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# SMALL LOAN LEGISLATION PROGRESS AND IMPROVEMENT

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## SMALL LOAN LEGISLATION PROGRESS AND IMPROVEMENT

THE small loan business is an old one in this country, and some of the evils surrounding it go back to our earliest records of the business. It is said that Abraham Lincoln's first public address, when running for election to the legislature of Illinois, was devoted to a discussion of the prevailing high interest rates on small loans, and he pledged himself, if elected, to put through a law making such rates illegal and punishable. His good intentions cannot be questioned, but, like many others who came after him, he was acting upon insufficient knowledge of the subject.

The first real attempt to make a serious and exhaustive study of the subject before attempting a reform was that begun by the Russell Sage Foundation in 1907-08, when it financed preliminary investigations and publication of reports on the salary and chattel loan business, by Dr. Clarence Wassam and myself, then holding fellowships in the Bureau of Social Research of the New York School of Philanthropy.

These showed the business of lending small sums on security of pledge or mortgage of personal property or the assignment of wages to be an extensive one; and that, under the conditions which governed it, a considerable proportion of borrowers were being exploited instead of relieved. It was realized that the subject was an involved one, but as the extent and manner of the operations of many of the agencies engaged in the business were recognized as an important cause of poverty and distress, it came within the province of the Foundation. Consequently I was assigned to make a further study of the matter, and a year later was appointed Director of the Division of Remedial Loans which was organized by the Foundation in October, 1910.

The object of the Division was to conduct a campaign of public education with regard to the necessity for the small loan business as part of our fiscal machinery, and to point out the evil effects resulting from the operations of the prevailing commercial agencies in this field; to procure intelligent, reasonable legislation based on



a desire to regulate rather than to annihilate the business; to secure the enforcement of such laws and oppose the passage of drastic, impractical laws; and to encourage the organization of remedial loan societies that would make loans at the lowest rate consistent with sound business principles and a reasonable but definitely limited return upon capital.

These societies were expected to provide such competition as would result in an improvement of the methods commonly employed by money-lenders, and to afford an object lesson that would attract reputable capital into the business. It was never expected or hoped that the remedial loan societies would so grow in strength or in numbers as to monopolize the field. They were intended as experimental agencies—an object lesson—a stabilizing force. I know that the Division was looked upon by the loan men as an enemy of the business; that they believed it sought to drive out the money-lender and monopolize the field for the remedial loan societies. It was even stated that the Foundation was seeking a profitable way of investing its endowment. Nothing could be farther from the truth, but the loan men were slow to realize this.

We found that usury, like profiteering, is readily denounced but not so easily defined or prevented. We also found ourselves standing between two groups or forces: one representing the belief that all loans, no matter how small or upon what form of security made, should be limited in interest to the ordinary banking rate; the other representing the belief that competition untrammelled by law or regulation could be trusted to establish interest rates, and that rates so fixed were bound to be fair and reasonable.

The first group consisted of a large part of the public which had any opinion on the subject whatever, and its views were frequently and forcefully voiced by newspaper editors, legislators, and would-be reformers, who traced their authorities back to and before the dawn of the Christian Era and justified their opinions by extensive quotations from the Bible and the Roman law-makers. The other school, whose members professed to believe that the solution was to be found in unregulated competition, consisted largely of high-rate money-lenders who viewed any restriction that promised to be effective as an unwarranted encroachment upon their rights and a violation of sound economic law. They could not trace their family tree as far back as the

first group. Their patron saint was Jeremy Bentham, an economist of the late eighteenth century, who gave birth to this famous doctrine: "If I borrow a sum of money with interest at 100 per cent per annum and can find no one else willing to lend to me at a lower rate, then the rate of 100 per cent is fair and reasonable." This is not an exact quotation, but is substantially correct.

The contention of the first group—that banking rates should govern small loans—was effectively disproved by the unsuccessful experiences of those agencies which attempted to make small loans at banking rates on non-fluid and non-substantial security. Of course, I know that we still have a chain of loan agencies in many cities, organized to "lend to workingmen on their character at 6 per cent per annum" which assert that they are accomplishing "remarkable sociological results." Suffice it to say that there has been nothing in their experience to justify the belief that small loans can be made at banking interest. Such a belief has no basis other than sentiment; and a remedial plan based upon sentiment without regard to knowledge and experience has never cured any evil, and never will. Small loans are a necessity in our present state of civilization, and any attempt to work unnecessary hardship on the lender, or to compass him about with unreasonable restrictions, has the inevitable result of forcing the borrower to pay a still higher charge than he would otherwise pay. If the law prescribes terms which make it impossible to conduct business on a legitimate basis, then both borrower and lender will defy the law and take their chances on its being enforced. In the end the borrower always pays the price in high interest charges.

The contention of the second group—that determination of the rate may be left entirely to competition—holds true only when lender and borrower are on a substantially even footing. In large loans secured by real estate mortgages or marketable securities the law of competition may have full play, the rate being determined by the lowest figure at which money can be secured. But in the case of small loans the inherent inequality of lender and borrower vitiates this law. It can have no basis except in the ability of the borrower to refuse the terms offered, if too onerous. This the small borrower rarely can do. He goes to the loan agency as a last resort and when his need for money is imperative. By reason of this urgency and his inability to get money from another source he is in no position to bargain, with the result that the lender, unless otherwise controlled, charges an unreasonable rate.

At the time the Division of Remedial Loans was organized most of the states were depending upon one of the two theories, to which I have referred, to regulate the business, and we spent much time in gathering data as to the effect of such laws. I need not take up your time this evening to describe our investigations, to recount the cases of rank extortion found to have occurred under the most drastic as well as the most liberal types of law. You are doubtless all familiar with the conditions which we found to exist. That such laws were uniformly unsatisfactory in practice was conclusively demonstrated, and we determined to advance another plan of control which, though it could boast no ancient lineage, seemed sound and practical; that is, reasonable interest rates under state license and supervision. This plan was based on recognition of the small loan business, not as a parasitic growth but as a necessary element in our financial system, and on desire to attract into the business reputable capital which should furnish the sort of competition necessary to keep profits within reasonable limits. It was our aim from the outset to dissociate the small loan business from the character of some of those engaged in it; to show that it was the practices of the loan sharks and not the need for loans that was disreputable. To educate the public to a realization that the evil was inherent in the methods pursued, which were more or less a product of the laws in force, and not in the institution itself, was not an easy task. Our facts and motives were at first questioned. Conscientious objectors received able succor from loan men, who, perhaps not unnaturally, felt constrained to oppose us as strenuously as they had opposed previous interference from any quarter. If we had been able to convince the loan men earlier of our good faith, the story would not have been so long in the writing. But, gradually, as a result of speeches, articles, motion pictures, and meetings, defense of borrowers, arrests and prosecutions, and other methods of propaganda, we began to secure results.

Following our study of existing conditions and existing laws, we drafted a bill which required all lenders charging more than the banking rate to submit to license and frequent examination by the State Banking Department. This bill set up numerous safeguards for the protection of borrowers which experience had shown to be necessary, and provided adequate penalties for violation, with power of enforcement in the hands of the supervisory authority. It authorized licensed lenders to charge on loans of



less than \$300 an interest rate of 2 per cent monthly, to be computed on unpaid balances as instalment payments were made, with a small additional fee to cover the cost of drawing and recording necessary instruments. A brief experience with this law showed the difficulty of safeguarding the fee charge against undue repetition and indicated that the interest rate allowed without a fee was insufficient to cover necessary costs and yield a reasonable profit. An alternative provision of a flat rate of 3 per cent per month without fees was substituted, and in spite of determined opposition several states were induced to enact the bill into law.

In the meantime the American Association of Small-Loan Brokers had been organized by some of the farsighted loan men. Opportunities for contact and exchange of views between them and ourselves became more frequent, and then came the epochal day when a committee of that association, consisting of Messrs. Harbison, East, Watts, Hubachek, Aufderheide, and Colonel Hodson, met with Mr. Glenn, General Director of the Foundation, Mr. Hilborn, Attorney for the Division of Remedial Loans, and myself in my office. For three days we debated the subject and finally agreed upon a redraft of the bill which was to be known as the "Uniform Small Loan Law." The new draft, besides other minor amendments, permitted a flat interest rate of  $3\frac{1}{2}$  per cent per month without fees or other charges. A higher rate had been proved to be unnecessary; a lower rate had proved insufficient to provide capital needed to meet the demand for loans in the small cities; a combination of a lower rate with additional fees had proved too susceptible of abuse. The new rate was based upon definite information concerning the necessary costs of operation and was keyed to the business of the lender of average capital in the moderate-sized cities.

The drafted bill reflected a desire to do justice to both borrower and lender. It recognized the fact that small loan agencies, unlike banks, have no deposits and must do business on their own capital; that their security is not substantial or fluid; that small loans on chattel mortgage or wage assignment security require more investigation than bank loans; that instalment repayments necessitate a large bookkeeping and collecting system; and that reputable capital would not come into the business unless it could see the prospect of profit above the necessarily high overhead cost. The bill also recognized the necessity of protecting the

borrower; of seeing that he understood the terms of the loan and of his contract, that he should receive a receipt for all payments; of providing a means of recovery in case of overcharge and of giving the supervisory power free access to all necessary data that he might determine whether the law was being religiously observed.

Of course, the new bill encountered strenuous opposition from the public who considered the rate of interest too liberal, and from lenders who considered it too low and thought the law too drastic in other respects.

I will not detail the efforts made to line up support for the bill, how social and civic agencies eventually came to our assistance and newspapers rallied to the cause. No history of the movement would be complete if it failed to give large credit to such agencies and to the public-spirited men in the various states who gave us their help. The time allotted will not permit me to do more than refer to that fact. One by one the barriers were forced down, and the striking fact before us is that in the short space of five years this bill is now a law, either in toto or in large part, in nearly half the states of the Union, and has fulfilled our hopes and expectations. Its constitutionality has been definitely established. It is being ably administered by state officials who have come to have an appreciation of the importance of the business, a respect for licensed lenders, and a realization of the earnestness and sincerity of purpose of the American Industrial Lenders' Association and its constituent state bodies which are striving to police the business and maintain it upon its new and high plane. The new law has vindicated the belief that neither a laissez faire policy nor coercive measures will cure the evil of usury; that the remedy lies in the creation of something that will facilitate credit and increase money in circulation as well as the means and sources by and from which it can be obtained.

The law has reduced unnecessary borrowing and lightened the burden of the deserving borrower. It has reduced the losses of the lender, legitimized the business and those engaged in it. It has substituted respect for disrepute. It has saved the borrowing public from the payment of excess interest running into many millions of dollars.

In bringing about this new and highly desirable condition, the American Industrial Lenders' Association has played a very important part, and it is destined to play an even more important

part in the further advance of the law and the complete metamorphosis of this once sordid business. I am not going to indulge in fulsome praise of your efforts. I doubt whether you yet deserve a place in the roll of fame beside the Christian martyrs or those who have given their lives in the cause of humanity. You have simply had the good sense to recognize the right road when you saw it, the courage to stand up and be counted in favor of a proposition which to the lending fraternity generally was anathema, the will and determination to stick to your declaration of principles, and by fair dealing and honest practice gain the confidence of your clientele, the co-operation of the agencies of reform, and the respect of the general public. These I think you have already obtained to a marked degree and will ultimately possess in their entirety if you continue to follow the course you have charted.

