

NO. S241434

**IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA**

EDUARDO DE LA TORRE, ET AL.,

*Plaintiffs and
Petitioners,*

v.

CASHCALL, INC.,

*Defendant and
Respondent.*

SUPREME COURT
FILED

FEB 14 2018

Jorge Navarrete Clerk

On a certified question from the
United States Court of Appeals for the Ninth Circuit,
Case Nos. 14-17571, 15-15042

Deputy

**AMICUS CURIAE BRIEF OF CALIFORNIA FINANCIAL
SERVICE PROVIDERS ASSOCIATION, FINANCIAL
SERVICE CENTERS OF AMERICA, COMMUNITY
FINANCIAL SERVICES ASSOCIATION OF AMERICA, AND
ONLINE LENDERS ALLIANCE IN SUPPORT OF
RESPONDENT**

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The California Financial Service Providers Association (CFSP), Financial Service Centers of America (FiSCA), Community Financial Services Association of America (CFSA), and Online Lenders Alliance (OLA), respectfully submit this brief as amici curiae in support of Respondent. CFSP represents over 60 California small-dollar lenders and money service businesses that offer financial services to consumers at over 1,500 store front locations throughout the State. FiSCA is a national trade association representing neighborhood financial service centers across the country, including state-licensed small-dollar lenders. FiSCA's membership consists of 346 companies operating over 4,100 store front locations. CFSA is a national organization dedicated to advancing financial empowerment for consumers through small-dollar, short-term loans. CFSA was established to promote laws and regulations that protect consumers while preserving their access to credit options, and to support and encourage responsible industry practices. OLA represents the growing and innovative industry of companies that offer loans online.

Amici and their members are committed to providing access to small-dollar credit in a transparent and competitive market. Amici support ethical and responsible business practices, including through the promotion of industry best practices and ethical codes of conduct. Amici's members operating in California are regulated by the California Department of Business Oversight and conduct their businesses in accordance with the California Financing Law.¹ Amici each have members that make loans

¹ The California Financing Law (Fin. Code, § 22000 et seq.) was recently renamed by statute and was previously known as the California Finance Lenders Law. (See Cal. Dept. of Business Oversight, California Financing Law <http://www.dbo.ca.gov/Licensees/Finance_Lenders/About.asp> (as of Feb. 4, 2018).)

over \$2,500 to California consumers. These loans typically carry an interest rate similar to the rates charged by Respondent, with whom they compete in a heavily regulated market. These interest rates are market driven, and reflect the risk of loans made to subprime borrowers.

INTRODUCTION

This Court accepted the United States Court of Appeals for the Ninth Circuit’s certified question to decide whether “the interest rate on consumer loans of \$2,500 or more governed by California Financial Code § 22303 [can] render the loans unconscionable under California Financial Code § 22302.” (*De La Torre v. CashCall* (9th Cir. 2017) 854 F.3d 1082, 1085.) The Court should answer that question in the negative.

Despite Petitioners’ strenuous attempts to paint Respondent as a lone wolf acting without constraint, the facts demonstrate otherwise. Respondent and amici’s members lend in a highly competitive market. There are dozens of lenders who provide access to credit with the type of loans at issue here. This market includes public and private companies, some of whom lend nationwide, and it continues to grow as new lenders enter. As in all markets, consumer choice among lenders constrains loan prices.

Federal law, the California Legislature and the California Department of Business Oversight comprehensively regulate lending by Respondent and by amici’s members. These lenders are subject to licensing requirements and extensive disclosure obligations as well as regulations on substantive loan terms. Within this carefully crafted set of federal and state regulations, and consistent with a statutory goal of ensuring access to credit, the Legislature eliminated rate caps for loans of \$2,500 or more.

Petitioners' position that courts can step in and potentially impose precisely these caps would carry a range of negative consequences and ultimately harm rather than help consumers. The kind of market uncertainty created by after-the-fact, ad hoc judicial determinations would disrupt the robust market for these loans. Lenders such as amici's members would be forced to scale back their credit offerings or exit the market altogether because of the uncertainty created by the potential for expensive litigation and second-guessing of underwriting decisions long after the loans were made. This is exactly the opposite of the Legislature's statutory goal of ensuring access to credit.

Limiting access to credit in this manner would leave consumers with fewer and potentially worse options for borrowing money. The subprime consumer lending market fills a gap for borrowers who are unable to obtain loans from banks. As the Legislature implicitly recognized in removing interest rate caps on these loans, lenders must ensure the price of these loans is commensurate with the risk of unsecured lending to borrowers with poor credit histories. The reduction in credit that would result from judicial regulation would not eliminate these borrowers' need for credit. It would simply require them to resort to other sources they view as less advantageous or leave them unable to obtain needed funds altogether.

The judiciary's necessary focus on the particular case before it does not allow for the complex weighing of competing policy considerations required here. The Legislature has been and continues to be active in this arena. The determination of whether interest rate regulation is needed, and if so, the nature of that regulation, should be left to the Legislature, not the courts.

ARGUMENT

I. PETITIONERS' INTERPRETATION OF THE CALIFORNIA FINANCING LAW WOULD LIMIT ACCESS TO CREDIT IN DIRECT CONTRAVENTION TO THE STATUTE'S PURPOSE.

A. There is a robust and competitive market in California for unsecured loans of \$2,500 or more.

Many California borrowers with poor credit history use the kinds of loan products at issue here. They may not be able to obtain credit cards or traditional loans from banks because, for example, they have prior bankruptcies or defaults in their credit history. (See CashCall Br. pp. 11, 15-16 [describing Petitioners' testimony about negative credit history].) Consumers with poor credit rely on alternative financial services to obtain loans, such as subprime loans, payday loans, tax refund anticipation loans, rent-to-own services, and pawnshop loans. (See Federal Deposit Insurance Corporation (FDIC), 2015 FDIC National Survey of Unbanked and Underbanked Households, p. 1.²) The FDIC found that in 2015, 7.7 percent of American households had used these types of services to obtain credit in the past twelve months. (*Id.* at p. 6.)

California consumers rely heavily on these types of loans. According to the Department of Business Oversight (DBO), in 2016, consumers obtained more than half a million loans for amounts between \$2,500 to \$4,999. (DBO, Annual Report: Operation of Finance Companies Licensed Under the California Finance Lenders Law (2016) p. 2 (hereafter

² Available at <<https://www.fdic.gov/householdsurvey/2015/2015report.pdf>> (as of Feb. 4, 2018).

DBO 2016 Report).³) Over 400,000 of these loans were unsecured. (*Id.* at p. 10.) These loans, then, are not “niche” products offered only by CashCall as Petitioners assert. (Pls.’ Reply Br. p. 5.) Rather, this is “one of the largest categories of consumer loans.” (DBO 2016 Report, *supra*, at p. 2; and see sources cited in CashCall Br. pp. 13-14.)

DBO licensed almost 3,000 companies to make loans under the California Financing Law in 2016. These non-bank lenders operate over 6,500 branches across the state. (DBO 2016 Report, *supra*, at p. 3.) Several of these non-bank lenders are public companies that operate nationwide. And the market for the loans at issue here continues to expand over time. (Compare DBO, Annual Report: Operation of Finance Companies Licensed Under the California Finance Lenders Law (2010) p. 9⁴ with DBO, Annual Report: Operation of Finance Companies Licensed Under the California Finance Lenders Law (2013) p. 10 [number of consumer loans in this range tripled between 2010 and 2013].⁵)

These myriad non-bank lenders compete with each other for borrowers’ business. Loan disclosures are heavily regulated by the federal Truth In Lending Act and by state law. (See, *infra*, at pp. 14-15.) These disclosures allow consumers to compare loan terms, including interest

³ Available at http://www.dbo.ca.gov/Licensees/Finance_Lenders/pdf/2016%20CFLI%20Annual%20Report%20FINAL%207-6-17.pdf (as of Feb. 4, 2018).

⁴ Available at http://www.dbo.ca.gov/Licensees/Finance_Lenders/pdf/CFL2010ARC.pdf (as of Feb. 4, 2018).

⁵ Available at http://www.dbo.ca.gov/Licensees/Finance_Lenders/pdf/2013_CFL_Annual_Report.pdf (as of Feb. 4, 2018).

rates. For example, an internet search using the terms “California cash installment loan” returns results from a wide array of different lenders offering loans for \$2,500 or more.

These lenders offer competitive rates in the range of the rate offered by Respondent. In 2016, DBO found that more than 60 percent of unsecured loans for amounts between \$2,500 to \$4,999 had an annual percentage rate (APR) of 100 percent or higher.⁶ (DBO 2016 Report, *supra*, at p. 16; and see CashCall Br. pp. 13-14 [discussing similar interest rates reported by DBO when the complaint was filed in 2010].) These rates, charged by Respondent and other non-bank lenders in a competitive market, reflect the risk of unsecured lending to borrowers with poor credit histories and the related extremely high default rates for which these lenders have no recourse. (CashCall Br. p. 12 [noting a 45 percent default rate]; DBO 2016 Report, *supra*, at p. 32 [reporting over 110,000 defaults in unsecured loans for amounts between \$2,500 to \$4,999].) These high interest rates offset other types of costs as well, including the costs of underwriting and servicing loans, as well as high costs of credit to the lenders themselves. (See 7-SER-1494 ¶¶ 9-13 [discussing CashCall’s costs].)

As in other competitive industries, then, Respondent, amici’s members, and other non-bank lenders set prices based on the cost of doing business. The high interest rates reflect those costs and are tempered by consumers’ ability to go elsewhere.

⁶ APR is the standardized cost of credit metric that lenders must calculate and disclose in accordance with federal regulations. It is the cost of credit expressed as an annual rate, including loan fees, interest, and other specified costs to the consumer. (See 12 C.F.R. § 1026.14.) It is designed to allow borrowers to compare credit terms offered by lenders.

B. These loans and lenders are heavily regulated under federal and state law.

Federal and state laws, regulations, and regulators ensure consumers can make informed lending choices.

The Truth In Lending Act (TILA) (15 U.S.C. § 1601 et seq.) and its implementing regulation, known as Regulation Z (12 C.F.R. pt. 1026), impose a comprehensive federal regulatory system governing loan disclosures. As the Federal Reserve Board explains, “[a] principal purpose of TILA is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. TILA also includes substantive protections.” (Board of Governors of the Federal Reserve System, Regulation Z: Compliance Guide.⁷) Among other things, lenders must disclose APR and all other relevant terms, including payment due dates, payment amounts, and prepayment penalties. (15 U.S.C. § 1638(a).)

TILA is administered by the Consumer Financial Protection Bureau (CFPB), which has authority to promulgate further regulations and to bring enforcement actions against lenders that engage in “unfair, deceptive, or abusive acts or practices” engaged in by lenders. (See 12 U.S.C. §§ 5531, 5562, 5564.) The CFPB operates a program specifically focused on the supervision of non-bank lenders, and it has not hesitated to exercise its authority to bring enforcement actions against such lenders targeting alleged unfair, deceptive, or abusive disclosure or lending practices. (Antonakes & Twohig, The CFPB Launches its Nonbank Supervision

⁷ Available at <https://www.federalreserve.gov/bankinfo/reg/regzcg.htm> (as of February 4, 2018).

Program (Jan. 5, 2012)⁸; see, e.g., Consent Order, *In the Matter of Flurish, Inc., d/b/a LendUp* (Sept. 27, 2016) 2016-CFPB-0023 [settlement of CFPB complaint alleging errors in loan finance charges and APRs due to faulty APR calculator].)

California law similarly imposes extensive regulations on Respondent and amici's members operating in the State. (See generally California Financing Law (Fin. Code, § 22000 et seq.) (the "CFL").) The goals of the CFL include fostering competition and ensuring an adequate supply of credit in the State, and protecting borrowers against unfair practices. (*Id.* § 22001.) The CFL and its implementing regulations impose:

- Lender licensing requirements (*id.* § 22100, subd. (a));
- Numerous disclosure obligations (*id.* §§ 22151, 22163, 22164);
- Underwriting requirements, ensuring lenders consider the borrower's ability to repay the loan (Cal. Code Regs., tit. 10, § 1452.)); and
- Substantive loan term requirements, including caps on late fees and a requirement that installment loan payments be made in substantially equal amounts. (Fin. Code, §§ 22320.5, subd. (a), 22307, subd. (b).)

Respondent and amici's members are subject to extensive record maintenance requirements. (*Id.* §§ 22156, 22157.) In addition, they must

⁸ Available at <<https://www.consumerfinance.gov/about-us/blog/the-cfpb-launches-its-nonbank-supervision-program/>> (as of February 4, 2018).

file annual reports with DBO. (*Id.* § 22159, subd. (a).) These reports must be made available to the public (subject to limited exceptions) and must contain information such as the lender's balance sheet, income statement, amounts and types of loans originated, and default rates. (Cal. Code Regs., tit. 10, § 1430.)

DBO has supervisory authority over Respondent and amici's members operating in California. DBO schedules examinations of lenders, spends weeks analyzing every aspect of lending practices, disclosures, and internal procedures, prepares detailed findings, and requires responses and changes to practices and procedures it deems out of compliance with state regulations. DBO also has enforcement authority to bring actions for administrative, civil, and criminal remedies, including for violations of the CFL. (See, e.g., Fin. Code, §§ 22707.5, 22713, 22753.)

DBO routinely passes matters identified in examinations over to enforcement, bringing administrative actions seeking injunctive relief, restitution, and penalties. DBO has pursued many such administrative actions, including against Respondent and other non-bank lenders. In the month of November 2017 alone (the most recent month for which such data is available), DBO reported actions taken in 23 different matters, including five matters involving alleged unlawful activity under the CFL. (Summary of Enforcement Actions (Administrative and Civil) by the California Department of Business Oversight (Nov. 2017).⁹)

⁹ Available at <http://www.dbo.ca.gov/ENF/Chron/2017/NOVEMBER-2017.pdf> (as of Feb. 4, 2018).

As far as amici are aware, neither DBO nor the Attorney General, which also has authority to bring such actions, has ever pursued an action against a lender alleging unconscionable interest rates. Rather, DBO has repeatedly recognized that “[s]tate law does not restrict interest rates on [CFL] loans of \$2,500 or more.” (DBO, *Installment Consumer Lending by Non-Banks grew more than 21 percent in 2016* (July 10, 2017).¹⁰)

C. Ad hoc judicial second-guessing of interest rates would limit the supply of credit.

As this Court has recognized, all businesses need certainty to operate: “[a]n undefined standard of what is ‘unfair’ fails to give businesses adequate guidelines as to what conduct may be challenged and thus enjoined and may sanction arbitrary or unpredictable decisions about what is fair or unfair.” (*Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 185.) Indeed, the Court has noted that vague standards “may even lead to the enjoining of *procompetitive* conduct and thereby undermine consumer protection.” (*Ibid.* (emphasis in original).)

Lenders are no exception. They rely on an underwriting process to evaluate all of the risks of making loans. Lenders look to the information regarding the borrower, including credit scores and income, to try to predict the likelihood that the borrower will default on the loan. This evaluation determines whether the lender makes the loan at all and if so, the price of the loan.

¹⁰ Available at http://www.dbo.ca.gov/Press/press_releases/2017/2016%20CFLL%20and%20RSDL%20Press%20Release%20FINAL%207-7-17.pdf (as of Feb. 4, 2018).

After-the-fact judicial review injects an unknown risk that lenders cannot anticipate. Under Petitioners' theory, lenders could face suits long after they have approved loans and disbursed the proceeds, even for loans for less than \$2,500 at interest rates at or below the caps specified in the CFL. As discussed below, for example, payday loans regulated under California law may well carry APRs that exceed the interest rates at issue here. (See, *infra*, at pp. 19-20.)

Lenders cannot predict and therefore cannot price for the risk of these post-loan judicial determinations—as well as the costs of litigating them, even if the lender is ultimately successful. Concern that courts could reduce rates or nullify these loans after-the-fact will create uncertainty. This is especially the case here given that the majority of loans over \$2,500 are made at rates above the rate Petitioners seek to impose through their lawsuit. (DBO 2016 Report, *supra*, at p. 16.) The possibility of litigation brought by each individual borrower long after the loan was made and the enormous costs imposed by this kind of litigation without any ability to predict how a court will rule will increase costs enormously.

This uncertainty would shrink consumers' access to credit—precisely the opposite of the Legislature's stated goal.

II. LIMITING ACCESS TO THIS TYPE OF CREDIT WOULD HARM CONSUMERS.

A. Subprime consumer loans make credit available to those who might not otherwise be able to borrow.

The record in this case is replete with evidence that subprime borrowers rely on the challenged loans because they lack alternatives. (CashCall Br. p. 11.) Class members testified about their poor credit histories, including defaults and bankruptcies, which limited their abilities

to get other types of loans. (*Id.* at p. 16.) The average class member's FICO score was less than 600, far below the national average of 700. Indeed, approximately 30 percent of the nation's population has a FICO score below 650. (FICO Blog, U.S. Average FICO Score Hits 700: A Milestone for Consumers (July 10, 2017) [table showing percentages of the population by range of FICO scores as of April 2017].¹¹)

Banks typically do not offer loans to borrowers with these kinds of credit histories. (Cf. 1-SER-54 [Petitioners' expert's recognition that "[i]t is reasonable to assume that [CashCall's prospective borrowers] may be under some type of financial stress with limited options for traditional loans"].) Respondent and amici's members fill this gap by providing access to credit for these borrowers. To do so, however, they must compensate for the additional risk. Some providers, such as pawnshops, offset the risk by using property as collateral. If a borrower cannot or chooses not to offset the risk by offering this type of collateral, the lender must offset the risk of default with higher interest rates.

This is the case for the loans at issue here and for other types of loans, such as payday loans, which are expressly authorized and regulated under California's Deferred Deposit Transaction Law (Fin. Code, § 23000 et seq.). Notably, that law authorizes lenders to charge rates well above 100 percent: Payday lenders may issue loans for up to \$300 for a maximum term of 31 days and may charge fees of up to 15 percent of the face amount of the check. (*Id.* §§ 23035, 23036.) When converted to an annual percentage rate, the interest on these loans can range from 180 to

¹¹ Available at <<http://www.fico.com/en/blogs/risk-compliance/us-average-fico-score-hits-700-a-milestone-for-consumers/>> (as of Feb. 4, 2018).

390 percent.¹² According to DBO, the average annual percentage rate for payday loans issued in 2016 was 372 percent. (DBO, Summary Report: California Deferred Deposit Transaction Law—Annual Report and Industry Survey (2016), p. 7.¹³)

The Legislature’s recent and ongoing experiments with various Pilot Programs for small-dollar loans underscore consumer demand for these products. The current Pilot Program for Increased Access to Responsible Small Dollar Loans permits certain lenders to charge higher interest rates for loans in the \$300 to \$2,499 range. (See DBO, Report of Activity Under the Pilot Program for Responsible Small Dollar Loans (Jan. 1, 2015 – Dec. 31, 2016), p. 1 (hereafter DBO Pilot Program Report)¹⁴; and see Fin. Code, § 22365 [authorizing the program].) The Legislature recognized in enacting this program that “consumer demand for responsible installment loans in principal amounts of at least three hundred dollars (\$300) but less

¹² Federal regulations explain that APR is calculated by multiplying each period rate by the number of periods in a year. (12 C.F.R. § 1026.14(b).) Thus, if the term of the payday loan is one month, the APR is 180 percent (15 percent multiplied by 12). If the term of the loan is two weeks, the APR is 390 percent (15 percent multiplied by 26).

¹³ Available at [http://www.dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2016%20CDDTL%20\(payday\)%20Annual%20Report%20FINAL%207-5-17.2.pdf](http://www.dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2016%20CDDTL%20(payday)%20Annual%20Report%20FINAL%207-5-17.2.pdf) (as of Feb. 4, 2018).

In other contexts, as with pawnbrokers, the lender uses personal property as collateral against the loan; if the loan is not paid, the lender can seize the property. (See Fin. Code, § 21000 et seq. [regulations governing pawnbrokers].)

¹⁴ Available at http://www.dbo.ca.gov/Licensees/Finance_Lenders/pdf/Pilot%20Program%20Report%202016.pdf (as of Feb. 4, 2018).

than two thousand five hundred dollars (\$2,500) exceeds the supply of these loans.” (Fin. Code, § 22365, subd. (b).) The enactment of this Pilot Program was not the State’s first attempt to fix the problem. As DBO explains, an earlier law enacted in 2010 was similarly designed to improve credit access in this market. (DBO Pilot Program Report, *supra*, at p. 1.) But “[a] stubbornly low lender participation rate led to [that program’s] demise.” (*Ibid.*)

In other words, the existing interest rate caps were limiting the supply of credit. Petitioners’ attempt to impose judicial oversight of interest rates on loans above \$2,500 would have the same effect.

B. The risk of a judicially imposed cap on interest rates would force consumers into worse options.

The decrease in access to the loans at issue that will result if Petitioners’ position were adopted will not limit the demand for them. Consumers with poor credit histories—like anyone else—may need to borrow money, including to pay bills, maintain their cars, and deal with various types of emergency expenses. (DBO Pilot Program Report, *supra*, at p. 10.) According to the Federal Reserve, “[n]early half of adults are ill-prepared for a financial disruption and would struggle to cover emergency expenses should they arise.” (Board of Governors of the Federal Reserve System, Report on Economic Well-Being of U.S. Households in 2015 (May 2016) p. 1 (“Federal Reserve Report”).¹⁵) According to the Federal Reserve’s recent study, 46 percent of adults say they would not have the means to cover an emergency expense of \$400. (*Id.*) More than twenty percent of survey respondents experienced a “major unexpected medical

¹⁵ Available at <<https://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf>> (as for Feb. 4, 2018).

expense that they had to pay out of pocket in the prior year” and forty-six percent of respondents who had major medical expenses currently owe debt from those expenses. (*Id.*)

The reduction in access to needed credit that would be caused by adoption of Petitioners’ position would only exacerbate an insufficient supply of credit. Just under half of the consumers who participated in the Federal Reserve’s survey indicated a desire for additional credit in the previous year. Of those, forty percent reported actual or perceived difficulty in obtaining credit, based either on a denial, being offered less credit than requested, or a perception that any application would be denied. (Federal Reserve Report, *supra*, at p. 29.) And the rate of actual or expected denial was “substantially higher for lower-income [survey] respondents.” (*Id.*)

A consumer in need of a short- or medium-term loan will have to explore other options if cash installment loans become unavailable, such as overdrawing her checking account, paying bills late (or not at all), or even seeking illegal sources of credit. There is little reason to believe that these alternative options will offer more favorable terms; if they did, borrowers would have chosen those options rather than the loans offered by Respondent at issue here. For example, paying the bills late can result in late charges, service interruption, or reconnection fees. Overdrawing a checking account can result in account closure, fees from merchants for bounced checks (known as “NSF fees”), or a fee from the bank for overdraft protection. These NSF and overdraft fees can amount to hundreds of dollars per year for consumers, with average overdraft fees that would constitute an APR of 17,000 percent had the consumer borrowed the funds. (Consumer Financial Protection Bureau, CFPB Study of Overdraft