines the financial stability of low-income individuals by keeping them in perpetual cycles of high-interest debt. Lenders may make more money by continuing to lend to the same borrowers who cannot afford to repay their original loans, thereby profiting by keeping borrowers in debt.[2] States are largely responsible to regulate this type of lending, and their regulations and enforcement vary dramatically. This Note emphasizes the problem of predatory lending and the duty of individual states to address it, using Vermont's consumer lending laws and their enforcement as a successful example.

States have broad latitude to regulate consumer lending.[3] Nonetheless, many states provide little protection from predatory lending practices that trap consumers in perpetual cycles of debt.[4] Vermont is a leader in this field, with a comprehensive regulatory scheme that substantially insulates Vermonters from the worst kinds of predatory lending.[5] "Predatory lending" encompasses retail loans that "impos[e] unfair and abusive loan terms on borrowers."[6] These loans range from subprime mortgages to short-term consumer loans for several hundred dollars.[7] Regardless of the size, predatory loans lack transparent costs and terms, and the issuers' profit incentives typically undermine borrowers' long-term financial stability.[8] The Great Recession highlighted lending abuses of predatory loans in the form of subprime mortgages, which received national attention and culminated in the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in 2010.[9] At the time, President Obama said the Dodd-Frank Act would create "the strongest consumer

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2. *See* infra Part II.C (explaining the methodologies lenders use to profit from borrowers while keeping them in debt).

3. Arthur E. Wilmarth, Jr., *The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893, 920 (2011).

4. *See infra* Part IV (identifying additional weaknesses in state predatory lending laws).

5. *See infra* Parts II, III (outlining Vermont's statutory scheme and its enforcement).

6. OFFICE OF THE INSPECTOR GEN., CHALLENGES AND FDIC EFFORTS RELATED TO PREDATORY LENDING 1 (2006), https://www.fdicig.gov/reports06/06-011.pdf.

7. *See id.* at 2–3 (describing "nontraditional mortgages and other loan products" as loan types that may be predatory).

8. *See* SARAH D. WOLF, THE CUMULATIVE COSTS OF PREDATORY PRACTICES 8 fig.1 (2015), http://www.responsiblelending.org/state-of-lending/reports/13-Cumulative-Impact.pdf (describing the signs of abusive lending practices).

9. NAT'L CONSUMER LAW CTR., INSTALLMENT LOANS: WILL STATES "PROTECT BORROWERS FROM A NEW WAVE OF PREDATORY LENDING?, at v (2015), https://consumermediallc.files.wordpress.com/2015/07/report-installment-loans.pdf [hereinafter INSTALLMENT LOANS]; Wilmarth, *supra* note 3, at 895; *The Great Recession*, ECON. POL'Y INST., http://stateofworkingamerica.org/great-recession (last visited May 3, 2017).

financial protections in history."[10]But, critically, the Dodd-Frank Act barred the Consumer Financial Protection Bureau (CFPB) from capping consumer lending interest rates.[11] The Act did, however, broaden state authority in lawmaking and law enforcement for consumer financial protection by reducing the issue of state preemption in the federal regulatory structure.[12] The Act created a regulatory "floor" whereby *stricter* state laws were not explicitly preempted by federal law.[13] The Act also enabled state Attorneys General to enforce the Act and the regulations promulgated by the CFPB.[14] Because the Dodd-Frank Act left the heart of consumer lending regulation to individual states, examining how states have responded to this challenge is particularly relevant several years after the Act took effect.[15]

This Note is divided into four parts. Part I explains the rise and problem of predatory lending and argues that robust state regulatory schemes are necessary to combat it. Part II argues that Vermont's lending laws—which include some of the most far-reaching laws in the country with respect to third-party liability for assisting illegal lenders—provide a

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10. Press Release, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010) (on file with the National Archives, The White House: President Barack Obama, https://obamawhitehouse.archives.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act).

11. Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5517(o) (2012) ("No provision of this title shall be construed as conferring authority on the [Consumer Financial Protection] Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.") (footnote omitted). *See also* Editorial, *Progress on Predatory Lending*, N.Y. TIMES (Sept. 16, 2003), http://nyti.ms/18EBU73 ("The Consumer Financial Protection Bureau is barred by law from setting interest rates."). Congress does, however, prohibit lenders from charging active military personnel more than 36% interest. 10 U.S.C. § 987(b) (2012) ("A creditor . . . may not impose an annual percentage rate of interest greater than 36 percent with respect to the consumer credit extended to a covered member or a dependent of a covered member."). The Pentagon found that military personnel were three times more likely than civilians to take out a payday loan. Tim Mathis, *Payday Lenders*, LA. BUDGET PROJECT, http://www.labudget.org/lbp/wp-content/uploads/2011/07/Payday-Lenders.pdf (last visited May 3, 2017).

12. *See* 12 U.S.C. § 5552(d)(1) ("No provision of this section shall be construed as altering, limiting, or affecting the authority of a State attorney general or any other regulatory or enforcement agency or authority to bring an action or other regulatory proceeding arising solely under the law in effect in that State."); Wilmarth, *supra* note 3, at 920.

13. *See* 12 U.S.C. § 5551(a)(2) ("For purposes of this subsection, a statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is greater than the protection provided under this title."); Wilmarth, *supra* note 3, at 922.

14. 12 U.S.C. § 5552(a)(1) ("[T]he attorney general . . . of any State may bring a civil action . . . to enforce provisions of this title . . . ."); Wilmarth, *supra* note 3, at 924.

15. Although the CFPB cannot set interest rates, they have proposed a regulation to require lenders to reasonably determine whether borrowers have the ability to repay the loan. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47864–65 (proposed July 22, 2016) (to be codified at 12 C.F.R. pt. 1041). For a discussion of this effort at the state level, see *infra* Part IV.B.

model regulatory scheme for other states. Part III argues that Vermont's aggressive enforcement of these laws is crucial to hold predatory lenders accountable, especially in the emerging arena of online lending. Finally, Part IV outlines how other states have failed to respond to the challenge posed by predatory lenders, and how lenders are adapting to weak regulatory schemes. The conclusion champions Vermont's comprehensive strategy to combat predatory consumer lending and encourages other states to adopt similar laws and enforcement efforts.

I. THE RISE OF PREDATORY LENDING

Short-term lending has exploded in recent decades in part because of the changing American economic demographic.[16] Overall, Americans today rely significantly on personal debt, while their personal savings have evaporated.[17] The purchasing power of the median household income has stagnated or declined over the past several decades.[18] Meanwhile, the cost of living has steadily risen during the same period.[19] Although these trends are widely known, their practical effects—especially in regard to ballooning personal debt—are often overlooked.[20]

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16. Nathalie Martin, *1,000% Interest - Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 564 (2010).

17. MINN. PRIVATE COLL. COUNCIL, UNITED STATES PERSONAL SAVINGS AND DEBT TRENDS (2015).

18. Brendan A. Cappiello, The Price of Inequality *and the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act*, 17 N.C. BANKING INST. 401, 403 (2013) (explaining that the median household income in 1997 was $50,123 in 2010 dollars, and decreased to $49,445 in 2010). It is beyond the scope of this Note to discuss why, during this same period, the share of income attributed to the top decile of income earners steadily rose. *See* Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913–1998*, 118 Q.J. ECON. 1, 8–11 (2003) (addressing trends in income inequality during the twentieth century).

19. *See* Douglas A. McIntyre, *The History of What Things Cost in America: 1776 to Today*, 24/7 WALL ST. (Sept. 16, 2010, 12:21 AM), http://247wallst.com/investing/2010/09/16/the-history-of-what-things-cost-in-america-1776-to-today (providing examples of the increased costs of consumer goods over the course of United States history). Cost of living has also increased since the Great Recession. *See* NAT'L EMP'T LAW PROJECT, OCCUPATIONAL WAGE DECLINES SINCE THE GREAT RECESSION 1 (2015) ("The failure of wages to merely keep pace with the cost of living is not a recent phenomenon. The declines in real wages since the Great Recession continue a decades-long trend of wage stagnation for workers in the United States.").

20. This economic situation, for example, affects housing options. The homeownership rate in the United States is the lowest it has been in two decades, while the median asking sales price for homes has doubled during the same period. ROBERT R. CALLIS & MELISSA KRESIN, RESIDENTIAL VACANCIES AND HOMEOWNERSHIP IN THE SECOND QUARTER 2015, at 2 fig.3, 5 fig.4 (2015), http://www.census.gov/housing/hvs/files/qtr215/currenthvspress.pdf (nominal dollars, unadjusted for inflation). Meanwhile, the rental vacancy rate has decreased from over 11% in 2009 to less than 7% today. *Id.* at 1 fig.1. Median asking rent, however, has almost doubled since 1995. *Id.* at 2 fig.2 (nominal dollars, unadjusted for inflation). In sum, more Americans are renting fewer available apartments for

The purchasing power of the federal minimum wage has only increased by about 50¢ over the last 20 years.[21] Even for median-wage earners, income has stagnated over at least the same period.[22] Not surprisingly, personal savings as a percentage of disposable income has decreased over this time, and mirrors the trend in increasing debt.[23] In the late 1970s, Americans saved about 10% of their disposable income.[24] Today that figure is less than 5% and below the 30-year average savings rate per capita.[25] In sum, the average American's purchasing power has not changed for decades, her or his daily cost of living has increased, and she or he saves about half as much as compared to several decades ago. There are still bills to pay, however, and without increasing incomes to match their expenses, Americans look elsewhere to get by.

To fill this gap, consumers increasingly rely on debt to fuel their consumption needs.[26] Household debt as a percentage of disposable income has steadily risen from 66% in 1981 to 113% in 2003.[27] Mortgage debt had a more pronounced increase than other consumer debt, but consumer debt nonetheless accounted for about one-quarter of total household debt as a percentage of disposable income before 2008.[28] During the 1980s and 1990s, credit cards became the de facto tool to access consumer debt.[29] Although poor households were less likely to have at least one credit card during this period, those that did have a credit card were more likely to carry a balance, averaging over $1,300 in 1995.[30] New and creative

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higher rents because they cannot afford the increasing costs of homeownership. These higher rents and lower incomes have led to a significant increase in evictions nationwide and contribute to the cycle of poverty. *See* Matthew Desmond, *Forced Out*, NEW YORKER (Feb. 8 & 15, 2016) http://www.newyorker.com/magazine/2016/02/08/forced-out ("For decades, social scientists, journalists, and policymakers have focused on jobs, public assistance, parenting, and mass incarceration as the central problems faced by the American poor, overlooking just how deeply housing is implicated in the creation of poverty.").

21. THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 309 fig.9.1 (Arthur Goldhammer trans., Harvard Univ. Press 2014).

22. Cappiello, *supra* note 18.

23. MINN. PRIVATE COLL. COUNCIL, *supra* note 17 ("Personal savings in dollars and as a percent of personal income dropped continuously since their high in the early 1980s until around 2006 when a slight bounce back began.").

24. *Id.*

25. *Id.*

26. Matteo Iacoviello, *Household Debt and Income Inequality, 1963-2003*, 40 J. MONEY, CREDIT & BANKING 929, 933 (2008).

27. *Id.* at 930.

28. *Id.* at 933.

29. Edward J. Bird et al., *Credit Card Debts of the Poor: High and Rising*, 18 J. POL'Y ANALYSIS & MGMT. 125, 128 (1999).

30. *Id.*

products emerged during this period to serve those with poor or no credit history, and who could not otherwise qualify for a traditional credit card.[31]

These alternative loan products have proliferated over the past two decades.[32] Between 1999 and 2006, short-term loan outlets almost tripled nationwide.[33] There were as many as 24,000 payday loan stores across the country in 2007.[34] This number has declined since then, but payday lending is nonetheless a $46 billion industry today.[35] Payday loans cost American families $6.75 billion each year *in fees alone*.[36] Sixty percent of Americans live in states where "high-interest lending" is legal.[37] Those that borrow from payday lenders take out an average of eight payday loans per year, spending about $520 on interest.[38] Critically, 40% to 60% of consumers take out high-interest loans to cover routine expenses like utility bills and rent.[39] Reliance on high-interest loans for regular expenses traps individuals in long-term debt: 75% of all payday loans are the result of "churning," where trapped borrowers take out *new* payday loans to cover the repayment of the original loan.[40]

Although often advertised as emergency loans for unexpected expenses, only 15.4% of first-time payday loans go toward "unexpected" expenses.[41] In this way, high-interest, short-term loans trap borrowers in

31. *See, e.g.*, INSTALLMENT LOANS, *supra* note 9, at v (describing the variety of nontraditional consumer debt products offered today); Martin, *supra* note 16, at 564 (explaining the proliferation of short-term loan outlets beginning in the 1990s).

32. Martin, *supra* note 16, at 564.

33. *Id.*

34. NICHOLAS BIANCHI, NAT'L PEOPLE'S ACTION, PROFITING FROM POVERTY 8 (2012), http://npa-us.org/files/images/profiting_from_poverty_npa_payday_loan_report_jan_2012_0.pdf.

35. Jessica Silver-Greenberg, *Consumer Protection Agency Seeks Limits on Payday Lenders*, N.Y. TIMES (Feb. 8, 2015, 7:31 PM), https://dealbook.nytimes.com/2015/02/08/consumer-protection-agency-seeks-limits-on-payday-lenders.

36. Patrick L. Hayes, *A Noose Around the Neck: Preventing Abusive Payday Lending Practices and Promoting Lower Cost Alternatives*, 35 WM. MITCHELL L. REV. 1134, 1139 (2009).

37. VT. ATTORNEY GEN.'S OFFICE, ILLEGAL LENDING: FACTS AND FIGURES 4 (2014), http://ago.vermont.gov/assets/files/Consumer/Illegal_Lending/Illegal%20Lending%20Report%20April%202014.pdf [hereinafter ILLEGAL LENDING].

38. *Id.*

39. *Id.* at 3.

40. *See id.* (explaining the phenomenon of debt "churning"); KATHLEEN BURKE ET AL., CONSUMER FIN. PROT. BUREAU, CFPB DATA POINT: PAYDAY LENDING 4 (2014), http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf ("Over 80% of payday loans are rolled over or followed by another loan within 14 days . . . .").

41. S*ee* FED. DEPOSIT INS. CORP., FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 42–43 (2009), https://www.fdic.gov/HOUSEHOLDSURVEY/2009/full_report.pdf (explaining that some households use predatory loans "to make up for lost income"); Kathryn Fritzdixon et al., *Dude, Where's My Car Title?: The Law, Behavior, and Economics of Title Lending Markets*, 2014 U. ILL. L. REV. 1013, 1036 tbl.7 (identifying rent and mortgage payments, car repairs, gifts, and utility payments as significant reasons for obtaining a small loan); THE

"cycles of debt" that undermine their financial stability.[42] Compounding this problem, these loans generally lack transparency of their actual cost to borrowers.[43] Borrowers become trapped because they need to borrow more money to cover their existing debt obligations.[44] Lenders' financial incentives "misalign" with borrowers' financial stability because lenders underwrite these loans *not* based on the borrower's ability to repay the loan, but rather on the profitability of the fees and interest generated from borrowers' ongoing debt obligations to the lender.[45]

Borrowers cannot effectively address this "misalignment" alone. Anticipatory, publicly enforced regulations can more efficiently prevent the harms of predatory lending for several reasons.[46] First, predatory lending affects a broad and disenfranchised population.[47] Predatory lending victims lack ready access to the legal system, and the sums borrowed are often low enough that individual litigation is unrealistic.[48] The harm is diffused among many borrowers, making individual lawsuits an ineffective regulatory mechanism.[49] When collective action is feasible, it fails to address the harm already inflicted on victims, who are often trapped in debt and do not have the time or resources to support a collective action suit.[50] Second, the repeated and uniform nature of lending transactions

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PEW CHARITABLE TRS., PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 14 exhibit 4 (2012), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf (showing that nearly 70% of borrowers take out their first loan for recurring expenses).

42. ILLEGAL LENDING, *supra* note 37, at 3.

43. INSTALLMENT LOANS, *supra* note 9, at 26.

44. *Id.*

45. *See* Martin, *supra* note 16, at 577 ("Short-term loan products like payday loans create a debt trap by design. In fact, the debt trap *is* the business plan.") (footnote omitted); INSTALLMENT LOANS, *supra* note 9, at 26 ("Yet in certain credit markets, the lender's and the borrower's interests diverge. High interest rates, non-amortizing payments, and loan-flipping that builds up the cost of the loan and keeps the borrower in long-term debt can ensure profits for the lender even when many borrowers eventually default."). This point is the most incisive critique of the predatory lending industry. As the CFPB said in a proposed regulation of this type of lending behavior: "The Bureau is concerned that lenders that make covered loans have developed business models that deviate substantially from the practices in other credit markets by failing to assess consumers' ability to repay their loans . . . ." Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47864, 47864 (proposed July 22, 2016) (to be codified at 12 C.F.R. pt. 1041).

46. *See* Susan Rose-Ackerman, *Regulation and the Law of Torts*, 81 AM. ECON. R. 54, 54 (1991) (proposing that regulation is better than private litigation when individuals face high barriers to litigation).

47. *See id.* (describing the relative value of litigation versus regulation for various kinds of liability).

48. *Id.*

49. *Id.*

50. *Id.* (explaining that after-the-fact collective action is less useful than regulation when significant preventable harm has already occurred); Martin, *supra* note 16, at 567. Moreover, payday

means that an anticipatory regulatory system can efficiently predict the costs and benefits of potential harm.[51] Finally, lending abuses are widespread and common enough that after-the-fact lawsuits are an inefficient means of deterring undesirable lending practices.[52] Consumer lenders are therefore best regulated through anticipatory, state-enforced regulatory schemes.[53]

Given the wide latitude the Dodd-Frank Act gave states to enhance consumer lending protections, state legislators and regulators must understand which regulatory schemes most effectively address abusive lending behavior that traps consumers in cycles of debt. Moreover, states must understand how to effectively enforce these laws to hold lenders accountable for the most pernicious lending behavior.[54] Fortunately, Vermont provides a model for both.

II. VERMONT'S PREDATORY LENDING LAWS

Vermont has a suite of laws to combat predatory lending, including the "strongest law in the nation" to tackle predatory lending conducted online.[55] The online arena is an emerging market for predatory lenders, especially in a state like Vermont that prohibits actual payday lending storefronts.[56] As a preliminary matter, Vermont requires all lenders doing business in the State (other than federally chartered banks) to obtain a license from the Vermont Department of Financial Regulation (DFR).[57] These licenses require lenders

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loan contracts often contain arbitration agreements that waive the right to class action lawsuits, making after-the-fact litigation an impossible remedy for lending abuses. Michael A. Satz, *How the Payday Predator Hides Among Us: The Predatory Nature of the Payday Loan Industry and Its Use of Consumer Arbitration to Further Discriminatory Lending Practices*, 20 TEMP. POL. & CIV. RTS. L. REV. 123, 137, 145, 151 (2010).

51. *See* Rose-Ackerman, *supra* note 46, at 54–55 (explaining that regulation is desirable when the regulated activity is consistently predicable).

52. *See id.* (explaining the lack of a deterrent effect from individual litigation).

53. *See id.* (asserting that regulation is desirable when the regulated activity is predictable and the deterrent effect from litigation is minimal); Noah M. Sachs, *Rescuing the Strong Precautionary Principle from Its Critics*, 2011 U. ILL. L. REV. 1285, 1299–1300 (endorsing *ex ante* government regulation when potential harms are widespread, as with toxic chemicals).

54. *See infra* Part II (discussing Vermont's statutory provisions which allow recovery of financial losses from lenders).

55. ILLEGAL LENDING, *supra* note 37, at 1.

56. *See id.* at 1 n.2 ("By statute, Vermont has no brick-and-mortar payday lenders; illegal lending in Vermont typically occurs online.").

57. *See id.* at 1 ("Vermont has long-standing laws regulating money lenders . . . including licensing requirements to solicit or make loans . . . ."); VT. STAT. ANN. tit. 8, § 2201(a)(1) (2015) ("No person shall without first obtaining a license . . . engage in the business of making loans . . . ."); *id.* § 2233(b) (2015) ("No person shall engage in the business of soliciting or making loans by mail, telephone, or electronic means to residents of this State unless duly licensed.").

to compile an annual report that outlines the types of loans made to Vermont residents, the collateral used for them, and their total value.[58]

Payday loans, which are loans secured by a postdated check for a future payday, are explicitly prohibited under Vermont law.[59] Lenders cannot use postdated checks as collateral for loans in Vermont.[60] Online lenders attempt to circumvent this prohibition, however, by directly deducting funds from borrowers' bank accounts without technically using borrowers' next payday as collateral.[61] Vermont also caps interest rates for most types of loans at 12% to 24%, depending on the type of loan.[62] The penalty for exceeding this rate cap includes a criminal misdemeanor.[63] Finally, third parties that assist in making these loans are liable for supporting lenders who do not comply with Vermont law.[64] These restrictions allow the Vermont Attorney General to enforce Vermont's lending laws against not only predatory lenders, but also the banks and financial processors who assist with a lender's business operations.[65] All of these provisions provide added enforcement options for the Attorney General to combat predatory lending practices.[66]

This Part of the Note outlines Vermont's statutory protections and argues that they are necessary to effectively protect borrowers from predatory lending practices. Part III shows how the Vermont Attorney General's Office enforces these statutes to protect Vermont borrowers.

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58. VT. DEP'T OF FIN. REGULATION, ANNUAL LICENSEE REPORT FOR 2014, http://www.dfr.vermont.gov/sites/default/files/AR2014LLMBSFLS_Web.pdf [hereinafter LICENSEE REPORT] (identifying items used to secure loans in Schedule A of the report).

59. *See* VT. STAT. ANN. tit. 8, § 2519(a)(13) (2015) ("No licensee shall agree to hold a payment instrument for later deposit. No licensee shall cash or advance any money on a postdated payment instrument.").

60. *Id.*

61. ILLEGAL LENDING, *supra* note 37, at 1.

62. *See* VT. STAT. ANN. tit. 9, §§ 41a(b)(1)–(9) (2014) (delineating various interest rate caps based on loan type).

63. VT. STAT. ANN. tit. 9, § 50(c) (2014) ("Any person . . . who knowingly or willfully contracts for or collects any sum in excess of legal interest for the loan . . . shall, for the first offense, be fined not more than $500.00 or imprisoned for not more than six months, or both.").

64. *See* VT. STAT. ANN. tit. 9, §§ 2481w(b)–(d) (2014); *id.* § 2481w(d) ("It is an unfair and deceptive act and practice in commerce for any person, including the lender's financial institution . . . to provide substantial assistance to a lender or processor when . . . the lender . . . is engaging in an unfair or deceptive act or practice in commerce.").

65. *See id.* (describing liability for third parties who assist illegal lenders).

66. *See* ILLEGAL LENDING, *supra* note 37, at 7–8 (describing Vermont's "crackdown" on lenders and "other players in the web of illegal lending").

A. Mandatory Lender Registration and Associated Penalties

Vermont requires consumer lenders to register with the DFR.[67] Registered lenders must maintain a surety bond with the state for at least $50,000.[68] This bond is "conditioned" on a lender's ongoing compliance with Vermont law and "all rules and regulations" promulgated by the DFR.[69] The State or individuals may sue the lender for violations of state law, and the lender's surety bond may be used to compensate those plaintiffs.[70] Registered lenders must also maintain "liquid assets" of at least $25,000 for their business operating expenses, further increasing the amount of money available to plaintiffs if a lender violates the law.[71]

These financial reserves are just a threshold requirement for licensure.[72] Lenders must adhere to three additional requirements: (1) the "experience, character, and general fitness" of the applicant must "command the confidence of the community"; (2) the applicant, including each "officer, director, and control person" of a partnership or association, must never have had a lending license revoked in another jurisdiction; and (3) the applicant and its officers, directors, and control person must never have been convicted of, or pled guilty or *nolo contendere* to, a felony involving fraud, breach of trust, or a similar crime, or any other felony within the last seven years.[73] The Commissioner of the DFR investigates each applicant and determines whether they have met these criteria.[74] Applicants who do not meet these criteria are denied a lending license.[75] And lending without a lending license is subject to a $10,000 penalty per violation.[76] These registration requirements provide heightened screening and compliance measures for potential Vermont lenders. Not only are unsavory "fly by night" lenders excluded from the Vermont lending market,

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67. *See* VT. STAT. ANN. tit. 8, § 2201(d) (2015) (enumerating lenders who are exempt from registration).

68. *Id.* § 2203(a)(1)(A).

69. *Id.* § 2203(a).

70. *Id.* ("The bond shall run to the State for the use of the State and of any person or persons who may have cause of action against the obligor of such bond under the provisions of this chapter.").

71. *Id.* § 2203(d) ("Every applicant for a lender's license shall also prove . . . that the applicant has liquid assets of $25,000.00 . . . available for the operation of such business . . . .").

72. *See id.* §§ 2204c(a)–(b) (enumerating additional requirements for lender applicants).

73. *Id.* §§ 2204c(a)(1)–(3).

74. *Id.* § 2204c(b).

75. *Id.* ("If the Commissioner does not find as set forth in subsection (a) of this section, the Commissioner shall not issue a license.").

76. *Id.* § 2201(a) ("No person shall without first obtaining a license under this chapter from the Commissioner: (1) engage in the business of making loans . . . ."); § 2215(a)(1) (2009) ("The Commissioner may . . . impose an administrative penalty of not more than $10,000.00 for each violation upon any person who violates or participates in the violation of this chapter . . . .").

but legitimate lenders also risk their surety bond with the State for noncompliance with state law.

Once DFR grants a lending license, the registered lender must, among other obligations, submit annual reports on their Vermont lending activities.[77] Failure to comply with this requirement alone can result in a $10,000 administrative penalty.[78] Failure to pay such a penalty and continuing lending activities is a criminal offense that can result in a fine of up to $100,000, a year in prison, or both.[79] Failure to comply with the annual reporting requirements is just one type of obligation that can result in these penalties.[80] The following subsections highlight the major additional lending requirements that are subject to the same penalties.

B. Vermont's Prohibition on Payday Lending

Payday loans originated about 20 years ago to allow "a customer who wanted a small amount of cash quickly to borrow money and pledge a check dated for the next payday as collateral."[81] Vermont statute prohibits licensed lenders from agreeing "to hold a payment instrument for later deposit" or to "cash or advance any money on a postdated payment instrument."[82] Unlike the tens of thousands of payday loan storefronts found in states across the country, Vermont has none.[83] With the advent of online lending, however, lenders have an even more direct route to their customers' money: direct withdrawal from their bank accounts.[84]

Loans made contingent on access to the borrower's bank account are technically not payday loans for the purposes of Vermont law because the direct withdrawals are not based on a "postdated payment instrument."[85] These online lenders, however, often charge fees and interest

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77. *See* LICENSEE REPORT, *supra* note 55 (explaining licensee requirements).

78. *Id.* § 2215(a)(1).

79. *Id.* § 2215(c) ("It shall be a criminal offense, punishable by a fine of not more than $100,000.00, or not more than a year in prison, or both, for any person, after receipt of an order directing the licensee to cease exercising any duties and powers of a licensee . . . to perform such duties or exercise such powers of any licensee until the penalty has been satisfied . . . .").

80. *Infra* Part II.B–D (describing additional restrictions that can result in lender liability).

81. ILLEGAL LENDING, *supra* note 37, at 1 (quoting THE PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: POLICY SOLUTIONS 1 (Susan K. Urahn et al. eds., 2003)).

82. § 2519(a)(13).

83. *See* ILLEGAL LENDING, *supra* note 37, at 1 n.2 ("Vermont has no brick-and-mortar payday lenders . . . ."); BIANCHI, *supra* note 34, at 9 ("An industry estimate reports that in 2010 there were approximately 19,700 payday stores nationwide . . . .").

84. *See* ILLEGAL LENDING, *supra* note 37, at 6 ("The agreement contains an express authorization giving the lender access to the consumer's bank account, and allowing automatic withdrawals or debits from the account.").

85. *Id.* at 1.

similar to payday lenders that, when annualized, far exceed the legal interest rate caps.[86] The mere prohibition on "payday" lending does not prevent the more pernicious practice of directly withdrawing money from consumers' bank accounts.[87] Additional statutory safeguards, however, protect consumers from these online loans.[88]

C. Interest Rate Caps

Vermont caps the interest rates of all loans subject to Vermont law.[89] Typically, annual percentage rates (APRs) are capped between 18% and 24% (although credit card agreements may specify higher rates).[90] Some online lenders charge APRs that significantly exceed this cap.[91] The Vermont Attorney General's Consumer Assistance Program collects complaints of such loans, and some examples are illustrative.[92] One Vermont borrower obtained an online loan for $400 with an APR of over 300%.[93] In that case, the lender deducted over $1,000 over five months in automatic bank withdrawals.[94] In another case, a $500 online loan had a $200 "finance charge" that the lender automatically deducted *every two weeks* from the borrower's bank account.[95] Every time the lender deducted a payment from the borrower's account, the lender also deducted the recurring $200 finance charge.[96] Similar complaints all show lenders charging an effective APR of several hundred percent above the statutory limits.[97]

Excessive APRs on small consumer loans help explain lenders' incentives underlying such loans. Larger loans are underwritten with a view that both the principal and the interest must be paid back to make the loan profitable.[98] Typically, loan underwriting emphasizes the borrower's ability

86. *See id.* at 2 (explaining that any such loans that exceed the interest rate caps are still illegal in Vermont).

87. *Id.*

88. *See infra* Part II.C–D (describing these additional measures).

89. VT. STAT. ANN. tit. 9, § 41a(c) (2014).

90. *See id.* § 41a(b)(3) ("For a bank credit card account . . . the rate shall be the rate agreed upon by the lender and the borrower.").

91. *See* ILLEGAL LENDING, *supra* note 37, at 2 ("Vermonters have been charged 10–20 times the legal interest rate . . . .").

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *See* INSTALLMENT LOANS, *supra* note 9, at 26 ("In a well-functioning market, the interests of lenders and borrowers are aligned. Lenders have an incentive to lend only to borrowers who are able

to repay the entire loan amount because the principal itself is so substantial.[99] With small consumer loans—when the principal is often small relative to the potential interest and fees—the profitability for the lender lies in the size of the fees, often irrespective of whether the principal is actually repaid.[100] The underwriting incentive to issue these loans is therefore not the borrower's ability to pay back the principal, but to collect higher fees and interest over time, irrespective of the borrower's ability to repay the original debt.[101]

In this way, lenders may prefer that borrowers do *not* pay back the loan principal, at least not right away, because that allows the lender to charge higher fees and interest over time.[102] Thus, what is good for the consumer—sustainable debt that fits within one's budget—can be at odds with lenders' incentives to collect the maximum fees and interest.[103] Vermont's interest rate caps effectively undermine this adverse incentive because of the high penalties imposed for exceeding these caps.[104] Vermont has also targeted those who facilitate these predatory loans.[105]

D. Third-Party Liability for Assisting Illegal Lenders

Vermont's most far reaching predatory lending law prohibits third parties, including banks, processors, and debt collectors, from assisting lenders who do not comply with Vermont law.[106] It is an "unfair and deceptive act" for a third-party processor to process funds in connection with a loan that does not comply with state lending laws.[107] It is likewise an "unfair and deceptive act" for anyone, including a lender's financial institution, to provide "substantial assistance" to a lender who does not

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to make the payments as scheduled. If the payments prove unaffordable, both the lender and the borrower lose.").

99. *Id.*

100. *See* ILLEGAL LENDING, *supra* note 37, at 2 (explaining that the second largest illegal lender in Vermont collected $30,000 more in fees alone than the entire principal loaned in Vermont).

101. *Id.* at 3 (explaining that many borrowers enter "cycles of debt" for over one year based on these short-term loans).

102. INSTALLMENT LOANS, *supra* note 9, at 26.

103. *Id.*

104. VT. STAT. ANN. tit. 8, § 2215(a)(1) (2015).

105. *Id.*

106. *See* ILLEGAL LENDING, *supra* note 37, at 7 ("Vermont's UNIQUE law imposes liability on other players in the web of illegal lending.").

107. VT. STAT. ANN. tit. 9, § 2481w(c) (2014) ("It is an unfair and deceptive act and practice in commerce for a processor . . . to process a check, draft, other form of negotiable instrument, or an electronic funds transfer from a consumer's financial account in connection with a loan solicited or made by any means to a consumer unless the lender is in compliance with [Vermont law].").

comply with Vermont's lending laws.[108] Third-party liability only exists when that party has received actual notice of the lender's noncompliance, learns about the noncompliance itself, "consciously avoids" knowing about the lender's noncompliance, or is otherwise engaged in "unfair or deceptive acts."[109] Debt collectors are also prohibited from collecting on loans made contrary to Vermont law.[110]

Third-party liability allows new channels for enforcement and reflects the threat posed by online-only lending.[111] Because online lenders often require direct access to borrowers' bank accounts, third-party processors and originating banks are necessary to complete the loan transactions.[112] These institutions are now subject to the same demand letters, settlements, and lawsuits as lenders themselves.[113] Lenders market their loans directly through search engine services and third-party referral websites that process loan applications for multiple lenders.[114] Once a loan has been electronically deposited into a borrower's account, the lender seeks to withdraw the principal and interest payments through their "originating" bank or through a third-party processor via the Automated Clearing House (ACH) network.[115] Since borrowers have expressly permitted these withdrawals, they cannot simply ask their banks to stop them.[116] Vermont broadened lending liability to those that *facilitate* predatory practices because of this increasingly complex web of online lending.[117] In addition to settlements with illegal lenders, Vermont has settled with one payment processor.[118]

III. VERMONT'S COMPREHENSIVE ENFORCEMENT EFFORTS

The Vermont Attorney General's Office (AGO) addresses illegal lending by: (1) settling with lenders who make illegal loans in Vermont; (2)

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108. § 2481w(d) ("It is an unfair and deceptive act and practice in commerce for any person . . . to provide substantial assistance to a lender or processor . . . .").

109. *Id.*

110. 06-004 VT. CODE R. § 104.05(c) (1974) (limiting debt collection to "[t]he collection of or the attempt to collect any interest or other charge . . . unless such interest or incidental fee, charge, or expense is . . . legally chargeable to the debtor, or is legally chargeable under state law . . . .").

111. *See* ILLEGAL LENDING, *supra* note 37, at 7–8 (explaining the unique enforcement options that third-party liability permits).

112. *Id.* at 5 fig.1.

113. *Id.* at n.14 (noting that Internet service providers and out-of-state loan originating banks have not been subject to Vermont legal action due to FDIC oversight, among other concerns).

114. *Id.* at 5.

115. *Id.* at 6.

116. *Id.*

117. *Id.* at 6–7.

118. *Id.* at 8.

suing lenders who do not comply with their requests; (3) sending cease-and-desist letters to illegal lenders; and (4) seeking assistance from online service providers and others to block illegal lenders from advertising in Vermont.[119] The AGO has settled with the three largest illegal lenders in Vermont, as well as a payment processor that did business for unlicensed lenders.[120] These settlements are discussed below to highlight the impact of the AGO's enforcement efforts.[121] The AGO initiated several lawsuits against lenders and payment processors who refused to comply with Vermont law.[122] The AGO has sent cease-and-desist letters to over 80 lenders who have violated Vermont law.[123] Finally, the AGO has sought help from major online content providers, like Google, Yahoo, and Microsoft, to limit the advertising reach of online lenders who do not comply with Vermont law.[124] The AGO also seeks help from local radio and TV stations, as well as Vermont banks and credit unions.[125] Additionally, the AGO communicates with various national associations for lenders and payment processors to warn them of Vermont's third-party liability laws.[126]

A. Settlements

Vermont has initiated several lawsuits against lenders and processors that have all resulted in settlements.[127] For example, the Intercept Corporation settlement stipulation discussed below was initially a lawsuit by the AGO.[128] The added hassle and cost of litigation has apparently deterred lenders or processors from litigating in court.[129] The track record of the AGO initiating such suits may also deter future illegal lenders from testing their chances in the Vermont market. The Vermont

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119. *Id.* at 8–10.
120. *Id.* at 8.
121. *Infra* Part III.A–C.
122. ILLEGAL LENDING, *supra* note 37, at 8.
123. *Id.* at 9.
124. *Id.* at 10.
125. *Id.*
126. *Id.*
127. *See id.* at 8–9 (highlighting the settlements with companies that began with litigation).
128. Assurance of Discontinuance at 4, *In re* Intercept Corp., No. 591-10-14-Wncr (Vt. Super. Ct. Oct. 1, 2014), http://ago.vermont.gov/assets/files/PressReleases/Consumer/Intercept%20AOD%20Filed.pdf [hereinafter *In re* Intercept Corp.].
129. Although the AGO initiated several lawsuits against lenders and processors, it appears that they have all settled to Assurance of Discontinuance agreements. *See* ILLEGAL LENDING, *supra* note 37, at 8–9 (recognizing settled disputes with lenders); *Illegal Lending*, VT. ATT'Y GEN.'S OFF. (Aug 2016), http://ago.vermont.gov/focus/consumer-info/money-and-credit/illegal-lending.php (recognizing no pending lawsuit for illegal lending in Vermont).

AGO has settled with ten illegal lenders or third parties as of August 2016.[130] These settlements have led to over $1,250,000 in refunds to over 6,700 Vermont borrowers.[131] Vermont has also collected approximately $225,000 in penalties from these settlements.[132]

1. Western Sky Financial

Vermont settled with the largest illegal lender to date, Western Sky Financial, who lent almost $1,000,000 to over 400 Vermonters and collected almost $900,000 in interest and fees.[133] This lender's activities were "illegal" because they charged interest exceeding Vermont's statutory cap, and did not have a license with the DFR.[134] Western Sky's loans to Vermonters ranged from $700 to $10,000 with APRs between 89% and 169%.[135] Most of these loans were under $5,000 with APRs exceeding 100%.[136] As part of the settlement with Vermont, the lenders paid $50,000 in penalties and will cancel over $500,000 in loans to Vermont consumers.[137] Civil fines account for $20,000 of the penalty, and the State's costs associated with their investigation account for the remaining $30,000.[138] Western Sky agreed to halt all lending to Vermonters until they fully comply with Vermont's licensing requirements.[139]

2. Government Employees Credit Center, Inc. and Sure Advance, LLC

Government Employees Credit Center (GECC) has a particularly egregious record of charging APRs exceeding 300% on almost $200,000 in loans.[140] GECC also lacked a state license, and ultimately charged Vermonters over $229,000 in interest and fees alone.[141] GECC

130. *Illegal Lending*, *supra* note 129.
131. *Id.*
132. *Id.*
133. ILLEGAL LENDING, *supra* note 37, at 8.
134. Assurance of Discontinuance at 5, *In re* W. Sky Fin., LLC, No. 241-4-14 Wncr (Vt. Super. Ct. Apr. 18, 2014), http://ago.vermont.gov/assets/files/Consumer/AOD%20filed%20(CashCall%204-18-14).pdf [hereinafter *In re* W. Sky Fin.].
135. *Id.* at 4.
136. *Id.*
137. *Id.* at 13; ILLEGAL LENDING, *supra* note 37, at 8.
138. *In re* W. Sky Fin., *supra* note 134, at 12.
139. *Id.* at 6.
140. Assurance of Discontinuance at 3, *In re* Gov't Emps. Credit Ctr., Inc., No. 173-3-14 Wncr (Vt. Super. Ct. Mar. 24, 2014), http://ago.vermont.gov/assets/files/Consumer/AOD%20filed%20(GECC)%203-24-14.pdf.
141. *Id.*

agreed to repay all of the interest and fees along with a $15,000 penalty to the State.[142]

Similarly, Sure Advance loaned almost $150,000 to 296 Vermonters without a license and in excess of the statutory interest rate caps.[143] These loans were smaller than those of Western Sky, ranging from $200 to $1000, but with significantly higher APRs, exceeding 300%.[144] In total, Sure Advance collected over $144,000 in fees and interest from Vermont consumers.[145] They collected fees and interest through direct access to Vermont borrowers' bank accounts using third-party payment processors.[146] As part of the AGO's Assurance of Discontinuance with Sure Advance, Sure Advance repaid all of the interest and fees to Vermonters.[147] Additionally, Sure Advance paid $15,000 in civil penalties and costs to Vermont.[148]

3. Intercept Corporation and T$$, LLC

Intercept Corporation (Intercept) is an electronic payment processor for consumer lenders.[149] Intercept provides software systems to process financial transactions through a national network for electronic fund transfers.[150] Intercept processed fund transfers for at least 26 separate lenders, totaling $680,000 from Vermont consumers' bank accounts.[151] None of these lenders were licensed with DFR.[152] The AGO sued Intercept, and Intercept ultimately agreed to an Assurance of Discontinuance.[153] Intercept agreed to stop processing transactions on behalf of unlicensed lenders and to credit $75,000 to individual consumers' bank accounts.[154] Additionally, Intercept paid the State $10,000 as a penalty.[155]

Like Intercept, T$$ (T Money) is a processor that debited over $900,000 from multiple Vermont financial institutions on behalf of at least

142. *Id.* at 6.

143. Assurance of Discontinuance at 3, *In re* Sure Advance, LLC, No.107-2-14 Wncr (Vt. Super. Ct. Feb. 25, 2014), http://ago.vermont.gov/assets/files/Consumer/AOD%20Filed%20(SureAdvance)%202-25-14.pdf.

144. *Id.*

145. *Id.*

146. *Id.* at 2.

147. *Id.* at 5.

148. *Id.* at 6.

149. *In re* Intercept Corp., *supra* note 128, at 1.

150. *Id.* at 3.

151. *Id.*

152. *Id.*

153. *Id.* at 4.

154. *Id.* at 5.

155. *Id.* at 6.

40 unregistered lenders.[156] T Money agreed to return $90,000 to Vermont borrowers, and pay $60,000 into an escrow account for additional claims.[157] Like Intercept, T Money paid an additional $10,000 to the State as a penalty.[158]

These settlements would not be possible without the 2012 addition of 9 V.S.A. § 2481w.[159] This section of the Vermont Consumer Protection Act allows Vermont to pursue the underlying processors for multiple lenders in addition to the lenders themselves.[160] The T Money and Intercept settlements stopped, at least temporarily, over 66 unlicensed lenders from deducting money from Vermont consumers' bank accounts.[161] As these cases demonstrate, settlements with payment processors may be more efficient than settling with individual lenders because payment processors often serve as a hub for multiple illegal lenders.

B. Cease-and-Desist Orders and Advisory Letters

The Vermont AGO has also sent cease-and-desist letters to 81 known illegal lenders demanding compliance with Vermont law.[162] In a separate effort, the AGO has contacted various parties to seek their assistance in enforcing Vermont's illegal lending laws.[163] The AGO contacted online content providers and television and radio providers to ask them to prohibit advertising from lenders who do not comply with Vermont law.[164] Most significantly, Google agreed to prohibit 66 illegal lenders from using Google's advertising services.[165] Similarly, Microsoft agreed to prohibit advertising by identified illegal lenders on the Bing search engine.[166] The AGO has also contacted various lending associations to warn their

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156. Assurance of Discontinuance at 2, *In re* T$$, LLC, No. 249-4-14 Wncr (Vt. Super. Ct. Apr. 22, 2014), http://ago.vermont.gov/assets/files/Consumer/T%20Money%20Vermont%20AOD%20(filed%204-22-14).pdf [hereinafter *In re* T$$].

157. *Id.* at 4–6.

158. *Id.* at 7.

159. VT. STAT. ANN. tit. 9, § 2481w(c) (2014) ("It is an unfair and deceptive act and practice in commerce for a processor . . . to process a check, draft, other form of negotiable instrument . . . in connection with a loan solicited or made by any means to a consumer unless the lender is in compliance with all provisions of [Vermont's consumer lending laws.]").

160. *Id.*

161. *See In re* Intercept Corp., *supra* note 128, at 11, exhibit A (processing transactions for at least 26 unlicensed lenders); *In re* T$$, *supra* note 156, at 3 (processing transactions for at least 40 unlicensed lenders).

162. *Illegal Lending*, *supra* note 129.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

institutional members of the penalties for violating Vermont law.[167] These include associations of third-party payment processors.[168]

These efforts compliment other actions the AGO has taken regarding illegal lending. If an online lender wants to skirt Vermont's lending laws, they now face a myriad of obstacles: (1) online advertising for illegal loans is restricted; (2) payment processors are reluctant to do business with unlicensed lenders; and (3) Vermont has established a track record of imposing significant penalties and restitution on lenders who violate Vermont law.[169] As discussed earlier, online high-interest lending can be highly lucrative, but with Vermont's multi-pronged enforcement and prevention efforts, illegal lending in Vermont is now a high-risk, low-reward venture.[170] Vermont borrowers are better off—to the tune of over $1,000,000 back in their bank accounts—because of these efforts.[171]

C. Promoting Alternatives to Predatory Lending

In addition to these enforcement and compliance efforts, the AGO promotes efforts by employers to provide alternatives to short-term, high-interest loans.[172] The AGO sent an open letter to Vermont employers encouraging them to provide income advances to employees as needed.[173] This letter highlights the efforts of the United Way of Chittenden County and their Working Bridges loan program.[174] In part, this program helps employers connect with local financial institutions to provide short-term emergency loans to employees.[175] This alternative to predatory lending is designed to help employees improve their financial stability while minimizing work disruptions and absenteeism.[176] Employers have a natural incentive to support employees' additional financial needs and minimize employee reliance on predatory lenders because financially stable

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167. *Id.*

168. *Id.*

169. *See infra* Part III (discussing Vermont's comprehensive enforcement efforts).

170. *See, e.g.*, Assurance of Discontinuance at 5–6, *In re* A-1 Premium Budget, Inc., No. 731-12-14 Wncr (Vt. Super. Ct. Dec. 3, 2014), http://ago.vermont.gov/assets/files/Consumer/Illegal_Lending/2014%2012%2003%20Cash%20in%20a%20Wink%20AOD%20Filed.pdf (requiring penalties and restitution exceeding the total interest earned from lending activities).

171. ILLEGAL LENDING, *supra* note 37, at 9.

172. *Illegal Lending*, *supra* note 129.

173. Letter from Justin E. Kolber, Assistant Attorney Gen., State of Vt., to Vt. Emp'rs 2 (Apr. 22, 2014), http://ago.vermont.gov/assets/files/Consumer/Illegal_Lending/Letter%20to%20VT%20Employers%20April%202014.pdf.

174. *Id.* at 2.

175. *Id.*

176. *Working Bridges*, UNITED WAY OF NW. VT., http://www.unitedwaycc.org/Working-Bridges (last visited May 3, 2017).

employees are more reliable workers.[177] This approach to combatting the instability created by predatory lending has received national acclaim and is being studied as a nationwide model for promoting the financial stability of moderate-income workers.[178] As the Vermont letter of support for these employer initiatives makes clear, employee wage advances received directly from employers are not considered loans under Vermont law, as long as employers do not charge interest.[179]

IV. Failures in Predatory Lending Regulation and Enforcement

Many states lack rigorous statutory schemes that allow for aggressive enforcement against predatory lenders.[180] Even as states like Vermont limit payday lending specifically, predatory lenders "are offering alternative products like installment loans and open lines of credit," which are technically outside of states' payday lending laws.[181] Alternative loan products such as these take advantage of loopholes in state predatory lending laws. Of the 15 jurisdictions that prohibit payday lending, four do not cap fees on open-ended credit, five allow full APRs up to 65%, and only six, including Vermont, limit full APRs on small loans at 36% or lower.[182] These alternative loan products—often used by consumers as an alternative to federally regulated credit cards and state-regulated payday loans—have flown "under the radar" of state legislators and regulators.[183] For example, 11 states have no cap on interest rates for installment loans, and five of those states do not even prohibit "unconscionable" lending practices.[184] These 11 states also allow payday lending.[185] Without the effective enforcement of "unconscionable" interest rates, loans in these

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177. *See id.* (highlighting the benefits of this program for both employees and employers).

178. *Id.*

179. *See* Letter from Justin E. Kolber to Vt. Emp'rs, *supra* note 173 (explaining that interest-free advances are not loans).

180. Ashlee Kieler, *Most State Laws Can't Protect Borrowers from Predatory Installment Loans, Open-End Lines of Credit*, CONSUMERIST (July 30, 2015), http://consumerist.com/2015/07/30/most-state-laws-cant-protect-borrowers-from-predatory-installment-loans-open-end-lines-of-credit (explaining the loopholes in state payday lending laws).

181. *Id.*; Ashlee Kieler, *Can New Payday Loan Rules Keep Borrowers From Falling Into Debt Traps?*, CONSUMERIST (Mar. 26, 2015, 12:01 AM), http://consumerist.com/2015/03/26/proposed-rules-would-change-the-face-of-payday-loans-add-protections-for-borrowers.

182. INSTALLMENT LOANS, *supra* note 9, at 55.

183. *Id.* at v. *See also* Jim Hawkins, *Credit on Wheels: The Law and Business of Auto-Title Lending*, 69 WASH. & LEE L. REV. 535, 602–03 (2012) (discussing lenders' methods for evading interest rate caps).

184. INSTALLMENT LOANS, *supra* note 9, at 6.

185. *Id.* at 7.

states can have APRs as high as 1500%.[186] This Part highlights the variable nature of state standards and explains how emerging loan products take advantage of weaknesses in these standards.

A. Statutory Loopholes for Fees, Interest, and Loan Packaging

"Full APRs" account for both the interest rate and loan fees applied to a loan product.[187] States that cap interest rates but allow exorbitant fees provide little protection to borrowers.[188] Some courts have interpreted interest rate caps to include additional fees within that limit, which is generally consistent with the broad definition of interest under federal law.[189] The math on interest and fees is telling: although Indiana caps interest for a $500 fixed-installment loan at 36%, the State also allows a $50 loan-origination fee.[190] This allows for a full APR of 71%.[191] For the same size loan in Oklahoma, the full APR is 116%, with 10% interest on the principal, and a monthly charge of approximately $22.[192] Full APRs become exorbitant when the loan amount is relatively low: a $100 fee on an $8,000 loan is quite small, but the same fee on a $300 loan can equal a full APR of 149%.[193] A $200 two-week loan with only $30 in fees would amount to an APR of 391%.[194]

Full APR caps for installment and open-ended loans can be very high, ranging from 94% in Alabama, to 93% in Texas, 85% in Louisiana, and no cap at all in Idaho, Illinois, Kansas, Missouri, New Mexico, South Dakota, Utah, Wisconsin, and Ohio.[195] All of these states also allow payday lending.[196] States that prohibit payday lending also limit full APRs for installment and open-ended credit, with caps ranging from 61% in Georgia and 54% in Connecticut, to 65% in New Jersey, and 18% to 25% in Maryland, Vermont, North Carolina, and New York.[197]

Vermont prohibits origination fees and has an interest rate cap of 24%.[198] Such a ban creates more transparency for borrowers because a

186. *Id.*
187. *Id.*
188. *Id.* at 10.
189. *Id.* at 10–11.
190. *Id.* at 10.
191. *Id.*
192. *Id.*
193. *Id.* at 11.
194. *Payday Lenders*, DEBT.ORG (2017), https://www.debt.org/credit/payday-lenders.
195. INSTALLMENT LOANS, *supra* note 9, at 56.
196. *Id.*
197. *Id.* at 57.
198. *Id.* at 13.

loan's "full APR" is easier to discern.[199] Most states, however, will try to regulate loan fees and interest rates separately, diminishing the transparency of the full APR.[200] Moreover, many states fail to regulate the sale of add-on products, known as loan packaging.[201] Lenders regularly sell credit insurance with their loans that is often low-value and unnecessary, yet yields greater profits for the lenders.[202] These insurance products lead to payouts for consumer claims ranging from 13% to 44% of premiums, which is significantly below the typical "loss ratio" of 70% of premiums for most insurance products.[203] In this way, these add-on products are simply one more way that lenders charge borrowers more money without providing better services.[204] Legislators should draft statutory language with these loopholes in mind because transparency of the actual cost of short-term loans is a key tool to protect the financial stability of vulnerable borrowers.

B. Addressing the Diverging Interests of Lenders and Borrowers

Because small-amount lenders are generally uninterested in a borrower's actual ability to repay a loan, as long as the lender receives enough fees and interest, some states have tried to correct this perverse incentive.[205] Only California, Oregon, Missouri, and Texas require lenders to consider a borrower's creditworthiness when making an installment loan.[206] Colorado and Illinois set loan standards based on the borrower's income.[207] Although vague ability-to-repay standards may not prevent unaffordable lending practices, such standards provide an additional incentive to merge the interests of lenders and borrowers.[208] However, this additional measure is only effective within a regulatory regime that caps interest rates, prevents lending loopholes, and effectively enforces the law.[209]

Another method to reduce actual APRs is to cap the length of repayments for low-amount consumer loans.[210] A $500 loan with $50 payments will have a full APR of 70% if paid back in six months, or a full

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199. *Id.*
200. *Id.*
201. *Id.*
202. *Id.* at 13–14.
203. *Id.* at 14.
204. *Id.*
205. *Id.* at 27.
206. *Id.*
207. *Id.*
208. *Id.* at 26–27.
209. *Id.* at 27.
210. *Id.* at 31.

APR of 237% if paid back over two years, because of how many payments are made over time.[211] About half of states cap the length of repayment for loans based on a loan's principal.[212] These time limits for a $1,000 loan range from 18 months in Oklahoma to eight years in North Carolina.[213] Vermont, however, does not set loan-repayment timeframes.[214] The National Consumer Law Center recommends that states that already have rigorous interest rate limits should also cap the repayment period for these loans.[215] For larger loan amounts the repayment timeframe should naturally be longer, so a $1,000 loan should generally be capped at a 24-month repayment period, and a $500 loan should be capped at a 12-month repayment period.[216]

CONCLUSION

Consumer lending laws vary dramatically among states.[217] How these laws protect consumers from unfair lending terms is a crucial regulatory concern because of the destabilizing effect that predatory loans have on low-income borrowers.[218] Vermont provides an excellent example of a comprehensive statutory scheme and robust enforcement efforts.[219] Given the primary role that states have in creating and enforcing predatory lending laws, other states would serve their citizens well by looking to Vermont as a model for consumer lending protection.[220] Vermont's comprehensive interest rate caps provide the teeth with which the Vermont Attorney General's Office holds predatory lenders accountable.[221] Several years after the passage of the Dodd-Frank Act, it is about time that other states followed Vermont's lead in predatory lending regulation and enforcement.

State legislators and regulators must recognize the pernicious effect that unregulated consumer lending has on the financial stability of low-income borrowers.[222] Legislators must revamp their statutory scheme to cap

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211. *Id.* at 29–30.
212. *Id.* at 29.
213. *Id.* at 31.
214. *See id.* (noting the lack of a repayment statute in Vermont).
215. *Id.*
216. *See id.* ("A number of existing state laws impose a 24-month limit on a loan of $1000, and a 12-month limit on a loan of half the size would be consistent with that limit.").
217. *Supra* Part IV.
218. *Supra* Part I.
219. *Supra* Parts II, III.
220. *See supra* Part IV (detailing state failures to protect borrowers from excessive interest rates and fees).
221. *Supra* Section II.C.
222. *Supra* Part I.

interest rates and close loopholes.[223] Legislators must be wary of exempting any types of loans or categories of lenders from these caps, and include all fees when calculating interest rates.[224] Finally, the appropriate enforcement agency needs to have the resources and authority to aggressively enforce these laws.[225] Without a significant enforcement effort, the online world of predatory lending will continue to proliferate despite strong laws against their lending practices.[226]

—*Tucker Jones*[*†]

223. *See, e.g.*, *supra* Section II.C (describing Vermont's interest rate cap).

224. *Supra* Section IV.A.

225. *Supra* Part III.

226. *See supra* Section III.A (outlining the significant funds returned to consumers from Vermont's settlements with lenders, including online lenders).

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