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Loan Sharks, Interest-Rate Caps, and Deregulation

Robert Mayer*

Abstract

The specter of the loan shark is often conjured by advocates of price deregulation in the market for payday loans. If binding price caps are imposed, the argument goes, loan sharks will be spawned. This is the loan-shark thesis. This Article tests that thesis against the historical record of payday lending in the United States since the origins of the quick-cash business around the Civil War. Two different types of creditors have been derided as "loan sharks" since the epithet was first coined. One used threats of violence to collect its debts but the other did not. The former has been less common than the latter. In the United States, the violent loan sharks proliferated in the small-loan market after state usury caps were raised considerably and these loan sharks dwindled away as a source of credit for working people before interest-rate deregulation began to be adopted at the end of the 1970s. The other type of loan shark thrived both when usury ceilings were very low and when they were very high or even removed. Deregulation does not starve the nonviolent species of loan shark into extinction but instead feeds it. Hence the loan-shark thesis is seriously flawed. It does not accord well with the historical record of the market for payday loans.

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I. Introduction

Defenders of expensive, subprime credit products like payday loans often claim that imposing interest-rate caps on consumer credit will bring back the loan sharks that were said to have been starved into extinction by the policy of financial deregulation. This is the loan-shark thesis. The thesis is often asserted in passing by advocates of interest-rate deregulation,[1] but it has recently been defended in detail in an article published in *Banking Law Journal* entitled "*History Repeats Itself: Why Interest Rate Caps Pave the Way for the Return of the Loan*

1. *See* Todd Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONSUMER L. REV. 425, 457 (2010) ("The flexibility and deregulation of consumer credit markets in the United States has substantially reduced the importance of illegal loan-shark lending." (citation omitted)).

Sharks."[2] According to its authors, Justice David Baker and MacKenzie Breitenstein, "it is possible if interest-rate caps are again used as a primary means of regulating consumer credit that the loan-shark industry will return to prominence as regulated lenders will quit lending to high risk borrowers."[3] This is said to be the perverse consequence of trying to regulate the price of consumer credit. Outlawing high prices spawns loan sharks, who are the worst sort of creditors. They beat or kill debtors who are late with their payments. Rate caps, we are told, unintentionally drive credit-constrained consumers into their clutches because price ceilings ration legal credit away from the least-advantaged and riskiest applicants. According to Baker and Breitenstein, the history of credit regulation in the United States teaches us this lesson.[4]

But in this Article I will show that, depending on how we define "loan shark," this intuitively plausible thesis is either false and indeed exactly wrong, or too simple and thus misleading. Historically, there have been two distinct types of creditors that were derided as loan sharks, one using threats of violence to collect its debts but the other not. The former has been less common than the latter. In the United States, the violent loan sharks proliferated in the small-loan market *after* state usury caps were raised considerably and these loan sharks dwindled away as a source of credit for working people *before* interest-rate deregulation began to be adopted at the end of the 1970s. The other type of loan shark thrived *both* when usury ceilings were very low *and* when they were very high or even removed. Deregulation, we must realize, does not starve the nonviolent species of loan shark into extinction but instead feeds it. That is the perverse consequence of removing the cap on interest rates in the market for small loans.

Once we adopt a more nuanced view of what a loan shark is, it becomes clear that no policy can eliminate this type of creditor once and for all. There will always be loan sharks of one sort or

2. *See generally* Justice David Baker & MacKenzie Breitenstein, *History Repeats Itself: Why Interest Rate Caps Pave the Way for the Return of the Loan Sharks*, 127 BANKING L.J. 581 (2010).

3. *Id.* at 594.

4. *See id.* at 598 (referring to "the disastrous, unintended consequences created by interest rate regulations").

another. The aim of public policy ought to be to minimize both varieties and not just the violent species. The regulatory strategy that best achieves this goal is the moderate price cap, neither too low nor too high (let alone rescinded). What history teaches us is that an interest rate capped between the extremes in the small-loan market has reduced the total loan-shark population more effectively than the policy of interest-rate deregulation favored by those who subscribe to the loan-shark thesis. While it is true that excessively low interest-rate caps do have perverse consequences for the population this policy is meant to protect, we have to recognize that interest-rate deregulation also has perverse consequences because it spawns at least as many loan sharks as financial repression. The history of payday lending since its origins at the end of the nineteenth century illustrates this double-sided perversity of interest-rate regulation.[5]

II. What Is a Loan Shark?

As Ronald Goldstock and Dan Coenen observe, "The term 'loanshark' lacks a precise definition; neither linguists nor lawyers have concentrated on the term."[6] They also correctly note that "differing generations have assigned the term differing connotations."[7]

The epithet loan shark is an Americanism and emerged in popular discourse late in the nineteenth century.[8] It is one of a family of slang metaphors that likens some object of opprobrium to the predatory behavior of the shark ("card shark," "land shark," "money shark," "legal shark"). Though any sharp lender may be described disparagingly as a loan shark, from the beginning this particular phrase was associated with a set of expensive small-loan products that had come into existence around the Civil War, in particular the chattel mortgage and the salary loan. The chattel-mortgage lender advanced cash on the

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5. *See generally* ROBERT MAYER, QUICK CASH: THE STORY OF THE LOAN SHARK (2010) (recounting the history of loan-sharking).

6. RONALD GOLDSTOCK & DAN COENEN, EXTORTIONATE AND USURIOUS CREDIT TRANSACTIONS: BACKGROUND MATERIALS 1 (1978) (citation omitted).

7. *Id.* at 2 (citation omitted).

8. *See* MAYER, *supra* note 5, at 3–4, 13–14.

security of a debtor's furniture or household possessions, while the salary lender or salary broker took a wage assignment to ensure repayment.[9] The latter product was the original payday loan, tied as it was to the debtor's payment cycle, but in the popular press of the day these vendors of what was typically an unamortized cash advance were regularly labeled as loan sharks. The anathema was applied not narrowly, to the exceptionally unscrupulous lender, but broadly, to the industry as a whole. Lending in this fashion, at high rates and on the security of a wage assignment, was widely viewed as predatory behavior.

A. Original Intent

What was thought to be predatory or shark-like about the salary loan, however, was not the use or threat of violence to collect the debt. Salary lenders did not beat or kill borrowers who defaulted on their loans.[10] These creditors also did not have ties to organized crime families, which scarcely existed at this time.[11] The collection methods of the first loan sharks were certainly aggressive, but in contemporary accounts one almost never reads about acts of brute force. To compel repayment, salary lenders pestered debtors incessantly at home, or sent "bawlers-out" to make a scene at work, or processed wage assignments, or used the powers of attorney they had taken to confess judgment before justices of the peace.[12] They did not have to lay a hand on customers in arrears to do a profitable business. Indeed, many firms had a preference for hiring women as loan agents because, as one news story explained, "they give an appearance of harmlessness to the lending establishment, and an outraged borrower is not so anxious to kick the manager out of a window if

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9. *See* LOUIS ROBINSON & ROLF NUGENT, REGULATION OF THE SMALL LOAN BUSINESS 35–36 (1935).

10. *See* Mark Haller & John Alviti, *Loan-sharking in American Cities: Historical Analysis of a Marginal Enterprise*, 21 AM. J. LEGAL HIST. 125, 125 (1977) ("There is no evidence that these loansharks used violence for collection of debts.").

11. *See id.* ("Such loansharks, so far as can be determined, had no connection with gambling syndicates or other 'organized crime' activities.").

12. *See* MAYER, *supra* note 5, at 38–41.

she is a woman."[13] The salary-lending businesses were not thuggish, even though the vast majority operated in defiance of the applicable usury statute.

The "bite" in the salary-loan transaction that provoked the loan shark epithet came not at the end, when the debt was collected, but at the beginning and referred to the peculiar structure of this credit product, which took the form of a trap. According to *Neifeld's Manual on Consumer Credit*, published in 1961, "[t]he essence of loan shark deals is small amounts for short terms, with an effort to keep the principal out all the time to secure repeated renewals of the interest charge."[14] It was lending in this fashion, to prolong the interest payments and to ensnare borrowers in debt, that qualified a creditor as a loan shark in the original sense of the phrase: "Loan shark evils appear where the method of lending requires the entire indebtedness of the wage earner to mature at one time. Inability to pay anything but the interest on the loan almost inevitably results from this method of lending money."[15]

Neifeld's Manual on Consumer Credit appeared at the beginning of a decade in which the idea of what a loan shark is was about to change and acquire its more modern connotation, but the manual merely summed up the widely held view that had crystallized over the previous half-century. "The real aim of loan sharks," explained Avon Books' *How and Where to Borrow Money*, "is to keep their customers eternally in debt so that interest (for the sharks) becomes almost an annuity."[16] A scholarly study on *The Small-Loan Industry in Texas*, published in 1960, noted that, while the loan shark always charges a high rate of interest, "he does more than this. He loans for . . . too short a period of time . . . making the payments too high, and . . . encouraging renewals or refinancing."[17] "This insistence upon planned, orderly liquidation of the loan is one of the hallmarks of the honest lender," reported an earlier scholarly article.[18] "The unlicensed

13. *See* Staff, *Loan Shark Hires Women to Weave Web About Him*, CHI. TRIB., Feb. 7, 1912, at 1, 7.

14. M.R. NEIFELD, NEIFELD'S MANUAL ON CONSUMER CREDIT 389 (1961).

15. *Id.* at 387–88.

16. IRA COBLEIGH, HOW AND WHERE TO BORROW MONEY 109 (1964).

17. DONALD TYREE, THE SMALL-LOAN INDUSTRY IN TEXAS 59 (1960).

18. Charles Gates, *The Social Worker in the Service of the Small Loan*

loan shark, on the other hand, seldom wants his principal so long as he gets his interest."[19] Even as late as 1982, after the associations of the loan shark had already begun to change, Playboy Paperbacks' *The Complete Guide to Credit and Loans* could still say "the major feature [in this type of credit transaction] is that the loan shark is more concerned in collecting the interest than the principal."[20] Violent debt collection was not identified as a necessary element, let alone the defining trait, of the loan-shark deal.

B. A Second Sense

But the word association of the loan shark epithet changed quickly during the 1960s. Exposés of mob lending operations captured the headlines in cities like Chicago and New York and helped to redefine this opprobrium.[21] The emphasis shifted to the method of debt collection, which was depicted as extortionate. A loan shark came to be understood as a black-market creditor with ties to organized crime who employed violence, or threats of violence, to compel repayment of a debt. In 1968, Congress enacted the Consumer Credit Protection Act,[22] the second title of which proscribed "Extortionate Credit Transactions."[23] Though the phrase loan shark did not figure in the legislation itself, popular and legal commentary equated the extortionate credit transaction with loan-sharking, thereby shifting the emphasis in the concept to the back end of the exchange.[24] How repayment of a debt is compelled became the defining trait of the loan-shark transaction. The idea now implied violence. This new understanding increasingly supplanted the original conception,

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Business, 196 ANNALS OF THE AMERICAN ACADEMY OF POLITICAL AND SOCIAL SCIENCE 221, 223 (1938).

19. *Id.*

20. GERALD GIBBS, THE COMPLETE GUIDE TO CREDIT AND LOANS 65 (1982).

21. *See* MAYER, *supra* note 5, at 105 (discussing several newspaper articles related to mob lending).

22. Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968).

23. *Id.* §§ 891–896.

24. *See, e.g.*, N.Y. COMM'N OF INVESTIGATION, AN INVESTIGATION OF THE LOAN-SHARK RACKET (1965).

which emphasized the cost of the debt and the trap-like nature of the repayment plan. If "loan-sharking" is made synonymous with the extortionate credit transaction, then ironically the turn-of-the-century salary lenders, for whom the epithet had been invented, could no longer be classified as loan sharks.

Court opinions over the course of the twentieth century nicely registered this transformation in the image of the loan shark. In *People ex rel. Chicago Bar Ass'n v. Wheeler*,[25] one of the first opinions to employ this colloquialism, the Illinois Supreme Court explained that "the 'loan shark' business, so-called, . . . is said to consist in the loaning of small amounts of money to clerks and other salaried employés, and to other persons, on chattel mortgages covering household goods, etc., at usurious rates of interest, from 10 per cent. upwards a month."[26] Here the clientele, the nature of the loan product, and the cost are emphasized; there is no mention of violence. Fast-forward forty years and the same idea is still being expressed by the Supreme Court of Kansas in *State ex rel. Fatzer v. Molitor*[27]:

> defendants engaged in what was commonly known as the "loan shark business," the principal object of which was to collect and exact usurious rates of interest from laboring people, wage earners and others of small means who are forced by necessitous circumstances, such as sickness and other emergencies which placed them in critical situations, necessitating their obtaining funds to borrow small sums of money.[28]

Another ten years elapses before the first association of the phrase with violence is recorded, in *Macari v. N.Y. Mid-Hudson Trans-Corp.*,[29] issued by the Supreme Court of New York: "[T]he deceased was deeply indebted to 'loan sharks' and was fearful of his safety."[30]

25. People *ex rel.* Chi. Bar Ass'n v. Wheeler, 102 N.E. 188 (Ill. 1913).

26. *Id.* at 188.

27. State *ex rel.* Fatzer v. Molitor, 263 P.2d 207 (Kan. 1953).

28. *Id.* at 208.

29. Macari v. N.Y. Mid-Hudson Trans-Corp., 19 A.D.2d 671 (N.Y. App. Div. 1963).

30. *Id.* at 671.

C. The Common Denominator

What this quick history of an Americanism demonstrates is that the loan shark has been not one breed but two. One variety uses violence to collect its debts but the other does not. The bite of this other loan shark, which appeared first on the scene, consists in the steep price it charges for its cash advances and in the debt trap that its product becomes for many consumers because the cost is high and the repayment period short. This original loan shark was fundamentally a debt trapper; the creditor vended an ostensibly short-term product that was "so designed as to handicap repayment."[31] We identify this loan shark by the volume of expensive renewals it authorizes and by the duration of its nominally short-term debts.

In fact, the other type of loan shark, the one that uses force against debtors in default, has tended to engage in the same sort of behavior as the first. It is a debt trapper too. Many mob loans have been unamortized and interest-only (or "vigorish"), thus requiring a lump-sum payment at the end to retire the debt.[32] This lender, like the other, wants the borrower to extend the debt continuously because the steep interest payments are lucrative and because it can be both costly and risky to switch clients frequently.[33] As one mob-connected loan shark catering to factory workers in the 1960s explained, "I don't care when you pay back the principal . . . . Just keep up the interest payments every payday, that's all."[34] This is the business model of every bona fide loan shark, violent or not.

Certain kinds of lenders, catering to certain kinds of customers and operating in certain kinds of conditions, have had to employ violence to make the business model of debt trapping

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31. FINDLEY WEAVER, OKLAHOMA'S SMALL LOAN PROBLEM 21 (1938).

32. *See* PETER REUTER & JONATHAN RUBINSTEIN, ILLEGAL GAMBLING IN NEW YORK: A CASE STUDY IN THE OPERATION, STRUCTURE, AND REGULATION OF AN ILLEGAL MARKET 173–74 (1982) (distinguishing between "knockdown," or installment loans, and lump-sum "vig" loans).

33. *See Loan-Sharking: The Untouched Domain of Organized Crime*, 5 COL. J.L. & SOC. PROBS. 91, 95–96 (1969) ("A loan shark never wants his loan paid back." (quoting interview with Gerard T. McGuire, Special U.S. Attorney, U.S. Dep't of Justice Strike Force, in N.Y.C. (Oct. 31, 1968))).

34. *The Confessions of a 6-For-5 "Juice Man,"* 49 BURROUGHS CLEARING HOUSE 40, 40 (1965).

financially profitable. But other kinds of lenders, like the salary brokers a hundred years ago, did not. Their debt trapping was nonviolent. A regulatory policy that intends to attack loan-sharking ought to address both forms of the phenomenon and not only the violent breed. The violent loan sharks have always been less common than the nonviolent ones and the predations of the latter are thus typically more widespread. The two stand in a complicated relationship to one another, as we shall see. Strategies that reduce one population may increase the other. Hence fighting each breed in isolation can be counterproductive. The history of interest-rate caps confirms this observation. When they are too low *or* too high, debt trapping in one form or the other has proliferated.

III. Low Caps and No Caps

The development of consumptive lending in Great Britain and the United States late in the nineteenth century illustrates what happens when interest-rate regulation veers toward one extreme or the other. In both countries, loan-sharking of the nonviolent sort spread widely in urban areas. In the United States, interest-rate caps were very low; in Great Britain, there was no cap at all.

A. American Loan Sharks

Until the late 1970s, regulation of the interest rates lenders could charge was entirely decentralized in the United States. Each state government established its own policy.[35] During the nineteenth century, a few states deregulated interest rates, at least briefly, but the great majority imposed an annual percentage rate cap between 6% and 12%.[36] As a rule, newer states permitted higher charges to attract lending capital for

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35. *See* J.B.C. MURRAY, THE HISTORY OF USURY 70–91 (1866) (recounting the history of interest-rate regulation in each of the states through the Civil War).

36. *See* George Holmes, *Usury in Law, in Practice and in Psychology*, 7 POL. SCI. Q. 431, 431–33 (1892) (discussing the rate caps imposed by the states).

development.[37] The ceiling applied to every loan transaction within the jurisdiction, except where pawnbroking was licensed.[38] Usury before the twentieth century was rarely classified as a criminal offense. When proven, lenders forfeited the remaining interest specified by the contract, and sometimes the principal as well, but they were not sent to jail.[39]

Despite the existence of such low caps since colonial days, loan-sharking did not emerge in the United States until sometime around the Civil War.[40] Its precondition has always been a large mass of urban workers, white- and blue-collar, earning modest but steady pay.

> Loan-sharking isn't feasible in a population that ekes out a bare subsistence. It also isn't feasible if the debtors lack a steady income stream. Only people with recurring paydays can get payday loans. The phenomenon of payday is a product of the industrial revolution and its routinization of wage-labor. Factory-hands and office workers became employees—people whose services were engaged on a more or less continuous basis and who were paid not at the end of the harvest but every week or month.[41]

As David Caplovitz observes, "the bureaucratization of the world of work is a structural prerequisite for the credit society."[42] Loan sharks were present at the birth of our credit society and they were spawned in the income stream of a swelling mass of wage-workers who lived from payday to payday.

Chattel-mortgage and salary-loan sharks proliferated at the end of the nineteenth century because the small, short-term loans

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37. *See* Edward Glaeser & Jose Scheinkman, *Neither a Borrower nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws*, 41 J.L. & ECON. 1, 13 (1998) ("In general, usury-rate ceilings rise with distance from the Atlantic Ocean.").

38. *See* JOHN CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 20 (1994) (describing the higher interest rates pawnbrokers were allowed to charge).

39. *See* Holmes, *supra* note 36, at 433–35 (classifying the penalties for usury in each state).

40. *See* ROBINSON & NUGENT, *supra* note 9, at 35–45 (recounting the history of small-loan products in the United States).

41. MAYER, *supra* note 5, at 15.

42. David Caplovitz, *Consumer Credit in the Affluent Society*, *in* CONSUMER CREDIT REFORM 3, 5 (Clark Havighurst ed., 1970).

working people needed to get them to the next payday could not be made profitably when the interest rate on credit was capped at such a low level. A typical salary loan of $20 due in one month at a rate of 7% a year would only earn the lender about a dime—hardly enough to cover the expenses of an office, processing the loan application, debt collection, and default.[43] Any lender who tried to make a business of catering to the swelling demand for payday loans at that time would have had to charge substantially more than the law permitted. By the start of the twentieth century, the going rate for unamortized salary loans was 20% a month or 240% a year.[44] That's cheaper than the typical payday loan today but it was twenty times the rate permitted a hundred years ago in states with the highest caps. Despite the expense, demand for these tiny bridge loans was great. At the height of the market, in the second decade of the twentieth century, reformers estimated that something like one-quarter of all urban wage earners borrowed from loan sharks in any given year.[45]

The cost of the salary-loan product was inflated by the grayness of the market, which increased the lenders' risk, by collusion among the lenders, and by the ignorance of borrowers and their failure to shop widely for credit. Competition in this market was very imperfect.[46] But high cost by itself is not the hallmark of loan-sharking. Short-term loans will always be relatively expensive. The distinctive feature of loan-sharking, as noted in the previous Part, is the debt trap into which many borrowers are enticed by the either/or structure of these unamortized cash advances: either pay off the debt in one lump sum this payday or extend the due date another cycle for an additional, expensive fee. If you borrowed $20 last payday, you could pay $24 today and clear the debt or roll over the principal another cycle for an additional $4 charge. Inevitably, given the

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43. *See* CLARENCE WASSAM, THE SALARY LOAN BUSINESS IN NEW YORK CITY 24 (1908) (describing average transactions).

44. *See* MAYER, *supra* note 5, at 36 (reporting standard interest rates for a salary loan).

45. *See* CLARENCE HODSON, MONEY-LENDERS, LICENSE LAWS AND THE BUSINESS OF MAKING SMALL LOANS 13 (1919).

46. *See* Clyde Phelps, *Monopolistic and Imperfect Competition in Consumer Loans*, 8 J. MARKETING 382, 382 (1944) (distinguishing between the market for commercial loans and consumer personal installment loans).

cash-strapped clientele to which the salary lenders catered, many debtors opted for the smaller payment. A new financial emergency might compel them to borrow from a different salary lender, using the proceeds of this new transaction to pay the fee for the old one. Late charges were added to the principal, which meant the fee would rise too. Frantic borrowers built pyramids of debt from a single, small cash advance. One survey from the period reported that 40% of these ostensibly short-term loans were extended for at least twenty-four months.[47] The newspapers of the day were filled with stories of debtors bled dry for years and driven to desperate straits by the predations of the salary lenders.[48] That's why they were derided as loan sharks.

B. British Moneylenders

Low usury ceilings a hundred years ago helped spawn the first loan sharks. The low rates lenders were required to charge prevented the development of more responsible products in the legal market. But deregulation of interest rates in the market for consumer loans did not automatically put an end to loan-sharking. Great Britain repealed its usury statute in 1854, initiating a bold experiment in deregulation.[49] But the new class of moneylenders that multiplied during the next fifty years engaged in the same sorts of practices that were beginning to make the American salary lenders notorious near the turn of the century.

Baker and Breitenstein recount the indictment of the British moneylending industry that was drawn up by reformers and a parliamentary commission in the last years of the nineteenth century,[50] but they fail to note that these abuses abounded in a deregulated market for consumer credit. Rates were condemned as excessive, the lenders engaged in deceptive practices, harsh

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47. *See* WASSAM, *supra* note 43, at 81.

48. *See* MAYER, *supra* note 5, at 37.

49. *See* DOROTHY ORCHARD & GEOFFREY MAY, MONEYLENDING IN GREAT BRITAIN 43 (1933).

50. *See* Baker & Breitenstein, *supra* note 2, at 584–85.

collection methods were still employed, and many who borrowed became trapped by their debts.[51] The commission found

> that in many cases default is inevitable, and that once a borrower has obtained a loan from a money-lender it is extremely difficult for him to get clear of the transaction. The circumstances are generally such as to force him to obtain renewal after renewal at increasingly extortionate rates until he is utterly ruined.[52]

This is precisely what the Americans were beginning to call loan-sharking in the 1890s, but it flourished in an essentially free market. The report concluded that "the system of money lending by professional money-lenders at high rates of interest is productive of crime, bankruptcy, unfair advantage over other creditors of the borrower, extortion from the borrower's family and friends, and other serious injuries to the community."[53] Indeed, the commissioners went so far as to claim "that only in rare cases is a person benefited by a loan obtained from a professional money-lender, and that the evil attendant upon the system far outweighs the good."[54]

In comparison to the American salary loan, the British promissory note seemed like a bargain. The typical rate was 5% a month, but the sums advanced were often larger and thus not exactly comparable to the American payday loan product of that period.[55] Interest-rate deregulation may therefore have made small cash loans in Great Britain less expensive than in the United States, but deregulation did not do away with the debt trap that was the main loan-shark evil plaguing consumers. Rather than re-impose price controls, Parliament opted instead for information disclosure and judicial review of contracts in the Moneylenders Act of 1900. Creditors were required to register

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51. *See* ORCHARD & MAY, *supra* note 49, at 43–76 (describing the abuses that flourished during the era of deregulation); *see also* THOMAS FARROW, IN THE MONEY-LENDER'S CLUTCHES (1895).

52. SELECT COMMITTEE ON MONEY-LENDING, REPORT, 1898, H.C., at iv (U.K).

53. *Id.* at v.

54. *Id.*

55. *See* ORCHARD & MAY, *supra* note 49, at 67 ("The usual rate on promissory notes, not too well secured, was 60 or 70 per cent a year . . . . Charges as high as 3,600 per cent were not unknown.").

with the government and to desist from false advertising, while courts of equity were authorized to give relief when they deemed a transaction to be "harsh and unconscionable."[56] "But," as Dorothy Orchard and Geoffrey May observed in their classic study, *Moneylending in Great Britain*, "business practice is like a gyroscope; to change its direction a considerable force must be applied. The act of 1900 did not apply sufficient force to redirect the course of moneylending; its results were modifications of details and extremes only."[57] Shark-like practices persisted in the market for cash loans and had to be attacked a quarter century later by a new Moneylenders Act, which established the presumption that interest in excess of 48% a year was unconscionable.[58]

Price deregulation in Great Britain did not prevent the emergence of loan-sharking in its nonviolent form at the end of the nineteenth century. That form of predatory lending thrived where the rate was low and where the rate ceiling had been removed. In both environments lenders prospered by trapping many of their customers. A better, more responsible loan product was not generated spontaneously in either market. It took philanthropic initiative and government action to fashion such a product in the United States after the turn of the twentieth century. The low ceilings in many American states were raised, but only to the point where experience demonstrated that this new and more consumer-friendly type of loan product could be vended profitably by authorized creditors. The result was a drastic reduction in the cost of credit for consumers and, simultaneously, a dwindling of the old loan-shark population.

IV. Finding the Mean

The invention of the Uniform Small Loan Law (USLL) was one of the great achievements of progressivism in the first

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56. *See id.* at 76–80 (reproducing the text of the Money-Lenders Act of 1900).

57. *Id.* at 81.

58. *See id.* at 115–35 (reproducing the text of the Moneylenders Act of 1927).

decades of the twentieth century.[59] This model law was drafted by representatives of the Russell Sage Foundation in cooperation with a fraction of chattel-mortgage lenders who were seeking to rehabilitate their industry by carving out a legal exception to the low usury caps for a new, responsible lending product.[60] Variations of the USLL were adopted by three-quarters of the state legislatures by the middle of the century.[61] Baker and Breitenstein acknowledge that the USLL was "effective in eliminating the moneylenders" who had operated in defiance of the old usury statutes, yet they depict the model law as a misguided failure because violent loan sharks emerged in some jurisdictions after its provisions were put into effect.[62] But this assessment is too harsh. The USLL was in fact the most successful regulatory strategy ever devised to minimize the two kinds of loan-sharking that have been the plague of payday since the birth of the credit society. In many states where this law was enacted the loan-shark debt trap that had once been so common all but disappeared by the middle of the twentieth century.

A. The Anti-Loan Shark Act

The story of the origin of the USLL has been told before,[63] so my discussion will be brief. This piece of legislation was the product of trial and error by progressive reformers who had come to the realization that low usury caps were counterproductive. As the author of the USLL, Arthur Ham, explained, "drastic laws result, not in the discontinuance of the usurious loan business, but in driving it further into the dark. Any attempt to work unnecessary hardship on the lender, to compass him about with

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59. *See* MAYER, *supra* note 5, at 46–47 (explaining why the USLL was "a textbook example of progressive public policy").

60. *See* ROBINSON & NUGENT, *supra* note 9, at 113–17 (recounting how the USLL was drafted).

61. *See* F. B. Hubachek, *Progress and Problems in Regulation of Consumer Credit*, 19 LAW & CONTEMP. PROBS. 4, 8 (1954) (noting that there were "36 states now having effective or partially effective small loan laws").

62. *See* Baker & Breitenstein, *supra* note 2, at 586.

63. *See generally* Elizabeth Anderson, *Experts, Ideas, and Policy Change: the Russell Sage Foundation and Small Loan Reform, 1909–1941*, *in* 37 THEORY & SOC'Y 271 (2008) (describing the history, origin, and effect of the USLL).

unreasonable restriction, has the inevitable result of forcing the borrower to pay a still higher charge for his loan."[64] Experience had demonstrated that a purely repressive strategy missed its mark. Consumers would continue to patronize the loan sharks until they were provided with a better alternative. Ham was able to convince a broad coalition of progressive forces that "the remedy appears to lie in attracting honest capital into the salary loan business on a reasonable money-making basis."[65] This was accomplished by devising a credit product that was more expensive than a bank loan but still reasonably priced and, most importantly, structured in such a way that debtors could retire the principal in installments spread over a number of paydays.[66]

The first draft of the USLL, authored in 1916, carved out an exception to the existing state usury ceiling for cash loans of $300 or less when vended by licensed dealers, subject to regulatory oversight, who were required to compute interest on the unpaid balance of the loan only and were not permitted to take interest in advance.[67] The maximum permissible charge was 3.5% a month, or 42% a year, but because the debt was amortized, the effective cost was considerably less.[68] A borrower who received $100 in cash and was given a year to retire the debt paid less than $24 in interest.[69] In the early years of the new "personal finance industry" called into existence by the USLL, the debt was typically secured with a chattel mortgage on home furnishings,

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64. ARTHUR HAM, REMEDIAL LOANS: A CONSTRUCTIVE PROGRAM 4–5 (1912).

65. *Id.* at 11.

66. *See* M. R. Neifeld, *Institutional Organization of Consumer Credit*, 8 LAW & CONTEMP. PROBS. 23, 27 (1941) (explaining that because "[i]n the American statute, the rate is a monthly one and must be so expressed," lenders must schedule repayment in monthly installments).

67. *See* DAVID GALLERT, WALTER HILBORN & GEOFFREY MAY, SMALL LOAN LEGISLATION 90–94 (1932) (reproducing the text of the first draft of the USLL).

68. *See id.* at 92 (explaining that principal on loans must not exceed $300, interest rates must not exceed 3½% per month and may not be compounded, nor may interest be applied to any portion of the loan that had already been paid).

69. *See* EVANS CLARK, FINANCING THE CONSUMER 117 (1930) ("Borrowers who are charged 3½% per month on a $100 installment repayment loan do not pay $42 on the $100, as they would if their notes were discounted at that rate in advance. They pay a total of $22.75 because they are charged each month only for the balance of the loan of which they still have the actual use.").

but over time most lenders dispensed with this formality and converted these extensions of credit into signature loans.[70]

In states like Illinois, where the existing usury cap was 7%,[71] the USLL raised the legal price creditors could charge for small-cash loans by a factor of six. But, since the typical salary loan cost 20% a month in interest, the USLL managed to cut the stated price of small loans by a factor of six.[72] The effective savings were even greater, since the regulated loans had to be amortized and the penalty fees lenders could assess were limited. Cash loans cost one-tenth of what had been the going rate when the usury cap was low.[73] Raising the permissible charge saved consumers enormously. Lower prices also reduced the likelihood that borrowers would become trapped by their debts. Regulators and lenders also took steps to ensure that households could not pyramid debts by borrowing from more than one authorized dealer at a time.[74]

Over the next three decades the USLL went through seven drafts.[75] Later versions closed loopholes through which new types of loan sharks, like the salary buyers, managed to slip for a time.[76] Baker and Breitenstein claim that "interest rate caps were largely abandoned as a means of regulating consumer credit beginning in the 1930s . . . because of the pervasive loan shark problem in the United States,"[77] but the opposite is true. In fact, a number of states in the 1930s experimented with *reducing* the

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70. *See* Adele Rabino, The Small Loan Law and Its Application in Illinois 64 (1942) (unpublished M.A. dissertation, Northwestern University) (noting the transformation from chattel-mortgage to signature loans in the personal finance industry) (on file with the Washington and Lee Law Review).

71. *See* FRANKLIN W. RYAN, USURY AND USURY LAWS 29 (1924) (charting the legal rates and lawful limits of interest in 1921).

72. *See* Mayer, *supra* note 5, at 114.

73. *See id.*

74. *See* WILLFORD KING, THE SMALL LOAN SITUATION IN NEW JERSEY 22 (1929) ("[T]he loan companies make every effort to prevent one man from borrowing from several different companies at once.").

75. *See* Hubachek, *supra* note 61, at 7 ("Seven drafts of the Foundation's uniform bill were published, the last in 1942. The basic principles of the first draft were continued in all later drafts. Changes merely improved the law to meet changing conditions.").

76. *See* ROBINSON & NUGENT, *supra* note 9, at 157–61.

77. Baker & Breitenstein, *supra* note 2, at 582.

statutory rate to save consumers even more money.[78] No state deregulated consumer credit during this era of bank failures. Modest reductions in the price of credit proved feasible; 36% a year became the maximum charge in many places at this time.[79] But where the ceiling was lowered too much, loan-sharking in its antediluvian form resurfaced.[80] It also continued unabated in the eighteen states that had not enacted some version of the USLL before World War Two. The Russell Sage Foundation estimated that there was about $100 million in unregulated lending occurring in the United States in 1937.[81] More than three-fourths of it was concentrated in the states with low usury caps, even though these jurisdictions accounted for less than 30% of the total population.[82]

B. The Extinction of a Predator

By the middle of the twentieth century, when the personal finance industry had fully matured and salary buying had been completely stamped out in the regulated states, many experts attested that loan-sharking had been all but extirpated where the USLL was in effect.[83] A 1954 symposium in *Law and Contemporary Problems* extolled the success of the model law: "This law has virtually eliminated the loan shark wherever it has been enacted in full. It has done so by permitting a regulated, commercial, competitive source of consumer loans to operate at much lower than the loan shark's rates though substantially

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78. *See* Rolf Nugent, *Three Experiments in Small-Loan Interest Rates*, 11 HARV. BUS. REV. 35, 37–46 (1933) (discussing the impact of three states' decisions to lower maximum small-loan interest rates, beginning in 1929 and continuing into the 1930s).

79. *See* ROBINSON & NUGENT, *supra* note 9, at 259–60.

80. *See* Nugent, *supra* note 78, at 42–46 (noting the growth of illegal lending in New Jersey and West Virginia after the rate cap for small loans was reduced).

81. *See* ROLF NUGENT, CONSUMER CREDIT AND ECONOMIC STABILITY 401 (1939).

82. *See id.* at 390–402 (reporting estimates of illegal lending across the United States at the end of the 1930s).

83. *See* NATIONAL CONSUMER FINANCE ASSOCIATION, THE CONSUMER FINANCE INDUSTRY 6 (1962) ("The Uniform Small Loan Law eliminated the loan shark wherever it was enacted.").

higher than ordinary usury limits."[84] The Legal Aid Society of Minneapolis was "pleased to report that no cases of usurious lending in the small loan field have come to the attention of this office in the past several years. Prior to the passage of the Uniform Small Loan Act in 1939 this office was constantly involved in defending victims of 'loan shark' lending at rates far in excess of the legal limits."[85] Nebraska's Department of Banking reported that "The disturbing activity and influence of the loan shark is today at more than a low ebb in Nebraska. It is virtually non-existent. . . . This almost complete absence of loan sharks is the most important reason why the borrowers of Nebraska are receiving the good small loan service they deserve."[86] Searches of the local press in these states from that time period confirm that loan-sharking, once so common, had vanished everywhere except in the movie theaters, where George Raft's 1952 mob thriller "Loan Shark" was a matinee favorite.

It was not price deregulation that brought about the demise of the salary brokers and the salary buyers, those first payday lenders. The USLL was a price-control law. It capped the rate lenders could charge, but at a level that made responsible lending feasible. Price deregulation a hundred years ago would have been not only politically impossible, given the ancient prejudice against usury that was still powerful then, but also counterproductive as a way to fight debt trapping because the policy would have amounted to issuing a license to loan shark. Legalization might have made the salary loan somewhat cheaper, though price deregulation in today's payday-loan market has not had that effect.[87] But legalization of high rates would have done nothing to force the salary lenders to amortize their product and to prevent overborrowing. We know this is true because price deregulation in the payday-loan market today has never had

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84. Hubachek, *supra* note 61, at 5.

85. *See* J.A.A. Burnquist, *A Regulatory Small Loan Law Solves Loan Shark Problem*, 19 L. & CONTEMP. PROBS. 29, 41 (1954) (quoting a letter from the Chief Counsel of the Legal Aid Society of Minneapolis).

86. Harold Johnson, *Nebraska Has No Loan Shark Problem Today*, 19 L. & CONTEMP. PROBS. 42, 53 (1954).

87. States that do not cap prices for payday loans record the highest fees per $100 borrowed.

those effects.[88] It does not undercut loan-sharking but authorizes it. The experience of the USLL completely contradicts the loan-shark thesis: what it teaches us is that unless interest rates in the small-loan market are capped at a moderate level, debt trapping will flourish.

V. The Rise and Fall of Mob Payday Lending

While conceding that the USLL eliminated the nonviolent loan sharks that had savaged America's cities in the first half of the twentieth century, Baker and Breitenstein argue that this piece of legislation had perverse consequences because it "actually helped to create the American loan shark."[89] They apply this label to the type of illegal lender "who is usually tied to organized crime and who, in addition to using deceptive practices and charging high interest rates, uses violence or threats of violence as a means of collection."[90] Baker and Breitenstein claim that this violent type of loan shark is "uniquely American,"[91] hence the label, but this is certainly false. Violent, mob-connected lenders have also operated in recent decades in Great Britain,[92] Italy,[93] and Japan.[94] This breed of loan shark is not uniquely American, though it does not seem to be present in every

88. Some payday lenders have switched to expensive installment loans where prices have been capped, but in states without price caps the main product is the short-term single-payment loan. *See* Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 568 (2009) (documenting "a general shift in the New Mexico small-loan marketplace from payday loans to a new product called the 'installment loan'" after more stringent regulations were imposed).

89. Baker & Breitenstein, *supra* note 2, at 586.

90. *Id.* at 582.

91. *Id.* at 583.

92. *See* Alistair Macdonald & Jeanne Whalen, *Loan Sharks Circle Credit-Starved Consumers—Illicit Operators Feed on Desperate Borrowers Who Gorged During Debt Boom; a 2,437% Interest Rate in Britain*, WALL ST. J., Sept. 1, 2009, at A13 (noting an increase in illegal loan sharks in Great Britain).

93. *See* Mary Jordan, *As Italian Banks Tighten Lending, Desperate Firms Call on the Mafia*, WASH. POST., Mar. 1, 2009, at A01 (detailing an increase in illegal Mafia lending amid the global financial crisis).

94. *See* DAVID KAPLAN & ALEC DUBRO, YAKUZA: JAPAN'S CRIMINAL UNDERWORLD 155–57 (2003) (describing an underground consumer credit market in Japan with "heavy gangster overtones").

developed society. Some countries that impose interest-rate ceilings have had to contend with these predators but others have not.[95] Removing the ceiling also does not guarantee that violent loan sharks won't emerge. Great Britain is a case in point. Violent, mob-connected creditors only came to prominence there *after* interest rates were deregulated once again in 1974. More will be said about this case in a later Part of the Article.[96] But the point I want to make here is that the relationship between interest-rate regulation and violent loan-sharking is complicated and cannot be reduced to a simple, elegant formula like the loan-shark thesis. That thesis does not explain well the pattern of violent payday lending in the United States over the last century.

A. Appearance and Reality

Before examining those patterns, three facts about mob loan-sharking should be borne in mind. First, it hasn't been as violent in practice as the media has made it out to be. Experts agree that "most loan-shark transactions are amicably conducted with both parties being satisfied."[97] The client needs cash that the loan shark agrees to provide without asking a lot of questions. The price is high but nobody else would lend the debtor money, so the exchange is mutually advantageous. The debtor is motivated to pay not only because his body is pledged as collateral but also because he wants to preserve his only line of credit.[98] The creditor, in turn, wants to avoid the expense of hiring a "nutcracker" to collect the debt. As a 1960s Chicago "juice man" explained, the cost of hiring a thug to break a deadbeat's leg

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95. *See* NEW ECONOMICS FOUNDATION, DOORSTEP ROBBERY: WHY THE UK NEEDS A FAIR LENDING LAW 21 (2009) ("The Institut für Finanzdienstleistungen (IFF, Institute for financial services) recently, in a submission to the Office of Fair Trading, highlighted the lack of evidence on loan sharks in Germany. In addition, extensive internet and literature research did not reveal evidence of illegal lending in Germany and France.").

96. *See infra* Part VII.B (providing examples from states with deregulated interest rates).

97. *Loan-Sharking*, *supra* note 33, at 97.

98. *See* REUTER & RUBINSTEIN, *supra* note 32, at 183 ("Persons who have needed to borrow from a loanshark are . . . likely to wish to borrow from him again . . . . [M]aintenance of the relationship which a borrower has established with a loanshark is an important consideration for the borrower.").

might exceed the sum he owed and, with a broken leg, it would be hard for the debtor to earn money and catch up on his payments. Imposing a less debilitating penalty usually made more sense: "[A] finger deliberately slit open with a razor blade never kept anybody from working, and serves as a constant reminder of next payday."[99] But the best strategy, this loan shark insisted, was to select customers carefully and not load them with excessive debt: "When business is good in a smoothly-run operation, muscle is seldom needed for collections."[100] One of the few empirical studies of a mob loan-shark operation confirms this view. Based on FBI case files, the study reported that interviews with 115 customers of the loan business turned up only one debtor who had been threatened. None were beaten.[101] Perhaps mob lenders in this particular city were unusually placid, but it would not be surprising if the use of force was rare. It would not take many examples to teach the lesson to debtors, and excessive use of force would only scare off business. The economics of violence in the loan-shark market tends to diminish the resort to corporal or capital punishment.

Second, while expensive, the fees charged by mob lenders were often no more—and sometimes even less—than the fees charged by today's payday lenders in the deregulated states. John Seidl says the standard rate in the 1960s was 20% a week,[102] which is more than payday lenders charge now. But he also gives examples of small loans to working people with annual interest rates below 200%, which is cheap for a payday loan.[103] The Chicago "juice man" cited above said he charged 10% a week for a $100 cash advance, which is a little less than the going rate for payday loans today in states that do not cap the fees.[104] The study based on FBI case files also reported surprisingly low rates. The

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99. *The Confessions of a 6-For-5 "Juice Man," supra* note 34, at 41.

100. *Id.*

101. *See* ANNELISE ANDERSON, THE BUSINESS OF ORGANIZED CRIME 66 (1979) (finding that "[t]he use of force by members of the Benguena family to encourage payment is almost nonexistent").

102. JOHN MICHAEL SEIDL, "UPON THE HIP"—A STUDY OF THE CRIMINAL LOAN-SHARK INDUSTRY 40 (1968).

103. *See id.* at 41, 78, 100–01.

104. *See The Confessions of a 6-For-5 "Juice Man," supra* note 34, at 40 ("If you borrow $100, your interest by next payday would only be $10.").

typical charge was 20% spread over 10 or 12 weeks; the annual percentage rate for this product was about 150%.[105] Payday loans today are never that inexpensive.

Third, and most important, we must bear in mind that most mob loan-sharking in this country has neither catered to working people in search of emergency cash nor operated as payday credit in the way that salary lending did early in the twentieth century. The target populations of extortionate lenders have typically been gamblers, small businessmen, and fellow criminals in need of emergency financing.[106] There has been some mob payday lending, too, but it died out long ago and has not been revived in states that restrict or prohibit payday lending now.[107] Awful though it may be, we must bear in mind that most criminal loan-sharking in the United States has operated in a different market from that of high-priced consumer credit. The one product does not substitute for the other, at least not in the twenty-first century. Hence regulatory changes in one market, bridge loans for working people, do not stimulate or constrict operations in the other market, which caters to a fundamentally different clientele.

B. Scope and Development

Bearing these facts in mind, let us return to the loan-shark thesis. It says that interest-rate caps breed violent loan sharks. The USLL is cited as a case in point. But if, as Baker and Breitenstein maintain, responsibility for the rise of mob loan-sharking is to be ascribed to the USLL, two patterns must be explained: first, why this new sort of loan shark emerged only in certain jurisdictions where interest rates were capped but not in others; and second, in the jurisdictions where it did emerge, why mob loan-sharking appeared only long after the law was changed.

Regarding the first question, the evidence is clear that mob loan-sharking has occurred only in certain geographical areas and not wherever interest rates are capped or criminal penalties imposed for usurious lending. Like the nonviolent type of loan-

105. ANDERSON, *supra* note 101, at 65.
106. *Id.* at 66–67.
107. *See infra* Part V.B.

sharking, it is an urban phenomenon, but the scope of mob lending has always been more restricted. Traces of it are to be found only in the vicinity of the largest metropolitan areas—big cities like New York, Boston, Philadelphia, or Chicago. These are the places where crime families have been organized, but outside their relatively narrow territories mob loan-sharking seems never to have gained a foothold in this country. In an important study of criminal loan-sharking carried out in the late 1960s, Seidl tried to gauge the extent of its reach by traveling across New England and making inquiries about illegal lending at police stations, bars, and factories.[108] He found no evidence of underworld credit networks outside the biggest cities.[109] There were bookies in the smaller towns but no loan sharks, not even where there were large concentrations of factory workers.[110] Mob lending could only establish itself in the largest markets, where it was possible to escape detection by the authorities.[111] Other studies confirm the same point, that the imposition of interest-rate caps or the criminalization of illegal lending does not automatically spawn violent loan sharks. When Maine tightened restrictions on lending in 1967, many licensed lenders were forced out of business, but the author of a study critical of this policy conceded that "no evidence of loan sharking was found" after the limits were imposed.[112] The mob did not suddenly fill the vacuum left by the retreat of the small-loan companies in states lacking the megalopolises that offer protective cover to these criminal organizations.

Violent loan-sharking, then, is not inevitably called into existence wherever rate caps are imposed. And where it did come into existence in states that enacted a version of the USLL, the lag in time is considerable. There is agreement that mob loan-

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108. SEIDL, *supra* note 102, at 97–100.

109. *Id.*

110. *Id.*

111. *Id.*

112. *See* George Benston, *An Analysis of Maine's "36 Month Limitation" on Finance Company Small Loans*, *in* 2 TECHNICAL STUDIES OF THE NATIONAL COMMISSION ON CONSUMER FINANCE 1, 59 (1975) (claiming that although no evidence of loan sharking was found in this study, "the evidence of other states and times speaks otherwise").

sharking emerged first in the boroughs of New York.[113] Organized rings only began to operate in the 1930s, after the repeal of Prohibition.[114] But the New York state legislature had raised the cap for small loans twenty years earlier.[115] This is a lengthy delay, and it is even greater in the other states where mob lending took root. Illinois, for example, pushed through its version of the Anti-Loan Shark Act in 1917, yet there are no traces of syndicate loan-sharking to be found in Chicago until after World War Two.[116] More than a quarter century separates the enactment of the Illinois law and the rise of "juice" lending, as it came to be known in Chicago.[117] We cannot say, then, that criminal prohibition of high-rate lending and the emergence of mob loan-sharking are like cause and effect. Because there is considerable variance across time and space in the incidence of this type of violent payday lending, circumstantial factors not accounted for by the loan-shark thesis seem crucial.

C. Evolution and Decay

As Seidl notes, "criminal loan-sharking developed first as a small-loan business."[118] It was a form of payday lending but distinctive because its debt collectors were willing to lay their hands on customers who fell behind in their payments. For fifteen or twenty years this model of payday lending was largely concentrated within the boundaries of New York.[119] It seems to

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113. *See* SEIDL, *supra* note 102, at 43 ("The earliest criminal loan-sharking that the author is aware of was conducted in New York City during the 1920's.").

114. *See* Haller & Alviti, *supra* note 10, at 142 ("Not until the early 1930's did racketeer loansharks develop the small loan market to consumers that had been serviced by the salary lenders.").

115. *See* ROGER BARRETT, COMPILATION OF CONSUMER FINANCE LAWS 422 (1952) (discussing the legislative history of New York's Consumer Finance Act).

116. *See* ILLINOIS CRIME INVESTIGATING COMMISSION, JUICE RACKETEERS 6 (1970) ("[D]uring the post-World War II period organized crime discovered the tremendous profits to be made from loan sharking.").

117. *Id.*

118. *See* SEIDL, *supra* note 102, at 126.

119. *See* Haller & Alviti, *supra* note 10, at 126 ("For many cities, . . . such loan sharking probably did not become a standard underworld activity until the 1950s.").

have sprouted in Chicago and other big cities during the 1950s but only came to the attention of the media in the next decade. Many sensational stories were written about the violence of "juice racketeers," reshaping the popular image of what a loan shark is.[120] But even as the public was becoming aware of this new type of loan-sharking, and at the same time forgetting that another type had once existed in the days before the USLL, mob lending was transforming itself. By the end of the decade informed observers began to note that, "while the prime victims of the loan sharks were formerly selected from impoverished wage earners, the prey is now found in the middle classes."[121] Businessmen and professionals had become the preferred clientele for syndicate loan sharks because they had collateral to seize in case of default and because a few larger loans were easier to service, less risky, and more lucrative than many tiny payday loans.[122] Another observer at this time claimed that the $6-for-$5 factory operations of yesteryear were now "an anachronism bearing virtually no relation to current reality" in the black-market world of loan-sharking.[123] Later still, an FBI official in New York would insist that "organized crime in this region has grown from the traditional concept of giving small loans to poor slobs who are beaten up by the system and need a few hundred bucks to a corporate level of substantial loans to businessmen."[124] In this respect, the mob loan sharks were merely imitating the behavior of the personal finance companies, which were increasingly abandoning the payday-loan business they had been established to provide because it was less profitable than selling second mortgages.[125] Both sorts of lenders, legal and illegal, moved up

120. *See* MAYER, *supra* note 5, at 104–07 ("The Chicago Papers were filled with stories in the 1960s of debtors who were harassed and beaten.").

121. Comment, *Syndicate Loan-Shark Activities and New York's Usury Statute*, 66 COLUM. L. REV. 167, 167 (1966).

122. *See* REUTER & RUBINSTEIN, *supra* note 32, at 172, 175 (giving details of small and big loan transactions and the relationship of lenders to professionals and businessmen).

123. Fred Cook, *If You Are Willing to Put Up Your Body for Collateral*, N.Y. TIMES MAGAZINE, Jan. 28, 1968, at SM19.

124. Selwyn Raab, *Loan-Sharking Inquiry Gives Officials New Insights into Organized Crime*, N.Y. TIMES, Aug. 17, 1984, at B2.

125. *See* MAYER, *supra* note 5, at 108, 120–21 (comparing loan sharks lending money to businessmen to personal finance companies selling second

the income scale in search of a more lucrative and less troublesome clientele.

One New York loan shark explained why he no longer worked the waterfront districts that had once teemed with mob payday lenders: "I wouldn't put out any money even at 15 per cent [a week] now because operating costs are so high. Half the guys who borrow are on dope and no matter what you do, they aren't going to pay you back because they end up on Rikers Island [in jail] or getting shot by the cops."[126] Even a juice man couldn't squeeze blood from a turnip. His money was now invested with a brokerage firm, he said, "because even if it ain't sure, you don't have all those creeps and bums to work with."[127]

Baker and Breitenstein claim that "the American [or mob] loan shark problem remained severe until the late 1970s," when interest rates began to be deregulated.[128] The landmark Supreme Court decision was *Marquette National Bank v. First Omaha Service Corp.*, which authorized national banks to export whatever interest rate was operative in the state where they were chartered.[129] "Because this final deregulation of interest rates," Baker and Breitenstein say, "included nearly every potential borrower in the market for legal lending, the American loan shark, whose collection practices were unappealing to borrowers, was run out of business."[130] This fits the script of the loan-shark thesis but it does not accord with the facts on the ground. Mob payday lending had withered well before interest rates were deregulated by the federal and state governments at the end of the 1970s.[131] The juice men were not run out of business by new, high-priced forms of credit like the postdated

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mortgages).

126. *See* FRANCIS IANNI, A FAMILY BUSINESS: KINSHIP AND SOCIAL CONTROL IN ORGANIZED CRIME 99 (1972).

127. *Id.*

128. Baker & Breitenstein, *supra* note 2, at 587.

129. *See* Marquette Nat'l Bank v. First Omaha Serv. Corp., 439 U.S. 299, 318 (1978) (allowing exportation of interest rates from one state to another, no matter the laws of the state to which the rates are being imported).

130. *See* Baker & Breitenstein, *supra* note 2, at 587.

131. *See Syndicate Loan-Shark Activities*, *supra* note 121, at 168 (stating in 1966 that "syndicate loan-shark transactions no longer involve small sums of money borrowed by impoverished wage earners").

check loans that were beginning to emerge in the 1980s. They had already quit the field of their own accord. The mob loan-sharking that endured into the era of deregulation targeted different populations and did not compete directly with the new payday loans. It has been decades since anyone has had to worry about underworld affiliates working the local factories and trapping blue-collar family men with expensive $100 debts.

Even before its demise, it is doubtful that the problem of mob payday lending could have been classified as "severe." Certainly it never reached anything like the scale of nonviolent loan-sharking that flourished early in the twentieth century. In the urban centers for which FBI case files were made available, the estimate is that criminal loan sharks provided 0.1% of all consumer credit in the city, or 43¢ per person.[132] Because working people in need of emergency cash constituted but one fraction of the underworld lender's clientele, it seems more accurate to describe the problem of mob payday lending as minor, even insignificant, but not severe.

Mob payday lending does belong to the era of the USLL, but it is too great a simplification of the historical record to say that it was caused in any direct way by that piece of legislation. The story is more complicated. It is also inaccurate to say that deregulation killed off the violent loan sharks, because that population dwindled before interest rates were deregulated. What is more, as I shall demonstrate below, black-market lending—even of the violent sort—has endured where interest-rate caps have been lifted. At the same time, deregulation has permitted the older type of nonviolent loan sharks to reemerge in a new form—as today's payday lenders.

VI. The Return of the Loan Sharks

Baker and Breitenstein fear that if interest rates are capped once again, the loan sharks will return. But what they do not see is that the loan sharks in the original sense of the epithet have already reappeared in large numbers, precisely because interest rates were uncapped. Financial deregulation in the 1980s revived

132. ANDERSON, *supra* note 101.

the business of high-priced, short-term lending that the USLL had largely quashed. Today's payday lenders are the newest breed of loan shark.

A. The Evolution of Payday Lending

The main difference between the salary loan of a hundred years ago and today's payday advance is the instrument of security that binds the debtor to the creditor. Salary loans were typically secured with a wage assignment, which entitled the creditor to collect the payment due from the payroll office where the debtor worked.[133] While payday lenders now sometimes take wage assignments too, their main instrument of security is the postdated check debtors leave when they collect their cash. That check is held in pawn and then redeemed on the borrower's next payday, unless the debt is renewed.[134] Postdated-check lending dates back to the 1930s but only became a big business during the era of financial deregulation.[135] It is an offshoot of the check-cashing industry and could only develop on a large scale when checking accounts had proliferated into the bottom half of the income scale.[136] In some jurisdictions interest rates were deregulated before the new product appeared on the scene, but in others the established check cashers began to vend the product first and only later sought legislative exemption from the existing usury statutes, when the courts determined that the transaction counted as an extension of credit.[137] Eventually, forty-one states accorded legal recognition to these new, high-priced loans, but a cluster of states along the eastern seaboard retained their traditional usury caps and thus blocked the development of a

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133. *See* Guy Blake, *The Validity of Laws Regulating Wage Assignments*, 5 ILL. L. REV. 343, 343 (1911) (describing how salary loan debts were collected).

134. *See* Michael Stegman, *Payday Lending*, 21 J. ECON. PERSP. 169, 169 (2007) (describing the process by which a person gets a payday loan).

135. *See* MAYER, *supra* note 5, at 128–37 (explaining why postdated-check lending grew in the 1980s and 1990s).

136. *See* CASKEY, *supra* note 38, at 30–35 (recounting the development of the check-cashing business).

137. *See* MAYER, *supra* note 5, at 160 ("[L]egislators in many states decided the demand for this technically illegal product was such that it warranted statutory authorization.").

legal market in payday loans. Over the past decade a backlash has grown against the product, and some states have rescinded the authorization they once granted to this industry. Today, payday lending is feasible and permitted in thirty-four states.[138]

Interest-rate deregulation was one of the preconditions for the rise of payday lending, but just as important was the deregulation of banking that began at the end of the 1970s.[139] New subprime credit products were developed, more credit was extended further down the income scale, and banks began to impose heavier penalties for bouncing checks and overdrawing accounts. The new fees—combined with greater indebtedness, decreased savings, and accelerating income inequality—stoked the demand for the short bursts of liquidity that check lenders began offering to subprime consumers at a premium price. Payday lending grew in part as a way to avoid incurring the expensive charges banks imposed when checking accounts ran dry before they could be replenished from the income stream of cash-strapped consumers.

In the space of twenty-five years, payday lending grew from nothing into a $50 billion business.[140] The fees the check lenders charge today in the most deregulated jurisdictions are double the rate of the old salary lenders and often more than the mob payday lenders assessed. In states like Wisconsin, which does not cap fees, the typical two-week, $300 loan costs $66.[141] Stated as an annual percentage rate, the cost is 573%.

B. The Debt Trap

Many people would classify a loan that expensive as loan-sharking. But, as I argued in a previous section of this paper, the

138. *See Know Your Fee,* COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA, http://cfsaa.com/our-resources/customer-resources/know-your-fee.aspx (last visited Apr. 3, 2012) (on file with the Washington and Lee Law Review).

139. *See* MAYER, *supra* note 5, at 119–28 (explaining the "infrastructure of liquidity" in the late 1970s and 1980s).

140. *See* Bob Driehaus, *Some States Set Caps to Control Payday Loans*, N.Y. TIMES, Sept. 8, 2008, at A17 (citing an estimate of Stephens, Inc., a consulting firm that monitors the industry).

141. *See* MAYER, *supra* note 5, at 234 (recalling a time the author borrowed on a payday loan).

real measure of loan-sharking isn't the annual percentage rate lenders charge, but the length of time expensive debt endures.[142] Loan-sharking is debt trapping; it is a predatory practice that consists in renewing short-term loans again and again in order to maximize fee income. This is what the salary lenders and the juice men both did. They structured their extensions of credit in such a way that ostensibly short-term loans became expensive long-term debts.

If we make debt duration the measure of loan-sharking, rather than the application of violence to collect the debt, then today's payday lending is loan-sharking. Only a small minority of payday loan customers borrow for two weeks and then quit or take out just a few loans dispersed over the course of a calendar year.[143] A recent report by the Center for Responsible Lending offers telling evidence. Based on regulatory data gathered in Oklahoma, the study reveals that payday borrowers "are indebted an average of 212 days in the first year they borrow (or 58 percent of the year), and continue to be indebted over half the time in their second year as well."[144] This average includes the 15% of customers who borrow once and never go back to the payday lender. The report notes that, "if we leave out these one-time borrowers, we estimate that the remaining 85 percent of borrowers are indebted for [an average of] 345 days (63 percent of the total time period) in their first 18 months and 432 days (59 percent of the total time period) on average over the course of two years."[145] What is more, the data "demonstrate that borrowers tend to become more heavily indebted—taking out loans more frequently and for larger amounts—as they continue to borrow from payday lenders."[146] These are exactly the sorts of patterns that earned the salary lenders the loan shark epithet a hundred years ago.

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142. *See supra* Part II.C.

143. *See* URIAH KING, LESLIE PARRISH & OZLEM TANIK, CTR. FOR RESPONSIBLE LENDING, FINANCIAL QUICKSAND: PAYDAY LENDING SINKS BORROWERS IN DEBT WITH $4.2 BILLION IN PREDATORY FEES EVERY YEAR 6–9 (2006) (reporting that "most borrowers renew payday loans many times per year").

144. URIAH KING & LESLIE PARRISH, CTR. FOR RESPONSIBLE LENDING, PAYDAY LOANS, INC.: SHORT ON CREDIT, LONG ON DEBT 5 (2011).

145. *Id.*

146. *See id.* at 6.

The results of this study are entirely representative. The payday lenders' national organization cautions consumers that "payday advances should be used for short-term financial needs only, not as a long-term financial solution."[147] But in every jurisdiction where regulatory data are reported on the pattern of consumer use, trends like those revealed in Oklahoma recur.[148] These short-term loans become, in the majority of cases, long-term and very expensive debts. The product forms a trap, clever because it does not ensnare every consumer and because the result is achieved without the use of fraud or violence. If we judge matters by the public outcry, payday lending is the shrewdest form of loan-sharking yet devised.

C. The Scale of Payday Lending

Measured by the fraction of the population that makes use of the product, payday lending has not reached the scale of salary lending a hundred years ago and it is unlikely ever to do so. The consumer credit market has expanded enormously over the past century and it is now thickly populated with many different kinds of products. Many wage earners who might have patronized the salary lenders at the start of the twentieth century can now charge purchases on a bank card and pay the bill later or get a cash advance with a credit card. Both options will be much cheaper than a payday loan, unless late penalties are incurred.[149]

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147. According to the Consumer Financial Services Association (CFSA) best practices, all member stores display a sign with this warning or one similar to it. *See CFSA Best Practies*, http://cfsaa.com/cfsa-member-best-practices.aspx (follow "Encourage Consumer Responsibility") (last visited Apr. 3, 2012) (on file with the Washington and Lee Law Review). Many members also post such a warning on their website. *See, e.g.*, *Express Check Advance*, http://www.expresscheckadvance.com/ (last visited Apr. 3, 2012) (displaying the quoted warning near the bottom of the member company web sites) (on file with the Washington and Lee Law Review); *Check Into Cash*, http://www.checkintocash.biz/ (last visited Apr. 3, 2012) (same) (on file with the Washington and Lee Law Review).

148. *See* URIAH KING & LESLIE PARRISH, CTR. FOR RESPONSIBLE LENDING, SPRINGING THE DEBT TRAP: RATE CAPS ARE ONLY PROVEN PAYDAY LENDING REFORM 8–12 (2007) (finding that long-term recurring debt is common with payday loans).

149. *See* Kelly D. Edmiston, *Could Restrictions on Payday Lending Hurt Consumers?*, FED. RES. BANK OF KANSAS CITY ECON. REV. 63, 65 (2011) ("[T]he fee on a typical payday loan is more than 25 times greater than the interest on a

Estimates of the percentage of the population that has secured a payday advance are imprecise. According to the 2007 Survey of Consumer Finances, 2.4% of households reported getting a payday advance during the preceding twelve months.[150] But self-reporting surveys probably underestimate significantly the size of the market because a taint attaches itself to the product. The latest regulatory report on payday lending in Florida stated that about 750,000 individuals had secured at least one payday loan during the previous twelve months, which works out to be 5% of the adult population in the state and as many as one in ten households.[151] Two million adults (or one in seven) have secured a payday advance in Florida over the past decade, according to state records,[152] but only an estimated 303,000 residents admitted doing so in a comprehensive survey carried out by the Federal Deposit Insurance Corporation in 2009.[153] But whether the higher or lower estimates are more accurate, it seems clear that loan-sharking of the nonviolent sort does not engulf as large a share of the population today as it did in the heyday of salary lending.

There is proportionately less salary debt trapping now than there once was in the earliest phases of the credit society, but in contrast to the past, the great bulk of this debt trapping is legal. The market now is white, not gray or black. Loan-sharking in its original sense has been licensed, in part due to the misguided fear that prohibition of high-rate lending will revive the mob loan sharks that continue to haunt the modern imagination. In the next Part of the Article, I explain why this fear is misplaced and what forms black-market lending now takes in the twenty-first century.

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typical credit card.").

150. Brian Bucks, Arthur Kennickell, Traci Mach & Kevin Moore, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*, 95 FED. RES. BULL. A1, A47 (2009).

151. *See* VERITEC SOLUTIONS, FLORIDA TRENDS IN DEFERRED PRESENTMENT 6, 11 (2010).

152. *See id.* at 8.

153. *See* FEDERAL DEPOSIT INSURANCE CORPORATION, ADDENDUM TO THE 2009 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS: USE OF ALTERNATIVE FINANCIAL SERVICES 50 (2010).

VII. Illegal Lending Today

According to Baker and Breitenstein, "[i]t is very likely that elimination of the other alternative sources of credit which are the main competition for the American loan shark would result in his return."[154] If the interest rates lenders may charge are capped so low that payday lending and other forms of expensive subprime credit disappear, violent loan-sharking will be revived, they claim. But there is no need to speculate about whether low usury caps would have this effect. Payday lending is infeasible or prohibited today in sixteen states plus the District of Columbia.[155] If the loan-shark thesis is valid, extortionate payday lending ought to flourish where prohibition is enforced and should not exist where interest rates have been deregulated. But the evidence suggests that neither of these propositions is correct.

A. Where Prohibition Is in Effect

With a maximum permissible interest rate of 18% a year, Vermont has one of the lowest usury caps in the nation.[156] Payday lending has never been authorized there, yet no federal indictments have been recorded in the state during the last twenty years for engaging in an extortionate credit transaction, and the local press has not published a single story in that time about local black-market lending.[157] If the loan-shark thesis were valid, violent loan-sharking ought to be rampant in Vermont, but there is no evidence that it is. The usury cap in Maine is 30% a year,[158] but no federal prosecutions for extortionate lending have been initiated during the twenty-first century. One such case was processed during the 1990s, but it concerned a botched drug deal,

154. *See* Baker & Breitenstein, *supra* note 2, at 596.

155. COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA, *supra* note 138.

156. *See* VT. STAT. ANN. tit. 9, § 41a (West 2011) (detailing the specific provisions of Vermont's maximum loan laws).

157. U.S. District Court, District of Vermont, Official Court Electronic Document Filing System, case search for U.S. Code Section 18:894, Collection of Credit by Extortion, performed 1 September 2011.

158. ME. REV. STAT. ANN. tit. 9-A, § 2-401 (2011).

not a loan-sharking operation.[159] The local press has also failed to register any reports about criminal gangs engaged in illegal lending over the past two decades. Maryland is another state that retained its version of the USLL but shows no evidence that loan-shark rings have ever flourished there during the last quarter-century.[160]

Other states that prohibit expensive check loans have recorded more federal indictments for extortionate lending, in those jurisdictions where organized crime has long operated. Since the turn of the twenty-first century, four cases were initiated under Part 18:894 of the United States Code in Connecticut; seven in the Eastern District of Pennsylvania; seventeen in Massachusetts; seventeen in New Jersey; and seventy-one in the Southern District of New York.[161] But where accounts of individual cases are available, it seems clear that none of the mob loan-sharking prosecuted by federal authorities could be classified as payday lending. The loans were too large and the interest rates too low to make these transactions comparable to the payday advance. The typical victims of these criminal loan sharks were gamblers and small businessmen, not single moms in search of emergency cash.

Very rarely, reports surface in some of these states of vest-pocket credit operations that more closely approximate payday lending. New York State's Office of the Inspector General reported a case in 2009 of a state employee who had been making small loans for some years at usurious rates to coworkers.[162] A $30 cash advance cost $40 two weeks later, which translates into

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159. U.S. District Court, District of Maine, Official Court Electronic Document Filing System, case search for U.S. Code Section 18:894, Collection of Credit by Extortion, performed 1 September 2011.

160. U.S. District Court, District of Maryland, Official Court Electronic Document Filing System, case search for U.S. Code Section 18:894, Collection of Credit by Extortion, performed 1 September 2011.

161. Case searches were performed on 1 September 2011 for U.S. Code Section 18:894, Collection of Credit by Extortion, for these U.S. District Court jurisdictions: District of Connecticut, District of Massachusetts, District of New Jersey, Eastern District of Pennsylvania, and Southern District of New York.

162. *See* Final Report, State of New York, Office of the State Inspector General (Jan. 22, 2009) (detailing an investigation of an employee in the State Higher Education Services Corporation) (on file with the Washington and Lee Law Review).

an annual percentage rate of 865%.[163] Other loans cost less or were for considerably larger sums, and, like many independent operators, this black-market lender never threatened debtors with physical harm.[164] Over the space of a decade he extended approximately $13,000 in credit.[165] The man was an old-fashioned loan shark, but it is striking how rare his breed is in a state that caps interest rates so low. The Inspector General's Office has issued scores and scores of press releases over the past five years detailing allegations of employee impropriety, but in that time period only one case of vest-pocket loan-sharking has come to light.[166] No doubt some illegal lending is never detected, but if violent payday lending were rife, as the loan-shark thesis predicts it will be in states with low usury caps, more evidence of its occurrence ought to surface because loan-sharking—especially violent loan-sharking—makes for good headlines.

B. Where Deregulation Is in Effect

The loan-shark thesis is wrong in both its predictions: states with low rate caps have experienced little or no violent loan-sharking in recent years, while at least some states with high or no rate caps have failed to exterminate this form of predation. Illinois is one example. It deregulated interest rates in 1982, but federal prosecution of extortionate credit transactions still occurs. In the 1990s, nineteen cases were prosecuted and since 2000, when efforts to regulate payday lending began, another six cases were initiated.[167] As is true elsewhere, none of these cases involved what could be called payday lending, which the juice crews gave up long ago. In slum areas in Chicago, reports have surfaced of neighborhood loan sharks who extend credit to

163. *Id.*

164. *Id.*

165. *Id.*

166. *See Reports of Investigations and Press Releases*, NEW YORK STATE OFFICE OF THE INSPECTOR GENERAL, http://www.ig.ny.gov/reports/reports.html (last visited Apr. 3, 2011) (displaying links to archived reports of investigation 2006–2012) (on file with the Washington and Lee Law Review).

167. U.S. District Court, Northern District of Illinois, Official Court Electronic Document Filing System, case search for U.S. Code Section 18:894, Collection of Credit by Extortion, performed 1 September 2011.

"shopkeepers and residents who may not have bank accounts or access to lines of credit."[168] One sociologist counted seventeen loan sharks in the community where he did fieldwork back in the 1990s, some employing violence to collect debts but others not.[169] Compared to a payday loan, the rates being charged seemed like a bargain: 20%–30% spread over several weeks or months. This black-market business persisted even though licensed lenders could charge any rate they liked in the legal market. Rate caps cannot explain the phenomenon because they had been removed.

The case of Great Britain also exposes the fallacy of the loan-shark thesis. Violent loan-sharking existed there in rough neighborhoods before it made its appearance in the United States and it occurred both before interest rates were restricted in 1927 and after.[170] Interest rates were deregulated once again in 1974, but the problem of violent loan-sharking has become more prominent since that time.[171] It occurs mostly in depressed areas among the unemployed, who rely on public assistance. The illegal lender takes the debtor's benefit book as collateral for the cash advance but may also use violence to compel repayment.[172] A survey of low-income households in Great Britain reported that 3% had turned to illegal lenders for credit, which works out to be 0.44% of the total British population.[173] The problem could not be described as severe, although the press regularly reports harrowing anecdotes, but the key point is that violent loan-sharking occurs in Great Britain even though interest rates are not capped. Deregulation does not automatically exterminate this

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168. SUDHIR VENKATESH, OFF THE BOOKS: THE UNDERGROUND ECONOMY OF THE URBAN POOR 140 (2006).

169. *See id.* at 399–400 (describing seventeen "creditors" in the underground economy of Marquis Park).

170. *See* SEAN O'CONNELL, CREDIT AND COMMUNITY: WORKING-CLASS DEBT IN THE UK SINCE 1880 131–37, 162–63 (2009) (recalling examples of threats and violence from loan sharks in Great Britain).

171. *See* AVRAM TAYLOR, WORKING CLASS CREDIT AND COMMUNITY SINCE 1918 58–65 (2002) (describing how since 1974 it has been illegal for anyone to lend any amount of money for interest if they do not have a license, and as a result, loan sharks have turned to violence to collect debts).

172. *See id.* at 60 (describing using the benefit book as collateral as "important" because once introduced into the relationship, "the individuals no longer needed to have any trust in each other").

173. PERSONAL FINANCE RESEARCH CENTRE, ILLEGAL LENDING IN THE UK 38, 77 (2006).

breed because not even a payday lender unencumbered by rate caps will extend credit to everyone who walks through the door. Some types of debtors are too risky to lend to unless you can extort repayment from them, which means that even the freest market will not be able to kill off every loan shark.

C. In Cyberspace

The loan-shark thesis is too simple, I have shown, but it is also outdated. It does not take account of the way that technological change has remade the market for illegal loans. Today, somebody who is short of cash before payday and who cannot access legal credit will not go searching for a break-your-leg loan shark in her neighborhood but will turn instead to the Internet, where unlicensed lending abounds.[174] Cash can be deposited directly in a checking account and payments debited automatically, without debtor and creditor ever having to meet face to face. The charges are very high, typically $25–$30 dollars for every $100 borrowed, and, "in many cases, the default option is to pay the finance charge only and renew the loan for another payday. If a consumer does nothing, the loan is automatically flipped."[175] This is the purest sort of loan-sharking, understood as debt trapping, but no customer is ever beaten by an online payday lender. The unlicensed vendors often locate themselves in tribal jurisdictions that claim sovereign immunity from local regulations or offshore, beyond the reach of American laws.[176] They have developed aggressive methods of debt collection, sometimes falsely threatening debtors with arrest for bank fraud,[177] but they cannot be classified as violent loan sharks even

174. *See generally* JEAN ANN FOX & ANNA PETRINI, CONSUMER FEDERATION OF AMERICA, INTERNET PAYDAY LENDING (2004) (outlining the advent of Internet payday lending and recommending increased regulation).

175. *Id.* at 4, 17.

176. *See id.* at 7–8 (citing examples of American companies that operate online out of Canada and the Federation of Saint Christopher and Nevis).

177. *See* Intelligence Note, *Telephone Collection Scam Related to Delinquent Payday Loans*, INTERNET CRIME COMPLAINT CENTER (Dec. 1, 2010), http://www.ic3.gov/media/2010/101201.aspx (last visited Apr. 3, 2012) ("[C]allers threaten victims with legal action, arrests, and in some cases physical violence if they refuse to pay.") (on file with the Washington and Lee Law Review).

when their techniques are extortionate. They are a new mutation of the loan shark genus and constitute a bigger problem than the violent loan sharks that ceded the payday loan market long ago.

There are no reliable figures on the volume of illegal Internet payday lending that is occurring today.[178] Some states that impose lower rate caps and prohibit payday lending have aggressively pursued the unlicensed vendors,[179] but this does not mean more of that type of loan-sharking is occurring in these states. Unlicensed lenders can trap consumers anywhere in cyberspace, regardless of whether payday lending is permitted in the borrower's locale. Statistics reported by the Internet Crime Complaint Center for each state do not show any correlation with local usury laws.[180] A news article on payday lending in Oregon reported that complaints against payday lenders increased after the usury rate was lowered to 36% a year, but the numbers cited were small.[181] It stands to reason that Internet payday lending would be more frequent where the product is not available from bricks-and-mortar vendors, but only these cyber loan sharks know the actual numbers. Whatever the numbers may be, what must be appreciated is that unlicensed virtual payday lending is the new face of loan-sharking now. It is not violent and its appeal as a way to raise cash quickly and anonymously reduces still further the likelihood that violent loan-sharking will be revived where rate caps are imposed or reduced. The shape of black-market credit has changed. Mob payday lending ought to be seen as a historical anomaly rather than an ever-present threat. There is no reason to think it will swell where price caps are imposed today.

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178. *See* DENNIS TELZROW, PRESENT AND FUTURE OF THE PAYDAY ADVANCE INDUSTRY (2008) (estimating that the legal market for Internet payday lending is $7 billion).

179. *See* Stephen Franklin, *Trapped by Web Loans with the 842% Interest Rate*, CHI. TRIB., May 11, 2008, at 1 (reporting on Illinois officials who heavily fined a short-term lender who had charged a consumer 2,190% annual interest on a loan).

180. INTERNET CRIME COMPLAINT CENTER, 2010 INTERNET CRIME REPORT 22 (2010), *available at* http://www.ic3.gov/media/annualreport/2010_IC3Report.pdf.

181. *See* Matthew Kish, *Payday Mayday: After Reform, Borrowers Flock to Shady Internet Payday Lenders*, PORTLAND BUS. J., Feb. 11, 2011, at 1 (citing sixty-three Oregonians complaining in 2010, up from twenty-one in 2005).

VIII. Conclusion: The Minimization of Loan-sharking

If we define loan-sharking as it was originally understood, as expensive debt trapping, and if we recognize that some loan sharks are violent but others are not, then the American experience with payday lending over the past 150 years teaches us that the total quantity of loan-sharking has been reduced the most when interest-rate ceilings are pegged at a moderate level. The USLL, which capped the price of small loans in the vicinity of 36% a year, was the most effective anti-loan-sharking measure ever adopted in this country. It raised the ceiling high enough for authorized lenders to market responsible credit products but not so high that it licensed the short-term, interest-only extensions of credit that have been the preferred method of debt trapping by every species of loan shark. Even if it is true that the USLL spawned a certain number of violent mob lenders in the biggest cities—a result, as we have seen, that did not occur automatically or everywhere—it must also be acknowledged that this law and the industry it regulated starved into extinction many more of the nonviolent but no less predatory salary lenders and salary buyers who were the pests of payday early in the twentieth century. Financial deregulation, by contrast, came on the scene after mob payday lending had vanished, and what it managed to accomplish was to call back into existence a loan-sharking industry that progressive reformers thought they had vanquished.

Defenders of today's payday lending industry correctly observe that other credit products exist now that are even more expensive than the postdated-check loan. When calculated as an annual percentage rate, the overdraft charges levied by banks can exceed 1000%.[182] Such products could be construed as debt trapping too and more onerous than payday loans.[183] Where payday advances are permitted, consumers have a lower cost and convenient alternative that can help them avoid the debt traps

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182. *See* Owen Asplundh, *Bounce Protection: Payday Lending in Sheep's Clothing*, 8 N.C. BANKING INST. 349, 349–51 (2004) (noting that "[l]ike payday lending," which can cost 300% to 1,000% expressed as an APR, "the calculated APR for bounce protection is potentially astronomical").

183. *See* Marc Fusaro, *Hidden Consumer Loans: An Analysis of Implicit Interest Rates on Bounced Checks*, 29 J. FAM. ECON. ISSUES 251, 251 (2008) (comparing payday loans to new bounce protection loans offered by banks).

laid by banks.[184] Viewed from this angle, payday lending looks like a market-based solution to the most expensive forms of predatory lending. We fight loan sharks, too, the payday lenders might say, but we get no credit because the loan sharks we fight—the chartered banks—hide behind a cloak of respectability.

Whether payday lending increases or decreases the demand for overdraft products is a disputed issue that I will not try to resolve here.[185] But the point with which I will conclude is that this is the right way to frame the question about loan-sharking. The problem of loan-sharking is fundamentally the problem of debt trapping. It comes in different forms and the aim of public policy ought to be to minimize the total quantity of trapping that occurs. The goal should be to reduce the whole population of loan sharks and not just one breed. The violent sort of loan shark emphasized by what I have called the loan-shark thesis is the most exotic and dangerous species in this genus, but it is also the rarest. Whatever threat it may have represented decades ago, it has dwindled away and is unlikely to be revived in the altered environment of the twenty-first century. What we ought to be worried about is not the mob shark but all of the other debt trappers that have proliferated since our credit markets were deregulated. There are more of them now than ever before and most of them have been issued licenses. That is the loan-shark problem regulators should confront.

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184. *See* Zywicki, *supra* note 1, at 426, 453 (listing APRs as high as 520% for just one check in overdraft protection plans).

185. *Compare* Dennis Campbell, Asis Jerez & Peter Tufano, Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures (Dec. 3, 2008) (concluding that when compared with overdraft activity, "access to payday lending seems to lead to higher rates of account closure") (unpublished working paper) (on file with the Washington and Lee Law Review), *with* DONALD P. MORGAN & MICHAEL R. STRAIN, PAYDAY HOLIDAY: HOW HOUSEHOLDS FARED AFTER PAYDAY CREDIT BANS (Fed. Reserve Bank of N.Y. Staff Rep. No. 309) (2008) (reporting that the volume of bounced checks increased in Georgia after the state banned payday lending).