

## Article

# Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits

Christopher L. Peterson<sup>†</sup>

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<sup>†</sup> Associate Professor of Law, University of Florida, Fredric G. Levin College of Law. The author wishes to thank the following for helpful conversations, comments, encouragement, research assistance, and suggestions: Michael Barr, Mark Fenster, Julie Hill, Pat McCoy, Robert Lawless, Ronald Mann, Gregory Mark, Tera Peterson, Greg Polsky, Geoff Rapp, Ralph Rhoner, Elizabeth Warren, Larry Winner, Steven Willis, and Michael Wolf. The author also wishes to thank panelists and observers who commented on early versions of this research in connection with presentations at the 2007 Law and Society Association Conference at Humboldt University in Berlin, a plenary presentation at the National Association of Consumer Agency Administrators annual meeting in Philadelphia, the Second Annual Conference on Empirical Legal Studies at New York University, the California Consumer Affairs Association 33rd Annual Conference in Los Angeles, and speeches at The Ohio State University Moritz College of Law and University of Utah, S.J. Quinney College of Law. Errors are mine alone. This Article was supported by generous faculty development assistance from the University of Florida. Copyright © 2008 by Christopher L. Peterson.

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Throughout the history of the American Republic, all but a small minority of states have capped interest rates on loans to consumers with usury law. But in the past twenty years, for a variety of complex historical, macroeconomic, and cultural reasons, these rules have increasingly yielded to a new, largely unregulated credit marketplace. While many different types of businesses have stepped into this breach in the edifice of consumer protection law, payday lenders have been at the financial services industry vanguard. While payday lending was virtually nonexistent in 1985, by 2002 it exploded into an industry with over twenty-five thousand retail outlets nationwide, more than McDonald's, Burger King, Sears, J.C. Penney, and Target stores combined.<sup>1</sup> Today this industry, despite spending millions on lobbying and public relations,<sup>2</sup> is at the center of an inferno of rage and public controversy.<sup>3</sup>

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1. HOWARD KARGER, *SHORTCHANGED: LIFE AND DEBT IN THE FRINGE ECONOMY* 73–74 (2005); see also Rani Gupta, *High Living Costs Help Perpetuate Poverty*, PALM BEACH POST, Jan. 8, 2006, at 1C (discussing the effect that payday lending has had on the poor in the United States).

2. Recently, the Community Financial Services Association, a trade association of payday loan companies, began a multimillion dollar public relations blitz to stem rising criticism of social fallout from their financial products. Stuart Elliott, *Critics of Lending Practices Adopt a Harder Edge*, N.Y. TIMES, Mar. 6, 2007, at C6; Sue Kirchoff, *Payday Lenders Craft User Protections: Voluntary Guides Not Enough, Consumer Advocates Maintain*, USA TODAY, Feb. 22, 2007, at 1B; Susanne M. Schafer, *Payday Loan Industry Acts to Quell Criticism: The Lender's Trade Group Plans Changes, but Consumer Advocates and Lawmakers Remain Wary*, L.A. TIMES, Mar. 8, 2007, at C8.

3. See Don Baylor, *Loopholes Allow Loan Sharks to Prey on Hardworking Texans*, SAN ANTONIO EXPRESS-NEWS, Feb. 16, 2007, at 9B; Robert H. Frank, *Payday Loans Are a Scourge, but Should Wrath Be Aimed at the Lenders?*, N.Y. TIMES, Jan. 18, 2007, at C4; Bill Graves, *Legislators Try to Lasso Payday Loans*, OREGONIAN, Mar. 29, 2007, at B1; Carrie Teegardin, *Fierce Debate over Payday Loans*, ATLANTA J. & CONST., Feb. 28, 2007, at A1; Paul Wenske, *Payday Loans—Attorney General Seeks Law Restricting the Industry: Missouri Demands Reforms, the Average Loan Has an Annual Interest Rate of 422 Percent*, KAN. CITY STAR, Feb. 17, 2007, at C1. Even a short survey of the horror stories typical of press coverage of payday lending gives one a sense of the intensity of the public debate on this topic. See, e.g., Bill Graves, *Loans up the Ante for Addict Gamblers*, OREGONIAN, Mar. 18, 2007, at A1 (describing how a

Although usury law has always been a fertile field for legal and economic commentary, recent payday lending trends have stimulated a thoughtful new crop of law review articles. For example, empirical pieces by Creola Johnson and Paul Chessin paint a troubling picture of payday lenders systematically disregarding state consumer-protection laws and intentionally manipulating borrowers into long-term debt traps.<sup>4</sup> Michael Barr has explored ways the government might facilitate less expensive financial services for vulnerable groups.<sup>5</sup> Steven Graves and I have demonstrated that in the absence of strictly enforced usury law, payday lenders cluster around military bases, targeting enlisted personnel and their families.<sup>6</sup> Richard Brooks has argued that government might temper the harsh effects of payday lending by forcing or encouraging the industry to share borrower repayment information with national credit reporting agencies.<sup>7</sup> Ronald Mann and Jim Hawkins have argued that government policy should drive small “Mom and Pop” payday lenders out of business, instead facilitating large pay-

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metalworker and Vietnam War veteran took out 200 different loans all at interest rates of over 300% in a spiral of depression and gambling addiction); Diana B. Henriques, *Seeking Quick Loans, Soldiers Race into High-Interest Traps*, N.Y. TIMES, Dec. 7, 2004, at A1 (describing how a Navy petty officer borrowed \$500 at 390%, which then spiraled into a chain of loans with \$4000 outstanding at interest rates as high as 650%); Cheryl L. Reed, *The ‘Wild, Wild West’ in Loans: Lax Laws Let Lenders Charge as Much as They Want While Borrowers Face Triple-Digit Interest*, CHI. SUN TIMES, Aug. 15, 2004, at 20 (describing how a single mother of three borrowed \$1000 at a 521% interest rate to deal with a financial emergency, which eventually resulted in a \$10,743 debt); Melissa Wahl, *Surge Puts Payday Loans Under Scrutiny: More Regulation Is Called for as Customers Struggle with Interest Rates Exceeding 500%*, CHI. TRIB., May 7, 2000, at 1 (describing how a nurse’s decision to borrow \$600 to meet her child support obligations spiraled into \$10,000 of interest of over the course of two years); Wenske, *supra* (describing how a Wal-Mart sales associate with family medical problems began borrowing to save his family home and ended up paying \$10,000 a year in interest on twelve different loans).

4. Paul Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado’s Deferred Deposit Loan Act*, 83 DENV. U. L. REV. 387 (2005); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1 (2002).

5. Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121 *passim* (2004).

6. Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of “Payday” Loans in Military Towns*, 66 OHIO ST. L.J. 653 *passim* (2005).

7. Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994 *passim* (2006).

day lending companies motivated by reputational constraints.<sup>8</sup> These and many other thoughtful legal pieces are only one part of similar debates raging in economic, geographic, sociological, and public advocacy literatures.

Surprisingly absent from recent discussion is careful nationwide analysis of usury law, the body of law that most directly confronts payday lending's primary feature: high prices. In the Western intellectual tradition, usury law has historically been the foremost bulwark shielding consumers from harsh credit practices. Usury law, "the oldest continuous form of commercial regulation," dates back to the earliest recorded civilizations, and continues to constrain payday lending in many American states.<sup>9</sup> While usury law has generated copious legal analyses at various times in our country such as the late 1960s and early 1970s,<sup>10</sup> the explosion of payday lending around the country nevertheless prompts several unanswered questions. Precisely how has our usury law changed to allow the growth of

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8. Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 *passim* (2007).

9. Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 151–54 (1988).

10. See, e.g., Douglas V. Austin & David A. Lindsley, *Ohio Usury Ceiling and Residential Real Estate Development*, 4 AM. REAL EST. & URB. ECON. ASS'N J. 83 (1976); Marion Benfield, *Money, Mortgages, and Migraine—The Usury Headache*, 19 CASE W. RES. L. REV. 819 (1968); Rudolph C. Blitz & Millard F. Long, *The Economics of Usury Regulation*, 73 J. POL. ECON. 608 (1965); William J. Boyes & Nancy Roberts, *Economic Effects of Usury Laws in Arizona*, 1981 ARIZ. ST. L.J. 35; Barbara A. Curran, *Legislative Controls as a Response to Consumer-Credit Problems*, 8 B.C. INDUS. & COM. L. REV. 409 (1967); Carl Felsenfeld, *Consumer Interest Rates: A Public Learning Process*, 23 BUS. LAW. 931 (1968); S. Hugh High, *Consumer Credit Regulation in Texas—A Rejoinder by an Economist*, 50 TEX. L. REV. 463 (1972); Robert W. Johnson, *Regulation of Finance Charges on Consumer Instalment Credit*, 66 MICH. L. REV. 81 (1967); Robert L. Jordan & William D. Warren, *A Proposed Uniform Code for Consumer Credit*, 8 B.C. INDUS. & COM. L. REV. 441 (1967); Robert L. Jordan & William D. Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387 (1968); Michael Kawaja, *The Case Against Regulating Consumer Credit Charges*, 5 AM. BUS. L.J. 319 (1967); Homer Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445 (1968); Gene C. Lynch, *Consumer Credit at Ten Per Cent Simple: The Arkansas Case*, 1968 U. ILL. L.F. 592; James R. Ostas, *Effects of Usury Ceilings in the Mortgage Market*, 31 J. FIN. 821 (1976); Philip K. Robins, *The Effects of State Usury Ceilings on Single Family Homebuilding*, 29 J. FIN. 227 (1974); Robert P. Shay, *The Uniform Consumer Credit Code: An Economist's View*, 54 CORNELL L. REV. 491 (1969); William D. Warren, *Consumer Credit Law: Rates, Costs, and Benefits*, 27 STAN. L. REV. 951 (1975); Ronald W. Del Sesto, Comment, *Should Usury Statutes Be Used to Solve the Instalment Sales "Problem"?*, 5 B.C. INDUS. & COM. L. REV. 389 (1964); *An Empirical Study of the Arkansas Usury Law: "With Friends Like That . . ."*, 1968 U. ILL. L.F. 544.

payday lending throughout the country? Why are usury laws written the way that they are? Do the changes in usury law tell us anything interesting about how law generally and consumer law in particular is made? And, can careful textual analysis of usury statutes provide useful guidance to policy makers and to the public, which must ultimately pass judgment on the national debate over predatory lending? This Article is the first research that systematically categorizes, analyzes, and measures state usury statutes with an eye toward answering these questions.

Accordingly, this Article presents an empirical analysis of all fifty states' usury laws in two time periods: 1965 and the present. A unique data set was created based on a careful mathematical and legal analysis of each state's usury statute. First, the study calculated the highest permissible price of a typical payday loan under each state's usury law. These prices were then translated into an annual percentage rate format following the federal Truth-in-Lending Act (TILA) cost-of-credit disclosure guidelines. Unlike state usury laws, which use a confusing variety of methods for calculating credit prices, the TILA prescribes one uniform, relatively consistent measuring stick for comparing the cost of various forms of credit. Although the TILA requires that all creditors give loan applicants uniform federal price disclosures, it does not require that state legislatures use this federal terminology in state laws. Nevertheless, this study provides a snapshot of what terms state legislatures would have written into law *if* they had used the uniform federal terminology for expressing their state credit price caps. In doing so, this Article suggests a classification of six different basic methods of capping credit prices used by legislatures in the states and time periods studied. Furthermore, this study creates a new method of measuring how misleading a state usury law is. That is, it compares how each state legislature describes its most expensive permissible payday loan, with how that loan is characterized under federal price-disclosure law. It does so by suggesting a new financial concept that I label "salience distortion."<sup>11</sup> For purposes of this Article, salience dis-

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11. While the concept of salience distortion is my own, the importance of salience as a feature of analysis of consumer decision making was perhaps best championed by Amos Tversky and Daniel Kahneman. *See, e.g.*, Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 *SCIENCE* 1124 (1974), reprinted in *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES* 3, 11 (Daniel Kahneman et al. eds., 11th ed. 1991) ("In addition to familiarity, there are other factors, such as salience, which af-

tortion is the absolute value of the difference between the annual percentage rate of a usury statute's most expensive permissible loan and the most prominent, or salient, number ten in the statutory language limiting the price of the loan.<sup>12</sup> Using this concept, the study develops a scale variable that measures the extent to which the most salient price term in any given state usury law underemphasizes or overemphasizes the true price of credit. While in this Article I use salience distortion in the context of credit pricing, this new theoretical concept may prove useful not only to consumer and commercial law scholars, but also to any scholars studying legislative misuse of numeric information. Potential future applications of this theory include environmental law, tax law, and budget analysis.

Although this Article methodologically relies on the federal TILA as a tool for evaluating usury laws, the intellectual contribution of this piece is less about truth-in-lending than it is about truth-in-legislation. This Article presents three empirical findings: since 1965 usury law has become more lax, more polarized, and (perhaps most interestingly) more misleading. These empirical conclusions give rise to several deeper insights. First, these findings suggest that the language in current state usury laws is not chosen because it helpfully describes some expectation of commercial behavior. Rather, legislatures have chosen the language of most current credit price caps because it sounds in an ancient moral tradition—a mythology of sorts—that roughly delineates popular perception of moral and immoral interest rates.

Second, these findings should serve as compelling evidence of the power of what behavioral economists call “framing effects.” This study demonstrates that states that have legalized triple-digit annual percentage rate consumer loans for the working poor use small and misleading numbers in their legal texts to do so. This suggests that political leaders understand what many traditional neoliberal economists apparently do not. In the real world how a value is described can be much more important than the value itself. Many state legislatures use

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fect the retrievability of instances.”); Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economists*, 93 AM. ECON. REV. 1449, 1468 (2003) (revised lecture accepting Nobel prize in economics) (“[T]he likelihood that the subject will detect a mis-weighting of some aspect of the information depends on the *salience* of cues to the relevance of that factor . . . .” (emphasis added)).

12. For further elaboration of this concept, see *infra* Part II.B.

small, innocuous numbers in usury law because they are attempting to minimize the public and media outcry over their decision to legalize triple-digit interest rate loans.

Finally, this Article raises a surprising point about the nature of commercial regulation in a federal system. For years the financial services industry has complained about the high costs of complying with the patchwork of nonuniform consumer protection laws adopted by each state. But, variation in the degree to which credit prices are capped is not what makes state-based regulation costly. Rather it is the tremendous variety and ambiguity of methodologies used by states to calculate those price caps that makes compliance difficult. Ironically, it has been credit industry lobbyists who, state-by-state, have built a host of exceptions (and exceptions to exceptions) into the financial methodology of usury law—all with an eye toward driving up maximum credit prices without appearing to do so—that created the high costs of nonuniformity.

Part I of this Article provides a concise background discussion of American usury law and the payday lending industry. Part II sets out the methodology of this piece, including both a basic description of the financial and accounting concepts necessary to measure the effect of usury law on typical payday loans and an exposition of the salience distortion concept. Part III presents empirical findings. Parts IV and V analyze these findings and offer policy recommendations.

## I. HOW MUCH IS TOO MUCH?

Usury law has exerted significant influence over the development of the American financial services industry. Section A of this Part provides a short description of the evolution of American usury law. Section B introduces the payday lending industry.

### A. USURY LAW IN THE AMERICAN TRADITION

As a nation, America has historically been deeply committed to usury law. This commitment sounds, in an ancient moral tradition, skeptical of the advisability of high-cost loans to those with limited means. The immediate forbearers of American usury law were English, the Statute of Anne in particular, which capped interest rates with a simple nominal annual rate of 5%.<sup>13</sup> English usury law was a product of a theological view

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13. Act to Reduce the Rate of Interest, 1713, s Ann., c. 16 (Eng.).

of the moral limits of acceptable lending practices.<sup>14</sup> While Charlemagne and many other early medieval papal and feudal leaders prohibited taking any interest at all, in the fifteenth and sixteenth centuries many voices in the Catholic Church settled on a 5% limit.<sup>15</sup> In 1461, Pope Paul II gave his tacit approval to charitable pawnshops to charge a 6% simple nominal annual rate.<sup>16</sup> Protestant reformers, such as Martin Luther, argued more explicitly that interest rates of 5%–6% were moral, and that even 8% was permissible in some cases.<sup>17</sup>

The first American usury laws grew directly out of shared public consciousness and acceptance of these specific numbers handed down by their moral traditions. The first American usury law, adopted by the Massachusetts colony in 1641, predates the U.S. Constitution by nearly 150 years.<sup>18</sup> That statute echoed Luther's position, limiting rates to no more than 8% per annum.<sup>19</sup> While the thirteen original American states were divided on many legal issues, as illustrated in Table 1, *infra*, they unanimously adopted usury laws capping interest rates. Early American usury laws were all written in clear terms, specifying a maximum simple nominal annual interest rate.<sup>20</sup> These seminal American statutes were undiluted, trim, and perhaps even elegant in comparison to contemporary statutes that employ a variety of different types of interest rates and include a host of exceptions for various fees and different types of lenders.<sup>21</sup>

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14. See NORMAN JONES, *GOD AND THE MONEYLENDERS: USURY AND LAW IN EARLY MODERN ENGLAND* 47–48 (1989).

15. See SIDNEY HOMER & RICHARD SYLLA, *A HISTORY OF INTEREST RATES* 78, 82 (4th ed. 2005).

16. See *id.* at 76.

17. See *id.* at 77.

18. See RANSOM H. TYLER, *A TREATISE ON THE LAW OF USURY, PAWNS OR PLEDGES, AND MARITIME LOANS* 50 (1891).

19. See *id.*

20. See, e.g., *Stovall v. Ill. Cent. Gulf R.R. Co.*, 722 F.2d 190, 192 (5th Cir. 1984) (“[T]he general American rule [is] that when interest is allowable, it is to be computed on a simple rather than compound basis in the absence of express authorization otherwise.”); *Stricklin v. Cooper*, 55 Miss. 624, 624 (1878) (holding that it is impermissible to charge interest on interest); *Greenmoss Builders, Inc. v. Dun & Bradstreet, Inc.*, 543 A.2d 1320, 1323–24 (Vt. 1988) (“Simple interest has long been the common law method of calculating interest on a damages award in this state.”); *Flannery v. Flannery*, 5 A. 507, 508–10 (Vt. 1886) (discussing the calculation of interest rates).

21. See, e.g., HOWARD BODENHORN, *STATE BANKING IN EARLY AMERICA: A NEW ECONOMIC HISTORY* 287–88 (2003) (stating that all early American banks accepted the limits of usury law as a matter of course).

Table 1. State Usury Limits at Independence<sup>22</sup>

State	Maximum Annual Rate (%)	Year Adopted
Connecticut	6	1718
Delaware	6	1759
Georgia	8	1759
Maryland <sup>a</sup>	6	1692
Massachusetts	8	1641
New Hampshire <sup>b</sup>	6	1791
New Jersey	7	1738
New York	7	1737
North Carolina	6	1741
Pennsylvania	6	1700
Rhode Island	6	1767
South Carolina	8	1748
Virginia	5	1734

<sup>a</sup> Loans payable in tobacco or other property were capped at 8%.

<sup>b</sup> New Hampshire adopted its first usury statute after independence.

The public spirit behind these rules is perhaps best exemplified by the thinking of America's "first Great Man of Letters."<sup>23</sup> In the preface to the twenty-fifth anniversary issue of *Poor Richard's Almanac*, Benjamin Franklin expressed the profound skepticism of the social and moral consequences of the consumer over indebtedness generally accepted by Colonial America:

[T]hink what you do when you run in debt; you give to another power over your liberty. If you cannot pay at the time, you will be ashamed to see your creditor; you will be in fear when you speak to him; you will make poor pitiful sneaking excuses, and by degrees come to lose your veracity, and sink into base downright lying; for, as Poor Richard says, *the second vice is lying, the first is running in debt*. . . . When you have got your bargain, you may, perhaps, think little of payment; but *creditors*, Poor Richard tells us, *have better memories than debtors*; and in another place says, *creditors are a superstitious sect, great observers of set days and times*. The day comes round before you are aware, and the demand is made before you are prepared to satisfy it, or if you bear your debt in mind, the term which at first seemed so long will, as it lessens, appear extremely short. Time will seem, to have added wings to his heels as well as shoulders. *Those have a short lent*, saith Poor Richard, *who owe money to be paid at Easter*. Then

22. TYLER, *supra* note 18, at 50–53.

23. Leonard W. Labaree, *Benjamin Franklin's British Friendships*, 108 PROC. AM. PHIL. SOC'Y 423, 426 (1964) (quoting Scottish philosopher David Hume).

since, as he says, *The borrower is a slave to the lender, and the debtor to the creditor*, disdain the chain, preserve your freedom; and maintain your independency: be industrious and free; be frugal and free.<sup>24</sup>

This deep American skepticism of consumer lending encouraged a legal commitment to limited interest rates that continued largely unabated through the end of the nineteenth century.<sup>25</sup> While from time to time states experimented with eliminating usury laws, these experiments tended to be short and regarded as failures.<sup>26</sup> Collectively the early American commitment to interest-rate caps with nominal annual interest rates in this range created a type of folklore, or even a mythology, of the acceptable pricing in the use of money.

American usury law entered a second phase at the beginning of the twentieth century. In the late 1800s and early 1900s, enforcement problems facilitated the development of a large group of high-cost lenders charging triple-digit interest rates of 500% and beyond.<sup>27</sup> While these businesses referred to themselves as salary lenders, they were popularly known as loan sharks.<sup>28</sup> Unlike the stereotypical Hollywood-organized crime imagery (which came much later), turn-of-the-century loan sharks did not rely on violence or extortion.<sup>29</sup> But, they did charge extremely high prices for loans with short initial durations that frequently turned into crippling long-term debts.<sup>30</sup> These companies managed to conduct business profitably using a variety of legal ruses and questionable practices, including confessions of judgment, developing mutually profitable rela-

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24. Benjamin Franklin, *The Way to Wealth*, in THE NORTON ANTHOLOGY OF AMERICAN LITERATURE 221, 225–26 (Nina Baym ed., shorter 6th ed. 2003).

25. See TYLER, *supra* note 18, at 59–60.

26. See *id.* at 59.

27. See HOMER & SYLLA, *supra* note 15, at 428–29; IRVING S. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS 106–11 (1970).

28. As a historical matter, salary lenders, the nation's first loan sharks, engaged in essentially the same business model as today's payday lenders. Payday lenders *are* loan sharks in the most historically correct sense of that word. See LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 49–52 (1999); MICHELMAN, *supra* note 27, at 112–29; LOUIS N. ROBINSON & MAUDE E. STEARNS, TEN THOUSAND SMALL LOANS: FACTS ABOUT BORROWERS IN 109 CITIES IN 17 STATES 11–13 (1930); CLARENCE W. WASSAM, SALARY LOAN BUSINESS IN NEW YORK CITY 26 (1908); Mark H. Haller & John V. Alviti, *Loansharking in American Cities: Historical Analysis of a Marginal Enterprise*, 21 AM. J. LEGAL HIST. 125, 133–34 (1977); Peter R. Shergold, *The Loan Shark: The Small Loan Business in Early Twentieth-Century Pittsburgh*, 45 PA. HIST. 195, 195–96 (1978).

29. See Haller & Alviti, *supra* note 28, at 133–35.

30. See *id.*

tionships with magistrate judges, characterizing loans as a salary assignments, and collections through public humiliation.<sup>31</sup>

Led by an exceptionally energetic social reformer named Arthur Ham, a consensus eventually emerged on a new direction for the law.<sup>32</sup> Ham argued that the best course for reform would be to raise the old traditional usury limits to a point where more mainstream financial institutions could profitably lend small amounts to working-class borrowers.<sup>33</sup> Working with the Russell Sage Foundation, a powerful and well-funded charitable organization funded by the widow of an industrial baron, Ham drafted a model law, which most American states eventually adopted in the early part of the twentieth century.<sup>34</sup>

The Russell Sage Foundation's Small Loan Law required consumer lenders to obtain licenses from state governments.<sup>35</sup> In exchange, states gave these licensed lenders special exceptions to the older usury laws (which generally remained on the books) authorizing interest rates between 2% and 4% per month, or, between 24% and 42% per annum.<sup>36</sup> Competition from mainstream lenders operating under these higher caps, along with aggressive enforcement by courts and state regulators, managed to stamp out salary lending throughout most of the mid-twentieth century.<sup>37</sup>

While the new, more moderate usury limits contained in the Russell Sage-inspired Small Loan Laws undoubtedly lega-

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31. See Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807, 852–55 (2003) (pointing out lax enforcement of state usury limits in the gilded age).

32. See CALDER, *supra* note 28, at 124–35, 143; MICHELMAN, *supra* note 27, at 112–29.

33. See MICHELMAN, *supra* note 27, at 116–17.

34. See ROGER S. BARRETT, COMPILATION OF CONSUMER FINANCE LAWS AND OF USURY, SALES FINANCE, AND ALLIED LAWS, at xiii (1952); CALDER, *supra* note 28, at 134–35, 143. Many of the states that did not use the Russell Sage Foundation model law relied on statutes that legalized “Morris Plan” lending, which facilitated higher real prices by using an add-on interest rate, rather than traditional simple actuarial interest rates. See EVANS CLARK, FINANCING THE CONSUMER 68–72 (1930); FRED H. CLARKSON ET AL., CONSUMER CREDIT AND ITS USES 32 (Charles O. Hardy ed., 1938); PETER W. HERZOG, THE MORRIS PLAN OF INDUSTRIAL BANKING *passim* (1928); NAT’L CONSUMER LAW CTR., THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 2.2.3.1, at 39 (1995).

35. See BARRETT, *supra* note 34, app. at 677.

36. See NAT’L CONSUMER LAW CTR., *supra* note 34, § 2.2.3.1, at 38–40, § 2.3.3.1, at 48.

37. See *id.* § 2.5, at 59.

lized many mutually beneficial transactions, they also diluted the traditionally sparing American perspective on usury law. Once states made an exception to the traditional theologically inspired general usury laws, finding a backstop against further creditor-encouraged deregulation proved difficult.<sup>38</sup> In the mid-twentieth century, each state began to chart its own course, creating exceptions to the traditional usury laws for a variety of types of lenders in a variety of ways.<sup>39</sup> Nevertheless, despite these changes, through the Vietnam War era every state in the union retained an interest-rate cap more or less intellectually indebted to the Ham-era reforms.<sup>40</sup> During all but the last years of the twentieth century, usury limits were the accepted norm in American consumer protection law.<sup>41</sup>

The third, and still current, period in American usury law began in 1978 with the Supreme Court's decision in *Marquette National Bank v. First of Omaha Service Corp.*<sup>42</sup> In this landmark case, the Court confronted for the first time the question of which state usury law applies when a national bank lends money to a consumer across state lines: should the law of the bank's home state or the law of the consumer's home state apply?<sup>43</sup> In a historically dubious interpretation of the Civil War-era National Bank Act of 1864,<sup>44</sup> the Supreme Court concluded that the law of the bank's home state applies.<sup>45</sup> This seemingly innocuous holding was like a gunshot starting a frenzied race-to-the-bottom in American usury law.<sup>46</sup> Recognizing the oppor-

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38. *See id.* § 2.2.3.2, at 40.

39. *See* Peterson, *supra* note 31, at 862–63.

40. *See infra* Part IV for a discussion surveying usury laws from 1965.

41. JOHN A. SPANOGLE ET AL., CONSUMER LAW: CASES AND MATERIALS 682–83 (3d ed. 2007).

42. 439 U.S. 299 (1978).

43. *Id.* at 309–13.

44. National Bank Act, ch. 106, 13 Stat. 99, 108 (1864) (codified as amended at 12 U.S.C. § 85 (2000)).

45. *Marquette Nat'l Bank*, 439 U.S. at 309–13; *see also* BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR 725–34 (1957) (detailing the events that led to the enactment of the National Bank Act); NAT'L CONSUMER LAW CTR., *supra* note 34, § 3.4.5.1.1, at 74–75 (questioning the historical accuracy of *Marquette Nat'l Bank*).

46. *See* DEE PRIDGEN, CONSUMER CREDIT AND THE LAW § 10:29, at 10-47 to -53 (2002); William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 UTAH L. REV. 1009, 1010–11; Robert C. Eager & C.F. Muckenfuss, III, *Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System*, 8 N.C. BANKING INST. 21, 66–67 (2004); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 36–37 (2005); Elizabeth R. Schiltz, *The*

tunity to attract lucrative financial services jobs to their moribund economies, South Dakota and Delaware eliminated their ancient usury laws, allowing national banks headquartered there to “export” the nonexistence of an interest-rate cap to consumers in other states.<sup>47</sup>

State-chartered banks were aghast at their national bank competitors’ newfound power and immediately began lobbying Congress for equal treatment.<sup>48</sup> Two years later Congress complied. But instead of explicitly preempting usury limits, Congress finessed the issue by granting state banks whatever power that was already held by national banks.<sup>49</sup> State legislatures, who were now powerless to constrain the interest rates charged by any bank headquartered in South Dakota or Delaware, capitulated.<sup>50</sup> Seeing no point in punishing local businesses, every other state in the union passed “parity laws” granting their own local banks the right to charge whatever interest rate South Dakota and Delaware banks could import into their jurisdictions via federal law.<sup>51</sup> The end result was what James White called a *trompe l’oeil*—a grand illusion.<sup>52</sup> Every state in the union, save two, had relatively aggressive usury law on the books. And yet, even though no legislature had ever passed a law saying as much, the newly synthesized usury rule became: any bank can charge any interest rate it wants anywhere it wants.

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*Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 619–20 (2004).

47. James J. White, *The Usury Trompe l’Oeil*, 51 S.C. L. REV. 445, 447–48, 464–65 (2000); see also Schiltz, *supra* note 46, at 618–20 (referencing Professor James White).

48. Howard J. Finkelstein, *Most Favored Lender Status for Insured Banks*, 42 BUS. LAW. 915, 918 (1987).

49. 12 U.S.C. §§ 1463(g), 1831a(b), 1831d(a) (2000); see also Federal Deposit Insurance Corporation Notice of General Counsel’s Opinion No. 10, 63 Fed. Reg. 19,258 (Apr. 17, 1998) (interpreting section 27 of the Federal Deposit Insurance Act as providing state-chartered, federally insured banks the same interest rate exporting powers as those granted to national banks under section 85 of the National Bank Act).

50. NAT’L CONSUMER LAW CTR., *supra* note 34, § 3.4.5.1.1, at 74–75 (discussing the effect of “sister-state” preemption).

51. Christian Johnson, *Wild Card Statutes, Parity, and National Banks—The Renaissance of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 368 (1995); John J. Schroeder, *“Duel” Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions*, 36 IND. L. REV. 197, 207 (2003).

52. See White, *supra* note 47, at 445–48.

## B. QUICK CASH: PAYDAY LENDING AND ITS CRITICS

While *Marquette* and its progeny deregulated interest rates banks could charge, they did not necessarily do so for nondepository financial institutions. State usury laws, where they remained on the books, continued to constrain ordinary businesses. Thus, the personal finance companies licensed under state small-loan laws still had to comply with those interest rate caps.<sup>53</sup> Yet, in the 1980s the moral authority of those rules became somewhat suspect. Why should banks be allowed to charge any interest rate while other businesses could not? This, along with relatively high prevailing market interest rates brought about by rampant inflation, gave critics of the usury laws that remained in force ample ammunition to continue battering state usury laws.<sup>54</sup> Emboldened by this new regulatory environment, salary-assignment loan sharks, now using the more colloquial appellation of “payday lender,” reappeared.<sup>55</sup> Since the Federal Trade Commission declared loans in the form of a salary assignment illegal, payday lenders required a slight variation in contractual formalities.<sup>56</sup> Post-dating personal checks for the anticipated duration of a loan was a convenient substitute.

A contemporary payday loan usually involves an initial balance of between \$100 and \$500, with \$325 being typical.<sup>57</sup> Generally the consumer borrows by writing a personal check to the lender for the loan amount plus an additional fee.<sup>58</sup> While there is no agreed upon source of information for payday loans, the Center for Responsible Lending estimates a typical charge of \$52 for a \$325 loan.<sup>59</sup> The borrower “post-dates” the check by writing the due date of the loan one or two weeks in the future, rather than the day on which the consumer actually writes the

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53. See NAT'L CONSUMER LAW CTR., *supra* note 34, § 2.3.1.3.1, at 43.

54. SPANOGLE ET AL., *supra* note 41, at 685.

55. JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWN-SHOPS, AND THE POOR 30–35 (1994).

56. See 16 C.F.R. § 444.2(a)(3) (2007).

57. URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, FINANCIAL QUICKSAND: PAYDAY LENDING SINKS BORROWERS IN DEBT WITH \$4.2 BILLION IN PREDATORY FEES EVERY YEAR 8, 18–19 (2006), [http://www.responsiblelending.org/pdfs/rr012-Financial\\_Quicksand-1106.pdf](http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf).

58. Mann & Hawkins, *supra* note 8, at 861–62.

59. KING ET AL., *supra* note 57, at 8. Many lenders, especially Internet payday lenders, now obtain consent to debit the borrower's back account with an ACH transfer, rather than using a check. See Mann & Hawkins, *supra* note 8, at 868–71.

check.<sup>60</sup> An initial duration of fourteen days is the industry norm.<sup>61</sup> Payday lenders generally do not obtain the borrower's credit history from one of three national credit reporting companies, nor do they generally report the borrower's repayment history later on.<sup>62</sup> Instead, payday lenders verify the debtor's identity by asking for documents or identification such as a driver's license, recent pay stubs, bank statements, car registration, or telephone bills.<sup>63</sup> Some lenders may also call the borrowers' employers to verify a source of income.<sup>64</sup> After the paperwork is complete, the debtor walks away with the loan principal in cash or a check drawn on the lender's account.<sup>65</sup> When the duration of the loan has expired, the lender is repaid by depositing the borrower's check.<sup>66</sup> If the debtor lacks the funds to cover the obligation, most lenders will allow her to pay another \$52 fee in exchange for holding the check another two weeks.<sup>67</sup> If the borrower does nothing, and her check does not clear, most lenders charge an insufficient funds penalty in addition to assessing another \$52 charge every two weeks.<sup>68</sup> Assuming a fourteen-day loan duration, the nominal annual simple interest rate of this prototypical loan is about 417%.<sup>69</sup>

Critics of payday lending allege that loans with triple-digit nominal annual interest rates by their nature often develop into inescapable debt traps. Generally speaking, a high-risk debtor lacking \$325 of liquid assets on any given day is reasonably unlikely to have \$377 two weeks later. Studies by industry-sponsored think tanks,<sup>70</sup> federal regulators,<sup>71</sup> state regulators,<sup>72</sup>

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60. Scott Andrew Schaaf, Note, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. BANKING INST. 339, 341–42 (2001).

61. KING ET AL., *supra* note 57, at 3.

62. See Brooks, *supra* note 7, at 1007.

63. Johnson, *supra* note 4, at 9.

64. Christopher Lewis Peterson, *Only Until Payday: A Primer on Utah's Growing Deferred Deposit Loan Industry*, 15 UTAH B.J. 16, 16 (2002).

65. Johnson, *supra* note 4, at 10–11.

66. *Id.*

67. *Id.*

68. *Id.*; KING ET AL., *supra* note 57, at 3–4.

69. This rate does not include the insufficient funds fee. In order to calculate interest rates using the Annual Percentage Rate Calculation Program for Windows (APRWIN), visit <http://www.occ.treas.gov/aprwin.htm>.

70. See, e.g., GREGORY ELLIEHAUSEN & EDWARD C. LAWRENCE, GEORGETOWN UNIV. MCDONOUGH SCH. OF BUS. CREDIT RESEARCH CTR., PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CUSTOMER DEMAND 38 (2001), [http://www.cfsa.net/downloads/analysis\\_customer\\_demand.pdf](http://www.cfsa.net/downloads/analysis_customer_demand.pdf) (stating that about 35% of borrowers rolled over between one and four times in the preced-

private contractors hired by state governments,<sup>73</sup> consumer advocacy organizations,<sup>74</sup> and academics<sup>75</sup> universally agree that

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ing year, about 9% of borrowers renewed existing loans nine times or more, and about 10% of borrowers renewed fourteen times or more).

71. See, e.g., Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 16–18 (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005), available at [http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP\\_2005-09\\_Flannery\\_Samolyk.pdf](http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf) (determining that high frequency borrowers are more profitable because they generate lower loss ratios and lower operating costs); COMPTROLLER OF THE CURRENCY ADMIN. OF NAT'L BANKS, FACT SHEET: EAGLE NATIONAL BANK CONSENT ORDER 2 (2002), <http://www.occ.treas.gov/ftp/eas/eaglenbfact%20sheet.pdf> (describing payday loan employee compensation incentives for promoting repeat borrowing).

72. See, e.g., N.C. OFFICE OF THE COMM'R OF BANKS, REPORT TO THE GENERAL ASSEMBLY ON PAYDAY LENDING (n.d.) (stating that 14.06% of customers used payday lending as a source of credit nineteen or more times at the same company during the year); LAURA E. UDIS, REPORT OF THE UNIFORM CONSUMER CREDIT CODE REVISION COMMITTEE AND ACTIONS OF THE COLORADO COMMISSION ON CONSUMER CREDIT 23 (1999) (on file with author) (estimating that half of licensed payday lenders authorized to refinance loans do so); Chessin, *supra* note 4, at 400–02 (discussing official Colorado payday loan statistics); ILL. DEPT. OF FIN. INSTS., SHORT TERM LENDING: FINAL REPORT 26 (1999), <http://www.idfpr.com/dfi/ccd/pdfs/shorterm.pdf> (determining that the average payday loan customer earns \$24,000 per year and remains indebted for at least six months); IND. DEPT OF FIN. INSTS., SUMMARY OF PAYDAY LENDER EXAMINATION 3 (1999), <http://www.in.gov/dfi/legal/paydaylend/Payday.PDF> (finding that only 9% of customers had not renewed, and that customers averaged ten renewals of their payday loans); WASH. STATE DEPT OF FIN. INSTS., PAYDAY LENDING REPORT 3 (2003), [http://dfi.wa.gov/news/DFI\\_paydayreport.pdf](http://dfi.wa.gov/news/DFI_paydayreport.pdf) (determining that over 30% of borrowers borrow more than ten times per year, and almost 10% borrow twenty times or more per year).

73. See, e.g., VERITEC SOLUTIONS, FLORIDA TRENDS IN DEFERRED PRESENTMENT: STATE OF FLORIDA DEFERRED PRESENTMENT PROGRAM 12 (2005), [http://www.veritecs.com/FL\\_trends\\_sep\\_2005.pdf](http://www.veritecs.com/FL_trends_sep_2005.pdf) (stating that the average Florida customer borrows 7.9 times per year, and 26.5% of customers borrow 12 or more times per year, which accounts for 57.7% of all transactions); VERITEC SOLUTIONS, OKLAHOMA TRENDS IN DEFERRED DEPOSIT LENDING: OKLAHOMA DEFERRED DEPOSIT PROGRAM 8 (2005), [http://www.veritecs.com/OK\\_trends\\_11\\_2005.pdf](http://www.veritecs.com/OK_trends_11_2005.pdf) (finding that the average Oklahoma customer borrows 9.4 times per year and 26.8% of customers borrow 13 times or more per year, which accounts for 61.7% of all transactions).

74. See, e.g., OR. STUDENT PUBLIC INTEREST RESEARCH GROUP, PREYING ON PORTLANDERS: PAYDAY LENDING IN THE CITY OF PORTLAND 4 (2005), <http://www.uspirg.org/uploads/WX/q1/WXq1aunM3sfFqK6Taixxiw/preyingonportlanders.pdf> (finding that 74% of payday loan borrowers are unable to pay their loan when it comes due); U.S. PUB. INTEREST RESEARCH GROUP, SHOW ME THE MONEY: A SURVEY OF PAYDAY LENDERS AND REVIEW OF PAYDAY LENDER LOBBYING IN STATE LEGISLATURES 8 (2000), [http://www.uspirg.org/uploads/0J/JI/0JJIXjoITQIIpsOOhaP\\_dg/showmethemoneyfinal.PDF](http://www.uspirg.org/uploads/0J/JI/0JJIXjoITQIIpsOOhaP_dg/showmethemoneyfinal.PDF) [hereinafter SHOW ME THE MONEY] (stating that payday loans are designed to keep consumers in perpetual debt).

75. See, e.g., Johnson, *supra* note 4, at 55–72 (discussing the pervasive practice of “rollover” lending and the failure of state laws to adequately ad-

payday borrowers tend to fall into recurring debt patterns. Payday loans are not short-term debts. Because payday loans carry such high prices, and because payday lenders do not use underwriting guidelines to determine borrowers' ability to repay, payday loans typically compound for durations far beyond the initial one or two week due date. Looking past the boilerplate terms written on loan contracts, it is economically more accurate to think of payday loans as medium-term debts with modest prepayment rates.

Critics of payday lending also allege that those most likely to be caught in debt traps are members of vulnerable groups who can least afford triple-digit interest rate pricing. Empirical evidence suggests that in some areas black families are more likely than white families to take out multiple payday loans.<sup>76</sup> Payday lenders disproportionately set up locations in poor and minority neighborhoods.<sup>77</sup> And, payday lenders systematically cluster around military bases with large populations of enlisted personnel.<sup>78</sup>

Despite targeting a clientele of limited means, payday lending has proven wildly profitable. The evidence suggests that payday lending profits come disproportionately from re-

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dress the practice); Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 *ECON. DEV. Q.* 8, 19 (2003) (discussing the "rollover" lending practice and the effect it has on the customer).

76. See Michael A. Stegman & Robert Faris, *Welfare, Work and Banking: The Use of Consumer Credit by Current and Form TANF Recipients in Charlotte, North Carolina*, 27 *J. URB. AFF.* 379, 387–88 (2005) ("African American households are eight times more likely to borrow from a payday lender as whites . . ."); see also MICHAEL A. STEGMAN & ROBERT FARIS, THE CTR. FOR CMTY. CAPITALISM AT THE UNIV. OF N.C. AT CHAPEL HILL, *WELFARE, WORK, AND BANKING: THE NORTH CAROLINA FINANCIAL SERVICES SURVEY 2* (2001), [http://www.ccc.unc.edu/documents/CC\\_welfare.pdf](http://www.ccc.unc.edu/documents/CC_welfare.pdf) (finding that African Americans and Hispanics are half as likely as whites to own bank accounts).

77. See ANTHONY KOLB, REPORT ON: SPATIAL ANALYSIS OF BANK AND CHECK-CASHING LOCATIONS IN CHARLOTTE, NC 14, 27 (1999) (on file with author) (finding that there are four times as many check cashing offices in Charlotte neighborhoods with 10% or greater minority populations than in neighborhoods with 10% or less minorities); Steven M. Graves, *Landscapes of Predation, Landscapes of Neglect: A Location Analysis of Payday Lenders and Banks*, 55 *PROF. GEOGRAPHER* 303, 312–13 (2003) (reporting that payday lenders are disproportionately located in poor and nonwhite Illinois and Louisiana communities).

78. Graves & Peterson, *supra* note 6, at 822 (reporting that in twelve of the nineteen surveyed states, the highest per capita concentration of payday lenders was in a military county).

peat borrowers.<sup>79</sup> By one estimate, approximately 90% of payday lending revenues are based on fees stripped from trapped borrowers.<sup>80</sup> After only a few extensions of the original loan principal, a borrower can find that she has repaid more than the original balance but still owes the same principal.<sup>81</sup> The best available nationwide estimate suggests that the average payday loan borrower repays \$793 for a \$325 loan.<sup>82</sup> Industry observers estimate that, even after charge-offs, most payday lenders earn a return on assets between ten and twenty times greater than traditional banks.<sup>83</sup> Responding to these returns, capital has flooded into the payday lending industry, transforming financial services offered to lower- and middle-class borrowers in little more than a decade. In the early 1990s, payday lending was a small peripheral component of the financial services industry with only a few hundred locations nationwide.<sup>84</sup> Today, payday lending is no longer a “fringe” business.<sup>85</sup> Between 2000 and 2004 alone, the number of payday lender locations more than doubled from 10,000 to 22,000.<sup>86</sup> Investment analysts predict that absent government intervention, this number will nearly double again, growing to upwards of 40,000 by 2011.<sup>87</sup>

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79. PETER SKILLERN, CMTY. REINVESTMENT ASS'N. OF N.C., *SMALL LOANS, BIG BUCKS: AN ANALYSIS OF THE PAYDAY LENDING INDUSTRY IN NORTH CAROLINA 4* (2002) (on file with author) (finding that 3% of customers who borrow twenty-five times or more per year generate 10% of industry revenue, while 16% of customers who borrow once per year generate less than 2% of revenue and borrowers using payday loans five times or more per year account for 85% of total transactions).

80. KING ET AL., *supra* note 57, at 2, 6.

81. See Michael A. Stegman, *The Public Policy Challenges of Payday Lending*, 66 *POPULAR GOV'T.* 16, 19–20 (2001).

82. KING ET AL., *supra* note 57, at 8.

83. Michael Hudson, *Going for Broke: How the 'Fringe Banking' Boom Cashes in on the Poor*, *WASH. POST*, Jan. 10, 1993, at C1; see also *SHOW ME THE MONEY*, *supra* note 74, at 8 (“The Tennessee Department of Financial Institutions reported to its legislature that licensed payday lenders earned over 30% return on investment in the first nine months of legal operation.”).

84. Federal Deposit Insurance Corporation, *An Update on Emerging Issues in Banking: Payday Lending* (Jan. 29, 2003), <http://www.fdic.gov/bank/analytical/fyi/2003/012903fyi.html> (“Industry analysts estimate that the number of payday loan offices nationwide increased from less than 500 in the early 1990’s to approximately 12,000 in 2002, with continued growth expected.”).

85. *Cf.* CASKEY, *supra* note 55, at 30–35 (providing an early analysis of the resurgence in salary lending).

86. Flannery & Samolyk, *supra* note 71, at 2.

87. DENNIS TELZROW & DAVID BURTZLAFF, *STEPHENS, INC. INV. BANKERS*,

A background discussion of the current state of usury law and payday lending demands one additional point. In late 2006, Congress for the first time broke its long silence on the propriety of consumer credit pricing, albeit for a special subset of the population. Recognizing the troubling implications of payday lenders clustering around military installations, Congress adopted a 36% interest-rate cap on loans to all military personnel and their dependents.<sup>88</sup> In hearings preceding passage of the statute Congress pointed to research identifying this pattern.<sup>89</sup> It remains to be seen whether the new congressional usury law for military service members will be the first step returning to more traditional credit-pricing limits for all Americans.

## II. METHODOLOGY: THE ANATOMY OF A PRICE CAP

This study is unique in that no research has yet systematically measured state usury laws by translating them into a single uniform terminology. Because states have written their usury laws with a hodgepodge of different accounting methods and legal terminology,<sup>90</sup> policy makers, the press, and the public cannot easily compare the extent to which different states have actually provided meaningful consumer protection to their residents. This study explores whether these different methods create significant variations in prices that can be more accurately revealed by using one actuarially sound pricing terminology. This is possible because while there is no accepted method for *capping* loan prices, there is a uniform national method of *comparing* loan prices. Indeed, the federal TILA was

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88. John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a), 120 Stat. 2083, 2266 (2006) (to be codified at 10 U.S.C. § 987(b)) (“A creditor . . . may not impose an annual percentage rate of interest greater than 36 percent with respect to the consumer credit extended to a covered member or a dependent of a covered member.”).

89. See *A Review of the Department of Defense’s Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 109th Cong. (2006) (written testimony of Christopher Peterson, Associate Professor, University of Florida, Fredric G. Levin College of Law), available at [http://banking.senate.gov/\\_files/ACF7541.pdf](http://banking.senate.gov/_files/ACF7541.pdf) (discussing predatory lenders clustering around military bases); *Financial Service Needs of Military Personnel and Their Families: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 109th Cong. 7 (2006) (statement of Rep. Maxine Waters).

90. See *infra* text accompanying notes 120–22.

designed to do exactly this: provide an accurate way to compare loans.<sup>91</sup> Section A of this Part explains how the TILA's federal price comparison rules can be used to compare and contrast the most expensive payday loans allowed in each state. Moreover, Section B suggests a new way of measuring the extent to which states deviate from the TILA's descriptive conventions in their usury statutes.

#### A. MEASURING USURY LIMITS: A NEW APPLICATION OF THE TRUTH-IN-LENDING ACT

This Article measures usury law by calculating the most expensive typical payday loan permissible in each state. Currently the best available evidence estimates that the prototypical American payday loan involves a cash advance of \$325 for fourteen days.<sup>92</sup> Assuming a hypothetical loan with these two characteristics, one can calculate a maximum dollar amount that a lender may legally charge in any given state.<sup>93</sup> The price of each state's most expensive permissible loan is then expressed using the uniform credit-pricing terminology created by the federal Truth-in-Lending Act (TILA).

In 1968, Congress adopted the TILA,<sup>94</sup> a disclosure statute, in hopes of providing a more efficient way for consumers to compare the cost of credit.<sup>95</sup> Under the TILA, there are four key components in the pricing of a payday loan: the amount financed, the finance charge, the total of payments, and an an-

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91. NAT'L CONSUMER LAW CTR., *supra* note 34, § 4.4.1, at 121–22.

92. KING ET AL., *supra* note 57, at 3, 18–19. Unfortunately, there are no publicly available statistics estimating a national mean payday loan principal or initial duration. The King et al. study comes as close as possible by compiling information from industry sources as well as information from nineteen different state regulators. *See id.* at 18 (estimating the average payday loan amount).

93. Many states allow different types of lenders to charge different prices based on what type of loan is offered and whether the necessary licensing requirements have been met. In selecting which price-rate cap to measure, this study analyzed each potential cap in each statute and selected the cap that would allow the highest price for the hypothetical loan. This study presumed that any necessary licensing requirements were satisfied.

94. Truth-in-Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601–1667e (2000)).

95. 15 U.S.C. § 1601(a) (“It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him . . . .”); *see also* Peterson, *supra* note 31, at 875–902 (discussing the TILA's legislative history, purpose, and efficacy).

nual percentage rate.<sup>96</sup> An amount financed is roughly equivalent to the principal of the loan—“the amount of credit of which the consumer has actual use.”<sup>97</sup> A finance charge includes all charges incident to the extension of credit expressed as a dollar amount.<sup>98</sup> Roughly speaking, the finance charge is the *price* of a loan.<sup>99</sup> Importantly, as defined under federal law, the finance charge includes not only interest paid on the loan, but also most fees and closing costs.<sup>100</sup> The term “total of payments” refers to the total amount of money a borrower must repay under the loan contract.<sup>101</sup> Accordingly, in a payday loan the total of payments is generally equivalent to the amount financed plus the finance charge.<sup>102</sup> Finally, the annual percentage rate, or “APR” as it is commonly abbreviated, is an actuarially sound measure of the cost of credit expressed as a yearly rate that relates to the amount and timing of value received by the consumer to the amount and timing of payments made.<sup>103</sup> Although the annual percentage rate is expressed as a rate, it is not an interest rate.<sup>104</sup> Rather, it is simply an annualized ex-

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96. See 15 U.S.C. §§ 1605, 1606, 1638.

97. *Id.* § 1638(a)(2)(A); see also PRIDGEN, *supra* note 46, § 6:10, at 6-29 to -30 (discussing the requirement to disclose the amount financed); RALPH J. RHONER & FRED. H. MILLER, TRUTH-IN-LENDING ¶ 5.05[2], at 294–97 (Robin A. Cook et al. eds., 2000 & Supp. 2003) (describing the computation of and required disclosure within statutorily defined “amount financed”).

98. For definitions of “finance charge,” see 15 U.S.C. § 1605(a) and 12 C.F.R. § 226.4(a) (2007).

99. See 15 U.S.C. § 1605(a); 12 C.F.R. § 226.4(a).

100. See 12 C.F.R. § 226.4(a)–(b), for a definition of which fees are included within the finance charge disclosure. Late fees and other contingent charges are not included within the definition of a finance charge. *Id.* § 226.4(c)(2). Congress and the Federal Reserve Board of Governors have come under criticism for making exceptions for some fees, particularly with respect to real estate loans. For example, in a home mortgage, money paid by the consumer to the lender to acquire a credit report is counterintuitively not considered a charge incident to the extension of credit. *Id.* § 226.4(c)(7)(iii). Most of the more controversial exceptions, however, are not relevant to this study.

101. In installment loans, the total of payments is equivalent to the sum of all scheduled payments. RHONER & MILLER, *supra* note 97, ¶ 5.05[8], at 319–20.

102. The total of payments disclosure is optional in single payment loans. 12 C.F.R. § 226.18(h) & n.44. Prepaid finance charges need not be included in the total of payments. RHONER & MILLER, *supra* note 97, ¶ 5.05[8], at 319–20. In most payday loans no prepaid finance charges are involved. Accordingly, the total of payments in a payday loan will generally be the sum of the finance charge and the amount financed.

103. 15 U.S.C. § 1606(a) (defining annual percentage rate).

104. See NAT’L CONSUMER LAW CTR., *supra* note 34, § 4.4.1, at 121–22 (distinguishing annual percentage rates from interest rates).

pression of the ratio between the finance charge and the amount financed.<sup>105</sup>

Comparing loans with an annual percentage rate is much more accurate than attempting to make comparisons with the ambiguous notion of an interest rate. Although it is common to speak casually about credit in terms of an interest rate, this concept is surprisingly ambiguous and subject to manipulation.<sup>106</sup> An interest rate is subject to manipulation because of the different time periods for which it can be quoted, the various modes of calculation, and the associated fees. Interest rates can be quoted in terms of a daily, monthly, annual, or any other nominal time period.<sup>107</sup> Interest rates can be calculated as simple or effective rates.<sup>108</sup> Nominal interest rates can be calculated as simple rates, as add-on rates, or discount rates—all of which generate widely varying prices for loans.<sup>109</sup> Moreover, unlike an annual percentage rate, none of these concepts capture the added price of ancillary fees or closing costs associated with a loan.<sup>110</sup> Unless one clarifies and understands the math and accounting behind all of these terms, the concept of an “interest rate” is essentially meaningless and prone to great mischief. In contrast, federal law defines and prescribes the annual percentage rate.<sup>111</sup> Quoting an annual percentage rate is generally more reliable because the concept is based on an actuarially sound methodology that generates a uniform standardized “yardstick” by which to compare all types of loans.<sup>112</sup>

This study examines loan-price limits in two time periods: the law in force in 1965 and current law. The study uses mid-twentieth century usury laws to provide a basis of comparison to current law to illustrate how usury law has changed in recent generations. The year 1965 was chosen in particular because it provides a good snapshot of traditional usury laws in

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105. 15 U.S.C. § 1606(a)(1)(A); PRIDGEN, *supra* note 46, § 6:9, at 6-24 to -29.

106. See Peterson, *supra* note 31, at 853.

107. See NAT'L CONSUMER LAW CTR., *supra* note 34, § 4.3, at 99 (stating that there is a periodicity to interest calculations).

108. Simple interest accrues on money borrowed but not previously accrued interest. BLACK'S LAW DICTIONARY 830 (8th ed. 2004). An effective, or compound interest rate includes interest both on the money borrowed as well as previously accrued interest. *Id.* at 830–31.

109. These terms are discussed further *infra* notes 120–22 and accompanying text.

110. 15 U.S.C. §§ 1605, 1606(a).

111. *Id.*

112. PRIDGEN, *supra* note 46, § 6:9, at 6-24 to -29.

force throughout most of the twentieth century. By the mid-1960s the Russell Sage Foundation's influential model small-loan law was in its fully mature seventh draft.<sup>113</sup> By 1959, all fifty states had been admitted to the Union.<sup>114</sup> The financial hardship and trauma associated with the Great Depression and World War II were receding,<sup>115</sup> and America's "greatest generation"<sup>116</sup> had assumed control of the government. The year 1965 also predates passage of the Consumer Credit Protection Act in 1968, which complicated consumer law by shifting the focus of policymaking away from contract restrictions to disclosure.<sup>117</sup> Finally, the American Bar Association published Barbara Curran's treatise on consumer credit pricing in 1965, creating a useful historical record and cogent legal classification of usury limits upon which this study extensively relies.<sup>118</sup>

To compare current usury laws to those in effect in 1965, the current typical payday loan size of \$325 was adjusted for inflation to its relative value in the earlier time period. Legislation adopted in 1965 likely would have governed loans made in the subsequent year. This study, therefore, converted the value of 2006 dollars (the most recent year with conversion factors available at the inception of this project) into the value of 1966 dollars using the Consumer Price Index's conversion factor of 0.161.<sup>119</sup> Accordingly, this study estimates that a typical contemporary loan of \$325 would have had a value of approximately \$52.33 in loans governed by 1965 usury law.

In 1965, states limited prices on a two-week loan of \$52.33 in one of four basic ways. First, thirty-five states articulated their price limit with a simple monthly or annual nominal in-

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113. See George G. Bogert, *The Future of Small Loan Legislation*, 12 U. CHI. L. REV. 1, 4 (1944) (noting that the seventh draft was formed in 1942 and was influential in small loan laws).

114. See An Act to Provide for the Admission of the State of Hawaii into the Union, Pub. L. No. 86-3, 73 Stat. 4 (1959) (admitting the fiftieth state, Hawaii, to the Union).

115. See Christina D. Romer, *What Ended the Great Depression?*, 52 J. ECON. HIST. 757, 757-61 (1992) (discussing the economic factors that brought the United States out of the Great Depression).

116. TOM BROKAW, *THE GREATEST GENERATION* 3-12 (2004).

117. Peterson, *supra* note 31, at 880.

118. BARBARA A. CURRAN, *TRENDS IN CONSUMER CREDIT LEGISLATION* 158-66 (1965).

119. Robert C. Sahr, *Inflation Conversion Factors for Dollars 1665 to Estimated 2017* (Jan. 18, 2007), <http://oregonstate.edu/cla/polisci/faculty-research/sahr/sahr.htm>.

terest-rate cap.<sup>120</sup> Second, seven states capped prices with an “add-on” interest-rate cap.<sup>121</sup> Third, another seven states used a “discount” interest-rate cap.<sup>122</sup> And finally, one state used a fee schedule listing a specific dollar amount that lenders could charge for a loan of the size studied.<sup>123</sup> For each state, standard accounting rules were followed to generate the largest permissible finance charge for an inflation-adjusted typical fourteen-

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120. CURRAN, *supra* note 118, at 158–66. Simple interest rates are also referred to as actuarial interest rates. NAT’L CONSUMER LAW CTR., *supra* note 34, § 3.1.1, at 61–63. Calculation of a simple interest rate is a matter of multiplying the principal by the interest rate by the term of the loan. *Id.* § 4.2, at 98–99.

121. CURRAN, *supra* note 118, at 158–66. In an add-on interest rate, the lender precomputes interest at the outset of the loan for the full term of the loan as if the principal did not decline over the course of the loan. NAT’L CONSUMER LAW CTR., *supra* note 34, § 4.3.2, at 106–08. This distinction is important in installment loans since the amount of money actually available to the borrower declines as the consumer makes each payment. Thus, in an installment loan, an add-on interest rate significantly understates the actual price of the loan in comparison to a simple interest rate. *Id.* For purposes of this study the distinction between add-on and simple interest rates does not come into play because the hypothetical loan in question is a single payment loan.

122. CURRAN, *supra* note 118, at 158–66. Similar to an add-on interest rate, lenders that use a discount interest rate precompute the interest at the outset of the loan for the full duration of the loan. NAT’L CONSUMER LAW CTR., *supra* note 34, § 4.3.3, at 108–09. But, with discount interest, the lender subtracts or discounts the interest from the “face amount” of the loan. *Id.* The National Consumer Law Center’s *Cost of Credit: Regulation and Legal Challenges* treatise provides a helpful example: in a one-year loan of \$1000 at an 8% discount interest rate, the precomputed interest will be \$80. *Id.* If this interest is discounted, then the borrower walks away from origination with \$920 in actual principal. *Id.* In installment loans, discount interest rates understate actual credit prices in comparison both to simple interest rates and add-on interest rates. *Id.*

123. CURRAN, *supra* note 118, at 161. This state was Mississippi. *Id.* Mississippi’s small-loan law included a schedule of maximum monthly charges for loans of \$99 or less. *Id.* For loans between \$51 and \$60, interest and service charges could not exceed \$2.06 per month. *Early v. Williams*, 123 So. 2d 446, 448 (Miss. 1960). Unfortunately, the statute does not specifically address how to calculate maximum permissible charges for loans with durations less than one month. Making an educated guess, this study calculated a maximum permissible charge for the hypothetical fourteen-day loan by multiplying the monthly limit by twelve in order to extrapolate an annual maximum charge of \$24.72. This represents an actuarial annual nominal interest rate of 47.23867%. Using this rate we found a maximum charge for our fourteen-day loan of \$0.9481642, which rounded to \$0.95. Mississippi’s strategy for capping prices is probably rare because, unlike interest-rate caps, it does not naturally adjust with inflation. In this regulatory environment the usury limit actually declines over time.

day payday loan.<sup>124</sup> When a statute authorized an ancillary fee in addition to interest, this fee was included in the finance charge if current federal law would require disclosure of that fee as part of the finance charge under TILA regulations.<sup>125</sup> Next, the study used the Office of the Comptroller of the Currency's publicly available annual percentage rate calculation software, APRWIN v.6, to determine the maximum permissible annual percentage rate for our hypothetical loan in each state.<sup>126</sup>

Where price limits in 1965 were generally expressed in terms of an interest rate, many states now limit prices in relation to the size of a loan rather than the speed with which it grows over time.<sup>127</sup> Accordingly, measuring current price caps required adjusting methodology to account for two newer methods used by state legislatures. First, some states now impose price limits on payday loans relative to the amount of money borrowed by the consumer in any given transaction. For example, Kansas currently caps payday loan prices at 15% of the amount borrowed.<sup>128</sup> In a payday loan of typical size and duration, this limits the lender's finance charge to \$48.75. This Article classifies price limits of this type as amount-financed caps. Second, some states impose price limits relative to the amount which the consumer must repay upon completion of the loan contract. For example, Arizona caps loan prices at 15% of the

124. See *infra* app. tbl.6. Where the usury law used a monthly nominal interest rate, a maximum annual percentage rate on our hypothetical fourteen-day loan was calculated by first converting the monthly nominal interest rate into an annual nominal interest rate by multiplying the monthly rate by twelve, the number of months in a year. Next, a finance charge was calculated based on the maximum annual nominal interest rate extrapolated from the monthly limits. Thus, for Alaska's 1965 price limit, which allowed a finance charge of 4% per month on the first \$300 of credit, we assumed twelve equal periods producing an annual nominal interest rate of 48%. CURRAN, *supra* note 118, at 158. A finance charge based on this cap was obtained by taking, where  $p$  is principal,  $r$  is the annual nominal interest rate, and  $t$  is the loan term in days. This generates a finance charge of

$$I = \frac{52.33 \cdot 0.48 \cdot 14}{365} = 0.96$$

125. Thus, a "service fee" would be included in the finance charge, but a late payment fee would not. 12 C.F.R. § 226.4 (2007).

126. In order to access the Annual Percentage Rate Calculation Program for Windows (APRWIN), visit <http://www.occ.treas.gov/aprwin.htm>.

127. Compare *infra* app. tbl.5, with *infra* app. tbl.6.

128. KAN. STAT. ANN. § 16a-2-404 (1)(c) (Supp. 2006) ("[A] licensed or supervised lender may charge an amount not to exceed 15% of the amount of the cash advance.").

amount a consumer is scheduled to repay at the terminal date of the loan.<sup>129</sup> So, for a typical payday loan in Arizona, a lender can legally charge up to \$57.35. This Article classifies price limits of this type as total of payment caps. For states with both amount-financed caps or total-of-payment caps this study calculated the highest dollar amount, rounded to the nearest cent, permitted for a typical payday loan. This dollar amount was next converted into an annual percentage rate using APRWIN v.6 software. The resulting annual percentage rates provide comparable characterizations of each state's usury limit on a typical payday loan.<sup>130</sup>

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129. ARIZ. REV. STAT. ANN. § 6-1260(F) (2000 & Supp. 2007) (“A licensee shall not directly or indirectly charge any fee or other consideration for accepting a check for deferred presentment or deposit that is more than fifteen per cent of the face amount of the check for any initial transaction or any extension.”).

130. See, e.g., ALA. CODE § 5-18A-12 (Supp. 2007); ALASKA STAT. § 06.50.460 (2006); ARIZ. REV. STAT. ANN. § 6-1260(F); ARK. CODE ANN. § 23-52-104(b) (Supp. 2007); CAL. FIN. CODE § 23036 (West Supp. 2008); COLO. REV. STAT. § 5-3.1-105 (2007); CONN. GEN. STAT. § 36a-563 (2004); DEL. CODE ANN. tit. 5, §§ 2227–2238, 2744 (2001 & Supp. 2006); FLA. STAT. § 560.405 (Supp. 2007); GA. CODE ANN. § 7-3-14 (2004); HAW. REV. STAT. § 480F-4(c) (Supp. 2007); IDAHO CODE ANN. §§ 28-42-201(1), 28-46-401 to -413 (2005 & Supp. 2007); 815 ILL. COMP. STAT. 122/2-5(e) (2007); IND. CODE § 24-4.5-7-201(1), (2) (Supp. 2007); IOWA CODE § 533D.9(1) (Supp. 2007); KAN. STAT. ANN. § 16a-2-404; KY. REV. STAT. ANN. § 286.9-100(2) (West Supp. 2007); LA. REV. STAT. ANN. § 9:3578.4(A) (Supp. 2008); ME. REV. STAT. ANN. tit. 9-A, § 2-401(2), (7)(C) (Supp. 2007); MD. CODE ANN., COM. LAW § 12-306(a)(2)(i) (LexisNexis 2007); MASS. GEN. LAWS. ch. 140, § 100 (Supp. 2007); 209 MASS. CODE REGS. 26.01 (2007); MICH. COMP. LAWS § 487.2153 (Supp. 2007); MINN. STAT. § 47.60, subdiv. 2 (Supp. 2007); MISS. CODE ANN. § 75-67-519(4) (Supp. 2007); MO. REV. STAT. §§ 408.505(3), 408.100 (Supp. 2007); MONT. CODE ANN. § 31-1-722 (2007); NEB. REV. STAT. § 45-918 (2004); NEV. REV. STAT. ANN. §§ 604A.010–940 (2007); N.H. REV. STAT. ANN. § 399-A:12(1) (2006); N.J. STAT. ANN. § 2C:21-19 (West 2005 & Supp. 2007); N.M. STAT. § 58-15-33 (Supp. 2007); N.Y. PENAL LAW § 190.40 (McKinney 1999); N.C. GEN. STAT. § 53-173 (2007); N.D. CENT. CODE § 13-08-12 (2004 & Supp. 2007); OHIO REV. CODE ANN. §§ 1315.39, 1315.40 (LexisNexis 2007); OKLA. STAT. tit. 59, § 3108(A) (2007); OR. REV. STAT. § 725.622 (2007); 7 PA. CONS. STAT. ANN. § 6213 (West 2007); R.I. GEN. LAWS § 19-14.4-4 (Supp. 2007); S.C. CODE ANN. § 34-39-180(E) (Supp. 2007); S.D. CODIFIED LAWS §§ 54-3-1.1, 54-4-65 (Supp. 2007); TENN. CODE ANN. § 45-17-112(b) (Supp. 2006); TEX. FIN. CODE ANN. § 342.252 (Vernon 2006); UTAH CODE ANN. §§ 15-1-1, 70C-2-101 (Supp. 2007); VT. STAT. ANN. tit. 9, § 41a (Supp. 2007); VA. CODE ANN. § 6.1-460 (Supp. 2007); WASH. REV. CODE § 31.45.073(3) (2006); W. VA. CODE ANN. § 46A-4-107 (LexisNexis Supp. 2007); WIS. STAT. ANN. §§ 138.04, 138.05 (West Supp. 2007); WYO. STAT. ANN. § 40-14-363 (2007).

## B. MEASURING PERCEPTION OF USURY LIMITS: SALIENCE DISTORTION

In addition to measuring permissible annual percentage rates under state usury laws, this Article also creates a new method of measuring how much a usury statute underemphasizes or overemphasizes the price of a loan in comparison to federal disclosure law. The central concept in this new method of analyzing usury laws is referred to as the salience distortion associated with a price cap. Salience distortion is defined as the absolute value of the difference between the annual percentage rate of a usury statute's most expensive permissible loan and the most prominent, or salient, number written in the statutory language limiting the price of the loan.

The notion of salience as it is used here merits some further explanation. Because currency is numerical, in any statute that caps the price of a loan, the legislature must at some point pick a number or numbers.<sup>131</sup> While this is true of every usury law, the specific number a legislature chooses only has meaning in relation to other variables associated with the law in question. For example, one legislature might adopt a usury limit of 8% per year while another might adopt a cap of 8% per month. Both legislatures would have chosen to feature the same number in the language of the statute, but the latter cap is twelve times higher than the former because there are twelve months per year. Theoretically, if it wanted to do so, a legislature could instead adopt an interest-rate cap of 8% per century—which would create a price cap much, much lower than either the monthly or annual cap. Or a legislature could adopt a cap of 8% per second, which would generate an extremely high price limit. Of course no state has chosen to do either because centuries and seconds are not convenient temporal units of measurement in the context of loans. The point here is simply that if it chooses to do so, a legislature can pick a small number and create a relatively high price limit. Or, it can pick a large number and create a relatively low price limit. Legislatures can feature whatever number they want in a usury law. The concept of salience in this study merely gives weight to the legislatures' linguistic choice, irrespective of the actual price generated.

To this end, several guidelines were used in ascribing the most salient number to each statute.<sup>132</sup> If the state's price limit

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131. See *infra* tbl.4.

132. Some states use tiered caps based on different loan amounts. For ex-

was expressed with an interest-rate cap, that interest rate is presumed to be the most salient number in the statute. This statement holds irrespective of the nominal time limit referred to in the statute. For example, in an interest-rate cap of 3% per month, the most salient number is presumed to be 3. Yet, if the statute has an interest-rate cap of 36% per year, the most salient number is 36, even though the actual price allowed is the same as the 3% monthly cap. Similarly, in keeping with the ancient convention of describing credit with interest rates, even where a law authorized ancillary fees (such as a service fee), the interest rate is nevertheless presumed to be the more salient number.<sup>133</sup> Moreover, in states where the price limit was expressed with a fraction, the numerator divided by the denominator is presumed to be the most salient number in the statute. For example, Connecticut limits loan prices to \$17 per \$100 per year, or 17%.<sup>134</sup> So, the most salient number in the Connecticut usury law is presumed to be 17.<sup>135</sup> The same concepts hold in states using amount-financed caps and total-of-payment caps.<sup>136</sup>

The notion of salience distortion builds on the assignment of a salient number to each statute by contrasting it to the maximum annual percentage rate permitted by the statute for a given loan. Thus, a statute's salience distortion was generat-

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ample, New Hampshire's 1965 statute capped prices at a limit of \$16 per year per \$100 loaned on the first \$600 of principal, then \$12 per \$100 on principal in excess of \$600. CURRAN, *supra* note 118, at 162. The most salient number is the percentage rate applicable to the amount financed because this study focuses on a typical payday loan. Thus, the number 16, as New Hampshire's most salient number in 1965. In states where the two pricing tiers were applied to the loan, the study selected the percentage rate applicable to the preponderant amount of principal lent.

133. Lawmakers and creditors have used interest rates as the central component of credit pricing and usury limits since the first recorded civilizations. See CHRISTOPHER L. PETERSON, TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH COST CREDIT MARKET 45-75 (2004) (discussing ancient usury laws and loan terms); see also HOMER & SYLLA, *supra* note 15, *passim* (cataloguing prevailing interest rates in major human civilizations).

134. CURRAN, *supra* note 118, at 159.

135. Like Connecticut, virtually all states that express their price limits with a fraction use the number 100 in the denominator, in effect translating a dollar amount into a percentage. One exception was North Carolina's 1965 usury limit, which limited loan prices to \$1 per \$5 per year. *Id.* at 163. This is simply another way of imposing a 20% annual interest rate cap. Dividing 1 by 5, the most salient number in this statute is presumed to be 20.

136. Thus, the most salient number in Kansas's current cap of 15% of the amount advanced to a consumer is 15. KAN. STAT. ANN. § 16a-2-404 (1995 & Supp. 2006).

ed by subtracting the statute's most salient number from its maximum permissible annual percentage rate. The greater the difference between the most salient number and the annual percentage rate, the higher the salience distortion. For example, current Virginia law states that payday lenders may charge "an amount not to exceed fifteen percent of the amount of the loan proceeds advanced to the borrower."<sup>137</sup> Fifteen percent of a \$325 loan is \$48.75. A finance charge of this amount in a loan with an intended duration of fourteen days would carry an annual percentage rate of about 391%. Given these facts, this study assigns the current Virginia statute a salience distortion score of 376. Like Virginia, any statute with a low salient number and a high maximum annual percentage rate would have a large salience distortion. Conversely, a statute with a salient number that happens to be the same as the maximum annual percentage rate would have a salience distortion of zero. The innovation of a salience distortion variable is that it creates quantifiable measurement of the extent to which the number featured in a usury law underemphasizes or overemphasizes the uniform national descriptive standard in credit price comparison.

### III. FINDINGS: THE ATTRITION OF AMERICAN USURY LAW

Applying these methodologies to state usury laws leads to three empirical findings: (1) usury law has become more lax, (2) usury law has become more polarized, and (3) usury law has become more misleading. This Part takes each finding in turn.

#### A. USURY LAW HAS BECOME MORE LAX

In virtually every measurable way usury law has become much more lax since 1965. In 1965, every state in the union had a usury limit on consumer loans.<sup>138</sup> Today, seven states have completely deregulated interest rates within their borders.<sup>139</sup> In 1965, banks were bound to comply with all state usury laws. Today, banks are free to charge whatever interest rate they choose within the loose and changing tolerances chosen by banking regulators for their safety and soundness guide-

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137. VA. CODE ANN. § 6.1-460 (Supp. 2007).

138. CURRAN, *supra* note 118, at 158–66.

139. States with no credit price limit whatsoever include Delaware, Idaho, Nevada, New Hampshire, South Dakota, Utah, and Wisconsin. *See infra* app. tbl.6.

lines.<sup>140</sup> In 1965, no state had law either explicitly or implicitly authorizing prices with an annual percentage rate of over 300%.<sup>141</sup> Today, at least 35 states have laws allowing lenders to charge over 300% on a typical payday loan.<sup>142</sup> In 1965, usury laws were drafted with sufficient rigidity that 45 states held actual allowed annual percentage rates to 60% or under.<sup>143</sup> Today, the number of states accomplishing this has fallen to only 6.<sup>144</sup> The state with the highest price cap on payday loans of the studied size and duration was Missouri. Missouri allows licensed lenders to originate payday loans with interest and fees amounting to 75% of the initial amount of any single loan.<sup>145</sup> A \$325 loan that grows 75% in 14 days carries an annual percentage rate of 1955.36%. The Appendix following this Article includes a complete list of annual percentage rates on maximum state usury limits, along with a national rank for each state.

While a strong deregulatory trend existed across the country, not every region abandoned usury law with equal disregard. Figure 1, *infra*, compares the median maximum permissible annual percentage rate for five regions around the country in both time periods. The northeastern states have tended to limit consumer loan pricing most aggressively.<sup>146</sup> In 1965 the median actual annual percentage rate of the northeastern states' usury limit on an inflation-adjusted typical payday loan was 30%. By 2007 this median more than tripled to 94%.<sup>147</sup> In other regions of the country, 1965 usury laws resolved to a median of 36%.<sup>148</sup> By 2007 every region outside the Northeast had a regional median of over 300%.<sup>149</sup> The most *laissez faire* region of the country is currently the Mountain West with a regional median of 521%.<sup>150</sup>

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140. *See supra* note 46 and accompanying text.

141. *See infra* app. tbl.5.

142. *See infra* app. tbl.6.

143. The five states allowing more than 60% were Georgia, Maryland, Oklahoma, South Carolina, and Wisconsin. *See infra* app. tbl.6.

144. These states are Connecticut, Maryland, New Jersey, New York, Vermont, and West Virginia. *See infra* app. tbl.6.

145. MO. REV. STAT. §§ 408.100, 408.505(3) (Supp. 2007).

146. *See infra* fig.1.

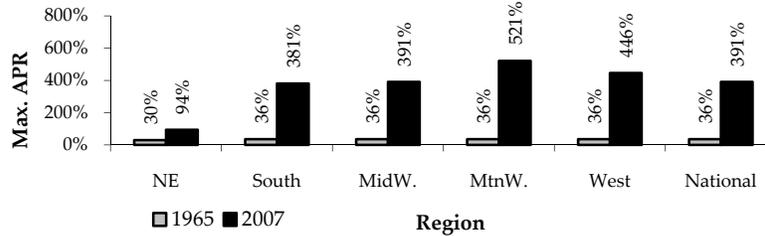
147. *See infra* fig.1.

148. *See infra* fig.1.

149. *See infra* fig.1.

150. *See infra* fig.1.

Figure 1. Median APR of State Usury Limits on Typical Payday Loans by Region: 1965 & 2007



Taking the Northeast and Mountain West regions as examples, Tables 2 and 3, *infra*, provide specific state-by-state usury limit information. In 1965 every northeastern state capped credit prices.<sup>151</sup> Eight of eleven states capped prices at an annual percentage rate of 36% or below. Delaware, Maryland, and Pennsylvania all had comparable limits on interest rates.<sup>152</sup> But each of these states also allowed special fees in addition to interest, which drove their actual prices much higher than their regional counterparts. Maryland, in particular, allowed a one-time fee of \$4 at the origination of every loan.<sup>153</sup> Because of the relatively small principal, \$52.33, of an inflation adjusted typical payday loan, the initial fee drove Maryland's actual maximum permissible annual percentage rate up to 205%, the fourth highest in the nation at that time. Maryland later closed this loophole, settling on a much more consumer protective cap of around 33% annual percentage rate.<sup>154</sup> Maryland's 1965 limit of 205% does not seem out of the ordinary in comparison to regional 2007 limits. Two northeastern states, Delaware and New Hampshire, have deregulated completely.<sup>155</sup> Rhode Island has adopted a payday lending authorization statute capping credit prices proportional to the amount of money financed, resulting in a limit on payday loan prices of around 391%.<sup>156</sup> Massachusetts, Maine, and Pennsylvania all have traditional interest-rate-limiting usury laws but allow relatively high special fees that generate actual annual percentage rate limits of around 201%, 183%, and 94%, respectively. Connecti-

151. *See infra* tbl.2.

152. CURRAN, *supra* note 118, at 159–64.

153. *Id.* at 161.

154. *See infra* tbl.2.

155. *See infra* tbl.2.

156. *See infra* tbl.2.

cut, Maryland, New Jersey, New York, and Vermont have all retained traditional usury regulation with minimal loopholes or exceptions.

**Table 2. Maximum Annual Percentage Rates of Northeastern State Usury Limits on Typical Payday Loans, 1965 & 2007**

State	1965 Maximum APR (%)	1965 APR Rank	2007 Maximum APR (%)	2007 APR Rank
Connecticut	17	47	17	50
Delaware	58	7	unlimited	1
Maine	36	13	201	39
Maryland	205	4	33	45
Massachusetts	30	34	183	41
New Hampshire	16	48	unlimited	1
New Jersey	30	34	30	47
New York	30	34	25	48
Pennsylvania	60	6	94	43
Rhode Island	36	13	391	26
Vermont	30	34	18	49

Like the Northeast, in 1965 every Mountain West state limited the prices of loans with a duration and principal comparable to today's payday loans. These 1965 limits ranged between 20% and 42%, with four states settling on a mode of 36%.<sup>157</sup> In 2007, two states, Idaho and Utah, deregulated their permissible loan prices altogether.<sup>158</sup> The remaining states now have only half-hearted limits on loan prices that range between New Mexico's recently enacted cap of about 404% to Montana's lender-friendly 652% legal maximum—the second highest cap in the nation on a loan of the studied size and length.<sup>159</sup>

157. *See infra* tbl.3.

158. *See infra* tbl.3.

159. *See infra* tbl.3.

**Table 3. Maximum Annual Percentage Rates of Mountain West State Usury Limits on Typical Payday Loans, 1965 & 2007**

State	1965 Maximum APR (%)	1965 APR Rank	2007 Maximum APR (%)	2007 APR Rank
Arizona	36	13	460	16
Colorado	36	13	496	15
Idaho	36	13	unlimited	1
Montana	20	44	652	10
New Mexico	36	13	404	1
Utah	36	13	unlimited	1
Wyoming	42	10	521	13

In summary, the 1965 median usury limit on an inflation adjusted typical payday loan was approximately 36% annual percentage rate. In 2007 the median national usury limit on a typical payday loan has grown ten times over to an astonishing annual percentage rate of 391%.<sup>160</sup> It is perhaps not a coincidence that the recent Pentagon-backed legislation reestablishing a traditional usury limit for loans to military personnel caps prices at an annual percentage rate of 36%—the 1965 national median.<sup>161</sup>

#### B. USURY LAW HAS BECOME MORE POLARIZED

By every measure of spread, the state limits on consumer loan pricing became more polarized between 1965 and 2007. Driven by Missouri's outlying price cap, the range of all state usury limits on typical payday loans has grown from 257 percentage points in 1965 to 1939 percentage points in 2007.<sup>162</sup> As

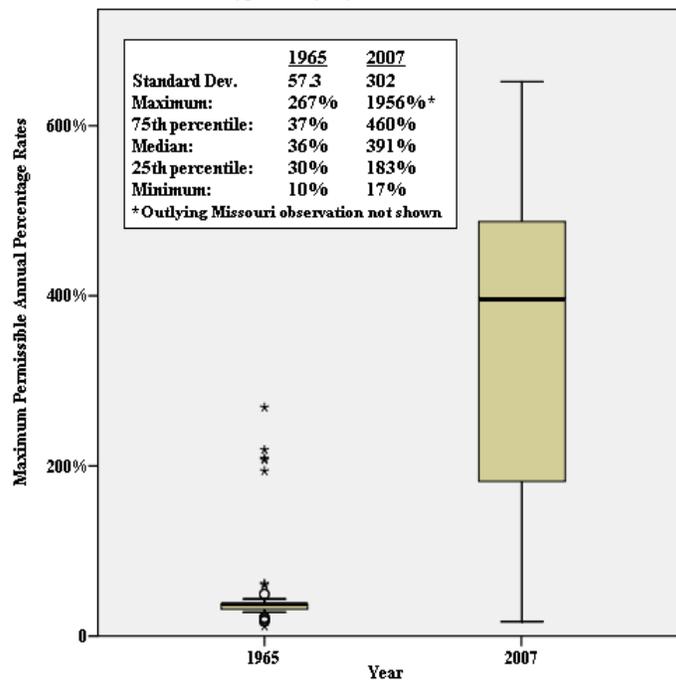
160. Average maximum permissible annual percentage rates provide a somewhat less statistically useful picture. The 1965 national mean was a somewhat misleading 51.7% annual percentage rate. The 1965 national mean was strongly influenced by five outlier states that allowed unusually large one-time fees at origination. These states included Georgia, Maryland, Oklahoma, South Carolina, and Wisconsin. Calculating a national average for 2007 is not meaningful because of the nine states that have no limit whatsoever. In these states, presumably the legal maxima are infinite. Because an average gives equal weight to outlying observations, the current national average maximum legal annual percentage rate on typical payday loans is also infinite.

161. John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a), 120 Stat. 2083, 2266 (2006) (to be codified at 10 U.S.C. § 987(b)).

162. See *infra* app. tbls.5 & 6. Statisticians calculate range by subtracting the smallest observation from the largest observation of a given variable. ALAN AGRETI & CHRISTINE FRANKLIN, STATISTICS: THE ART AND SCIENCE OF

illustrated in side-by-side box plots in Figure 2, *infra*, the 25th percentile in an ordering of maximum permissible state usury limits on typical payday loans grew six times over from 30% to 183%.<sup>163</sup> The 75th percentile grew more than twelve times over from 37% to 460%.<sup>164</sup> Statisticians sometimes look to the interquartile range of a set of observations to determine how compressed those observations are. Interquartile range is simply the difference between the 75th percentile and the 25th percentile. Figure 2 graphically illustrates interquartile range by including the twenty-five state usury limits that fall within this range inside the shaded box for both years. In 1965 the interquartile range was only 7 percentage points. In 2007 the interquartile range of maximum permissible annual percentage rates on typical payday loans had grown to 277 percentage points. Thus, the prices allowed by 1965 usury laws were far more concentrated than those permitted today.

Figure 2. Boxplot of Maximum Permissible Annual Percentage Rates for Typical Payday Loans, 1965 & 2007



LEARNING FROM DATA 57 (2007).

163. See *infra* fig.2.

164. See *infra* fig.2.

Where possible, statisticians also prefer to describe the spread of data with a measurement of standard deviation. Standard deviation measures the typical distance from the mean for a given set of observations.<sup>165</sup> While a standard deviation of 1965 law is readily figured, calculating a standard deviation of 2007 maximum permissible annual percentage rates on typical payday loans requires a further assumption. Because currently seven states have no limit on credit prices whatsoever (an infinite cap), a standard deviation for all states would provide a meaninglessly distorted measure of spread. Still, excluding states with unlimited prices gives a conservative, lower-bound measure of the standard deviation. Given this conservative measure, the standard deviation of the maximum permissible annual percentage rates on typical payday loans for the forty-three usury-limited states increased to 302 in 2007, up from only 57.3 in 1965.<sup>166</sup>

What is the significance of these findings? This decompression of state credit price maxima further illustrates the shattered national consensus on usury law. But perhaps more interestingly, this finding shows that state legislatures have not been able to find a principled method of capping prices. In 1965, whether they were right or wrong in doing so, the vast majority of state legislatures loosely agreed about the point at which credit prices become antisocial. Today, the law evidences no such agreement. At least those states that have no usury limits whatsoever can point to the neoclassical Benthamite arguments against the paternalism of government intervention in the marketplace. In contrast, what is the commercially justifiable reason why Montana lenders need an annual percentage rate of 652% to run a profitable business while nearby in Washington, lenders can get by on 392%? Why should short-term lenders in Massachusetts need special fees amounting to an annual percentage rate of 183% on a typical payday loan when lenders in Connecticut are only allowed 17%? Is there something beyond the *fait accompli* of raw political power that justi-

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165. Standard deviation is the square root of the variance in a set of observations. Variance, in turn, is the average of the squared deviations from a mean. Standard deviation is expressed as

$$\sigma = \sqrt{\frac{\sum_i (x_i - \mu)^2}{N}}.$$

See ARGESTI & FRANKLIN, *supra* note 162, at 57–58 for a helpful introduction.

166. See *supra* fig.2.

fies what governments have done to the traditional American notion of commercial law and order? These empirical findings demand that an intellectually responsible defense of the current usury law include a principled answer to these questions.

### C. USURY LAW HAS BECOME MORE MISLEADING

While there is now tremendous variety in the actual annual percentage rates allowed by state law, there is far less variety in the numbers most prominently featured within usury statutes. This is to say that the numerical language chosen by state legislatures to cap credit prices does not transparently reflect the regulatory environment it produces. This Section explains that although legislatures have raised usury limits, they have simultaneously changed the method of capping prices to continue to describe those higher prices with roughly the same smaller numbers used back in 1965. For those who read legislation, such as journalists, advocates, legislative staffers, and legislators themselves, legal limits on credit prices have become more misleading.

Table 4, *infra*, divides all state usury laws for 1965 and 2007 into classes based on how each statute goes about limiting prices with (1) a simple nominal interest rate limit; (2) an add-on interest rate limit; (3) a discount interest rate limit; (4) a specified dollar amount; (5) a percentage limit on the amount financed; (6) a percentage limit on the proportion of the total of payments; or (7) no limit at all. The letter *n* represents the number of states using each method. Next, the table provides an average of the most prominent, or salient, number featured in the language of each state law for each type of cap. In both 1965 and 2007, these average salient numbers all fall within a relatively tight compression. Average salient numbers for each type of limit type fall between 15 and 43—numbers similar to the simple nominal annual interest rates generally used in old Ham-era small-loan laws. Yet, the mean of salient numbers in usury statutes do not rise appreciably along with the average permissible annual percentage rate allowed under each statute. For example, in 2007 the average number written by state legislatures that cap prices in proportion to a borrowers' total of payments is 15. This is true, even though these same state legislatures currently tolerate typical payday loans at about 452% annual percentage rate. Nationwide, the forty-three state legislatures that cap credit prices currently choose to describe their price limitation with numbers averaging out to eighteen. How-

ever, if these same price limits are described in the context of a typical payday loan, using the federal price disclosure terminology, the average number produced is 358%.

**Table 4. Salience Distortion by Usury Limit Type, 1965 & 2007**

Type of Usury Limit	1965				2007			
	<i>n</i>	Mean Salient Number	Mean Maximum APR (%)	Mean Salience Distortion	<i>n</i>	Mean Salient Number	Mean Maximum APR (%)	Mean Salience Distortion
Smpl. Nmnsl.	35	5	34	29	10	21	116	121
Add-on	7	15	70	55	1	17	17	0
Discount	7	8	123	115	2	10	157	147
Fee Schedule	1	2	47	45	2	28	221	193
Amount Financed (%)	0	—	—	—	17	19	500	481
Total Payment (%)	0	—	—	—	11	15	452	437
Unlimited	0	n/a	n/a	n/a	7	n/a	n/a	n/a
TOTAL	50	7	58	45	50	18	358 <sup>a</sup>	363 <sup>a</sup>

<sup>a</sup>Mean excludes states with unlimited permissible rates.

Salience distortion, the new scale variable this study proposes, describes the difference between price-limiting numbers chosen by state legislatures and the actual annual percentage rates those numbers allow. For example, the state with the highest salient distortion in the country for the typical payday loan studied was Montana. The Montana legislature chose to cap payday loan prices by limiting the finance charge to 25% of the loan's principal.<sup>167</sup> Seemingly similar, the New York legislature has capped loan finance charges at an interest rate of 25%.<sup>168</sup> Both states feature the number 25. New York's no-exception, simple, nominal, annual cap does in fact limit the permissible annual percentage rate to 25%.<sup>169</sup> In stark contrast, the Montana statute tolerates payday loans where the finance charge grows to a quarter of the original principal after only two weeks—an annual percentage rate of about 652% on a typi-

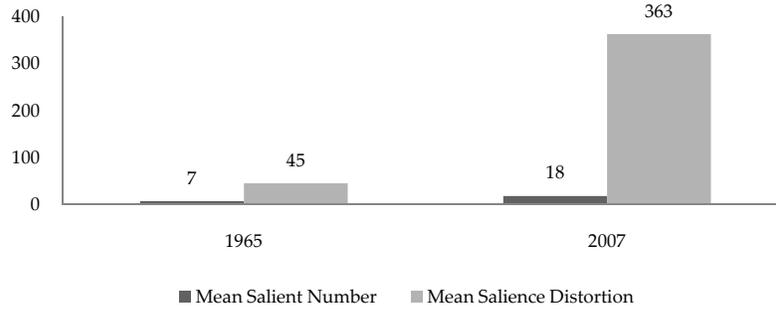
167. MONT. CODE ANN. § 31-1-722 (2007).

168. N.Y. PENAL LAW § 190.40 (McKinney 1999).

169. *Id.*

cal payday loan.<sup>170</sup> While the salience distortion in New York is zero, Montana's salience distortion is 627.

**Figure 3. Mean Salient Number and Distortion in State Usury Limits on Typical Payday Loans, 1965 & 2007**



Replicating this analysis nationwide leads to an inescapable and profound conclusion: the salience distortion of state usury limits has grown significantly. Figure 3 shows the mean salient number at which state legislatures have chosen to cap payday loan prices alongside the salience distortion associated with that number. From 1965 to 2007 there was a slight increase in the mean salient number used in state price caps on typical payday loans. However, the extent to which that number understates typical payday loan pricing relative to the federal annual percentage rate measurement has grown to an average of 363 percentage points.

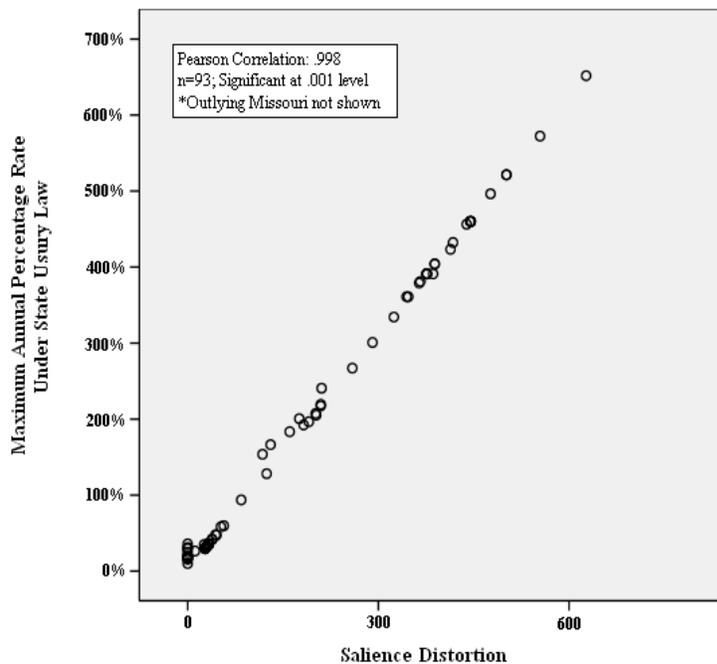
Figure 4, *infra*, makes a similar point in a slightly different way. This scatter plot illustrates the strong correlation between permissible annual percentage rates and salience distortion. This chart plots the maximum annual percentage rate for every state price cap included in this study along the Y-axis. The X-axis tracks the salience distortion score assigned to these same statutes. For *every* usury law studied in both 1965 and 2007, as the price permitted by the legislature rises, so too does the severity with which those legislatures mislead about the actual cost of the allowed loans. Statisticians usually measure the correlation of two scale variables with a statistic known as the Pearson product-moment correlation coefficient.<sup>171</sup> Pearson's Correlation is a way of summarizing the strength of a linear re-

170. MONT. CODE ANN. § 31-1-722.

171. See ARGESTI & FRANKLIN, *supra* note 162, at 103–05.

relationship between two variables with a single figure that ranges between  $-1$  and  $+1$ .<sup>172</sup> The stronger the relationship between the variables the closer the correlation figure is to  $\pm 1$ . With a correlation value of  $0.998$ , Figure 4's scatter plot of the relationship between permissible annual percentage rates and salience distortion shows a virtually certain positive correlation. What exactly does this mean? In both 1965 and 2007, high price caps were always described with small numbers. This analysis suggests that the higher the payday loan price limit a state chooses, the more misleading that state was in the language it used to create the limit.

Figure 4. Scatterplot of Maximum Annual Percentage Rates vs. Salience Distortion of All State Usury Limits for Typical Payday Loans, 1965 & 2007



172. Pearson's Correlation is represented as:

$$r = \frac{1}{n-1} \sum \left( \frac{x-\bar{x}}{s_x} \right) \left( \frac{y-\bar{y}}{s_y} \right)$$

where  $r$  is the correlative value,  $n$  is the number of observations,  $x$  is the salience distortion value for a statute,  $y$  is the annual percentage rate for a statute, and  $s$  represents the standard deviations for each variable. For further explanation of these concepts, see *id.*

While this linear relationship between price and distortion is apparent from even a casual glance at Figure 3, it is important to remember there is nothing inherent in the nature of credit or usury law that predetermines the strength of correlation between these two variables. If, for example, a state legislature chose to allow payday loans with a 500% annual percentage rate, that legislature *could* choose to describe that price limit with the number 500. A state that did this would have a salience distortion of zero, placing it by itself in the far upper left corner of Figure 4.<sup>173</sup> Indeed using the same methods to create a scatter plot of the usury laws of the thirteen founding American states would suggest no meaningful correlation because none of those state laws saliently distorted. This is to say that the number featured in each state's colonial statute was roughly the same number as the annual percentage rate of the most expensive permissible loan. The strength of the Pearson's correlation in Figure 4 merely reflects a simple fact: many states have chosen to elevate their permissible prices; but no states chose to elevate their description of permissible prices. If even a few states had chosen to express credit prices in ways mathematically comparable to Regulation Z, the Pearson's correlation between the maximum permissible annual percentage rate of state usury laws and the salience distortion of those laws would plunge. This chart is a graphic representation of the fact that in the history of our republic, no state legislature willing to cap loan prices at over 300% has ever had the courage of conviction to transparently describe this choice with a price figure reflective of the true annual percentage rate. Since 1965 the typical American state legislature has passed laws driving up maximum credit prices while attempting to appear otherwise.

#### IV. ANALYSIS

These findings give rise to three intellectual contributions: (1) a cultural point regarding the way American society perceives the ethical boundaries of credit pricing; (2) a behavioral-

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173. Similarly, if a state wanted to, it could create a price cap generating a low annual percentage rate but describing that rate with a high number. A maximum interest *per century*, for example, could accomplish exactly this. This would place the state in the bottom right corner of the chart with a low annual percentage rate and a high salience distortion. Ironically, I am aware of no state that has ever *overemphasized* its usury limit. Apparently there is no political capital to be gained from aggressively regulating while pretending you are not.

economic point exploring how payday lending legislation may exploit bounded rationality; and (3) a political point concerning the appropriate level of government from which to regulate credit pricing.

A. SOCIAL NORMS OF COMMERCIAL MORALITY AND THE MYTHOLOGY OF CREDIT PRICING

First, a cultural point: legislatures have chosen the numeric language in American usury laws because those numbers sound in an ancient moral folk-wisdom on the tolerability of interest rates.<sup>174</sup> Policy makers, the press, and the American people understand the morality and advisability of credit prices through a lens created by the decisions of religious, political, and cultural leaders of our historical tradition. Today's legislatures refuse to use numbers transparently reflective of actual credit prices because to do so would put them in contention with the moral wisdom of people like Pope Paul II, Martin Luther, Benjamin Franklin, and Arthur Ham.<sup>175</sup> Each of these individuals led their people on credit issues at transformative cultural moments. In doing so, each sanctioned annual interest rates, as this concept is generally understood, at between 6% and 36%. Our society has imbued numbers within this range with a moral authority—a mythology of sorts—when these numbers reference the price of loans. Legislatures deploying these numbers in price caps that authorize triple-digit interest rates perpetuate something of a legislative fraud against those Americans (and there are many) who have trouble recognizing the difference.

Using numbers within a range of 6 to 36 to create triple-digit annual percentage rate price limits of 300% or more insulates legislatures from the political fallout of their decision. Usury law in general, and payday lending regulation in particular always make for hotly contested, controversial bills.<sup>176</sup> This type of legislation tends to live or die in the final moments of legislative cycles and subject to the most bare-knuckle political tactics.<sup>177</sup> Legislatures that adopt usury laws so completely at odds with ancient moral visionaries and longstanding legal

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174. See *supra* Part I.A.

175. See discussion *supra* Part II.

176. See Baylor, *supra* note 3; Frank, *supra* note 3; Teegardin, *supra* note 3; Wenske, *supra* note 3.

177. See, e.g., Chris Flores, *Whistle-Blowers Suing Payday Lender*, NEW-PORT NEWS DAILY PRESS (Va.), Oct. 27, 2007, at A1.

traditions are understandably nervous. Hiding the import of that legislation within misleading language has proven too tempting for many state legislatures to pass up. Like guilty children sweeping a broken vase under the sofa, a majority of American state legislatures have adopted fundamentally misleading mechanisms for limiting credit prices.<sup>178</sup>

Arkansas provides a particularly poignant example. In 1965 Arkansas courts strictly enforced the simple nominal annual interest rate cap of 10% included in the Arkansas State Constitution.<sup>179</sup> Currently the Arkansas legislature has adopted a statute that purports to allow 10% of the face value of a payday loan check, plus an additional fee of \$10.<sup>180</sup> While the current statute just echoes the number 10, the actual price difference for a typical payday loan is an annual percentage rate of about 10% versus an annual percentage rate of 423.40% for each time period.<sup>181</sup> What is perhaps even more troubling is that subsequent to 1965, the people of Arkansas recognized that a true 10% limit is too low, and amended the constitution to limit simple nominal annual interest rates to a more reasonable 17% per annum.<sup>182</sup> Admirably stating the legally obvious, the Supreme Court of Arkansas has held that the current state payday lending authorization statute is unconstitutional and contrary to the will of the people of Arkansas.<sup>183</sup> Defying its own Supreme Court, the Arkansas Legislature, with the collusion of state regulators, has facilitated evasion of its own Constitution, siding instead with the well-funded payday lending

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178. Twenty-four states' credit price limits create a disparity of over 350 percentage points between the actual annual percentage rate of their most expensive permitted payday loan and the number featured in the statute. These states are Alabama, Alaska, Arizona, Arkansas, California, Colorado, Hawaii, Illinois, Indiana, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, Nebraska, North Dakota, Oklahoma, Rhode Island, South Carolina, Virginia, Washington, and Wyoming. *See infra* app. tbl.6. Based on the methodology of this study, an additional three states can be said to distort their true price limit on a typical payday loan by 250 to 350 percentage points. These states include Florida, Iowa, and Ohio. *See infra* app. tbl.6.

179. *See* Kenneth E. Galchus et al., *A History of Usury Law in Arkansas: 1836-1990*, 12 U. ARK. LITTLE ROCK L. REV. 695, 699-701 (1990).

180. *See* ARK. CODE ANN. § 23-52-104 (Supp. 2007).

181. *See infra* app. tbl.6.

182. *See* ARK. CONST. art. 19, § 13.

183. *See* Luebbers v. Money Store, Inc., 40 S.W.3d 745, 749 (Ark. 2001) (“[T]he mere fact that the transaction has been given a certain form by the General Assembly will not exempt it from the scrutiny of the court, which is bound to exercise its judgment in determining whether or not the form of the transaction is a device to cover usury.”).

industry lobby. Hundreds of Arkansas payday lenders now openly charge predatory prices in violation of the state constitution.<sup>184</sup>

Special mention should also be made of unusual loopholes in Texas and Florida. Both of these states have legislation that purports to place modest limits on the prices of typical payday loans.<sup>185</sup> What makes these states unusual are obscure statutes that authorize companies called “Credit Service Organizations” to take fees in exchange for brokering loans from other companies.<sup>186</sup> Under these statutes, payday lenders partner with anonymous third-party companies (which likely have close ties to the payday lender itself) to make payday loans outside the scope of state price limits.<sup>187</sup> In these arrangements the underlying loan itself generally complies with state law, but the companies also assess a brokering fee that generates a price that is far in excess of the usury limit.<sup>188</sup> As a result, many payday lenders in Florida, and virtually the entire industry in Texas, simply ignore the price limits in state law by generating the

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184. See ARKANSANS AGAINST ABUSIVE PAYDAY LENDING, PAYDAY LENDERS IN ARKANSAS: THE REGULATED AND UNREGULATED 3 (2006), [http://www.stoppaydaypredators.org/pdfs/news%20articles/06\\_0200\\_Payday\\_U\\_Study.pdf](http://www.stoppaydaypredators.org/pdfs/news%20articles/06_0200_Payday_U_Study.pdf); Jason Wiest, *Without Legislation, Payday Lending Battle Shifts Back to Court*, ARK. NEWS BUREAU, Apr. 11, 2007, <http://www.arkansasnews.com/archive/2007/04/11/News/341687.html>.

185. Texas has not passed a separate usury statute granting licensed payday lenders authority to charge fees unique to payday loans. Accordingly, payday lenders in Texas are subject to the state’s traditional small-loan law that limits interest rates at 48% per annum, plus an additional loan “acquisition” fee of up to \$10 per loan—generating an annual percentage rate of 128% on a typical payday loan. See 7 TEX. ADMIN. CODE § 83.501 (2007); TEX. FIN. CODE ANN. § 342.201 (Vernon Supp. 2007); see also *Foreclosure, Predatory Lending, and Payday Lending in America’s Cities: Hearing Before the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Domestic Reform*, 110th Cong. (2007) (written testimony of Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America Consumers Union), available at <http://domesticpolicy.oversight.house.gov/documents/20070323143722-93666.pdf> (stating that Texas has a small-loan rate cap of 48% annual interest). Florida has adopted a licensing statute for payday lenders that includes a price limit of 10% of the advance plus a “verification fee” of no more than five dollars—generating an annual percentage rate on a typical loan of about 300%. See FLA. STAT. § 560.404(6) (2007).

186. See FLA. STAT. § 817.7001(2)(a)(2); TEX. FIN. CODE ANN. § 393.201.

187. See Baylor, *supra* note 3; Richard Burnett, *Some Payday Lenders Flout State’s Reform Law: They Say the Law Doesn’t Apply Because They Are Exempt or Peddle Loans via the Web*, ORLANDO SENTINEL, Apr. 1, 2007, at A1; Pamela Yip, *Tightening Payday Lending Loopholes*, DALLAS MORNING NEWS, Mar. 5, 2007, at 1D.

188. See Burnett, *supra* note 187.

bulk of their revenue from fees nominally associated with brokering, but functionally identical to interest.<sup>189</sup> While this study evaluated Florida and Texas price limits based on their plain meaning, in reality these two states should be considered in a class similar to Delaware, South Dakota, Utah, Idaho, Nevada, and other states that have no price limits on payday loans whatsoever.<sup>190</sup>

Ironically, many of the state legislatures that surreptitiously authorize triple-digit interest rate payday lending also adopt statutory provisions requiring that payday lenders follow the uniform price disclosure conventions of the TILA.<sup>191</sup> As a legal matter, these rules are pointless since payday lenders must comply with the federal law anyway.<sup>192</sup> But, such provisions are not *culturally* pointless. Passing a law that is merely duplicative of some preexisting rule is a classic legislative tactic used to look like you are doing something when you are not. Legislators that want to pretend to address payday lender abuses need to fill up their bills with something. What is so particularly insincere about these provisions is that they remind payday lenders to use accurate price disclosure when dealing with consumers, while at the same time these legislators ignore those conventions when talking to the press.

#### B. LEGISLATIVE EXPLOITATION OF BOUNDED RATIONALITY: FRAMING EFFECTS AND ANCHORING IN USURY LAW

Legislative decisions to express credit price caps with relatively small numbers take advantage of the bounded rationality of readers, including potential critics, of those statutes. Two cognitive distortions, framing effects and anchoring, are particularly relevant. With respect to the former, psychologists and behavioral economists have presented compelling evidence that the way financial information is presented, or “framed,” can profoundly and predictably influence human choices.<sup>193</sup> For ex-

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189. See Baylor, *supra* note 3; Burnett, *supra* note 187; Yip, *supra* note 187.

190. See *infra* app. tbl.6.

191. See, e.g., FLA. STAT. § 560.404(13) (“For each deferred presentment transaction, the deferred presentment provider must comply with the disclosure requirements of 12 C.F.R., part 226, the federal TILA, and Regulation Z of the Board of Governors of the Federal Reserve Board.”).

192. See Official Staff Commentary on the Truth-in-Lending Act, 65 Fed. Reg. 17,129, 17,130 (Mar. 31, 2000) (stating that payday lenders must comply with the Truth-in-Lending Act).

193. Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the*

ample, people are more averse to medical treatments when identical risk data is framed as a mortality rate than when it is framed as a survival rate.<sup>194</sup> Consumers treat identical investment risks differently depending on whether they are presented as a gamble or insurance.<sup>195</sup> Moreover, “[i]ndividuals will perceive a penalty for using credit cards as a loss and a bonus for using cash as a gain; this will lead individuals to use cash if and only if the ‘penalty’ tack is taken, although the two situations are, from an economic and end-state perspective, identical.”<sup>196</sup>

Similarly, there is no objective mathematical difference between a typical payday loan limited in price with a 391% annual percentage rate cap and one limited with a cap of 15% of the loan principal. Both expressions limit the finance charge on a two-week loan of \$325 to about \$48.75. But, the empirical findings in this study strongly suggest there *is* a profound difference in the way these two numerical expressions are understood. The fact that *not a single* legislature chose to describe this functionally identical price limitation using an annual percentage rate (which is, after all, the federal national standard) suggests that legislatures are aware that the annual percentage rate cap is *perceived* as higher than the amount financed cap.

Furthermore, behavioral economic research has demonstrated an “anchoring” effect that leads to a closely related observation. People tend to rely too heavily on first impressions when assessing risk and value.<sup>197</sup> This is to say, we tend to “anchor” on early estimates and fail to sufficiently revise our perception of price or risk when further information comes to

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*Psychology of Choice*, 211 SCIENCE 453, 453 (1981).

194. See Barbara J. McNeil et al., *On the Elicitation of Preferences for Alternative Therapies*, 306 NEW ENG. J. MED. 1259, 1259–62 (1982); Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. BUS. S251, S254–55 (1986).

195. See John C. Hershey & Paul J. H. Schoemaker, *Risk Taking and Problem Context in the Domain of Losses: An Expected Utility Analysis*, 47 J. RISK & INS. 111, 126 (1980).

196. Edward J. McCaffery et al., *Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards*, in BEHAVIORAL LAW AND ECONOMICS 259, 262 (Cass R. Sunstein ed., 2000); see also Richard Thaler, *Towards a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39, 45 (1980) (discussing the “opportunity costs” of using credit cards).

197. See Mathew Rabin & Joel L. Schrag, *First Impressions Matter: A Model of Confirmatory Bias*, 114 Q.J. ECON. 37, 68–72 (1999).

light.<sup>198</sup> Research suggests anchoring on the early estimate of the value of a lawsuit tends to disrupt later settlement negotiation.<sup>199</sup> Even accountants conducting audits anchor on early estimates and insufficiently correct their judgments.<sup>200</sup> Marketing professionals have absorbed these lessons and systematically design sales tactics to exploit this pattern in judgment making.<sup>201</sup>

Perhaps then we should not be too surprised if legislatures have taken to the same strategy. The empirical findings in this Article suggest that legislatures use small numbers in usury legislation to frame the public debate and comprehension of the law to their political advantage. By proposing legislation with, for example, a price limit of 15% of the amount financed, legislators anchor the perception of their opponents, the press, consumer advocates, and the public. Everyone that reads the price cap will initially anchor on a price expression that underemphasizes cost. As further investigation of the financial significance of such a limit comes to light, that new information must psychologically contend with the earlier label. For those who lack the financial expertise to easily distinguish the tremendous mathematical difference between a cap proportional to a loan principal and a traditional interest-rate cap, the true value of a price limit becomes obscured and thus less objectionable.

### C. FEDERALISM AND THE COMPLIANCE COSTS OF USURY LAW

A final insight raised by these findings speaks to the nature of our federal system and the continuing debate over the

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198. See Hillel J. Einhorn & Robin M. Hogarth, *Decision Making Under Ambiguity*, in RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY 41, 46–48 (Robin M. Hogarth & Melvin W. Reder eds., 1987); Hillel J. Einhorn & Robin M. Hogarth, *Behavioral Decision Theory: Processes of Judgment and Choice*, 32 ANN. REV. PSYCHOL. 53, 78–80 (1981); Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 PSYCHOL. BUL. 197, 197–211 (1981); Daniel Kahneman & Amos Tversky, *Conflict Resolution: A Cognitive Perspective*, in BARRIERS TO CONFLICT RESOLUTION 45, 54–55 (Kenneth J. Arrow et al. eds., 1995); Richard H. Thaler, *The Psychology of Choice and the Assumptions of Economics*, in QUASI RATIONAL ECONOMICS 137, 152 (Richard H. Thaler ed., 1991); Tversky & Kahneman, *supra* note 11, at 1124–31.

199. Kahneman & Tversky, *supra* note 198, at 47.

200. William R. Kinney, Jr. & Wilfred C. Uecker, *Mitigating the Consequences of Anchoring in Auditor Judgments*, 57 ACCT. REV. 55, 55–56 (1982).

201. See generally Brian Wansink et al., *An Anchoring and Adjustment Model of Purchase Quantity Decisions*, 35 J. MARKETING RES. 71 (1998) (discussing how marketing professionals can utilize the anchoring model).

appropriate level of government to address predatory lending policy. Our federal system of government has placed policy makers, judges, advocates, and scholars in the position of periodically reevaluating whether the federal, state, or local governments should make decisions on consumer policy. In recent years the general trend of banking industry sentiment has favored national policymaking.<sup>202</sup> The rationale usually given is that nonuniform state policymaking imposes a higher regulatory compliance cost than justified by its benefits.<sup>203</sup> In this view, designing loan products compliant with fifty different regulatory environments is simply too complex.<sup>204</sup> While there is clearly merit to this argument, this study hints at a slightly more interesting, nuanced view of the costs of compliance—at least with respect to usury law.

State government choices about the *level* at which to set a price limit do not by themselves impose significant compliance costs. Under the federal TILA and, more fundamentally, as a matter of basic accounting, all lenders must calculate the cost of their loans.<sup>205</sup> Recognizing whether a particular loan exceeds a legal limit is accomplished at a glance. Rather, what creates high compliance costs is the tremendous and ambiguous variety of *methods* of calculating price caps. While this study identified six different ways that state legislatures cap prices, it is by no means a simple task to recognize which method a legislature has chosen. Moreover, there are many significant exceptions in different jurisdictions for special fees, or types of lenders within these basic classes of usury limits. For each methodology and each exception there are frequently questions left unanswered by the statute forcing regulators and courts to guess at legislative intent. The result is that each state is forced to develop its own unique and robust jurisprudence of credit pricing. Understanding and complying with these different bodies of law

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202. Christopher L. Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting off More Than They Can Chew?*, 56 AM. U. L. REV. 515, 525–27 (2007); Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225, 246–52 (2004).

203. Julie L. Williams & Michael S. Bylsma, *Federal Preemption and Federal Banking Agency Responses to Predatory Lending*, 59 BUS. LAW. 1193, 1193 (2004).

204. *Id.*

205. See 15 U.S.C. § 1631 (2000).

created by the variety of usury law methodologies *is* complicated and time consuming.

Perhaps these methodological choices would be justified if they were necessary to effectuate some important government purpose—in this case the protection of vulnerable consumer borrowers. But, from a consumer perspective, what is important is not the method by which a cap is set, but rather the extent to which that cap constrains inefficiency in the market. The point here is that the characteristics of state usury law that create high compliance costs are not those characteristics that protect consumers. As creditors have fought for authorization to charge higher and higher prices, each state legislature has pushed a costly regulatory apparatus that conceals their efforts to raise permissible credit prices. As a matter of political reality, adoption of lax usury limits led legislators to turn to misleading accounting methodology, which in turn raised compliance costs for creditors.<sup>206</sup> The counterintuitive irony is that high cost lenders actually *advocated* for the very exceptions and loopholes that have raised the compliance costs associated with nonuniform state policymaking.<sup>207</sup> The current design of credit price limits is not only misleading, but compliance is also unnecessarily expensive.

## V. POLICY RECOMMENDATIONS

While the American consumer credit regulatory system is in need of many reforms, this Article most directly argues in favor of three policy recommendations. First, legislators should write usury laws in annual percentage rate format. This is to say, in the twenty-first century our consumer-credit usury law and disclosure law should be linked. The same policy arguments that led reformers in the 1960s to create a uniform method of disclosing loan prices apply, perhaps with even more force, in the context of usury limits. The variety of methodologies used to express price limits has left the door open to those who wish to mislead the public and the press on the true meaning of credit price limits with a variety of confusing and counterintuitive pricing methodologies. Moreover, these various me-

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206. Donald C. Lampe, *Wrong from the Start? North Carolina's "Predatory Lending" Law and the Practice vs. Product Debate*, 7 CHAP. L. REV. 135, 138–39 (2004); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 63–64 (2005).

207. See, e.g., SHOW ME THE MONEY, *supra* note 74, at 15–21 (describing payday lender lobbying efforts in Florida, Illinois, and Wisconsin).

thodologies have imposed unnecessary costs of compliance on well-meaning creditors with little or no consumer protection provided as a result. While there is no disputing the fact that federal truth-in-lending regulations include some significant loopholes and exceptions, these problems pale in comparison to the legal charades found in a majority of state credit price limitations.<sup>208</sup> Particularly troubling have been those states which have delinked credit price limits from time. Price limits expressed as a percent of the principal loaned or the amount to be repaid are poor methods of limiting credit prices because they ignore the most important variable in the true cost of credit: time.

Some have argued that annual percentage rates are not meaningful in the context of payday loans because these loans are intended as a short term form of credit.<sup>209</sup> These critics generally assert that payday loans are more easily compared with a dollar amount.<sup>210</sup> There is no empirical evidence, however, to support this claim. Moreover, while focusing on a dollar amount might simplify comparison of one payday loan to another payday loan, it confuses the more important price comparison to *other types* of debt such as credit cards, pawnshop loans, home mortgages, and personal loans from finance com-

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208. One particularly important loophole that needs attention lies in the relationship between noncontingent administrative fees and the finance charge in open-end credit. In open-end loans, the finance charge cannot be calculated in advance because neither the lender nor the borrower knows how much the money will be advanced ahead of time. Currently, Regulation Z requires disclosure of the annual percentage rate that will be applied to balances incurred by the borrower. *See* 12 C.F.R. §§ 226.17, 226.18 (2007). But fees, such as annual participation fees are not included in the annual percentage rate, even though these fees meet the classic expression of a finance charge: a cost incident to the extension of credit. *See id.* The potential loophole is this: if the usury limit is expressed as an annual percentage rate, could payday lenders restructure debts as open end loans and then charge large administrative fees which are not included within the usury limit? The answer is that along with usury limits expressed as annual percentage rates, legislatures, regulators, and courts must vigilantly guard against sham transactions designed to avoid the price limit. This, of course, has always been the challenge with usury law. *See, e.g.,* *Sanford v. Hawthorne*, 174 N.W. 863, 864 (Neb. 1919). One possible solution might be requiring an annual statement period where lenders are required to rebate any money collected in excess of 36% of the amount of credit actually extended to the borrower. Over the course of a year, a lender would not be allowed to charge more in noncontingent fees and interest than 36% of the actual credit extended to the consumer. If administrative fees pushed this rate over the cap, then the lender would be required to rebate the excess fees.

209. Mann & Hawkins, *supra* note 8, at 903 n.242.

210. *Id.*

panies, banks, or credit unions. Annual percentage rates are the yardstick our society uses to express loan prices. Using one yardstick for mainstream loans, such as mortgages and credit cards, and another yardstick for payday loans creates a dangerous opportunity to mislead borrowers. Too many consumers cannot easily distinguish a 15% annual percentage rate on a credit card and a payday loan with a payment of 15% of the amount borrowed (which carries an annual percentage rate of about 391% in a typical loan). Furthermore, to the extent that comparison of a dollar amount is useful for payday loan borrowers, the TILA facilitates exactly this with a finance charge disclosure.<sup>211</sup> Consumers are *already* entitled to disclosure of a dollar amount.<sup>212</sup> Even still, policy makers must recognize that despite consumers' intentions, payday loans *are* long term forms of credit. Consumers that resort to payday loans over the course of their lives and consumers that are trapped by high payday loan prices *do* use payday loans over the course of years, making annual percentage rates a fundamentally appropriate measure of cost. Finally, independent of payday loan borrowers themselves, the expression of usury limits in our law should reflect our national tradition of expressing credit prices in a nominal annual format. Throughout the history of our republic, credit prices have most commonly been understood in a nominal annual interest rate format. Departing from this tradition has frustrated the ability of the press and the voting public to understand the law and to exercise their will. Indeed, that was probably the point.

Second, we should reestablish traditional usury limits of no higher than 36% annual percentage rate. Liberal economists condemned credit price restrictions asserting that they inefficiently prohibit mutually beneficial transactions.<sup>213</sup> In this view, demand for usurious credit will fund a black market that charges higher prices to insure against the risk of being caught and that specializes in violence.<sup>214</sup> Counterarguments include the assertion that borrowers are not receiving mutually beneficial exchange because they lack sufficient information, are irrationally discounting the value of future wealth, or are simply

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211. 12 C.F.R. §§ 226.17, 226.18.

212. 15 U.S.C. § 1632(a) (2000).

213. JEREMY BENTHAM, DEFENCE OF USURY: SHEWING THE IMPOLICY OF THE PRESENT LEGAL RESTRAINTS ON THE TERMS OF PECUNIARY BARGAINS 1–5 (Routledge/Thoemmes Press 1998) (1787).

214. BARON DE MONTESQUIEU, THE SPIRIT OF THE LAWS 374–402 (Thomas Nugent trans., Hafner Publishing Co. 1962) (1752).

suspending rational price comparison because of desperate circumstances.<sup>215</sup> Usury law apologists also argue that many borrowers willing to borrow from nonviolent legal lenders may be unwilling or unable to borrow in a black market, decreasing the volume of usurious loans to the point that gains from the rule outstrip utility losses. Usury limits may also provide strong signaling effects that improve borrower shopping behavior. Usury limits may provide a rough form of social insurance.<sup>216</sup> Usury limits provide a moral compass protecting creditors from their own avarice.<sup>217</sup> And, usurious loans may have significant externalities not reduced by rational bargaining where it does exist.<sup>218</sup> This debate is, of course, at least several hundred years old.

What this study adds to that debate is a vivid *aide memoire* of the law as it was throughout all but the most recent few years in American history. One cannot be an ardent advocate of unregulated credit pricing and also unapologetically eulogize the founding fathers of our nation. Each of the signatories to the Declaration of Independence and every delegate at the U.S. Constitutional Conventions returned home to states with meaningful usury law.<sup>219</sup> The “greatest generation” weathered the Great Depression and the Second World War with usury limits in place.<sup>220</sup> And the sustained economic growth throughout the 1950s and 1960s, including extensive consumer finance of a host of goods and services, took place in a usury-limited credit market.<sup>221</sup> The snapshot of usury law in 1965 provided by this study should serve as a reminder that not long ago every state in the nation limited credit prices well below our current national median limit. The fact that legislatures

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215. See, e.g., PETERSON, *supra* note 133, at 156–98.

216. Edward L. Glaeser & Jose Scheinkman, *Neither a Borrower Nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Law*, 41 J.L. & Econ. 1, 1 (1998).

217. JOHN WHIPPLE, *FREE TRADE IN MONEY* 30–32 (Boston, Dayton & Wentworth 1855).

218. PETERSON, *supra* note 133, at 199–214.

219. See *supra* tbl.1.

220. See generally BROKAW, *supra* note 116 *passim*.

221. Compare Nicholas Crafts, *Economic Growth in the Twentieth Century*, 15 OXFORD REV. ECON. POL'Y 18, 27–28 (1999) (characterizing mid-twentieth century U.S. growth as a “golden age” of outstanding growth performance), with Elliot Zupnick, *Consumer Credit and Monetary Policy in the United States and the United Kingdom*, 17 J. FIN. 342, 342–43 (1962) (arguing that “spectacular” growth in consumer credit in the mid-twentieth century would dilute the effectiveness of monetary policy).

were only able to raise usury limits through misleading methods is one additional argument for the merits of traditional usury law. From a historical perspective a 36% annual percentage rate price limit—the 1965 national median—strikes a reasonable compromise in the age-old usury law debate.

Finally, usury limits should apply to all lenders irrespective of their mission, charter, or ownership. While the Russell Sage-era small-loan laws succeeded in inducing mainstream creditors into the consumer lending market, the legacy of these special usury laws has become a patchwork of exceptions, subterfuge, and disrepair.<sup>222</sup> State after state now retains skeletons of usury law stripped bare by federal preemption, state legislative exceptions, and regulatory neglect. The all too common maze of general usury laws (both constitutional and statutory), small-loan usury laws, special retail installment loan usury laws, motor vehicle financing usury laws, industrial loan act usury laws, pawnbroker usury limits, parity statutes, and deferred presentment acts serves no one's interests. The bedrock principal of equal treatment under the law suggests that states should adopt, and the federal government should facilitate, more transparent usury legislation. Old special usury limits applicable only to one licensed class of lenders or another should be cleared out and replaced with a single, clear limit applicable equally to all.

### CONCLUSION

This Article presents an empirical analysis of prices tolerated by all fifty state usury laws in both 1965 and 2007. The study calculated the highest permissible price of a typical payday loan for each state and time period and then expressed these prices as annual percentage rates following federal TILA guidelines. Moreover, this study proposes a new statistical concept, labeled salience distortion, to measure the difference between a usury law's maximum annual percentage rate and the number most prominently featured within the text of each usury statute. While in this piece salience distortion measures credit pricing, the theoretical concept could easily be adapted to study a wide range of legislation.<sup>223</sup> The empirical analysis in

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222. NAT'L CONSUMER LAW CTR., *supra* note 34, § 2.3.3, at 38–40.

223. Possible future applications of the salience distortion concept could include analysis of the Environmental Protection Agency's automobile fuel economy disclosure standards, the description of revenue generated by various tax laws, and the use of off-budget funding for wars.

this Article leads to three findings: since 1965 usury law has become much more lax, more polarized, and more misleading. This Article argues that with accounting sleight of hand, many state legislatures now use small, innocuous numbers in usury laws in an attempt to minimize the public and media outcry over their decisions to legalize triple-digit interest rate loans. Abandoning the expression of loan price limits with simple nominal interest rates has allowed legislatures to frame the public debate over usury in a way that understates the recent national departure from the American historical tradition of aggressive credit price regulation.

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## APPENDIX

**Table 5. State Usury Limit Data for Inflation-Adjusted Typical Payday Loans, 1965**

State	Cap Type	Finance Charge (\$)	Total of Payments (\$)	APR (%)	Salient Number	Saliency Distortion	APR Rank	Saliency Distortion Rank
AL	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
AK	SmplNom	0.96	53.29	<b>47.83</b>	4	44	8	9
AZ	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
AR	SmplNom	0.20	52.53	<b>9.96</b>	10	0	50	42
CA	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
CO	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
CT	Add On	0.34	52.67	<b>16.94</b>	17	0	47	45
DE	Discount	1.17	53.50	<b>58.29</b>	6	52	7	7
FL	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
GA	Discount	5.36	57.69	<b>267.04</b>	8	259	1	1
HI	SmplNom	0.84	53.17	<b>41.85</b>	3.5	38	10	10
ID	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
IL	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
IN	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
IA	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
KS	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
KY	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
LA	SmplNom	0.84	53.17	<b>41.85</b>	3.5	38	10	10
ME	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
MD	Discount	4.12	56.45	<b>205.26</b>	3	202	4	3
MA	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
MI	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
MN	SmplNom	0.66	52.99	<b>32.88</b>	2.75	30	32	30
MS	Fee Schedule	0.95	53.28	<b>47.33</b>	2.06	45	9	8
MO	SmplNom	0.53	52.86	<b>26.41</b>	15	11	43	41
MT	Add On	0.40	52.73	<b>19.93</b>	20	0	44	47
NE	SmplNom	0.60	52.93	<b>29.89</b>	30	0	34	49
NV	Discount	0.70	53.03	<b>34.87</b>	9	26	31	40
NH	Add On	0.32	52.65	<b>15.94</b>	16	0	48	43
NJ	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
NM	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
NY	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
NC	Add On	0.40	52.73	<b>19.93</b>	20	0	44	47
ND	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
OH	Add On	0.32	52.65	<b>15.94</b>	16	0	48	43
OK	Add On	3.86	56.19	<b>192.31</b>	10	182	5	5
OR	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
PA	Discount	1.20	53.53	<b>59.79</b>	3	57	6	6
RI	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
SC	Add On	4.16	56.49	<b>207.26</b>	6	201	3	4
SD	SmplNom	0.72	53.05	<b>35.87</b>	36	0	13	50
TN	SmplNom	0.64	52.97	<b>31.89</b>	3	29	33	31
TX	Discount	0.38	52.71	<b>18.93</b>	19	0	46	46
UT	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
VT	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
VA	SmplNom	0.60	52.93	<b>29.89</b>	2.5	27	34	32
WA	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
WI	Discount	4.36	56.69	<b>217.22</b>	8	209	2	2
WV	SmplNom	0.72	53.05	<b>35.87</b>	3	33	13	13
WY	SmplNom	0.84	53.17	<b>41.85</b>	3.5	38	10	10

Note: The following abbreviations appear in this Table 5: (1) SmplNom = simply monthly or annual

nominal interest rate limit; (2) Add on = Add-on interest rate limit; (3) Discount = discount interest rate limit; (4) Fee Schedule = specific dollar amount that lenders could charge for loan.

**Table 6. State Usury Limit Data for Typical Payday Loans, 2007**

State	Cap Type	Finance Charge (\$)	Total of Payments (\$)	APR (%)	Salient Number	Salience Distortion (\$)	APR Rank	Salience Distortion Rank
AL	% of AF	53.75	378.90	<b>432.38</b>	15	417	21	14
AK	% of AF	53.75	378.90	<b>432.38</b>	15	417	21	14
AZ	% of TOP	57.35	382.35	<b>460.06</b>	15	445	14	7
AR	% of TOP	52.78	377.78	<b>423.40</b>	10	413	22	15
CA	% of TOP	45.00	300.00	<b>460.08</b>	15	445	14	7
CO	% of AF	61.88	386.88	<b>496.40</b>	20	476	13	6
CT	Add On	2.11	327.11	<b>16.93</b>	17	0	50	42
	D No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
	E							
FL	% of AF	37.50	362.50	<b>*300.82</b>	10	291	35	28
GA	Discount	27.35	352.35	<b>219.40</b>	10	209	37	30
HI	% of TOP	57.35	382.35	<b>460.06</b>	15	445	14	7
ID	No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
IL	% of AF	50.38	375.38	<b>404.15</b>	15.5	389	23	17
IN	% of AF	47.25	372.25	<b>379.04</b>	15	364	31	24
	I % of TOP	41.67	366.67	<b>334.28</b>	10	324	34	27
	A							
KS	% of AF	48.75	373.75	<b>391.07</b>	15	376	25	19
KY	% of TOP	57.35	382.35	<b>460.06</b>	15	445	14	7
LA	% of TOP	45.00	370.00	<b>360.99</b>	16.75	344	32	26
ME	Fee Schdl	25.00	350.00	<b>200.55</b>	25	176	38	32
MD	SmplNom	4.11	329.11	<b>32.97</b>	2.75	30	45	38
MA	SmplNom	22.87	347.87	<b>183.46</b>	23	160	40	33
	M % of AF	45.00	370.00	<b>360.99</b>	14	347	32	25
	I							
MN	% of AF	24.50	349.50	<b>196.54</b>	6	191	39	31
MS	% of TOP	71.34	396.34	<b>572.29</b>	18	554	10	3
MO	% of AF	243.75	568.75	<b>1955.36</b>	75	1880	8	1
MT	% of AF	75.00	375.00	<b>651.79</b>	25	627	9	2
NE	% of TOP	57.35	382.35	<b>460.06</b>	15	445	14	7
NV	No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
NH	No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
NJ	SmplNom	3.73	328.73	<b>29.92</b>	30	0	47	43
NM	% of AF	50.38	375.38	<b>404.15</b>	15.5	389	23	16
NY	SmplNom	3.11	328.11	<b>24.95</b>	25	0	48	41
NC	SmplNom	20.74	345.74	<b>166.38</b>	36	0	41	34
ND	% of AF	65.00	390.00	<b>521.43</b>	20	501	11	4
OH	SmplNom	48.75	373.75	<b>391.07</b>	5	261	25	18
OK	% of AF	47.50	372.50	<b>381.04</b>	15	366	30	23
OR	SmplNom	42.43	367.43	<b>153.72</b>	36	118	42	36
PA	Discount	11.68	336.68	<b>93.70</b>	9.5	84	44	37
RI	% of AF	48.75	373.75	<b>391.07</b>	15	376	25	19
SC	% of TOP	52.94	352.94	<b>460.04</b>	15	445	19	12
SD	No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
TN	Fee Schdl	30.00	355.00	<b>240.66</b>	30	211	36	29
TX	SmplNom	15.98	340.98	<b>*128.19</b>	4	128	43	35
UT	No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
VT	SmplNom	2.24	354.25	<b>17.97</b>	18	0	49	39
VA	% of AF	48.75	373.75	<b>391.07</b>	15	376	25	19
WA	% of AF	48.75	373.75	<b>391.07</b>	15	376	25	19
WI	No Limit	n/a	n/a	<b>n/a</b>	n/a	n/a	1	n/a
WV	SmplNom	3.86	328.86	<b>30.96</b>	31	0	46	40
WY	% of TOP	65.00	390.00	<b>521.43</b>	20	501	11	4

*Note:* The following abbreviations appear in this table: (1) SmplNom = simple nominal interest rate limit; (2) Add On = add-on interest rate limit; (3) Discount = discount interest rate limit; (4) % of AF = percentage limit on the amount financed; (5) % of TOP = percentage limit on the proportion of the total

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of payments; (6) No limit = No limit at all.

\*Florida and Texas annual percentage rate figures do not reflect unlimited Credit Service Organization brokerage fees currently common in those states.