METRO IDEAS PROJECT

Fighting Predatory Lending in Tennessee

A simple strategy for cities and counties

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Contents

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Executive Summary

For many Americans, loans and banking go hand in hand. Borrowing money from an institution typically requires a traditional financial provider, such as a bank or credit union, to underwrite that loan. But many of those facing tough financial situations have few options but to turn to nontraditional, and often less scrupulous, lenders.

These lenders, often known as payday lenders or check cashers, are used by over twelve million Americans. The loans they offer are characterized by some of the highest interest rates in the financial industry—annual percentage rates (APRs) range between 391 percent and 521 percent in the 28 states that these lenders are legally allowed to operate in, according to The Pew Charitable Trusts.[1] In fact, payday loans frequently carry fees and interest charges that exceed the principal amount loaned.

Tennessee has the most predatory lenders in the country. Based on an analysis of state licensing data:

- There are over 1,200 predatory lending locations across 89 of Tennessee's 95 counties.
- Shelby County leads the state, with 232 brick-and-mortar predatory lending locations in the county.
- Madison County has the highest concentration of lenders amongst Tennessee's 20 most populous counties, with 29.5 locations per 100,000 residents.
- People without a four-year college degree, home renters, African-Americans, and those earning below $40,000 are more likely to have used a payday loan. And contrary to payday lender advertising, seven in 10 borrowers use them for regular, recurring expenses as opposed to unexpected or emergency costs.

And the demand for payday and installment loans, another kind of high-interest revolving loan, is huge—with industry revenues exceeding $14.3 billion in 2016. This is indicative of a growing

1 The Pew Charitable Trusts. May 2016. *Payday Loan Facts and the CFPB's Impact.*

need for short-term, alternative credit options for people who are often underserved by traditional financial institutions. Predatory lenders are able to exploit this need, in part, because there are few alternatives for consumers to go to.

Traditional banks are typically restricted in the interest rates they can charge, with limits of 10 or 11 percent annual percentage rates for consumer loans. And access to credit cards is often limited to those lacking good credit scores.

Predatory lenders rely on extended indebtedness. The Consumer Financial Protection Bureau (CFPB) finds that 80 percent of payday loans are taken out within two weeks of repayment of a previous payday loan.[2] The industry often concentrates in distressed communities and areas with high rates of poverty.

These kinds of bad business practices are not only damaging to consumers, but they're also detrimental to the development of strong and prosperous communities. That's why the Metro Ideas Project (MIP) is taking on predatory lending as an urban policy challenge. In this report, we will dive into data from Tennessee to better understand the predatory lending landscape in our own state. But the policy recommendations and solutions presented herein are applicable to cities across the country.

This report proposes a three-prong strategy to combat predatory lending:

- **Warn:** Leverage laws allowing municipalities to regulate signage and require predatory lenders to post plainspoken warnings on all exterior signage (e.g., billboards, exterior signs, posters) about the dangers and risks associated with their services.

- **Permit:** Require an additional local permit to operate a predatory lending establishment in city boundaries.

- **Lend:** Create an alternative, community-based, and nonprofit lending institution under the same legal structure utilized by predatory lenders, featuring affordable rates, transparent fees, and honest underwriting practices.

As cities look to build strong local economies and bring people out of poverty, ensuring that people are not trapped in debt and have lending options that encourage upward mobility will be paramount. This research aims to provide cities a selection of tools and strategies to help achieve those goals.

2 The CFPB Office of Research. March 2014. *CFPB Data Point: Payday Lending.*

A Brief History of Predatory Lending

For most of American history, laws regulating lending and banking ensured high interest rate loans were illegal by simply banning their terms outright. The original colonies, later forming states and commonwealths, capped interest rates at 6 percent per year.[1] These laws were carried forward to many of the states that followed, including Tennessee. These laws were holdovers from English common law, established well prior to the development of mass-market consumer credit. These laws would be updated occasionally, expanding the powers of state legislatures to set conventional interest rates. In 1870, the state constitution of Tennessee capped interest rates at 10 percent, where it would remain for over a hundred years.[2]

As throughout human history, however, there were always less savory lenders willing to provide lines of credit with interest rates far exceeding state usury limits—loan sharks, in essence.[3] A hundred years ago, these "salary lenders" would offer one-week loans with APRs upward of 700 percent, threatening public humiliation, job loss, and even physical violence to ensure timely payment. Early attempts to regulate this gray market were failures. Efforts included establishing prohibitive legislation that created an explosive demand for small loans that were largely met by illegal lenders.

As early as 1909, the United States Congress would take up legislation designed to provide alternatives to these kinds of loan sharks in the District of Columbia with a financial service referred to as "remedial loans," a proposed financial product for low-income people seeking lines of credit. These kinds of loans would've allowed lenders to charge a monthly interest rate of 2 percent—or 24 percent APR. However, Washington regulators and congressmen at the time balked at the idea. Standards of decent lending practices, even with good intentions undergirding the proposal, slowed the adoption of legal small loan regulations—one prominent member of Congress summed up the sentiment by saying: "I do not think the money lenders who seek to get 2 percent a month ought to be protected. In my judgment, they ought not be permitted to do business in the United States. I want strict regulations on this subject. I will never support any measure that proposes 2 percent a month or 1.5 percent a month. More harm than good will come

1 Murray, J.B.C. 1866. *The History of Usury From the Earliest Period to the Present*.

2 Laska, Lewis. 1990. *The Tennessee State Constitution.*

3 Ham, Arthur H. January 1912. *Remedial Loans—A Constructive Program.*

of it."[4]

Eventually, however, the demand for small, short-term loans outstripped concerns about usury. Changes in the national economy meant many families were in need of consumer credit to cover shortfalls when wage interruptions or emergencies occurred. Around 1916, several states adopted laws that established so-called "reasonable rates" for licensed institutions to provide small loans with higher interest rates and fees, on the condition these lenders were subjected to strict supervision and regulation.[5] The justification for these laws held that legitimate lenders who supply credit in small amounts, at reasonable and legal rates, would push loan sharks out of the market and keep people out of financial ruin. These rates were higher than allowed by traditional loans, but far below the triple-digit rates charged by illegal loan sharks.

By 1923, the social stigma of small loan providers changed. Loan sharks, of course, were not content to simply give up their businesses. At every turn, they fought small loan laws and sought loopholes that allowed them to continue to charge exorbitant interest rates. Eventually, negative public perception of these small loan lenders diminished and they grew to be acknowledged as generally acceptable lending institutions. In some states, the availability of small loan lenders virtually eliminated illegal loan sharks.

Private foundations, in particular the Russell Sage Foundation (an early founder and champion of credit unions in the United States), were responsible for advocating for putting small loan laws on the books, generally referred to as the Uniform Small Loan Laws. They saw these laws as an answer to the problem of a lack of credit options for the nation's poor. States that adopted these laws early were typically states where employment circumstances increased the prevalence of illegal loan sharks. The foundation supported remedial loan funds, a strategy born out of the idea that the best way to combat predatory lenders was to compete with them directly in the marketplace, eventually forcing them to offer better terms. Remedial loan funds offered small loans at low rates on terms that were clear and transparent to borrowers, rooted in the principal that capital should be rewarded but not excessively.[6]

This experiment began to decline with the onset of the Depression. Falling interest rates and deflation set in and prompted some to demand reductions in maximum interested rates. By 1933, these reductions reached unrealistically low levels, and many small loan lenders weren't able to survive. In many states, this had the effect of ceding the market back to illegal loan sharks. Lenders who survived would eventually fall out of favor with American consumers, in large part due to the emergence of credit cards.

By the mid-20th century, social norms and lending practices had changed, and usury laws would begin to shift as well. Mortgages to purchase homes and credit cards would become far more prevalent. Tennessee's voters would vote to remove the 10 percent usury ceiling from its state constitution in 1978. A rapid period of deregulation at the federal level occurred as well, with national financial companies gaining broad rights to ignore interest rate caps at the state level.[7]

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4 Ibid

5 Hubachek, F.B.. 1938. *The Development of Small Loan Laws*.

6 Carruthers, Bruce G. & Guinnane, Timothy. September 2002. *Uniform Small Loan Laws in the United States, 1900-1940: A Case Study in the Influence of Foundations.*

7 Marquette Nat'l Bank v. First of Omaha Service Corp. et al. 1978. 439 U.S. 299.

As the consumer credit industry boomed, some states would continue the deregulation trend by allowing deferred presentment transactions—what many know today as payday loans. The payday industry emerged in the 1990s and would allow loans to be made against a postdated check in exchange for triple-digit APRs, with effective annual percentage rates sometimes exceeding 1,826 percent.[8] The number of payday brick-and-mortar locations grew from virtually zero in 1990 to over 10,000 locations across the United States by 1999.[9]

Tennessee, for its part, passed its Deferred Presentment Services Act in 1997, explicitly authorizing payday loans with some regulation. This initially had the effect of driving out many existing payday lenders until the industry successfully lobbied for more favorable terms. By 2009, Tennessee had the most payday lender locations in the entire country.[10]

Today, payday loans and other forms of predatory lending are a multi-billion-dollar industry. The Consumer Finance Protection Bureau estimates that in 2015 there were 15,766 payday loan stores across 36 states—compare that to the 14,350 McDonald's fast-food outlets in all of the United States in 2014 for a sense of scale. The industry is adopting new practices to increase market adoption and push the boundaries of already-loose regulatory environments, from online providers incorporated offshore or on tribal lands to the development of new products that exist outside of current regulation entirely.

Although they operate within a legal framework, many of the practices adopted by subprime, small-dollar credit providers reflect those of black market loan sharks of the early 20th century. And just as then, an alternative is required to induce bad actors to adopt fairer terms.

Consumers deserve a better lifeline than a business model that profits from keeping them in a long-term debt trap.

8 Moss, Lisa B., Alabama Law Review 51(4). 2000. Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation.

9 Stevens Inc. 1999. *The Developing Payday Advance Business*. Little Rock, Arkansas.

10 BBB. 2009. *The Payday Loan Industry in Missouri: A Study of the Laws, the Lenders, the Borrowers, and the Legislation.*

The State of Predatory Lending in Tennessee

A study by The Pew Charitable Trusts shows that 6 percent of Tennessee residents utilized predatory or payday loans in 2013.[1] A separate study published in 2009 by the Better Business Bureau of Southwest Missouri found that Tennessee led the nation in payday lending locations.[2]

Methodology

MIP sought to go beyond state-level data to provide a more current snapshot of the state of predatory lending in Tennessee. With data provided by the Tennessee Department of Financial Institutions, this report analyzes predatory lending by uniquely identifying and geolocating each individual payday lending storefront. Furthermore, varying license types were aggregated by unique location.

This report analyzed lending locations with at least one of four license types as defined by the state of Tennessee: Deferred Presentment, Title Pledge Lenders, Flexible Credit, and Check Cashers. Regardless of how many license types a particular location had, each location was only counted once per address.

This research allowed analysis by county and census tract, and to better understand any correlative relationships between resident demographics and the prevalence of predatory lending locations.

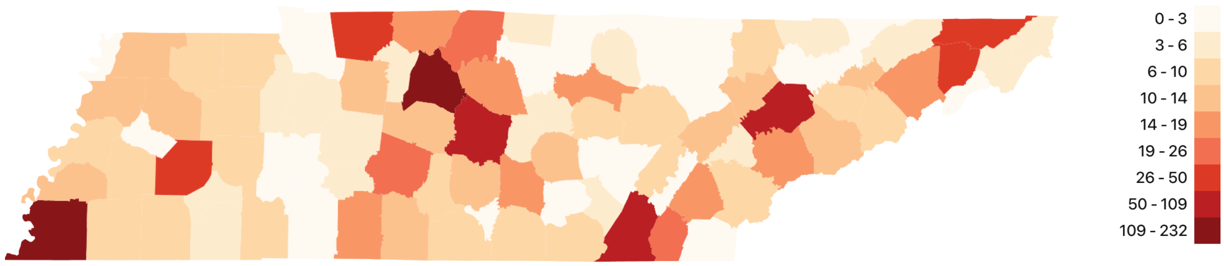
The data set referenced and utilized throughout this report is available for download at https://metroideas.org/media/tn-payday-data.csv.

1 The Pew Charitable Trusts. January 2014. *State Payday Loan Regulation and Usage Rates.*

2 BBB. 2009. *The Payday Loan Industry in Missouri: A Study of the Laws, the Lenders, the Borrowers, and the Legislation.*

Findings

MAP 1. Payday Lending Locations by County



In total, there were 1,233 payday lending locations in Tennessee in November 2017. Compare that to the 155 total retail locations of Walmart or the 393 McDonald's franchises or even the 3,350 gas stations serving customers in the state.

TABLE 1. Tennessee Counties with the Most Predatory Lenders

County	Predatory Lenders	Population
Shelby County	232	937,750
Davidson County	109	658,506
Hamilton County	71	348,121
Knox County	68	444,348
Rutherford County	50	282,558

Unsurprisingly, the areas with the most payday lending locations were the state's most populous counties. Shelby County, with the city of Memphis as the county seat, leads the state with 232 unique locations. However, among the 20 most populous counties in Tennessee, Madison County leads the state with the highest concentration of predatory lenders, with over 29 stores per 100,000 residents.

TABLE 2. Tennessee Counties with the Highest Concentration of Predatory Lenders (per 100,000 Residents)

County	Population	Predatory Lenders per 100,000 Residents
Madison County	98,184	29.53
Shelby County	937,750	24.74
Putnam County	73,810	24.38
Maury County	84,089	22.59
Bradley County	102,062	22.53
Robertson County	67,426	20.76
Washington County	125,317	20.74

County	Population	Predatory Lenders per 100,000 Residents
Greene County	68,576	20.41
Hamilton County	348,121	20.39
Sullivan County	156,752	19.77

The high totals of predatory lender locations in Tennessee are indicative of a loose regulatory environment. States with more restrictive limits on APRs, fees, and aggregate loan limits tend to see fewer predatory lenders per capita. Furthermore, payday loans tend to cost more in states where laws allow higher rates; this indicates that competition doesn't tend to lower prices.[3]

Ultimately, these findings reaffirm national studies that find Tennessee to have the most predatory lending facilities anywhere in the nation and that these institutions are pervasive in communities of poverty, color, and low educational attainment.

3 The Pew Charitable Trusts. April 2014. *How State Rate Limits Affect Payday Loan Prices.*

A Local Strategy to Eliminate Predatory Lending

As cities look to curb predatory lending practices, many find their hands tied and policy options restricted. This is particularly true in Tennessee, where state preemption of municipalities on this issue (and many others) effectively eliminate the ability to impose reasonable APR limits. Additionally, the predatory lending industry fields a well-funded and talented team of lobbyists at the state and federal levels who work to ensure any proposals that would cut into profit margins are swiftly defeated.

In an environment that favors predatory lending firms, cities must be creative if they are to effectively push back against business practices that prey on their most vulnerable residents. This section will outline the existing regulatory environment in which predatory lending firms currently operate and three strategies that municipalities in the state could adopt to severely reduce predatory lending in their communities.

Regulation and Local Preemption

According to the Pew Safe Small-Dollar Loans Research Project, payday loans are available in 36 states, with an average annual percentage rate limit of 391 percent.[1] In contrast, Tennessee offers deferred presentment lenders the opportunity to charge up to 459 percent APR. Additionally, Tennessee's regulatory environment effectively preempts any meaningful local efforts to reform or regulate the terms of the loans that payday lenders can offer to consumers in their cities.

Typically, state preemption of local control falls into one of three categories[2]:

- **Express (or Complete) Preemption:** This preemption typology is the easiest to identify, as the policy and legislative intent of the relevant federal or state law explicitly prohibits the enactment of laws and ordinances to the contrary of federal or state legislation, or it provides exclusive jurisdiction to the federal or state government. Typically, lawmakers justify this by claiming that there is a need for uniformity of regulations in the subject matter across the

1 The Pew Charitable Trusts. January 2014. *State Payday Loan Regulation and Usage Rates.*

2 Griffith, Kelly, et al. 2007. *Controlling the Growth of Payday Lending through Local Ordinances and Resolutions: A Guide for Local Advocacy Groups and Government Officials.*

entire state or nation.

- **Implied Preemption:** Absent express preemptive action by a state or the federal government, there may be implied preemption when existing legislation casts such a wide net and is so pervasive that it is deemed to occupy the entire scope of potential regulation. This sets up the possibility of a potential conflict between state and local laws. One important thing to note about implied preemption is that it is typically determined by court decision, and traditionally, courts are reluctant to intervene against local governments when state and federal governments could easily express preemptive intent explicitly. Unless local laws explicitly are in direct conflict with state or federal law, courts are often reticent to step in without strong public policy justifications for doing so.

- **Conflict Preemption:** Similarly to implied preemption, conflict preemption is a form of preemption that manifests when local action or legislation explicitly is in direct conflict with state or federal law—making the local laws unenforceable. In other words, conflict preemption exists when legislative provisions conflict in such a way that complying with local law requires a violation of state or federal law. This means that local ordinances could not outright prohibit that which state or federal law has expressly licensed or authorized (in the case of deferred presentment lenders) or authorize what state or federal law has explicitly prohibited.

The latter two forms of preemption do not bar local ordinances that speak where the statute does not or where state or federal law only tangentially relates. Rather, as long as the ordinance is within the scope of municipal power and isn't in conflict with (or exceeds) state or federal law, courts will generally rule in favor of an ordinance's constitutionality.

TABLE 3. Tennessee Limits on Payday Loans (Deferred Presentment)

APR Limit	Maximum Loan	Loan Term	Rollovers Permitted?	Maximum Outstanding Loans	Maximum Fees
459%	$425	31 Days	No	3 (2 per licensee)	15% of loan

Tennessee's current regulatory environment for deferred presentment lenders effectively represents both implied preemption and conflict preemption, as it has broadly regulated nearly every relevant aspect of the terms deferred presentment lenders may offer—albeit with regulations that are highly favorable to the payday industry.

This means that, barring legislative changes by the Tennessee General Assembly, municipalities are stuck with the rates, fees, turnover limitations, or aggregate loan limits as outlined by state law.

State law is still the most robust and direct way of regulating predatory lenders. Legislative action and strict limitations have effectively eliminated payday loan storefronts in 15 states, with nine more allowing payday lenders but imposing lower limits on fees or loan usage. But municipalities with an uncooperative state legislature that seek to curb predatory lending practices aren't entirely without options.

We present a three-prong strategy (Warn, Permit, and Lend) for consideration that is designed to be complementary, legal, and effective.

WARN: Plainspoken Consumer Warnings

While many local strategies to reduce or eliminate predatory lenders are preempted by Tennessee state law, ranging from restrictions on interest rates to a cap on the total loans that can be taken out by a consumer at one time, there are still options afforded to municipalities to both protect consumers and send a strong message in the community about the danger of predatory lending practices.

In lieu of barring the existence of predatory lending in a community entirely, informing consumers about the dangers of predatory lending is one particularly compelling alternative.

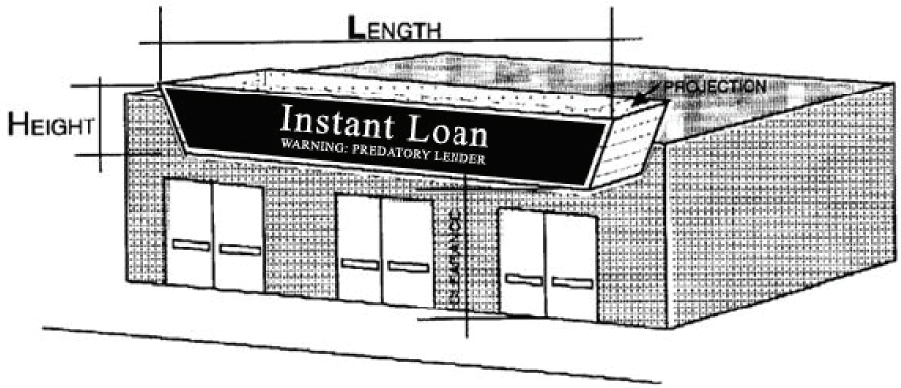
The Small Predatory Lending Ordinance is a policy that was originally proposed by Christopher Peterson, a former special adviser at the United States Consumer Finance Protection Bureau and endowed professor at the University of Utah's College of Law. The ordinance would provide a local government the authority to require a cautionary message to consumers at businesses offering credit at annual percentage rates in excess of 45 percent.

The ordinance as proposed by Peterson requires that predatory lending businesses allocate over a third of the spatial area on all exterior signage to a cautionary message that reads "Warning: Predatory Lender" in white text on a black background. This requirement is waived if the lender chooses to forgo exterior signage advertising its location, thus providing a warning that matches the prominence of a lender's advertising.

Furthermore, the ordinance would require that predatory lenders display an official door sign with the same message displayed on the lender's existing exterior signs, along with additional information outlining that the municipality in question has determined that the business displaying the sign engages in predatory lending; that local city or county code requires the signs be posted under a consumer protection law; that the lender offers loans at interest rates above 45 percent; and a statement informing consumers that "these loans can cause bounced checks, penalty fees, repossessions, lawsuits, and severe financial hardship." The ordinance provides responsibility and authority to the director of a specific city or county department to enforce the ordinance.

In addition to outlining the language, the proposed ordinance also would include graphic illustrations of the ordinance's signage requirements.

FIGURE 1. Ordinance Signage Requirement Example[3]



It is almost certain that the predatory lending industry will aggressively push back against any municipality willing to adopt the ordinance, using any legal and lobbying resources afforded to them. But the ordinance is rooted in legislative findings based on the plethora of empirical research that finds predatory lenders to be hurtful and damaging to consumers. They will trot out misleading public relations efforts to the contrary, but predatory lenders have demonstrated themselves to be legalized con artists preying on the working poor and middle class—underwriting unaffordable loans with exorbitant fees that are designed to keep consumers trapped in debt.

The ordinance works in large part due to its simplicity, providing a meaningful, bold, and clear message warning potential victims of abusive lending practices. Peterson undercuts the predictable justification of the predatory lending industry's inevitable opposition, stating in his proposal, "High-cost lenders will object to this warning not because it is inaccurate, but because they will realize its power and effectiveness."

The 45 percent threshold set by the proposed ordinance is a clear and enforceable "bright line price threshold" to identify predatory small loans. Peterson argues that this is an appropriate limit for two primary reasons. First, characterizing loans at prices above this threshold as "predatory" reflects current federal policy objectives and evidentiary thresholds in federal criminal law (annual interest rates in excess of 45 percent are considered a factor in establishing prima facie evidence that a loan is extortionate). Second, many federal and state laws already use an interest rate limit as a firm standard of illegal and potentially criminal behavior (e.g., current federal law establishes a 36 percent APR usury limit on loans made to military service members and their dependents).

In fact, Tennessee's own usury limit generally doesn't allow loans to exceed 24 percent APR, and willful collection of usury is a Class A misdemeanor. However, many forms of predatory lending (including payday lending and flexible credit lenders) are exempt from those limits.

There are likely to be questions raised over whether or not a variety of consumer loans would fall into the scope of the proposed ordinance, ranging from some pawnshop loans to tax refund anticipation loans. While many of these loans can be underwritten responsibly and with more

3 Image credit: Peterson, Christopher L. This is one of several examples of required signage that could be imposed by this proposed ordinance.

modest pricing, if the federal Truth-in-Lending Law identifies these loans as carrying APRs exceeding 45 percent, then the ordinance as written will require the same signage warnings as typical payday and car title lending businesses. This is likely to result in balking from some lenders and merchants, including demands for special exceptions. That would establish a poor precedent and open the policy to the argument that it is establishing an uneven playing field that would ultimately weaken the policy itself.

The legality of requiring a commercial business to post a warning, particularly through the regulation of signage, is a well-established authority delegated to local governments by the courts. While there is significant variation in the powers granted to local governments by state regarding the ability to regulate commercial activity, this proposal appears to currently be within the scope of Tennessee's municipality "home rule" authority. Moreover, the consumer warning is well-aligned with the spirit of existing public policy to protect consumers from bad actors in lending. This proposal also sidesteps the conflict or field preemption challenge, as the Tennessee state law provides no regulation over exterior signage of lender locations.

Finally, Peterson argues in his proposal that the ordinance is constitutional, as the Supreme Court has distinguished commercial speech from public discourse. While commercial speech does receive constitutional protection, the court has provided less scrutiny of commercial speech—albeit inconsistently at times. Government action that merely compels speech, such as warnings or disclosures, also tends to come under less constitutional scrutiny than outright restrictions of speech. The Supreme Court has not viewed the right of commercial enterprises not to speak as a fundamental right and rather has said that "disclosure furthers, rather than hinders, the First Amendment goal of the discovery of truth."[4]

Additional analysis of the legality of the proposed ordinance is extensively provided in Peterson's initial proposal paper.

This strategy, while certain to be controversial, is an effective approach to provide a stark warning and a clear message to consumers concerning the dangers of predatory loans in lieu of serious action to curb these damaging practices at the state or federal levels.

PERMIT: Require a Permit

In addition to signage requirements, Peterson's proposal also requires all businesses charging in excess of 45 percent APRs to obtain a permit to operate within the municipality.

This provision is designed to operate in tandem with local zoning regulations that are designed to prevent "clustering" of predatory lenders by regulating the proximity and location of title and payday lenders. Similar laws are on the books in many of Tennessee's largest cities, including Nashville, Knoxville, and Chattanooga. While zoning requirements alone may provide local governments a "victory," they typically fail to produce effective results to curb predatory lending practices or eliminate predatory lending businesses. This is, in part, because many predatory lenders are already well-established in a location by the time zoning regulations are a priority and are "grandfathered in," and thus, the new anti-clustering restrictions do not apply to existing businesses, limiting the usefulness of such regulation.

4 *American Meat Institute v. United States Department of Agriculture.* 2014

Permitting would provide more institutional authority to cities to regulate predatory lenders by requiring a licensing fee to cover the cost of enforcement of the zoning regulations and the signage ordinance while also generating revenue for the city or county that adopts the proposal. Furthermore, by permitting predatory lenders, cities would be able to more effectively enforce additional regulations and warn consumers of the pitfalls of legalized debt traps.

The legality of requiring a local permit is well established in the state of Tennessee, ranging from caterers to day care centers. Additionally, Chattanooga already requires that pawnshops provide records on each sale, including identifying details on each person making the pawn, to the Chattanooga Police Department within 48 hours of any transaction. A local government in Nebraska had a similar law upheld by the Nebraska Supreme Court, mandating that predatory lenders submit detailed weekly reports on every loan made to a city auditor. Tennessee cities and counties could consider similar requirements.

Establishing the requirement of a permit is an accessible, immediately achievable step for local governments aiming to regulate predatory lending businesses in an effective manner. It is not mutually exclusive with other existing local zoning ordinances restricting clustering, and local governments should adapt a permitting requirement to fit within their existing laws.

LEND: Competitive Alternative to Predatory Lenders

While the prior two policy recommendations are focused on informing consumers about the risks and harm predatory lenders can inflict upon unsuspecting customers, and ultimately reducing the overall number of predatory lending institutions, this recommendation proposes an alternative to the predatory lending model.

Absent payday and flexible credit lenders, few options currently exist to serve consumers without the credit history necessary to access traditional loans. Ironically, this is in part due to restrictions and caps on interest rates above 10 percent for traditional banking institutions in Tennessee, such as banks and credit unions. While predatory lenders are free to charge rates up to 459 percent APR, banks are held to traditional usury limits established by state law. This means that, for smaller subprime loans, banks are not able to underwrite the loan at a price that also mitigates the risk of default.

While almost every predatory lender in Tennessee charges the maximum rate allowed by law, there’s no reason they couldn’t attempt to be competitive with consumers by reducing interest rates and fees. Instead, however, most predatory lenders seek to maximize profit by further investing in marketing to increase market share among subprime borrowers and adopting more aggressive debt collection approaches.

Recognizing that, currently, traditional banking institutions are legally barred from charging high-enough interest rates to cover the cost of lending for subprime borrowers, and current subprime options charge unaffordable and predatory rates that trap consumers in poverty, it’s clear consumers need another option.

We propose a novel solution: **provide consumers better options by competing with predatory lenders on terms and price.** Put simply, set up a nonprofit, non-predatory lender for residents with poor or nonexistent credit histories using the deferred presentment and flexible credit legal framework already allowed by state law. This institution could be capitalized by existing banks, credit unions, and philanthropic foundations with active impact investing strategies. These institutions, by charter, would only charge interest rates and fees at prices necessary to manage the risk inherent in lending to a subprime borrower. While these interest rates and fees would be priced higher than the limits currently charged by traditional banks, they would be far below usurious rates north of 400 percent charged by existing predatory lenders.

These nonprofit community lenders should adopt a governing structure that would serve to ensure that community interests are represented and that interest rates and fees remain affordable and non-predatory. Furthermore, these institutions would have the opportunity to offer debt and credit counseling, as well as strict underwriting policies to ensure borrowers can afford any loans issued to consumers.

This isn't without precedent. Community Check Cashing in Oakland, California, is an emerging storefront modeled after the payday lending industry that charges far less than their for-profit, predatory competitors. Sometimes actively talking people out of loans, Community Check Cashing represents a model that puts their community's residents first. Their results have been widely successful, with a default rate under 1 percent (contrast with a 20 percent default rate with for-profit predatory lenders[5])—although many customers do pay late.

This model harkens back to the Remedial Loan Funds of the early 20th century, where consumers had access to loans at a reasonable rate through foundation-backed lenders. At no obligation to turn a profit, these institutions provided loans for Americans who had little by way of options in an emergency. This proposed institution could also leverage market forces to incentivize predatory lenders to offer lower rates in order to remain competitive—or drive them out of business if a large-enough alternative, non-predatory institution were to capture enough market share.

By operating with a deferred presentment or similar license, these institutions would be operating in the same legal environment as predatory lenders but with more competitive, fairer rates. This inoculates this strategy from effective pushback against the predatory lending lobby, effectively using the results of their own legislative maneuvering to price bad actors out of the market.

Each city (perhaps even individual communities) would see these alternative financial institutions manifest in slightly different ways. Funding and revenue models may vary from place to place, with some choosing to offer loans at a loss because of sustained programmatic grant funding or others adopting a slight profit-generating rate to replenish capitalization over time. The defining characteristics that unite these lenders are community input and non-usurious fees and rates.

While measures to ensure consumers understand the risks of borrowing from predatory lenders and reducing the likelihood that these kinds of loans are available in the first place are important, they are only parts of an effective and comprehensive strategy to ensure that vulnerable residents have access to affordable and fair credit. Community leaders, financial institutions, and philanthropic foundations would be wise to invest in alternative means for residents to access credit without risking financial ruin.

5 CFPB. 2016. *Payday Loans, Auto Title Loans, and High-Cost Installment Loans: Highlights from CFPB Research.*

Conclusion

The vast majority of Americans want payday loans to be further regulated, with seven in 10 of both the general population and payday borrowers supporting that position in a 2017 poll by The Pew Charitable Trusts.[1] The Tennessee General Assembly, however, has failed to act and instead has chosen to give away the store to the payday industry. To date, it seems that statewide reform of APRs, fees, or enforcement of aggregate loan limits is off the table until state legislators are willing to act. In lieu of state action, cities must take the issue into their own hands.

By forcing predatory lenders to provide a frank warning about the dangers of their products and submit to permitting, consumers will at least be armed with the information necessary to make an informed decision. Furthermore, by establishing financial institutions that can provide an affordable and fair alternative to predatory lenders, consumers gain access to lending options that won't further trap them in debt.

This three-prong approach (Warn, Permit, and Lend) ultimately puts Tennessee cities back in the driver's seat and provides the options to effectively combat the damaging effects of predatory lending in their communities.

1 The Pew Charitable Trusts. April 2017. *Americans Want Payday Loan Reform, Support Lower-Cost Bank Loans.*

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