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James P. Nehf
Indiana University McKinney School of Law

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FINTECH, PAYDAY LOANS AND THE CHANGING LANDSCAPE OF CASH-ADVANCE CONSUMER CREDIT IN THE UNITED STATES

*—James P. Nehf**

High-cost, cash-advance or "payday" loans have plagued low-income consumers in the United States for several decades. With little regulation at the federal level, states have created a wide variety of regulatory frameworks addressing payday loans--from banning payday loans altogether in some states to permitting them with few restrictions on fees and practices in others. In recent years, however, an alternative to payday loans has emerged as fintech lenders partner with employers to offer "earned wage access" or EWA plans to low wage workers which allows them to obtain part of their earned wages before their actual payday. At present, EWA plans are usually offered free or for a small fee. This paper discusses the evolution of payday loan regulation in the United States and the emergence of the EWA alternative. It maintains that while EWAs are currently a less expensive way for consumers to obtain cash-advances before their next payday, there are enough similarities to traditional payday loans that consumer credit regulators should take a close look at and create frameworks for curtailing potential abuses in this emerging market.

Keywords: fintech, consumer credit, payday loans, Consumer Financial Protection Bureau.

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* James P. Nehf is the Thomas F. Sheehan Professor at Indiana University McKinney School of Law.

I. INTRODUCTION

Cash-advance loans in the United States, sometimes known as "payday" loans," involve non-bank lenders who make short term cash advances to borrowers in need of relatively small amounts of money for a short period of time. Before the advent of online cash-advance transactions, the typical payday loan was secured by a post-dated check drawn from the consumer's bank account. If secured by a post-dated check, the lender did not deposit the check for collection until the date has passed, which usually was an employed consumer's next payday. Payday lenders make money by advancing less than the face amount of the check, retaining the difference as a check advance fee. In the modern form of the transaction, the lender obtains the consumer's authorization for a delayed automatic debit from the consumer's bank account, a transaction that payday lenders increasingly solicit over the Internet. The most common term for payday loans is two weeks, and the amounts are almost always less than $1,000, averaging less than $200. In states that specifically regulate payday loans, the maximum loan amount varies between $300 and $1,000.

Fees for payday loans are either a percentage of the loan amount or a fixed fee ranging from $15 to $35, but the ultimate costs of a payday loan can be much higher. One problem with payday loans is that they are often renewed. If the consumer does not want the lender to deposit the post-dated check or draw the electronic debit because the bank account has insufficient funds, the consumer may request an extension of the loan and pay an additional fee. Alternatively, a consumer may obtain a second payday loan from another lender to cover the check given to the first lender. If this pattern continues, the consumer is continually paying fees and interest at a very high rate for a relatively small initial cash advance. Although renewals can be very expensive, consumers may fear that if a personal check is dishonored or a debit transaction is refused by their bank, or if the transaction will result in an overdraft, the consumer will incur fees and possibly be subject to civil or criminal charges for writing checks against insufficient funds. In addition, in the traditional payday loan, an unscrupulous lender may deposit a check knowing that the funds are not likely available, generating the lender's own bounced check fees that increase the amount the consumer already owes.

In recent years, fintech companies have been disrupting the payday loan model, allowing workers to access portions of their paychecks prior to payday through a concept known as earned wage access (EWA). These services are sometimes offered at no cost to the consumer but often fees are charged for the service. These digital "earned-wage access services" are provided either

directly to consumers or, more commonly, through employers who affiliate with fintech companies to advance the funds to their workers on request. When transactions are not integrated with employer payroll systems, consumers may need to prove that they are getting paid regularly, and some fintech providers use technology to track or anticipate when incoming payments will hit a customer's bank account, and transfer the funds at that time.

This paper discusses whether these EWA cash advances should be considered credit transactions similar to payday loans and subject to the same (or similar) regulatory limitations. The paper begins with an overview of how consumer credit regulation in the United States depends largely on state laws and discusses the benefits of this multifaceted approach. It then discusses how the regulation of payday loans has evolved, largely by individual state laws with some federal overlay, over several decades. The debate over how to regulate EWA transactions is then explored. The paper concludes that while EWA transactions are significantly different from payday cash advances, and (for now at least) significantly less costly, they raise enough consumer credit concerns to warrant some form of protective regulation at the state, if not the federal, level.

II. REGULATION OF SHORT-TERM CONSUMER LOANS IN OTHER COUNTRIES

In 2019, a joint report on the regulation of short-term consumer credit was issued by the G20 OECD Task Force on Financial Consumer Protection, FinCoNet, and the OECD International Network on Financial Education.[1] The joint report recognized that short-term consumer credit products if properly regulated and used by informed consumers, can effectively meet certain consumers' needs and contribute to their financial well-being, but they can also adversely affect the most vulnerable sectors of the population (e.g., poor, under-employed, less educated, and elderly consumers), both in mature and emerging economies. The report observed that a wide variety of regulatory approaches to short-term consumer credit have been implemented throughout the world, including special disclosure requirements, caps on the cost of short-term credit, responsible lending obligations, and mandatory cooling-off periods.

In most reporting jurisdictions, the disclosure requirements regarding standard terms and conditions, and advertising regulations, that generally apply to

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[1] G20 OECD Task Force on Financial Consumer Protection, FinCoNet and the OECD International Network on Financial Education, *Short-Term Consumer Credit: Provision, Regulatory Coverage and Policy Responses* (OECD 2019) ("*OECD Joint Report*").

other forms of consumer credit also apply to short-term credit.[2] Some jurisdictions have, however, added specific disclosures for short-term credit through special legislation. These may include a warning to consumers about the relatively high cost of the short-term credit product and instructions to access a financial regulator's website to encourage consumers to become better informed about their credit options and possibly find less expensive sources of financing, as well as information about credit counselling opportunities.

Several jurisdictions reported the imposition of caps on the cost of short-term consumer credit.[3] The cap can be on the interest rate, on the fees imposed for the credit product, on the APR (combining both interest rates and mandatory fees), or on the total cost of credit. Some caps also apply to default charges (e.g., late fees in repayment). Interest rate caps are the most common. Caps on interest rates are generally designed to prevent deceptive and abusive lending practices or to combat anti-competitive behavior among lenders. Around 40% of national economies impose an interest rate cap on short-term credit transactions.[4]

Most of the jurisdictions reported that generally applicable responsible lending obligations also apply to short-term credit underwriting decisions.[5] In Australia, however, besides the responsible lending obligations that apply to most consumer credit transactions, additional provisions for short-term credit were introduced in 2013. These include a presumption of unsuitability if either the consumer is in default under another short-term credit transaction or the consumer has engaged in two or more other such transactions in the previous ninety days. In addition, ninety days of bank statements may have to be reviewed. And for consumers who receive at least 50% of their income in government benefits, not more than 20% of their income can be used for repayments under short-term credit products. In Lithuania, changes were made to the Law on Consumer Credit requiring lenders to assess consumers' solvency more prudently. This resulted in a substantial reduction in the volume of short-term loans being issued.[6]

Almost all of the reporting jurisdictions also required cooling-off periods during which consumers can withdraw from the transaction without incurring

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[2] ibid 33-34.

[3] ibid 36-37.

[4] Samuel M. Maimboand C.A. Henriquez Gallegos, 'Interest Rate Caps around the World: Still Popular, but a Blunt Instrument. Policy Research Working Paper' (2014) World Bank Group Working Paper No. 7070 <https://openknowledge.worldbank.org/handle/10986/20494> accessed 26 August 2022.

[5] *OECD Joint Report* (n 2) 39-41.

[6] ibid 41.

a penalty.[7] The length of these periods varies, and in all reporting jurisdictions, these periods apply to both short-term consumer credit and more generally to other forms of consumer credit, with some exceptions.

The joint report did not specifically address EWA transactions, which were not prevalent internationally at the time and were just beginning to gain popularity in the United States.

III. CONSUMER CREDIT REGULATION IN THE UNITED STATES--OVERVIEW

Consumer legislation in the United States exists at federal, state, and (sometimes) local/city levels, but most consumer protection legislation for the most vulnerable among us exists at the state level. Over the years, states have adopted laws on consumer credit, distance selling, unfair contract terms, and a wide variety of deceptive trade practices. Some of these statutes prohibit certain merchant conduct or contract terms (e.g., pyramid schemes, door-to-door selling, "bait and switch" advertising), while others provide a regulatory framework for a particular type of commercial activity or industry (e.g., rental-purchase contracts or the time-share industry). Although there are common themes present in the array of state laws, and some areas in which federal law preempts state law, for the most part, each state adopts its own approach to protecting its residents from unfair or deceptive trade practices.

State consumer statutes became popular in the 1950s and 1960s during the rise of post-war consumerism in the United States. Prior to that time, the Federal Trade Commission was the principal government agency charged with protecting consumer rights. The FTC promulgated consumer protection regulations under the FTC Act and brought enforcement actions to combat widespread merchant misconduct in areas such as deceptive advertising, fraudulent business opportunity schemes, abuses arising from home solicitation sales, and unfair debt collection tactics. Protection at the state level was comparatively weak. Much of the objectionable merchant conduct did not rise to the level of common law fraud. Even when it did, the difficulties of proving the elements of fraud, especially the scienter requirement (willfulness), and the high cost of litigation as compared to the injury suffered, often discouraged enforcement actions. Existing state statutes governing business conduct, such as the Uniform Commercial Code, included few consumer protection provisions. The FTC, therefore, began encouraging the states to create statutory enforcement mechanisms designed specifically to promote consumer rights, and by the end

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[7] ibid 41-43.

of the 1970s most states had enacted at least one general consumer protection law to curb unfair or deceptive acts and practices, and a variety of industry-specific laws.

Today, state consumer statutes vary widely among the states because states have frequently amended their statutes in non-uniform ways, either to resolve ambiguities in statutory language, to clarify or supplement consumer rights, or to address new consumer problems.

Nevertheless, despite the largely uncoordinated and ad-hoc enactment and amendment process, there has been a general convergence of laws over time. As a few states begin to address a new problem (e.g., telemarketing fraud in the 1980s), other states have usually followed suit, and over time most states now address the same basic set of consumer issues, although the laws may differ somewhat in scope and content.

Adding to the non-uniformity of state consumer laws, state courts have had to decide many interpretive issues--what type of plaintiffs are protected, what kinds of transactions are covered, what type of sellers or businesses are subject to liability, etc. For example, courts have had to decide whether small businesses can bring actions under the statute, whether the statute applies to the "learned professions" such as the practice of law or medicine, and whether the statutes can be used to ease the burden of proof or enhance the recovery in a personal injury action, and whether certain areas of commerce, such as real estate, investment securities and insurance regulated under other laws, are also subject to the consumer protection statutes.

As a result of differing statutory language in enacted laws and evolving court interpretations of those laws, consumer protection norms under the array of state statutes continue to vary among the fifty states. And while there are occasional calls for uniformity or a more national and harmonized approach, the calls generally have not gained widespread support. Indeed, in the last decade or so, calls for harmonization typically originates in the business community, seeking the adoption of a national law that will insulate members from liability under state laws that are perceived to be less business-friendly than they would prefer.

The consensus among consumer representatives is that a state-by-state approach is preferred unless there is a strong need for uniformity in a particular area of commerce. The approach has worked well over time and carries several advantages. First, it allows for a healthy degree of experimentation and an evolutionary approach to consumer protection nationwide. As states adopt different laws and models to address similar problems, there is an opportunity

to evaluate which laws and models work best. Over time, the good ideas take hold in other states, and the weak approaches get strengthened or jettisoned.

Second, a particular consumer problem (e.g., fraud in the home mortgage market) may be more prevalent in one state or region before it takes hold in others. A state where the problem is most serious may enact protective legislation that can serve as a guide to other states where the problem is only in its early stages.

Third, state legislatures have been able to react more quickly to emerging consumer problems than the U.S. Congress. Proposed national legislation, or a proposed amendment to existing national legislation, is perceived as a high stakes political event, and competing interest groups are inclined to expend tremendous resources to get their views heard. This often results in legislation either stalling in Congress or being enacted in a diluted form that is the least objectionable to major stakeholders but does little to solve the problem.

The evolution of consumer law in the United States has been far from uniform among the states for decades. The variety of regulatory approaches to payday loans in particular, and the interplay between federal and state control, has been especially challenging over the years, as the next section demonstrates.

IV. THE EVOLUTION OF PAYDAY LOAN REGULATION IN THE UNITED STATES

To avoid usury limits and disclosure requirements under state consumer credit laws, payday lenders initially maintained, in the 1980s, that they charge a check-cashing or other fee for service, and not interest for an extension of credit.[8] When tested in court, the argument usually failed, but not always, and absent special legislation exempting payday loans from coverage, courts generally held that payday advances are consumer loans covered by the federal Truth in Lending Act (TILA) and state consumer credit laws that regulated consumer credit disclosures and interest rate limits.[9] In *Livingston v Fast Cash*

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8 Lynn Drysdale and Kathleen E. Keest, 'The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking about the Role of Usury Laws in Today's Society' (2000) 51 South Carolina Law Review 589, 642.

9 See, e.g., *Cashback Catalog Sales Inc v Price* 102 F Supp 2d 1375 (2000); *Turner v E-Z Check Cashing of Cookeville, TN Inc* 35 F Supp 2d 1042 (1999); *Hamilton v York* 987 F Supp 953 (1997); *White v Check Holders Inc.* 996 SW 2d 496 (1999). In the year 2000, the Federal Reserve Board of Governors' official interpretation of Regulation Z clarified the Board's position that payday lending or deferred deposit check cashing services were covered by Regulation Z. *Arrington v Colleen Inc.* 2000 US Dist. LEXIS 20651, at 16. Before the Board

USA Inc.,[10] for example, a payday lender in Indiana argued that its $33 fee was authorized by a section of the consumer credit code allowing a minimum charge in that amount for small loans.[11] The Indiana Supreme Court disagreed and held that the maximum APR for small loans limited payday lenders to a 36% rate under the small loan statute. To hold otherwise, and allow payday lenders to charge over 400% interest, would "create an absurd result which the legislature could not have intended."[12]

In states where usury rates would prohibit high payday loan fees, when converted to annual interest rates, lenders sought protective legislation or affiliations with depository institutions in states that have favorable or no interest rate regulation. Because federal law gives national banks and other financial institutions in one state a right to "export" their home state laws to transactions initiated with consumers in other states, such affiliations may evade lower interest rate limits in those states. The legality of this practice depended upon an interpretation of section 85 of the National Bank Act, which allowed (and still does) a nationally chartered bank to "take, receive, reserve, and charge, on any loan … interest at the rate allowed by the laws of the State … where the bank is located."[13] National banks located in states that had no rate caps on consumer credit transactions, such as Delaware and South Dakota, did not have to comply with the usury limits in states where their customers were located.[14] A similar federal statute still allows state-chartered banks to use favorable interest laws of their home state in transactions with out-of-state customers.[15]

To take advantage of federal preemption, some payday lenders partnered with national or state-chartered banks that were located in high interest rate states. The partnerships took several forms. The local payday lender might broker the loan, with the bank originating or underwriting it. The bank may or may not approve the extension of credit. The local lender usually processed

clarification, decisions within Florida were not consistent on this issue. See *Gonzales v Easy Money Inc* No. 5:00-cv-2-Oc-10GRJ (February 22, 2001).

[10] *Livingston v Fast Cash USA Inc* 753 NE 2d 572 (2001).

[11] See Indiana Code Ann. § 24-4.5-3-508(7) ($30 fee maximum but indexed for inflation).

[12] *Timberlake v State* 753 NE 2d 591 (2001) at 577. The Indiana legislature subsequently passed a law regulating payday loans as a separate transaction, insulating them from the limitations of the small loan act. See Ind. Code Ann. §§ 24-4.5-7-101, et seq. Thus, Livingston is superseded by statute. See *Cash in a Flash Inc v McCullough* 853 NE 2d 533 (Ind Ct App 2006).

[13] 12 US Code, § 85.

[14] *Marquette Nat'l Bank v First of Omaha Service Corpn* 1978 SCC OnLine US SC 216 : 58 L Ed 2d 534 : 99 S Ct 540 : 439 US 299 (1978) (allowing exportation of Nebraska interest rate laws to credit card customers in Minnesota).

[15] See s 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub L No. 96-221, 94 Stat. 132, codified at 12 US Code, § 1831d(a).

the loan, transmitting the consumer information to the bank and approving credit. The bank would usually immediately sell the loan back to the local payday lender, retaining a participation share. The payday lender might agree to indemnify the bank from any legal liability resulting from the relationship.[16]

Legal challenges to affiliations between payday lenders and chartered banks met with mixed results. Some courts held that federal law did not insulate payday lenders from state usury limits when the lender was a separate non-bank legal entity and the chartered bank itself was not charged with violating state law. Since the action was only against the non-bank lender, the federal preemption statute did not apply.[17] Other courts held that federal law preempted state law usury claims against affiliated entities, at least when both the payday lender and the bank were named defendants in the action.[18]

Beginning in 2000, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) took steps to prohibit national banks, thrift institutions, and federal reserve member banks from partnering with payday lenders.[19] The agencies found that payday lending exposes financial institutions to unacceptable safety and soundness risks and undermines consumer interests.[20] As a result of OCC and OTS pressure, affiliations between payday lenders and national banks ended. Some banks, however, chose to conduct payday lending directly rather than through affiliates, and neither the OCC nor OTS has objected.[21]

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16 See Elizabeth Renuart and others, *The Cost of Credit: Regulation, Preemption, and Industry Abuses* (3rd edn, National Consumer Law Center 2005). These arrangements are sometimes referred to as "rent a bank" scenarios.

17 See *Goleta Nat'l Bank v Lingerfelt* 211 F Supp 2d 711, 718 (EDNC 2002); *Colorado, ex rel. Salazar . Ace Cash Express Inc* 188 F Supp 2d 1282, 1284–85 (D Colo 2002. See also *BankWest Inc v Oxendine* 266 Ga App 771, 598 SE 2d 343 (noting but not deciding issue).

18 See *Jenkins v First Am Cash Advance of Ga* LLC, 2003 US Dist LEXIS 25154 (SD Ga September 5, 2003); *Hudson v Ace Cash Express, Inc* 2002 US Dist LEXIS 19210 (SD Ind September 30, 2002).

19 See Comptroller of the Currency Administrator of National Banks, *Annual Report Fiscal Year 2003: The Value of the National Bank Charter* (2003) 17. "*All national banks with known payday lending activities through third-party vendors were ordered in FY 2003 to exit the payday lending business*".

20 See Comptroller of the Currency Administrator of National Banks, *Third-Party Relationships* (Advisory Letter No. LA 2000-10, 2000); Comptroller of the Currency Administrator of National Banks, *Payday Lending* (Advisory Letter No. LA 2001-47, 2001). Also see 'Payday Lending' (*OCC*, 2022) <http://www.occ.gov/topics/consumer-protection/payday-lending/index-payday-lending.html> accessed 26 August 2022.

21 See Centre For Responsible Lending, *Mainstream banks making payday loans: Regulators must put swift end to new trend* (2010); Office of the Federal Register,*76 FR 33409 - Guidance on Deposit-Related Consumer Credit Products* (National Archives and Records Administration, 2011); In 2013, the OCC issued guidance for banks that wish to engage in payday (or "deposit advance") lending. See 'Office of the Comptroller of the Currency Releases Guidance on Deposit Advance Products' (*OCC*, 25 April 2013) <https://www.occ.

As federal regulators halted payday lending affiliations with banks under their supervision, payday lenders turned to state-chartered banks (insured by another federal agency, the Federal Deposit Insurance Corporation (FDIC)) that operates outside the reach of OCC and OTS. In 2003, the FDIC responded by issuing guidelines for the supervision of state-chartered banks that affiliate with payday lenders.[22] The guidelines, which the FDIC amended in 2005, did not prohibit such affiliations but recognized that payday loans can be subject to high levels of transaction risk given the large volume of loans and the movement of loan funds between the institution and third-party originators. Because payday loans may be underwritten in locations far away from the state-chartered bank, there also was the risk that local payday lending employees could misrepresent information about the loans or increase credit risk by failing to adhere to established underwriting standards. The FDIC guidelines cautioned that payday lending raises many consumer protection issues and attracts a great deal of attention from consumer advocates and other regulatory organizations, increasing the potential for consumer litigation. Due to the heightened safety and soundness and compliance risks posed by payday lending, the guidelines called for regulators to conduct enhanced risk management and consumer protection examinations of FDIC-insured banks that affiliate with payday lending firms.[23] The FDIC stopped short of banning the affiliations, however, and its guidelines have had a limited deterrent effect. The agency did, however, create a pilot program in 2008 to encourage banks to provide lending options to consumers in need of short-term financing at lower interest rates.[24] Due to the cautionary statements from federal regulators over the years,

gov/news-issuances/news-releases/2013/nr-occ-2013-69.html> accessed 26 August 2022; Office of the Comptroller of the Currency, *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products - 78 FR 70624* (2013); In late 2020, the OCC reversed its guidance and issued a "true lender" rule under which a bank would be considered the lender if, as of the date of origination, it was named as the lender in the loan agreement or funded the loan. See Office of the Comptroller of the Currency, *National Banks and Federal Savings Associations as Lenders 85 F.R. 68742* (2020). This effectively permitted OCC-regulated banks to affiliate with local payday lenders. Congress took action to reverse the OCC rule with a joint resolution in the summer of 2021. See Julie Bykowicz, 'Congress Ends Trump-Era Rule Enabling Payday Lenders to Avoid Interest Rate Caps' (*The Wall Street Journal*, 24 June 2021) <https://www.wsj.com/articles/congress-ends-trump-era-rule-enabling-payday-lenders-to-avoid-interest-rate-caps-11624563763> accessed 26 August 2022.

[22] FDIC, *Guidelines for Payday Lending* (2003). The guidance was updated in 2005 and 2015. See FDIC, *FDIC Clarifying its Approach to Banks Offering Products and Services, such as Deposit Accounts and Extensions of Credit, to Non-Bank Payday Lenders* (2015); Federal Deposit Insurance Corporation, *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products* (2013).

[23] ibid.

[24] Jordan Weissmann, FDIC Pilot Program Explores Alternatives to Payday Loans (*Los Angles Times*, 12 August 2008) <https://www.latimes.com/archives/la-xpm-2008-aug-14-fi-banks14-story.html> accessed 26 August 2022.

relatively few banks or credit unions offered large-scale formal loan programs of this type.[25]

The OCC repealed its guidance in 2017 and the FDIC announced in May 2020 that it would repeal its deposit advance product guidance, along with its 2007 small dollar loan guidance that encouraged banks to limit interest rates on small dollar loans to 36%. The joint guidance encouraged banks and credit unions to make "responsible" small dollar loans with appropriate underwriting and terms that support successful repayment rather than reborrowing, rollovers, or immediate collectability in the event of default.[26] But the guidance offered few specifics, explicitly permitted "shorter-term single payment structures," and was vague on appropriate interest rates, though it said that pricing should be reasonably related to the institution's risks and costs.

Shortly before the 2020 presidential election, the federal bank regulators issued guidance that would permit greater bank involvement in payday lending. This was the so-called "true lender" rule that permitted federally regulated banks to affiliate with payday lenders and effectively avoids usury limits nationwide. The rule permitted partnerships in which federally chartered banks would originate loans on behalf of high-cost lenders to customers who had no other relationships with the banks; such loans would otherwise be prohibited by state laws. The loans could then be quickly sold to nonbank lenders. These partnerships are known as "rent-a-bank" or "rent-a-charter" arrangements. The rule declared that the bank should always be considered the true lender, essentially shielding the partnerships from legal and regulatory scrutiny, even when they served little purpose other than to circumvent state laws. But this approach poses a serious risk to borrowers and the banking system.

The saga continued, however, after the 2020 election. President Joe Biden signed an act into law in June 2021 that rescinded the "true lender" rule of the OCC.[27] Congress used the Congressional Review Act, which gives lawmakers the ability to rescind recently enacted agency regulations. On the day of the Senate action, the White House issued a statement supporting repeal, saying the rule "undermines state consumer protection laws and would allow the proliferation of predatory lending by unregulated payday lenders using, among

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[25] See Consumer Financial Protection Bureau, *Payday, Vehicle Title, and Certain High-Cost Installment Loans* (2016).

[26] See Jan Kruse, *FDIC to Repeal 36% Rate Cap and Bank Payday Loan Guidance, but Banks Should not Take the Bait* (National Consumer Law Center, 2020).

[27] Alex Horowitz and Nick Bourke, Congressional Repeal Highlights Issues with Risky Bank Lending Partnerships (PEW, 2 July 2021) <https://www.pewtrusts.org/en/research-and-analysis/articles/2021/07/02/congressional-repeal-highlights-issues-with-risky-bank-lending-partnerships> accessed 26 August 2022.

other vehicles, 'rent-a-bank' schemes to move high-interest loans through national banks to evade state interest rate caps."

During all of this federal regulatory debate, some states were showing hostility to payday loans. Back in 2004, Georgia enacted a statute that specifically criminalized payday lending.[28] To avoid preemption by federal bank statutes, the act does not prohibit out-of-state banks from using local agents to make payday loans, so long as the local agents do not receive "a predominant economic interest" in the loan revenues. Payday lenders challenged the law in *Bankwest Inc v E. Baker*,[29] claiming that the use of local agents under this limitation is not economically feasible so the law effectively bars out-of-state banks from making payday loans in Georgia. A federal district court upheld the statute, finding that agents who receive less than a majority of loan revenues could still operate profitably. Noting the low overhead needed to run such operations, which require little space or equipment and relatively few employees, and the high dollar volume of loans that these businesses generated, the court concluded that local agents could operate profitably even though they receive less than half of loan revenues.[30] Attempts to conduct payday lending on the Internet with Georgia residents have met legal challenges as an attempt to evade the reach of the Georgia law.

Interestingly, in 2006 Congress enacted the Military Lending Act (MLA)[31] to address concerns that service members and their families were being targeted by high-cost payday loan-type credit products. Under the MLA, a small loan lender may not impose an annual percentage rate[32] greater than 36 percent in connection with an extension of consumer credit to a military borrower. The initial MLA regulations limited the Act's application to closed-end loans with a term of 91 days or less in which the amount financed did not exceed $2,000, closed-end vehicle title loans with a term of 181 days or less, and closed-end

28 Georgia Code Ann § 16-17-1 to -10.

29 324 F Supp 2d 1333 (ND Ga 2004), vacated as moot, 446 F 3d 1358 (11th Cir Ga 2006). See also *Glenn v State* 282 Ga 27, 644 SE 2d 826 (2007) (upholding law under Georgia Constitution).

30 40 id. at 1347. See, e.g., *State ex rel Olens v Western Sky Fin. LLC* 2015 Ga Super LEXIS 11 (Georgia law applied to lending to Georgia residents by a bank that was located in the Cheyenne River Indian Reservation; the agreement included a provision stating, "This Loan Agreement is subject solely to the exclusive laws and jurisdiction of the Cheyenne River Sioux Tribe, Cheyenne River Indian Reservation.").

31 The Military Lending Act, part of the John Warner National Defense Authorization Act for Fiscal Year 2007, was signed into law in October 2006. The interest rate cap took effect October 1, 2007. It is codified at 10 USC § 987.

32 The military annual percentage rate is an APR that includes a broader range of fees and charges than the APR that must be disclosed under the federal Truth in Lending Act. See 32 CFR 232.4; 10 USC § 987(i)(3); *Davidson v United Auto Credit Corp* 2021 US Dist LEXIS 95302, at *6 (ED Va May 19, 2021).

tax refund anticipation loans.[33] The Department of Defense found, however, that “the extremely narrow definition of ‘consumer credit’ in the [then-existing rule] permits a creditor to structure its credit products in order to reduce or avoid altogether the obligations of the MLA.”[34] As a result, the Department expanded its definition to include open-end credit and longer-term loans so that the MLA protections generally apply to all consumer credit that is subject to the requirements of Regulation Z (with a few listed exceptions).[35]

In 2017, the Bureau of Consumer Financial Protection (CFPB) issued a final rule to create a small set of consumer protections for payday loans, vehicle title loans, and related short-term, high-cost lending practices.[36] The rule had two primary parts. First, the Bureau said that it was an unfair and abusive practice for a lender to make such loans without reasonably determining that consumers have the ability to repay the loans, and it required that a lender must reasonably determine that the consumer can repay the loan before extending credit.[37] These were called the “mandatory underwriting provisions” and were revoked by the CFPB in July 2020 before the presidential election.[38] Second, the Bureau said it was an unfair and abusive practice to attempt to withdraw payment from a consumer’s account after two consecutive payment attempts have failed, unless the lender obtains the consumer’s new and specific authorization to make further withdrawals from the account. This was one of the most problematic issues with payday lending—a lender could pile up charges for bounced checks by repeatedly submitting the same check for payment from

[33] 72 Fed Reg 50580 (August 31, 2007).

[34] 80 Fed Reg 43560, 43567 n 78 (July 22, 2015).

[35] 80 Fed Reg 43560 (July 22, 2015) (to be codified at 32 CFR 232). In general, creditors must comply with the new regulations for extensions of credit after October 3, 2016; for credit card accounts, creditors are required to comply with the new rule starting October 3, 2017.

[36] 12 CFR Pt 1041; 82 FR 54472. The rule exempts several types of consumer credit, including: (1) loans extended solely to finance the purchase of a car or other consumer good in which the good secures the loan; (2) home mortgages and other loans secured by real property or a dwelling if recorded or perfected; (3) credit cards; (4) student loans; (5) non-recourse pawn loans; (6) overdraft services and lines of credit; (7) wage advance programs; (8) no-cost advances; (9) alternative loans (similar to loans made under the Payday Alternative Loan program administered by the National Credit Union Administration); and (10) accommodation loans.

[37] In its research prior to issuing the rule, “The Bureau concluded that there is consumer harm in connection with these practices because many consumers struggle to repay unaffordable loans and in doing so suffer a variety of adverse consequences. In particular, many consumers who take out these loans appear to lack the ability to repay them and face one of three options when an unaffordable loan payment is due: Take out additional covered loans (‘re-borrow’), default on the covered loan, or make the payment on the covered loan and fail to meet basic living expenses or other major financial obligations.” 85 FR 44382.

[38] 85 FR 44382, 44444 (July 22, 2020). It remains to be seen whether the CFPB will reinstate the mandatory underwriting provisions under new leadership after the 2020 presidential election.

the debtor's bank account.[39] The rule also required lenders to provide certain notices to the consumer before attempting to withdraw payment from the consumer's account.

While this interplay between federal and state law can be confusing, the bottom line is that if not preempted by federal law (e.g, the Military Lending Act), state consumer credit laws regulate the limits of payday loans and the high fees associated with them. At present, state laws fall into two general categories. Through legislative initiatives similar to those in the rent-to-own industry a decade earlier, more than half the states have enacted legislation authorizing and regulating payday loans specifically.[40] These "deferred deposit" laws usually require that payday lenders obtain licenses or register before beginning operations, and several mandates that the lender put up a bond or maintain a minimum level of capital or net worth. They may also specify a maximum loan term, principal amount, and fee structure for the transaction. For example, Colorado amended its payday loan law in 2010 to set a minimum six-month term for loans based on unfunded checks held by the lender. Lenders could charge 45 percent per annum interest, a finance charge of 20% for the first $300 borrowed plus 7.5% of $301 to $500, plus a $7.50 per $100, up to $30, monthly maintenance fee after the first month.[41] Colorado changed the law again in 2018, capping the interest rate at 36 percent annually.[42] Some state laws require mandatory disclosures and contract terms. Although the allowable fees can appear relatively low ($15 to $30 per transaction), they translate into annual interest rates of several hundred percent.[43] At least nineteen states cap payday loan amounts between $500 and $600.[44]

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[39] "The Bureau is concerned that consumers may be subject to multiple fees and other harms when lenders make repeated unsuccessful attempts to withdraw funds from their accounts. In these circumstances, further attempts to withdraw funds from consumers' accounts are very unlikely to succeed, yet they clearly result in further harms to consumers." 85 FR 44382.

[40] According to the Consumer Federation of America, thirty-one states permit "high cost" payday loans. 'Legal Status of Payday Loans by State' (*Payday Loan Information for Consumers*, 2022) <https://paydayloaninfo.org/state-information/> accessed 26 August 2022. See, e.g., Ala Code § 5-18A-13; Ariz. Rev Stat §§ 6-1251 to -1263; Colo Rev Stat §§ 5-3.1-101 to -123; Del Code Ann tit 5, §§ 961, 976, 2227, 2235A; DC Code Ann §§ 26-301 to -323; Haw Rev Stat §§ 480F-1 to -7; Idaho Code §§ 28-46-401.

[41] Colo Rev Stat 5-3.1-105.

[42] See Colo Rev Stat 5-3.1-101.5 ("The people of this state find and declare that payday lenders are charging up to two hundred percent annually for payday loans and that excess charges on such loans can lead Colorado families into a debt trap of repeat borrowing. It is the intent of the people to lower the maximum authorized finance charge for payday loans to an annual percentage rate of thirty-six percent.").

[43] See Consumer Federation of America, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury* (2004) (APRs typically over 400%).

[44] See Ala. Code sec. 5-18A-12(a); Alaska Stat. sec. 06.50.410; Cal. Fin. Code sec. 23035(a); Del. Code Ann. tit. 5, sec. 2227(7); Fla. Stat. sec. 560.404(5); Haw. Rev. Stat. sec. 480F-4(c); Iowa Code sec. 533D.10(1)(b); Kan. Stat. Ann. Sec. 16a-2-404(1)(c); Ky. Rev. Stat. Ann.

In nineteen states, statutes either specifically prohibit payday lending or apply to payday lending the interest rate caps on small loans in general.[45] Because the rate limits in these small loan statutes, typically at 36% per annum, are far lower than the rates the payday industry charges, payday lenders in these states have the greatest incentive to disguise the transaction as something other than a loan or to partner with state or federal chartered banks for the benefits of interest rate preemption. Laws regulating small loans may also limit the amount and term of the loan, impose penalties for charging usurious rates, include prepayment rebate formulas, require the filing of annual reports, and prohibit certain contract provisions.

All of this was going well for the payday loan industry until fintech firms found a way to achieve much of the same function (pre-payday advances) but at lower fees, as described in the next section.

V. FINTECH AND THE EMERGENCE OF EWA PROGRAMS

In contrast to traditional payday loans, EWA programs have now emerged as an innovative way for employees to meet short-term financial needs that arise between paychecks. Under these programs, an employer partners with an EWA provider and allows employees to request a certain amount (or share) of accrued earned wages, disbursing the requested amounts to the employees prior to payday, and later recouping the funds through payroll deductions or bank account debits on the subsequent payday.

Earned-wage access products entered the mainstream around 2018.[46] The typical employer-backed model allows people to access a portion of their paychecks early and pay the advance back over a subsequent pay period or period. Companies that provide earned-wage products directly to consumers get the funds paid back by accessing users' bank accounts. Fee structures can also

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Sec. 286.9-100(9); Mich. Comp. Laws sec. 487.2153(1); Miss. Code Ann. Sec. 75-67-519(2); Mo. Rev. Stat. sec. 408.500(1); Neb. Rev. Stat. sec. 45-919(1)(b); N.D. Cent. Code sec. 13-08-12(3); Ohio Rev. Code Ann. sec. 1321.39(A); Okla. Stat. tit. 59, sec. 3106(7); R.I. Gen. Laws sec. 19-14.4-5.1(a); S.C. Code Ann. sec. 34-39-180(B); S.D. Codified Laws sec. 54-4-66; Tenn. Code Ann. Sec. 45-17-112(o); Va. Code Ann. Sec. 6.2-1816(5).

[45] 'Legal Status of Payday Loans by State' (*Payday Loan Information for Consumers*, 2022) <https://paydayloaninfo.org/state-information/> accessed 26 August 2022. See Alaska Stat. § 45.45.010; Conn. Gen. Stat. §§ 36a-555 to -573; Ga. Code Ann. §§ 16-17-1 to -10; Md. Code Ann., Com. Law § 12-301 to -317; Me. Rev. Stat. tit. 9-A, § 2-101 to -601; Mass. Gen. L. Ann. ch. 140, §§ 90 and 96;; N.C. Gen. Stat. §§ 53-164 to -191; N.J. Rev. Stat. §§ 2C: 21 to -19; N.Y. Penal Law § 190.40, 190.42; Pa. Stat. Ann. tit. 7, §§ 6201 to 6219; R.I. Gen. L. §§ 19-14.2-1 to -16; Vt. Stat. Ann. tit. 8, §§ 2200 to 2239; W.Va. Code §§ 46A-1-101 to 8-102.

[46] The market is expected to grow in the coming years, as large employers such as Walmart announced plans to purchase an EWA provider as part of an expansion of the retailer's financial services app.

vary depending on the provider. Some employers choose to cover fees for their employees when they partner with an EWA provider, while other plans require employees to pay a fee to the EWA provider for making the advances.

Consumer advocates say that models where consumers pay fees, directly or indirectly, are indistinguishable from extensions of credit and the charging of interest. High fees (compared to the amount of the advance) can translate to high interest rates, nearly as high as those that exist with payday loans. The EWA industry, however, has received some support from the CFPB which concluded that EWA programs do not constitute loans or credit transactions, at least if they do not include high fees. During the Trump administration, the CFPB specifically exempted earned wage access products from its 2017 rule on payday loans.[47] CFPB Director Kathleen Kraninger, a Trump appointee, later issued an advisory opinion on EWA plans in November 2020.[48] Under the CFPB's interpretation, no-fee (or a small fee) EWA products are not offering credit because people are accessing their earned money and paying it back through future earnings without accruing any debt besides the initial amount advanced.

The CFPB advisory opinion stated that a "covered" EWA program did not constitute a loan or credit transaction. In a "covered" program, the amount of each EWA transaction cannot exceed the accrued cash value of the wages the employee has earned up to the date and time of the transaction. Moreover, the employee makes no payment, voluntary or otherwise, to access EWA funds. However, the CFPB created some confusion by saying that "there may be EWA programs that charge nominal processing fees . . . that nonetheless do not involve the offering or extension of credit." This raised a question of what kind of fees, and in what amounts, could be charged and still maintain protection as a covered EWA transaction.

In support of its conclusion, the CFPB reasoned that an EWA program does not create any "debt." It said the meaning of the term debt is a "[l]iability on a claim; a specific sum of money due by agreement or otherwise." The CFPB determined that no such liability of the employee arises in the context of an EWA program. Rather, an EWA program simply gives employees access to wages they have already earned, and to which they are already entitled, and thus operates like an employer who decides to pay its employees for already earned wages earlier than the scheduled payday. Further, an EWA fintech company can recover EWA funds only through an employer-facilitated payroll

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[47] The final rule was published at 82 Fed Reg 54472 (November 11, 2017).

[48] See Bureau of Consumer Financial Protection, *Truth in Lending (Regulation Z); Earned Wage Access Programs* (2020).

deduction that occurs on the next scheduled payday or payday. EWA providers have no rights against the employee in the event of nonpayment and therefore cannot report nonpayment as a delinquent debt to a credit reporting agency. Nor do they engage in debt collection activities.[49]

Some states, particularly New Jersey, supported by the CFPB's 2020 advisory opinion, attempted to enact legislation exempting certain employer-based EWA programs from the state's 30% criminal usury cap. Legislatures in other states, such as New York, North Carolina, South Carolina, Georgia, Nevada, and Utah, later introduced legislation to regulate EWA plans in 2021. Thus, the debate over how to regulate EWAs is finding its way to the state legislatures just as the debate over payday lending rules did several decades earlier. The parallels are striking. In both instances, a new industry developed in a legal vacuum in less than a decade. Both types of transactions generated heated debate over whether they were credit transactions and how, if at all, they should be regulated. As was discussed above, the regulation of payday lending is still evolving and is far from uniform among the fifty states. Fintech-driven EWA programs seem destined to follow a similar path unless Congress (or the CFPB) moves to create a uniform approach nationwide, which in the current political climate seems unlikely.

A large part of the debate over EWA programs is whether the transactions are a form of consumer credit, and even if not, whether some form of consumer protection is desirable to guard against potential abuses and unfairness involving a vulnerable class of consumer wage earners. The next section argues that, while EWA programs are presently less problematic for vulnerable wage-earning consumers than payday loans, they present concerns that states (if not the federal government) should consider imposing some constraints on this form of cash advance.

VI. SHOULD EWA PROGRAMS BE REGULATED?

Consumer advocates in the United States have pushed back on the CFPB's advisory opinion that endorsed EWA advances, and with good reason. While recognizing that EWA programs can be less expensive than payday loans, there are still concerns that parallel those in the payday lending environment.

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[49] The CFPB also noted that its interpretation was consistent with its discussion of these types of products in its 2017 Payday Lending Rule, where it noted that "some efforts to give consumers access to accrued wages may not be credit at all. For instance, when an employer allows an employee to draw accrued wages ahead of a scheduled payday and then later reduces the employee's paycheck by the amount drawn, there is a quite plausible argument that the transaction does not involve 'credit' because the employee may not be incurring a debt at all."

EWAs, particularly those that allow fees in any amount, are not without risks. The CFPB opinion takes the position that EWA products that involve no payment whatsoever by the employee, voluntary or otherwise, to access the funds or the program are not "credit" transactions because the employee does not incur a "debt." Certainly, those programs are far less expensive, and pose fewer risks, to consumers than payday loans. But even a free EWA poses the risk of a cycle of debt and continuing advances (akin to renewal payday loans) when repayments from the next paycheck are not affordable. Taking an advance on the next paycheck when a consumer cannot cover an expense with the current paycheck creates a hole in the next paycheck.[50] Even free loans can create financial hardship and trigger a cycle of debt that puts pressure on a low wage earner's budget. Studies have shown that the typical frequency of use for employees who use EWAs runs from 12 times per year to 120 times per year, with most users taking out EWAs around 24 times a year.[51]Many users of EWA stake out wage advances nearly every pay period. With this regular use of EWAs, low wage earners are not getting liquidity to cover their expenses on a regular basis; later advances are merely filling the gap created by the prior advance. This is similar to traditional payday loans, where an additional payday loan is needed when the first loan comes due. Even if the EWA fee is nothing or a small amount, EWAs pose the same problems as payday loans. In addition, EWA plans that make it easy to reduce the next week's pay may make it harder to save up for large, monthly expenses such as rent. It can also make saving money and financial management more difficult.[52]

The CFPB opinion states that EWAs differ from payday loans because wages have already been earned. Yet payday lenders also make loans with the expectation that wages will pay them off, and with most payday loan advances some or all of those wages have often already been earned. In fact, payday lenders could also establish a mechanism to confirm that a consumer's wages have been earned, which would simulate an EWA plan. But even if a payday lender were to do this, the transaction would still be a credit transaction creating a debt.

The CFPB opinion also reasoned that the EWA funds are transferred at no (or low) cost to the employee, just as receiving a paycheck or automatic payroll

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[50] See Rohit Chopra, Concern about prior leadership's finding that certain earned wage access products are not "credit" under TILA (Consumer Financial Protection Bureau, 2021). Hereinafter referred to as the "NCLC Letter."

[51] See Leslie Parrish, Aite, Employer-Based Loans and EarlyPay: Disruption Reaching Scale, at 13-14 (2019), and the NCLC Letter 43 .

[52] A biweekly paycheck works well as a savings device for large, once-a-month bills such as rent, credit cards and utilities because in some months the employee will receive three paychecks.

deposit costs nothing. But whether there is a charge for an extension of credit is irrelevant to whether a "debt" has been incurred. Indeed, a lender may be a creditor covered by consumer credit laws even if there is no interest charged or any cost to the consumer.[53]

The fact that EWA plans do not involve a credit check or an assessment of the employee's credit risk is also not relevant to the question of whether a credit transaction has occurred. The fact that the EWA fintech lender has a guaranteed repayment mechanism that minimizes the need to assess the worker's credit record does not mean that money is not a credit advance. Lack of underwriting standards is a credit practice chosen by the lender, not a rationale for finding that consumer credit laws do not apply. Moreover, the EWA lender does take steps to ensure that it will be repaid for its advance because it arranges for automatic repayment from the employer. Were there truly no debt created the EWA lender would have no need to make payroll records into account and make arrangements with the employer to transfer the borrower's wages to the lender on the next payday. The EWA lender's coordination with the employee is analogous to a payday lender ensuring that a prospective borrower has a job and a paycheck coming that will cover the amount of the payday loan plus associated fees.

Finally, the CFPB advisory opinion claims that EWA plans are not extensions of credit and do not create debt because (i) providers have no rights against the employee in the event of nonpayment; (ii) employees are not charged a participation fee or required to use a certain account; (iii) no interest or other fees are charged against the transaction; (iv) there are no late fees or prepayment penalties; (v) providers do not take payment authorization from the employee, such as a check, ACH, or debit authorization; (vi) providers do not pull credit reports or scores or otherwise assess credit risk; (vii) providers do not report to consumer reporting agencies, and (viii) providers do not engage in debt collection activities. These are mostly irrelevant to the question of whether a transaction is an extension of credit that should be covered under consumer credit laws. Debt is created and credit is extended even if the creditor limits the mechanisms by which the debt will be repaid. State statutes often define the sale or assignment of earned wages as loans. The California Financing Law, for example, states: "The payment by any person in money, credit, goods, or things in action as consideration for any sale or assignment of, or order for, the payment of wages, salary, commissions, or other compensation for services, whether earned or to be earned, is, for the purposes of

[53] The definition of "creditor" in the federal truth-in-lending act includes someone who regularly advances funds that are payable in "more than four installments" even if no finance charge is made. Regulation Z, 12 CFR 1026.2(7).

regulation under this division, a loan secured by the assignment. The amount by which the assigned compensation exceeds the amount of the consideration actually paid is interest and charges upon or for the loan, calculated from the date of payment to the date the compensation is payable."[54]Simply because the employer and EWA lender disavow the right to collect a loan by means other than payroll deduction does not mean that a debt has not been created. Decades ago, pawnbrokers made similar arguments. The Federal Reserve Board rejected these arguments when explicitly made pawnbrokers subject to federal consumer credit laws.[55]

The Fair Debt Collection Practices Act similarly defines the word "debt" in a way that would cover EWA advances.[56] The Supreme Court made this clear in *Obduskey v McCarthy & Holthus LLP*.[57] Lawyers who conducted mortgage foreclosures argued that they did not collect debts when they foreclosed on homes because they were not trying to collect the unpaid mortgage debts as personal liabilities of the homeowners. Instead, they said they were only taking possession of the collateral securing those liabilities. The Supreme Court rejected this narrow view of the term "debt." The lawyers were enforcing a debt obligation even though they were claiming only the real estate as collateral and were not claiming personal liability on the debts owed by the defaulting homeowners.

VII. CONCLUSION

There are good reasons to be concerned about the proliferation of EWA transactions and the aspirations of fintech lenders who wish to partner with employers and offer cash advances to financially strapped workers as an alternative to payday loans. While at present EWA advances are less expensive than traditional payday loans, that may not always be the case. Even if

[54] California Consumer Financial Protection Law (CCFPL), Cal. Fin. Code § 90005(h). See NCLC Letter 43.

[55] 61 Fed Reg 14, 952, 14, 954 (April 4, 1996), now Official Interpretation § 1026.17(c)(1)-18 ("Pawn Transactions").When, in connection with an extension of credit, a consumer pledges or sells an item to a pawnbroker creditor inreturn for a sum of money and retains the right to redeem the item for a greater sum (the redemption price) within a specified period of time, disclosures are required."). *Spinner, In re* 398 BR 84 (Bankr. ND Ga 2008) (pawn transactions are extensions of credit under federal consumer credit definitions); *Wiley v Earl's Pawn and Jewelry Inc* 950 F Supp 1108, 1113 (MD Ala 1997) (rejecting pawn lender's characterization of no debt for purposes of consumer credit laws where there is no personal liability for consumer).

[56] 15 USC 1692a(5) ("The term 'debt' means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.").

[57] 2019 SCC OnLine US SC 45 : 203 L Ed 2d 390: 139 S Ct 1029 : 586 US (2019).

EWAs continue to be a less costly alternative for workers who need money before their next payday, debt is still being created, credit is being extended, and some of the consumer concerns that plague the payday loan industry are present with EWA cash advances. Not only can fees for the advances equate to high effective interest rates for these small, short-term advances, but the problem of roll-over advances from paycheck to paycheck is no less a concern with EWAs than it has been with payday loans. The CFPB and state consumer credit authorities should be watching EWA transactions with a close eye and create frameworks for curbing potential abuses of this relatively new way of addressing an age-old problem: low wage workers often struggle from paycheck to paycheck just to make ends meet. Laws should work to help them out of a cycle of continual debt and high-cost loans, and not facilitate additional ways to exploit their condition.