Income, Equality, and Consumer Protection

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By Liz Coyle

Consumer protection laws exist for the purpose of leveling the playing field in the marketplace. In reality, the significant power imbalance that permeates society virtually ensures that only certain consumers, and not the most vulnerable, receive the intended benefit of these regulations. Policy makers wrongly assume a level playing field exists when they enact "buyer beware" disclosure requirements. Laws based on open markets and marketplace competition incorrectly assume consumers will always have access to and will choose what's in their best interest. Often, consumers get the blame for being duped when they should have known better.

With these underlying assumptions as the basic tenets of consumer protection law, the scales of justice are tilted toward the wealthy, the well-educated, and the powerful. Wealthier consumers are more likely to have access to resources to help them make the decisions that are in their best interest, while lower-wealth individuals are more likely to encounter systemic barriers to the tools needed to protect themselves. This very dynamic perpetuates a system that ensures the rich keep getting richer and the poor, poorer.

Since 1980, the gap between rich and poor in the United States has grown steadily wider, with wealth increasingly concentrated in the top 10 percent of the population. According to the report *What Wealth Inequality in America Looks Like: Key Facts and Figures,* published by the Federal Reserve Bank of St. Louis in August 2019 (https://tinyurl.com/v8hqh5m):

> Wealth inequality in America has grown tremendously from 1989 to 2016, to the point where the top 10% of families ranked by household wealth (with at least $1.2 million in net worth) own 77% of the wealth "pie." The bottom half of families ranked by household wealth (with $97,000 or less in net worth) own only 1% of the pie.

The study also examined disaggregated data, finding that the country's large racial and ethnic wealth gap is basically unchanged: "In 2016, the typical white family had about 10 times the wealth of the typical black family and about 7.5 times the wealth of the typical Hispanic family." Over the nearly 30 years of the study period, "the U.S. has seen very little progress in narrowing racial and ethnic wealth gaps."

These discouraging trends underscore the impact of an unlevel playing field in the consumer marketplace on society writ large.

Consumer Protection in the Financial Marketplace

According to the Federal Deposit Insurance Corporation's *2017 FDIC National Survey of Unbanked and Underbanked Households* (https://tinyurl.com/sowf38g), "In 2017, 6.5 percent of households in the United States were 'unbanked.'" This proportion represents approximately 8.4 million households. The report further indicates that 18.7 percent of U.S. households (24.2 million) were underbanked, "meaning that the household had an account at an insured institution [e.g., a checking or savings account] but also obtained financial products or services outside of the banking system." The FDIC study found:

> Consistent with previous surveys, banking status in

2017 varied considerably across the U.S. population. For example, unbanked and underbanked rates were higher among lower-income households, less-educated households, younger households, black and Hispanic households, working-age disabled households, and households with volatile income.

Individuals who lack access to credit from banks or other traditional sources often become victims of predatory lenders and can get trapped in a cycle of debt. Households with limited access to mainstream financial services are subjected to the high costs and risks associated with the exploitative alternative financial marketplace. Accessing paychecks, paying bills, and borrowing money all come with punishingly high fees. Households that are barely getting by, that live paycheck-to-paycheck, and that cannot save at least $500 are one unexpected emergency expense away from the debt trap of predatory lending. Some of the greatest lapses in equal consumer protection are apparent here.

Early in its history, the United States enacted usury laws (already common across the globe since biblical times) for very important reasons. In its 1827 ruling in *Whitworth v. Adams,* the court stated:

> These statutes were made to protect needy and necessitous persons from the oppression of usurers and monied men, who are eager to take advantage of the distress of others; while they, on the other hand, from the pressure of their distress, are ready to come to any terms; and with their eyes open, not only break the law, but complete their ruin.

Whitworth v. Adams, 5 Rand. 333, 335, 1827 WL 1200 (Va. 1827) (quoting *Brown v. Morris,* Cowp. Rep. 792).

Yet, almost 200 years later—despite the enactment of usury laws—payday, installment, and car title lenders continue to prey on the most vulnerable consumers.

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These predatory lenders wield enormous power in the halls of the U.S. Congress and state capitols across the nation. Year after year, we witness the intense lobbying efforts that the car title and payday lending industries engage in to write the very rules by which they are to be governed. Lobbyists for this powerful special interest routinely argue that desperate consumers would be harmed by restricting access to their small-dollar loans that in some states can bear annualized interest rates ranging from 300 percent to 2,000 percent. Despite this industry claim, consumers in states that have enacted double-digit usury caps have fared better than those from states without caps.

At the turn of the 20th century, Georgia stopped lenders from using assignments of future wages as security for a debt and from rolling over said debt—both common practices at the time. In response, lenders began buying future wages outright and finding ways around the rollover ban. In the 1950s, Georgia fired back at these attempts to evade state law by instituting its first usury caps for small-dollar loans. It also required small lenders to register with the state's Office of the Industrial Loan Commissioner.

These regulations could not stop payday lenders from unearthing other ways to circumvent the law. In the 1990s, lenders began securitizing personal checks and using the "rent-a-bank" model to subvert Georgia's usury laws. Finally, in 2004, Georgia passed the Payday Lending Act, which capped small consumer loans at a rate of 60 percent per year, added stiff criminal and civil penalties for violators, and barred non-bank lenders from collaborating with banks to avoid Georgia's usury laws. This Act effectively outlawed payday lending and made it the first state law to expressly prohibit payday lenders from scheming with out-of-state banks to avoid state usury limits. Less than ten years later, payday lenders tested the scope of these penalties. The Georgia Department of Law received complaints that out-of-state lenders were making payday loans through the Internet. Three separate Georgia attorneys general sued Western Sky Financial, an online payday lender, to enforce the ban.

Despite barring payday lenders, Georgia is still a sanctuary for another type of exploitative loans: those tied to car titles. Currently, the state does not treat this type of predatory lending as a small-dollar loan, but rather allows car titles to be "pawned" with interest rates as high as 300 percent. Today, car title loans in Georgia are governed by the Pawnbroker Act (O.C.G.A. § 44-12-130). This Act grants special rights to pawnbrokers, including the right to collect interest, charges, and fees on personal property pawns, including car titles, that would otherwise be considered usurious or even criminal.

Title pawn lenders are permitted to repossess a borrower's vehicle upon default of payment and keep any surplus profits from the sale. Stop and think about the imbalance of this transaction. Car title lenders claim they must charge high interest rates because they're making loans to risky borrowers—even though the loan is collateralized by the car.

Georgia Watch, a nonprofit consumer advocacy organization for which I serve as executive director, recently worked with the Student Innovation Fellowship at Georgia State University to map title pawn lending locations across the state (https://tinyurl.com/wcervnj). Their maps revealed an astounding 755 title pawn lending locations in Georgia in 2018, with 74.4 percent operating in areas with a poverty rate above the national average. The data show that title pawn lenders and alternative financial service providers set up shop in low-wealth communities where consumers often live paycheck-to-paycheck. For example, in the city of Macon, title lenders and check cashers group to the south and west of downtown along Interstate 75. This area is primarily African American (88 percent to 95 percent); the median household income in this area is $14,787 to $21,262, and the poverty rate is 55.9 percent. The data further show that car title lenders cluster around military installations such as Dobbins Air Force Base in Marietta and along highways in areas such as northeast Atlanta's Buford Highway—an area famous for its large and diverse immigrant community.

Consumers harmed by bad business practices lack equal access to justice.

In these areas, financial literacy is low. The study found a striking correlation between poverty rate by census tract and the clustering of these predatory lenders.

This clustering around vulnerable communities is a tell-tale sign of the predatory lending industry's underlying business model—the debt trap. Fees and interest rates are so high that the borrower is never able to pay off the original loan without reborrowing. The Consumer Financial Protection Bureau (CFPB) found that the typical payday borrower takes out ten loans over a 12-month period, indicating that the consumer is unable to pay back a loan and meet other expenses that occur within the same pay period (*Payday Loans and Deposit Advance Products,* April 24, 2013; https://tinyurl.com/rrhockv). In short, the industry thrives on making unaffordable loans to desperate consumers.

After years of extensive research into the state of small-dollar lending and its impact on consumers, the CFPB in 2017 issued a Final Rule governing Payday, Vehicle Title, and Certain High-Cost Installment Loans. The core principle of the Final Rule requires lenders to ensure that a loan is affordable without having to re-borrow or default on other expenses.

In February 2019, CFPB Director Kathy Kraninger announced her decision to delay the Bureau's August 2019 compliance date for the Mandatory Underwriting Provisions of the 2017 Final Rule. It is expected that the Rule's critical ability-to-repay provision ultimately will be removed, leaving millions of low-income Americans still vulnerable to the debt trap.

UNDERLYING STRUCTURAL CAUSES OF INEQUITY

Systemic and institutional barriers perpetuate inequity and poverty. In the ways these inequities materialize, the evidence is clear that consumers lack equal access to civil justice when they are harmed by bad business practices.

Discrimination in mortgage lending. Wealth begets wealth. Through property ownership, individuals build equity they use to access capital to attain higher education, grow wealth, start businesses, and pass familial wealth to the next generation. A major reason for a lack of wealth in the black community is tied to the historic lack of homeownership. Limited access to credit persists in areas of the country that were historically redlined (i.e., denied access to mortgages and other financial services based on the racial and ethnic makeup of the community). The practice known as redlining dates back to the 1930s, when the federal government began marking maps by circling in red African American neighborhoods considered to be too risky for federally backed mortgage loans. These areas are still disproportionately poor and disproportionately black.

An analysis by the Center for Investigative Reporting released in February 2018 on its website *Reveal* (https://tinyurl.com/ybauyg2h) found that race is still a factor in lending practices:

> Fifty years after the federal Fair Housing Act banned racial discrimination in lending, African Americans and Latinos continue to be routinely denied conventional mortgage loans at rates far higher than their white counterparts. . . . This modern-day redlining persisted in 61 metro areas even when controlling for applicants' income, loan amount and neighborhood, according to a mountain of Home Mortgage Disclosure Act records. . . . [The analysis] found a pattern of troubling denials for people of color across the country, including in major metropolitan areas such as Atlanta, Detroit, Philadelphia, St. Louis and San Antonio. African Americans faced the most resistance in Southern cities—Mobile, Alabama; Greenville, North Carolina; and Gainesville, Florida—and Latinos in Iowa City, Iowa.

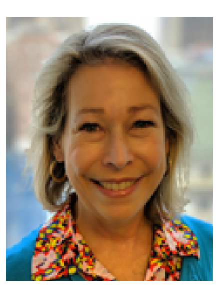
A 2016 report from the National Consumer Law Center, *Toxic Transactions: How Land Installment Contracts Once Again Threaten Communities of Color* (https://tinyurl.com/sfbwwrd), uncovered the reemergence of another wealth-stripping method once used to finance homes in low-income, minority communities: the "land contract" or "contract for deed." In this financing scheme, the would-be buyer enters into a contract with the seller to pay installments toward the purchase of a home and is permitted to live in the property; however, the seller keeps the home's title until the property is fully paid off.

The companies selling these dangerous contracts buy up blighted homes in low-income neighborhoods and target families that cannot get a traditional mortgage. Like predatory lenders, the business model used by these companies counts on the consumer to miss payments. Under the contract terms, the purchaser is responsible for repairs, taxes, and insurance on the property, plus paying a high interest rate, but they receive none of the protections of a mortgage. Consumers who enter into these contracts often believe they've become homeowners. In reality, they're one missed payment away from an eviction notice. Homeownership and the important accumulation of equity that comes with it are lost.

Discrimination in small business lending. Black entrepreneurs face a harder road than their white counterparts because of systemic barriers to credit, capital, markets, and social capital. Limited access to capital for businesses in communities of color hampers wealth building not only for the minority business owner, but also the communities they serve, including employees, neighborhoods, and even the local economy. Higher rates of liquid asset poverty among minorities and women exacerbate the challenges faced. According to *Mind the Gap: How Do Credit Market Experiences and Borrowing Patterns Differ for Minority-Owned Firms?*, a report by the Federal Reserve Bank of Atlanta published in September 2018 (https://tinyurl.com/r9ttjqj), disparities in credit approval by the race or ethnicity of the business owner limit the success and growth of minority-owned businesses. "Notably, black-owned firms are less likely to receive approval for financing when compared with otherwise similar white-owned firms," the researchers found.

CONCLUSION

Fundamentally, our consumer protection regulations have not created the level playing field low- and middle-income Americans need to thrive in a marketplace that benefits the wealthiest among us. ■



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