LAW AND CONTEMPORARY PROBLEMS

VOLUME 19 | WINTER, 1954 | NUMBER 1

FOREWORD

About a decade ago, *Law and Contemporary Problems* published an issue on "Combating the Loan Shark."[1] The present symposium discusses subsequent developments in the small loan field. On the one hand, the battle against the loan shark continues and is slowly being won. On the other hand, new problems have appeared which introduce further complexities into the overall field of consumer credit, of which small loans constitute a significant part.

During the last few years, several states have enacted the Russell Sage Model Small Loan Law and thus effectively stamped out loan shark activities within their borders. Other states during this period have modernized their existing small loan laws with beneficial effects. Consequently, today approximately 80 per cent of the United States by population has reasonably adequate protection against the loan shark. Unfortunately, there still remains a hard core of approximately a dozen states, concentrated largely in the south and southeast, where, because of unrealistic usury laws which make impossible profitable, legal, commercial small loan operations, the loan shark continues to be the primary, if not the sole, source for small loans. This situation is daily becoming more serious because many of these states—for example, Texas, Georgia, and North and South Carolina—are undergoing rapid industrialization with a correspondingly increased need and demand for legitimate sources for small loans for wage-earners. It seems inevitable that these states some day will enact legislation which will adequately cope with this problem, but it is disappointing that progress in this respect continues to be so slow.

Moreover, even in states with satisfactory model small loan laws, other factors are creating problems. In these days of inflation and rising costs and prices, the size of loans has tended to increase in response to the borrowers' needs and desires for larger sums and the lenders' needs for larger profits with which to offset increased overhead costs of operation. Reflecting this trend has been a movement to increase the statutory ceiling in small loan laws from $300 to $500 or even more. Such a change may present serious dangers. As Mr. Smith points out, there is even today, and probably always will be, an urgent demand for the truly small loan of $25 to $50 or less to meet family or other emergencies. For this type of small loan, usually no source exists except the small loan operator, and it was in recognition of this fact that the small loan laws were enacted. If, therefore, the legitimate small lender

[1] 8 LAW & CONTEMP. PROB. 1-206 (1941).

voluntarily withdraws from this area, inevitably the loan sharks will replace him. On the other hand, the larger loans probably can always be supplied, as they are in part today, by commercial banks and other sources. We must not forget that the main purpose of the small loan law is to meet the urgent needs, still present even in days of inflation and prosperity, for the truly small loan of $25 to $50 or less. Accordingly, the small loan operators must not shirk their responsibilities in this field and thus frustrate the primary objective of the small loan laws.

Most legitimate small loan companies, and even loan sharks, customarily do not attempt to obtain really adequate security from borrowers other than character and personal integrity. Actually, of course, if the borrower could give such security, he could probably obtain the loan from a commercial bank or other customary channel of credit. Recently, however, there has developed in certain places considerable pressure among lenders to have borrowers furnish for small loans certain types of insurance: either health, life, or accident insurance on the borrower; or some type of insurance on any chattels, such as an automobile, constituting security for the loan. It is quite possible that where the borrower really desires such insurance, this practice may then serve a useful purpose even though it does increase the cost of the loan to him. Where, however, the insurance is forced upon the borrower by the lender, though ostensibly for the mutual benefit of both, it seems an unwarranted expense if paid for by the borrower. Furthermore, it is most unlikely that prohibition by the legislature of such insurance in connection with small loans, except where the borrower of his own volition buys the insurance from the lender, can effectively be enforced. Most small borrowers are inevitably only too sensitive to subtle and indirect hints and pressures from their lenders concerning the voluntary purchase from the lender of such insurance in connection with obtaining much needed loans. If, in addition, as in certain states such as North Carolina, the lender personally profits through commissions upon the sale of such insurance to his borrowers, it is evident that by means of these tie-in insurance sales the lender may be able easily to evade legal restrictions on interest rates and charges for small loans. The resulting profits from such tie-in sales may quickly revive loan shark activity. Accordingly, whether the loan is protected by insurance or not, the lender should not be permitted any personal profit from the insurance in addition to his permissible legal rate of return on the loan itself. Whether the lender's charges are stated as one all inclusive rate denominated "interest," or whether they are broken down into various categories, such as interest, service charges, fees, insurance, etc., would seem of far less importance to the borrower than the fact that the total cost to him, in either case, should not exceed a fair maximum which is sufficiently high to permit and encourage legitimate lenders to operate at a reasonable profit.

Perhaps the most striking development in the small loan field of late has been the tremendous increase in the credit supplied by others than the small loan companies to consumers. Commercial banks, industrial banks, credit unions, installment sales finance companies, in the last decade have greatly expanded their supply of

consumer credit and in many cases are operating today, at least in part, in the small loan field. The large-scale entry of these other sources of credit into the small loan field creates problems which are thus far largely unsolved. For example, although there is inevitably some competition and overlapping among these credit agencies, yet in some cases this may not be true. Commercial banks tend to service the larger and usually better secured consumer loans. It is difficult, for example, to imagine a negro day laborer in the south obtaining a small loan from a commercial bank. There is a serious danger, however, that this may result in the commercial banks and other credit agencies skimming off the cream, so to speak, of consumer credit. This not only leaves unsatisfied the needs of those who most require true small loans, but also makes it more difficult for them to obtain such loans elsewhere at reasonable rates. If the lenders servicing the true small loan have left to them only the riskier and less profitable types of credit operations, they must inevitably increase their charges.

In most states, all these different sources of consumer credit function today under separate and unrelated statutes which frequently give unfair and unjustified advantages, in the way of maximum returns or allowable fees and charges, to one type of lender as compared with another. Thus, in some states, an installment sale may be completely unregulated in so far as fees and charges are concerned, since it is not regarded as a loan subject to the general usury statutes. Frequently, credit unions, industrial banks, and the consumer loan departments of commercial banks are granted special exceptions from the general usury laws, with no legal safeguards, comparable to those of the Model Small Loan Law, provided for protection of their borrowers. The need exists and daily becomes more urgent for the formulation of a model code for all sources of consumer credit. Such a code must recognize the legitimate differences among the various credit agencies, but it must give the borrower adequate protection whatever the source of his credit. One state, Missouri, by reason of its peculiar constitutional provisions, has already been forced to adopt this approach. Other states are moving in this direction. The time would seem appropriate for the American Law Institute or the Commissioners on Uniform State Laws to give such a project serious consideration.

ROBERT KRAMER.