# Credit, Morality, and the Small-Dollar Loan

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*Modern jurisprudence and regulation of small-dollar lending is centered on a consumer protection framework. State and federal agencies and regulators monitor lender behavior, policing fraudulent activity, lack of disclosure, or predation. However, for most of American history, the relevant legal framework relating to small-dollar lending was the law of Usury. This is due, in part, to Court decisions and legislative deregulation that made it difficult for states to enforce usury laws. However, the broader shift was ideological—from the Progressive era framework acknowledging small-dollar lending as a systemic problem to the general dominance of the neoliberal lens on the market that filtered interest rate through market competition. Usury laws, having been infused with moral and even religious overtones, seemed out of touch with the emphasis on "freedom of contract." Regulating interest rates (i.e., setting prices) for small-dollar loans became anathema for a market-centric ideology. Yet, the tide has begun to turn, at least ideologically. This Article explores the legal and political evolution in lending regulation and offers suggestions on how to account for both systemic and moral concerns in small-dollar lending. The Article concludes with a proposal for a public banking option through postal banks.*

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## Introduction

Interest rates have reached unprecedented heights,[2] but there is evidence that the tide of moral opinion is turning. In May of 2019, Senator Bernie Sanders and Congresswoman Alexandra Ocasio-Cortez proposed a federal usury cap of 15% on credit card loans. Through the "Loan Shark Prevention Act," Senator Sanders and Congresswoman Ocasio-Cortez expressed a moral critique of high interest rates and invoked the familiar trope of loan sharks[3] as ruthlessly exploitative.[4] Sanders called current high interest rates charged by credit card issuers and banks "grotesque and disgusting."[5] The bill reintroduces moral condemnation to more than just the predatory fringe banking sector: it is a critique of the debt contract itself. The 15% rate cap is well below the current market for payday loans and would apply to most mainstream credit card issuers, peer-to-peer lenders, banks, and payday lenders.[6] The bill gained praise from supporters and ignited controversy, reviving a familiar conversation about usury that has laid dormant in American discourse since the Progressive era.[7] Indeed, modern public and policy conversations with regard to payday lending have been engaged through the lens of consumer protection rather than usury laws. This is partly due to laws that have made usury laws difficult to enforce as well as the general dominance of the neoliberal lens on the market that filtered interest rate through market competition and outside morality. This Article explores the history of morality and capitalism and shows how views about usury have revealed the tensions inherent in the debate.

This Article examines one type of contract that sits at the tense intersection of capitalism and morality: the small-dollar loan. The debt contract, or loan, is the exchange of money now for payment in the future.[8] Typically,

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[2] *See, e.g.*, Amanda Dixon, *Interest Rates Will Keep Rising in 2019, But a Slowdown is on the Horizon*, Bankrate (Jan. 2, 2019), https://www.bankrate.com/finance/mortgages/interest-rates-forecast.aspx [https://perma.cc/24MW-DN4Y].

[3] The term "loan shark" refers to moneylenders who "lend small sums at higher rates of charge than the law allows." Rolf Nugent, *The Loan-Shark Problem*, 8 Law and Contemporary Problems 3 (1941).

[4] Bernie Sanders, who has included "fair banking" in his 2020 presidential platform, discusses the need for protections from the "exploitative practices of these modern day loan sharks." *Issues: Fair Banking for All*, BernieSanders.com, https://berniesanders.com/issues/fair-banking-for-all/ [https://perma.cc/MB8Q-6BUG].

[5] Jacob Passy, *Bernie Sanders and Alexandria Ocasio-Cortez's Interest-Rate Cap Could be the Death Knell for Credit-Card Rewards Programs*, MarketWatch (May 13, 2019), https://www.marketwatch.com/story/how-bernie-sanders-and-alexandria-ocasio-cortezs-proposal-to-cap-credit-card-interest-rates-at-15-could-hurt-consumers-2019-05-10 [https://perma.cc/D3C3-ZWL4].

[6] Among mainstream credit cards, the national average APR is 17.8%. *See* Kelly Dilworth, *Credit Card Interest Rates Chart*, CreditCards.com (Aug. 21, 2019), https://www.creditcards.com/credit-card-news/historic-credit-card-interest-rate-chart.php [https://perma.cc/28Z4-RKWC].

[7] *See* Passy, *supra* note 5.

[8] *Loan*, Investopedia (Aug. 28, 2019), https://www.investopedia.com/terms/l/loan.asp [https://perma.cc/NH35-MYE7].

the borrower agrees to pay "interest," the set amount of money owed in addition to the principle sum. The law of usury interacts with private lending arrangements by setting a maximum allowable rate of interest. Any payment above this legally mandated rate of interest is called "usury." Whether the counterparties—the lender and the borrower—can make any interest arrangement they want has been, both historically and recently, a source of great controversy.[9] These questions are especially prevalent in the realm of small-dollar lending. The common law of contract allows two parties to make practically any deal insofar as there is a "bargained for exchange."[10] Indeed, one of the foundational concepts of contract law, called "consideration," is that the law does not concern itself with how much parties are willing to pay in an agreed-upon exchange.[11] The exceptions to this presumption are contracts that are against public policy.[12] But, in the case of usury, the bargain—the exchange of access to money now in exchange for interest on the principle—is not itself against public policy (unlike, for example, the trading of organs). The moral acceptance of the bargain operates on a sliding scale—some interest rates are too high to be morally acceptable.

The regulation of small-dollar lending implicates broader social mores around liberty, dignity, and equality. Loan sharks represent the hard edges of a capitalist economy where the poor are the principle victims of excess interest and fraudulent terms. The small-dollar loan industry both benefits and exploits its customers, which makes it emblematic of capitalism writ large. Questions about how much credit should cost (i.e., how much interest is acceptable) and how vigorously the law should police private contracting are really about the tension between morality and capitalism. The terms of the debate have shifted over time, as have the proposed solutions to the problem.

The law of usury reflects prevailing moral attitudes about morality and capitalism. In some historical moral-legal contexts, *any* interest charged was considered usurious.[13] Since the rise of laissez faire capitalism, however, usury laws have relaxed significantly.[14] In the contemporary American legal context, usury is defined as any interest charged above the legal maximum,

[9] *See, e.g.*, Passy, *supra* note 5; Suraj B. Gupta, *The Controversy Over Differential Lending Rates for Banks: An Examination*, 8 Indian Econ. Rev. 16, 38 (1973).

[10] Restatement (Second) of Contracts § 17 (Am. Law Inst. 1981).

[11] *See id.* § 79.

[12] Robert A. Hillman, Principles of Contract Law, 245 (4th ed. 2018). For much of human history, selling humans was acceptable. Today, it is not: selling organs, children, or humans is not allowed because we as a society have decided that capitalism cannot extend that far. Contracts for the sale of human eggs, sperm, and wombs varies across cultures depending on social norms. These contested and controversial contracts draw attention to each culture's moral code as it relates to markets. For an exploration of morality and markets, *see* Michael J. Sandel, What Money Can't Buy: The Moral Limits of Markets (2013).

[13] *See, e.g.*, Tracy A. Westen, *Usury in the Conflict of Laws: The Doctrine of the Lex Debitoris*, 55 Cal. L. Rev. 123, 128–29 (1967) (explaining that before the Enlightenment, charging interest of any kind was prohibited as unlawful usury by the law and the church); *Usury*, Black's Law Dictionary (11th ed. 2019).

[14] *See* Westen, *supra* note 13, at 136–37.

which in turn relies on the state legislature's democratic decisionmaking.[15] These determinations are no longer framed in moral terms. Now, to the extent policymakers and academics discuss the price of a loan, they are asking the "market" price and not the "moral" price. In other words, where earlier eras decried the usurer as "greedy" and "evil," today the tone of the debate is about market pricing and efficiency.[16] This is not surprising as market pricing is the *sine qua non* of the neoliberal philosophy.[17] Interest caps, regulations, and lending prohibitions are seen as unnecessary state interventions.

Interest rate laws and the debates surrounding them have always been at the intersection of capitalism and morality and have appeared in debates over whether capitalism can be moral or whether they are at odds.[18] In defense of setting very high or no interest rate caps at all, some claim that individuals should have the freedom to borrow at any rate and that firms only charge high rates to compensate for accepting high risks.[19] Moreover, defenders of unregulated interest rates claim that interest rate caps actually harm low-income consumers who are the most likely to need small loans and have lower credit scores.[20] Opponents of interest rate caps point out that lenders must be able to charge more in interest to make up for the risk of lending to these borrowers.[21] If Congress passed the Sanders and Ocasio-Cortez bill mandating a low interest cap, opponents argue, lenders simply would not lend to high-risk borrowers who may need small loans. In a sense, these observers are right that typically high interest rates correlate with higher risk, but the data on payday lending does not fully support this conclusion.[22] In fact, most payday lenders do not make rate determinations based on creditworthiness but rather charge the maximum allowable rate by law.[23]

On the other side of the debate, advocates for low interest rate caps point out that, regardless of market forces, charging the poor such high inter-

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[15] *See* Black's Law Dictionary, *supra* note 13.

[16] *See generally* Mehrsa Baradaran, *Banking and the Social Contract,* 89 Notre Dame L. Rev. 1338 (2014).

[17] *See generally* Sandel, *supra* note 12.

[18] *Id.*

[19] *See* Stefanie Haeffele & Todd Zywicki, *Loans Are Not Toasters: The Problems With a Consumer Financial Protection Agency,* Mercatus Center (Oct. 2009), https://ppe.mercatus.org/publications/financial-markets/loans-are-not-toasters-problems-consumer-financial-protection-agency [https://perma.cc/WE78-JXN2].

[20] Anne Fleming, *Sanders and AOC Want to Cap Interest Rates on Consumer Loans at 15% — Here's Why That's a Bad Idea*, The Conversation (May 28, 2019), http://theconversation.com/sanders-and-aoc-want-to-cap-interest-rates-on-consumer-loans-at-15-heres-why-thats-a-bad-idea-117060 [https://perma.cc/XQF2-PCS5].

[21] *Id.*

[22] Pew Charitable Trusts, Payday Loan Facts and the CFPB's Impact, (Jan. 14, 2016), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2016/01/payday-loan-facts-and-the-cfpbs-impact [https://perma.cc/DM6M-EFHY].

[23] *Id.* ("The payday loan market is not price competitive. Most lenders charge the maximum rate allowed under state law. States without rate limits have the highest prices.")

est rates is immoral—as Sanders said, "grotesque and disgusting."[24] It is impossible to resolve these points of view because they do not share a common scale for measuring right and wrong. One side measures good based on economic efficiency;[25] the other side measures good based on social well-being. On the first extreme, libertarians claim that capitalism benefits everyone, including poor borrowers, by allowing them more autonomy to borrow at whatever rates the market will bear and they will agree to. On the other extreme, anti-capitalists argue that what the market will bear is irrelevant to this conversation and that the rate that a lender should be able to charge is fundamentally about dignity and protection of the disempowered.

Usury law occupies an uncomfortable place in capitalism because, in the language of contracts, it steps between two willing parties and nullifies their mutually agreed-upon deal. The renewed focus on usury in American political discourse attests to a broader backlash against market rules and assumptions: the neoliberal legal framework that has been a guiding principle of the modern financial landscape is facing resistance across the globe.[26] Seen in this context, the ongoing conversation about debt and usury is a discussion about morality, justice, and fairness. The history of interest rate caps in the United States correlates with the relative dominance of free market orthodoxy or progressive economic theory. This essay will provide an overview of that terrain and ultimately suggest a path forward that moves past the usury debate.

The debates over market regulation generally have been cast into a binary of anti-capitalist or anti-market institutional reforms versus laissez-faire unregulated capitalism.[27] For example, Progressive era solutions to high interest rates were cooperative institutions like the credit union that served as grassroots non-profit alternatives to profit-making banks. In response to rising institutional power, disparate groups, movements, and unions coalesced into the Progressive movement.[28] Many of these groups were grassroots organizations that offered self-help services to members, but it would be a mistake to confuse their particular aims with their guiding philosophy. These progressive groups practiced self-help not because they believed, like modern conservatives or earlier philanthropists, that personal responsibility was

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[24] Passy, *supra* note 5.

[25] Some will even argue that capitalism *is* morality. *See, e.g.*, John Tamny, *Ayn Rand's "Free Market Revolution" by Yaron Brook and Don Watkins,* FORBES (Nov. 8, 2012) (book review), https://www.forbes.com/sites/johntamny/2012/11/08/book-review-ayn-rands-free-market-revolution-by-yaron-brook-and-don-watkins/#41f260396bf0 [https://perma.cc/T5GA-RBEA] ("But in the eyes of the authors, capitalism is moral and the only true economic system 'because it enables the individual to make the most of his *own* life — to exercise his mind, take risks, make money, pursue and achieve his own happiness.'").

[26] *See* Owen Worth, *Resistance to Neoliberalism Before and Since the Global Financial Crisis, in* THE SAGE HANDBOOK OF NEOLIBERALISM 609, 609–19 (Damien Cahill et al. eds., 2018).

[27] *See* WILLIAM J. NOVAK, THE PEOPLE'S WELFARE: LAW AND REGULATION IN NINETEENTH-CENTURY AMERICA 101 (1996).

[28] *See* K. SABEEL RAHMAN, DEMOCRACY AGAINST DOMINATION 69 (2016).

the antidote to poverty. Rather, they engaged in cooperative self-help as a form of political resistance against power. The Progressive project was to oppose centralized power—whether held by banks, railroads, or corporations.[29] They shared a commitment to counteract market power through democratic governance—even if the democracy was practiced on a micro-scale like a thrift or credit union. Meanwhile, the laissez-faire ideology of the *Lochner* era jurisprudence promoted contract supremacy and unregulated free markets.[30]

Yet, large corporations and grassroots cooperatives were not the only option. There were other paths not taken out of the binary of large corporate power versus grassroots cooperatives. One possibility was a public utility, or a "public option," a term that recently entered the political lexicon in the healthcare fights of the Clinton and Obama eras.[31] The country already had experience with a few public options before the Progressive era, but there would be more after the New Deal. The most emblematic example of a historic public option is the U.S. Post Office ("USPS"). There were competitors that could deliver mail such as the pony express and private carriers, but the Post Office would deliver mail to every home.[32] Customers pay for the services of the Post Office—the USPS would be self-sufficient, but not profitable.[33] When the Post Office was running a deficit, they added products such as telegraphs, air mail, or postal banking. What the Post Office could *not* do was to close down routes or locations because as a public option, the USPS had to service all communities regardless of costs.

This is the nature of a public option—it is available to all. It competes in a free market, and it must charge all people the same amount for the same services. This Article proposes a public option in banking that would offer services at a lower price, but one that is self-sustaining—if not profitable. This Article will also discuss some of the drawbacks of a public option and suggest how some of those obstacles can be averted. Offering a public option reduces the need to regulate usury and push for the elimination of pay day lenders. It provides a way out of the duality of capitalism and anti-capitalism by allowing the government to compete with markets. Instead of forcing private lenders to adopt a low interest rate or alternatively allowing the status quo wherein low-income borrowers have no option but to borrow money at crushingly high interest rates, this essay will suggest an alternative: a public option in lending.

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[29] *See id.*

[30] *See* Novak, *supra* note 27, at 101–02.

[31] *See, e.g.*, Ganesh Sitaraman & Anne L. Alstott, The Public Option (2019).

[32] *See* Richard R. John, Spreading the News: The American Postal System from Franklin to Morse, 112–15 (1995); Mehrsa Baradaran, How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy 211 (2015).

[33] *See* Ryan Cooper, *The miracle of the United States Postal Service*, The Week (Aug. 2, 2018), https://theweek.com/articles/787585/miracle-united-states-postal-service [https://perma.cc/9MW4-NEES]; John, *supra* note 32.

Part II of this essay provides a historical overview of the early protective usury regime in the Unites States and its subsequent erasure during the neoliberal deregulatory era. Part III explores the current small-dollar lending market, federal and state attempts at regulating the industry, and common law theories used to fight lending contracts. This Part also compares and contrasts the solutions to usury discussed during the Progressive era and those considered today. Finally, in Part IV, this Article concludes by considering the road not taken during the Progressive era and makes the case for a public option alternative in the small credit market.

## I. The History of Usury

### A. *Morality and Usury*

Usury is an ancient legal and moral concept with surprising longevity. Many early civilizations had sophisticated codes addressing usury and, still today, most countries have a legally mandated usury cap.[34] Yet the law of usury, perhaps because it is an ancient relic, is at odds with the common law of contracts as well as the modern understanding of credit markets. In many early societies, lending money at a profit was prohibited by religious law. The three Abrahamic religions, Judaism, Christianity, and Islam, have spoken directly about usury or interest and expressly prohibited it at one point or another.[35] The early Vedic texts also prohibited usury.[36] In the beginning, all of these religions forbade interest-bearing loans—in other words, usury was synonymous with interest.[37] Today, "reasonable interest" is socially acceptable and usury refers to "too much interest," or above what the law

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[34] According to a World Bank report, 76 countries have imposed restrictions on lending rates, which apply to 80% of global GDP and financial assets. *See* Aurora Ferrari & Oliver Masetti, *Interest Rate Caps: The Theory and the Practice*, World Bank Blogs (Apr. 11, 2018), http://blogs.worldbank.org/developmenttalk/interest-rate-caps-theory-and-practice [https://perma.cc/69P8-U23H].

[35] This is not to say that human civilization was ever free of usury. In fact, predatory lending has been present as long as human societies have existed, but has generally operated on the fringe of society within a sphere of corruption, violence, and stigma. *See* David Graeber, Debt: The First 5000 Years 10–11 (2011); *see also* Eric Toussaint, *The Long Tradition of Debt Cancellation in Mesopotamia and Egypt from 3000 to 1000 BC*, Comm. for the Abolition of Illegitimate Debt (Sept. 2, 2012), http://www.cadtm.org/The-Long-Tradition-of-Debt [https://perma.cc/DSG9-893T].

[36] In the years 2000 to 1400 BC, usury is mentioned in the Vedic texts of Ancient India; in 700–100 BC the Sutra texts and the Buddhist Jatakas of 600–400 BC prohibit usury. Vasishtha, a well-known Hindu lawmaker of that time, forbade usury and disparaged the practice saying that only "hypocritical ascetics are accused of practicing it." *See* L.C. Jain, Indigenous Banking in India 6 (1929). Vasishtha made a special law which forbade the higher castes of *Brahmanas* (priests) and *Kshatriyas* (warriors) from being usurers or lenders at interest. *See id.*

[37] *See* Ronald W. Del Sesto, *Should Usury Statutes Be Used to Solve the Installment Sales "Problem"?*, 5 B.C. L. Rev 389, 390 n.7 (1964).

allows.[38] Laws on usury thus reflect a changing moral understanding about the nature of lending and interest.

Ancient concerns about usury were often expressed in political terms. High concentrations of wealth and the deep inequalities they produce are destabilizing and ancient empires used debt repudiation to cancel debts before the problem reached a boiling point.[39] Apart from religious teachings, moral philosophers like Aristotle condemned usury as immoral, calling usurers greedy and the idea of usury unnatural.[40] "The most hated sort [of moneymaking], and with the greatest reason, is usury, which makes a gain out of money itself, and not from the natural use of it. For money was intended to be used in exchange, but not to increase at interest. And this term usury, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Wherefore of all modes of making money this is the most unnatural."[41]

The history of usury in pre-market societies is long and varied and this Article does not intend to cover even a small portion. However, it is safe to say that before the rise of the market economy, Western culture's predecessors viewed usury rules through a moral lens. This perspective changed with the rise of the market economy. The historian Ruston claims that around the 1620s, "usury passed from being an offence against public morality which a Christian government was expected to suppress to being a matter of private conscience [and] a new generation of Christian moralists redefined usury as excessive interest."[42]

### *B. Lending in America*

Tensions between debt and market capitalism shaped American politics from the beginning of settler-colonialism.[43] Many colonists came to America

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[38] *Usury*, Black's Law Dictionary (11th ed. 2019).

[39] In ancient Mesopotamia from 3000 to 1000 BC and then in Jerusalem and the Persian empire up to 400 BC, debts were forgiven through jubilee ceremonies and other political and religious rituals. *See* Michael Hudson, The Lost Tradition of Biblical Debt Cancellations 5–7 (1993), http://michael-hudson.com/wp-content/uploads/2010/03/HudsonLostTradition.pdf [https://perma.cc/4K9J-S85P]. This ceremony had religious significance as well as political and practical utility. The cancelling of the debt subdued unrest that might threaten political power. Ancient Athenians did the same — when Solon re-wrote the Athenian constitution in the early sixth century BC, he wiped the slates clean, forgave all debt and outlawed the practice of debt bondage. *See* Ivan Mortimer Linforth, Solon the Athenian 281 (1919).

[40] Aristotle, Dialogues of Plato and the Politics of Aristotle 16 (rev. ed., trans. Benjamin Jowett, New York City, The Colonial Press, 1899).

[41] *Id.*

[42] Roger Ruston, *Does it Matter What We Do with Our Money?*, Priests & People 173–74 (1993).

[43] Imprisonment was a common penalty for debtors in colonial America, as indebtedness was regarded as a sin as well as a crime. Jill Lepore, *I.O.U: How We Used to Treat Debtors*, The New Yorker (Apr. 6, 2009), https://www.newyorker.com/magazine/2009/04/13/i-o-u [https://perma.cc/F3CL-PKZF].

to escape their debts. A few states, most notably Georgia, were even established as debtor havens.[44] Before the Continental Congress ratified the Constitution, several state governments shielded their residents from debt enforcement, including the enforcement of federal taxation.[45] A debtor in one state who owed money to a corporation or government entity in another could appeal to their home state government and have their debt wiped out without consent of the creditor.[46] This frustrated many large creditors and merchants who were prohibited from collecting on their loans that they made through valid contracts.[47]

Nearly 90% of Americans at the time of ratification were small farmers who were hit hard during recessions.[48] In the recession that followed the Revolutionary War, farmers asked their representatives for debt relief on their obligations to pay taxes and other credit obligations. Because the state governments were responsive to the voters—all of the state constitutions except one required legislators to face the voters at least once a year—popular majorities could demand debt and tax relief, and legislators complied with their demands.[49] This was a problem for those who held government bonds, which were serviced by taxes, and private creditors like storekeepers who had sold merchandise on credit. The possibility that debt contracts could be unilaterally revoked by government fiat scared off investors, and many of the Framers believed that it had led to the prolonged recession of the 1780s.[50]

According to historian Woody Holton, this tension between capitalists and state governments was one of the most important issues debated and ultimately resolved in the U.S. Constitution.[51] It was resolved in favor of the creditor capitalists.[52] The Constitution shifted the power to regulate debt and credit contracts and tax forgiveness to the federal government.[53] Article I, Section 10 ("Contracts Clause") prohibited states from interfering with con-

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[44] Colonial Georgia was founded by philanthropist James Oglethorpe as a refuge from the debtors' prisons common during that time. Once the Constitution was ratified, states could no longer shield debtors from collection efforts. *See* KENNETH COLEMAN, COLONIAL GEORGIA: A HISTORY 13 (1976). Georgia was established to become a debtors' colony—a haven to keep debtors safe from being imprisoned if they remained in Georgia. *See* Sarah Dolisca Bellacicco, *Safe Haven No Longer: The Role of Georgia Courts and Private Probation Companies in Sustaining a De Facto Debtors' Prison System*, 48 GA. L. REV. 227, 234 (2013).

[45] *See* Lepore, *supra* note 43; WOODY HOLTON, UNRULY AMERICANS AND THE ORIGINS OF THE CONSTITUTION 9 (2008).

[46] *See* Lepore, *supra* note 43.

[47] Woody Holton, *The Capitalism Constitution, in* AMERICAN CAPITALISM (COLUMBIA STUDIES IN THE HISTORY OF U.S. CAPITALISM) CHAPTER 1 (Sven Beckert & Christine Desan eds., Kindle ed., 2018).

[48] *See id.*

[49] *See* Woody Holton, *Did Democracy Cause the Recession That Led to the Constitution?*, 92 J. AM. HIST. 442, 442 (2005).

[50] *See* Holton, *supra* note 47.

[51] *See id.* at 231–35.

[52] *See id.* at 9.

[53] *See id.*

tracts, with the purpose of attracting investors both to government bonds and to private enterprise.[54] Article I, Section 10 prohibits the state assemblies from making "any Thing but gold and silver Coin a Tender in Payment of Debts," or adopting any "Law impairing the Obligation of Contracts."[55] This provision prohibits states from interfering with contracts in favor of creditors, a result of a vigorous dispute during ratification. According to Holton, in order "to make sure that this new national government would not adopt its own tax and debt relief measures, or at least would not look the other way when individual states did so, the authors of the Constitution made it much less amenable to pressure from ordinary farmers."[56]

The pro-capitalist Federalists referred to the ban on paper money and the Contracts Clause as "the best in the Constitution," "the soul of the Constitution," and "Sufficient to outweigh all Objections to the System."[57] According to one New Jersey Federalist, "Nothing, in the whole Federal Constitution, is more necessary than this very section."[58] James Wilson and Benjamin Rush both believed that even if the Constitution had done nothing more than ban paper money, that alone would still have been, in Rush's words, "eno' to recommend it to honest men."[59] It is likely that Northern Federalists were more likely to be creditors, and creditors were often frustrated by debt forgiveness offered by state governments to their citizens. Progressive historians believed that it was the creditors among the Framers that pushed for this clause.[60] Holton claims that although many were creditors, "there is abundant evidence that the Framers had a larger motive for writing a pro-creditor Constitution: making America safe for capitalist investment."[61] In either scenario, the debate and its ultimate resolution were among the first of many conflicts about debt that pitted the needs of "the people" against the needs of free-market capitalism.[62]

This tension between indebted farmers and creditor capitalists remained a central issue in American politics and shaped the most important political debates at the turn of the twentieth century — a crucial but turbulent era defined by industrialization, the laissez-faire regulation of the *Lochner* era, and the height of the Progressive movement.

The *Lochner* era began with the Supreme Court case *Lochner v. New York* in 1905, which held that a New York state labor law limiting hours worked violated the 14th Amendment and the right to contract.[63] This find-

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[54] *See id.*
[55] U.S. CONST. art. I, § 10.
[56] HOLTON, *supra* note 45, at 37.
[57] *Id.* at 9.
[58] *Id.*
[59] *Id.*
[60] *See, e.g.*, PETER NOVICK, THAT NOBLE DREAM 336 (1988).
[61] HOLTON, *supra* note 45.
[62] *Id.*
[63] Lochner v. New York, 198 U.S. 45 (1905). The term "Lochnerism" has since been defined as "a form of judicial activism in which court decisions are made based upon pre-

ing represents the height of contract fundamentalism and laissez-faire in the United States, which lasted until the New Deal and the formal overturning of *Lochner* in the 1937 case *West Coast Hotel Co. v. Parrish*.[64] With courts upholding the power of corporations, grassroots groups formed political coalitions designed to oppose this power—the political movement retrospectively dubbed the Progressive era, which began in the 1890s and lasted until the 1920s.[65] The dual forces created confrontations among unchecked market forces, the rights of workers and "the people" at large, and the role of the state in mediating clashes. The government's involvement in matters of workers' rights, monopoly power, and the regulation of private debt came to a head during the *Lochner* era, which was defined by minimal state intervention in contracts or labor arrangements, and coincided with the height of political opposition to market dominance in the Progressive era, which saw more state policing of labor rights, credit availability, and corporate power.[66] States usually did not intervene to regulate interest rates or terms offered by these lenders.[67] Courts in the *Lochner* era saw their role as enforcing contracts that were mutually agreed upon and ensuring that state and federal governments did not intervene in market regulation.[68] Courts struck down labor protections and most attempts by state, local, and federal governments to infringe on private business transactions or corporate labor management.[69]

The Progressives believed that problems such as poverty, homelessness, and inequality were structural problems in need of structural reforms.[70] They fought corporate power and sought to break up monopolies.[71] Lochnerism centered the private contract and the private ordering of labor arrangements, housing, and debt with minimal state intervention.[72] Today, we might label Lochnerism "Libertarianism," as the two philosophies are similar enough to be synonymous.[73] Today's opposing forces on the left are still sometimes referred to as progressives, but bear significant differences to the earlier Progressive era reformers.

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sumed rights not specifically addressed by existing (Constitutional) law, especially when influenced by political or personal beliefs." *Lochnerism*, DOUBLE-TONGUED DICTIONARY, https://www.waywordradio.org/lochnerism/ [https://perma.cc/62CM-NHN8].

[64] West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937) (upholding the constitutionality of state minimum wage legislation). This ruling effectively ended the *Lochner* era.

[65] JOHN D. BUENKER, JOHN C. BURNHAM & ROBERT M. CRUNDEN, PROGRESSIVISM 3–23 (1986).

[66] *See* NOVAK, *supra* note 27, at 28, 187.

[67] *See* LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 120–26 (2001).

[68] *See* Cass R. Sunstein, *Lochner's Legacy*, 87 COLUM. L. REV. 873, 877 (1987).

[69] *See id.* at 880.

[70] *See* Maureen A. Flanagan, *Progressives and Progressivism in an Era of Reform*, *in* OXFORD RESEARCH ENCYCLOPEDIA, AMERICAN HISTORY 3 (2016). *See also* RAHMAN, *supra* note 28.

[71] *See* Flanagan, *supra* note 70, at 9.

[72] *See* David E. Bernstein, *Lochner Era Revisionism, Revised: Lochner and the Origins of Fundamental Rights Constitutionalism*, 92 GEO. L.J. 1, 28, 42 (2003).

[73] *See* Trevor W. Morrison, *Lamenting Lochner's Loss: Randy Barnett's Case for a Libertarian Constitution*, 90 CORNELL L. REV. 839, 841–42 (2005).

The Populist and Progressive Parties between 1890 and 1910 pushed for both more credit options and easier debt forgiveness.[74] Meanwhile, Northern creditors, Wall Street bankers and industrialists favored the inviolability of contracts and conservative monetary policy. The debate over monetary policy centered on whether to uphold the gold standard, which favored Wall Street, or to adopt a silver standard or bimetallism, which benefited small creditors.[75] These debates led to clashes over banking charters, the Federal Reserve, and the gold standard. The compromises between the two interests helped shaped the system of banking and credit we have today.[76] There was also an ongoing debate about the level of state intervention that was appropriate in private matters.[77] One of the most important causes to Progressive and Populist reformers was access to credit for farmers and workers. Progressives fought for policies that made credit easier to acquire and less costly.[78] Theirs was a multi-pronged movement, which fought against high interest rates, advocated fiat currency or silver-backed currency rather than gold, and included the organization of their own networks of credit and banking in order to free farmers and workers from the authority of Wall Street banks.[79]

In the post—Civil War era, banks were very lightly regulated, and most small-dollar lending was done outside the purview of law and regulation.[80] Many low-income wage earners reported high interest rates and onerous terms. Farmers were often at the mercy of creditors with each cyclical downturn—and there were many of them.[81] Between the Civil War and the panic of 1907, there were repeated banking runs, credit freezes, and bank failures.[82] The turbulence hurt markets and banks, but it especially harmed poor

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[74] Charles Postel, The Populist Vision 123 (2007).

[75] The "free silver" debate peaked between 1893 and 1896. *See generally* Michael Kazin, A Godly Hero: The Life of William Jennings Bryan (2006); Postel, *supra* note 74, at 151–53; Gretchen Ritter, Goldbugs and Greenbacks: The Antimonopoly Tradition and the Politics of Finance in America, 1865-1986 183–90 (1997); Elizabeth Sanders, Roots of Reform: Farmers, Workers, and the American State, 1877-1917 137–38 (1999); Allen Weinstein, Prelude to Populism: Origins of the Silver Issue, 1867-1878 (1970).

[76] *See generally* Bray Hammond, Banks and Politics in America: from the Revolution to the Civil War (1957).

[77] *See* Flanagan, *supra* note 70, at 2–4. *See also* Suresh Naidu, Dani Rodrik & Gabriel Zucman, *Economics After Neoliberalism*, Boston Rev. (Feb. 15, 2019), http://bostonreview.net/forum/suresh-naidu-dani-rodrik-gabriel-zucman-economics-after-neoliberalism [https://perma.cc/6J2E-3TJM].

[78] *See generally* Susan Hoffman, Politics and Banking: Ideas, Public Policy, and the Creation of Financial Institutions (2001).

[79] *See id.*

[80] Calder, *supra* note 67, at 120–26.

[81] Charles W. Calomiris & Stephen H. Haber, Fragile By Design: The Political Origins of Banking Crises and Scarce Credit 195–201 (2014); Richard S. Grossman, Unsettled Account: The Evolution of Banking in the Industrialized World since 1800 268 (2010).

[82] *See* Grossman, *supra* note 81, at 312; *see also* Calomiris & Haber, *supra* note 81, at 201.

farmers who relied on credit to buy machines and materials.[83] With each banking panic, banks froze credit, called loans, and foreclosed on farms and equipment.[84] Repeated banking crises and recessions, combined with low-wage work in the industrializing North and defaulting farm loans in the South, led to mass movements that were centered on credit.[85] Unreliable credit forced farmers in the South to turn to tenant farming, "borrowing from their landlord against their next year's crop at exorbitant prices."[86] Moreover, because of the relaxed enforcement of anti-trust laws, railroad and granary monopolies were increasingly engaged in price-fixing.[87] Frustrated farmers responded with cooperatives such as the Grangers, which began as a cooperative grain operation to avoid monopolists but evolved into a political group that made up the Progressive base. Progressives fought for trust-busting laws, labor rights, and for accessible credit policies.[88] The credit union, thrifts, and several philanthropic or cooperative lending institutions were formed to counteract the scourge of high-interest money lenders. Credit unions and thrifts were as much political movements as they were alternative forms of banking. Their zealous proponents depicted the cooperative institution as an alternative to private capitalism and the greed of commercial banks.[89] As Sabeel Rahman explains about the shared vision of the Progressive movement:

> "Confronted by corporate entities of unprecedented scope and power and troubled by the violence of industrialization apparent in recurring strikes, financial panics, and economic dislocation, a number of Progressive Era thinkers developed a rich critique of market capitalism. Approaching the problem from diverse methodologies including law, philosophy, sociology, and economics, this critique focused not on efficiency or distribution so much as a more fundamental problem of domination. The problem of the market, for these thinkers, was at its root a problem of disparate economic and political power — power that had to first be identified and unmasked before it could be contested and checked through collective action and reform politics. Popular sovereignty — the ability of ordinary people to engage in collective action — became a crucial touchstone: The disparities of economic and political power could not and would not be remedied unless and until

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[83] Grossman, *supra* note 80, at 312–13.

[84] *Id.*

[85] Calomiris & Haber, *supra* note 81, at 158–60.

[86] Edward L. Rubin, *Communing with Disaster: What We Can Learn from the Jusen and the Savings and Loan Crises*, 29 L. & Pol'y in Int'l Bus. 79, 80 (1998).

[87] *See* Rahman, *supra* note 28, at 129–35; *see generally* William J. Novak, *The Myth of the "Weak" American State*, 113 Am. Hist. Rev. 752 (2008).

[88] *See Granger Movement*, Encyclopedia Britannica, https://www.britannica.com/event/Granger-movement [https://perma.cc/S6K6-6L23].

[89] *See* J. Carroll Moody & Gilbert C. Fite, The Credit Union Movement 29–30 (2nd ed. 1984).

> ordinary people reclaimed their role as the true drivers of public policy."[90]

Before the Progressives became a dominant political force, philanthropic organizations were the only groups that attempted to offer an alternative to high-interest loans. The Provident Loan Society and the Russell Sage Foundation were created to offer small loans at a low-interest rate to poor borrowers.[91] These were explicitly not market transactions, but charitable contributions. The loan was often collateralized through pawned personal objects or tools.[92] These organizations also preached thrift and savings to the poor. Taking on debt was seen as immoral, and the poor were advised to save their money so as to avoid small-dollar lending.[93] The Progressives and Populists differed from these charitable organizations because they talked about credit and debt as a necessity rather than a moral failing. As with most of their other battles, the Progressives sought structural reforms to personal problems. Debt was seen not a moral failing or a lack of virtue and "thrift," but rather the result of a lack of options.[94] These reformers set about creating alternative institutions to remedy these structural problems. The Progressive movement established grassroots organizations that were cooperatively owned and managed. These movements changed the way Americans viewed debt shifting from a matter of moral weakness to one of independence and cooperation. The following sections will examine two key Progressive era innovations: credit unions and thrifts.

### 1. *Credit Unions*

Credit unions were the first significant financial institution of the Progressive movement. The credit union was the embodiment of the Progressive era idea of grassroots institution building. It was the anti-bank "bank" and its proponents endorsed it with evangelical zeal.[95] The "bank" was to be owned by members, not shareholders; it was not to operate at high profits and it was to replace high interest with relationship lending, or a "mutual bond."[96] Credit unions focused on small loans, which would come from members' deposits. Credit unions could offer these small loans at a low interest rate because the members knew each other and the close group dynamic led to low default rates.[97] In an era dominated by powerful monopolies like U.S. Steel and big banks like J.P. Morgan, the credit union

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[90] Rahman, *supra* note 28, at 11.
[91] Calder, *supra* note 67, at 120–26.
[92] *See id.* at 120.
[93] *See id.* at 227.
[94] *See id.* at 155.
[95] *See* Moody & Fite, *supra* note 89, at 61–62.
[96] *See id.* at 36-52.
[97] Canada House of Commons, Reports of the Special Committee of the House of Commons, to whom was referred Bill No. 2, An Act Respecting Industrial and Cooperative societies (1907).

movement advocated an anti-capitalist structure. Credit unions explicitly rejected the corporate model, organizing themselves instead as mutually owned cooperatives. Members of the credit union were joint owners and they shared profits and losses.[98]

The buzz about credit unions started to appear in Northeastern newspapers and public dialogue in the late 1800s.[99] The need for a less costly source of credit was acute. Wage workers reported having to pay interest rates that totaled 50% of the value of the loan. Many decried the injustices of the system as "legalized robbery."[100] The purpose of the credit union was to provide small consumer loans to "wage workers,"[101] but the proponents of the credit union had more lofty and ambitious visions. Early credit union advocates aimed to bring "banking facilities to all classes—to the poor man as well as the rich man, to the workingman and the farmer as well as to the manufacturer and capitalist."[102] Credit unions were thus the institutional response to class struggle and exploitation.

From the beginning, credit union advocates responded to what they saw as the negative social effects of usury, high interest rates, and exploitative banking practices. Understanding the connection between access to loans and quality of life, credit unions offered loans to working men at a much lower cost than what was available from traditional banks.

The first credit union in North America was organized in 1900 by Alphonse Desjardins in Levis, Canada. He claimed that he opened the credit union because he was frustrated by the lack of banking options for wage-earners in Canada and the high-rate lenders that dominated the market.[103] He reported being particularly moved by testimony of low-income workers that had been charged a staggering several hundred percent interest on small loans.[104] His credit union was open to anyone in the community who was determined to be in "good standing," and a committee of members would make decisions on which loans to make based on a person's character and record of financial stability.[105]

The credit union movement migrated to the United States a few years later due to work by Edward Albert Filene, who was the son of a Jewish immigrant and the owner of Filene's department store.[106] In 1907, he trav-

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[98] *See* Moody & Fite, *supra* note 89; Federal Credit Union Act 12 U.S.C. § 1751 (1934).

[99] The credit union had foreign origins: in 1849, Friedrich Raiffeisen established the first credit society in southern Germany, and word soon spread to the United States. *See Historical Timeline of Credit Unions*, MyCreditUnion.gov, https://www.mycreditunion.gov/about-credit-unions/historical-timeline [https://perma.cc/PL6E-F4GQ].

[100] *See* Moody & Fite, *supra* note 89, at 12.

[101] *See* Roy F. Bergengren, *Credit Co-Operation as Adapted to the Needs of the Worker*, 15 Int'l Lab. Rev. 709, 717–23 (1927).

[102] Lee J. Vance, *Banks for the People*, 160 N. Am. Rev. 382, 383 (1895).

[103] Alphonse Desjardins, The cooperative people's bank 3 (1914).

[104] *See id.* at 27.

[105] *See* Moody & Fite, *supra* note 89, at 16.

[106] *See* Saul Engelbourg, *Edward A. Filene: Merchant, Civic Leader, and Jew*, 66 Am. Jewish Hist. Q. 106, 106–08 (1976).

elled around the world and was shocked by the poverty he witnessed in India and the Philippines.[107] His travels convinced him that poor villagers in the Global South needed adequate credit and the ability to own land.[108] Upon his return to the United States he discussed his experience with President Theodore Roosevelt.[109]

Nothing came of it until Filene crossed paths with John Jay, the bank commissioner for Massachusetts. Jay, son of the first Supreme Court Chief Justice John Jay, had already started to study the credit union movement in Europe and even invited Desjardins to Boston.[110] Jay began advocating for the credit union and convincing the legislature that it was necessary despite the fact that building and loan organizations already existed in the state.[111] His argument was that there were many people "who have neither real estate nor shares as security [who] undoubtedly have legitimate need for loans."[112] He saw a "demand for loans which [was] not being supplied by existing banking institutions."[113] He recognized that borrowing was sometimes "improvident," but said that "there can be but little doubt that much of it is the borrowing that comes of necessity."[114] The legislature approved his bill. Testifying in support of the bill, Filene said: "as a large employer I have long felt that some provision should be made by which people of small means can, in case of necessity or distress, borrow at reasonable rates of interest and under thoroughly honest and fair conditions."[115]

The Massachusetts Credit Union Act of 1909, which would be the model for the subsequent Federal Credit Union Act, defined a credit union as "a cooperative association formed for the purpose of promoting thrift among its members."[116] The charter required that the credit unions be run democratically with one vote per member, regardless of how many shares that person owned.[117] Volunteers, including board members, would run the credit union without compensation.[118]

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[107] *See* Moody & Fite, *supra* note 89, at 29–30 (citing Edward A. Filene, Trip Around the World: Edward A. Filene (1907)).

[108] *See id.*

[109] *See id.* at 22.

[110] *See id.* at 23.

[111] *See id.* at 23–25.

[112] *See id.* at 25 (citing Annual Report of the Bank Commissioner. 1908. Part I Relating to Savings Banks, Institutions for Savings, Trust Companies, and Foreign Banking Corporations liii (Wright & Pottinger Printing co., 1909)).

[113] Moody & Fite, *supra* note 89, at 25 (citing Bank Commissioner, *supra* note 112, at liii).

[114] *See id.* at 25.

[115] *See id.* at 25–26 (citations omitted).

[116] Mass. Credit Union Act of 1909, Mass. Gen. L. ch. 171, § 1 (1909). The Act authorized credit unions to "receive the savings of its members . . . lend to its members at reasonable rates or invest . . . the fund so accumulated; and may undertake such other activities relating to the purpose of the association, as its by-laws may authorize." *Id.* § 2.

[117] *See id.*

[118] Volunteerism was a fundamental value of the early Credit Union movement. NCUAchannel, *NCUA History*, YouTube (July 2, 2019), https://www.youtube.com/watch?v=Q7uBLWseqq4 [https://perma.cc/C7TM-J7AA].

The credit union movement did not have a robust start—but after state recognition and specialized charters, applications began to roll in.[119] The most important challenge as credit unions expanded was keeping true to their mission of serving the poor by rejecting high profits, while also remaining viable enough to protect the savings of their members and retain state support.[120] Moreover, because of political opposition from bankers and existing moneylenders, credit unions could not easily win state support.[121] To become a viable industry, the credit union movement would need federal support—which arrived during Franklin Delano Roosevelt's administration.[122] The major animating force legitimizing the credit union came when Roosevelt included credit unions in his expansive New Deal reforms. Roosevelt said of the credit union: "I have sort of a hunch that we owe a duty to our fellow citizens not to violate the biblical injunction against usury."[123] He urged Congress to pass the Federal Credit Union Act ("FCUA") in 1934 to address the "great national problem" of addressing the credit needs of the "poorer and working classes."[124]

Much like early state charters, the FCUA required that credit union members elect management, giving each member only one vote.[125] Furthermore, membership in a credit union was "limited to groups having a common bond of occupation, or association, or to groups within a well-defined neighborhood, community, or rural district."[126] Roosevelt signed the FCUA in 1934, which formally recognized and chartered the credit unions. Congress established a special regulator for the credit union industry called the National Credit Union Administration ("NCUA"). Credit unions had a special charter that entitled them to tax-exempt status so long as they maintained their mission, but even when they were no longer mandated to maintain the mutual bond, they were able to retain their tax-exempt status.

But as the movement became an industry during the New Deal, credit unions lost much of their populist character. The initial activism of credit union advocates was eventually replaced by corporate management and the credit union began to operate much like a bank. Though credit unions still

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[119] *See* Moody & Fite, *supra* note 89, at 92.

[120] *See generally* Mehrsa Baradaran, *How the Poor Got Cut Out of Banking*, 62 Emory L.J. 483 (2013).

[121] *See id.* at 63–65.

[122] *See id.* at 118–20.

[123] William R. Emmons & Frank A. Schmid, *Credit Unions and the Common Bond,* Fed. Res. Bank of St. Louis Rev. (1998), https://research.stlouisfed.org/publications/review/99/09/9909we.pdf [https://perma.cc/9WJA-4QVH]*; Roosevelt Reveals Own War On Usury*, N.Y. Times, May 25, 1929, at 15.

[124] *See* Baradaran, *supra* note 32, at 70 (citing 78 Cong. Rec. 7259–61 (1934) (comments of Sen. Sheppard noting that credit unions "came through the depression practically without runs or failures")); Federal Credit Union Act, ch. 750, 48 Stat. 1216 (1934).

[125] The 2006 Federal Credit Union Act bylaws contain the same requirement. *See* Fed. Credit Union Admin., Federal Credit Union Bylaws Art. IV § 5 (2006), https://www.ncua.gov/files/publications/FCUBylaws2006-04.pdf [https://perma.cc/VDA2-4NSZ]

[126] Federal Credit Union Act, *supra* note 124, at 1219. This language was repealed in the 1980s' deregulation of the industry.

retain some distinctions from banks, such as an interest rate cap of 18% and a tax-exempt status, the industry changed from a mission-oriented one to one oriented toward profit.[127] Credit unions have continued to lobby their regulator and Congress to allow them to compete with banks by removing the restrictions that set the industry apart at their founding, such as their enforced smallness and cohesion between members.[128] In 1989, the Credit Union National Association ("CUNA") deregulated the most distinctive feature of the credit union, the requirement that there be a "common bond" between members.[129] This has allowed credit unions to grow in size and scope and to operate much like banks. Over the course of the last several decades, regulators and Congress have rolled back some of the defining features of the credit union. In 2019, a circuit court upheld CUNA's decision to extend the definition of "community" to rural areas with more than one million people and allowed credit unions to avoid urban areas in their definition of community.[130] The ruling is likely to lead to even larger credit unions even further removed from their initial progressive mission.[131]

### 2. *Thrifts*

Several other institutions arose in response to Progressive era credit shortage. The two most notable institutions are the Savings and Loan ("S&L") and the Building and Loan ("B&L") associations.[132] Both came to be labeled "thrifts" based on their mission to provide low-cost products for blue-collar wage workers and rural farmers. Thrifts were part of the same wave of backlash against the dominance of private enterprise and the harmful effects of industrialization on low-wage workers and small farmers.[133] Though the thrift industry began in 1830, it gained momentum during the Progressive era.[134]

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[127] 26 U.S.C.A. § 501, I.R.C. § 501; NAT'L CREDIT UNION ADMIN., BOARD EXTENDS 18 PERCENT INTEREST RATE CAP (Feb. 23, 2017), https://www.ncua.gov/newsroom/news/2017/board-extends-18-percent-interest-rate-cap [https://perma.cc/T84Z-PE23].

[128] *See generally* William R. Emmons & Frank A. Schmid, *Credit Unions Make Friends—But Not With Bankers*, REG'L ECONOMIST (Oct. 1, 2003), https://www.stlouisfed.org/publications/regional-economist/october-2003/credit-unions-make-friendsbut-not-with-bankers [https://perma.cc/72XX-7QCZ] (explaining credit unions' modern lobbying activities, competition with banks, and related legislative history).

[129] *See* Nat'l Credit Union Admin. v. First Nat. Bank & Tr. Co., 522 U.S. 479, 483 (1998); 12 U.S.C.A. § 1759 (2006).

[130] American Bankers Ass'n. v. Nat'l Credit Union Admin., 934 F.3d 649, 673 (D.C. Cir. 2019).

[131] John Reosti, *Legal Win Has Credit Unions on Defense Again Over Redlining Charges*, AM. BANKER (Aug. 26, 2019), https://www.americanbanker.com/news/legal-win-has-credit-unions-on-defense-again-over-redlining-charges [https://perma.cc/8SLT-2SWV].

[132] *See* Edward L. Rubin, *Communing with Disaster: What We Can Learn from the Jusen and the Savings and Loan Crises*, 29 LAW & POL'Y INT'L BUS. 79, 80–81 (1997).

[133] SUSAN HOFFMAN, POLITICS AND BANKING: IDEAS, PUBLIC POLICY, AND THE CREATION OF FINANCIAL INSTITUTIONS 43 (2001).

[134] David A. Price & John R. Walter, *It's a Wonderful Loan: A Short History of Building and Loan Associations*, FED. RESERVE BANK OF RICHMOND ECON. BRIEF (Jan. 2019), https://

Like credit unions, thrifts were a crucial part of the Progressive movement and soon formed a nationwide coalition to spread their message and organizational structure. David Mason, a historian of the thrift movement, explains that the thrift movement thrived because its principles coincided with a rising progressive spirit.[135] There were several natural harmonies between the Progressive movement and the thrift movement. First, thrifts would help alleviate some of the problems with inner-city living standards, a Progressive era preoccupation, by providing an opportunity for homeownership.[136] Second, the Progressives wanted to include recent immigrants in the mainstream economy by offering them credit, and the thrift movement provided a way.[137] The movement's leaders advocated homeownership in order to reduce labor unrest and socialism—"every time you make a home, you make a citizen."[138] The third Progressive era goal, encouraging thrift, was aided by World War I-era efforts to turn household savings into investments in the government. Policymakers encouraged personal savings and even hosted national events supporting thrifts, which the B&L national organization would use to promote its institutions and gain more members. Finally, the cooperative structure of the thrift was the embodiment of the grassroots, anti-trust spirit of the Progressive reformers.[139]

The thrift industry, like the credit union industry, was mission-oriented and attempted to serve a population excluded from mainstream institutions.[140] The thrift was also a cooperative bank that offered mortgage loans.[141] Like the credit union, thrifts had primarily social, rather than profit-making, purposes. Members described the B&L as a "brotherhood," a "society of friends."[142] It operated as a soft financial institution that protected its members from harsh capitalistic forces—"should misfortune overtake a borrower, his interests are in the hands of friends, from whom he will receive

www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2019/pdf/eb_19-01.pdf [https://perma.cc/89GZ-3NGA].

[135] David L. Mason, From Buildings and Loans to Bail-Outs: A History of the American Savings and Loan Industry, 1831-1995 26–28, 40 (2004).

[136] The National Housing Association ("NHA") was created in 1911 to address substandard tenement conditions. Though they did not engage with the B&L at first, they did create cooperative remedial banks that would loan small amounts to the poor with the aim of eventually enabling them to borrow from B&Ls, which lent to the class above the lowest. They saw the B&L as providing an exit from the inner-city slums after the remedial bank attended to the emergency needs of the poor. *Id.* at 41–42.

[137] *Id.* at 156.

[138] The inclusion of immigrants in the movement was one of the reasons it advanced so quickly. Immigrants took to the B&Ls because they formed within a community, allowed membership control and decisionmaking, and enabled their soft entry into American life through homeownership and savings. Edward G. Hartmann, The Movement to Americanize the Immigrant 113 (1967).

[139] Mason, *supra* note 135, at 22–24.

[140] *See* Heather A. Haveman, Hayagreeva Rao & Srikanth Paruchuri, *The Winds of Change: The Progressive Movement and the Bureaucratization of Thrift*, 72 Am. Soc. Rev. 117, 120–23 (2007).

[141] *Id.* at 123, 139.

[142] Baradaran, *supra* note 32, at 86.

more lenient treatment and more well-directed help than from private capitalists or industrialists."[143] These institutions were structured as the antithesis of a privately held corporation or bank. They were cooperatively owned, and decisions were made according to the mission-oriented nature of the bank. The motto of the thrift was "neighbors helping neighbors," emphasizing mutual cooperation; the focus was on building homes for neighbors, not making profits.[144] These were distinctly not market entities.

Based on populist and Progressive ideals, the B&L, like the credit union, self-identified as a political "movement" in opposition to monopolies. Just as farming cooperatives set up their own grange to fight the monopolized industry, farmers and laborers lent to each other instead of relying on Wall Street money trusts.[145] Between the 1880s and the Great Depression, the movement started to spread from the Northeast to the South and the Midwest as it joined with other populist groups like the Knights of Labor and the Farmers' Alliance, organizations focused on providing rural farmers access to credit amidst the forces of industrialization.[146] These thrift banks grew alongside unions, workers' collectives, and farmers' coalitions.

During the 1930s, thrifts were institutionalized. Federal support for the thrift industry was swift and strong both because the industry's goals aligned with Progressive principals and because it was already an organized and stable movement.[147] Thrifts that did not fail during the Great Depression consolidated with other thrifts and modernized their practices, leading to national organization of the industry.[148] Henry Morton Bodfish, the national director of the thrift association, sought standardization and modernization, stating that in order for the thrift to withstand modernizing forces, it must follow "a business procedure with the same demands for skill and manage-

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[143] Charles K. Clark, *A Review of the Evolution of the Various Premium and Non-Premium Plans*, *in* The American Savings and Loan Industry: 1831-1935 97 (1893).

[144] Susan Hoffmann, Politics and Banking: Ideas, Public Policy, and the Creation of Financial Institutions 43 (2001); Mason, *supra* note 135, at 17–18.

[145] *Cf.* Lawrence Goodwyn, The Populist Moment: A Short History of the Agrarian Revolt in America 230–63 (1978); John D. Hicks, The Populist Revolt: A History of the Farmers' Alliance and the People's Party 134–36 (1961).

[146] The Knights of Labor, founded in 1869, described themselves as "the great brotherhood" of the working class. It was an inclusive organization, which included Black people and women, into cooperatives that would allow the members to increase their financial power in the South. The Knights of Labor would merge with the Farmers' Alliance, bringing farmers together into cooperatives to gain leverage in negotiations with the railroad and shipping industries. The group had over three million members by 1890. It was also a populist political movement that advocated easier access to credit by moving off of the gold standard into silver or bimetallism. These two groups along with several other Christian cooperatives propelled the thrift industry; the grassroots and political nature of these groups, made the B&L a movement with a purpose to improve individual lives and strengthen the democracy. *See* Mason, *supra* note 135, at 22–23.

[147] *Id.* at 77.

[148] *Id.* at 107–08.

rial ability, which characterize any business enterprise" while remaining co-operative and not profit-oriented.[149]

Roosevelt made the thrift movement into a federally sponsored industry through federal recognition, insurance, and other measures to increase their lending ability. For example, the creation of the FDIC insurance fund in 1933 caused deposits to flow out of S&Ls and into banks. Roosevelt responded by creating the Federal Savings and Loan Insurance Corporation ("FSLIC") to preserve thrifts and help them compete with mainstream banks.[150] S&Ls also got their own federal supervisor, the Federal Home Loan Bank Board ("FHLBB"), with recognition that the industry operated distinctly from mainstream banks. Thrifts were also exempt from many of the restrictions placed on commercial banks at the time. For example, thrifts could merge or affiliate with other thrifts across state lines. Roosevelt supported thrifts continued work through several federal programs and subsidies. For example, Congress created the Federal Housing Administration ("FHA") to aid the thrifts and administer federal housing initiatives, and the Home Owners' Loan Corporation ("HOLC") to provide quick relief to homeowners with defaulting mortgages.[151] The HOLC, acting with the thrifts, created the fifteen-year mortgage, which allowed more people to own homes.

Comprehensive federal support during the New Deal era and onwards helped the S&L industry channel resources into homeownership. The successes of the Progressive movement led to legislation that created accessible credit mechanisms administered by the federal government, and this same success weakened the cooperative banks that were the heart of the movement.[152] The New Deal reforms bolstered the thrift industry's mission to provide home financing, but the reforms diluted their cooperative structure. They remained local, community thrifts, but their pure cooperative structure, though alive in theory and in their corporate charters, was no longer the heart of the movement.[153] Just like the credit union, the thrift industry was deregulated during the neoliberal 1980s, but with much more consequential—even disastrous—results. The thrift industry itself fought for deregulation and ultimately became the emblem of risky lending and even money

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[149] *Id.*

[150] The FHLBB was charged with implementing the home loan bank. Its responsibilities included overseeing the federal B&Ls and ensuring that there was enough credit to satisfy the purchasing needs of Americans. Not only did the Board have to inject capital into the federal home loan bank system, but as a result of an amendment attached to the Federal Home Loan Bank Act by Senator James Couzens, the FHLBB had to operate a retail mortgage operation. The Board struggled implementing the retail lending service and, in 1933, the Couzens amendment was repealed by the Emergency Mortgage Act of 1933. *Id.* at 86–88, 91–93.

[151] The HOLC allowed homeowners to refinance with a lower-interest loan, fixed monthly payments, and long-term amortization. The agency successfully issued more than $3.1 billion in loans and despite a 20% default rate, it eventually turned a profit for the U.S. Treasury.

[152] *See* BARADARAN, *supra* note 32, at 65-101.

[153] *See id.* at 106–08.

laundering.[154] The thrift industry imploded in the S&L crisis of the late 1980s, creating billions of dollars of losses for taxpayers.[155] They had long stopped being a model of progressive cooperatives, but today the industry is remembered for reckless lending and corporate greed.[156] An industry with a mission of "neighbor helping neighbor" turned into what one book about the industry described as a "[d]en of [t]hieves."[157] By the time of its crisis, few people could remember the guiding principles of the thrift or the progressive fight against greed that the thrift was meant to remedy.

After the experiments with alternative banking forms during the Progressive era, banking became standardized. Credit unions and thrifts became standardized industries and not political outliers.[158] Public policy also experienced a slow transition from viewing high-interest lending as "immoral" to necessary. Today, when regulators like the Consumer Financial Protection Bureau ("CFPB") propose rules curtailing high-cost lending such as payday loans, the industry's defenders claim that regulating these loans is harmful for consumers because it reduces "access to credit."[159] The industry thus uses market demand for payday loans as a justification for deregulating the sector. By contrast, in past eras in American history, high demand for consumer loans led reformers to create new forms of banking and to wage political fights against the mainstream banks.[160] Progressive era reformers viewed credit disparities through the lens of institutional power and politics as opposed to markets and responded accordingly.

### *3. Access to Credit*

New Deal reforms were so monumental that banking history can be divided into the "Before New Deal" and "After New Deal" eras. Before, states primarily governed banking law, and each state determined which banks would be granted charters.[161] The New Deal banking reforms imposed federal governance, including new restrictions, rules, and chartering require-

[154] *See* Simon Johnson & James Kwak, 13 Bankers: The Wall Street Takeover and the Next Financial Meltdown 95–96 (2010); Jennifer Taub, Other People's Houses: How Decades of Bailouts, Captive Regulators, and Toxic Bankers Made Home Mortgages a Thrilling Business 42–46 (2015); Baradaran, *supra* note 32, at 93.

[155] Rubin, *supra* note 86, at 91–92.

[156] *See generally* Stephen Pizzo, Mary Fricker & Paul Muolo, Inside Job: The Looting of America's Savings and Loans (1989); James B. Stewart, Den of Thieves 519–27 (1992); Lawrence J. White, The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation (1991).

[157] *See generally* Stewart, *supra* note 156.

[158] O. Emre Ergungor & James B. Thomson, *Industrial Loan Companies*, Fed. Res. Bank of Cleveland Econ. Comment (Oct. 1, 2006).

[159] *Access to Credit or Access to Debt? Under New Leadership Consumer Financial Protection Bureau Caves to Loan Sharks, Reopens Historic Payday Protections*, Woodstock Inst. (Feb. 6, 2018), https://woodstockinst.org/news/press-release/release-access-credit-access-debt/ [https://perma.cc/3JDM-9M9J].

[160] Calder, *supra* note 67, at 49.

[161] Grossman, *supra* note 81, at 180.

ments. In return, banks got access to federal networks of deposit insurance, loan guarantees, and other buffers and protections.[162] Federal deposit insurance, which effectively ended runs on bank deposits,[163] was especially significant. FHA insurance on loans created a torrent of investor capital. Deposit insurance had the same effect on customer deposits. Confident savers entrusted their money into the banking system to be deployed in the great lending markets.[164] In part, Progressivism was a victim of its own success as many aspects of its political agenda have been adopted over time.[165] Yet even as Progressivism "won" the passing of its agenda during the New Deal and thereafter, the last 30–40 years has seen a slow and steady chipping away at many of these reforms. This era, dubbed the "neoliberal" era, has centered market ideology and curtailed state regulation in business matters. It has been the prevailing ideology for both parties.[166]

Many reformers pining for the lost days of "community" and "grassroots" banking forget that it was the extensive federal support of the credit union and thrift industry that enabled their viability. While credit unions and cooperative thrifts are no longer fulfilling their progressive mission of "neighbor helping neighbor," many still seem to believe that the answer to financial inclusion is a return to these forms.[167] Yet these forms only succeeded with robust federal government support.

As credit unions and thrifts became institutionalized, they expanded into mortgage and business lending.[168] Though credit unions still offered consumer loans, over time the bulk of the consumer loan market migrated away from the banking sector and toward non-bank consumer lenders and credit card issuers offering revolving debt.[169] The nature of borrowing also changed. Beginning in the booming 1920s economy, small lending began to increase.[170] By the 1940s and 1950s, the consumer lending market was dominated by the middle class.[171] Small lending grew exponentially in the postwar economy as Americans began borrowing regularly for newly available consumer goods.[172] Credit was cheap and plentiful due to a booming economy and the creation of robust revolving credit markets[173]—and there was so

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162 *See* Calomiris & Haber, *supra* note 80, at 190.

163 *Id.* at 190–91.

164 *See id.* at 196; Grossman, *supra* note 81, at 13.

165 Jacob S. Hacker & Paul Pierson, American Amnesia: How the War on Government Led Us to Forget What Made America Prosper 2, 171 (2017).

166 *See* Jacob S. Hacker & Paul Pierson, Winner-Take-All Politics: How Washington Made the Rich Richer—and Turned its Back on the Middle Class 223–24, 247–48 (2011); Suresh Naidu, Dani Rodrik & Gabriel Zucman, *Economics After Neoliberalism*, Bos. Rev. (Feb. 15, 2019), http://bostonreview.net/forum/suresh-naidu-dani-rodrik-gabriel-zucman-economics-after-neoliberalism [https://perma.cc/6Q2X-5E4X].

167 *Id.*

168 Louis Hyman, Debtor Nation: The History of America in Red Ink 186 (2012).

169 *See id.* at 220–21.

170 *See id.* at 10–12.

171 *See, e.g.*, *id.* at 100–01; Calder, *supra* note 67, at 32.

172 *See* Calder, *supra* note 67, at 204.

173 *See* Hyman, *supra* note 168, at 132.

much to buy. Refrigerators, cars, vacuum cleaners, and other time-saving appliances, which either did not exist before the 1930s or were inaccessible to average Americans, were ubiquitous by mid-century. Suddenly, they were everywhere—and they were usually purchased by credit.[174]

A booming and profitable market led the small-credit industry to come out from the shadows and create a legitimate industry with its own codes of governance.[175] Activists were joined by responsible lenders who wanted to cull the "loan sharks" from their ranks.[176] Reformers, lenders, legislators, and activists fought (and sometimes coordinated efforts) to strike the right balance of protecting borrowers against predation by lenders while not excessively constraining the availability of small-dollar credit.[177]

The small lending market had always been an unregulated, even if not universally derided, sector of the financial market.[178] "Loan sharks" were not seen as legitimate businessmen because they operated in informal markets and through unconventional means.[179] Many operated illegally while others exploited legal loopholes.[180] For example, lenders would often hire beautiful young women to show up at a debtor's worksite to publicly shame the male borrowers to pay off their debt.[181] Lenders would make repeated calls to employers informing them of the unpaid debt and bad moral character of their employee.[182] While these practices were coercive, it was not against the law.[183] Activists and reformers had long pressed for small-dollar credit reform, but ubiquitous consumer credit markets and the profitability of the industry spurred the industry to self-regulate.[184] As consumer debt moved from poor neighborhoods to wealthy suburbs, lenders stepped out of the shady alleyways into legitimate businesses.

Lenders mobilized to protect their bottom line. Lenders justified their high interest rates by claiming that they were meeting a demand and providing "access to credit."[185] Installment lenders even began to advertise their products as a social good in the 1920s. The industry also organized their ranks and codified their lending practices, which imbued them with a veneer of legal formality even though the codes were created by the industry. A coordinated group of small lenders created the Uniform Small Loans Law, which was a self-governing set of rules and codes.[186] These elaborate codes

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[174] *See* Calder, *supra* note 67, at 204.
[175] *See, e.g.*, *id.* at 19–20; Hyman, *supra* note 168, at 174.
[176] *See* Hyman, *supra* note 168, at 20.
[177] *See id.* at 174.
[178] *See* Anne Fleming, City of Debtors: A Century of Fringe Finance 47 (2018).
[179] *See* Calder, *supra* note 67, at 119–20.
[180] *See, e.g.*, *id.* at 119; Fleming, *supra* note 178, at 48.
[181] *See* Fleming, *supra* note 178, at 29.
[182] *See* Calder, *supra* note 67, at 54.
[183] *See id.* at 23–24.
[184] *See id.* at 64.
[185] *See id.*
[186] *See* Anne Fleming, *The Long History of "Truth in Lending,"* 30 J. Pol'y Hist. 236, 239–40 (2018).

further legitimized the small lenders. The group also expelled bad apples from the industry and portrayed themselves as law-abiding lenders—even as they created their own laws.[187] Groups of responsible lenders allied themselves with reformers to self-monitor responsible lenders and exclude the sharks and lawbreakers.[188]

### 4. *Fringe Lending*

The New Deal banking system that had maintained a banking industry focused on small community banks, credit unions, and thrifts gave way over the 1980s to the imperatives of deregulation and the rapid growth of the banking sector.[189] In order to compete, small banks merged with larger banks and larger banking conglomerates abandoned low-profit communities and customers. Over the last several decades, deregulation, heightened market competition, and the subprime crises have led to a conglomerated banking industry. Deregulation of interest rates was coupled with deregulation of banking in general, which caused a wave of mass mergers starting in the 1980s and continuing until today.[190] Community banks, credit unions, and thrifts merged into large bank holding companies. As a result of the merger wave and the heightened banking competition that accompanied deregulation, banks began to avoid small consumer lending.[191] Industry consolidation meant that many communities, especially in rural regions across the country, are banking deserts where communities do not have a bank.[192] In these banking deserts, it is not uncommon that the only ATM in the entire area is at a gas station with fees up to $7.50 per transaction.[193] But even where banks are physically available, there remain many barriers for low-income Americans. Banks charge excessive and onerous overdraft fees and excess activity fees—fees that are lucrative for banks and disastrous for low-income consumers.[194] Small accounts are not profitable for banks so they avoid them by

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[187] *See generally* Calder, *supra* note 91, at 136–37; Fleming, *supra* note 178, at 76–77.

[188] *See* Fleming, *supra* note 178, at 61.

[189] *See* Johnson & Kwak, *supra* note 154 at 95–96.

[190] *See* Fleming, *supra* note 178, at 231.

[191] *See* Janell Ross, *A Town With No Bank: How Itta Bena, Mississippi, Became a Banking Desert*, NBC News (June 15, 2019), https://www.nbcnews.com/news/nbcblk/how-itta-bena-mississippi-became-banking-desert-n1017686 [https://perma.cc/LXD4-JM32].

[192] Bank closures are not spread out evenly—93% of bank closings are in low to moderate income communities. Frank Bass & Dakin Campbell, *Study Finds Latest Bank Brach Closings Strike Hardest in Poor Neighborhoods*, St. Louis Post-Dispatch (May 2, 2013), https://www.stltoday.com/business/local/study-finds-latest-bank-branch-closings-strike-hardest-in-poor/article_b33a4103-280f-5b3c-9754-3086de4b0070.html [https://perma.cc/T3D3-XGNH].

[193] *See* Ross, *supra* note 191.

[194] *See, e.g.*, Spencer Tierney, *Overdraft Fees: Compare What Banks Charge*, NerdWallet (Sept. 6, 2019), https://www.nerdwallet.com/blog/banking/overdraft-fees-what-banks-charge/ [https://perma.cc/RZ3P-XR7S]; Jessica Dickler, *Bank Overdraft Fees Could Jump if Consumer Watchdog Eases Rule*, CNBC (June 26, 2019), https://www.cnbc.com/2019/06/25/bank-overdraft-fees-could-jump-if-consumer-watchdog-eases-rule.html [https://perma.cc/5RSG-66AQ]; Peter Smith, Ctr. for Responsible Lending, Report: FDIC Data Shows that Banks Collected $11.45 Billion in Overdraft Fees in 2017 (Aug. 7, 2018), https://

either leaving low-income areas or repelling low-income customers through fees.[195] Faced with seemingly random and punitive fees, low-income customers have taken their business to the fringe banking sector.[196]

As soon as banks opted out of lending to the poor, a new "fringe banking" industry popped up to meet their needs and has grown ever since.[197] Fringe banking refers to the varied market of financial service providers that are not chartered banks. For example, check cashers, payday lenders, and the like charge fees for bank-like services. Payday lending went from being a non-existent industry due to usury caps to being an increasingly common lender in certain communities.[198] Chris Peterson's *Taming the Sharks* notes that because "[l]ow-to-moderate income consumers have lost access to banks and credit unions since the late seventies, . . . they have naturally moved to [fringe lenders] for their financial needs."[199] Payday lending emerged during the 1990s "to serve a void created by the withdrawal of traditional lenders from the very small loan market."[200] Fringe banking has grown exponentially since the 1980s and hasn't stopped. There are more pawnshops today than at any point in history.[201] Prior to the mid-1970s, check-cashing institutions existed in only a few urban areas, but throughout the 1980s these institutions rapidly expanded throughout the country. The sector went from being essentially nonexistent three decades ago to growing into a $100 billion business—an annual growth of 10% since the mid-

www.responsiblelending.org/media/report-fdic-data-shows-banks-collected-1145-billion-overdraft-fees-2017 [https://perma.cc/HE6E-25JP]; Peter Smith, Ctr. for Responsible Lending, Unfair Market: The State of High-Cost Overdraft Practices in 2017 (Aug. 7, 2018), https://www.responsiblelending.org/research-publication/unfair-market-state-high-cost-overdraft-practices-2017 [https://perma.cc/A6EN-CDAT].

[195] Many major banks require balances of $1,500 to avoid fees on their basic accounts. *See, e.g.*, Abby Vesoulis, *Millions of Americans Can't Afford a Checking Account. The Post Office Could Fix That*, Time (Aug. 7, 2018), https://news.yahoo.com/millions-americans-t-afford-checking-150440495.html [https://perma.cc/ERW5-7KMY]; Lisa J. Servon, *The High Cost, for the Poor, of Using a Bank*, The New Yorker (Oct. 9, 2013), https://www.newyorker.com/business/currency/the-high-cost-for-the-poor-of-using-a-bank [https://perma.cc/Q8K2-AZ34]. *See generally* Gov't Accountability Office, GAO-18-244, Community Reinvestment Act: Options for Treasury to Consider to Encourage Services and Small-Dollar Loans When Reviewing Framework (2018), https://www.gao.gov/assets/700/690050.pdf [https://perma.cc/E9M9-NXFX].

[196] The rise of fringe banking, check-cashing, and payday lending was a direct result of the decline of community banks. *See* Baradaran, *supra* note 32, at 111–15.

[197] Economist John Caskey and others have noted that it was only when the banks left that the fringe banking industry exploded. *See* John P. Caskey, Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor 7–8 (1996); Gregory Elliehausen & Edward C. Lawrence, Payday Advance Credit in America: An Analysis of Customer Demand 2 (2001).

[198] Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. Rev. 855, 861 (2007).

[199] Christopher L. Peterson, Taming the Sharks: Towards a Cure for the High-Cost Credit Market 21 (2004).

[200] Elliehausen & Lawrence, *supra* note 197, at 2.

[201] Caskey, *supra* note 197, at 1.

1990s.[202] With over twenty thousand storefronts, the payday lending industry makes $40 billion in loans annually.[203]

Members of low-income communities have reported that they are "not comfortable" dealing with traditional banks.[204] Due to various regulatory measures, including anti-money laundering and anti-terrorism regulations, mainstream banks require extensive documentation simply to open an account.[205] Providing this array of documentation—especially documents that cost money in the first place—can pose a significant barrier to banking for many. In addition, some poor Americans face information barriers to traditional banking structures, such as illiteracy or limited English skills. These dovetail with the intangible barriers of class and culture. Mainstream banking has thus both abandoned poor areas by shutting down branches and by failing to speak the financial language of the poor. Even when banks have remained geographically available to the unbanked, they are often still out of reach.[206]

An important aspect of fringe lending success has been the precision with which they reach their customers. Unlike inaccessible banks, payday lending businesses operate behind a façade of informality. These lenders operate in cash, at all hours, on a short-term basis, in the direct vicinity of their customers, and usually in their language.[207] This business model contrasts sharply with banks and their rigid hours, requirements, fees, and procedures. Customers trust payday lenders more than banks and feel more comfortable and respected in these institutions because these lenders do not demand as much documentation, do little to no underwriting, and don't pry into the

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[202] Joe Mahon, *Tracking "Fringe Banking": The Location of Alternative Financial Services in the District Shows that They Serve a Distinct Need*, FED. GAZETTE (Sept. 1, 2008), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=4030 [https://perma.cc/2EH9-N5BC].

[203] SHEILA BAIR, "LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES" 7 (2005) https://www.cfsponline.com/uploads/LowCostPaydayLoans.pdf [https://perma.cc/524T-59RP].

[204] Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 180 n.282 (2004) ("About 18% of unbanked respondents to surveys reported that they were not 'comfortable' dealing with banks."); FED. DEPOSIT INS. CORP., FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 29–32 (2017), https://www.economicinclusion.gov/downloads/2017_FDIC_Unbanked_HH_Survey_Appendix.pdf [https://perma.cc/RDE2-4BR2]. Surveys reveal that many low-income individuals feel "snubbed" and disrespected by mainstream financial institutions. *See* Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8, 13 (2003) ("Focus groups of low-income and ethnic consumers . . . identified five ways in which check cashers were superior to banks: (a) easier to access for immediate cash; (b) more accessible locations; (c) better service in the form of shorter lines, more tellers, more targeted product mix in a single location, convenient operating hours, and Spanish-speaking tellers; (d) more respectful, courteous treatment of customers; and (e) greater trustworthiness.").

[205] *See, e.g.,* 18 U.S.C. §§ 1956–57 (1986); 31 C.F.R. § 1020.220 (2010); 12 U.S.C. §§ 1730d, 1829b, 1951–59 (1982); 31 U.S.C. §§ 5311–22 (1982).

[206] *See* Brian K. Bucks et al., *Recent Changes in U.S. Family Finances: Evidence From the 2001 and 2004 Survey of Consumer Finances*, FED. RES. BULL. 9–11 (2006).

[207] LISA SERVON, THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES 19 (2017).

borrower's credit score or other assets.[208] They offer everyone the same rates regardless of these factors. Besides, unlike payday lenders, banks rarely make small consumer loans; while banks do give credit in the form of credit cards and overdraft fees, relying on these products as loans gets expensive, and many of the fees and interest rates are hidden in the fine print. Research has shown that low-income borrowers who have "credit card liquidity," or the ability to borrow on a credit card, still opt for payday loans.[209]

Despite the informal façade, fringe banks are highly profitable corporations. In fact, often one single payday lending operation will own all the title, pawn, and payday units in one area and operate them under different names.[210] These stores give the appearance that they are in competition with each other and will often run aggressive negative ads. This business strategy yields more clientele because when customers feel cheated by a lender, they will move to the competition, believing that they will be treated differently. In fact, they are all run and operated by the same owners. As one commentator observed about a Washington, D.C. check-cashing outlet, "[t]he primitive hands-on processing and tawdry exterior of the outlets both exude welcome to poor customers and mask [the firm's] close ties to and substantial financing from large corporations and big banks."[211] The rigid practices of fringe banks become obvious as soon as debts become due. These businesses can resort to intimidation, harassment, and legal process in order to collect payments.[212] By mimicking informal markets, fringe banks have convinced their customers that they are operating in the informal realm, but their debt collection practices are inflexible and unforgiving.

*(a) Payday Loans*

Currently, the most common fringe loans are payday loans, which are permitted in thirty-eight states.[213] There are more payday lender branches

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[208] *Id.* at 79.

[209] Sumit Agarwal, Paige M. Skiba & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles*?, NAT'L BUREAU OF ECON. RES. (Jan. 2009), https://www.nber.org/papers/w14659.pdf [https://perma.cc/YX83-794G] ("One summary measure suggests a common pecuniary mistake: two-thirds of the matched sample has at least $1000 of credit card liquidity on the day they take their first payday loans, much more than the typical $52 payday loan. For a two-week payday loan with a finance charge of 18 percent, using credit card liquidity first would save these households $300 . . . if the credit card APR is 18 percent.").

[210] GARY RIVLIN, BROKE, USA: FROM PAWNSHOPS TO POVERTY, INC.—HOW THE WORKING POOR BECAME BIG BUSINESS 28 (2010).

[211] Brett Williams, *What's Debt Got to Do With It?*, *in* NEW POVERTY STUDIES: THE ETHNOGRAPHY OF POWER, POLITICS, AND IMPOVERISHED PEOPLE IN THE UNITED STATES 87 (Judith Goode & Jeff Maskovsky eds., 2001).

[212] PETERSON, *supra* note 199, at 16 ("For example, in 718 payday lender inspections conducted over a three-year period, North Carolina Banking officials found 8,911 violations of simple state consumer-protection rules.").

[213] Heather Morton, *NCSL Payday Lending State Statutes*, NAT'L CONF. OF STATE LEGIS., http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx [https://perma.cc/A3ZS-MW9R]; CONSUMER FED'N OF AMERICA, PAYDAY LOAN

today than there are McDonald's or Starbucks stores, without even counting online lenders.[214] Many payday lenders operate online and outside of state boundaries. As such, they have been able to find loopholes in usury rate caps by being chartered on Native American reservations or in states without usury caps.[215] Most of these branches congregate around low-income communities. A payday loan is so called because the borrower must have a regular paycheck against which she borrows, usually up to $500, with a typical term of anywhere from a week to a month.[216] The borrower gives the lender access to her bank account in the form of either a post-dated check or permission for direct withdrawal.[217] The lender then deducts the outstanding payment when it becomes due, typically the next payday. The loan is technically one pay cycle, but these loans are often "rolled over," which means that they are renewed for a fee.[218] These fees, which do not reduce the principle, are the reason that payday loans end up being so costly.[219] Most borrowers pay more in fees than they received in the original loan.[220] Consider these staggering statistics about the payday lending sector:

- The average payday lending customer is indebted for 199 days, "or roughly 55% of the year"; according to one study, "[a] quarter of consumers were indebted for 92 days or less over the 12-month study period, while another quarter was indebted for more than 300 days."[221]

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CONSUMER INFORMATION: LEGAL STATUS OF PAYDAY LOANS BY STATE, http://www.paydayloaninfo.org/state-information [https://perma.cc/8N2W-AG7J].

[214] *There Are More Payday Lenders in U.S. Than McDonald's,* NBC NEWS (Nov. 24, 2014), https://www.nbcnews.com/business/economy/there-are-more-payday-lenders-u-s-mcdonalds-n255156 [https://perma.cc/M7WC-3MC5]. *See also* ALEX KAUFMAN, FED. RES. BOARD, 4 FIN. AND ECON. DISCUSSION SERIES, PAYDAY LENDING REGULATION (Aug. 15, 2013), http://www.federalreserve.gov/pubs/feds/2013/201362/201362pap.pdf [https://perma.cc/2ZCX-GLFK]; Richard R. W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994, 996 (2006).

[215] Susan Tompor, *Westland Woman Had 350% Interest Rate on $1,200 Loan—And a Loophole Allows It*, DETROIT FREE PRESS (July 12, 2019), https://www.freep.com/story/money/personal-finance/susan-tompor/2019/07/12/plain-green-loans-litigation/1685589001/ [https://perma.cc/F3HJ-4DAN].

[216] *See* Nick Bourke, *Payday Loan Facts and the CFPB's Impact,* PEW RESEARCH CENTER (Jan. 14, 2016), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2016/01/payday-loan-facts-and-the-cfpbs-impact [https://perma.cc/9XLM-BHUT].

[217] *See id.*

[218] *See* CONSUMER FIN. PROTECTION BUREAU, WHAT DOES IT MEAN TO RENEW OR ROLL OVER A PAYDAY LOAN? (June 7, 2017), https://www.consumerfinance.gov/ask-cfpb/what-does-it-mean-to-renew-or-roll-over-a-payday-loan-en-1573/ [https://perma.cc/KQ9Y-TULB].

[219] *See id.*

[220] Bourke, *supra* note 216.

[221] CONSUMER FIN. PROTECTION BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS: A WHITE PAPER OF INITIAL DATA FINDINGS 23 (Apr. 24, 2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf [https://perma.cc/M2R8-ANH7]. The CFPB sample size was fifteen million loans in 2013. *Id.*

- Over 80% of payday loans are rolled over or followed by another loan within fourteen days (i.e., renewed).[222]
- Of the loans that are rolled over, the majority, 62%, are in a sequence of seven or more loans, and *half* of all loans made are in a sequence of *at least ten loans*.[223] The payday industry relies on the constant renewal of these loans.[224] One large payday lender even uses a circular diagram, representing constant renewal, to instruct its employees on how to perpetuate the loans.[225]
- The vast majority of payday loans are given to borrowers who are repeat borrowers—taking out anywhere from five to twelve loans a year. [226]
- Few borrowers amortize, or have reductions in principal amounts, between the first and last loan of a loan sequence. For more than 80% of the loan sequences longer than one loan, the final loan in the sequence is the same size or larger than the first. Loan size is likely to go up in larger loan sequences, and principal increases are associated with higher default rates.
- The average borrower pays an average of $520 in interest.[227] One-quarter of the borrowers paid $781 or more in fees.[228]
- A Pew report also found that a payday loan takes 36% of a borrower's pre-tax paycheck.[229]

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[222] *See* Kathleen Burke et al., Consumer Fin. Protection Bureau, CFPB Data Point: Payday Lending 4 (Mar. 25, 2014), http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf [https://perma.cc/R4R8-U3KB].

[223] *Id.* at 12.

[224] *Id.* at 4–5.

[225] Consumer Fin. Protection Bureau, CFPB Takes Action Against ACE Cash Express for Pushing Payday Borrowers Into Cycle of Debt, (Jul. 2014) https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-ace-cash-express-for-pushing-payday-borrowers-into-cycle-of-debt/ [https://perma.cc/2M3R-BQR5].

[226] Fees on these loans quickly add up. If a typical payday loan of $325 is flipped eight times usually this takes just 4 months—the borrower will have paid $468 in interest. In order to fully repay the loan and principal, the borrower will need to pay $793 for the original $325. Most borrowers pay even more than that. *See* Ctr. for Responsible Lending, Payday Loan Quick Facts: Debt Trap by Design (July 2014), https://www.responsiblelending.org/payday-lending/payday_loans_quickfacts.pdf [https://perma.cc/P9MD-K3VK].

[227] *See* Pew Charitable Trusts, Payday Lending in America: Who Borrows, Where They Borrow, and Why 4 (July 2012), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf [https://perma.cc/RFG4-BHUL]. The CFPB found that the average consumer had over 10 transactions in a 12-month period, paying a total of $574 in fees, which does not include the loan principal. *See* Consumer Fin. Protection Bureau, *supra* note 221, at 22.

[228] Consumer Fin. Protection Bureau, Consumer Financial Protection Bureau Study Finds Debt Trap Concerns with Payday and Deposit Advance Loans 4 (2015), https://files.consumerfinance.gov/f/201304_cfpb_payday-factsheet.pdf [https://perma.cc/98A4-T5XM].

[229] *See* The Associated Press, *States with highest, lowest payday loan rates*, USA Today (Apr. 20, 2014), http://www.usatoday.com/story/money/personalfinance/2014/04/20/id-nv-ut-have-among-highest-payday-loan-rates/7943519/ [https://perma.cc/J29G-8Q2Q].

Payday lenders do not require a credit report or significant documentation. In most cases, a borrower only needs a bank account (which they allow the lender to access) and a paystub to verify income.[230] Over half of payday borrowers end up overdrawing from their bank accounts (and incurring bank fees), with more than a quarter of them as a direct result of payday lenders withdrawing money directly from their accounts.[231] The fees and interest on the loan are generally between $10 and $30 for every $100 borrowed.[232] A typical two-week payday loan with a $15 per $100 fee equates to an Annual Percentage Rate ("APR") of about 400%.[233] By comparison, APRs on credit cards can range from about 12% to 30%.[234] But APR vastly underestimates the costs of these loans, because they are short-term and the interest compounds quickly and exponentially if they are held for a year. Because most of these loans are rolled over, the interest is actually much higher than what the APR reflects. For example, say a borrower takes out a $300 loan. When she is unable to pay the loan at the end of the payday cycle, she pays $50 to extend the loan term, a "rollover," for another two weeks. The borrower still owes the original amount of the loan, the principle. Until she can come up with the principle amount, she continues to make a $50 payment every two weeks to avoid default. This can and usually does go on for months and years, with the borrower paying $50 in fees every two weeks just for the original loan amount.[235] If continued for a year, the borrower will have paid $1,300 in interest in exchange for the use of $300 in cash.

*(b) Title Loans*

In states where payday lending is prohibited, title loans often take its place. Title lenders operate in twenty-one states, some of which expressly authorize these loans.[236] In states where they are not expressly authorized, lenders are able to operate through loopholes in the law. Title loans emerged in the 1990s and are essentially payday loans secured by collateral—often,

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[230] Bourke, *supra* note 216.

[231] *See* Pew Charitable Trusts, Overdraft Frequency and Payday Borrowing: An analysis of characteristics associated with overdrafters (Feb. 2015), https://www.pewtrusts.org/~/media/%20assets/2015/02/consumerbanking_overdraftsupplementbrief_v9.pdf [https://perma.cc/E84S-E93W].

[232] *See* Consumer Fin. Protection Bureau, What are the costs and fees for a payday loan?, https://www.consumerfinance.gov/ask-cfpb/what-are-the-costs-and-fees-for-a-payday-loan-en-1589/ [https://perma.cc/JD8W-JXFY].

[233] *See* Pew, *supra* note 231.

[234] *See* Pew, *supra* note 231.

[235] *See* Consumer Fin. Protection Bureau, What Does It Mean To Renew Or Roll Over A Payday Loan? (June 7, 2017), https://www.consumerfinance.gov/ask-cfpb/what-does-it-mean-to-renew-or-roll-over-a-payday-loan-en-1573/ [https://perma.cc/KQ9Y-TULB].

[236] States which allow car-title lending include Alabama, Arizona, California, Delaware, Georgia, Kansas, Louisiana, Idaho, Illinois, Mississippi, Missouri, Nevada, New Mexico, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, and Wisconsin. *See* Susanna Montezemolo, Ctr. for Responsible Lending, Car-Title Lending: The State of Lending in America & its Impact on U.S. Households 11, 15 (July 2013).

the title to the borrower's car.[237] The loans are configured this way in order to avoid prohibitions on payday lending. With title loans, not only do borrowers pay very high interest rates, but they also stand to lose their car, which is perhaps their most valuable asset. In other words, despite being a "secured" loan in which the lender is fully protected, the cost is still exorbitant. A typical borrower receives a cash loan equal to about 26% of a car's value and pays 300% APR.[238] This means that borrowers are paying very high interest for loans with significant excess collateral. One in six borrowers also faces repossession, with repossession fees averaging half of the borrower's outstanding loan balance.[239] Title loans have grown into a massive industry. Approximately 7,730 car title lenders operate in twenty-one states and generate $1.6 billion in loans annually, while borrowers pay more than $3.5 billion in fees.[240]

Because title lenders can rely on the threat of repossession, the majority of borrowers repeatedly renew their loans.[241] What is described as a short-term loan "turns into long-term, high-cost debt, with borrowers paying more than twice in interest what they received in credit."[242] The average principal of a title loan is $1,042, much higher than what can be borrowed from payday lenders.[243] Much like the payday lending industry, the average car-title borrower renews a loan eight times, paying $2,142 in interest for $951 of credit.[244] Title lenders have recently taken a more high-tech approach to ensuring repayment. Rather than having to undergo the costs associated with finding and repossessing a car, many lenders now install chips that have the ability to remotely disable the ignition in borrowers' vehicles.[245] This happened to one borrower whose car was disabled while she was at a shelter hiding from her abusive husband, as well as to others whose cars were shut down in dangerous neighborhoods or after picking up their children from school.[246]

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[237] *Id.* at 11.

[238] According to a study done by the Center for Responsible Lending, the median loan-to-value ratio among borrowers is 26%. In other words, the loan received is worth less than a third of the collateral. *Id.* at 3.

[239] *Id.* at 8.

[240] *Id.* at 16. *See also* Delvin Davis et al., Consumer Fed. of Am. & Ctr. for Responsible Lending, Driven to Disaster: Car-Title Lending and Its Impact on Consumers 2 (Feb. 28, 2013), http://www.responsiblelending.org/other-consumer-loans/car-title-loans/research-analysis/CRL-Car-Title-Report-FINAL.pdf [https://perma.cc/AZY6-E9LP] (with similar but not identical figures).

[241] *See* Davis et al., *supra* note 240, at 3.

[242] *Id.*

[243] *See* Consumer Fin. Protection Bureau, *supra* note 235, at 6; Jim Hawkins, *Credit on Wheels: The Law and Business of Auto-Title Lending*, 69 Wash. & Lee L. Rev. 535, 535–36 (2012); *see also* Montezemolo, *supra* note 236, at 6.

[244] Davis et al., *supra* note 240, at 2.

[245] *See* Michael Corkery & Jessica Silver-Greenberg, *Miss a Payment? Good Luck Moving that Car*, N.Y. Times Dealbook, (Sept. 24, 2014), http://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/ [https://perma.cc/MJS6-G2V5].

[246] Corkery, *supra* note 245; *see also* Robert Szypko, *Your Car Won't Start. Did You Make The Loan Payment?*, Nat'l Pub. Radio (Oct. 16, 2014), https://www.npr.org/sections/alltech-

*(c) Pawn Loans*

Pawn loans are the oldest and perhaps least financially ruinous form of fringe loans, yet even they exact a high price.[247] Today, the borrower takes something of value to the pawnshop and gets a loan worth much less than the value of the item, usually around 20% of the value. There is a flat interest on the loan, around 30%, which the borrower must pay to retrieve their item within a predetermined period of time, typically two weeks to one month. The borrower can pay another 30% to take out another loan if they cannot pay at the end of the term. If they choose not to pay back the loan principle, they lose their pawned item. While the interest rates are very high on these loans, they are not as punishing as other fringe loans because the loss to the borrower's exposure is capped at the interest paid each time and the value of the collateral offered. Pawn lenders do not require any credit check or bank account information; all loans are secured by an item that can be seized.

*(d) Fintech: Peer-to-Peer Lending*

Peer-to-peer lending describes online platforms that link investors to borrowers, although the industry has taken a variety of forms.[248] Online peer-to-peer lenders, which operate platforms that match lenders to borrowers and attempt to take banks out as a middleman, appeal to many people distrustful of the banking sector. This sector has been on the rise since the 2010s. The biggest stars in the peer-to-peer market, Prosper and Lending Club, promised to disrupt the market for small loans and were embraced by optimistic investors who flooded both companies with venture capital funds and then flocked to purchase shares during IPOs.[249] However, both companies lost the

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considered/2014/10/16/356693782/your-car-wont-start-did-you-make-the-loan-payment [https://perma.cc/PY7L-EYJY].

[247] The Provident Loan Society, established in 1894 with $100,000 provided by the richest men in New York City, was a charitable organization that aimed to "relieve distress through enlightened and liberal lending but also, through competition, to force lower margins on profit-making pawnbrokers." By 1919, it was making more loans than any domestic savings bank with a policy "first, to make small and costly loans and, only second, to make large and profitable ones. It made loans of as little as one dollar [that required minimal collateral]." The fund's humanity was in stark contrast to the pawnbrokers at the time, but due to the nature of the bank's loans, "[t]he truly indigent, almost by definition, were excluded, as they had nothing to pawn." JAMES GRANT, MONEY OF THE MIND 77, 85, 87 (1994).

[248] *See* Kim Porter, *LendingClub Personal Loans: 2019 Comprehensive Review*, BANKRATE (Aug. 7, 2019), https://www.bankrate.com/loans/personal-loans/reviews/lending-club/ [https://perma.cc/XG37-PEMA].

[249] *See* Michael Corkery, *As Lending Club Stumbles, Its Entire Industry Faces Skepticism*, N.Y. TIMES (May 9, 2016), https://www.nytimes.com/2016/05/10/business/dealbook/as-lending-club-stumbles-its-entire-industry-faces-skepticism.html [https://perma.cc/CQ5F-E96R]; *see also* Max Chafkin & Noah Buhayar, *How Lending Club's Biggest Fanboy Uncovered Shady Loans*, BLOOMBERG (Aug. 18, 2016), https://www.bloomberg.com/news/features/2016-08-18/how-lending-club-s-biggest-fanboy-uncovered-shady-loans [https://perma.cc/LBL4-JRTY]; Jonathan Shieber, *Lending Club IPO Shows The Profit Potential For Financial Technology Investments*, TECH CRUNCH (Dec. 11, 2014), https://techcrunch.com/2014/12/11/lend-

trust of investors and their initial momentum.[250] Both have struggled under layoffs[251] as well as claims of mismanagement, fraud, and exaggerated profit margins. Unlike banks, these lenders do not have a steady low-cost deposit base and thus rely on investor capital. With hiccups on the market, their business model has been vulnerable.

Peer-to-peer lenders and other fintech companies are filling in the gap in medium sized loans that used to be offered by community banks and credit unions. Other small lenders, such as Goldman Sach's Marcus Bank, also target the market of unsecured loans around $15,000 to $25,000.[252] Thus far, these lenders have focused on loans starting at $1,000, with an upper limit of $40,000, and thus operate in a different market than do the fringe lenders mentioned above.[253] Their approval process takes at least a week, and these companies cater to borrowers with higher credit scores compared to payday lenders.[254] With a minimum credit score of 600, these loans are intended for higher income borrowers.[255] Their APR rates are between 6% and 40%, which are higher rates than banks typically charge on mortgage or student loans, but much lower than payday and pawn loans.

Other online lenders promise to use algorithmic information to target loans to businesses[256] and individuals.[257] AI lending is likely the future of lending, and its proponents promise that more targeted loan products based on algorithmic underwriting can lower the cost of small-dollar credit. In other words, the lenders can collect fine-tuned data about borrowers that goes beyond credit scores. Privacy activists have expressed concerns about the collection of data for credit purposes, and warn that these practices endanger the liberty of consumers and can lead to harms for certain individuals and communities.[258] Some consumer advocates have expressed concerns that

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ing-club-ipo-shows-the-profit-potential-for-financial-technology-investments [https://perma.cc/L25N-Q326].

[250] Corkery, *supra* note 249.

[251] Chafkin, *supra* note 249.

[252] *See* Nathaniel Popper, *After 147 Years, Goldman Sachs Hangs a Shingle on Main Street,* N.Y. Times (June 18, 2016), https://www.nytimes.com/2016/06/19/business/dealbook/after-147-years-goldman-sachs-hangs-a-shingle-on-main-street.html [https://perma.cc/BTM5-H5RW].

[253] *See* Jeanne Lee, *LendingClub vs. Prosper: How They Compare for Personal Loans,* NerdWallet (Jan. 25, 2019), https://www.nerdwallet.com/blog/loans/lendingclub-vs-prosper-which-is-best-for-personal-loans/ [https://perma.cc/ZF95-78ZX].

[254] Porter, *supra* note 248.

[255] *Id.* ("Consider one of these loans if . . . [y]ou have good to excellent credit. Borrowers need a credit score of at least 600 to qualify, according to the company.")

[256] *See* John Detrixhe, *Will Small Businesses Trust the Banks' Lending Robots?*, Quartz (July 25, 2019), https://qz.com/1673722/banks-like-rbss-natwest-are-pushing-online-algorithmic-loans/ [https://perma.cc/RJ8P-G94K].

[257] Aseem Mital & Atul Varshneya, Tavant Tech., Reshaping Consumer Lending with Artificial Intelligence 15-16 (2018).

[258] *See* Cathy O'Neil, Weapons of Math Destruction: How Big Data Increases Inequality and Threatens Democracy 141–60 (2016); *see also* Frank Pasquale, The Black Box Society: The Secret Algorithms That Control Money and Information 15, 38 (2016).

these algorithms have already demonstrated racial disparities in the rates they offer minority borrowers.[259] However, other scholars point out that these lenders actually discriminate less than face-to-face lenders.[260] Both acknowledge, however, that black and brown borrowers are charged higher rates than whites with similar credit profiles.

## II. Fighting The Sharks

### A. *Using Unconscionability to Attack Usury*

In the history of fighting against high interest rate loans, debates over the enforceability of certain contracts have taken center stage. This tension was litigated in courts, discussed in legislatures, and codified in industry regulation. Legal interpretations of the law of contracts and contract defenses were used by both debtors and creditors to fight for or against debt enforcement. Moreover, while legal codes and judicial decisions have shaped the small-dollar lending market, the fight has also shaped legal doctrine. Without changing the system of wealth inequality that created these conditions, individual litigants challenged exploitative contracts in court.

Litigants' primary legal tool was the doctrine of unconscionability. Section 2-302 of the Uniform Commercial Code ("UCC") "authorizes a court to find, as a matter of law, that a contract or a clause of a contract was 'unconscionable at the time it was made.' Upon so finding, the court may refuse to enforce the contract, excise the objectionable clause or limit the application of the clause to avoid an unconscionable result," even though the rate was within the law of the state. Unconscionability can be used as a last-ditch effort when a contract is otherwise valid but one party still asks the court to nullify it because the terms are unfair. If a court determines that contract terms are so unjust or one-sided in favor of the party with the superior bargaining power, it can deem the contract unconscionable and void. Borrowers in unconscionability cases argued that the cost of the loan was so unfair that the court should intervene in the bargain and terminate it.[261] While the borrower had signed the contract and had agreed to the terms, they argued that the deal itself was unjust.[262] The use of unconscionability provided relief for many poor borrowers, but it was not without cost.[263] These cases stretched and muddied contract law and doctrine like unconscionabil-

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[259] *See* Matthew A. Bruckner, *The Promise and Perils of Algorithmic Lenders' Use of Big Data*, 93 Chi.-Kent L. Rev. 3, 25–27 (2018).

[260] *See* Robert Bartlett et al., Nat. Bureau of Econ. Res., Consumer-Lending Discrimination in the FinTech Era 16 (2019), https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf [https://perma.cc/EZ35-J2UX].

[261] *See* Jones v. Star Credit Corp., 298 N.Y.S.2d 264, 264–65 (Sup. Ct. 1969).

[262] *Id.*

[263] *Id.* at 267.

ity and it is not clear whether these cases had any lasting impact on this market or just a last gasp before the industry was normalized.

The heyday of the unconscionability doctrine was during the 1960s, when judges voided contracts that they deemed unconscionable. In *Jones vs. Star Credit,* for example, a welfare recipient was sold a freezer with a value of $300 for $900 with fees and interest.[264] After the tenant paid over $600 for the unit, she defaulted.[265] The court ruled that, though installment contracts were sometimes necessary and useful, public policy and unequal bargaining power dictated that consumers be protected from onerous and predatory contracts.[266] The backlash to this case by lenders was swift because it threatened the very industry to have judges second-guessing valid and legal contracts. Using such a central part of the contract—the price—to nullify a contract as unconscionable was controversial, and after the *Jones* cases, it was no longer used.[267] Typical unconscionability cases involve both "procedural" and "substantive" unconscionability, meaning that the way that the contract was made and its terms are both unconscionable, which could mean "unfair," "egregious," "predatory" or "fraudulent."[268]

Unconscionability remains a highly contested contract defense, and it became a focal point in a heated debate in 2019.[269] The American Law Institute, a group of 4,000 lawyers, law professors, and judges, writes the Restatement of Contracts.[270] The Restatement is meant as a survey or a restatement of law as interpreted by courts, not binding law—but judges and lawyers still rely on the Restatement as a reference.[271] Thus, the Restatement is self-referential and influences legal decisionmaking even as it purports to describe the law. Three members of the ALI took on the task of writing the Restatement of Consumer Law and proposed a version that was contested and finally blocked, or postponed, for further revisions.[272]

The debate became heated and charged as law professors and advocates took to professional listservs, blogs, and public commentary to make their case. Some even accused the drafters of the Restatement of bad faith or

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[264] *Id.* at 264–65.

[265] *Id.* at 265.

[266] *Id.* at 267.

[267] *Id*; *see also* Richard E. Speidel, *Unconscionability, Assent and Consumer Protection*, 31 U. Pitt. L. Rev. 359, 371–75 (1970); William J. Britt, *Kugler v. Romain: Price Unconscionability and the Consumer Class Action — Are They Compatible*, 22 Cath. U. L. Rev. 187, 197–98 (1972).

[268] Restatement (Second) of Contracts § 208 (Am. Law Inst. 1981).

[269] *See* Melvin Eisenberg, *The Proposed Restatement of Consumer Contracts, if Adopted, Would Drive a Dagger Through Consumers' Rights*, 36 Yale J. on Reg.: Notice & Comment (Mar. 20, 2019), http://yalejreg.com/nc/the-proposed-restatement-of-consumer-contracts-if-adopted-would-drive-a-dagger-through-consumers-rights-by-melvin-eisenberg [https://perma.cc/P9F9-6EZJ]; *see also* David Dayen, *Controversial Change to Consumer Rights Postponed,* The Am. Prospect (May 22, 2019), https://prospect.org/economy/controversial-change-consumer-rights-postponed/ [https://perma.cc/4EL7-MSJM].

[270] Dayen, *supra* note 269.

[271] *Id.*

[272] *Id*. *See also*, Eisenberg, *supra* note 269.

political motivations.[273] This debate was a highly unusual response to the drafting of the Restatement. Usually, scholars just describe the current state of the law and elaborate conflicts of interpretation among courts if there are any.[274] An important piece of the debate was the Restatement's perceived weakening of the unconscionability doctrine. The authors depicted the doctrine as being more exacting than how the opponents presented it.[275] The opponents claimed that in fact, unconscionability was being used more often by courts to protect consumers from onerous contract terms.[276] The heated debate over the unconscionability doctrine was clearly about more than just a non-binding legal treatise. The scholars and activists who vigorously opposed the Restatement language knew that to curtail the use of the unconscionability doctrine would harm weaker plaintiffs fighting against stronger corporations.[277] Consumer advocates like former CFPB Director Richard Cordray and Senator Elizabeth Warren even waded into the fight in opposition of the Restatement.[278] It is a defense rooted in fairness and justice, but it threatens reliance on contracts. Though the current standard for unconscionability is high—the plaintiff has to establish that there was gross unfairness in the procedure and substance of how the contract is made[279]—the defense is still a last resort defense and the closest the common law comes to a "defense for the poor."

Despite the current attempt by law professors to preserve the unconscionability doctrine, its use has undoubtedly waned. Today, it is used in the most egregious cases where the formation of the contract involved fraud or duress, something above and beyond just unfairness. Unconscionability is no longer available to challenge high interest rates.

The waning of the doctrine of unconscionability coincided with national deregulation of laws regarding usury. The legal system came to redefine what rates of interest it understood as usurious over time, most dramatically during the 1980s, as many state limits were lifted or significantly increased.[280] Usury limits, which had hovered around 6 to 12% for most of U.S. history, were allowed to reach three hundred to 700%. Inflationary pressures caused the initial deregulation of interest rates by the states, but it was a Supreme Court decision that ultimately eradicated real

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[273] Eisenberg, *supra* note 269; Dayen, *supra* note 269.

[274] Dayen, *supra* note 269.

[275] *Id.*

[276] *Id.*

[277] Eisenberg, *supra* note 269.

[278] *See* Richard Cordray, *Former Director, U.S. Consumer Fin. Protection Bureau, Letter to Richard L. Revesz, Director, Am. Law Inst.*, (May 19, 2019), https://pubcit.typepad.com/files/cordray-opposition-letter.pdf [https://perma.cc/3EEH-TXRC]; *see also* Elizabeth Warren (@SenWarren), Twitter (May 20, 2019, 5:42 PM), https://twitter.com/senwarren/status/1130635062158995457 [https://perma.cc/GMT9-3JMP].

[279] *See* Restatement (Second) of Contracts § 208 (Am. Law Inst. 1981).

[280] *See* Charles R. Geisst, Beggar Thy Neighbor: A History of Usury and Debt 258 (2013) ("Many states dismantled their usury laws in the 1980s as a result [of the proliferation of adjustable rate mortgages] . . . .").

interest rate caps in the United States. In *Marquette National Bank v. First Omaha Service Corporation*, the Supreme Court held that a credit card lender could export the interest rates of one state to any other, which meant that a bank could choose the state with the highest interest rate and apply that rate to all of its loans across the country.[281] Banks immediately lobbied for and were granted the same privilege. The predictable outcome was that lenders began to charter in states with the highest allowable interest rates that they could then export nationwide. This in turn caused a "race to the bottom" as states competed for lending businesses by lowering borrower protections and increasing usury limits.[282]

*Marquette National Bank* did not apply to payday lenders because the industry was not prevalent at the time, but the payday lenders quickly took advantage by "borrowing" bank charters, a practice dubbed "rent-a-bank," in order to "benefit" from high interest rates. After banking laws prohibited this arrangement, payday lenders fled to charter on Native American tribal lands, which are exempt from state usury laws, in order to charge high rates. These lenders have been known to charge effective interest rates of up to 2000%.[283] The result? As explained by one scholar, "the problem of loan-sharking was brushed aside by making [high interest rates], once typical only of organized crime, perfectly legal—and therefore, enforceable no longer by just hired goons and the sort of people who place mutilated animals on their victims' doorsteps, but by judges, lawyers, bailiffs, and police."[284]

### B. *Fighting the Sharks*

Regulating the industry or "taming the sharks" is difficult because of the incredible market demand for what they offer. State and federal actions may make existing loans less disastrous, which would be an excellent outcome, but increased regulation may also make it harder for the poor to borrow, relegating individuals that need credit to find options on the unregulated and much more dangerous informal market. Fringe loans, like payday and title loans, exist because a large portion of the population needs

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[281] 439 U.S. 813 (1978).

[282] *Cf.* Peterson, *supra* note 199, at 108. Today, the states with the highest average interest rates are Idaho at 582% APR; South Dakota and Wisconsin at 574% APR; Nevada at 521% APR; Delaware at 517% APR; and Utah at 474% APR. *CRL Issue Brief: Effective State and Federal Payday Lending Enforcement: Paving the Way for Broader, Stronger Protections*, Ctr. for Responsible Lending, (Oct. 4, 2013), http://www.responsiblelending.org/payday-lending/research-analysis/State-Enforcement-Issue-Brief-10-4-FINAL-fix.pdf [https://perma.cc/4ZDL-FSEJ]. The five states with the lowest rates are: Colorado (129%), Oregon (156%), Washington (192%), Maine (217%), and Minnesota (252%). *Id.*

[283] *See* Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?*, 69 Wash. & Lee L. Rev. 751, 763 (2012).

[284] Graeber, *supra* note 35, at 376.

them. Until the demand stops (i.e., people are less poor) or fair credit is more widely available, variations on high-interest small loans will keep popping up.

The rise of high-cost, small-dollar lenders is a result of the deregulation of usury laws and the conglomeration of the banking sector that left so many communities without access to safe credit. Yet the demand for these loans has also increased due to rising inequality.[285] Many Americans do not have stable work or enough wealth,[286] but do have high healthcare and housing costs.[287] Economic inequality in America today is worse than any time since the Lochner and Progressive era of the 1920s.[288] 40% of American families do not have any savings and would need to borrow money if they had a shortfall of $400, according to the Federal Reserve.[289] Government studies show that 60% of Americans do not have enough to get by for three months.[290] Many workers' incomes have gotten less predictable as well. Since the 1970s, household incomes have become much more volatile—while household bills have remained constant.[291] "More than 30 percent of Americans reported spikes and dips in their incomes. Among that group, 42 percent cited an irregular work schedule; an additional 27 percent blamed a span of joblessness or seasonal work."[292] A quarter of American families have skipped necessary medical care because they could not afford it.[293] This is the reason that the number one cause of bankruptcy in the United States is

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[285] *See* Lisa Servon, *When It Comes to Regulation of Payday Loans, One Size Won't Fit All*, N.Y. Times (Jan. 20, 2015), https://www.nytimes.com/roomfordebate/2015/01/20/the-allure-of-easy-money/when-it-comes-to-regulation-of-payday-loans-one-size-wont-fit-all [https://perma.cc/K9T5-8YAY]; *see also* Emmanuel Saez & Gabriel Zucman, *How to Tax Our Way Back to Justice*, N.Y. Times (Oct. 11, 2019), https://www.nytimes.com/2019/10/11/opinion/sunday/wealth-income-tax-rate.html [https://perma.cc/J9A8-A2NU].

[286] *See* Eric Rosenbaum, *Millions of Americans are Only $400 Away from Financial Hardship. Here's Why*, CNBC (May 23, 2019), https://www.cnbc.com/2019/05/23/millions-of-americans-are-only-400-away-from-financial-hardship.html [https://perma.cc/4CUS-F9QD].

[287] *See* Karen Zraick, *Americans Borrowed $88 Billion to Pay for Health Care Last Year, Survey Finds*, N.Y. Times (Apr. 2, 2019), https://www.nytimes.com/2019/04/02/health/americans-health-care-debt-borrowing.html [https://perma.cc/M8U3-X7M]; Isabel V. Sawhill and Christopher Pulliam, Brookings *Six Facts About Wealth in the United States,* (June 25, 2019), https://www.brookings.edu/blog/up-front/2019/06/25/six-facts-about-wealth-in-the-united-states/ [https://perma.cc/L747-9JRV].

[288] *See* Christopher Ingraham, *Wealth Concentration Returning to 'Levels Last Seen During the Roaring Twenties,' According to New Research*, Wash. Post (Feb. 8, 2019), https://www.washingtonpost.com/us-policy/2019/02/08/wealth-concentration-returning-levels-last-seen-during-roaring-twenties-according-new-research/ [https://perma.cc/YW5X-ER2T].

[289] *See* Bd. of Governors of the Fed. Res. Sys., Report on the Economic Well-Being of U.S. Households in 2017 2, 21–22 (May 2018), https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf [https://perma.cc/Y733-FBDY].

[290] *Id.* at 32.

[291] *See* Patricia Cohen, *Unsteady Incomes Keep Millions Behind on Bills*, N.Y. Times (Dec. 3, 2014), https://www.nytimes.com/2014/12/04/business/unsteady-incomes-keep-millions-of-workers-behind-on-bills-.html [https://perma.cc/F47H-PECC].

[292] *Id.*

[293] *See* Bd. Of Governors of the Fed. Res. Sys., *supra* note 289, at 31–32.

unexpected medical expenses.[294] Thus, when faced with routine or unexpected costs and a fluctuating income, many people must borrow to survive. The rise in demand for short-term credit is a symptom of increased inequality and poverty.

This was also the predicament of the wage workers and farmers at the turn of the century who pushed for financial reforms. In many ways, economic inequality of this magnitude has not been seen since the Lochner era. When progressive reformers fought what they perceived as unjust credit markets, they created grassroots "public" alternatives. The causes of inequality and poverty, they surmised, were structural, and so too must be the solutions. Today, in the face of a large and growing payday lending sector, those who seek reform have focused on regulation—even as the tools to fight the payday lending sector have been neutered over time.

Regulating the payday industry has been a frustrating endeavor. The federal government does not have jurisdiction over interest rates.[295] States can regulate interest rates, terms, and various other dimensions of payday loans, but they cannot always stop out-of-state lenders from lending to in-state consumers. Since the *Marquette* decision allowed states to export their rates nationwide, it has been practically impossible for states to enforce maximum rates. Many states have chosen not to regulate payday loans or to set high maximum APRs. In fact, maximum rates allowed by law have steadily increased over the last decade with rates ranging from 300% APR to 1900% APR.[296] These APRs significantly exceed the rates allowed by credit card companies and banks.[297]

The grievances against the industry have led some state and federal regulators to crack down on the industry,[298] but this task has proven difficult both politically and practically. The payday lending industry is a powerful lobbying group that has successfully fought attempts at regulation.[299] And payday lenders have skirted regulations just as quickly because the industry

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[294] *See* Dan Mangan, *Medical Bills are the Biggest Cause of U.S. Bankruptcies: Study*, CNBC (June 25, 2013), http://www.cnbc.com/id/100840148 [https://perma.cc/MS8M-S659].

[295] *See* David Lazarus, *Payday Lenders, Charging 460%, Aren't Subject to California's Usury Law*, L.A. TIMES (June 2, 2017), https://www.latimes.com/business/lazarus/la-fi-lazarus-usury-laws-20170602-story.html [https://perma.cc/AJG3-PTJR].

[296] *See* Cathy Lesser Mansfield, *Predatory Mortgage Lending: Summary of Legislative and Regulatory Activity, Including Testimony on Subprime Mortgage Lending Before the House Banking Committee,* in Consumer Financial Services Litigation 40, PRACTICING LAW INST. CORP. LAW & PRACTICE (2001).

[297] *See* Renae Merle, *Sanders, Ocasio-Cortez Want to Cap Credit Card Interest Rates at 15 Percent*, WASH. POST (May 9, 2019), https://www.washingtonpost.com/business/2019/05/09/bernie-sanders-ocasio-cortez-want-cap-credit-card-interest-rates-percent/ [https://perma.cc/7UMQ-WYJU].

[298] *See* Neil Bhutta, Jacob Goldin & Tatiana Homonoff, *Consumer Borrowing After Payday Loan Bans*, 59 J. OF L. AND ECON. 225, 226 (2016); *see also* Alan Rappeport, *Payday Rules Relax on Trump's Watch After Lobbying by Lenders*, N.Y. TIMES (Feb. 2, 2018), https://www.nytimes.com/2018/02/02/us/politics/payday-lenders-lobbying-regulations.html [https://perma.cc/T4F7-UDEY].

[299] Rappeport, *supra* note 298.

has been able to create new products to replace the banned ones and new fee structures to avoid interest rate caps.[300] In states that banned payday loans, title loans proliferated.[301] Those that capped interest rates saw a rise in "fees" on the same loans.[302] State legislators have banned payday lenders or certain products only to see the high-interest loans pop up in another form—forcing lawmakers to play a frustrating game of whack-a-mole.[303]

Because usury law is primarily a state matter, enforcement has also varied among the states. Most states do not have strong usury laws; many are riddled with loopholes that exempt most lenders.[304] Even when states do have explicit and applicable usury rate caps, the state banking office or other business regulator charged with enforcement does not have the resources to find and prosecute each lender that evades its laws—especially when much of the lending occurs online.

Payday lenders operating online can use the rates—or lack thereof—in the state or territory where they are charted while operating nationwide.[305] Today, many payday lenders operate on the Internet and can charter in the states with the highest interest rate ceilings.[306] These lenders charge the highest rates of interest (with average rates of 650%) and are the hardest to regulate.[307] Pew Research also shows higher instances of fraud and abuse by online lenders. These online lenders can charge rates up to 1095% APR, which was the Missouri maximum in 2019.[308] Many still operate on Native American reservations,[309] and regulators who have attempted to enforce their

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[300] BARADARAN, *supra* note 32, at 124.

[301] Bhutta et al., *supra* note 298, at 227–28.

[302] *Id.* at 234*; see also* Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap*, 34 J. OF BANKING AND FIN. 546, 551 (2010) ("These results suggest that the effect of restricting access to payday loans on overall short-term, expensive borrowing is muted by the continued availability of overdrafts and late bill payment; i.e., that overdrafts and late bill payment are imperfect substitutes for payday loans."). When Oregon set a firm interest cap of 36% in 2008, lending took the form of overdraft fees and bank late payments, which often equal or surpass payday lending limits, to give themselves short-term loans. *Id.*

[303] *See* PETERSON, *supra* note 199.

[304] Lazarus, *supra* note 295; CONSUMER FED'N OF AMERICA, *supra* note 213.

[305] *See* Andy Stonehouse, *The Great Lending Loophole*, FAIR (Nov. 15, 2018), https://www.fair.com/blog/how-lenders-avoid-usury-laws [https://perma.cc/S37F-DTG5].

[306] *See* Kara Dry, *Payday Lenders Find Loopholes with Online Lending*, SHARED JUSTICE (Dec. 21, 2016), http://www.sharedjustice.org/domestic-justice/2016/12/21/payday-lenders-find-loopholes-with-online-lending [https://perma.cc/3J39-3APS].

[307] Kevin Wack, *Abuses in Online Payday Lending Are Widespread, Report Finds*, AM. BANKER (Oct. 2, 2014), http://www.americanbanker.com/issues/179_191/abuses-in-online-payday-lending-are-widespread-report-finds-1070347-1.html [https://perma.cc/63Z9-KJKF].

[308] Dry, *supra* note 306.

[309] Mary Jackson, *Tribal Lending Provides More Opportunities for America's Indigenous Peoples,* FORBES, (Nov. 6, 2019); Leslie Bailey, *"Tribal Immunity" May No Longer be a Get-Out-Of-Jail Free Card for Payday Lenders*, PUBLIC JUSTICE (Jan. 2, 2018), https://www.publicjustice.net/tribal-immunity-may-no-longer-get-jail-free-card-payday-lenders/ [https://perma.cc/D9PU-BT3Z.

rules have had difficulty because these loopholes comply with neither the letter nor the spirit of the usury laws.[310]

### *C. The Federal Government vs. Usury*

Only states have the power to regulate usury, which is why loopholes and evasions of state law have been so prevalent. Without a national rate cap, enforcement has been piecemeal and weak.[311] The CFPB Congress chartered in the Dodd-Frank Act did not attempt to give the federal regulator authority to set usury caps.[312] However, the agency does have the power to regulate almost every other aspect of the payday industry. The CFPB, which was created in 2010, is the first federal regulator with the direct mandate to protect consumers from financial products that the agency interpreted to be deceptive, abusive or unfair.[313] The agency, which was embattled and controversial from the start,[314] had placed payday lending reform near the top of its agenda.[315] Richard Cordray, the first CFPB director, has stated that, "the payday lending industry depends on people becoming stuck in these loans for the long term, since almost half their business comes from people who are basically paying high-cost rent on the amount of the original loan."[316] The CFPB issued a rule regulating payday lending in 2017 that included a variety of regulatory constraints on the industry.[317] The backlash was immediate. The rule never went into effect because the Trump administration's CFPB decided that it would not prioritize its enforcement.[318] Kathy Kraninger, who became the CFPB Director in 2018, explained the agency's deci-

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[310] Stonehouse, *supra* note 305; Rawan Elhalaby, *Fix the Loophole that Lets Predatory Lenders Rip People Off*, Greenlining Inst. (July 3, 2019), http://greenlining.org/blog/2019/fix-the-loophole-that-lets-predatory-lenders-rip-people-off/ [https://perma.cc/4HR3-SMMZ]; Lindsay Frankel, *Bill to Close Payday Loan Loophole Dies in Richmond, Virginia,* OppLoans (Jan. 10, 2018), https://www.opploans.com/payday-news/bill-to-close-payday-lending-loophole-dies-in-richmond-virginia/ [https://perma.cc/CB24-Z86R].

[311] Servon, *supra* note 285; Lazarus, *supra* note 295; Frankel, *supra* note 310.

[312] *See* Cong. Res. Serv., The Consumer Financial Protection Bureau (CFPB): A Legal Analysis (Jan. 2014); Jennifer Ballard et al., *Exploring the Legal Issues Relevant to Online Small-Business Lending*, Am. Bar Assoc. (Aug. 15, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2017/08/02_ballard/ [https://perma.cc/65QM-PANW].

[313] *Id.*

[314] *See* Daniella Cheslow, *Consumer Protection Bureau Aims to Roll Back Rule for Payday Lending*, Nat'l Pub. Radio (Feb. 6, 2019), https://www.npr.org/2019/02/06/691944789/consumer-protection-bureau-aims-to-roll-back-rules-for-payday-lending [https://perma.cc/26E3-WQXJ].

[315] *See id.*

[316] Richard Cordray, Director of the Consumer Fin. Protection Bureau, Remarks at the Payday Field Hearing, (Mar. 25 2014), http://www.consumerfinance.gov/newsroom/director-richard-cordray-remarks-at-the-payday-field-hearing/ [https://perma.cc/M3ZJ-2W5S].

[317] Payday, Vehicle Title, and Certain High-Cost Installment Loans; Delay of Compliance Date; Correcting Amendments, 84 Fed. Reg. 27,907 (June 17, 2019); Consumer Fin. Protection Bureau, Payday Loan Protections, (June 7, 2017), https://www.consumerfinance.gov/payday-rule/ [https://perma.cc/W2ZP-NM5U].

[318] Cheslow, *supra* note 314.

sion to roll back the payday rules as necessary in order to encourage competition in the payday lending industry and help improve credit options for borrowers in need.[319]

In 2007, to combat fringe lenders springing up around military bases, Congress passed the Military Lending Act ("MLA").[320] MLA capped interest rates to military borrowers at 36% and required written and oral disclosure of interest rates and payment obligations before loans were issued.[321] But the law was under-enforced and easily skirted: payday and title lenders simply changed the terms of the loan agreements to circumvent the reach of the regulations.[322] Holly Petraeus, wife of then-General David Patreus, was appointed to the CFPB in 2011 with Senator Elizabeth Warren's help and retired in 2016. Holly Petraeus advocated to amend the law and testified before the Senate to call for reforms improving MLA's enforcement in 2012. After the amendments were passed, she called for further reforms to ensure that lenders could not again evade the regulations by changing the terms of their loan agreements. She gave a few examples in her testimony, including a story of the spouse of a wounded warrior in the Illinois National Guard who took out an auto title loan of $2,575 at an APR of 300%. The finance charges on the loan were $5,720.24 for a total amount of $8,295.24. The loan was not subject to the Act's protections under the current rule because it had a term longer than 181 days.[323] She also told the story of an airman from California who borrowed $6,000 for thirty-six months at 102.47% APR, which, even though it was secured by the title of his car, ended up costing him $13,463.04. Because the loan was longer than 181 days, it was not covered by the law. In 2018, Trump appointee Mick Mulvaney, then Acting Director of the CFPB, questioned the agency's power to enforce the MLA and signaled that he would roll back regulations. Pentagon officials and veterans' groups publicly opposed the regulatory rollback.[324] As of 2019, Trump appointees leading the CFPB continued to express doubt over whether it

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[319] *Id.*

[320] 10 U.S.C. § 987.

[321] 10 U.S.C. § 987 §§ (b), (c)(1).

[322] Consumer Fin. Protection Bureau, CFPB Report Finds Loopholes in Military Lending Act Rules Rack up Costs for Servicemembers, (Dec. 29, 2014), http://www.consumerfinance.gov/newsroom/cfpb-report-finds-loopholes-in-military-lending-act-rules-rack-up-costs-for-servicemembers/ [https://perma.cc/BSG4-WHNA].

[323] Brady Dennis, *Holly Petraeus Will Lead Consumer Financial Protection Bureau's Office for Service Member Affairs*, Wash. Post (Jan. 4, 2011), http://www.washingtonpost.com/wp-dyn/content/article/2011/01/04/AR2011010405627.html [https://perma.cc/92F9-QZFS]; *Soldiers as Consumers: Predatory and Unfair Business Practices Harming the Military Community: Hearing Before the U.S. Senate Committee on Commerce, Science & Transportation*, 113th Cong. 16 (2013) (statement of Hollister K. Petreaus, Assistant Director, Consumer Fin. Protection Bureau, Office of Servicemember Affairs).

[324] Kate Berry, *Pentagon, Others Baffled by CFPB Plan to Cease Military Lending Exams*, Am. Banker (Oct. 11, 2018), https://www.americanbanker.com/news/pentagon-others-baffled-by-cfpb-plan-to-cease-military-lending-exams [https://perma.cc/QQK2-74RR].

could or would enforce the MLA.[325] If Congress passes the "Loan Shark Prevention Act" proposed by Senator Sanders and Representative Ocasio-Cortez, it will be the first federal usury rate cap.[326]

### *D. The Challenges of Regulation*

Besides the lack of authority by federal regulators and the piecemeal attempts by states to deal with high cost loans, there are broader questions about regulation in general and a lack of consensus about whether any regulation and how much regulation is appropriate and how else the market can meet the demands of those who need small loans to survive. Because those who need payday loans are already struggling financially, there is some evidence that prohibiting these loans may actually hurt consumers. For example, Paige Skiba found that check bouncing, customer complaints, and Chapter 7 bankruptcies all *increased* significantly in Georgia after payday loans were prohibited in 2004.[327] Pew found that if individuals were faced with a shortfall and payday loans were unavailable, 81% of borrowers say they would have to cut back on expenses such as food.[328] On the other hand, a natural experiment in Colorado proved that when the state cracked down on payday lenders and dramatically reduced interest rates, access to credit was not curtailed.[329] The Colorado rule imposed a cap on the amount an individual could borrow and also mandated that borrowers have at least six months to repay, which essentially outlawed the typical payday loan.[330] Borrowers paid less to borrow, defaulted on fewer loans, and saved, by Pew's estimate, roughly $40 million that they would otherwise have paid in fees.[331]

For years, economists have tried to study the effects of payday loans on their borrowers. Yet after a review of all the economic research attempting to answer the big question—"Do payday lenders, on net, exacerbate or relieve customers' financial difficulties?"—economist John Caskey concludes that

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[325] Katy O'Donnell, *Military Personnel Caught in Crossfire Over Lending Law*, POLITICO (Apr. 9, 2019), https://www.politico.com/story/2019/04/09/military-personnel-caught-in-crossfire-over-lending-law-1290791 [https://perma.cc/DG2H-ZRPE].

[326] Merle, *supra* note 297.

[327] Paige Marta Skiba, *Regulation of Payday Loans: Misguided?*, 69 WASH. & LEE L. REV. 1023, 1038 (2012).

[328] PEW CHARITABLE TRUSTS, *supra* note 227, at 5, 25.

[329] Nick Bourke, *Payday Loan Facts and the CFPB's Impact,* PEW CHARITABLE TRUSTS (Jan. 14, 2016), https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2016/01/payday-loan-facts-and-the-cfpbs-impact [https://perma.cc/2YRD-M69D].

[330] David Migoya, *Colorado Was Out Front in Payday Lending Reform*, THE DENV. POST (Mar. 26, 2015), https://www.denverpost.com/2015/03/26/colorado-was-out-front-in-payday-lending-reform/ [https://perma.cc/4PDG-BJYW].

[331] PEW CHARITABLE TRUSTS, TRIAL, ERROR, AND SUCCESS IN COLORADO'S PAYDAY LENDING REFORMS 2 (Dec. 2014), https://www.pewtrusts.org/-/media/assets/2014/12/pew_co_payday_law_comparison_dec2014.pdf?la=en&hash=5391FF0F62FDE3BDF3013A5267A6414B14FECD74 [https://perma.cc/TS6M-MBME].

there is no reliable answer.[332] Brian Meltzer's research concludes that instead of alleviating economic hardship, payday loans contribute to or cause more hardship. His research presents "robust evidence" that payday loans make it more difficult for households to pay their mortgage, rent, and utility bills, but it also causes them to delay medical and dental care and prescription purchases.[333] Paige Skiba and Jeremey Tobacman show that payday loans increase Chapter 13 bankruptcies even though they found that prohibiting payday loans increased Chapter 7 bankruptcies in other research.[334] Jonathan Zinman's research shows that borrowers suffered as a result of Oregon's cap that drove out payday lenders from the state.[335] After a review of all the research, Caskey ultimately concludes that "we cannot have substantial confidence in the results of any of these studies."[336]

This research is inconclusive and unsatisfying because it focuses on the wrong question. It is both true that people need these loans and that these loans are harmful. Thus, depending on your research question, you can conclude that these loans alternatively benefit or hurt consumers. On the one hand, payday loans are the only credit option for many households. Cutting off access to a loan that can help a family make it from one paycheck to the next can result in severe financial distress. On the other hand, these loans are too costly and can lead to a debt trap. In other words, the very loan that can help one person avoid a catastrophe can be the *cause* of a similar catastrophe for another similarly situated individual.

Even measures such as how many customers pay off their loans are hard to come by because of the way the industry measures default.[337] Furthermore, academic research on payday loans has come under suspicion. Separate investigations in 2016 and 2019 from a watchdog group called the Center for Accountability unearthed email exchanges and documents between the payday lending lobbyists and academic researchers revealing that the industry was paying for academic research that they had influenced.[338]

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332 John P. Caskey, *Payday Lending: New Research and the Big Question* 25 (Res. Dep't, Fed. Res. Bank of Phila., Working Paper No. 10-32, 2010), https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2010/wp10-32.pdf [https://perma.cc/J6P9-F4NL].

333 *See* Brian Meltzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Quarterly J. of Econ. 517, 520 (2011).

334 *See* Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, 11–13 Vand. L. & Econ. Research Paper 1, 4, 14 (2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215 [https://perma.cc/EB8S-7G2R].

335 Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects around the Oregon Rate Cap*, 34 J. of Banking and Fin. 546, 548 (2010).

336 Caskey, *supra* note 332, at 26.

337 *See* Renae Merle, *How a Payday Lending Industry Insider Tilted Academic Research in its Favor*, Wash. Post (Feb. 25, 2019), https://www.washingtonpost.com/business/2019/02/25/how-payday-lending-industry-insider-tilted-academic-research-its-favor/ [https://perma.cc/S4E6-YH28]; Dennis Glennon & Peter Nigro, *Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach*, 37 J. Money, Credit, and Banking 923, 924 (2005).

338 Kevin Wack, *How the Payday Lending Industry Shapes Academic Research*, Am. Banker (Feb. 5, 2018), https://www.americanbanker.com/news/how-the-payday-lending-in-

Professors accepted grant money from a payday lobbying group that they did not disclose.[339] They then published reports with data findings favorable to payday lenders.[340] Some of this research was used by legislators and the CFPB to justify deregulation.[341]

### *E. Why do people borrow?*

Payday borrowers are not, as is often assumed, financially illiterate or casual about borrowing under such demanding terms. The reality is that for many of the poor, these loans are their only access to credit and they go to them reluctantly. A Pew study found that desperation often influences the choice to borrow, as 37% of borrowers say that they have been in such a difficult financial situation that they would take a payday loan on any terms offered.[342] To pay off their loans, 40% of these borrowers turn to friends or family, sell or pawn personal possessions, or take out another type of loan.[343]

Nor is the borrowing frivolous. Surveys reveal that the loan is being used to pay for food, or rent, but the budget shortfall is likely due to a variety of setbacks such as a medical emergency, car problems, or some other unexpected life expense.[344]

Financial education has been embraced by policymakers as a way of turning consumers into responsible and empowered market players who can use these tools to increase their own welfare.[345] The thinking goes that if consumers would only learn to avoid financial landmines, the poor could maneuver the unrestrained free market to their benefit.[346] If they only knew how to manage their money, they would not be so poor!

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dustry-shapes-academic-research [https://perma.cc/HP47-2QE9]; Christopher Werth, *Tracking the Payday-Loan Industry's Ties to Academic Research*, FREAKONOMICS (Apr. 6, 2016), http://freakonomics.com/podcast/industry_ties_to_academic_research/ [https://perma.cc/WM27-8ER2].

339 *See* Werth, *supra* note 338.

340 *Id.*

341 *Id.*

342 PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA, REPORT 2: HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 6 (Feb. 2013), https://www.pewtrusts.org/-/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf [https://perma.cc/5HNB-4AMA].

343 *Id.* at 7 ("One in six has used a tax refund to eliminate payday loan debt.").

344 The Pew survey found that "[s]ixty-nine percent of first-time payday borrowers used the loan to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food, while 16% dealt with an unexpected expense, such as a car repair or emergency medical expense." *Id.* at 8. However, the loan may have gone to pay for such basics which would have been met by funds diverted to pay for such unexpected events. Thus it is possible that people do not subsist on these loans. *Id.*

345 *See* Lauren E. Willis, *The Financial Education Fallacy*, 101 AM. ECON. REV. 429, 433 (2011).

346 *Id.*

A study of payday borrowing showed that payday loan customers searched extensively for preferred credit before deciding on a payday loan.[347] Loan applicants had an average of over five credit inquiries during the twelve months leading up to their initial payday loan application.[348] Research shows that the poor understand debt and the costs of the loans they take out—they weigh options when in need and they choose these loans.[349] While borrowers may not understand the APR on their loans, they do understand finance charges.[350] In a 2007 California survey, 92% of the respondents said that they were aware of the fees on their loans before taking them out.[351]

Studies conducted by the CFPB, the FDIC, the Federal Reserve and Pew Charitable Trusts reveal the characteristics of the population that must rely on the fringe banking industry.[352] Payday borrowers generally have a steady job and must have a bank account.[353] The average payday borrower profile is a white woman who is divorced or separated, does not have a college degree, and is between twenty-five and forty-four years old.[354] Single parents, Blacks, Hispanics, and recent immigrants were all more likely to use payday loans than other groups.[355] Payday advance customers are also relatively educated according to one survey (74.4% had a high school diploma or some college), with incomes that most would describe as middle class (over half had incomes between $25,000 and $49,999, with an average income of $40,000).[356] The studies are clear that their customer base is not the destitute, but those households with low to moderate income.[357] The av-

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[347] *See* Neil Bhutta, Paige Marta Skiba & Jeremy Tobacman, *Payday Loan Choices and Consequences* 20 (Vand. U. L. Sch., Working Paper No. 12–30, 2012) ("[P]ayday loans appear to be used as a last resort: payday loan applications occur when credit card lines are generally exhausted and when the search for credit becomes much more intense but is largely unsuccessful.").

[348] *Id.* at 11.

[349] Caskey, *supra* note 197, at 6; Elliehausen & Lawrence, *supra* note 197, at 45–46.

[350] Caskey, *supra* note 197, at 6.

[351] *See* Applied Mgmt. and Planning Group, 2007 Department of Corporations Payday Loan Study 54 (2007).

[352] *See generally* Consumer Fin. Protection Bureau, *Nashville, TN: Field Hearing on Payday Loans* (Mar. 28, 2014), http://youtu.be/ZpnXG0UdeoQ [https://perma.cc/C3CR-TK95]; Consumer Fin. Protection Bureau, Payday Loans and Deposit Advance Products 15 (2013); Consumer Fin. Protection Bureau, Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings 28 (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf [https://perma.cc/NZV7-AFE7]; Pew Charitable Trusts, Payday Lending in America: Who Borrows, Where They Borrow, and Why 32 (2012), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/PewPaydayLendingReportpdf.pdf [https://perma.cc/E9ZB-FW63].

[353] Pew Charitable Trusts, *supra* note 227, at 6.

[354] *Id.* at 8.

[355] *Id.* at 11.

[356] Fed. Deposit Ins. Corp., *supra* note 204; Elliehausen & Lawrence, *supra* note 197.

[357] *See* John P. Caskey, *Payday Lending: New Research and the Big Question* 3 (Fed. Res. Bank of Phila., Working Paper No. 10–32, 2010), https://www.philadelphiafed.org/research-and-data/publications/working-papers/2010/wp10-32.pdf [https://perma.cc/RQ2Y-KSB6]; *see generally* Fin. Serv. Centers of Am., Consumer Financial Services Fact Sheet, *cited by* Christopher S. Fowler et al., *The Geography of Fringe Banking,* 54 J. of Regional Science 690 (2014).

erage loan this borrower needs is only $350 but because none of the high interest payments on these loans goes to reduce the principle loan amount, the debt can quickly compound.[358]

According to the research, financial education just does not work to discourage this borrowing.[359] Educating the poor to choose better options must mean that there are better options to choose from. While more education and financial savvy would certainly help all of us make the most of our money, financial education is not what separates the poor and the middle class. Contrast, for example, the financial literacy required by an average middle- to high-income family who puts their money in their local bank and perhaps invests their extra money in a 401(k) provided by their employer with someone who is poor and must manage several loans at a time while making small payments on each and factoring in costs of fees on their simple financial transactions. Many of the fees and costs juggled by low-income families show a level of financial literacy that many in the middle class don't have, and frankly don't need.[360] The middle class juggle too—transferring

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[358] *See* PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA, REPORT 2: HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 6 (2013).

[359] For discussion of the muddled empirical evidence, *see* Annamaria Lusardi & Olivia S. Mitchell, *The Economic Importance of Financial Literacy: Theory and Evidence,* 52 J. OF ECON. LITERATURE 5 (2014); Willis, *supra* note 345; Paul Kiel & Annie Waldman, *The Color of Debt: How Collection Suits Squeeze Black Neighborhoods*, PROPUBLICA (Oct. 8, 2015), https://www.propublica.org/article/debt-collection-lawsuits-squeeze-black-neighborhoods [https://perma.cc/XGP2-5HSD]; AM. CIV. LIBERTIES UNION, A POUND OF FLESH: THE CRIMINALIZATION OF PRIVATE DEBT (2018), https://www.aclu.org/issues/smart-justice/mass-incarceration/criminalization-private-debt [https://perma.cc/YY53-EEE8].

[360] In many ways, the "lessons" that modern reformers want to "teach" the poor are trying to change behavior that is perfectly rational. The famous "marshmallow experiment" revealed that children who could delay gratification by waiting for the second marshmallow were more successful as adults across the board. Yet the experiment has been misunderstood as it relates to poverty. One consistent result of the experiment, noted by its designer Walter Mischel and replicated by each experimenter, was that the poor consistently "failed" the marshmallow test. The experiment presents children with the option of eating a marshmallow right away or waiting fifteen minutes to get two marshmallows. Mischel followed these children for decades and found that those who exhibited delayed gratification and waited for the two marshmallows were more successful than those who ate the marshmallow right away. They made more money, received better grades, and were less likely to be in prison. The experiment has been used by schools and motivational speakers for years to demonstrate the important lesson that self-control is the most important trait for success. *See* AM. PSYCHOLOGICAL ASS'N., DELAYING GRATIFICATION, https://www.apa.org/helpcenter/willpower-gratification.pdf [https://perma.cc/M77F-TQHE]. One might be tempted to believe that being poor was thus a result of lack of self-control. However, as researchers like Melissa Sturge-Apple have honed in on the decisionmaking process, they have revealed a much more complex story. By measuring the heart rate and brain activity of the children during the test, the experimenters revealed that the poor children were making a careful and calm choice to enjoy the marshmallow immediately instead of waiting for an uncertain second marshmallow. Sturge-Apple explains, "[w]hen resources are low and scarce, the rational decision is to take the immediate benefit and to discount future gain." *See* Roberto A. Ferdman, *The Big Problem With One of the Most Popular Assumptions About the Poor*, WASH. POST (June 8, 2016), https://www.washingtonpost.com/news/wonk/wp/2016/06/08/the-problem-with-one-of-the-most-popular-assumptions-about-the-poor/ [https://perma.cc/4Z43-J2X9]. Calmer decision making—or less impulsiveness—among wealthy children led them to wait for the additional treat, but that same

credit card debt from one card to a new one that offers 0% APR for six months hoping to pay less than 16% interest for a few months.[361] But the stakes of getting it wrong are much higher for low-income families.

When Obama Treasury Secretary Jack Lew was asked in 2016 to address the racial wealth gap, he acknowledged that the financial crisis wiped out a significant portion of black wealth and said that the Treasury department was very concerned about the gap.[362] He went on to offer some advice on how to accumulate wealth:

> A lot of people say they can't afford to save. I understand. Living on a paycheck to paycheck income is really challenging. I experienced it at the beginning of my career and I know how hard it is. By the same token, most people buy a cup of coffee without thinking about it. Most people by an extra magazine or a video without thinking about it . . . If you take the accumulated decisions people make lightly and in one of those occasions say, I am going to put money away for retirement, you'd see people start out with more . . . I think financial education, financial literacy is about understanding that some people buying a home might not be a good idea.[363]

This is all sound advice from the Treasury Secretary, but the entire black community could abstain from lattes indefinitely and yet the wealth gap would remain. In reality, Black people save an average of 11% of their annual income and whites only save 10%.[364] The idea of Black people spending frivolously while whites save is a meaningless, damaging, and sadly persistent stereotype.

If anything, the pervasive usage of payday lending does not show irresponsibility or ignorance. Rather, it is a structural indictment of our economic system. This is what the Progressives understood and what modern

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measured and calm decisionmaking led the poor children to decide not to wait. Thus, poverty can lead to "bad decisionmaking" instead of the reverse. *Id.*

[361] For example, see Discover's balance transfer offers. DISCOVER, https://www.discover.com/credit-cards/member-benefits/balance-transfer.html [https://perma.cc/DN7W-CZMD].

[362] Jack Lew, Treasury Secrtary, Address at Freedman's Bank Forum, (Sept. 23, 2016), http://www.yorkcast.com/treasury/events/2016/09/23/freedmansbank/ [https://perma.cc/C8PC-Y283].

[363] *Id.*

[364] *See* DALTON CONLEY, BEING BLACK, LIVING IN THE RED: RACE, WEALTH, AND SOCIAL POLICY IN AMERICA 29 (1999); Joseph G. Altonji & Ulrich Doraszelski, *The Role of Permanent Income and Demographics in Black/White Differences in Wealth*, (Nat'l Bureau of Econ. Res., Working Paper No. 8473, 2001), http://www.nber.org/papers/w8473.pdf [https://perma.cc/272B-9QU8]; Sharmila Choudhury, *Racial and Ethnic Differences in Wealth and Asset Choices*, 64 SOCIAL SECURITY BULLETIN (2001), https://www.ssa.gov/policy/docs/ssb/v64n4/v64n4p1.html [https://perma.cc/4TR3-MPJU]; Gillian B. White, *How Blacks and Whites Spend Differently*, THE ATLANTIC, (June 7, 2016), https://www.theatlantic.com/business/archive/2016/06/how-blacks-and-whites-spend-differently/486038/ [https://perma.cc/S3UA-Y6BZ]. Other researchers support this finding showing "no difference in the savings rates of blacks and whites." W. HRUNG, DEP'T OF ECON., U.C. BERKELEY, THE PERMANENT INCOME HYPOTHESIS AND BLACK/WHITE SAVINGS DIFFERENTIALS (1997).

reformers often miss: poverty is a system of oppression, not a result of poor personal choices. Wealth inequality and the opportunity gap are at an all-time high.[365] Many Americans will have no way of escaping poverty despite their best efforts.[366] Almost half the U.S. population would have to borrow money if they fell short $500.[367] They borrow to pay for things that are widely considered essential.[368] They borrow with forethought and with care.[369] This is a large portion of the U.S. population who are forced to borrow at the fringe.[370] And fringe lenders are the only ones meeting this large market demand because banks, credit unions, and other mainstream lenders have chosen not to.[371] Shaming the poor or "educating them" is not the answer to structural inequalities.

It is especially unfair to be morally opposed to the use of fringe lending when there are no meaningful alternatives. The rise of fringe banking correlates directly with the decline of banks in poor communities. The result is a disparity in banking services today: government-funded large and small banks competing for the deposits of the wealthy and middle class with the other half is left to fringe institutions that are often usurious, sometimes predatory, and almost always much worse for low-income individuals than the services offered by traditional banks to their customers.

## III. A Public Option

What the Progressive reformers understood and what modern politics has forgotten is that credit policy is public policy. To the extent that certain communities are excluded from mainstream banking institutions, their exclusion is a problem of public policy and not a gap in the market. What this Article proposes is a different sort of public option—a bank account and small-credit option to compete with the check cashing and payday lending alternatives. In a way, a public option is the path not taken during the Progressive era and in the New Deal reforms that followed it.

Each aspect of banking, including deposits, loans, and simple financial transactions, relies on a robust network of government support.[372] Each time a bank sends or accepts money, they are using the Federal Reserve's pay-

[365] *See* Breno Braga et al., *Wealth Inequality is a Barrier to Education and Social Mobility*, Urban Inst. 1 (2017), https://www.urban.org/sites/default/files/publication/89976/wealth_and_education_4.pdf [https://perma.cc/DMG5-Q54X].

[366] *Id.*

[367] *See* Aimee Picchi, *A $500 Surprise Expense Would Put Most Americans Into Debt*, CBS News (Jan. 12, 2017), https://www.cbsnews.com/news/most-americans-cant-afford-a-500-emergency-expense/ [https://perma.cc/CA5B-AFZQ].

[368] *Id.*

[369] Picchi, *supra* note 367.

[370] *Id.*

[371] Baradaran, *supra* note 32, at 118.

[372] *See* Justin Pritchard, *Understanding the FDIC*, The Balance (Sept. 3, 2019), https://www.thebalance.com/what-is-the-fdic-315786 [https://perma.cc/B2TZ-CDA9].

ments system.[373] Banks can take and lend customer deposits and engage in fractional reserve lending (and the magic money multiplier effect this enables) only because customer deposits are insured by the FDIC.[374] Unlike all other corporations,[375] banks pay virtually nothing for their funding (customer deposits) because of this federal government subsidy.[376] And when the FDIC fund goes into the red—as it did in 2008—these deposits are backstopped by the full faith and credit of the United States Treasury.[377] On the asset side, most mortgages and student loans are guaranteed, bundled, or subsidized by the FHA or the Government Sponsored Entities ("GSEs") Fannie Mae, Freddie Mac, Ginnie Mae, and Sallie Mae.[378] These entities purchase almost every mortgage and student loan in the country and resell them to investors. And when these institutions fail, they too have the implicit backing of the Federal Government.[379] These GSEs enable banks to lend ex-

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[373] *Id.*

[374] *Id.*

[375] Baradaran, *supra* note 32, at 3.

[376] Banks do pay into the FDIC insurance fund through premiums, but most scholars agree that the premiums are underpriced. Furthermore, it is not just the actual funds that are paid out in the event of a failure that is of importance here. It is the fact that bank deposits are backed by the full faith and credit of the federal government making them a safe repository for their customers' funds.

> Until the early 1990s, the FDIC levied flat-rate insurance premiums on banks as a function of deposits, but not the banks' risk. In 1991 the FDICIA required that the FDIC introduce risk-based premiums. However, to date, the range of premiums is much narrower than the range of risk exposures of the FDIC to individual bank failures. Under the Deposit Insurance Funding Act of 1996, when the FDIC reserve fund exceeds 1.25% of deposits, the "safest" of banks pay no deposit insurance premium meaning that recently more than 90% of banks holding over 90% of total bank assets paid NO premiums.

Joe Peek & James A. Wilcox, *The Fall and Rise of Banking Safety Net Subsides*, in Too Big to Fail: Policies and Practices in Government Bailouts 177–78 (Benton E. Gup ed., 2004).

[377] *Id.*

[378] Sallie Mae ceased being a GSE, and became fully privatized, when Congress terminated its charter on December 29, 2004. At that point, the GSE became SLM Corporation, "a fully private sector corporation." U.S. Dep't of Treasury, Office of Sallie Mae Oversight, Lessons Learned from the Privatization of Sallie Mae 1 (2006), http://www.treasury.gov/about/organizational-structure/offices/Documents/SallieMaePrivatizationReport.pdf [https://perma.cc/F5Z4-RSDE]. A table on page three of this Treasury report distinguishes the former GSE-Sallie Mae from the fully privatized SLM Corporation. Notable differences include: (1) the GSE's charter was created by an act of Congress; (2) the President appointed the GSE's board members; (3) the GSE could borrow up to $1 billion from the Treasury, whereas the SLM Corporation cannot borrow from the Treasury; (4) the GSE's debt was eligible for federal open market purchases; (5) the GSE was exempt from SEC registration and financial and other filings with the SEC; and (6) the GSE was exempted from federal, state, and local income taxes. *Id.* at 3.

[379] Fannie Mae and Freddie Mac were spun off of the federal government and privatized, which meant that they were run by a board of shareholders. It did not mean that they operated in normal markets. The market still treated them like government entities, meaning that they did not contemplate their failure. When they did fail because of the excessive risks their managers took, the government bailed them out without flinching. *See id.*

ponentially more loans than what their customer deposits would allow.[380] At the crux of our banking system, then, is a state-enabled credit system.

Deposits and loans—assets and liabilities—are all supported by the Federal Government. And that's just the tip of the iceberg. When an individual has a liquidity crisis or can't pay a bill, she has to go to a payday lender and take out an emergency small loan at anywhere from 300% to 2000% APR.[381] In contrast, when a bank has a liquidity crisis, they are able to go to the Fed's discount window, which provides banks loans at 0.5% higher than the Federal Funds rate, which is currently set at 2%.[382] None of this takes into account the government bailout, the staggering magnitude of which went on full display after the 2008 financial crisis.[383] Using its § 13(3) emergency lending powers, the federal government bailed out a failing banking industry with over a trillion dollars of equity infusions, loans, guarantees, asset purchases, and other forms of financial support.[384] The help came on very favorable terms with interest rates not available on the market. The arrangement was so good that the CEO of one of the largest bailed out banks, upon seeing the terms of the deal, remarked, "This is very cheap credit!"[385]

Then there are the unprecedented waves of asset purchases and money pumped through banks, ostensibly so that the money will pass through financial institutions and make it to the public.[386] Another less well-known example of monetary policy is interest on excess reserves ("IOER"). In a payment that seems to violate what people may assume to be the laws of the market and basic common sense, the Federal Reserve pays billions of dollars in interest to banks on their reserves.[387] In just one year, the Federal Reserve

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[380] *Id.*

[381] Mansfield, *supra* note 296.

[382] *See* Kimberly Amadeo, *Federal Reserve Discount Window and How It Works*, The Balance (Nov. 26, 2018), https://www.thebalance.com/federal-reserve-discount-window-3305923 [https://perma.cc/L97W-4Z2B]; Bd. of Governors of the Fed. Res. Sys., Monetary Policy, http://www.federalreserve.gov/monetarypolicy/openmarket.htm [https://perma.cc/ST3K-3TRM].

[383] *See* Peek et al., *supra* note 376.

[384] The actual amount of the bailout is difficult to determine because much of it was in guarantees. The special inspector general for the Troubled Asset Relief Program estimated a total potential support package of $23.7 trillion, or over 150% of the U.S. GDP. However, many of these guarantees were never used. Johnson & Kwak, *supra* note 154, at 174.

[385] David Wessel, In Fed We Trust: Ben Bernanke's War on the Great Panic 240 (2009).

[386] *See* Peek et al., *supra* note 376.

[387] Due to the massive amounts of money created by QE, bank reserves swelled to over $1.7 trillion as of October 2018. This overage is called excess reserves and even though it was created by the federal reserve, banks earn interest on these reserves. These reserves comprise a substantial portion of the nation's monetary base. The Federal Reserve is using this payment, called an "administered rate" as its primary monetary policy tool post QE. Simon Potter, Executive Vice President, Fed. Res. Bank. N.Y., Remarks at Workshop Organized by Columbia University SIPA and the Fed. Res. Bank. N.Y., (May 4, 2016), https://www.newyorkfed.org/newsevents/speeches/2016/pot160504 [https://perma.cc/DUT8-SNJ5]; Fed. Res. Bank of St. Louis, Required Reserves of Depository Institutions (Nov. 8, 2018), https://fred.stlouisfed.org/series/REQRESNS [https://perma.cc/6BEF-MX4A]. Banks are required to

paid about seven billion dollars in interest to commercial banks, including more than $100 million to Goldman Sachs and more than $900 million to JPMorgan Chase. The point of this payment is that it will "pass through" the banks to the depositor, but the IOER is in fact not being passed on. Instead, it is absorbed by the bank as profits, and thereby increasing inequality.[388] Because excess reserves pay higher interest than Treasury bills, there is no reason banks would pass up a risk-free, high-interest opportunity. Each dollar held on reserve is a dollar not lent for real estate, infrastructure, or business operations in the American economy.[389]

All this federal government support sets the banking sector apart from other business that must create their own wealth without the use of other people's money or cheap loans when they fall short. Banks and the government (and by extension the people) should have a mutually beneficial arrangement that consists of the government providing market-enabling structures and trust-inducing deposit insurance and banks, in return, playing their essential role in financing the expansion of the economy and serving the needs of their customers and local communities. The relationship can be described as a social contract or an implicit promise or exchange made by the government and the banks.[390] Viewed from this lens, it becomes clear that this level of government support to the banking sector must mean that the government and by extension "the people" must be entitled to demand a banking sector that serves all of us.

When confronting the power of banking trusts and monopoly power over credit, Justice Louis Brandeis proposed that certain industries are especially suited to a public utility model. Banking or railroads, for example, were considered services essential to full participation in commerce. In

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hold roughly 10% of their deposits in reserves at the central bank. The required reserves on just customer deposits would equal roughly $189.6 billion. *See* Walker F. Todd, *The Problem of Excess Reserves, Then and Now* 8, 15 (Levy Economics Institute, Working Paper No. 763, 2013).

[388] This policy, which was meant to encourage lending by banks has turned into a subsidy that in fact discourages lending because banks can earn more by "lending" customer deposits to the Federal Reserve than they can pursuing consumer or business loans. Excess funds can be rolled over at no cost and liquidated on the same day, making excess reserves more attractive than lending. *See* Darrell Duffie & Arvind Krishnamurthy, *Commentary: Passthrough Efficiency in the Fed's New Monetary Policy Setting* 4 (Kan. City Fed. Res. Symp., Paper, 2016); Morgan Ricks, *Money as Infrastructure*, 2018 COLUM. BUS. L. REV. 757, 758–762 (2018).

[389] Todd suggests that the Federal Reserve sell about $180 billion in mortgage-backed securities or longer maturity Treasury securities per year in order to prevent future inflation. Todd, *supra* note 387, at 15–16.

[390] There is a long and rich philosophical discussion about the social contract between individuals and society. In general, social contract theory posits that individuals consent to surrender some natural liberty in exchange for protection or other benefit conferred by society. The relationship between the government and banks is similar. The social contract between individuals and the state has been taken up by Hobbes, Kant, Rousseau, Rawls, and others. Paul Tucker, Deputy Governor, Bank of England, Remarks at the British Bankers' Association Annual International Banking Conference, *Regimes for Handling Bank Failures—Redrawing the Banking Social Contract* (June 30, 2009), http://www.bis.org/review/r090708d.pdf [https://perma.cc/NH6W-KHTU].

these cases, Brandeis offered an alternative: to create a public utility that could compete with the market. This is what led Brandeis to say "deposit banking should be recognized as one of the businesses 'affected with a public interest.'"[391] He went so far as to suggest that banks should be considered public utilities.[392] Even without creating a public utility model in banking, perhaps it is time to consider a public option in banking.

The phrase "public option" entered the political lexicon during the healthcare debates as an alternative to market-based forms of health care provision.[393] However, the concept of a public option has been around since the founding of the country.[394] A public option is when the government enters a market and offers a product or service to compete with private companies.[395] Government funded health insurance would have been a public option.[396] More common public options include public libraries, public pools, or the U.S. Post Office.[397] The government offers these services either through subsidies or at cost (as is the case with the post office). Private companies like bookstores or UPS can compete with the public option, but consumers can make a choice to use the public option. Broadly conceived, public options already exist in banking. The Federal Reserve's payments system is a public option.[398] It competes with private payment providers, but banks can choose to use the Federal Reserve's payments system.[399] Adam Levitin and Susan Wachter have also called the U.S. housing finance system a public option and argue that federal government credit institutions and subsidies created the American mortgage.[400] As Thomas Herndon and Mark Paul explain, "the creation of a stable mortgage structure during the New Deal provides an excellent case study of how public options can be used to regulate in the public interest by shielding households from risk."[401]

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[391] Louis D. Brandeis, Other People's Money 64 (1914).

[392] *Id.*

[393] *See* Margot Sanger-Katz, *The Difference Between a "Public Option" and "Medicare for All"? Let's Define Our Terms*, N.Y. Times (Feb. 19, 2019), https://www.nytimes.com/2019/02/19/upshot/medicare-for-all-health-terms-sanders.html [https://perma.cc/6K8B-HG7M].

[394] *See* Richard R. John, *How the Post Office Made America*, N.Y. Times, (Feb. 8, 2013), https://www.nytimes.com/2013/02/09/opinion/how-the-post-office-made-america.html [https://nyti.ms/Z0xbW7].

[395] *See* Sanger-Katz, *supra* note 393.

[396] *Id.*

[397] *See* Ganesh Sitaraman & Anne L. Alstott, *There Should Be a Public Option for Everything*, N.Y. Times (July 6, 2019), https://www.nytimes.com/2019/07/06/opinion/sunday/public-option.html [https://nyti.ms/2Jga7hT].

[398] *See* Bd. of Governors of the Fed. Reserve Sys., *Payment System Risk*, https://www.federalreserve.gov/paymentsystems/psr_about.htm [https://perma.cc/9K5L-QQ4P].

[399] Jesse Hamilton, *Fed's Real-Time Payments System to Compete with Wall Street*, Bloomberg (Aug. 5, 2019), https://www.bloomberg.com/news/articles/2019-08-05/fed-plans-real-time-payments-system-to-compete-with-wall-street [https://perma.cc/7HRQ-7K5G].

[400] *See* Adam J. Levitin & Susan M. Wachter, *The Public Option in Housing Finance*, 46 U.C. Davis L. Rev. 1111, 1119 (2013).

[401] Thomas Herndon & Mark Paul, A Public Banking Option 17 (2018), http://rooseveltinstitute.org/wp-content/uploads/2018/07/Public-Banking-Option-final.pdf. [https://perma.cc/7HN3-EZJE].

The federal government also provides deposit insurance for banks.[402] Banks pay premiums for the insurance, which makes deposit insurance resemble other public options, but Federal Deposit Insurance Corporation ("FDIC") insurance is not an "option."[403] All banks must buy in to the scheme. Still, the innovation of a public and federal insurance scheme was crucial in stabilizing the banking sector and avoiding near-constant panics, runs, and crises.[404] Despite many attempts at private deposit insurance, only federal insurance has been an effective antidote to runs.[405]

The Progressive coalition, made up of Southerners and farmers, pushed for small community institutions instead of large federal ones.[406] For instance, in their fight against monopolies, they preferred to break apart big companies and form smaller ones tied to each community.[407] FDIC insurance itself was such a bargain.[408]

Reforming the banking sector could have taken a variety of forms: one was FDIC insurance which was first proposed by William Jennings Bryan, the Democrat who most embodied the Progressive spirit at its height. FDIC insurance would stabilize banking by diminishing runs, but crucially, it would favor small local banks. The other option was the Republican option at the time, proposed by Theodore Roosevelt—another icon of the Progressive era, but a Republican, who proposed postal banking as a potential reform after the Panic of 1907.[409] Postal Banking was not adopted in Roosevelt's administration, but he did set the ball rolling. Congress enacted the United States Postal Savings System ("USPSS") in 1910 and President William Howard Taft signed the Act into law.[410]

Franklin Delano Roosevelt adopted many of the Progressive reformers' agenda items and New Deal reformers viewed banking through the lens of a public utility.[411] Yet Roosevelt chose FDIC insurance instead of treasury-backed deposit accounts (postal banking) to stabilize the banking sector.[412]

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402 *See* Fed. Deposit Ins. Corp., *Deposit Insurance FAQs*, Fed. Deposit Ins. Corp. (July 3, 2019), https://www.fdic.gov/deposit/deposits/faq.html [https://perma.cc/6VY4-U5ET].

403 *Id.*

404 *See* Grossman, *supra* note 81 at 246–50; *see generally* Richard Scott Carnell, Jonathan R. Macey & Geoffrey P. Miller, The Law of Financial Institutions chs. 1–2 (5th ed., 2013).

405 *See* Roger Lowenstein, *There's a Reason for Deposit Insurance*, N.Y. Times, (Mar. 23, 2013), https://www.nytimes.com/2013/03/24/business/deposit-insurance-and-the-historical-reasons-for-it.html [https://perma.cc/49K5-WLJ4].

406 Samuel Proctor, *The National Farmers' Alliance Convention of 1890 and Its "Ocala Demands,"* 28 The Fla Hist. Q. 161 (1950).

407 *Id.* at 172.

408 Baradaran, *supra* note 120, at 543.

409 *See* Theodore Roosevelt, President of the United States, Seventh Annual Message (Dec. 3, 1907) (transcript available through the UVA Miller Center).

410 Baradaran, *supra* note 120, at 499; *see also* 45 Cong. Rec. S2, 7766–68 (June 9, 1910).

411 *See* Brandeis, *supra* note 388, at 161.

412 *See* Jane W. D'Arista, The Evolution of U.S. Finance Volume II: Restructuring Institutions and Markets 204 (1994).

Postal banking remained viable and was even deployed by Roosevelt to help fund the war and alleviate the government debt from the Great Depression, but the public utility option—or the public option through postal banks—was left on the table as an abandoned Progressive idea.[413]

Postal banking could have proved to be as effective as FDIC insurance in stabilizing the banking sector. Both were federal government supports of the banking sector—a federal backstop that could stop runs. FDIC insurance was a fund that would guarantee all deposits, but it was ultimately backed by the U.S. Treasury. Postal banking was a public option—or a utility model of Treasury banking.[414] Accounts held by the postal banks were directly backed by the United States Treasury, so the postal banks were immune to runs. They were immune not just because of the direct Treasury backstop, but because these banks did not engage in fractional reserve lending; the deposits were held as Treasury bonds or they circulated as excess liquidity in local banks.[415] In either case, there was never a run on postal banks.[416] In fact, postal banking helped ease the general panic conditions during the Great Depression.[417] Panicked depositors fleeing from failing banks used postal banks as a safe alternative, which helped ameliorate the liquidity crisis in the banking sector.[418]

Thus, this Article builds on previous work to propose a reconsideration of a path not taken during the New Deal: a public option in banking. Public options have recently begun to be studied in the legal and economic literature.[419] Law professors Morgan Ricks, John Crawford, and Lev Menand have suggested that the Federal Reserve should offer accounts directly to all individuals and businesses through a "FedAccount," which they claim could be offered through the Post Office.[420] They argue that "restricting central bank accounts to an exclusive clientele (banks) is no longer justifiable on policy grounds if indeed it ever was."[421] Their proposal for a public account at the Federal Reserve would extend to all businesses, individuals, and organiza-

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413 *See* Mehrsa Baradaran, *A Short History of Postal Banking*, SLATE (Aug. 18, 2014), https://slate.com/news-and-politics/2014/08/postal-banking-already-worked-in-the-usa-and-it-will-work-again.html [https://perma.cc/F6M5-22CA].

414 *Id.*

415 *Id.*

416 *Id.*

417 *Id.*

418 *See* Steven Sprick Schuster, Matthew Jaremski & Elisabeth Ruth Perlman, *An Empirical History of the United States Postal Savings System* 12–13 (Nat'l Bureau of Econ. Research, Working Paper No. 25812, 2018), https://ssrn.com/abstract=3306033 [https://perma.cc/ZT2K-MZE3].

419 *See, e.g.*, HERNDON & PAUL, *supra* note 401; Levitin & Wachter, *supra* note 400; Morgan Ricks, John Crawford & Lev Menand, *A Public Option for Bank Accounts (Or Central Banking for All)* (Vand. L. Res. Research Paper 18–33, U.C. Hastings Res. Research Paper 287, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3192162 [https://perma.cc/97PV-3DBH]; SITARAMAN & ALSOTT, *supra* note 31; BARADARAN, *supra* note 32, at 210-225.

420 *See* Ricks et al., *supra* note 419, at 1, 5.

421 *Id.* at 1.

tions.[422] After all, banks make billions per year just in interest payments on reserves (IOER) that they do not pass on to customers.[423] Both postal banking and proposed FedAccounts could be designed to create revenue for the post office and the Federal Reserve.[424] Herndon and Paul also propose a public banking option with two components: First, their public option would create a new public bank with basic deposit and transaction services and "'plain vanilla' consumer financial services, such as small-dollar loans, auto loans, and mortgages." Second, a public bank would "manage an online financial services marketplace, where public services would directly compete with private services."[425]

One promising path toward effectuating a public option is to repurpose an old democratic institution: the Post Office.[426] American banks long ago deserted the most impoverished communities. But post offices, even two centuries later, have remained, still rooted in their original egalitarian mission. As America's oldest instrument of democracy in action, the Post Office can once again level the playing field. This is not a new or radical idea. The United States had a robust postal banking system from 1910 until 1966, and most other countries have offered or are still offering postal banking accounts.[427] The idea has recently gained traction in the United States as well. I proposed postal banking in a 2013 article and have been actively involved in its promotion since.[428] The Post Office Inspector General issued a 2014 White Paper studying the issue.[429] Senator Elizabeth Warren endorsed postal banking in 2015, and was followed by Senators Bernie Sanders and Kirsten Gillibrand, both of whom have proposed legislation to this effect.[430] The

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[422] *Id.*

[423] *See* Morgan Ricks, *Money as Infrastructure*, 2018 COLUM. BUS. L. REV. 757, 794, 798 (2018).

[424] For revenue projections for the post office, see U.S. POSTAL SERV., OFFICE OF INSPECTOR GENERAL, PROVIDING NON-BANK FINANCIAL SERVICES FOR THE UNDERSERVED 16 (2014). As for FedAccounts, as Ricks, Crawford, and Menand explain, the FedAccounts would increase revenue. "Central banks" asset portfolio returns typically exceed their interest payments and other expenses by a wide margin. These earnings are called "seigniorage": fiscal revenue from money creation. The amounts are large. The Federal Reserve remitted $98 billion, $92 billion, and $90 billion in earnings to the U.S. Treasury Department in 2015, 2016, and 2017, respectively. Because FedAccounts would probably greatly expand the Federal Reserve's balance sheet (see Part III.A), these remittances could easily double or triple, even after accounting for the costs of maintaining millions of retail accounts. Ricks et al., *supra* note 419, at 16–17.

[425] HERNDON & PAUL, *supra* note 401, at 20–21.

[426] *See* JOHN, *supra* note 32, at 25–26.

[427] *See* BARADARAN, *supra* note 32, at 187–209, 212–13.

[428] Mehrsa Baradaran, *How the Poor Got Cut Out of Banking*, 62 Emory L. J. 483 (2013).

[429] U.S. POSTAL SERV., *supra* note 424.

[430] *See* Joe Pinsker, *Bernie Sanders's Highly Sensible Plan to Turn Post Offices Into Banks*, THE ATLANTIC (Oct. 20, 2015), https://www.theatlantic.com/business/archive/2015/10/bernie-sanders-lets-turn-post-offices-into-banks/411589/ [https://perma.cc/AQ6B-L436]; Kevin Wack, *Postal Banking is Back on the Table. Here's Why That Matters*, AM. BANKER (Apr. 26, 2018), https://www.americanbanker.com/opinion/postal-banking-is-back-on-the-table-heres-why-that-matters [https://perma.cc/9ZRX-9DBM].

2016 Democratic National Platform included postal banking.[431] The postal workers unions also negotiated a postal banking pilot in their contract negotiations in 2015.[432] As of this writing, the Postmaster General has not supported postal banking and legislation has not been passed, but efforts to enact such reform are ongoing.

The basic idea of modern postal banking is a public bank that would offer a wide range of transaction services, including small lending.[433] The post offices could offer these services at a much lower cost than banks and the fringe industry because they can use natural economies of scale and scope to lower the costs of the products.[434] Their existing infrastructure significantly reduces overhead costs, and they do not have profit-demanding shareholders and thus would be able to offer products at cost.[435] As for communities without access to safe credit and banking services, the Post Office remains one of the only public institutions that still serves these communities regardless of profits. Post offices offer money orders, and many customers use money orders in lieu of a checking or savings account.[436] Researchers Terri Friedline and Mathieu Despard concluded in their "Mapping Financial Opportunity" project that postal banking can best help rural areas that are banking deserts.[437]

The most important argument in favor of postal banking is that it has the potential to bank the unbanked and expand access to savings accounts that could diminish the need for fringe banking services. Postal banking can provide transactional services and small loans without life-crushing fees and interest. Critically, by making banking available to those deserted by a government-supported banking system, the state can minimize the threat to democracy posed by the heavily subsidized, exclusionary, and powerful banking sector.

Many Americans do not save. More than 40% of Americans do not have even $500 in savings and would need to borrow if they had a shortfall and over 60% would need to borrow $1000 if they faced a financial emergency.[438] The primary reason is likely insufficient income. Still, it is likely

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[431] Democratic Platform Committee, 2016 Democratic Party Platform 11, https://democrats.org/wp-content/uploads/2018/10/2016_DNC_Platform.pdf [https://perma.cc/9TYG-TDXW].

[432] *See* Dave Johnson, *Postal Workers and the Public Want a Postal Banking Public Option*, HuffPost (Feb. 19, 2015), https://www.huffpost.com/entry/postal-workers-and-the-pu_b_6717096 [https://perma.cc/E8DD-DTDW].

[433] *See* Mehrsa Baradaran, *It's Time for Postal Banking*, 127 Harv. L. Rev. F. 165 (Feb. 24, 2014).

[434] *Id.* at 166.

[435] *Id.* at 167, 172.

[436] *Id.* at 167.

[437] Terri Friedline & Mathieu Despard, Mapping Financial Opportunity: Final Report 8–9 (2017), https://aedi.ssw.umich.edu/sites/default/files/publications/Mapping-Financial-Opportunity.pdf [https://perma.cc/V5AF-2FLF].

[438] Bd. of Governors of the Fed. Reserve Sys., *Report on the Economic Well-Being of U.S. Households in 2017 - May 2018: Dealing with Unexpected Expenses* (last visited Dec. 13,

that the lack of safe and accessible banks contribute—or rather, that availability of such banks would enhance savings.[439] Cash savings are vulnerable to theft and loss.[440] Having a safe, low-cost, and easily accessible savings account could lead to more savings, which could diminish the need for payday loans when families hit a snag. When individuals can dip into savings, they are less likely to need payday loans. A postal savings account, made possible through a local postal branch, could significantly ease the burden on many families, leading to more savings. There is some evidence for this historically. When the postal savings accounts were first established in 1910, they became very popular with immigrants living in urban areas who had previously stored their earnings in "stocking banks."[441] Most of the deposits into the early savings banks came from these home hiding places.[442] Historian Sheldon Garon has contrasted the low savings rates in the United States versus higher rates in Germany and Japan and has surmised that the difference had much to do with the strong network of postal banks that remained in those countries while they were disbanded in the United States and the culture of savings they cultivated abroad.[443]

During World War II, the United States Post Office sold postal savings bonds to schoolchildren and housewives who invested as a patriotic duty.[444] By the end of World War II, the government had raised about $8 billion in additional war funding through war bonds and Treasury bonds sold through the Post Office.[445]

Today, postal savings accounts have the potential to become a trustworthy receptacle for savings for the financially excluded. Just as our postal banks successfully increased savings by the broader public for half a century,[446] their rebirth can do the same. By providing low-barrier savings accounts, the Post Office can again offer a refuge for the countless small savers in the U.S. who have been shut out of the banking system because their too-

2019), https://www.federalreserve.gov/publications/2018-economic-well-being-of-us-households-in-2017-dealing-with-unexpected-expenses.htm [https://perma.cc/KR64-WCUM].

[439] Derek Thompson, *Why Don't Americans Save More Money?*, THE ATLANTIC (Apr. 19, 2016), https://www.theatlantic.com/business/archive/2016/04/why-dont-americans-save-money/478929/ [https://perma.cc/L6N6-ZS2X].

[440] PEW CHARITABLE TRUSTS, DROWNING IN DEBT: A HEALTH IMPACT ASSESSMENT OF HOW PAYDAY LOAN REFORMS IMPROVE THE HEALTH OF MINNESOTA'S MOST VULNERABLE (Mar. 2016), https://www.pewtrusts.org/-/media/assets/external-sites/health-impact-project/hip-2016-payday-lending-report.pdf [https://perma.cc/S7V6-VBZN].

[441] *See* BARADARAN, *supra* note 32, at 202.

[442] *Compare Postal Savings System Practically Self Sustaining*, N.Y. TIMES (May 25, 1913) (reporting a mid-year figure of $28 million) *with* ANNUAL REPORT OF THE POSTMASTER GENERAL FOR THE FISCAL YEAR ENDED JUNE 30, 1913 303 (1914) (stating that deposits totaled $33 million by the end of the year).

[443] *See* SHELDON GARON, BEYOND OUR MEANS: WHY AMERICA SPENDS WHILE THE WORLD SAVES 374 (2011).

[444] DEP'T OF TREASURY, UNITED STATES SAVINGS BONDS PROGRAM: A STUDY PREPARED FOR THE COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES 18 (1981).

[445] BARADARAN, *supra* note 32, at 205.

[446] *See id.*

small savings accounts are no match for high bank fees. Increased access to low-cost savings accounts can greatly benefit a population living without any financial cushion. Even having a few hundred dollars stored away can make a significant difference to a moderate-income family who may face an emergency in their lives. It is difficult to measure how many people are not saving in banks because of financial and cultural barriers of entry, but it is possible that just as in the 1900s, hoarded money from across the country would pour into the postal banks from under mattresses, prepaid cards, or funds otherwise wired abroad.

Postal banking may seem radical to many in the United States who are convinced that banking should be a "private market" free from "government intervention," but it is a mundane part of life for the rest of the world.[447] Postal banking abroad is the norm, not an aberration.[448] According to Clotteau and Measho, "[p]osts in 87 countries hold some 2 billion current or savings accounts on behalf of around 1 billion customers."[449] Postal banking is a highly successful means of financial inclusion worldwide. For example, in India and China, postal banks are critical drivers of financial inclusion.[450]

Postal banking has been operational in many European countries since the 1800s. Currently, fifty-one countries worldwide have postal banking as their primary method of financial inclusion—only 6.5% of global postal carriers do not offer banking services.[451] It is estimated that postal banking has banked over one billion people worldwide.[452] There are a variety of models—some focused on the poor and others that offer postal banking services to the entire population.[453] In fact, the United States is one of the only developed countries in the world without a postal banking network.[454] That said, we do not need to look abroad for a justification or even a model for postal banking when we can refer to our own rich history of postal banking.

The transition to postal banking would not require substantial costs or changes to the Post Office's business. Financial transaction services are straightforward products that do not require a high level of sophistication.

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[447] Nils Clotteau & Bsrat Measho, Universal Post Union, Global Panorama on Postal Financial Inclusion 2016 9, http://www.upu.int/uploads/tx_sbdownloader/globalPanoramaOnPostalFinancialInclusion2016En.pdf [https://perma.cc/EL4S-4EGJ].

[448] *Id.*

[449] *Id.*

[450] The World Bank Group, Global Info. & Comm. Tech. Postal Policy, The Role of Postal Networks in Expanding Access to Financial Services: Worldwide Landscape of Postal Financial Services, Asia Region 6 (2012), http://documents.worldbank.org/curated/en/410191468337292692/704230ESW0P0850C0Box370041B0000Asia.doc [https://perma.cc/RQT8-YC9Y].

[451] Alexandre Berthaud & Gisela Davico, Universal Postal Union, Global Panorama on Postal Financial Inclusion: Business Models and Key Issues 9–10 (2013), http://www.uniglobalunion.org/sites/default/files/pictures/post/globalpanoramafinancial_inclusion_-upu_-en.pdf [https://perma.cc/43KU-FHB9].

[452] *Id.* at 11.

[453] *See id.* at 9, 19–20.

[454] *See id.* at 81–82.

The Post Office can build on its existing network to offer these services. The Post Office already has the transactional capabilities to deal with cash as well as the back-end security systems in place to transport cash because it sells money orders. A simple ATM machine can be placed inside the post office and tellers can offer debit cards or other transactional services through USPS-contracted servicers or in partnership with a bank. Walmart, for example, attempted to become its own bank in 2005, but when that route was blocked by regulators, they settled for a partnership with Green Dot bank to offer low-cost checking accounts and transactional services.[455] The company has been able to use its size and existing infrastructure to offer financial products at a fraction of the price while making a healthy profit offering them. Amazon has announced that it will be accepting cash for payment for goods in partnership with brick and mortar stores in order to facilitate transactions for the underbanked. Amazon has claimed that it will not charge fees for these cash transactions.[456] These large companies are able to underprice check-cashers and payday lenders due to their ability to cross-subsidize their products. Yet these large companies do not have an egalitarian mandate. Insofar as offering financial transaction services can lead to greater market dominance through increased sales, they will offer such services, but we should be hesitant to outsource the essential right to participate in commerce to the profit/loss calculations of large corporations.

Estimates show that $89 billion is spent each year by the unbanked on financial fees and services, including payday lenders, check cashers, prepaid cards, and other services.[457] These are significant expenses for families. The average annual income for an unbanked family is $25,500, and about 10% of that income, or $2,412, goes to the fees and interest paid to access credit or other financial services—services that those with bank accounts often get for free.[458] If these costs can be reduced through a public option, unbanked and underbanked families would be able to save more money, which would reduce the need for short-term borrowing. Providing these services at much lower costs has a triple advantage of reviving the beleaguered but too-important-to-fail postal service, putting the money back in the pock-

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[455] Eric Dash, *Wal-Mart Abandons Bank Plans*, N.Y. Times (Mar. 17, 2007), https://www.nytimes.com/2007/03/17/business/17bank.html [https://perma.cc/93FW-NL5C]; Hiroko Tabuchi & Jessica Silver-Greenberg, *Walmart Prepares to Offer Low-Cost Checking Accounts*, N.Y. Times (Sept. 23, 2014), https://www.nytimes.com/2014/09/24/business/finding-a-door-into-banking-walmart-to-offer-checking-accounts.html [https://perma.cc/4BLU-X2RD]; Ciara Linnane, *Green Dot, Wal-Mart Partnership is a Big Milestone: JP Morgan*, MarketWatch (Sept. 25, 2014), https://www.marketwatch.com/story/green-dot-wal-mart-partnership-is-a-big-milestone-jp-morgan-2014-09-25 [https://perma.cc/BX3Q-49N5].

[456] David Z. Morris, *You Can Now Pay Cash When Shopping on Amazon. Here's How,* Fortune (Sept. 19, 2019) https://fortune.com/2019/09/19/you-can-now-pay-cash-when-shopping-on-amazon-heres-how [https://perma.cc/MC96-EM2X].

[457] U.S. Postal Serv. Off. of Inspector Gen., RARC-WP-14-007, Providing Non-Bank Financial Services for the Underserved 2 (2014).

[458] U.S. Postal Serv., *supra* note 421.

ets of the poor, and providing an alternative to a harmful industry that has proved near impossible to regulate away.

The Post Office could offer small loans at lower interest rates than the payday lenders. Lending even small loans of less than $500 at a reasonable interest rate can help a significant portion of the American public withstand a short-term credit crunch.[459] Even with more just economic conditions, individuals may occasionally need to borrow small loans to cope with unexpected harms and so must have access to a low-cost loan so that they can survive their illiquidity before it turns into insolvency. In other words, if a person needs $500 to pay a bill for food or shelter, will they have to pay an additional $1000 in fees to extinguish the loan or something closer to $50 in interest? The answer can make the difference between sustainability and bankruptcy. A public option in lending can make a difference to many families struggling to make ends meet.

There are some pitfalls to be aware of in designing any public option or utility. Public institutions are just as prone to predation, mismanagement, and fraud as are private organizations.[460] In order to protect consumers against predatory products or fraud, the USPS would need to be monitored. The USPS has a system of fraud prevention in place through its own regulator and Inspector General. If USPS decides to lend, the CFPB should be empowered to provide oversight to ensure that consumers are protected. Moreover, the incentive structure of the USPS must be made coherent with its egalitarian mission. Thus far, any profits made by the USPS have been deposited into the U.S. Treasury.[461] The USPS, unlike most banks and large corporations, is not under pressure by shareholders to maximize profits so it follows that it does not have an incentive to engage in predatory pricing.

An example of how a public option can turn toward private profit-making can be found in the example of the GSE Fannie Mae. After Fannie Mae was privatized, its shareholders engaged in fraud and mismanagement. Ultimately, Fannie Mae took on so much risk (for the sake of profit) that it had to be rescued by the federal government. Even without a profit motive, public services can become predatory. An example is the student loan market. Here, the problem is that the Department of Education essentially has a monopoly in the provision of student loans. The Department of Education handles the large majority of student loans through private servicers. These servicers have long been accused of fraud and below-par service to students seeking information, loan modification, or other services. The Department of

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[459] *Id.* at 13 (The Post Office White Paper suggests that they can offer loans with a 28% APR, a rate sustainable for the Post Office and its customers.).

[460] *See* Ass'n of Certified Fraud Examiners, Report to the Nations on Fraud and Abuse 4 (2014).

[461] Eric Katz, *Postal Service Loses $3.9 Billion in Fiscal 2018: Postmaster General Says the Losses Will Only Get Worse Without Congressional Intervention*, Gov't Executive (Nov. 14, 2018), https://www.govexec.com/management/2018/11/postal-service-loses-39-billion-fiscal-2018/152826/ [https://perma.cc/7LUS-8SZ3].

Education has been slow to respond to complaints and the private servicers have shielded themselves from all state-led lawsuits by claiming sovereign immunity.[462] The danger to be avoided here is a lack of sufficient oversight as well as the lack of any market competition. If the Post Office is the only provider of banking services, it would become a monopoly like the Department of Education and consumers would have no option but to use its products.[463]

The postal banking system would also need a system of strong and accurate underwriting procedures that can adequately separate the insolvent from the merely illiquid and only lend to the latter. Of course, this is easier said than done. There will always be loans that default as long as human beings are responsible for repaying them. Any individual or company, wealthy or poor, can take out too large a loan at too high a cost and be crushed by it. Formulas such as credit scores that track an individual's history of previous repayments can eliminate some of the guesswork. But when it comes to distinguishing creditworthy borrowers among the low income, credit scores are often too blunt a tool. Innovative private lenders have already realized this and are working to develop fine-tuned underwriting formulas based on publicly available borrower data to predict loan default with better results than credit scores.[464] Pioneering peer-to-peer internet lenders have begun to boast of their success deploying these emerging mathematical models for small lending.[465] The Post Office can rely on this developed expertise in designing its own underwriting system. The bottom line is that doing any sort of underwriting, even simply using credit scores, would set the Post Office apart from the payday lending industry, which currently makes no attempt to distinguish between borrowers. The FDIC reports, "the prevailing underwriting criteria of most payday lenders require that consumers need proof only of a documented regular income stream, a personal

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[462] Stacy Cowley, *Student Loan Servicers' Frequent Mistakes Went Unpunished, Audit Finds*, N.Y. TIMES (Feb. 14, 2019), https://www.nytimes.com/2019/02/14/business/student-loans-education-department.html [https://perma.cc/5KXM-Z7PK]; Grant A. Premo & Keith S. Anderson, *Student Loan Servicers' Fight Over Federal Preemption of State Regulation May End Up in the Supreme Court*, BRADLEY ARANT BOULT CUMMINGS LLP (Apr. 15, 2019), https://www.financialservicesperspectives.com/2019/04/student-loan-servicers-fight-over-federal-preemption-of-state-regulation-of-may-end-up-in-the-supreme-court/ [https://perma.cc/HBH3-9UPM].

[463] *See* Julie Margetta Morgan, *Who Pays? How Industry Insiders Rig the Student Loan System—And How to Stop It* (June 2018), https://rooseveltinstitute.org/wp-content/uploads/2018/06/How-Industry-Insiders-Rig-the-Student-Loan-System.pdf [https://perma.cc/FEA6-ZALF].

[464] Sarah Todd, *An Alternative Lender Whose Credit Reviews Are Academic*, AM. BANKER (July 8, 2014), http://www.americanbanker.com/issues/179_130/an-alternative-lender-whose-credit-reviews-are-academic-1068506-1.html [https://perma.cc/9THJ-TC6F].

[465] *Id.*

checking account, and valid personal identification to receive a payday loan."[466]

Distinguishing the merely illiquid from the insolvent is no easy task, but it is at the crux of any successful effort to provide credit to the poor. The credit unions and cooperative thrifts thrived because they succeeded in doing just that. They used the tools available to them at the time: they lent to neighbors and friends and people they already knew through a cooperative structure. Most banks used "character" or "relational lending" to make underwriting decisions.[467] Today, with widescale loan standardization, that is less common. Most lenders just plug in numbers to an underwriting formula or algorithm to make decisions.[468] Even credit unions no longer work the way they used to. Relational lending is difficult today and it would not be a practical way for the Post Office to lower costs, even though postal employees would probably be best suited for the task. After all, in many rural communities across the country, postal workers have more information about the town's population than any other citizen. However, this is not the case with every community, and it is not clear whether the knowledge acquired by postal workers can be parlayed into accurate loan underwriting without significant training.

The lesson from these historic "people's banks" is to reuse their philosophy, not their tools. The Post Office or any public banking option must learn to adapt existing modern technology to offer fair, useful, and self-sustaining products to those neglected by mainstream banks. There are several reasons to believe that the Post Office is uniquely capable of lending responsibly while reducing the costs of small loans. First, and most importantly, the Post Office is not primarily motivated by profitmaking, but rather is committed to a public service mission. Therefore, it can charge borrowers the actual cost of the loan. This was the necessary premise behind every successful movement to foster financial inclusion. The Post Office is not profit motivated because is an independent agency connected to the federal government, meaning that all excess profits are forfeited to the Treasury.[469] The Post

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[466] FED. DEPOSIT INS. CORP., PAYDAY LENDING: AN UPDATE ON EMERGING ISSUES IN BANKING 4 (2003), https://www.fdic.gov/bank/analytical/fyi/012903fyi.pdf [https://perma.cc/LW4T-QAEP].

[467] Laura Doering, *Risks, Returns, and Relational Lending: Personal Ties in Microfinance*, 123 AM. J. OF SOC. 1341, 1341 (2018); Caroline Banton, *Underwriting*, INVESTOPEDIA (May 13, 2019), https://www.investopedia.com/terms/u/underwriting.asp [https://perma.cc/KCW9-4NPN]; Brian Browdie, *Can Alternative Data Determine a Borrower's Ability to Repay?*, AM. BANKER (Feb. 24 2015), https://www.americanbanker.com/news/can-alternative-data-determine-a-borrowers-ability-to-repay [https://perma.cc/9RDB-RJX6].

[468] Banton, *supra* note 464; Aaron Klein, *Credit Denial in the Age of AI*, BROOKINGS INST., (Apr. 11, 2019), https://www.brookings.edu/research/credit-denial-in-the-age-of-ai/ [https://perma.cc/J46M-3TMU].

[469] Katz, *supra* note 461. *See generally* TASK FORCE ON THE U.S. POSTAL SYS., United States Postal Service: A Sustainable Path Forward (Dec. 2018), https://home.treasury.gov/system/files/136/USPS_A_Sustainable_Path_Forward_report_12-04-2018.pdf [https://perma.cc/Q6AU-L4J8].

Office has no shareholders demanding a return on investment so it is unlikely that the organization will be motivated to take advantage of its customers for private gain.[470] All gains will be public, as will losses. A board of directors, public representatives chosen by a democratically elected President, should be tasked to oversee its activities with an Inspector General's office doing periodic audits as well as an independent regulatory agency that has rate-setting power.[471]

Second, the Post Office can naturally reduce the high costs of lending to the poor through "economies of scale" and "economies of scope."[472] It can use its already existing and large network of branches to sell new products without much additional startup, overhead, or marketing costs. Compared to payday lenders, the Post Office can reduce costs immediately by using its existing branches and staff thus saving money otherwise spent on advertising, personnel, and locations. This ability to offer more at a lower cost is the reason large banks now dominate the market. Likewise, the size and reach of the Post Office can lead to lower costs of credit. "Economies of scale," or control of a large market of a single product, could bring down the costs for financial services and even loans if the Post Office has many customers. "Economies of scope," costs saved when an institution can sell a variety of products, could mean, for example, lower costs on loans because the Post Office is attracting more deposits, cashing more checks, or wiring more funds.[473]

Finally, because the Post Office never left communities deserted by banks and other businesses, it is available in all the regions forsaken by banks and has also developed an ongoing relationship of trust within these communities.[474] Many unbanked individuals already buy their money orders at their local Post Office.[475] This means that the Post Office has access to a customer base that is not comfortable in banks.[476] Surveys of the unbanked show that minority groups are significantly more likely to be unbanked than other groups.[477] But the cultural and class barriers that keep many people away from the mainstream banks do not exist at the local post office. Americans rank the USPS highest among all federal agencies with more than 70%

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[470] Mehrsa Baradaran, *Postal Banking's Public Benefits*, 2 Am. Affairs J. 18, 21 (2018).

[471] Office of the Inspector General, U.S. Postal Serv., Governance of the U.S. Postal Service, RARC Report RARC-WP-17-002 23 (Nov. 10, 2016), https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-17-002.pdf [https://perma.cc/N5DR-LMK7].

[472] Cathy M. Rogerson, William M. Takis & Thomas M. Lenard, *Economies of Scale and Scope and Competition in Postal Services in* 12 Topics in Regulatory Economics and Policy Series: Regulation and the Nature of Postal and Delivery Services (1993).

[473] Steven Nickolas, *How do Economies of Scope and Economies of Scale Differ?*, Investopedia (May 6, 2019), https://www.investopedia.com/ask/answers/042215/what-difference-between-economies-scope-and-economies-scale.asp [https://perma.cc/U9H5-QDMC].

[474] *See* Baradaran, *supra* note 32, at 26, 218-19.

[475] *Id.*

[476] *Id.*

[477] *Id.*; Fed. Deposit Ins. Corp., *supra* note 204.

of those polled saying it does an excellent or good job.[478] With millennials, the rate is even higher, at 81%.[479] About 70% of Americans trust the Post Office compared to 18% who trust payday lenders and 26% who trust banks.[480]

In both inner-city and rural communities, post offices can be crowded and bustling places where the neighborhood gathers to do its business, helped by clerks who are members of that same community. Even people who never go to their post office branch may be familiar with the mail carrier who visits their home daily. And following history's cue, the postal network can offer information in more languages than do banks and appeal to the large population of immigrants, or even undocumented people, who have money to save, but no access to banks. Many of these workers currently send their money abroad[481]—money which can be induced to stay within American borders. As it was in the 1900s, this can be a surprising source of revenue for the postal banks.

Trust, especially in banking, is more than just a nice feeling. It is a way to lower costs and reduce barriers of entry. This was the point of government deposit insurance. Banks cannot survive if their customers do not trust them to hold and lend their money. It is hard to predict whether the public will warm to postal banking, but in light of historical and international experience, and the significant modern distrust of fringe banks, the public may view the Post Office as a safer and more trustworthy place to store funds.

And this trust is not undeserved. The Post Office has a history of service to the American people, unrivaled by any other institution or any other government entity. In a way, the Post Office serves as a perfect foil for the banking industry. The latter receives hefty federal government support and rejects any public-serving functions. The former is currently receiving limited federal government support and yet sees public service as its primary mission. Even today, the stated mission of the U.S. Post Office is: "to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render

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[478] Steve Ander & Art Swift, *Americans Rate Postal Service Highest of 13 Major Agencies*, Gallup (Nov. 21, 2014), https://news.gallup.com/poll/179519/americans-rate-postal-service-highest-major-agencies.aspx [https://perma.cc/J6CM-YR5C].

[479] *Id.*

[480] Peter Moore, *Poll Results: Post Office Bank*, YouGov (Feb. 10, 2014), https://today.yougov.com/topics/finance/articles-reports/2014/02/10/poll-results-post-office-bank [https://perma.cc/MPZ9-EAND]; Dennis Jacobe, *Americans' Confidence in Banks Up for First Time in Years*, Gallup (June 13, 2013), https://news.gallup.com/poll/163073/americans-confidence-banks-first-time-years.aspx [https://perma.cc/WTZ4-MQPQ]; Atym, United States Postal Service Brand Survey (Apr. 21, 2012), as cited in U.S. Postal Serv., *supra* note 424.

[481] William Lacy Swing, *How Migrants Who Send Money Home Have Become a Global Economic Force,* World Economic Forum (June 14, 2018), https://www.weforum.org/agenda/2018/06/migrants-remittance-global-economic-force/ [https://perma.cc/B9RV-A2CY].

postal services to all communities."[482] This makes the Post Office an ideal means of providing a public option in banking.

Short-term credit is not a solution to inequality. The reason that most people need high-cost credit products is unstable work, inequality, and rising costs in healthcare and education, and the best solution is not credit, but addressing these structural problems. Full-scale reform of the economy is necessary to right the ship. Employees must have a living wage, families must have affordable shelter, and healthcare costs must not be so onerous. With these reforms in place, the need for payday loans will naturally be diminished. The industry, after all, has risen alongside trends in inequality.[483] Yet, credit can be a lifeline for many families and individuals who face unexpected circumstances.

## Conclusions

American reformers and politicians have long debated what to do about high-interest lending. The high-cost consumer loan occupies a tense space at the intersection of ideals of free market capitalism and contract supremacy on the one hand and justice and morality on the other. Various historical moments in American history have yielded different debates and resolutions about this corner of the credit market. Progressive reformers viewed the scourge of "loan sharks" as a result of concentrated credit and banking power and thus sought to fight large conglomerates while also building up an alternative grassroots model for credit provision for the low-income. The credit union and thrift industry arise from this tradition. During the more recent neoliberal era of bank deregulation, the high-cost lending sector has risen to fill the void vacated by small community banks, credit unions, and thrifts. A patchwork of state usury laws, common law contract cases, and a federal agency has attempted to regulate this industry without much success. This Article proposes an alternative: a public option in banking. A public option can take many forms and can offer an alternative for all banking services or it can be limited to small loans and bank accounts for the underbanked. Participation in commerce is essential for full civic engagement and today, many Americans are excluded from commerce or forced to pay fees for simple loans and transactions. A public option has the potential to resolve these inequalities. For a variety of historic and practical reasons, the U.S. Postal System would be the best means of offering a public option to all communities.

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[482] Postal Reorganization Act, Pub. L. 91-375, 84 Stat. 719 (1970) (codified as 39 U.S.C. § 101(a)).

[483] Payday lending began to increase in the late 1980s and has risen since then, as has inequality. Elliehausen & Lawrence, *supra* note 197, at 2