Proposed Federal Usury Legislation

—an idea whose time has come

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The talking heads in the media have thus far explained the Great Recession on the sub-prime real estate lending market and something called "credit-default swaps." Little attention, however, has been paid to the crippling effect of our obscene credit card debt and the industry that has fueled it. That is, not until U.S. Senator Bernie Sanders, an independent from Vermont, introduced S. 582 on March 12, 2009. His bill would create a national usury law, slapping a fifteen percent cap on all credit card debt.

Usury is the practice of charging excessive interest on loaned money. Laws prohibiting usury date back as far as currency itself. Lending for excess profit has historically been reviled by the church, secular rulers, and philosophers. Dante, in *The Divine Comedy*, places usurers in the seventh circle of hell, below suicides. The Romans limited interest on loaned money while the Qur'an forbids interest altogether.

From the formation of the Republic until the late 1970s, interest rates in the United States were regulated by the states. Each state passed its own usury laws to protect its citizens from scoundrels and loan sharks. States typically limit consumer interest to somewhere between twelve and eighteen percent. However, in 1978, states' authority to regulate lending was trumped by the U.S. Supreme Court in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.* That case opened a pandora's box of runaway credit card debt, outrageous interest rates, and ultimately to the current state of the economy.

Marquette National Bank has been described as "the biggest case of our lifetimes." Marquette basically holds that national banks are not subject to the usury laws of the state of the borrower. Lenders need only comply with the usury laws of the state in which the lending decision is made. In other words, interest rates are governed by the states where loans are processed. The ruling opened the door for lenders to set up shop in states with liberal or non-existent usury laws and then "export" their usurious rates throughout the country. After *Marquette*, it wasn't long before credit card companies went shopping for host states that would eliminate their usury laws in exchange for the promise of jobs.

Citibank was the first to act. Its Chairman and CEO Walter Wriston traveled from New York to the home of then South Dakota Governor Bill Janklow to strike a deal neither could refuse. The CEO of the troubled bank (remember, banks in the late 1970s and early 1980s were struggling with runaway interest rates) cut a deal with the nearly insolvent State of South Dakota that would change the credit card industry. The governor agreed that South Dakota would eliminate its usury laws in exchange for relocation of Citibank credit card operations to the state. Citibank literally wrote the new South Dakota usury law which was then passed by the South Dakota legislature within weeks of the initial meeting at the governor's kitchen table.

Unlimited interest rates allowed banks to lend to customers who could not otherwise get credit. Low monthly minimums encouraged consumers to revolve their credit, guaranteeing they would never get out of debt. "Revolvers," as they were called, and other high risk customers became the most profitable customers, by some estimates accounting for seventy-five percent of industry profits. High interest rates more than offset losses from consumer defaults.

With unlimited interest rates, it was "game on" for the credit card companies. They began to spread credit cards around the country like candy. The greater a consumer's credit problems the more credit cards he got in the mail. Credit card companies pushed credit on the most vulnerable borrowers. Credit card companies were soon on every college campus recruiting the next generation of borrowers who they hoped would never escape their debt. Such predatory lending practices continue unabated to this day.

The deal also turned out to be good for states that eliminated their usury laws. According to former South Dakota Governor Janklow, at one point sixteen percent of all South Dakota residents were employed in the financial services industry. Seeing the opportunity for jobs, corporate-friendly Delaware soon joined the bandwagon eliminating usury laws and attracting a number of large lending institutions to the state.

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Credit card companies have been careful to protect their golden goose. When consumers began to file bankruptcy in record numbers, the lenders lobbied Congress for what ultimately became the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act. This Act is a piece of "No Lending Institution Left Behind" legislation that basically consigns borrowers who cannot pay their bills to debtor prison. The companies have also instituted the concept of "universal default," under which a late or missed payment on any one credit card places the borrower in default on all of their credit cards. Universal default activates penalty interest rates that sometimes exceed thirty percent.

The rise of credit card balances combined with free flowing mortgage money to create the perfect storm. Borrowers simply took larger and larger readily available low interest tax deductible home loans to bail themselves out of their high-interest credit card debt. The cycle of borrowing escalated until the cycle was broken by an external event such as a loss of a job, medical problems or divorce—which together account for as much as ninety percent of all defaults. Ultimately, the entire house of cards has come tumbling down as the unreal spending, borrowing, and lending practices of Americans could simply not be sustained.

According to Elizabeth Warren, Harvard Law Professor and Chair of the Congressional Oversight Panel in charge of the Troubled Asset Relief Program ("TARP"), the simple solution to the current credit crisis is to institute a national usury law. Under her program, which presumably is the inspiration behind Senator Sanders' Bill, a national limit on interest rates would end current predatory lending practices. Without outrageous interest rates to compensate for bad loans, banks would no longer prey on marginal borrowers.

One hopes that Congress is of a mind to fix the current credit crisis so it won't happen again. Capping consumer interest rates is a critical piece to any long-term solution. In the words of Professor Warren: "America has had more than twenty years to observe the effects of a deregulated lending industry, and the evidence is overwhelming. It is time to call the experiment a failure."

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