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# THE CONSUMER LENDING PROTECTION. HOW TO PREVENT THE PREDATORY LENDING AND "DEBT SLAVERY" ON THE SMALL-DOLLAR LENDING MARKET

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**Abstract**

**The purpose of the article/hypothesis.** The present contribution is focused on the lending market, its credit products, and actors, with particular regard to the non-bank small-dollar lenders and the underserved borrowers. The purpose is to analyze some of the specific small-dollar loans and related legislative initiatives from the American and European financial markets which may constitute remedies to the problem of predatory lending. **Methodology.** The analysis was based on the legal and administrative acts and documents as well as on the doctrine related to the topic examined. **Results of the research.** The study revealed that the misleading, abusive conducts and numerous sales strategies of professionals operating on the banking market may regard almost any individual. These unethical practices have intensified during the pandemic, becoming particularly dangerous.

**Keywords:** financial consumer protection, small-dollar lending, predatory lending, unbanked households, COVID-19.

**JEL Class:** K15, N22, G23.

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## INTRODUCTION

The financial market is a rapidly transforming sector, especially because of new technology, and entrance of new bank and non-bank competitors. However, what if another unexpected and breakthrough component arrives, such as a global pandemic providing damages which cannot be sized quickly? To protect the financial market actors the governs, competent authorities and supervisors must promptly adjust their strategy to the unforeseen circumstances in order to prevent misconducts of who see these times as an opportunity for abuses and to safeguard both collective and individual interests of participants and regular market competition.

Poverty and financial distress in the era of COVID-19 will desperately aggravate, in some cases going from bad to worse, thus the lack of adequate protection of the community and essential services will become more perceptible and acute.

Nevertheless, it must be kept in mind that the excessive debt levels and over-indebtedness are detrimental not only for consumers. They may endanger the stability of financial institutions, slow down the growth of economy driving it into recession.

The unforeseeable final impact of the ongoing pandemic that is able to lead to the serious delinquency[1] and default rates of Americans have pushed the author of the present paper to reflect on the fate of millions of underserved, low-wealth households and vulnerable consumers.

For this reason, the author has attempted to describe and propose some possible measures that could be taken in the lending market in order to protect debtors against unethical and predatory practices of small-dollar lenders and fly-by-night entities. Those loans providers frequently prey on the consumer vulnerability, illiteracy, inability to assess the risks, and/or temporary arduous financial situation which finally may lead to debt traps, vicious circle of borrowing, financial disasters, serial defaults, over-indebtedness.

## 1. LENDING MARKET ACTORS

On the financial market different financial products providers exist, such as banks, credit unions, financial intermediaries, and many other non-bank professionals. They offer many financial products and services, both secured (usually proposed by traditional banks and credit unions), and unsecured credit products offered by non-banks providers. Frequently, those secured ones are not accessible to every

[1] Defined as loans that are already in foreclosure and/or with payments that are 90 days or more late (Apgar and Herbert, 2005).

individual who wished to obtain them. Generally, such products require several financial conditions, such as regular incomes, bank account, adequate credit scores, and so forth. Unfortunately, a lot of consumers are not able to satisfy those specific requests for various reasons. Therefore, they are forced to use available alternatives, which are usually unsecured, high-cost, easier and faster to obtain, credit products offered by non-bank professionals, such as small-dollar lenders.

Generally, regulations related to consumer protection focus on the "average" consumer in the "average situation", especially in almost all consumer protection laws of the European Union. However, some circumstances may occur which make this average consumer vulnerable. One of such circumstances has already occurred and it is the global pandemic due to the spread of COVID-19. Because of this particular situation, the number of vulnerable and underserved adults will likely increase. The arrival of a fly-by-night professional on the doorstep of a consumer who is facing an overwhelming financial obligation may appear as a "dream come true" (Engel and McCoy, 2002: 1297). Victims of predatory lending are likely to be sympathetic communities that are susceptible to manipulations (Putney, 2003).

The 2019 Study provided by the Financial Health Network affirms that "financially underserved consumers in the U.S. spend $189 billion in fees and interests on financial products in 2018" (Financial Health Network, 2020a).

The market of short-term and long-term credits is constantly growing. These products continue to dominate the fees and interests paid by subprime customers.

"In 2018, Underserved consumers spent $66,1 billion on fees and interests for short-term credit products" (Putney, 2003) and $39.9 billion for Single Payment Credit products.

There are millions of U.S. unbanked and underbanked consumers[2], it means individuals with a limited access, or with no access, to traditional financial products and services, living paycheck to paycheck. In accordance with the 2019 FDIC Survey (2020: 4) 50.4% of unbanked household in 2019 had previously been banked, slightly higher than in preceding years.

Then, there is also a huge segment of customers who display one or more characteristics of vulnerability[3]. Several studies revealed that consumers of high-cost loans are disproportionately African Americans, Hispanics and low-income households (Guedj, 2019; Apgar and Herbert, 2005). All of these groups are often

[2] The FDIC indicates, in the 2017 National Survey of Unbanked and Underbanked Households, that 6,5% of households in the United States were unbanked in 2017 (this is approximately 8.4 million households). The Survey on Household Use of Banking and Financial Services of 2019 shows that about 5,4% of American households were unbanked in 2019 (this is approximately 7.1 million). The 2019 unbanked rate is the lowest since the survey began in 2009.

[3] The Financial Health Network's 2019 U.S. Financial Health Pulse find that about 178 million adults are Financially Coping or Vulnerable.

a favorite target of non-banking lenders, such as dangerous fly-by-night entities and rapidly growing Fintech companies. Such loan providers have their own strategy to find and identify specific individuals who are already facing financial distress or who are going to face it. Stegman and Faris (2003) noted that payday lenders take many efforts to transform more and more also occasional clients into chronic borrowers.

Locating vulnerable individuals and procuring relevant information is becoming progressively sophisticated. The loan providers consult various local and municipal registers, track people online[4] and via mobile phones (Willis, 2017), they send unsolicited checks (Engel and McCoy, 2002), credit cards or other apparently attractive proposals to potential borrowers. In the storefront, lenders very often generate a psychological pressure on customers by creating a false sense of urgency or the impossibility of finding any other option, in order to move them quickly to accept onerous terms and conditions.

No lender should be allowed to exploit the vulnerability, the weaknesses, the bounded rationality, the lack of access to financial advice, the unforeseen need or the financial hardship of borrowers. Now more than ever, the solid understanding of consumer financial vulnerabilities and market actors' reactions are vital.

## 2. EXAMPLES OF SMALL-DOLLAR LOANS

Loans are credit products which allow individuals to buy goods and pay for services that they would not be able to immediately pay for in full, such as high unexpected bills, car reparations or new appliance.

Small-dollar loans are short-term, high-rates loans, such as a payday loan, a vehicle title loan, a pawnshop loan. Traditionally they are offered by storefront lenders, however many of them are available also online[5].

These kinds of credits are quite easy to obtain[6] and they are generally targeted at consumers with low incomes who take them out for unexpected and recurring expenses, such as regular expenses (utilities, car payments, credit card), mortgage instalments and food. In general, in order to obtain a small-dollar loan, the consumer should have a deposit account with a bank or credit union. However, "there is an emerging trend in favor of offering payday loans to customers without bank accounts" (Miller, 2019). In the case of pawnshop loans and vehicle title

[4] "Even if you never hit *Submit* to complete the transaction, your information can be captured through keystroke logging – a program used to see and store everything you enter on application" (Federal Trade Commission, 2021).

[5] For more detailed information, see Chen (2020).

[6] In some EU countries, such as Estonia, Finland, Sweden, they are granted via text message, so-called "SMS loans" with a credit decision available almost instantaneously, and which the average APR is about 2000%.

loans the problem does not even arise. Consumers are not required to demonstrate a regular income or possession of a bank account, as these loans are secured by collaterals. Consumers pledge a tangible personal property which is almost always worth more than the amount of loans received[7]. For this reason, they are more accessible, especially to subprime borrowers. Because of the pledge, there is a strong incentive to pay the borrowed sum back (Miller, 2019).

Some of them are exorbitantly expensive and have a dangerous structure that may entrap consumers in a spiral debt (National Consumer Law Center, 2014). Sometimes when a debtor seems more likely to default the lender charges a higher interest rate[8]. In other words, the higher the risk, the higher the interest rate, and as someone said: "being poor is expensive".

The small-dollar lending consists of borrowing a lump sum disbursed usually in cash. Most of them are around $100 to $500 and have finance charges of $13–$20 per each $100 borrowed over a 2-week period. Their APR can range from 300% to 600%[9]. Borrowers must repay the loan quickly in a one balloon payment.

These loans rely on high interest rates and intimidating practices to ensure the lender's possibility to collect the debt rather than the borrower's ability to repay.

The largest categories of short-term loans are those called "payday loans" (Consumer Financial Protection Bureau, 2020). In the case of a payday loan, the moment of repayment usually coincides with the consumer's next payday. In this particular loan, the borrower must guarantee repayment and can do so by providing a post-dated check or authorization for ACH. If a consumer is unable to repay the loan at the agreed-on date, she/he may rollover the credit for an additional fee[10], take out another loan to cover the previous one, or simply default on the loan.

On the other side, there are installment loans, in which a lump sum borrowed is paid back in a series of regular payments. This kind of loan may be repaid over longer periods of time.

Financial products and services offered by traditional banks usually have much lower interest rates than small-dollar loans, however they are not provided to low-income, high-risk population that may not be able to repay.

In recent years it is visible that consumer lending grows faster than consumption. Skiba and Tobacman (2019) in their research suggested that payday loan borrowers are very often financially stressed. Moreover, they have a persistent demand for credit, so, having discovered a place where the loan is

[7] Prager (2009) found that the offered loan ranges from 25% to 65% of the expected resale price of the asset provided by the borrower.

[8] Several studies have found that subprime lenders charge higher prices in minority neighborhoods, with high concentration of African American and Hispanic.

[9] In the U.K. market lending providers charged 5853% APR, see Evans (2013).

[10] Successive rollover of the initial loan increases the APR.

available, they return frequently. The 2019 FDIC Survey (2020: 4) reported that "use of the mobile banking as a primary method of account access in the past 12 months continued to increase sharply (from 9.5 percent in 2015 and 15.6 percent in 2017 to 34 percent in 2019)". Finally, we arrive to the ever-increasing FinTech. Through few clicks on screens the emerging online Fintech lending facilitates the access to credit products which may have dire consequences for Americans consumers.

### 2.1. The *Peanut effect* of small-dollar credits

Several scholars have shown that many borrowers do not know or understand the difference between different kinds of loans, sometimes underestimating the true cost of borrowing, their future income, or their ability to repay. Such behavior can be a symptom of the *peanut effect* (Markowitz, 1952; Prelec and Loewenstein, 1991), "whereby people do not consider the consequences of a small dollar transaction because small amount of money is *peanuts*" (Bertrand and Morse, 2011). It is something like a "smoking cessation method of getting a smoker to think about not just the next cigarette, which would have only a marginal effect on one's health, but instead about the next year of cigarette smoking" (Bertrand and Morse, 2011).

They do not comprehend the potential benefits and risks of different types of credits. Even worse, if the benefits of the acquisition of financial products are unclear or obfuscated.

Moreover, studies conducted by The Pew Charitable Trust (2012) and by Bertrand and Morse (2011) show that consumers confuse $15 payday loan fee per $100 borrowed vs. 15% Annual Percentage Rate, saying that the APR on a payday loan is 15%, or when deciding they focus more on the fee rather than on the whole repayment.

### 2.2. The *Quicksand effect* of small-dollar credits

Since borrowers often do not consider small-dollar loans as another bill and they only focus on short-term emergency needs, these credit products become a sort of quicksand. Consumers who face a problematic repayment situation, due to obligation to cover the unaffordable loan payment, ask for another loan to repay the previous one. The reborrowing can finally lead to default and delinquency.

One of the main problems of small-dollar loans is the fact that the access to them is much easier than to instalment secured loans. But on the other hand, individuals with low income, poor creditworthiness and/or existing debts generally have difficulties in obtaining a long term-installment loan. Nevertheless, borrowers

are frequently unaware about available safe alternatives that could enable them to afford a more expensive purchase or avoid high risks and financial distress.

Lenders often take advantage of lack of awareness, information asymmetries, disparity in bargaining power and, in particular, of the arduous situation of the consumer worried about his/her ongoing financial hardship. As a result, the violation of the general clause of "fairness in relations with customers" very often leads to the sale of unsuitable, inappropriate, disadvantageous and/or dangerous financial products.

### 2.3. The costs of the loans, risks and compliance

Small amounts of credits are generally expensive because of the fixed costs of loans and high risks of a borrower's default. As mentioned above, frequently lenders charge higher interest rates to low-income consumers (subprime borrowers).

Nevertheless, EFIN (2018) noted that rolling over or taking out a new loan by the same borrower generate more revenue for the payday lenders and are cheaper, just because of the lower operating costs.

According to the current legal situation, 16 States and the District of Columbia prohibit high-cost payday loans (CFA, *Payday…*). However, there are several scholars suggesting that a definitive ban on payday lending may be detrimental to consumers too. Such bans do not keep consumers from borrowing, they only push them towards illegal credit sources or into worse markets with products that are less advantageous (Mann and Hawkins, 2007). Reports have shown that many borrowers turn to pawnshop loans considering them as a complementary to payday loans, otherwise they use other high-interest credits, such as overdraft or bounced checks, where possible (Bhutta, Goldin and Hamonoff, 2016).

Furthermore, the access to the potentially harmful payday loans and other small-dollar loans could also be beneficial for consumers who has unforeseen, discrete and short-term needs (e.g. unexpected expenses[11]), but only if they are able to successfully avoid long sequences of loans, as suggested by the Consumer Financial Protection Bureau (2020).

The use of payday loan in a responsible manner, as an alternative to even higher-cost credit products or the failure to pay certain bills, can be beneficial (Campbell et al., 2011). Moreover, successful repayments of short-term credits can also improve a borrower's credit score. And on the contrary, if loans are

[11] Community Financial Service Association of America (2006) argues that some unforeseen expenses, such as the restart of an unexpected interruption of electricity can cost more than a payday loan fee. The advocates of payday loans affirm that these loans can be cheaper than paying overdraft fees to the bank (EFIN, 2018).

misaligned, unsecured or misused providing to a debt burden, they become detrimental rather than beneficial for borrowers.

In conclusion, on the one hand, legal restriction regarding interest rate cap can reduce the risk of unequal charge of high interests. But on the other hand, the restrictions and usury rules may misrepresent the real price of loans by hiding charges and fees, decrease competition in the market and consequently reduce the products available or the process of their innovation, they may even preclude the access to underserved borrowers to the market. Alternatively, the imposition of rate caps may lead to the creation of new products or practices that evade the legal norms or lead consumers to obtain other even less-attractive short-term loans (Campbell et al., 2011).

It also must be kept in mind that high compliances costs and low revenues may (and actually frequently do) drive banks, credit unions and non-banks out of some segments of a retail business.

## 3. ELIMINATION OF THE CONTROVERSIAL UNDERWRITING REQUIREMENTS

In accordance with the section 1031(b) of the Dodd-Frank Act[12] the Consumer Financial Protection Bureau "may prescribe rules applicable to a covered person or services provider identifying as unlawful unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or services, or the offering of a consumer financial product or services".

Section 1031(d)(2) of the Dodd-Frank Act specifies what should be considered as an abusive act or practice. In particularly it occurs when it takes unreasonable advantage of: (1) a consumer's lack of understanding of the material risks, costs, or conditions of the product or services; or (2) a consumer's inability to protect the interest of the consumer in selecting or using a consumer financial product or service.

Therefore, after long public consultations, in 2017 CFPB published the Final rule establishing consumer protection regulations for payday loans, vehicle title loans and certain high-cost installment loans. The protection of consumers in question should have been founded, in particular, on the so-called Mandatory Underwriting Provisions, which is regulated by the following provision:

"§1041.4 Identification of unfair and abusive practice

It is an unfair and abusive practice for a lender to make covered short-term loans or covered longer-term balloon-payment loans without reasonably determining that the consumers will have the ability to repay the loans according to their terms.

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[12] H.R.4173 – 111$^{th}$ Cong. (2010).

(2) A lender's determination of a consumer's ability to repay (…) is reasonable only if based on the calculation of the consumer's debt-to income ratio" or residual income "for the relevant monthly period and the estimates of the consumer's basic living expenses for the relevant monthly period".

However, as we can notice, these rules impose a number of burdensome and expensive procedural requirements on small-dollar lenders which preclude a fast and easy access to many low credit score borrowers to these products. Such circumstance can make the situation even worst, because those who seek this specific kind of loans are very often in financial distress focusing principally on quick, easy approval and application.

In accordance with the abovementioned provision, the loan providers should have obtained many written statements and reports, collected and reviewed several information about incomes, housing expenses and consumer's borrowing history from the own and other lenders records, in order to proof that borrowers would be able to repay the contemplated loan within maximum 45 days. Such compliance procedures should have been similar to those conducted by banks during the mortgages loans proceedings if the regulation had been entered in force.

Initially, the Bureau believed that the burden regarding the determinations about the consumer's ability to repay a loan could be deterrent for lenders from offering unsafe, harmful and/or risky products.

However, in 2019, the CFPB publicly affirmed they would provide some modifications to the 2017 Final Rule. Finally, in July 2020 the Bureau admitted that it has determined that the grounds provided in the 2017 Final Rule do not support its determination that the identified practices are unfair and abusive (Consumer Financial Protection Bureau, 2020). Thus, the Bureau noted that the Mandatory Underwriting Provisions are not supported by any appropriate legal basis.

In other words, CFPB affirmed that earlier rule did not satisfy standards provided by the Dodd-Frank Act's definitions of unfairness and abusiveness.

For this reason, and in order to guarantee access to the small value credits to unserved and unbanked consumers, on July 7, 2020, the CFPB has revalued its previous conclusions and rescinded this most discussed restriction about onerous ability-to-repay provisions that set requirements that no lender could satisfy.

As it has been noted by Kathy Kraninger, Director of CFPB, "that tough underwriting requirements would cut off access to credit, leaving low-income borrowers with few options for fast cash" (American Banker, 2020b). The CFPB has arrived at the conclusion that the countervailing benefits to consumers and competition in the aggregate from the practice in question would outweigh any relevant injury. Moreover, the Bureau believes that "with the elimination of the Mandatory Underwriting Provision, some borrowers who would be able to reborrow the full amount of the initial loan may avoid a default that would have occurred if lender had to comply with the Mandatory Underwriting Provision" (Consumer Financial Protection Bureau, 2020: 212).

Thus, the failure to determine the consumer's ability to repay will no longer be considered as an unfair and abusive practice. However, the Payment Provisions of the 2017 rule remain intact.

Although this presumably rational modification, there are many criticisms regarding the elimination of the Underwriting Provision, for instance the Financial Health Network said that the decision to abandon this Rule "is at odd with the Interagency Principles, which we believe are a step in the right direction. This decision also comes at a time when consumers are at their most vulnerable due to the Covid-19 Crisis" (Financial Health Network, 2020b).

On October 29, 2020, the National Association for Latino Community Asset Builders filed a lawsuit in D.C. Federal Court (Responsible Lending, 2020) against the CFPB asserting that "the Repeal Rule invents a new evidentiary standard – distinct from any statutory requirement – and changes the CFPB's interpretation[13] or application[14] of the statutory definition of unfair and abusive. (…) The CFPB also used an arbitrary truncated analysis, confined in most cases to data from the Payday Lending Rule. (…) The Repeal Rule unreasonably ignores[15] or dismisses available data and research". Thus, the "Repeal Rule is arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law" (Responsible Lending, 2020). Moreover, the Association asserted that the explanation provided by the CFPB regarding the Repeal Rule is a pretext for a desire to serve small-dollar lenders, contrary to the statutory mission of the Bureau. For these reasons, the Plaintiff requested the Court to declare the Rule in question unlawful, set aside it and order the CFPB to take necessary steps to implement the 2017 Final Rule.

As a counterreaction the CFPB filled a motion to dismiss plaintiff's complaint for lack of subject-matter jurisdiction. In January 2022 the United States District Court for the District of Columbia granted the motion[16].

## 4. INTERAGENCY STATEMENT FOR RESPONSIBLE SMALL-DOLLAR LENDING

The unfolding COVID-19 situation have had and still may have disastrous impact on consumer financial well-being, particularly on the unbanked and underbanked population. The joblessness[17] or the reduced incomes can increase the poverty and

[13] The Repeal Proposal "reflected the CFPB's earlier conclusions but changed the wording to be more favorable to the proposal's goal". (Complaint, p. 15).

[14] "The CFPB uses the standard to undermine the identification of the unfair and abusive practice, not to adjust a remedy" (p. 24).

[15] As it has been pointed out "a CFPB official testified to Congress that the CFPB had not conducted any new research to justify the Repeal Proposal. The Repeal Proposal did not even reference recent internal CFPB supervisory or enforcement data" (Complaint, p. 14).

[16] NALCAB v. CFPB No. 1:20-CV-03122 (APM).

[17] According to the survey conducted by the Federal Reserve Board, just in March 2020 13% of adults lost a job, and 6% had their work hours reduced or took unpaid leave. 18% of adults "did

financial straits. In turn, these circumstances may lead to insolvency, over-indebtedness, ever-rising number of suicides[18], family problems, homelessness, social (Civic Consulting of the Consumer Policy Evaluation Consortium, 2013) and financial exclusion[19], public disorders, and finally crimes. Thus, as we can see, the problem interest and have an impact on all of us.

In such circumstances, many consumers are forced to use a payday loan and other small-dollar loans because banks do not provide them and/or are easier and faster to obtain (Bhutta, Goldin and Hamonoff, 2016). As it has been highlighted by FDIC "many consumers turn to payday loans and overdraft programs because these products are easily accessible and generally more widely promoted than other more traditional, affordable loans" (Federal Deposit Insurance Corporation, 2007).

However, there are evidence that the bank and credit unions would be able to offer small loans at lower prices than those of payday and other similar lenders. "The cost of capital for banks and credit unions is the lowest of any provider, and their overhead costs are spread among the multiple products they sell" (The Pew Charitable Trust, 2018). According to their studies, the average payday borrower takes out a $375 loan over five months of the year and pays $520 in fees, while traditional financial institutions could lend the same amount over five months charging less than $100 of fees.

For these reasons and in response to the pandemic, on March 26, 2020, the five federal financial agencies[20] published joint statement (FDIC, Press Releases, *Federal Agencies Encourage…*) in order to encourage banks and credit unions and other financial institutions to offer responsible small-dollar loans to consumers and small business in response to COVID-19.

The agencies realized that well-designed responsible small-dollar products can play a significant role by helping people in need satisfy some urgent expenses or alleviate a difficult financial situation due to income disruptions during difficult pandemic period.

Since the interest rates for consumer loans applied by secured financial institutions are lower than either payday lenders or pawn shops, the small-value

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not expect to be able to pay all of their April bills in full. Among those who lost a job or have their hours reduced, 35% did not expect to be able to pay all bills in full" in Board of Governors of the Federal Reserve System, 2020; see also: The New York Times.

[18] For more accurate information about the relationship between insolvency and physical and mental health problems, see Fitch et al., 2011; Sweet, Kuzawa and McDade, 2018.

[19] "[In] Finland concern was raised that the use of high-cost SMS loans will lead to long-term exclusion from mainstream financial services in the future as many young people are unable to sustain their payments" (Reifner, Clerc-Renaud and Knobloch, 2010: 125).

[20] The Federal Reserve Board, the Federal Deposit Insurance Corporation, Consumer Financial Protection Bureau, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

credits provided by traditional banks are susceptible to be successfully paid back in time.

On May 20, 2020 (FDIC, Press Releases, *Federal Agencies Share…*), regulators issued core lending principles for offering short-term small-dollar credits called "Interagency Lending Principles for Offering Responsible Small-Dollars Loans". In accordance with the provided principles, responsible lending shall be consisted of fair commercial practices, such as the clear disclosure of contractual terms and conditions, the correct assessment of consumer's profile, risks and possible defaults, the fairly use of new technology and alternative underwriting information, the development of procedures that could support borrowers "successful repayment of principal and interest/fees in a reasonable time frame rather than reborrowing, rollovers, or immediate collectability in the event of default" (Interagency Lending Principles for Offering Responsible Small-Dollars Loans, 2020: 3). In other words, the credit products should be offered in a manner in which they offer consumers a meaningful possibility to repay based on their financial situation.

Secured small-dollar credits should balance the customers' need to borrow quickly with fundamentals of responsible lending. Thus, the lenders should act not only in their own interests, but they should take into consideration the borrowers' needs and interests as well. The fair, transparent and equal treatment shall occur both at pre-contractual and post-contractual stages of loan relationship. In addition, loan costs should respect pertinent state and federal laws in force.

An interesting and good structured example is the "Simple Loan" offered by U.S. Bank which is provided to checking customers of the bank in order to borrow up to $1.000. Despite the possibility to obtain the credit via online banking platform or mobile phone (which reduces both costs and time), the repayment of the loan occurs in three monthly payments. Moreover, every $100 borrowed costs $12 or $15 of fees depending on the modality of repayment, it means that the APR of the loan is about 71% which is almost six times lower that average payday loan rates. It seems that banks and credit unions are now well informed and equipped to retail small amount of credits in a responsible and affordable manner to consumers in need who used high-cost loans until now, such as payday loans, pawnshop transactions or vehicle title loans.

The supervised financial institutions should compliance and manage the risks related to the development or improvement of the products they offer. The underwriting process should reflect any prudent and rational policy and practice regarding responsible lending. All the activities shall encourage fair treatments of consumers and fair access to financial services in respect of the applicable laws and regulations.

As it has been already mentioned before, the high-quality, affordable and safe small-dollar loans that support repayment can build a positive credit history, since credit scores influence many aspects, such as insurance rates, rent apartments, employment, mortgages' possibilities, and following.

## 5. POSSIBLE REMEDIES TO PUT IN PLACE

As we could notice, there are numerous predatory and unethical conducts of professionals in the financial market. Now more than ever, these unfair and aggressive practices should be monitored and punished. Nonetheless, there are many preventive tools which could be put in place in order to anticipate the consumer harm in the lending market.

– Regulators shall **continue to encourage banks**, credit union and other financial institutions to offer responsible small-dollar loans (American Banker, 2020a) in order to increase access to fair and affordable credit products;

– **Create and promote alternative products** (The Pew Charitable Trusts, 2018; The Pew Charitable Trusts, 2019), because the "just say no" option does not constitute any valid alternative if an individual has no other possibility to borrow money (eg from family or friends). In fact, many argue that borrowers shall be personally responsible for their financial decisions. That could be an acceptable argument only if consumers, especially the vulnerable ones, have a free choice as to the credit products or at least their terms and conditions. Moreover, it is worthily stressed that individuals are likely to take more risks under pressure, in situations of uncertainty or persistent distress. In some cases, an alternative product to payday loan could be the specific kind of loan existing in Italy called *Cessione del Quinto* (a salary or pension secured loan which cannot exceed one-fifth of the monthly income). In the *Cessione del Quinto* an employer, every month, holds back a portion of employee's wages to repay his/her creditor. The loan contract must be secured by a payment protection insurance policy that insures the repayment of loan in case of death, unemployment, disability or temporary incapacity;

– **Replicate**, where possible, the recent successful experiences from Colorado, Ohio[21], Hawaii, and Virginia[22], regarding their reforms on small-dollar lending. For instance, under Virginia, Hawaii[23] and Ohio statues all high-interest rate lenders (both those in-store and online) must acquire a license. The Virginia Bill sets the duration of small-dollar loans at a minimum of four months and a maximum of 24 months. Loans sold without a license or using evasive practices

[21] See The Ohio Fairness in Lending Act, H.B. 123 (2018).

[22] See The Virginia Fairness in Lending Act, H.B. 789/S.B. 421 (2020). For more details, The Pew Charitable Trusts (2020).

[23] See H.B. 1883/S.B. 2587 (2020).

will be void and uncollectible. Total cost of a loan may not exceed half of the principal;

– **Control over unsafe financial products** (Bar-Gill and Warren, 2008), their distribution[24] and "unfair credit relationship".

The predatory and unethical professional conducts should be monitored and punished. In some European Union countries, National Competent Authorities try to discourage non-suitable financial products. Belgium, France, the UK and the Netherlands have introduced laws "to limit the products that they have classified as toxic[25]" (European Commission, 2018: 113). In Denmark, a particular system of product labeling using a traffic light technique has been introduced, marking each financial product with a red, yellow or green color depending on its complexity or risk level;

– **Saving Planner**. In order to increase saving and improve the management of borrowers' day-to-day finances, the idea developed by Bertrand and Morse (2011) seems particularly interesting. During their research, academics have proposed a so-called self-control treatment via a savings planner. Such savings planner shall contain a non-exhaustive list of "possible daily or weekly expenses[26] that a borrower could cut back on to enable saving for the repayment of the payday loan" (Bertrand and Morse, 2011: 1874).

We can compare it to the situation in which we want to lose some weight and start a healthy diet. To do so, dieticians and/or personal trainers ask us to list every single drink and food we consume throughout a day in order to make us and especially them aware of our daily calorie intake.

We often tend to underestimate our daily/weekly/monthly spending (as well as food and drink consumptions). The aims should therefore be to make people reflect about their habits. Providing some small daily or weekly changes could facilitate saving over time and consequently adjust our budgets. Since it does not require any additional cost, the author of this paper believes that such a savings planner shall accompany every loan agreement. The results could be that some borrowers may decide to moderate the amount or the frequency of a high-cost loans, may decide not to take them at all or abandon the idea of potential rollover.

[24] For instance, as the Recital 26 of the European Consumer Credit Directive (Directive 2008/48/EC) states: "Member States should take appropriate measure to promote responsible practices during all phases of the credit relationship, taking into account the specific features of their credit market. Those measures may include, for instance, the provision of information to, and the education of, consumers, including warning about the risks attaching to default on payment and to over-indebtedness. In the expanding credit market, in particular, it is important that creditors should not engage in irresponsible lending or give out credit without prior assessment of creditworthiness (…)".

[25] For an interesting explanation about the concept of toxicity, see Jérusalmy, 2020.

[26] Such as eating out with friends or family, cigarettes, alcohol, tickets for lottery, cinema and other entertainments, shoes, clothes, beauty products and services, video games, and so on.

Others may find that some of their expenses are unreasonable, unaffordable or simply unnecessary, consequently they may limit certain services, activities or purchases, which could make them behave in a more financially responsible and prudent manner.

– Application of a sort of the "**Duty of Suitability**"[27] to the small amount credit products, which asks for a case-by-case assessment of appropriateness. In the European Union, such duty is considered as a one of the principles of responsible lending (Financial Services User Group, 2019);

– **Control over and ban inappropriate**, complex[28] product design, misleading advertising, unsolicited credit offers[29] and unsuited cross-selling, which primarily benefits the lender and increases the total cost of credit. Ensure that customers have sufficient time to analyze the offer and their financial abilities. Furthermore, the information given to consumers shall be clear, fair and not misleading to enabling them to make conscious, sound and responsible loan decisions. The attention shall be focused also on the modern communication techniques[30], such as accompanying images and videos;

– **No multiple loans**, borrowers should not have any possibility to take out more than one small loan at a time, neither from the same lender nor from different ones;

– **Include all fees and charges** (comprise those related to late repayment or defaulting) **in the rate cap** for both closed-end and open-end credit (as proposed by National Consumer Law Center, 2019);

– **Adequate disclosure**, it means that it is not sufficient for the consumer to know that one day he or she might face a financial distress. The consumer must be fully aware that the financial problems are highly possible and directly related to the financial product or service which he/she is buying at that moment. Therefore, the credit products in question can effectively trigger the ever-rising sea of debt, the garnishment, the loss of possession of a vehicle or other pledged collaterals, over-indebtedness, and so on (like a packet of cigarettes or drugs that contain a warning about side-effects). In other words, the information provided to borrowers shall be very explicit about the consequences of defaulting, the penalty

[27] For different but interesting opinion of the application of the duty of suitability in lending market, see Putney, 2003: 2128–30.

[28] "Firms build complex products not merely to satisfy diverse consumer preferences, but also to confuse consumers and raise the cost of comprehension high enough that consumers will not bother to spend the time and effort that would be required to eliminate confusion" (Willis, 2017: 79).

[29] For instance, "in Belgium, unsolicited marketing is strictly regulated – it is forbidden, among others, to set up credit sales desks in public places such as railway stations, shopping centers" (Financial Services User Group, 2019).

[30] "The effective modern communication techniques are often emotion-based and targeted, segmented by detailed personal characteristics, sometimes right down to the individual consumer" (Willis, 2017: 81).

fees and charges which consumer may have to bear in case of delinquency. In this matter, the more stringent rules on advertising claims are desirable, for instance by using, in a storefront or on the website, particular slogans, such as "borrowing money also costs money";

– **The duty to treat and deal fairly** in respect of general rules of good faith and good conduct, in particular in payment difficulty.

In Belgium courts, the concepts of *bona fide* in contractual relationships to avoid consumer over-indebtedness have been used. In particularly, they "have held that credit providers violate this requirement to enter into *bona fide* contracts if they lend money to people who, at the outset of contract, cannot reasonably be expected to maintain the payments" (Reifner, Clerc-Renaud and Knobloch, 2010).

In the UK and Finland lenders are obliged to consider how they can help consumers with debt problems. In Code of Conducts for creditors in the Netherlands there is a provision regarding "the amount of money that should be left following credit repayments to meet essential household expenditure" (Reifner, Clerc-Renaud and Knobloch, 2010: 117).

The 2017 Payday Loans rule of CFPB has already contained a similar provision:

" (…) in addition to considering the information collected about income and major financial obligations, lenders must reasonably estimate an amount that the borrower needs for basic living expenses. They may do this in a number of ways, including, for example, collecting information directly from borrowers, using available estimates published by third parties, or basing estimates on their experience with similarly situated consumers".

Additionally, in Germany, Estonia and Italy there is a legal provision which considers given contract void[31] due to insincere purpose of one party and the usage of the urgent needs of the other party, if one party knew or should have known about a specific circumstance. This contractual sanction is provided in order to avoid the intention to take advantage of the weakness of the party in need.

– **Provide some aids** in order to defer loan payments temporarily[32] or insert into the contract a Hardship Clause, which permits a "credit repair", it means a renegotiation of the contractual terms and conditions;

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[31] Articles 1447 and 1448 of the Italian civil code regulate the so-called *rescissione del contratto*.

[32] Such as the Bill no. 2501 in California which enacts the COVID-19 Homeowner, Tenant, and Consumer Relief Law of 2020; the Minnesota Bill H.F. 1507 which establishes the COVID-19 Economic Security Act. The subd. 2 of the section 3 of the Bill regulates the repayment terms during public health emergency by extending the repayment period. In particular, the Bill allows the borrowers to repay the loans in equal installments over a period of 12 months. The loans sold in the violation of the section 3 are void and unenforceable against the borrower.; The Missouri Bill H.B. 1438 proposes modifications to the law relating to unsecured loans of $500 or less. The bill lowers

– **More digitalization** to reduce costs incurred by the lenders. In turn, lower costs may foster product innovation and competition;

– In some cases, and when it is convenient **the principle of unconscionability** provided by the Uniform Commercial Code may be applied to the aggressive or deceptive credit contracts (Engel and McCoy 2002);

– Despite the fact that financial education is important and helpful, many researchers stress that it is not sufficient to end predatory lending (Putney, 2003). As it has been pointed out by Engel and McCoy (2002), "reaching the potential victim of predatory lending is the biggest challenge for any educational campaign (…) there is no guarantee that the individuals will understand the information or be able to apply" (Engel and McCoy 2002: 1309-1310). Moreover, many borrowers, in serious financial straits facing a particular need, may not be even concerned about some specific data, facts and terms regarding their loan agreement;

– **Award premiums for good conducts** – i.e., for better disclosure, because as it has been highlighted by many studies, the credit product and service providers can be the most efficient supplier of information which consumer needs in order to make safe and sound financial decision (Willis, 2017; Campbell et al., 2011). The firms are better situated than regulators to achieve consumer comprehension by informing adequately their clients (Willis, 2017). Nevertheless, understanding is not a panacea, the bad decisions can be made also by well-informed and experienced individuals, as a result of lack of bargaining power, distraction, stress[33], decision-making biases or just a particular financial struggle;

– **Create advisory bodies** or institutions specialized in small loan advising and digital platform for product comparison;

– **Paying to get out of debt**. The last but not least is the circumstance that on the market there are specialized companies which theoretically want to help and assist consumers in debt, so-called "Debt management firms".[34] However, their assistance may be very expensive, with poor quality advice or inappropriate services, thus they are highly susceptible to be detrimental to debtors. As the study report of European Parliament (2014: 66) asserts "consumers can be left in a worse financial position by some debt solution".

the maximum number of renewals to two and provides the creation of an extended payment plan "EPP" in order to facilitate the loan repayment.

[33] Also, that caused by the decision itself.

[34] For more detailed information, Australian Securities and Investments Commission, 2016.

## CONCLUSIONS

Although the harms caused by financial products are less visible than those provided by tangible goods, regulators must be aware of the private suffer which accompany the financial problems (Porter, 2009) and take adequate effective actions in order to safeguard the rights and interests of citizens in need.

It must be kept in mind that there is a common societal responsibility to protect particular communities and to ensure non-discriminatory financial inclusion. Denying this segment of consumers fair and secure access to financial services and essential goods would preclude them full participation in the society and as a result it could lead to greater and more acute divisions of the population. A complete ban on small-dollar credit products can leave stranded many individuals facing long-term indebtedness, especially during and after the ongoing emergency due to the spread of COVID-19.

While the author of this contribution is aware that the rampant problem of predatory practices in lending and mis-selling of financial products and services may not be combated as a whole, governments, specialized authorities and enforcement agencies should try to curb or mitigate it as much as possible through the clear, decisive actions and comprehensible legislation that cause as little harm as possible to those it attempts to safeguard.

## DISCLOSURE STATEMENT

The authors report no conflicts of interest.

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