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PRIME INTEREST RATES FOR SUBPRIME BORROWERS?

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PAST

In the United States the price of goods, services, and real estate has seldom been regulated by anything other than market forces, except in unusual circumstances where demand is high but supply is low, such as in war time. However, that has virtually never been true for the price of money. The price of money has been regulated since colonial times by legislative enactments.[1] This exception to the general rule of market regulation usually is premised on the belief that persons do not borrow until they need to, and a necessitous borrower has little or no bargaining power or knowledge to bargain.[2]

For a considerable period of United States history, legislative limits on what could be charged for a loan ("usury laws") were quite low, such as 6% to 12%.[3] That level worked well enough up to after World War I when consumer credit was in its infancy, but as the demand for such credit grew in the 1920s for the purchase of automobiles, appliances, and other expensive consumer items, these laws began to seriously pinch, particularly if the credit sought was small amount, short term, and the prospective borrower posed some risk of repayment due to possible job loss, sickness, divorce, or other factors beyond the borrower's control when at that time there was not much of a social safety net beyond friends and family.

Some might consider that rationing by these usury laws was a good thing, since people ought not to encumber future income for

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1. Of course, this ignores to some degree the deregulation of rate limitations since the 1980's.

2. For this reason, legislative limits on the price of money usually do not apply to credit extended to businesses. For a long while they also did not apply to credit extended by sellers because, of course, a buyer need not buy on time. That quaint idea has been questioned by retail installment sales laws that regulate the price of sales credit.

3. BARBARA A. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION 15 n.5 (1965).

immediate needs when the cost of doing so is high.[4] This perspective, however, was not persuasive to a borrower who needed cash to pay the rent or the mortgage, to obtain needed medical services, to repair the family auto so one could get to work, or perhaps so the family could eat.[5] These consumers turned to the illegal market for credit—where the price was not regulated and repayment risk was reduced by the prospect of severe collection procedures.

Enter small loan laws, designed to make the small loan business attractive to legitimate lenders and to protect prospective borrowers against the abusive and coercive practices of some lenders.[6] The premise of these laws is that small loans, repayable in installments, cannot be made profitably at the rates permitted under usury statutes.[7] Accordingly, these laws permitted lenders who were licensed and regulated under the laws to charge rates, subject to specified

4. See the remarks of Senator Durbin on the introduction of S. 500, Protecting Consumers from Unreasonable Credit Rates Act of 2009, S. 500, 111th Cong. § 2(1) (2009), "If a lender can't make money on 36 percent interest, then maybe the loan shouldn't be made."

5. CURRAN, *supra* note 3, at 5.

6. *Id.* at 16.

7. Consider a small loan of $300 under these statutes repayable at the end of a year (for ease of computation) at a usury rate of 10%. The lender receives $30 to cover the cost of making and administering the loan, the cost of money to the lender, taxes, a reserve for bad debt, and profit. If instead $3000 were loaned on the same terms, the lender would receive $300. A dollar only stretches so far.

As William M. Clark, in his study entitled *An Economic Analysis of the Oklahoma Installment Loan Industry* wrote:

> [C]onsider a small Installment Loan office with 750 active accounts and receivables of $250,000, which typically incurs fixed costs (including salary, rent, etc.) of approximately $166 per loan per year while variable costs (such as the cost of capital and bad debt expense) account for around thirty-five percent of loans outstanding. Given this model . . . [the total annual cost of a $100 loan would be 201%, and of a $500 loan, 68%]. . . . [A] minimum APR of about eighty percent is needed to recover operating costs on an average small loan. Including . . . [taxes and a return on invested capital] . . . implies a breakeven APR of over one hundred percent. Considering this cost structure, Installment Loan APRs ranging from 70.38 percent (on a ten-month $800 loan) up to 240 percent (on a one month $10 loan) are economically necessary. . . .

60 CONSUMER FIN. L.Q. REP. 487, 492–93 (Fall 2006) (on file with author). Payday loans present similar statistics, except involving smaller amounts and shorter terms, which drives the necessary APR even higher; the average in Colorado in 2007 was 318%, but could be as high as 521% for a 14 day loan of $300 at the maximum $60 finance charge. Press Release, Colo. Attorney Gen., Attorney General's Office Releases Annual Lending Data (Nov. 3, 2008), http://www.coloradoattorneygeneral.gov/press/news/2008/.

ceilings,[8] in excess of the maximum rates permitted under applicable usury statutes for small loans of $300 or less. It was thought that loan sharks, with exorbitant rates and unscrupulous collection methods, would be forced out of business because of this legislation.[9]

Other inroads on usury laws also developed once the ice was broken. For example, in 1910 Arthur Morris devised the Morris Plan, which involved a loan at usury rates and a "separate" transaction where the borrower deposited installments into a "savings account" with the lender. The account balance ultimately was used to pay off the loan at maturity.[10] The deposits with the lender effectively reduced the amount the lender had outstanding on the loan, which was earning interest on the full amount lent and so the effective interest rate was almost doubled. Courts permitted this device, just as they permitted the common law time price doctrine; judges also recognized reality. There also were separate pawnbroker laws, which invariably allowed a greater rate than the usury rate. Without going into more detail, exceptions to the usury laws proliferated as the twentieth century progressed until the usury laws controlled very little of the price for credit, and perhaps justifiably so as a realistic matter.[11]

However, there was a down side to this pattern. It existed in these numerous specialized exceptions to the usury law that were designed to help consumers in favor of a particular types of creditors. The exceptions generally were reflective of the type of credit extended by that class of creditor. Thus banks, thrifts, and large consumer finance companies specialized in larger, longer-term loans and required more

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8. Under section 13 of the 1942 Uniform Act, 36% on the first $100 of a loan and 24% on any larger balance, computed as simple interest, and no other charges were allowed. UNIFORM SMALL LOAN LAW § 13 (Seventh Draft, as revised 1942).

9. CURRAN, *supra* note 3, at 6.

10. *Id.*

11. *Id.* at 45–123. "Ironically, usury ceilings are most harmful to the citizens they were apparently designed to protect – relatively poor credit risks." Robert Reich, *Consumer Financial Services: Policy Session* [Edited Version] (Office of Policy Planning & Research, Federal Trade Commission, Washington, D.C.), Oct. 25, 1979, at 139 (on file with the author).

Thus, essentially usury laws do not serve their purpose; good credit risks do not need them and they do not provide low rate credit to bad credit risks but rather deny them any legal credit. Usury laws, like prohibition, are at best theory, and legislative and judicial relief from them is not a result of creditor greed and successful lobbying but rather of solicitude to consumers who need legal credit.

collateral and better credit histories than did lenders that made smaller, shorter-term loans, and who thus needed higher rates. Such a pattern, as well as the cost structure for the particular class of creditor, was reflected in these exceptions. As a result, legal segmentation of the credit market occurred, and when coupled often with an ill-advised attempt to curb what was viewed as possibly "excessive competition," which was thought could lead to abuse, tended to eliminate inter-creditor competition by different types of creditors. These provisions, so-called "convenience and advantage" clauses, limited the number of creditors that could extend a particular type of credit at any one time. As a consequence, banks, for example, tended not to compete for "small loan type customers," and, within their own bank customer group, tended to treat all customers alike. The predictable result was interest rates that tended to rise to the legal ceiling for that type of creditor.[12]

PRESENT

In the 1960s, partly as a result of a report by the National Commission on Consumer Finance[13] and partly due to the threat of significant federal intervention in the consumer credit market through what ultimately became the Consumer Credit Protection Act,[14] the National Conference of Commissioners on Uniform State Laws (NCCUSL or ULC), a 118 year old organization devoted to the preparation and enactment of uniform and model state statutes that, when enacted by the states, will facilitate preservation of the viability of state law within the federal system, began work on a Uniform Consumer Credit Code (U3C).[15] Both the 1969 and 1974 versions of the U3C followed much of the pattern of the earlier small loan laws, including licensing for higher rate lenders, finance and other charge

12. UNIF. CONSUMER CREDIT CODE, Prefatory Note (1974).

13. NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES: REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE 216 (1972).

14. 15 U.S.C. § 1601 (2000); *see also* UNIF. CONSUMER CREDIT CODE, Prefatory Note (1974).

15. Two versions of the U3C were published. UNIF. CONSUMER CREDIT CODE, 7 U.L.A. 285 (1968); UNIF. CONSUMER CREDIT CODE, 7 U.L.A. 88 (1974). For disclosure, your author is a Commissioner from Oklahoma to NCCUSL, and was a co-reporter who worked on the 1974 version of the U3C.

limitations, regulation of agreements and practices, and a range of enforcement methods (private action, administrative, and criminal), but with one major difference; the statute contained no convenience and advantage provisions and it attempted to set similar maximum rates of finance charge for all types of creditors that were also high enough so it was believed that *all creditors* could compete for *all customers*.[16]

This statute was good theory, at least in part, but it lost out to hard reality. Not surprisingly, most creditors did not welcome the abrogation of their legal "monopolies" and were less than enchanted with the opportunity for competition. Indeed the concern over Sears possibly entering into the small loan business at retail locations all over the United States resulted in a non-uniform, so-called "brick wall" provision in the state law of Oklahoma, for example, that precludes a supervised lender from engaging in the business of selling goods at any location where supervised loans are made unless the two locations are separated by walls (a passageway may exist if the public cannot use it).[17] The uniform version of the provision only prohibited a lender selling a low cost, high priced item with the intent to augment yield.

There was some consumer opposition as well, which led Wisconsin to enact a more consumer-oriented version of the U3C. The ten enacting states, excluding Wisconsin, are: Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, and Wyoming. These enactments occurred primarily due to retailer support since the U3C codified the common law time-price doctrine then under attack as an exemption from usury laws. Wisconsin can be counted as an additional state from that perspective, but which added additional consumer protections.

16. UNIF. CONSUMER CREDIT CODE, 7 U.L.A. 88 (1974). The 1974 version basically set maximum rates at 36% for small extensions of credit with lesser rates as the amount of credit increased, or an average annual rate of 18%. There was some variation for open and closed end credit and on balance computations. Also the rates were of "finance charges," a more comprehensive concept than that of "interest." Only ten states enacted the U3C; the remainder of the states retained the traditional legally segregated market.

17. OKLA. STAT. tit. 14A, § 3-512 (2009).

There was a strange flaw in the U3C theory, given the policy of providing rates sufficiently high that competition, rather than legislation, could set the actual rates charged. This flaw was simply that by 1969 a 36% rate for short term, small amount loans was no longer adequate to implement the policy; that ceiling was too low. Oklahoma recognized this, and added a non-uniform amendment. That amendment left U3C § 3.508 alone, which set the maximum rate at 36% for supervised loans.[18] Then Oklahoma also enacted a non-uniform § 3.508B with a much higher maximum "rate" for the smallest credit extension of $29.99 or less,[19] expressed not as a rate but rather as so many dollars per amount of principal,[20] with a similar schedule as principal amounts increased up to $300.[21] Moreover, Oklahoma retained its separate pawnshop act that also allowed significantly higher annual rates,[22] and in later years enacted a deferred deposit lending act,[23] also separate from the U3C, and with more generous rate ceilings than in the U3C.

Other U3C states have somewhat similar patterns. For example, Colorado's U3C sets the maximum rate at 36%,[24] but contains a non-uniform provision akin to Oklahoma's § 3-508B on loans of up to a year and amounts of $1000 or less,[25] and Colorado has a deferred deposit lending act for loans up to $500 for up to 40 days,[26] and a Pawnbroker Act.[27] Idaho goes further and has deregulated under the

18. UNIF. CONSUMER CREDIT CODE § 3.508, 7 U.L.A. 88 (1974). Oklahoma lowered the maximum rate to 30%. In the uniform U3C, a supervised loan is a loan with a rate in excess of 18%. Oklahoma changed this rate to 10%.

19. OKLA. STAT. tit. 14A, § 3-508B (1984). These dollar amounts are higher today, being subject to dollar adjustment under Oklahoma U3C § 1-106. OKLA. STAT. tit. 14A, § 1-106 (1984).

20. Translated, the annual interest rate was approximately 240%. Given the times (Oklahoma's previous maximum rate was 10%), it is obvious why the legislature stated interest rate limits this way.

21. *See* OKLA. STAT. tit. 14A, § 3-508B (1984).

22. OKLA. STAT. tit. 59, § 1501 (2009).

23. *Id.* § 3101 (The finance charge limits are couched in the same language as in U3C § 3-508B).

24. COLO. REV. STAT. § 5-2-201 (1997). The average loan amount under this provision was $16,349 in 2007, and the average APR was 16% for most closed end supervised loans. Press Release, Colo. Attorney Gen., *supra* note 7.

25. COLO. REV. STAT. § 5-2-214 (1997). According to the Press Release, Colo. Attorney Gen., *supra* note 7, the average APR on these loans varied from 65 to 160%.

26. COLO. REV. STAT. § 5-3.1-101 (1997); *see supra* note 7.

27. COLO. REV. STAT. § 12-56-101 (1997). The credit price is 1/5 of the original purchase price of the pawn for each month of the pawn transaction plus the purchase price.

U3C,[28] under its Payday Loan Act,[29] and under its Title Loan Act.[30] Even so, there clearly is a lesser amount of segmentation of the market for consumer credit by legal rate differences in U3C states, when compared to non-U3C states, and to a similar extent, there is less diminishment in competition, less elevation of the consumer cost of credit, and perhaps less opportunity for the numerous "horror" stories that are circulated in other states about "perpetual debt" until relief in the form of bankruptcy eventuates.[31]

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28. IDAHO CODE ANN. § 28-42-201 (2009) (stating that the rate that is agreed upon is the applicable limit).

29. IDAHO CODE ANN. § 28-46-412(4) (2009). A licensee must post its fees expressed as dollars per 100 dollars but no statute sets the fees. *Id.* Of course, federal Truth in Lending will translate this to an annual percentage rate.

30. IDAHO CODE ANN. § 28-46-505 (2009). Again, no statute sets limits and only disclosure of interest, fees and charges is required. *Id.*

31. This is not to say that other factors, such as consumer financial illiteracy and mismanagement of finances and in some cases creditor manipulation and even fraud, are not present and contribute to the economic downward spiral. Nonetheless, there may be only limited experience in these stories. A study by Donald P. Morgan and Michael R. Strain, FED. RESERVE BANK OF N.Y., STAFF REPORT NO. 309, PAYDAY HOLIDAY: HOW HOUSEHOLDS FARE AFTER PAYDAY CREDIT BANS (Nov. 2007) (revised Feb. 2008), concluded:

> Payday loans are widely condemned as a "predatory debt trap." We test that claim by researching how households in Georgia and North Carolina have fared since those states banned payday loans in May 2004 and December 2005. Compared with households in states where payday lending is permitted, households in Georgia have bounced more checks [with resulting fees that, were credit involved, would produce APRs in the three figure range, or more; the Woodstock Institute survey of Chicago banks cited in this study found an average APR of 2400%], complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 bankruptcy protection at a higher rate. North Carolina households have fared about the same. This negative correlation—reduced payday credit supply, increased credit problems—contradicts the debt trap critique of payday lending, but is consistent with the hypothesis that payday credit is preferable to substitutes such as bounced check "protection". . . or loans from pawnshops.

See also Letter from the Governor of South Carolina to the Speaker of the South Carolina House of Representatives (June 2, 2009) (on file with author) vetoing H. 3301, R. 98, 118th Gen. Assem. (S.C. 2009), which would have added significant regulation and limits to payday lending practices, and which cited the above study. Indeed, the experience in Hawaii, where payday lending was increased in loan size in 2003 showed that the higher the supply of payday credit, the lower the problems. The study points out that Oregon and Pennsylvania also have banned payday loans, and New York, New Jersey, and most New England states have never granted entry. The Military Personnel Financial Services Protection Act of 2006, see *infra* note 37, also effectively prohibits payday loans to soldiers and other military personnel and relatives. The study then cites Stegman (2007) who relate that where payday loans are prohibited, "loan sharks" have been observed at check cashing stores waiting to collect from borrowers who have just cashed their paychecks. MORGAN & STRAIN, *supra* note 32 (citing Michael Stegman, *Payday Lending*, 21 J. ECON. PERSPECTIVES 169 (2007)). The moral perhaps is that laws of economics and human nature are not subject to legislation.

THE FUTURE: THE PAST AS PROLOGUE?

Senator Durbin, in his introduction of S. 500, recounts one of the horror stories, as reported in the *Chicago Tribune*. Rosa Mobley took out a car title loan[32] for $1000. Senator Durbin also mentioned that Ms. Mobley lived on Social Security and a small pension. She was charged 300% interest and wound up paying more than $4000 over twenty-eight months.[33] This story perhaps differs from statistics cited

32. *See supra* note 30 for an example of a car title loan statute.

33. Note that under Truth in Lending, this high rate would have to be disclosed. Regulation Z, 12 C.F.R. § 226.18(d)–(e). The author once asked a consumer, who complained to the Oklahoma U3C Administrator that her payments were too high, whether she had noticed the annual percentage rate (which was well over 100%) before entering into the transaction. The reply was the payment amount was what was important. Disclosure clearly can only accomplish so much. Nonetheless, the Clark study, *supra* note 7, at 490, citing an earlier study by Professor Willis Wheat in 1995, found that over 50% of installment loan customers had incomes over $15,000, 27% had a college or trade school education, 53% had borrowed before, and only 21% were over forty five years old and 10% were less than twenty five years old. Thus, a significant number of these customers were not totally uneducated, infirm or inexperienced. The 2006 Clark study, at 498, reported that 73% of installment loan customers had incomes over $15,000, 51% were twenty five years old or older (up to 45), only 8% were over sixty, and 56.4% completed high school or GED, and about 40% had some college, trade school or tech training. Clark, *supra* note 7 at 498. In short, customers of these lenders generally are educated, young to middle age, and working or middle class wage earners. A George Washington University study, on file with the author, found that more than 50% of payday loan customers earned more than $15,000 and up to $49,999. Indeed 39% had incomes of $40,000 or more and about 25% incomes of $50,000 or more. The study found few customers were old; most were 35–64. About 90% of customers had a high school diploma or more—almost 20% had a college degree. A New York Federal Reserve Bank study of a decade later, on file with the author, is consistent, finding the typical customer's age to be 40, the income between $30,000 and $40,000, and 20% to be college educated. The Clark study, at 496, reported that small loan customers were generally aware of the cost of credit and many recognized the high cost of this type of credit.

While there always will be some customers who can be taken advantage of, these statistics suggest that for many that is unlikely, and these customers may well keep abusive practices down. The Clark study, at 498, concludes: the installment loan industry does not exploit disadvantaged persons but rather provides valuable financial services to average persons. Another study by the Financial Services Research Program of the George Washington University School of Business dated January 2009 titled *An Analysis of Consumers' Use of Payday Loans*, Monograph No. 41. Gregory Elliehausen, *An Analysis of Consumers' Use of Payday Loans*, is available at http://www.sbpm.gwu.edu/research/centers/fsrp/pdf/m41.pdf. The George Washington University study concludes that payday loan decisions are purposive and intelligent; payday loans are used a small or moderate number of times during a year, and access to payday loans may increase resiliency to financial difficulties, relax credit constraints without increasing delinquency, and reduce the incidence of financial problems. Moreover, there is evidence to conclude that excessive spending (living beyond one's means) rather than excessive lending is a large part of any problem that exists. The George Washington University study found about 70% spent all or most of their monthly income.

Many small loan customers and customers of payday lenders and pawnbrokers who earn the lower incomes no doubt live from one paycheck or Social Security or other check to another so an emergency causes a need for credit. In these circumstances, why do these people not go to a bank? In *supra* in note 33 about the education, income, and sophistication level of persons who utilize short term, low amount loan credit. As the statistics cited demonstrate, many customers of these lenders are not persons of limited means or education so, for whatever reasons, pawnbrokers and other small loan short term lenders have become "banks for the middle class." Senator Durbin's remedy for what may not be a representative case in S. 500 would require that all fees and finance charges be included in a new usury rate calculation,[34] and would require all creditors, as that term is defined in the Equal Credit Opportunity Act,[35] to conform to that limit of no more than 36%.[36] So, did Senator Durbin and other Congressional members fail to study American economic history, both past and present?[37]

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many cases they do not like or trust a bank or want the more personal service that banks often seem no longer to supply. Moreover, many banks do not want these customers, as the prior discussion points out. However, as a recent news story in the Sunday, September 13, 2009 Minneapolis Star Tribune by Chris Serres notes, that may be changing. U.S. Bancorp, Wells Fargo and Fifth Third Bancorp have begun to market payday loan "type" products to their checking account customers. Chris Serres & Jennifer Bjorhus, *Banks on the Brink*, MINN. STAR TRIB., Sept. 13, 2009. These products perhaps can be offered because the borrowers already are customers and the amount owed is automatically repaid with the next direct deposit. Nonetheless, there is still risk and the loans carry an APR of 120%. Because the lenders are federally chartered, they do not need to follow state laws, except those of their location, which invariably is not limiting. Whether this innovation will continue is open to question as the Office of the Comptroller of the Currency has signaled opposition and of course S. 500 would limit rates to 36%.

34. There is a limited exception for one-time application fees to cover the cost of setting up a new account (the greater of $30 or 5% of the credit limit up to $120) and for a state law allowed late fee (not to exceed either $20 per late payment or $20 per month) and a NSF fee not in excess of $15. However, other fees, for example, default fees, are includable, even though they arise subsequent to the extension of credit and may even be awarded by statute, such as attorneys fees. This will require almost constant recalculation to assure 36% is not exceeded after the fact as penalties are severe; a violation, in addition to the remedies under 15 U.S.C. § 1640 (2000) of Truth in Lending, forfeits principal, interest, fees, charges, and any security interest.

35. 15 U.S.C. § 1691(a)(e) (2000). This definition includes not only persons that regularly extend, renew, or continue credit, but also persons that regularly arrange for such and any assignee of an original creditor that participates in the decision to extend, renew, or continue credit.

36. S. 500 is not the only bill in Congress dealing with this subject. H.R. 1608, 111th Cong. (2009) is essentially the same as S. 500; H.R. 1846, 111th Cong. (2009) is aimed more directly at payday loans, as is H.R. 1214, 111th Cong. (2009). H.R. 1640, 111th Cong. (2009), is more drastic, limiting the annual percentage rate to 15%; a similar bill, H.R. 1610, 111th Cong. (2009), but limited to consumer credit card rates by recipients of TARP money, fixes a maximum rate of 18%; S. 582, 111th Cong. (2009), co-sponsored by Senator Durbin, is like H.R. 1640 in its limit to 15%; and S. 257, 111th Cong. (2009), also co-sponsored by Senator Durbin, would in bankruptcy deny claims for high cost consumer credit, defined as credit carrying a rate that is the lesser of 15% plus the yield on 30 year U.S. Treasury Securities or 36%.

37. Senator Durbin acknowledged that in 2006, Congress enacted the Tallant Amendment to the John Warner National Defense Authorization Act, Pub. L. No. 109-364, § 670 (2006) (codified at 10 U.S.C. § 987) (the Act), that limited the maximum rate on extensions of credit to military personnel and

If so, they are not alone. According to Congressional findings stated in § 2(2) of S. 500, thirty-four states and the District of Columbia have limited annual interest rates to 36% or less for one or more types of consumer credit. But, again, that still leaves other legal sources. S. 500 would leave only those sources where the credit amount is large enough and the time period long enough, and perhaps the borrower creditworthy enough, that enough revenue is produced at an annual rate of 36% to cover cost, risk, and profit.[38] Also, if the coverage of S. 500 stays the same, and no other legislation or regulation intrudes, consumers who have deposit accounts may be able to obtain "credit" of a sort[39] by processing payments electronically or by paper instruments that overdraft the balances in those accounts.[40]

In conclusion, is it reasonable to assume that all these legislators, both state and federal, who support low maximum interest or finance charge rate legislation are ignorant of history and recent experience? Or as several respondents to questions asked on the government website dealing with these bills[41] stated, is it acceptable that the customers of the small amount (credit extensions under an estimated $2000) short term creditors that will be put out of business by some

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their families to 36%. However, the scope of the Act is much narrower than that of S. 500; the Act applies only to payday, title, and tax refund anticipation loans. Even so, it appears these sources of credit are drying up for military personnel, but many other legal sources still exist.

38. Thirty-six percent begins to be feasible on loans over $2000. Given the cost of borrowing funds to lend since non-depository institutions do not have deposits, the cost of placing a credit extension on the books and administering it (one estimate is under S. 500, if enacted, a $100 pawn would make $1.80, but it costs $2.00 to write the loan, and that is before salaries, rent, insurance, taxes, etc.) and the cost of bad debts (often over 15%), the profit cannot be large even at fairly large rates. One estimate is a rate of 99% for small loans is necessary. *See* Questions & Answers on S. 500, http://www.govtrack.us/users/questions.xpd?topic=bill:s111-500; and *supra* note 7.

39. "Credit" is defined as the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer payment. An overdraft plan that provides an agreement to pay overdrafts is thus credit, but one that leaves discretion in the depository institution to do so, or not, is not credit. 15 U.S.C. § 1691(a)(d) (2000).

40. It hardly makes sense to close down payday lenders who essentially charge 400% for "hot checks" and allow financial institutions, by Senator Durbin's own estimate, to charge 3500%. *See* Questions & Answers, *supra* note 38; *see also supra* note 31. Of course, now federal law is moving to plug this "option." *See, e.g.*, Press Release, Sen. Chris Dodd (Sept. 18, 2009); 75 Fed. Reg. 7658 (effective Feb. 22, 2010) (to be codified at 12 C.F.R. pt. 226), which requires consumer consent for over the limit fees on credit card accounts.

41. *See supra* note 38.

of these bills will have to depend on family and friends, on selling their assets at no doubt distressed prices (to other than pawnbrokers), or on illegal loan sharking?—Clearly not.

Senator Durbin's answer is that alternatives to "predatory lending" in the form of small dollar loans with minimal or no fees and affordable repayment periods should be encouraged.[42] Just how that might be accomplished is suggested by H.R. 1610, which would limit the rate of interest chargeable by recipients of financial assistance under the Emergency Economic Stabilization Act.[43] Of course, many of those recipients are scrambling to get out from under that act, and H.R. 1610 is limited to a particular type of credit (credit card accounts) in any case.[44] Thus this hardly is a long term answer.[45] Rather another bill in the 111th Congress, S. 786,[46] may suggest the longer term answer. This 2009 legislation, proposed by Senators Akaka, Schumer, Inouye, and Lieberman, introduced on April 2, 2009, would "encourage" expansion of access to mainstream financial institutions by authorizing the Secretary of the Treasury to award grants to eligible entities, IRC § 501(c)(3) organizations, federally insured depository institutions, state or local government agencies, community development financial institutions,[47] and Indian tribal organizations, to name a few, to establish accounts in federally insured depository institutions for low and moderate income individuals that do not have such an account.[48] The bill also would authorize the Secretary to award demonstration project grants to eligible entities to provide low cost, small loans to consumers as alternatives to "predatory" payday loans.[49] The rate would be that for national credit unions under 12 C.F.R. Part 701, and entities are

42. Protecting Consumers from Unreasonable Credit Rates Act of 2009, S. 500, 111th Cong. § 2(8) (2009) (findings by Congress).

43. H.R. 1610, 111th Cong. (2009).

44. *Id.*

45. Of course, the Community Reinvestment Act, which encourages credit extensions to many of these types of customers by the use of "gentle pressure," would still remain.

46. S. 786, 111th Cong. (2009).

47. Community Development Banking and Financial Institutions Act, Pub. L. No. 103-325, Title I, § 103(5), 12 U.S.C. § 4702 (1994). *See also* proposed legislation, H.R. 1983, 111th Cong. (2009).

48. S. 786, 111th Cong. (2009).

49. *Id.*

mandated to offer financial literacy and education opportunities by courses or counseling services. The clincher is § 6 of the bill; the Secretary has appropriated funds *as are necessary* to carry out these programs. In short, the government indirectly is going into the small loan business, and will "compete" with private industry without some of the costs and using the private industries' own dollars, as well as subsidy from more creditworthy consumers.

CONCLUSION

Congress is saying, "I can get it for you at less than the amounts others may have to pay by in essence reallocating some of what they will pay to subsidize your credit cost." There is a return to the past here, but with a new wrinkle: you won't be denied credit and you won't have to pay more either. Elections really do matter.