Universal Service and Small-Dollar Loans

*Briana McLeod**

Introduction

In 2003, Jason Withrow sustained injuries in a car accident.[1] To cover costs from the accident, he got a second job and took out a payday loan from a storefront lender. Later, Withrow injured his back and had to quit his second job. The interest piled up on his initial payday advance, and he took out new loans with different lenders just to pay that interest. In five months after the initial loan, Withrow spent $7,000 in interest and never paid on the principal amount of $1,900.[2]

Withrow's story is not rare. In 2015, Willie Pearl Gary took out a $4,000 title loan against her 2010 Toyota Camry.[3] In February 2016, she made a $440 payment toward the debt. The receipt for that payment showed that only $3.64 went toward paying off the outstanding principal of $4,300. Over a year later in summer of 2017, Gary still owed more than $3,900 on the loan.[4]

Elliott Clark, a Vietnam veteran, took out multiple payday loans totaling $2,500.[5] To cover the high fees and interest on the loans, Clark paid $190 monthly on principal balances totaling just $500. Over the five years it took to pay off the debt, Clark accrued $50,000 in interest payments. As a result, the Clark family lost their home.[6]

One might hear these stories and blame borrowers for mismanagement or laziness. But various complicated factors have heralded the rise of nontraditional, fringe lending. More Americans than

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1 *See The Victims of Payday Lending*, CTR. FOR RESPONSIBLE LENDING, https://perma.cc/YFH7-WQSV.

2 *See id.*

3 Kevin G. Hall et al., *Title-Pawn Shops 'Keep Poor People Poor.' Who's Protecting Georgians from Debt Traps?*, MCCLATCHY DC (Sept. 20, 2018), https://perma.cc/RR3Y-MUYT.

4 *Id.*

5 Martha C. White, *How Payday Loans of $2,500 Left One Man $50,000 in Debt*, TIME (May 18, 2016), https://perma.cc/77B9-V7KF.

6 *Id.*

ever face financial instability because of increasing volatility in employment, wages, and income, coupled with rising healthcare, childcare, and education costs.[7] Workers who make less than $40,000 annually are among those most vulnerable to fringe lending.[8] In fact, each of the above borrowers either has multiple jobs or a long-term position. Petty Officer Second Class Jason Withrow was a Navy nuclear submariner when he took out his initial payday loan.[9] Willie Pearl Gary is an inventory specialist for a grill manufacturer.[10] Finally, Elliott Clark is a security guard whose wife had to leave her job after a $22,000 medical emergency and whose daughter was in college at the time.[11]

Twelve million Americans utilize high-cost loan products yearly, usually to cover living expenses.[12] Traditional financial institutions like banks and credit unions are increasingly unwilling to lend to so-called "risky" borrowers.[13] Further, more than 33 million American households are considered "underbanked" or "unbanked."[14] Lacking access to relatively safe financial services and products limits consumers' abilities to obtain liquidity, or cash, in times of need or emergency.[15] The underserved, therefore, resort to high-cost, fringe loan products.[16] The average underserved consumer will spend $1,000 yearly on just the fees to access these high-cost loans.[17] Banked consumers, however, who can access safe, affordable, and government-backed financial services can secure liquidity and obtain the necessary financing for advancement.[18]

A combination of high transaction costs, risk, and convoluted regulation has cultivated a financial chasm that favors America's wealthy. By comparison, Congress has long required the telecommunications and broadband industry to serve "the public interest, convenience, and

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7 *See* LISA SERVON, THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES 68–69 (2017).

8 PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 8 (2012), https://perma.cc/6AKH-PR88.

9 *The Victims of Payday Lending*, *supra* note 1.

10 Hall et al., *supra* note 3.

11 Donald Bradley, *KC Man Pays $50,000 Interest on $2,500 in Payday Loans*, KAN. CITY STAR (May 17, 2016 5:30 PM), https://perma.cc/3BMJ-MGKY.

12 PEW CHARITABLE TRUSTS, *supra* note 8, at 4.

13 *Id.* at 26.

14 WILLIAM J. BYNUM ET AL., OPENING MOBILITY PATHWAYS BY CLOSING THE FINANCIAL SERVICES GAP iv (2018).

15 *See id.* at 2.

16 *Id.*

17 *Id.*

18 *Id.*

necessity."[19] Since 1996, Congress and the Federal Communications Commission ("FCC") have required telecommunications providers to pay into a fund that explicitly and massively subsidizes services for rural and vulnerable populations to ensure universal access to telephone and high-speed broadband.[20] Today, federal, state, and local governments and corporations are constantly innovating to achieve universal broadband service and close the "digital divide" that remains between those with access to broadband and those without.[21]

In stark contrast, modern unfocused banking regulation punishes consumers who need access to small-dollar, low-interest loans.[22] Instead of promoting access and competition for the underserved, the federal government has made it easier for financial firms to be solely profit-seeking and risk-defining.[23] Instead of providing mechanisms for safer alternatives to fringe lending products, regulators make it more difficult for reputable financial firms to meet the demand for liquidity.[24] But both banks and fringe lenders are winning in the modern regime. American taxpayers—who significantly subsidize banks and who are, overall, growing less financially secure—are the losers.[25]

This Comment argues for implementing creative solutions to propel the banking industry to benefit all citizens, taking lessons from the telecommunications and broadband industry. Recently, scholars and policymakers have proposed several potential solutions to the predatory lending problem, from interest rate caps to banking and small-dollar lending in the United States Postal Service.[26] This Comment asserts that rate caps cannot adequately solve the problem because offshore and online companies can still reach consumers with few ramifications via the internet.[27] Additionally, this Comment argues that postal banking would provide the federal government with a monopoly of access to low-income and rural consumers, and effectively squash competition from reputable

19 *See* 47 U.S.C. § 309(a) (2012).

20 *See id.* § 254; *see also* JERRY KANG & ALAN BUTLER, COMMUNICATIONS LAW AND POLICY 188–90 (6th ed. 2018).

21 Lifeline & Link Up Reform Modernization et al., 30 FCC Rcd. at 7830 (2015).

22 *See* MATTHEW SHERMAN, A SHORT HISTORY OF FINANCIAL DEREGULATION IN THE UNITED STATES 1–2 (2009), https://perma.cc/FLN8-6S43.

23 *See* SERVON, *supra* note 7, at 25.

24 *See* Anne Fleming, *Fishing for Loan Sharks: Small-Sum Lending Reform Over Time*, PERSPECTIVES ON HIST. (July 12, 2018), https://perma.cc/4P4V-UENS.

25 *See* SERVON, *supra* note 7, at 26, 47–48.

26 *See* MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY 213 (2015).

27 *See, e.g.*, HOW TO START A PAYDAY LOAN BUSINESS: MAKING MONEY LENDING MONEY loc. 177–90 (Khalid Eltag ed., 2016) (ebook).

banks. Instead, this Comment proposes a novel solution by drawing on regulatory and innovative schemes from the telecommunications and broadband field: explicit, transparent subsidies to infuse small-dollar lending in reputable financial firms, like banks and credit unions, through a Universal Banking Service Fund.

Part I of this Comment introduces the current banking landscape, which is fertile ground for high-cost products like payday and title loans. Part II shifts from banking to the modern telecommunications and broadband industry and describes the long-term commitment to providing connectivity to rural and vulnerable populations. Part III provides contrast between the two industries and explains why, historically, banks have not met the demands of the underserved. Finally, Part IV will evaluate the benefits and pitfalls of recent regulations and proposals to combat predatory lending, such as rate caps and postal banking. Additionally, Part IV introduces a measured approach to providing low-interest, small-dollar loans to underserved consumers.

I. Small-Dollar Loans in High Demand

A. *The Rise of Fringe Lending*

Fringe lending is booming. In 1993, the first payday lending storefront in the United States opened in Tennessee.[28] By 2001, nearly 69 million payday loan transactions occurred in the country per year, producing approximately $2.2 billion in fees.[29] Today, payday lending is a $30 billion business.[30] There are more payday loan storefronts in the United States than the combined total of McDonald's and Starbucks locations.[31] A market void catalyzed this explosion of payday lenders: small-dollar loans were not profitable enough for reputable banks to justify the transaction costs, leaving borrowers without access to safe, affordable alternatives.[32]

The most common loan product filling the market void is the payday loan.[33] To borrow, a payday loan customer must have a source of income and must give the lender access to her bank account.[34] The loan is typically

28 Pearl Chin, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 726–27.

29 *Id.*

30 *See* Megan Leonhardt, *This Map Shows the States Where Payday Loans Charge Nearly 700 Percent Interest*, CNBC, (Aug. 3, 2018), https://perma.cc/L3CN-DZFD.

31 SERVON, *supra* note 7, at 86.

32 *See* BARADARAN, *supra* note 26, at 110–11; *see also* ANNE FLEMING, CITY OF DEBTORS: A CENTURY OF FRINGE FINANCE 227 (2018); Chin, *supra* note 28, at 727.

33 BARADARAN, *supra* note 26, at 111.

34 *Id.* at 112.

due at the next payday, and the lender draws the amount owed directly from the borrower's account.[35] During the 1980s, many states deregulated interest rates.[36] Annual percentage rates ("APR"), which had previously remained between 6% and 12%, were subsequently allowed to reach 300% to 700%.[37] Mississippi, for example, has the highest concentration of payday lenders in the nation, and those lenders often demand 500% in interest.[38] Because of the short turnaround and high fees on payday loans, most borrowers only pay the fees at the end of the two weeks and "roll over" the principal owed to an additional loan.[39]

The fringe lending industry relies on rollover to generate higher fees.[40] More than 80% of payday borrowers roll over or take out another loan within fourteen days of the initial loan.[41] Borrowers plunge into harsh cycles of paying fees and interest rates that can churn up to 2,000% without reducing the principal owed.[42]

Borrowers with five or more loans generate 90% of the payday lending business.[43] Borrowers with twelve or more loans generate 60%.[44] Further, 12 million Americans borrow payday loans every year, spending an average of $520 in fees on $375 borrowed.[45] Thus, these 12 million Americans pay fringe lenders $6.2 billion annually just in loan-associated fees. So, without loan churning, where borrowers take out additional loans to cover their initial loans, payday lenders would likely fail.[46]

Payday loans are only one part of the fringe lending market. Most fringe lending customers are bound to other types of credit.[47] Another

35 *Id.* at 111.

36 *See* CHARLES R. GEISST, BEGGAR THY NEIGHBOR: A HISTORY OF USURY AND DEBT 258 (2013).

37 BARADARAN, *supra* note 26, at 109; *see also* Anne Fleming, *The Long History of "Truth in Lending"*, 30 J. POL'Y HIST. 236, 255 (2018) (explaining the historical differences between "interest" and "APR" as the total cost of credit); Elizabeth Renuart & Diane E. Thompson, *The Truth, the Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending*, 25 YALE J. REG. 181, 184 (2008) (arguing for more effective and truthful APRs that adequately inform borrowers of the total interest, fees, and other charges they will pay before signing for a loan).

38 *Predatory Lending*, MISSISSIPPI CENTER FOR JUSTICE, https://perma.cc/RD3R-KVPW.

39 *See id.*; *see also* BARADARAN, *supra* note 26, at 112–13.

40 BARADARAN, *supra* note 26, at 113.

41 *Id.* at 111.

42 *Id.* at 109.

43 *Id.* at 111–12.

44 *Id.*

45 PEW CHARITABLE TRUSTS, PAYDAY LOAN CUSTOMERS WANT MORE PROTECTIONS, ACCESS TO LOWER-COST CREDIT FROM BANKS 4 (2017), https://perma.cc/L6MJ-4HJN.

46 *See* Center for Responsible Lending et al., Comment Letter to the Consumer Financial Protection Bureau on Payday Lending Abuses (Apr. 23, 2012), https://perma.cc/4QXA-RNBD.

47 SUSAN D. WOLF, THE CUMULATIVE COSTS OF PREDATORY PRACTICES: THE STATE OF LENDING IN AMERICA & ITS IMPACT ON U.S. HOUSEHOLDS 22 (2015), https://perma.cc/H3WW-JV7F.

product, the title loan, is increasing in popularity as states and agencies attempt to dismantle payday loan schemes. Fifty-five percent of borrowers with title loans also have payday loans.[48]

Title loans are similar to payday loans, but are secured using the borrower's vehicle title as collateral.[49] Title loans foster an additional risk, however, as 20% of title loan borrowers lose their vehicle when they fail to stay afloat in the borrowing scheme.[50] Only one borrower in every eight borrows once and repays the loan without borrowing again.[51] The rest, or 87.5%, pay as the loan churns.[52] Average title loan borrowers pay 300% in APR.[53] When a borrower faces vehicle repossession, they also pay repossession fees that average half of the loan balance.[54]

Title lenders are thriving, generating more than $4 billion annually in fees.[55] And the industry has become high-tech to avoid paying vehicle location costs.[56] Now, at the time of signing, lenders install chips to remotely disable vehicles if borrowers default .[57]

So, a title loan scheme might look like this: A customer borrows $4,000 against his vehicle title to make it through the holiday season. The company gives him eighteen months to pay off his debt. With a triple-digit APR, his monthly payment is over $580. In eighteen months, the borrower will pay nearly $10,500, mostly in fees and interest. When he cannot repay the principal, the company repossesses his car and charges half of what he owes for recovery. If the borrower cannot pay that fee, the lender may sell the car and keep the amount owed.[58] Without reliable transportation, the borrower loses his job and ends up in a more precarious position than when he started.[59]

Fringe lending leaves borrowers in debt traps. In fact, the likelihood that someone will file for chapter thirteen bankruptcy doubles "within

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48 *Id.*

49 BARADARAN, *supra* note 26, at 113.

50 *See* CONSUMER FINANCIAL PROTECTION BUREAU, SINGLE-PAYMENT VEHICLE TITLE LENDING 4 (2016).

51 *Id.*

52 *See id.* ; *see also* Center for Responsible Lending, *supra* note 46 at 1.

53 BARADARAN, *supra* note 26, at 113.

54 *Id.*

55 *Id.*

56 *Id.* at 112–113.

57 *Id.*

58 *See Car Title Loans*, CONSUMER.GOV, https://perma.cc/6XWM-B9T3.

59 For scenarios similar to this hypothetical, see Nathalie Martin & Ozymandias Adams, *Grand Theft Auto Loans: Repossession and Demographic Realities in Title Lending*, 77 MO. L. REV. 41, 42–43 (2012).

two years of a successful first-time payday loan application."[60] Why, then, do borrowers sign these agreements and go back again? Recognizing borrowers' credit options is essential to understanding how fringe lending has become a multi-billion-dollar industry.[61]

B. *Who Is Borrowing from Payday and Title Lenders and Why?*

Regulators, lawmakers, and non-borrowers often make assumptions about consumers who borrow from fringe lenders. For example, Elliott Clark, who lost his home after accruing $50,000 in interest, told a reporter, "I've been called stupid, and they say I should read the fine print."[62] Even the terms "unbanked," and "underbanked," imply that those without access to stable financial institutions are faulty decision makers.[63] But national financial health and fringe borrowing statistics say otherwise.

In 2019, 54% of Americans, or 135 million people, reported struggling financially.[64] Fifty-five percent of middle-aged people reported they cannot save enough to cover three months of living expenses if they lose their income, a nearly 5% increase from 2018.[65]

Most fringe lending borrowers are not low-income individuals. The average borrower earns $40,000 a year.[66] In fact, 8% of predatory loan borrowers rent homes and earn up to $100,000, while 6% are homeowners who earn between $15,000 and $40,000.[67] Therefore, income is not a reliable indicator of those who will borrow.

Despite the misconception that people borrow to cover emergencies, most borrow to cover regular living expenses.[68] Sixty-nine percent of first-time borrowers use payday loans to cover expenses like utilities, prescription drugs, credit card bills, mortgage payments, and food,

60 Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, 2 (Vand. U.L. Sch., L. & Econ. Working Paper No. 11-13, 2011).

61 *See* David Horton, *Borrowing in the Shadow of Death: Another Look at Probate Lending*, 59 WM. & MARY L. REV. 2447, 2461 (2018).

62 Bradley, *supra* note 11.

63 SERVON, *supra* note 7, at 165. This Comment employs "underserved" instead of "unbanked" or "underbanked" to avoid furthering these misconceptions.

64 *See* FINANCIAL HEALTH NETWORK, U.S. FINANCIAL HEALTH PULSE: 2019 TRENDS REPORT 3(2019), https://perma.cc/PNP3-HNM9.

65 *See id.*at 5.

66 BARADARAN, *supra* note 26, at 115.

67 PEW CHARITABLE TRUSTS, *supra* note 8, at 4. Five categories of Americans are likely to borrow: those with no college degree but a high a school diploma or certificate, home renters, African Americans, workers who make less than $40,000 yearly, and those who are separated or divorced. *Id.*

68 *Id.* at 4–5.

compared to 16% who borrow for unexpected expenses like medical emergencies or car repairs.[69] Where borrowers do seek to cover unexpected expenses, often they are strapped for cash and must resort to risky loans to maintain liquidity.[70]

Scholars and policymakers suggest that most US consumers are underserved because banks are solely profit seeking.[71] When mainstream banks do not adequately serve people who are not already financially stable, what choice do borrowers have?[72]

The Federal Deposit Insurance Company ("FDIC") reports that 27% of households, or 33.5 million Americans, lack regular access to banks or mainstream financial services.[73] Three explanations account for these statistics. First and most commonly, underserved households report not having enough cash to keep in a bank account to cover the account's maintenance fees.[74] Second, a high proportion of underserved households do not trust banks.[75] Third, many who previously had bank accounts no longer do because of high or unpredictable fees.[76] Indeed, bank fees are growing.[77] For certain regional banks, customer fees account for 40% of the bank's income.[78]

While underserved populations need access to safe, reputable banks, those banks do not need to serve low- and middle-income populations to get richer.[79] For loans, bank transaction costs are relatively the same regardless of the amount borrowed, but high-dollar loans and more fees generate greater profits.[80] Banks also charge fees to maintain checking and savings accounts.[81] Following the dismantling of regulations that sought

69 *Id.*

70 *See* BARADARAN, *supra* note 26, at 9–10.

71 *See, e.g.*, SERVON, *supra* note 7, at 170.

72 *See id.* at 169.

73 *See* FDIC, 2015 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 1 (2016).

74 *Id.* at 3.

75 *Id.*

76 *Id.*

77 *See, e.g.*, Aaron Klein, *America's Poor Subsidize Wealthier Consumers in a Vicious Income Inequality Cycle*, BROOKINGS (Feb. 6, 2018), https://perma.cc/CJP6-6RGU; Bob Pisani, *Bank Fees Have Been Growing Like Crazy*, CNBC (Jul. 21, 2017), https://perma.cc/RVW8-UBPD.

78 Pisani, *supra* note 77.

79 *See* BARADARAN, *supra* note 26, at 141.

80 *See id.* at 140–42 ("Different estimates say that each deposit account costs a bank between $48 and $200 every year.").

81 *Id.* at 142.

to restrict their power in the 1970s and '80s, banks, and their fees and profits, grew exponentially.[82]

Today, more than half of the country cannot access $400 without either borrowing money or selling something.[83] A consumer undergoing financial strain could see the thousands of accessible payday and title lenders and fall prey to the ease and speed of the process.[84] Once within the predatory loan chokehold, borrowers repeat loan cycles, stay in debt for months or years, and finish with more debt than when they started.[85] The bottom line: without viable choices for access to liquidity, borrowers' debt churns, the middle moves further from prosperity, and the poor stay poor.

A senior staff member of a federal credit union voiced what many Americans perceive as the solution for fringe lending borrowers: "They need to save up . . . or borrow from friends and family."[86] This philosophy implies that borrowers can save money ex ante or have a private network of options ex post, and they simply choose the worst option for themselves.[87] Most borrowers do not have these options.[88]

Indeed, when asked whether payday loans should be illegal, one repeat borrower said, "No, I think they should still exist. You know it's undoable to take out five loans and be able to pay them back. But sometimes you have no choice."[89]

Commenters suggest, then, that payday and title lenders are doing middle-America a much-needed service.[90] This is convincing, because without small-dollar loan products, millions of Americans would have no options during financial strain.[91] But this should be a morally intolerable conclusion. Why should the only choice for temporary liquidity available

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82 *See id.* at 145–51 ("This was aided along by a banking sector that had shrouded itself in the ideology of free markets as well as deregulation that allowed it to jettison any duty it might have to serve anyone who did not help its bottom line.").

83 *Id.* at 116.

84 *See* Horton, *supra* note 61, at 2461 (noting that more than were more than twenty thousand payday lenders in the US in 2018).

85 Mehrsa Baradaran, *Payday Lending Isn't Helping the Poor. Here's What Might*, WASH. POST (Jun. 28, 2016), https://perma.cc/6Z9E-YMEL.

86 SERVON, *supra* note 7, at 82.

87 *See id.*

88 *Id.*

89 *Id.* at 83.

90 *See, e.g.*, William Isaac, *Why Payday Loans Are Good for Millions of People*, AM. BANKER (Aug. 13, 2003), https://perma.cc/4ET8-PT2V.

91 *See* FLEMING, *supra* note 32, at 2 ("Policymakers and everyday Americans are perpetually torn between dueling desires, wanting to protect working-class debtors while also allowing them easy access to credit and control over their own financial lives.").

to the most vulnerable populations be dangerous, untenable debt? Why should banks leave most Americans behind?

C. *Pot, Meet Kettle: Banks That Fear "Risky Borrowers," are Pretty Risky Themselves*

Rather than offering helpful services to vulnerable populations, banks have remained especially committed to growth and profits.[92] In the post–New Deal era, public interest has given way to corporate prosperity.[93] But experts estimate that taxpayers furnish banks with $12 to $83 billion annually.[94] Recent regulations and acts have revealed a strong desire to further protect banks rather than to support Americans in their demand for liquidity.[95]

Consider the 2008 financial crisis. That year, twenty-five banks failed.[96] Banks, however, receive money from the Federal Reserve at 1% interest and additional support during credit crunches.[97] When a bank cannot pay the bills, the Federal Reserve creates short-term loans so the banks do not need to sell off assets.[98] Banks have access to government support that most other businesses do not, utilizing taxpayer dollars as a buoy in turbulent waters.[99] When a too-big-to-fail bank becomes insolvent, as in the 2008 crisis, the government bails it out.[100] That year, the government bailed out the failing banking industry with financial support amounting to more than $1 trillion and very low interest rates.[101] Following the crisis, multiple outlets have reported that the government commitment to the banking industry totaled $16.8 trillion.[102]

Presidents George W. Bush and Barack Obama both urged that these bailouts were essential for the good of the American people to avoid

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92 SERVON, *supra* note 7, at 170–71.

93 *Id.* at 36.

94 *See* Editorial, *Remember that $83 Billion Bank Subsidy? We Weren't Kidding*, BLOOMBERG (Feb. 24, 2014), https://perma.cc/94UW-E9GE; Wolf Richter, *Here's How the US Taxpayer Paid $12 Billion to Banks in 2016*, BUS. INSIDER (Jan. 12, 2017), https://perma.cc/CBG9-3DCX.

95 *See* SERVON, *supra* note 7, at 36.

96 *Bank Failures in Brief – 2008*, FDIC (Apr. 3, 2020), https://perma.cc/3LKQ-XXRW.

97 BARADARAN, *supra* note 26, at 3.

98 *Id.*

99 *See id*

100 *See id.* at 3–4.

101 *Id.* at 4 ("The help came on very favorable terms with interest rates not available to the market. The arrangement was so good, the CEO of one of the largest bailed out banks saw the terms of the deal and remarked, 'This is very cheap credit!'").

102 Mike Collins, *The Big Bank Bailout*, FORBES (Jul. 14, 2015), https://perma.cc/6BGZ-2LLF.

economic collapse.[103] Perhaps the concept that banks and the American people are obligated to one another, or are together in crises, would ring truer if banks were committed to serving the majority of the American public.[104] A bank bailout does not exist to make banks richer, but to enhance the credit market.[105] Instead, banks are succeeding and getting ahead as borrowers are working hard from behind.[106] The American people have buoyed banks with tax dollars. Now, banks should serve a greater majority of the people.

This is the foundational principal underlying the regulation of publicly owned telecommunications spectrum: the public should benefit when firms use public-owned resources. An analysis of the telecommunications and broadband regulatory regime provides a helpful comparison to the contemporary banking paradigm. This Comment does not presume that the modern communications regime is perfect. But Congress and the FCC's conception of "universal service" and venerable commitment to closing the digital divide make an illuminating comparison to the modern banking regime that leaves millions without access to affordable financial options.

II. An Informative Comparison: Universal Service and an All-Hands Approach to Broadband Deployment

The concept of universal service stems from a longstanding undercurrent of FCC regulation that became law in the 1927 Radio Act: communications must serve the "public interest, convenience, and necessity."[107] Because radio and telephone providers utilized the publicly-owned electromagnetic spectrum, the idea became pervasive that government is responsible for creating a regime that benefits businesses and serves the broadest range of consumers.[108] In 1925, Secretary of Commerce Herbert Hoover said of the spectrum, "The ether is a public medium, and its use must be for a public benefit."[109] The spectrum belonged to the people, not to businesses, and so the people would not be deprived of spectrum services.[110]

103 BARADARAN, *supra* note 26, at 4.

104 *See id.* at 5.

105 *Id.* at 136.

106 *See id.*

107 47 U.S.C. § 309 (2018); *see also* PATRICIA AUFDERHEIDE, COMMUNICATIONS POLICY AND THE PUBLIC INTEREST: THE TELECOMMUNICATIONS ACT OF 1996, at 12–13 (1999).

108 *See id.*

109 *Id.*

110 *See id.*

Today, what is known as the Universal Service Fund provides telecommunications and broadband access for underserved Americans through four programs. First, the Connect America Fund subsidizes telephone companies that serve rural areas with otherwise high build-out costs, which ensures that rural customers pay reasonably comparable prices to urban areas.[111] Second, the Lifeline program assists low-income customers by subsidizing monthly telephone and broadband charges.[112] Third, the E-Rate program provides telecommunications services, internet access, and equipment to eligible schools and libraries.[113] Fourth, the Rural Health Care program subsidizes service contracts between telecommunications providers and rural health care providers.[114] The Universal Service Fund is not a direct subsidy to end users.[115] Instead, the Fund supports certain eligible providers to offset the high costs to build-out to and maintain service for rural customers.[116] The Fund also reimburses other providers who discount their services for lower-income customers, rural health care providers, schools, and libraries.[117] Understanding the origins of the universal service doctrine is essential for an analysis of the modern telecommunications and broadband regime.

A. *The Start of Spectrum: Something New, Different, and Ripe for Regulation*

Following Alexander Graham Bell's patent, the telephone industry remained unregulated, which created unchecked anticompetitive practices.[118] Telephone technology then was not the technology of today. If a customer of one company had a sister across town who was a customer of a competing company, the customer would also have to buy-in to the competing company to speak to his sister over a telephone connection.[119] This led to a chaotic number of wireline connections in homes and across regions so that people could connect.[120] Nearly 13% of customers paid

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111 *Universal Service*, FCC (June 15, 2020), https://perma.cc/89KV-52LK.

112 *Id.*

113 *Id.*

114 *Id.*

115 KANG & BUTLER, *supra* note 20, at 151.

116 47 U.S.C. § 254(a)(1)–(5) (2012); *see also* KANG & BUTLER, *supra* note 19, at 151.

117 KANG & BUTLER, *supra* note 20, at 151.

118 Jean-Paul Simon, *The Origins of US Public Utilities Regulation: Elements for a Social History of Networks*, 11 FLUX 33, 36 (1993) (translated by Judith Crews).

119 *See* KANG & BUTLER, *supra* note 20, at 70–71.

120 *See id.*

twice what other customers paid for the same services to connect to customers of different providers.[121]

The most powerful firm in the market at the time, AT&T, developed a doctrine of "universal service," which they stated was intended to provide consumers with protection against unfair competitors who did not care to serve everyone equally.[122] The doctrine actually allowed AT&T to gobble up the competition and reinforce a monopoly power, because no barriers to communication existed if all consumers across the country were AT&T customers.[123] "Universal service" was thus a guise to block out competitors from accessing consumers.[124] The chaos of this early age of spectrum created an exigency for regulation.

In 1913, to avoid antitrust pressure from the Department of Justice, AT&T wrote what became known as the Kingsbury Commitment.[125] In the Commitment, AT&T agreed to allow local phone companies to interconnect with AT&T's telephone technology, an ostensible end to the unregulated chaos of telephone.[126] But when President Wilson's Administration agreed to the Kingsbury Commitment, AT&T became a government-sanctioned monopoly that reigned for decades.[127] In exchange for market dominance, AT&T agreed to regulation as a public utility and committed to providing quality telephone access across the country without regard to income or geography.[128] Thus, in the Kingsbury Commitment, AT&T and the Wilson Administration shaped today's notion of universal service.

Radio had a similarly frenzied start. A year before the Kingsbury Commitment, radio operators aboard the sinking *Titanic* sent distress calls to the nearby *Californian*—but the *Californian's* radios were off, and the calls went unanswered.[129] Meanwhile, in distant New York City, radio operators on top of a department store could hear and relay the sinking *Titanic's* distress calls.[130] The 1912 Radio Act, just five months later,

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121 *See* Simon, *supra* note 118, at 36.

122 *Id.* at 36–37.

123 *See id.*

124 *Id.* at 36.

125 *See* Letter from N.C. Kingsbury, Vice President, AT&T, to James McReynolds, Attorney General, Dep't of Just. (Dec. 19, 1913) (on file at https://perma.cc/58KT-Z5GM).

126 Jodie Griffin, *100th Anniversary of the Kingsbury Commitment*, PUB. KNOWLEDGE (Dec. 19, 2013), https://perma.cc/495V-ZHU5.

127 Brian Fung, *This 100-Year-Old Deal Birthed the Modern Phone System. And It's All About to End.*, WASH. POST (Dec. 19, 2013), https://perma.cc/TJB3-CWL9.

128 *Id.*

129 *See* THOMAS W. HAZLETT, THE POLITICAL SPECTRUM: THE TUMULTUOUS LIBERATION OF WIRELESS TECHNOLOGY, FROM HERBERT HOOVER TO THE SMARTPHONE 3 (2017).

130 *Id.*

mandated that vessels-at-sea give "absolute priority to signals and radiograms relating to ships in distress."[131] The Radio Act did more than dictate that seafarers must leave on their radios, though.[132] The Act also established the first rules against radio interference, stating that transmitters must have a license to operate.[133]

At the start, this governmental authority was not contentious because many people had not yet tuned in to radio.[134] On November 2, 1920, however, KDKA in Pittsburgh aired election returns that solidified Republican Warren G. Harding as the twenty-ninth President.[135] Listeners caught a whiff of something good: by December 1922, more than 500 radio broadcasting stations were operating in the United States.[136] Radio broadcasting was quickly and outrageously popular, but its widespread use created chaotic signal-interference.[137] Stations utilized any wavelength they desired and interfered with other broadcasts.[138] Congress thus passed the 1927 Radio Act, establishing the Federal Radio Commission ("FRC") and mandating the use of the spectrum for only the "public interest, convenience, and necessity."[139]

Ultimately, the authority granted to the FRC was not extensive enough to cover all new uses of wireless spectrum, so in 1934 Congress passed the first Communications Act.[140] The 1934 Act created the Federal Communications Commission and brought the regulation of telephone, telegraph, radio, and future uses of spectrum under the Commission's purview.[141] The Act established that, because the spectrum is a public resource, the FCC would heavily regulate its use and the public would benefit.[142] Since then, telephone, radio, and broadcast television companies are required to serve the public interest.[143]

Telecommunications providers have argued against public interest requirements, particularly in reference to the rise of lesser regulated

131 *Id.*
132 *Id.*
133 *Id.*
134 *Id.*
135 *See* HAZLETT, *supra* note 129, at 3.
136 *Id.* at 38.
137 *See* R. H. Coase, *The Federal Communications Commission*, 2 J.L. & ECON. 4–5 (1959).
138 *See id.* at 5.
139 *Id.* at 6.
140 *See id.* at 7.
141 *See id.*
142 AUFDERHEIDE, *supra* note 107, at 13.
143 *See id.* at 13–14.

competitors, like cable, satellite, and streaming services.[144] Still, providers are statutorily required to serve the public interest today.[145] Broadband, however, is an entirely different regulatory structure, and the fodder for the most contentious debates in modern telecommunication.

B. *Regulating Broadband*

Broadband regulation began in the Telecommunications Act of 1996, which signaled the beginning of the internet age.[146] The Act distinguished between telephone services, which would remain heavily regulated, and broadband, which would not be regulated.[147] The Act did extend to broadband services one principle underlying telephone regulation since the Kingsbury Commitment: universal service.[148] Under the Act, the Commission sought to increase access to high-speed broadband for all consumers at "just, reasonable and affordable rates," accomplished through Universal Service Fund subsidies.[149] Telecommunications providers are statutorily required to pay a percentage of their yearly revenues into the Universal Service Fund.[150] This percentage is called the "contribution factor."[151] The FCC sets the contribution factor each quarter based on projected demand for services.[152] While one would expect that exorbitant costs are passed through to consumers, the FCC estimated in 2017 that each household paid a maximum of $2.77 to contribute to the Universal Service Fund.[153]

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144 *See* Stuart N. Brotman, *Revisiting the Broadcast Public Interest Standard in Communications Law and Regulation*, BROOKINGS (Mar. 23, 2017), https://perma.cc/772V-K8WT.

145 47 U.S.C. § 309(a) (2012).

146 EV EHRLICH, PROGRESSIVE POL'Y INST., A BRIEF HISTORY OF INTERNET REGULATION 1 (2014), https://perma.cc/77CE-MKPD.

147 *Id.* at 5.

148 *Universal Service*, *supra* note 111.

149 *Id.*

150 *Id.* This is a contentious aspect of modern telecommunications regulation. Under the Telecommunications Act of 1996, Congress labeled broadband providers as information services instead of telecommunications services. As of today, all telecommunications service providers are required to pay into the Universal Service Fund based on year-end revenues, but broadband providers are not. For history on these dichotomies, see *Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Serv.*, 545 U.S. 967, 973–80 (2005); Josh Burday, *The Rise and Fall of Net Neutrality*, ABA (Dec. 20, 2018), https://perma.cc/BJ3F-5CB2.

151 ANGELE A. GILROY, CONG. RESEARCH SERV., RL33979, UNIVERSAL SERVICE FUND: BACKGROUND AND OPTIONS FOR REFORM 4–5 (2011).

152 *Id.* The FCC set the contribution factor for the third quarter of 2020 at 26.5%. Press Release, FCC, Proposed Third Quarter 2020 Universal Service Contribution Factor, DA-20-617 (Jun. 12, 2020) (on file at https://perma.cc/5AHG-W8H2).

153 FCC, UNIVERSAL SERVICE MONITORING REPORT 21 (2017).

The doctrine of universal service has ensured that millions of Americans have connected to the internet.[154] In 2009, Congress passed the National Broadband Plan with the goal of providing access to broadband for every American.[155] Congress and the FCC have acted multiple times to ensure that providers are not only supporting access for all Americans, but innovating and expanding faster, safer services, even to those who could not normally pay without the Universal Service Fund.[156]

C. *The Universal Service Fund and Increasing Access*

Congress established the Universal Service Fund based on the idea that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable."[157] Before the Telecommunications Act of 1996, advocates contended that explicit subsidies for access made economic, social, and political sense.[158] As the industry expanded over time, the Fund would ensure that inclusion and access were folded into the growth.[159] The Fund would also constrain the dangers of a social divide between those who had access and those who did not.[160] In establishing the Fund, Congress transformed the doctrine of "universal service" into an operative mechanism to provide equal physical and social access to connectivity.[161] The Fund operates in two imperative ways: firms compete to build-out to and serve customers and thus receive the subsidies, and customers who could not otherwise afford the services benefit from the access, competition, and support.[162]

The Universal Service Fund is an immense subsidy. In 2016, the FCC reported that the Connect America Fund supported providers with $4.56 billion.[163] The Lifeline program supports 12.8 million people in accessing telephone and broadband.[164] The E-Rate program provides discounts to schools and libraries from 20% to 90%, and $4.16 billion in support.[165] Finally, the Rural Health Care Program provides $571 million to subsidize and improve connection speeds for rural hospitals and healthcare

154 *See* FCC, 2018 BROADBAND DEPLOYMENT REPORT, 33 FCC Rcd. at 1660 (2018).

155 *Universal Service*, *supra* note 111.

156 *Id.*

157 47 U.S.C. § 254(i) (2012).

158 AUFDERHEIDE, *supra* note 107, at 58.

159 *See id.*

160 *See id.*

161 *Id.* at 59.

162 *See id.* at 65.

163 FCC, *supra* note 153, at 32.

164 *Id.* at 23.

165 *Id.* at 39.

providers.[166] The Fund provides more than a one-time start-up fee, though: each program subsidizes ongoing support to maintain affordable access.[167] For example, in the E-Rate and Rural Health Care Programs, the funds assist providers to ensure that schools, libraries, and medical facilities pay affordable rates throughout the year.[168] In the Lifeline program, the funds support low-income users in paying monthly phone charges.[169] More than access to an on-switch, these subsidies provide ongoing, elaborate support to vulnerable populations.

The FCC is not the only entity committed to universal access to high-speed broadband and other connectivity.[170] In 2015, Housing and Urban Development launched ConnectHome, a pilot program focused on connectivity in public housing.[171] Further, all fifty states have established a commission or task force dedicated to broadband, and many of those initiatives include identifying underserved consumers.[172] Finally, corporations like Microsoft are innovating to expand services and reach rural customers.[173] The FCC has stated, "[N]o one program or entity can solve this problem on its own and what is needed is many different organizations, vendors, and communities working together to address this problem."[174]

In the 2018 Broadband Deployment Report, the FCC noted gains in closing the "digital divide."[175] The FCC reported that 92.3% of the overall population has access to fixed broadband, up from 81.2% in 2012.[176] Under Congress's mandate in the Universal Service Fund legislation to provide just, reasonable, and affordable rates, the FCC is remarkably well equipped

166 *See Universal Service*, *supra* note 111.

167 *See id.*

168 *Id.*

169 *Id.*

170 *See, e.g.*, Dina Bass, *Microsoft Boosts Rural Broadband Efforts to Reach More Users*, BLOOMBERG (Dec. 4, 2018), https://perma.cc/7FA7-Z5GQ; *ConnectHome Is Internet Access, Training, Devices*, HUD.GOV, https://perma.cc/6JQV-6SQW; *State Broadband Task Forces, Commissions or Authorities and Other Broadband Resources*, NAT'L CONF. STATE LEGIS., https://perma.cc/5H7M-3J5P.

171 *ConnectHome*, *supra* note 170.

172 For a list of state broadband initiatives, see *State Broadband Task Forces*, *supra* note 170.

173 *See* Bass, *supra* note 170.

174 Lifeline & Link Up Reform Modernization et al., 30 FCC Rcd. at 7830–31 (2015) (naming, as examples, Mobile Beacon's Internet Inclusion Initiative, Comcast's Internet Essentials program, and the New York Public Library as programs dedicating to closing the digital divide).

175 FCC, *supra* note 154, at 3.

176 *Id.* at 22. Despite these expansions, twenty-four million Americans still lack access. Rural, low-income, and tribal populations are disparately impacted by disconnection. *Id.* In 2011, only 42% of homes earning less than $30,000 annually were connected to high-speed internet—however, by 2017, connectivity in lower income homes increased to 74%. *See* COMMON SENSE MEDIA, THE COMMON SENSE CENSUS: MEDIA USE BY KIDS AGE ZERO TO EIGHT 6 (2017).

to close the digital divide, and appears committed to doing so.[177] Whether for political gain or a sincere steadfastness to serving the "public interest, convenience, and necessity," the FCC and Congress have historically guaranteed that all Americans would benefit from access to spectrum. With this understanding of a different industry and regime, we now shift back to the question at hand: how can a market intervention can bridge the banking gap?

III. Diagnosing the Multifaceted Problem in Banking the Underserved: Questionable Profitability, Risk, and Consumer-Punishing Regulation

Propelling banks to serve the underserved requires understanding why banks do not already meet the demand. Scholars and policymakers maintain that banks have willingly and intentionally retreated from the equation of small-dollar lending.[178] But reputable banks have never consistently met consumer demand for small-dollar loans, and therefore have never been part of the equation.[179] At the urging of policymakers, commercial banks loaned small amounts starting in the 1920s, but they predominantly served higher-income borrowers.[180] Commercial banks have historically not served lower-income borrowers for myriad reasons, which can be summarized in three points. First, small-dollar loans are not profitable enough to entice banks to enter the market.[181] Second, small-dollar loan borrowers are riskier than other borrowers.[182] Third, unfocused and consumer-punishing regulation drives away banks from entering the

177 *See, e.g.*, FCC, *supra* note 154, at 1740 (quoting FCC Chairman Ajit Pai, who noted that "while we are now headed in the right direction, we have much to do. Far too many Americans still lack access to high-speed Internet"); *id.* at 1748 (quoting FCC Commissioner Jessica Rosenworcel, who "believe[s] the future belongs to the connected. That's because a broadband connection is more than a technology—it's a platform for opportunity . . . It's past time for the FCC to go big and update its national broadband standard from 25 Megabits to 100 Megabits").

178 *See, e.g.*, Mehrsa Baradaran, *It's Time for Postal Banking*, 127 HARV. L. REV. F. 165, 168 (2014) ("Chartered banks are regulated by state and federal laws and therefore have . . . interest rate caps, on the loans they can offer. Fringe lenders do not. Once the regulated banks left these communities, so did reasonable interest rates.").

179 *See* Fleming, *supra* note 24.

180 *Id.*; *see also* FLEMING, *supra* note 32, at 21 ("In lieu of banks, working-class borrowers in the early twentieth century had three commercial sources for small loans: pawnbrokers, chattel loan companies, and salary lenders.").

181 *See* FLEMING, *supra* note 32, at 224.

182 *See* Isaac, *supra* note 90.

equation and does little to address the widespread demand for temporary liquidity.[183]

A. *The Ultimate Question for Banks: "What's in It for Us?"*

In a series of essays in 1914, soon-to-be Supreme Court Justice Louis D. Brandeis articulated fear of a powerful banking industry in then-modern America.[184] At the time, large investment banks controlled $22 billion—the buying power of $564 billion today—through railroads, industrial corporations, and life insurance companies.[185] Justice Brandeis warned consumers that banks "control the people through the people's own money."[186] Banks were allowed to make their own judgments about consumers in granting credit.[187] Justice Brandeis proposed conflict-of-interest legislation to require impartiality in granting credit, and argued that banks should be treated as railways or telephone companies: public utilities that serve the public interest.[188]

Inspired by Justice Brandeis's vision, President Franklin D. Roosevelt utilized the Great Depression to establish a social contract between banks and consumers.[189] As part of the New Deal, the Federal Reserve was completely reorganized in 1934 into a central banking system and legislators passed reforms to suppress bank runs and provide deposit insurance contingent on oversight.[190]

After the Great Depression, banks saw modest profits through deposits and loans.[191] Technological advances, financial innovation, capital markets, and commercial paper markets, however, began offering alternatives to banking.[192] Instead of utilizing banks, now considered middlemen, consumers made deposits in high-yield, unregulated markets.[193] The underpinnings of the New Deal could not meet the modern demands, speed, size, and complexity of finance in the 1970s and

183 *See* SERVON, *supra* note 7, at 40–41.
184 BARADARAN, *supra* note 26, at 42.
185 *See Id.*
186 *Id.*
187 *Id.* at 43.
188 *Id.*
189 *Id.*
190 *See* John Steele Gordon, *A Short Banking History of the United States*, WALL ST. J. (Oct. 10, 2008), https://perma.cc/E8F5-TE45.
191 BARADARAN, *supra* note 26, at 51.
192 *Id.* at 51–52.
193 *Id.* at 52.

'80s.[194] Thus, banks and policymakers dismantled the New Deal underpinnings without replacing them with modern analogs.[195]

This dismantling led to a new banking ideology: banks would only be safe when highly profitable.[196] Maximizing profitability to allow competition with nonbanks established banks as "purely 'market' entities."[197] Banks were relieved of the social contract.[198]

The dismantling also led to bank failure in the Panic of 1987.[199] Legislators responded to the economic panic with bank-friendly regulatory and deregulatory acts. Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which provided taxpayer dollars to resolve failed local thrifts, and the Federal Deposit Insurance Corporation Improvement Act of 1991, which further limited regulatory discretion in resolving banking industry problems.[200] In 1994, Congress passed the Riegle–Neal Interstate Banking and Branching Efficiency Act, which eliminated restrictions on interstate banking and branches.[201] In 1999, the Federal Reserve repealed the New Deal–era Glass–Steagall Act.[202] These fierce changes ushered in astronomical profitability for the banks. Decades of unfocused regulation also ultimately led to the Great Recession of 2008.[203]

Financial markets had not seen the level of turbulence in 2008 since the Great Depression.[204] Large banking corporations took major beatings: J.P. Morgan Chase bought Bear Stearns on the cheap, Lehman Brothers declared bankruptcy, and the Federal Government provided huge sums of capital to Bank of America, AIG, and Citigroup.[205] Between October 2008 and March 2009, a monthly average of 712,000 people lost their jobs.[206] Between December 2007 and early 2010, the economy lost an estimated 8.7 million jobs.[207]

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194 *Id.*

195 *Id.*

196 *Id.* at 53.

197 BARADARAN, *supra* note 26, at 53–54.

198 *See id.* at 56.

199 *See* 1 FDIC, HISTORY OF THE EIGHTIES: LESSONS FOR THE FUTURE at 10 (1997).

200 *Id.*

201 SHERMAN, *supra* note 22, at 1.

202 *Id.* at 2.

203 *See* BARADARAN, *supra* note 26, at 57.

204 SHERMAN, *supra* note 22, at 13.

205 *Id.*

206 CHRISTOPHER J. GOODMAN & STEVEN M. MANCE, EMPLOYMENT LOSS AND THE 2007-09 RECESSION: AN OVERVIEW 5 (2011).

207 CTR. ON BUDGET & POL'Y PRIORITIES: CHART BOOK: THE LEGACY OF THE GREAT RECESSION 5 (2018).

Following the crisis, the Federal Reserve purchased $1.25 trillion of securities to push liquidity into banks.[208] The theory was that these securities would increase reserves so banks would then lower interest rates and lend more money.[209] Meanwhile, the government issued bailouts to increase consumer confidence and encourage banks to act within the public interest.[210] Instead, after the crisis, the banks used the fresh cash to triple their stock prices.[211]

Most modern banks view customers in terms of their relative profitability: banks reject or punish the *unprofitable*—presumably those with low credit scores—with severe fees.[212] Justice Brandeis's definition of "public interest" suggested that banks should work for the benefit of as many consumers as possible.[213] Instead, banks have recaptured the idea of working for the "public interest" to mean that if banks are highly profitable, then everyone benefits.[214]

Even in periods when banks were considered agents of the traditional public interest, they were still not likely to engage in small-dollar loans for low-income borrowers.[215] For banks, small-dollar loans mean lower amounts of interest paid.[216] In 1930, for example, banks made average secured loans of $326 and unsecured loans of $250, relatively high amounts for the time.[217] Similarly, in 1969, banking professionals stated that "only loans of $600 or more are generally profitable."[218] Banks have therefore more consistently served those already served because of earnings potential, and have shied away from the relative unprofitability and risk of the underserved.[219]

208 BARADARAN, *supra* note 26, at 16.

209 *Id.*

210 *See id.* at 22–23.

211 *Id.* at 16.

212 *See id.* at 140.

213 SERVON, *supra* note 7, at 36.

214 *Id.*

215 *See* FLEMING, *supra* note 32, at 226.

216 *See id.*

217 *Id.* at 227 (adjusting for inflation, in today's dollars this means that commercial banks' average loan was around $4,800).

218 *Id.* at 226. Additionally, Fleming notes that "[t]he bank authorities interviewed for the study opined that any loan under $300 would lose money." *Id.* at 227 (adjusting for inflation, in today's dollars this means that banks are only profitable when they lend $4,120 or more).

219 *See id.* at 227.

B. *Risk Justifies the Exclusion that Proves the Risk*

Loans and risk are historically intertwined. In *Hamlet*, Shakespeare warned, "Neither a borrower or a lender be; For loan oft loses both itself and friend, And borrowing dulls the edge of husbandry."[220] In *Poor Richard's Almanack*, Benjamin Franklin advised, "If you'd lose a troublesome visitor, lend him money."[221] The ancient assumption that certain borrowers will renege on the promise of the transaction provides the foundation for risk valuations today.

A common justification for the high rates of fringe lending is that serving low-income borrowers is risky and expensive.[222] Where banks sort potential borrowers into categories to distinguish between "good credit" and "bad debt," payday and title lenders make no such differentiation.[223] Banks might refuse products for higher-risk borrowers and then offer low rates for lower-risk borrowers, but payday and title lenders offer the same exorbitant interest, fees, and terms, regardless of the borrower.[224] Over time, banks have rationalized that because they accrue more profits on higher-dollar loans, sorting lower-income borrowers for small-dollar loans is not worth their time.[225] So, banks consider lower-income borrowers too risky to justify the transaction costs.[226]

The economic concept of risk has afforded banks the historical support to exclude or differentiate between classes of borrowers.[227] Today, despite extensive laws and regulations against undue discrimination, borrowers who are Black, Hispanic, or women pay more for credit.[228] Historical perceptions of who constitutes a "risky" borrower fortify these lasting trends in lending. For example, in 1971, a prominent Chicago banker explained why his bank refused loans in a specific geographical area: "Have you looked around? It's a slum."[229] Similarly, in 1974, a bank board member said he would not vote to adopt standards for

220 WILLIAM SHAKESPEARE, HAMLET act 1, sc. 3.

221 *See* BENJAMIN FRANKLIN, POOR RICHARD'S ALMANACK (1744).

222 *See, e.g.*, Isaac, *supra* note 90 ("Very few banks are willing to make these loans [because] the transaction costs are simply too high.").

223 BARADARAN, *supra* note 26, at 133.

224 *See id.* The historical purpose and essential function of banks is to differentiate between the creditworthy and the not creditworthy. *Id.*

225 *Id.* at 134.

226 *See id.*

227 For historical examples of banks differentiating and discriminating between borrowers, see SERVON, *supra* note 7, at 41–43.

228 *See id.* at 42–43.

229 *Id.* at 42.

antidiscrimination against women because, "[w]omen get pregnant."[230] Risk, while objectively economic in nature, is therefore a pretense for subjective valuations of certain classes and demographics. Once banks define risk for themselves and exclude certain borrowers from affordable products, the borrowers become riskier when they cannot keep up with high-cost loans. Then, commenters are free to rationalize the fringe lending business because those consumers are *too risky* for commercial banks, and a consumer-punishing cycle restarts.[231] Along with risk, consumer-punishing regulation keeps banks from entering the small-dollar market.

C. *Uncertainty in the Face of Excessive and Unfocused Regulation*

Decades of complicated, unfocused regulations, even those seeking to curb bank power, have punished consumers. Some banks have offered loan products called "deposit advances," that allowed customers to borrow against their recurring direct deposits.[232] For example, Wells Fargo, Fifth Third, and U.S. Bank offered these advance products for a time, but discontinued them in 2014 after the Office of the Comptroller of the Currency ("OCC") and the FDIC imposed tight restrictions on small-dollar, high-interest loans.[233] The regulations did not forbid banks from offering the loans, but created rigid regulatory structures that made it too difficult for banks to continue offering the products.[234] These products, while potentially safer alternatives to fringe lending products, still accrued high fees and rates and were ultimately labeled as "debt traps" by the Consumer Financial Protection Bureau ("CFPB").[235]

Modern banking regulation in the United States is enormously complex.[236] Today's system evolved gradually as regulators and policymakers added more regulations, laws, and authorities to the pile

230 *Id.* at 43.

231 *See, e.g.*, Isaac, *supra* note 90.

232 Fleming, *supra* note 24.

233 *See* Danielle Douglas, *Wells Fargo, U.S. Bank to End Deposit Advance Loans, Citing Tougher Regulation*, WASH. POST (Jan. 17, 2014), https://perma.cc/4QE6-EFG4.

234 *Id.*

235 *See, e.g.*, *The CFPB Finds Payday and Deposit Advance Loans Can Trap Consumers in Debt*, CFPB (Apr. 24, 2013), https://perma.cc/N4ZQ-W6WK.

236 *See e.g.*, DALVINDER SINGH, BANKING REGULATION OF UK AND US FINANCIAL MARKETS 33, 35–36 (2016) ("It will be shown that the complexity of the system means issues are not always communicated efficiently between the regulators across the financial services industry, let alone the banking industry.").

without taking enough away.[237] Eight regulatory agencies create an umbrella of federal oversight: Federal Reserve, OCC, FDIC, National Credit Union Administration ("NCUA"), Securities and Exchange Commission ("SEC"), Commodities Futures Trading Commission ("CFTC"), Federal Housing Finance Agency ("FHFA"), Farm Credit Administration ("FCA"), and the CFPB.[238] Adding further complexity, financial institutions are subject to any number of these federal agencies because they engage in multiple kinds of activities.[239] Additionally, financial institutions are also subject to state regulators and other organizations.[240]

Most banks house compliance departments to navigate the multifarious regulatory and statutory requirements.[241] Scholars regularly refer to the thorny relationship between banks and the government as "the doom loop."[242] Two realities are apparent here. First, the vast, unfocused regulation of modern banks has not successfully protected consumers from predatory practices or answered the demand for liquidity that fringe companies offer.[243] Second, "the doom loop," while merely messy for highly profitable banks, ensures that the most vulnerable consumers on the margins continue to suffer and remain underserved.[244] Therefore, if banks remain purely market-driven, risk-defining entities

237 *See* CONG. RESEARCH SERV., R44918, WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 8–9 (2020); SERVON, *supra* note 7, at 40.

238 *See* CONG. RESEARCH SERV., *supra* note 237, at 8–9.

239 For an illustration of this complicated regulatory structure, see Figure 1 in CONG. RESEARCH SERV., *supra* note 237, at 10.

240 *See id.* at 7–9 ("There are also targeted regulators for specific financial activities . . . and markets . . . . [The list] does not include interagency-coordinating bodies, standard-setting bodies, international organizations, or state regulators . . . .").

241 SERVON, *supra* note 7, at 40–41. The governing statutory code and federal regulations are mammoth. Title XII of the United States Code is fifty-four chapters, 5,701 sections, or 3,162 pages. *See* 12 U.S.C. §§ 1–5710 (2012). Title XII of the Code of Federal Regulations is ten volumes, eighteen chapters, or 1,899 parts. *See* 12 C.F.R. §§ 1–1899 (2012).

242 *See* BARADARAN, *supra* note 26, at 59 ("We cannot have a banking system that is so large and powerful that it relies on government bailouts. Their size leads to bailouts, and the promise of bailouts in turn leads to more risk-taking, a cycle some have called a 'doom loop.'"); *see also* SERVON, *supra* note 7, at 37 ("Some call the relationship between banks and government a 'doom loop,' a 'virtue-less cycle in which banks take ever greater risks to boost returns . . . and governments are forced to break their promises "never again" to bankroll losses.'").

243 *See* Fleming, *supra* note 24. Striking the appropriate balance in regulation of small-dollar loans has long confounded Americans. *See* FLEMING, *supra* note 32, at 3 ("Each generation has wondered: Is there a way to grant low-wage workers small amounts of credit at lower cost, without restricting access for the riskiest borrowers? Can law make small loans safer, and if so, where should we draw the line between necessary protection and overreaching paternalism?").

244 *See* SERVON, *supra* note 7, at 37.

with no catalyst compelling them to serve lower-income consumers, and if the regulatory structure remains convoluted and continues to usher away willing banks, the market for and profitability of fringe lending will only expand.

IV. Evaluating Proposed Solutions to Meet Real Demand for Liquidity

In a how-to manual on starting a payday lending business, the author extols the profit-potential of the industry.[245] The author states that "everyone in this business is making a lot of money in excess of [tens] of thousands of dollars in just fee[s] every month by funding less than 300 loans."[246] The author expounds that a man operating a small loan store in Atlanta, Georgia "is averaging 200 loans per month with a payback in 14 days and he's making $20,000 in fees."[247]

Fringe lenders are thriving with little effort because of the most basic economic theory: supply and demand. Proponents of fringe lending suggest that without predatory lenders, risky borrowers would be insolvent.[248] This is true. Demand for predatory loan products exists because Americans are financially unstable and banks are unwilling to serve them. So, how should banks be thrust into the equation? The exigency that banking disparities create demands creative solutions.

A. *Why State and Federal Efforts Are Not Enough and Postal Banking is Not the Answer*

An oft-cited solution to serving the underserved and eliminating predatory lending practices is state-based initiatives.[249] But outright bans on predatory lending or federally and state-initiated interest rate caps are insufficient for solving the fringe lending problem.[250] The payday lending how-to manual illustrates simple methods to evade state interest rate caps and other state-based limitations on payday lending.[251] For example,

245 HOW TO START A PAYDAY LOAN BUSINESS, *supra* note 27, at loc. 57, 923.

246 *Id.* at loc. 923.

247 *Id.*

248 *See* Isaac, *supra* note 90.

249 *See* Timothy E. Goldsmith & Nathalie Martin, *Interest Rate Caps, State Legislation, and Public Opinion: Does the Law Reflect the Public's Desires?*, 89 CHI.-KENT L. REV. 115, 129 (2014); Patrick L. Hayes, *A Noose Around the Neck: Preventing Abusing Payday Lending Practices and Promoting Lower Cost Alternatives*, 35 WM. MITCHELL L. REV. 1134, 1148 (2009).

250 *See* Nathalie Martin, *Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap*, 34 N. ILL. U. L. REV. 259, 296 (2014).

251 HOW TO START A PAYDAY LOAN BUSINESS, *supra* note 27, at loc. 1024.

> I would recommend setting up your business in states such as:
>
> - South Dakota: No state taxes and no rate cap[.]
> - Nevada: No State taxes, no rate cap, and the owner can remain anonymous.
> - Wyoming: No state taxes, $30 can be charged per $100 borrowed, and the owner remains private.
> - Delaware: No rate cap and allows owner to remain unknown.
> - Colorado: No rate cap[.]
>
> You could set up a business in your home state for the sake of getting your business checked and register your business in another state and get license[d] in either of these states to operate. Or you can set up in one [] state initially because you can open your account online and never have to step foot into the bank. You have a couple of different choices.[252]

The manual also explains how to avoid state licensing and federal regulations: set up your company in another country.[253] According to the manual, certain payday loan operators are not registered, but are still located within the United States and correspondingly offer services in all fifty states.[254] "This type of setup is difficult for state regulators to control because the business is incorporated in another country . . . the USA does not have jurisdiction to fine them or even warn them," the manual rationalizes, citing the Virgin Islands and Belize as popular havens.[255]

So, even with a nationwide interest rate cap or state laws that crack down on predatory lending practices, businesses will prey on vulnerable borrowers where demand for liquidity exists. For example, Connecticut has outrightly banned all payday loans.[256] But a simple internet search of "Connecticut payday loans" provides dozens of online options for "fast cash."[257]

Demand will only increase in times of economic instability. Indeed, in the wake of the novel coronavirus, payday lenders are skirting state regulations by partnering with out-of-state entities to target consumers impacted by the crisis.[258] Enterprising businesses will avoid regulations, advertising bans, and federal interest rate caps. These kinds of solutions are ineffective and consumer harming, especially where high demand for fast liquidity exists. An outright ban on fringe lending without propelling

252 *Id.*

253 *See id.* at loc. 208–12.

254 *See id.* at loc. 208.

255 *Id.*

256 *See* Heather Morton, *Payday Lending State Statutes*, NAT'L CONF. STATE LEGIS. (Mar. 10, 2020), https://perma.cc/R7MP-HJR7.

257 *See, e.g.*, *Connecticut, CT Short Term Payday Loans*, BIG SKY CASH PAY DAY LOANS, https://perma.cc/LES3-98QV.

258 *See* Coulter Jones, Jean Eaglesham, & AnnaMaria Andriotis, *How Payday Lenders Target Consumers Hurt by Coronavirus*, WALL ST. J. (June 3, 2020), https://perma.cc/4QRA-HFUV.

reputable banks into the equation leaves potential borrowers desperate for options.

1. Recent Regulatory Initiatives Ignore Demand and Punish Consumers

In 2017, the CFPB established two new requirements to curb payday and title lending that provide helpful examples of consumer-punishing regulation: an "ability-to-repay" test and a "cooling-off period."[259] The ability-to-repay test required lenders to evaluate whether borrowers could repay without borrowing new loans.[260] Under the test, lenders obtained detailed information about the customer before approving the new loan.[261] If lenders determined that a customer could not repay the desired loan without reborrowing, the rule disallowed the lender from lending to that customer.[262] Similarly, the cooling-off period rule disallowed lenders from lending more than three short-term loans to a customer within thirty days.[263] Instead, they needed to wait thirty days after the third loan to relend.[264]

These rules represent regulatory efforts to reduce the prevalence of predatory lending, but do not address the demand that drives customers to the lenders.[265] Instead of establishing mechanisms that promote more liquidity, regulators are restricting consumer access to much needed cash.[266] Additionally, under the CFPB's reporting, a typical two-week payday loan garners triple digit APRs.[267] The ability-to-repay test and the cooling-off period did nothing to change the predatory nature of payday and title loans and their exorbitant rates, but instead deterred consumers who needed the liquidity that only those lenders would offer. These kinds of rules, while seemingly beneficial, ultimately punish borrowers more than they help. Regulators place the impetus on the borrowers' ability or

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259 CFPB, EXECUTIVE SUMMARY OF THE PAYDAY, VEHICLE TITLE, AND CERTAIN HIGH-COST INSTALLMENT LOANS RULE 3–4 (2017), https://perma.cc/X89V-BRN3. In 2019, the CFPB proposed to rescind these rules against predatory lending and delayed the mandatory date of compliance. *See* 12 C.F.R. § 1041.1 (2019).

260 CFPB, *supra* note 259, at 3.

261 *Id.* at 4.

262 *See id.*

263 *Id.*

264 *See id.*

265 *See* 12 C.F.R § 1041.1 (2019).

266 *See id.*

267 *What Are the Costs and Fees for a Payday Loan?*, CFPB (Jun. 5, 2017), https://perma.cc/5VGF-KXES.

inability to repay instead of diagnosing the reasons borrowers engage with the expensive products.

Today, almost 80% of Americans live paycheck to paycheck.[268] Financial insecurity is rampant, and not in the way we expect: in 2015, a study found that over 20% of small-dollar borrowers net more than $50,000 a year.[269] The middle class is growing more illiquid, and the modern financial regulatory regime is not adapting to meet those challenges. Instead, recent regulatory initiatives, like the ability-to-pay test and the cooling-off period, make consumers' only options less accessible in times of illiquidity.

Answering the exigencies of a less financially secure middle class requires offering products for consumers who need access to credit and liquidity. One proposal, postal banking, has gained traction as a potential solution to meet the demand.

2. Postal Banking as a Political Operation and Market Power

Scholars and policymakers have suggested that post offices are the solution for the underserved.[270] Postal banking is not a new proposal. In 1910, President William Howard Taft implemented the Postal Savings System for the poor to save money.[271] After a decline in deposits, President Lyndon B. Johnson discontinued the program in 1967.[272]

Senator Kristen Gillibrand proposed large-scale legislation to place banking options back into the United States Postal Service ("USPS").[273] The proposal would establish retail banking in all thirty thousand USPS branches, but, unlike past iterations, it includes loan products.[274] Senator Gillibrand's hope is for postal banks to offer low-interest loans to wipe out predatory lending.[275] The theory is that USPS can reach underserved populations because branches already do business in communities that banks left long ago.[276] Because potential borrowers are comfortable with

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268 Robert Reich, *Almost 80% of US Workers Live from Paycheck to Paycheck*, GUARDIAN (Jul. 29, 2018), https://perma.cc/PJ8T-ZULB.

269 *See* SERVON, *supra* note 7, at 50.

270 *See* Baradaran, *supra* note 178, at 165–66.

271 *See id.* at 170.

272 *See* Kevin Wack, *Postal Banking Is Back on the Table. Here's Why That Matters*, AM. BANKER (Apr. 26, 2018), https://perma.cc/ELH9-5GHC.

273 Press Release, Senator Kristen Gillibrand, Gillibrand Announces Major New Legislation to Create A Postal Bank to Wipe Out Predatory Payday Lending Industry Practices, Ensure All Americans Have Access to Basic Banking Services (Apr. 25, 2018), https://perma.cc/FQE9-H389.

274 *See id.*

275 *Id.*

276 *See* Baradaran, *supra* note 178, at 169.

post offices, banking options would likely be welcomed.[277] Further, scholars suggest that postal banks could offer lower rates than predatory lenders by taking advantage of economies of scale.[278]

Senator Gillibrand's proposal is ambitious and could be an effective method to meet the demand of the underserved and eliminate payday lending. But, despite the familiarity of the neighborhood post office, postal lending would create an entirely new and untested banking regime.[279] Postal lending would afford the federal government with a monopoly over low-income consumers. Relying on the advantages of the USPS's economies of scale ignores that postal banks would have a substantial advantage over and deter competition from potential reputable lenders.[280] Postal banks would have few barriers to enter the small-dollar loans market, whereas banking institutions not already in the community would have significant physical, financial, and reputational barriers.[281] Thus, the noteworthy advantages that postal banks boast about would establish the federal government as a monopolistic market participant. Meanwhile, community banks and credit unions would be forced to compete for checking and savings accounts with the federal government's new banking regime.[282] Further, while postal banks' rates would be more affordable, ultimately, choice would be just as scarce as in the current banking regime. With few firms able or willing to compete with such a mammoth as the federal government, consumers would lose out on the kind of competition that drives down prices.[283]

Economists and banking professionals are hesitant to support postal banking.[284] Two dominant criticisms are: postal banking is a partisan effort that would further politicize banking for the underserved; and, postal banking would empower a government agency with a history of

277 *See id.*

278 *See id.* An economy of scale is the "relative gain in output or saving of costs resulting from the greater efficiency of large-scale processes." *Economies of Scale*, OXFORD ENGLISH DICTIONARY (3d ed. 2008).

279 *See* Fleming, *supra* note 24.

280 *See* GEORGE J. STIGLER, THE ORGANIZATION OF INDUSTRY 67 (1968).

281 *See id.*

282 *See* Eric Naing, *Credit Unions to Democrats: Don't Push for Postal Banking*, CONG. Q. ROLL CALL (2016).

283 *See* Robert H. Lande, *Consumer Choice As the Ultimate Goal of Antitrust*, 62 UNIV. PITT. L. REV. 503, 503–04 (2001).

284 *See, e.g.*, Peter Conti-Brown, *Why the Next Big Bank Shouldn't Be the USPS*, BROOKINGS (May 31, 2018), https://perma.cc/9L37-XP2U; Eric Grover, *Return to Sender: Here's What's Wrong With Postal Banking*, AM. BANKER (May 17, 2018), https://perma.cc/B4DN-TK9K; Matthew C. Klein, *The Pros and Cons of Postal Banking*, BARRON'S (Apr. 30, 2018), https://perma.cc/624Z-SWWT; Wack, *supra* note 272.

mismanagement and too little experience in underwriting to augment the livelihoods of already vulnerable populations.[285]

One critic to Senator Gillibrand's proposal suggests that postal banking could be a boon for Democrats.[286] The critic states that the proposal is designed to offer subsidies that would garner political support.[287] The critic further challenges the Senator: "If [Senator] Gillibrand wants to subsidize specific Americans, let her propose doing so, in the light of day."[288]

While postal banking is more effective than unfocused regulation and interest rate caps because of the solution's emphasis on the demand for liquidity, the untested framework would likely ensure that commercial banks would never effectively enter underserved communities.[289] A more efficient solution would be to propel banks and credit unions to enter the small-dollar loan market and boost competition.

B. *A Creative Solution: The Universal Banking Service Fund*

This Comment proposes subsidizing low-interest, small-dollar loans for Americans. Inspired by the communications sector's longstanding adherence to universal service, banks and reputable lending firms could contribute to a universal service fund based on their annual revenue. Then, branches in underserved communities would use the fund to offer subsidized small-dollar, low-rate loan options. Americans have long accepted the ideology behind universal service and have demanded that telecommunications providers meet their obligations to serving the public interest, convenience, and necessity. Why should the banking industry, even more closely entwined with opportunity and advancement, be different?

The United States boasts the largest and most liquid financial market in the world.[290] In 2018, finance and insurance represented $1.5 trillion of the country's gross domestic product.[291] J.P. Morgan Chase, Bank of America, and Wells Fargo are the three largest banks in the United States, and together yield $284.1 billion in revenue in 15,512 branches.[292]

285 *See* Conti-Brown, *supra* note 284.

286 *See* Grover, *supra* note 284.

287 *See id.*

288 *Id.*

289 *See* STIGLER, *supra* note 280, at 67.

290 *See Financial Services Spotlight*, SELECTUSA, https://perma.cc/P9CM-BH72.

291 *Id.*

292 *See* Rachel Butt, *Here Are The 11 Biggest Banks in America*, BUS. INSIDER (Jun. 6, 2016), https://perma.cc/VK9U-957S; *Federal Reserve Statistical Release,* FED. RESERVE, https://perma.cc/F7WY-E3ZQ.

Meanwhile, experts estimate taxpayer subsidies to banks total $83 billion.[293] Banks have also benefitted exceptionally from bailout dollars.[294] The industry is therefore more heavily subsidized than ever.[295]

If a combination of transaction costs, risk, and unfocused, consumer-punishing regulation keeps reputable banks from meeting the widespread demand of small-dollar loans, and if taxpayers continue to lose out despite heavily subsidizing banks, then a Ronald Coase–inspired theory would call for minor market intervention.[296] Mirroring the FCC's commitment to nationwide connectivity through the Universal Service Fund, a similar program, the Universal Banking Service Fund ("UBSF"), could provide subsidized banking options from reputable financial firms like banks, credit unions, community groups, and nonprofits. Unlike postal banking, the government would not provide the loan products and thus compete with banks, but would subsidize the products to make low-cost loans safer and more appealing for banks to enter the small-dollar loan market. This proposal is a broad overview of how such a program could answer the demand for small-dollar loans.

1. The Mechanics of the Universal Banking Service Fund: Oversight and Administration

Like the Universal Service Fund, the UBSF would require regulatory oversight and independent administration.[297] In overseeing the Universal Service Fund, the FCC designated an independent nonprofit, the Universal Service Administrative Company ("USAC"), to administer the funds each year to telecommunications and broadband companies.[298] USAC also collects annual and quarterly revenue information from companies and estimates demand for services.[299] The FCC uses the compiled data and demand forecasts to determine the quarterly contribution factor.[300] Some companies pass through the contribution to

293 *See* Editorial, *supra* note 94.

294 *See* Collins, *supra* note 102.

295 Baradaran, *supra* note 178, at 175.

296 *See* Coase, *supra* note 137, at 18 ("[T]here is no reason why, on occasion, such governmental administrative regulation should not lead to an improvement in economic efficiency.").

297 *See About USAC*, UNIVERSAL SERV. ADMIN. CO., https://perma.cc/5VX4-8L9H.

298 *Id.*

299 *Universal Service*, UNIVERSAL SERV. ADMIN. CO., https://perma.cc/E96X-68ZM.

300 GILROY, *supra* note 151, at 4–5.

customers, but the FCC has established rules to ensure that providers are not gaming the system.[301]

Likewise, the UBSF would best function within a regulatory agency and with an independent administrator.[302] The agency, with Congressional oversight and approval, would explicitly define and oversee the mechanics of the UBSF. The agency would also determine each banking and lending firm's contribution factor into the Fund. Like the FCC, the agency could set the contribution factor at a percentage of the firms' interstate end-user revenues.[303] Questions of fees, rates, APR, default, new entrants, penalties for bad actors, etc., would also fall under the agency's purview.[304] Inherent in this proposal would be a mechanism to ensure that banks do not increase already exorbitant maintenance fees to cover the UBSF contribution. An independent administrator would manage filings and administer funds, which would then subsidize lenders who provide borrowers with small-dollar, low-interest loans.

2. The Mechanics of a UBSF Loan Product

Under this proposal, a traditional fringe loan customer would borrow a small amount from a reputable bank, credit union, nonprofit, or community group. From the borrower's perspective, the experience would be no different than borrowing a traditional loan or opening a small credit line. From the firm's perspective, a loan officer would analyze the borrower's credentials to determine eligibility, using parameters which Congress would define and the regulating agency would oversee.[305] Then, the UBSF would provide a government-backed, subsidized product with a conventional, safe APR for the borrower. Instead of churning, the loan would be subject to similar penalties as missed payments on reputable credit lines. The interest rate or fee structure would never increase. The UBSF would subsidize a portion or all of the bank's transaction costs of this loan.

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301 *See* 47 C.F.R. § 54.712(a) (2018) ("[A] line-item charge may not exceed the interstate telecommunications portion of that customer's bill times the relevant contribution factor.").

302 Under current statutory authority, the Consumer Financial Protection Bureau seems best suited to the task of regulatory oversight of a Universal Banking Service Fund.

303 *See Contribution Factor & Quarterly Filings—Universal Service Fund (USF) Management Support*, FCC, https://perma.cc/K5UR-839W.

304 The Federal Trade Commission would maintain oversight of anticompetitive practices.

305 Eligibility determinations could mirror federal programs that define eligibility for mortgages. For example, FHA mortgages have a credit score window based on the level of down payment, a defined debt-to-income ratio, employment, etc. *See* Denny Ceizyk, *Minimum Mortgage Requirements for 2020*, LENDINGTREE (Jan. 14, 2020), https://perma.cc/NF6E-3WXJ. Ideally, the regulating agency would infuse flexibility into the requirements and would reevaluate over time.

In any scheme, borrowers will default. Rolling over loans into new ones or selling defaulted loans to private buyers is a significant portion of the high-pressure, fringe-lending industry that harms borrowers.[306] The UBSF's default model could avoid these pitfalls by combining major postal lending proposals and the default model for Federal Housing Administration ("FHA") mortgages: if a borrower defaults, the UBSF could reimburse the lender for the remaining amount owed, in most cases up to $4,000, and employ the Treasury Department's debt collection services available to federal agencies.[307] The UBSF regulator could then garnish the borrower's tax refund for the defaulted amount.[308] The details of default and other specifics would require creative design and thorough oversight, but reducing the costs of debt collection could significantly reduce the fees associated with small-dollar loans.[309]

The UBSF loan products would be designed in partnership with reputable lenders. For example, in 2018, U.S. Bank introduced a product, the Simple Loan, designed to meet customer demand for small-dollar loans.[310] The Simple Loan allows U.S. Bank customers to borrow up to $1,000 in $100 increments, with a set fee of $6 for every $100.[311] U.S. Bank cites an average APR for the Simple Loan at 35.65%.[312] While still high for borrowers, this model is much less expensive than triple-digit rates and fees. Customers also benefit from a longer period to pay back the loan, at three months instead of two weeks.[313] The Simple Loan charges no additional fees or penalties for missed payments, and unlike fringe lenders, does not automatically debit the borrower's bank account when funds are too low.[314] The set fee structure ensures that customers are not blindsided by churned rates and fees. U.S. Bank has branches in only twenty-six states and is currently one of few reputable financial institutions with a loan product that competes with fringe lenders.[315] With

306 *See* BARADARAN, *supra* note 26, at 111–13.

307 *See id.* at 214; *see also* KATIE JONES, CONG. RESEARCH SERV., RS20530, FHA-INSURED HOME LOANS: AN OVERVIEW 1 (2018).

308 BARADARAN, *supra* note 26, at 215.

309 *See id.* ("Debt collection costs are one of the primary causes of the high fees attached to small loans.").

310 Mary Wisniewski, *US Bank Launches Payday Loan Alternative for Cash-Strapped Customers*, BANKRATE (Sep. 12, 2108), https://perma.cc/AGM2-HH68.

311 *See A Loan Option to Cover Immediate Cash Flow Needs*, U.S. BANK, https://perma.cc/5SJP-ADBU.

312 *See id.*

313 *Id.*

314 *See Simple Loan FAQs*, U.S. BANK, https://perma.cc/W2P2-QQ3W.

315 *See U.S. Bank Simple Loans Review*, FINDER (Nov. 30, 2018), https://perma.cc/XMZ8-AKZU.

a program like the UBSF, firms like U.S. Bank could offer even safer small-dollar products.

The UBSF could have a tiered structure for the level of subsidies offered like that of the Universal Service Fund.[316] The UBSF could offer a higher rate to banks that serve in areas of higher poverty. Also like the Universal Service Fund, the UBSF would not be a direct subsidy to end users. Instead, the Fund would support reputable, backed financial institutions which are otherwise not incented to enter the small-dollar loan market. Like the Connect America Fund and the Rural Health Care Program that provide subsidies and reimbursements for companies, the UBSF would either subsidize financial firms to encourage them to enter underserved markets or reimburse firms for a portion or all of the costs of making the loans.

Under U.S. Bank's Simple Loan model, the bank's profits come from some portion of the loan's set fees of $6 for each $100 borrowed.[317] In a hypothetical model under the UBSF, a U.S. Bank branch would offer the same product to a customer, but the subsidy would cover a portion or all of the fee. If the borrower qualifies, the subsidy could cover, for instance, $3 of the six-dollar fee for every $100 borrowed. The UBSF, then, would pay into the transaction up to $120 for $1,000, decreasing the fees the borrower pays by half.

These are merely hypothetical models for a Universal Banking Service Fund. Ideally, lenders could offer more than U.S. Bank's $1,000 loan and varying kinds of fees, rates, and payment plans based on consumer demand. The UBSF would subsidize and back loan products for lenders, and borrowers would benefit from lower rates, no churning, and safer options in default.

3. Benefits and Pitfalls of the UBSF

Instead of a "doom loop," the UBSF would encourage a cycle of innovation not yet seen in the small-dollar loan market. With more reputable financial institutions entering the market to receive the UBSF subsidies, competition would create more diversity for borrowers and encourage firms to innovate more affordable, safer transactions.

This proposal meets rising consumer demand for liquidity that modern regulation does not. Additionally, unlike postal banking, which sinks taxpayer dollars into a new, untested market power, this proposal relies on the infrastructure of the established banking industry, propels

316 *See, e.g.*, *E-rate: Universal Service Program for Schools and Libraries*, FCC, https://perma.cc/7LT9-YTM7.

317 *See A Loan Option to Cover Immediate Cash Flow Needs*, *supra* note 311.

already heavily subsidized firms into the equation to serve the taxpayers, and invites competition.[318]

Perceptions of risk, fear of default, and insistence for high profitability remain regardless of the loan product.[319] But the risk for default in fringe lending products is compounded when APRs are in the triple digits.[320] Under this proposal, lower rates and fees and prudent lending practices mean a higher probability that borrowers will not default. Additionally, this proposal does not suggest that banks must abandon their profit-seeking instincts. Instead, this proposal provides a mechanism and an incentive for banks and small-dollar borrowers to enter the kind of symbiotic relationship that politicians have long described but never achieved.[321]

Banking products are not telecommunications services. This analogy is not perfect. But the comparison between industries is useful in proposing a creative solution to a rampant problem. Additionally, this proposal is not without drawbacks. To establish a Universal Banking Service Fund is to add to an already murky and unfocused regulatory regime. But the infrastructure necessary to execute UBSF-backed loans already exists within the banking firms themselves. This proposal could therefore make room to clean up banking regulation by promoting access to safe products that could wipe out fringe lending.

To say that banks can afford to contribute to a Universal Banking Service Fund is not the point of this proposal. The point is that they should. If the top three banks in the United States contributed a little over 4% of their annual revenue, then the UBSF could subsidize and back all twelve million fringe-lending borrowers up to $1,000 each year.[322] But this proposal is not asking for these three banks to subsidize every borrower.

318 *See* BARADARAN, *supra* note 26, at 214–15. Postal banking proposals suggest that small-dollar loan funds would come from "deposits, other business revenues, and central bank lending." *Id.* Taxpayer dollars would inevitably cover the salaries of new postal lending employees and other maintenance costs. Like the Universal Service Fund, then, which covers employment through providers' contributions, the UBSF would include funding for regulatory oversight, and the banks themselves would cover their own salaries and other maintenance costs. *See* Press Release, *supra* note 152.

319 *But see* Lynn Drysdale & 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*, 51 S.C. L. REV. 589, 662 (2000) ("[T]o what extent does high cost create the risk, rather than compensate for it? Advocates have seen many individual credit transactions in which the consumer's budget could have supported a reasonably priced loan, but the high fringe credit price tag stretched this capacity too far.").

320 *See* PEW CHARITABLE TRUSTS, *supra* note 8, at 1–10.

321 *See* BARADARAN, *supra* note 26, at 4–5.

322 *See* Butt, *supra* note 292; *Federal Reserve Statistical Release*, *supra* note 292.

Instead, all banks could contribute support to ensure that they are working for consumers as much as consumers are working for them.

For over a century, the United States has supported the idea of universal service for telecommunications and broadband access because that access is essential for opportunity and advancement. Nothing is more intimately linked to advancement than financial liquidity and access to safe, reputable banking and credit options.

Conclusion

At the start of the Universal Service Fund, antiregulation proponents said that firms would meet the demand of rural and low-income consumers if only they could do so without government intervention.[323] They said that McDonald's and K-Mart met those consumers' demands, so of course telecommunications providers would, too.[324] This argument ignores the high build-out costs to reach rural consumers and the low revenues of poor urban areas.[325] It also presumes that other firms will build-out, compete, and drive down prices.[326] McDonald's would not be a giant in the fast food industry today without Burger King in constant competition.[327] The S.S. Kresge Company, later called K-Mart, needed to race against Arlan's Department Stores to win the corner of the market for the best discount store.[328] So, advocates for the Universal Service Fund held that first comes access, then comes competition, and all at just, reasonable, and affordable rates.[329]

Advocates and opponents for universal service cannot possibly know today what the market would look like if the Telecommunications Act of 1996 had not established the Universal Service Fund. But we can plainly see the modern landscape for today's vulnerable populations after decades of bank-friendly, consumer-punishing regulation: insufficient access, no competition, unaffordable rates, and a growing financial chasm. Maybe now is the time to try something different.

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323 *See* Gigi Sohn, *Why Government is the Solution, and Not the Problem: In the Pursuit of a Free Market for Telecommunications Services*, *reprinted in* AUFDERHEIDE, *supra* note 107, at 261, 263–64.

324 *See id.*

325 *Id.* at 263 ("[I]t is enormously expensive to lay telephone wire in rural areas, a cost that is rarely offset by telephone usage. In poor urban areas, per capita costs may not be as high, but neither are revenues.").

326 *Id.*

327 *See* Christopher Klein, *How McDonald's Beat Its Early Competition and Became an Icon of Fast Food*, HISTORY CHANNEL (Aug. 7, 2019), https://perma.cc/L2NJ-FCFT.

328 *See* Isadore Barmash, *At Kresge, Success Is Not Forgetting What You Are*, N.Y. TIMES (Sept. 19, 1976), https://perma.cc/W6B6-GD9K.

329 *See* Sohn, *supra* note 323, at 265.