SMALL LOAN SERIES

REGULATION OF THE SMALL LOAN BUSINESS

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FOREWORD

REGULATION of the Small Loan Business is the final volume of the Small Loan Series which has been in course of publication by the Russell Sage Foundation.

Preparation of the Series, sponsored by the Department of Remedial Loans of the Foundation, was begun in 1921 under the direction of Louis N. Robinson, formerly professor of economics at Swarthmore College. The Regulation of Pawnbroking, by R. Cornelius Raby, was issued in 1924, but other volumes were delayed because the Department of Remedial Loans was without a full-time director. In the fall of 1925 Leon Henderson became its director and he undertook to bring the unpublished studies up to date. The rapidity of the changes in the small loan field and the administrative duties of the Department, however, delayed the appearance of the second volume, Ten Thousand Small Loans, by Louis N. Robinson and Maude E. Stearns, until 1930. Small Loan Legislation, by David J. Gallert, Walter S. Hilborn, and Geoffrey May, which included a chapter on the constitutionality of small loan legislation by Frank R. Hubachek, followed in 1932; and Moneylending in Great Britain, by Dorothy Johnson Orchard and Geoffrey May, in 1933.

In 1934 Mr. Henderson resigned his position with the Foundation. He was succeeded as director of the Department by Rolf Nugent, who is co-author of this volume. Mr. Nugent was associate director of the Department and had been a member of its staff since 1926.

Regulation of the Small Loan Business is in the nature of a summary of previous publications of the series. It draws heavily upon materials presented in the previous volumes and in two earlier studies, The Salary Loan Business in New York City, by Clarence W. Wassam, and The Chattel Loan Business, by Arthur H. Ham, which were published in 1908 and 1909 respectively. The present volume is, however, far more than a summary of previous publications. The authors have used these as the foundation for an independent study of a mass of material which was either beyond the scope of the other issues or not available to those who prepared them.

The title requires explanation at this point. The term "small loan business" is used in its narrow specific sense. It refers to a business whose loans have always been confined to small sums. The principal securities required by lenders have been chattel mortgages on household furniture, assignments of wages, or simple promissory notes. Loans are made chiefly to wage-earners for consumptive purposes. During recent years the business has been further distinguished by its regulation under the Uniform Small Loan Law and similar statutes governing loans of $300 or less. Licensees under this act are generally known as personal finance companies.

There are many other types of agencies which lend small sums to wage-earners for consumptive purposes. Among them are pawnbrokers, credit unions, Morris Plan companies and their competitors, and commercial banks. Although frequent reference will be made to these institutions, none of them is included in the immediate area of this study.

Because of the rapidity with which changes occur in the small loan field, it is desirable to point out here that important historical events, including legislative changes, have been recorded to December 1, 1934; that data concerning expenses and profits include figures for the year 1933, but that in most other respects the latest material used was that for the year 1932.

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CHAPTER I

HISTORICAL BACKGROUND OF LENDING

THE small loan business in the United States is of comparatively recent and independent origin. It neither developed from earlier forms of lending nor borrowed to any substantial extent their techniques. It is essentially a product of modern urban life. A study of the small loan business in this country, however, cannot be confined to the period of its immediate existence. What the business originally was and to some extent what it has continued to be has been determined by its social and legal setting. This setting has been in the making throughout the thousands of years that organized society has attempted to deal with the problem of the necessitous borrower. Religious dogma, social custom, economic theory, royal and papal decree, judicial and statutory law have confronted the institution of lending and have modified it or have been modified by it. The common heritage of this background relates the small loan business in the United States to the generic institution of lending.

The purpose of this chapter is to review very briefly the history of lending and the development of the restraints which society has imposed upon it. Such a review, it is hoped, will contribute to an understanding of the prejudices that surround the lending of small sums, and will serve to show the relation of the scope of this study to the more general field of lending. Because of limited space, this review will be far from complete. We shall discard promptly or avoid entirely those portions of the history of lending which do not appear to contribute to our purpose.

Lending in Primitive Societies

Lending presupposes ownership, and since private property, in one form or another, seems to have existed in the most primitive human societies as well as among many of the lower animals, the history of lending probably coincides with the history of human society.[1] The earliest forms of property appear to have been weapons, dress, and ornaments.[2] Lending was natural and informal, and frequently assumed the character of a duty. Personal articles were lent freely or were even "borrowed" without permission of the owner. Social custom required the return of the borrowed article or, if damaged, its equivalent, but the lender frequently refused to accept its return.[3] The enforcement of property rights was left principally to the individual, and if undertaken by the social group was usually limited to compelling restitution.

The expansion of the concept of private property to include shelter and food appears to have had little effect on the relation between borrower and lender. Social custom continued to modify the rights of ownership. Merit was acquired not by hoarding property but by its distribution in specified ways. Gifts to the less fortunate and elaborate feasts for the community were required of the successful. In addition, rules of hospitality, which recur "with tolerable similarity among all primitive peoples,"[4] made it a social responsibility to provide freely for anyone who entered one's house.

Several characteristics of those societies in which only personal goods, shelter, and food were considered to be privately owned seem important to an understanding of the conditions that surrounded lending. First, many of their activities were undertaken collectively and this fact undoubtedly tended to give a communal tinge to all property concepts. Second, it was the animistic association with the owner rather than acquisitive desire for these articles that determined their private character.[5] Third, the ac-

[1] Beaglehole, Ernest, Property. The Macmillan Company, New York, 1932, pp. 31–197; Lowie, Robert H., "Property," chap. 9 in Primitive Society. Boni and Liveright, New York, 1920, pp. 205–256.

[2] Hobhouse, Wheeler, and Ginsberg, The Material Culture and Social Institutions of the Simpler Peoples. Chapman and Hall, London, 1915, p. 243.

[3] Radin, Paul, Social Anthropology. McGraw-Hill Book Company, New York, 1932, p. 108; Grinnell, George Bird, Cheyenne Indians, Their History and Ways of Life. Yale University Press, New Haven, 1923, p. 344.

[4] Bucher, Carl, "The Economic Life of Primitive People." In Source Book for Social Origins, by William I. Thomas, University of Chicago Press, Chicago, 1909, p. 114.

[5] The reader will find an excellent discussion of the origins of the concept of property in Professor Beaglehole's monograph on Property to which we have already referred.

cumulation of goods beyond the needs of the relatively immediate future was a burden rather than an advantage to the owner. These characteristics seem to account, at least in part, for the requirement and willingness to lend and give freely, the leniency toward theft, and the absence of any conception of security or of rental for the use of borrowed property.

A natural accompaniment of the rule of hospitality and free lending in these partially communal societies was an equivalent social pressure toward doing one's share, and even excelling others in the activities of the group. Since honor could be had by distributing goods, the acquisition of goods for distribution was essential to public esteem. Approval of productivity, which appears to have been general, was frequently supplemented by the taboo of indolence as an offense against the tribe.

Lending in Established Agricultural Societies

As long as agriculture consisted of planting yams or harvesting wild grains, and hunting was an attack upon ample game resources where skill was rewarded with prestige, there was apparently little need for elaborate social protection against idleness. The addition of land to the concept of private property appears, however, to have changed these conditions.

Land seems to have become private property first in those societies in which its area was limited, or in which extensive clearing was necessary. Even in very primitive agricultural societies in small South Sea islands, and in tropical West Africa, land was usually private, while among the higher cultures of the Indians of the American plains it continued to be communal. In an agricultural society living on a limited area, greater effort was necessary to keep the soil productive. Moreover, with each family cultivating its own land, the harvest was a measure of its skill and effort.

It cannot be contended that in each such society the semi-communal rules of hospitality and free lending gave way to complete individualism and self-sufficiency. The limited data available make such a generalization extremely dangerous, even if the tenaciousness of social customs elsewhere did not render this generalization doubtful. Security for loans and servitude for debt seem, however, to have occurred in societies in which land was privately owned and not to have occurred in others.

Interest-taking, though obviously associated with social changes that led to security-taking and servitude for debt, appears to have had a somewhat different origin. The most primitive forms of property were unproductive. Fertile land, slave labor, and herds of domestic animals, however, were productive and returned an increase to their owners.[1] Among the Ifuago in northern Luzon, a creditor to whom a field was given as security for a loan shared the harvest with the owner under certain conditions.[2] Among the Yoruba of West Africa, a lender who took a slave or a member of the borrower's family as security was entitled to the labor of the person as compensation for the accommodation until the loan was repaid. In Ireland it was the custom of chieftains to lend their cattle to tribesmen in return for one-third of the increased stock.[3]

Regulations of Lending among the Israelites

An interesting example of a society in transition between a pastoral, nomadic culture and an established agricultural economy is found in the early biblical history of the tribes of Israel. There is undoubtedly considerable chronological confusion in the Pentateuch because these books were written many centuries after the events they described.[4] Many of the provisions of the Mosaic Code recorded in Leviticus and Deuteronomy suggest a more highly developed social organization and a higher stage of material culture than their nomadic existence would imply. Land, implements, crops, and livestock as well as personal goods appear to have been privately owned. Damage to the property of one man by another required its restitution;[5] a thief had to repay stolen property four or fivefold;[6] and debtors sold themselves into servitude.[7] In addition to these protections to property rights, however, the

[1] We have found no evidence to suggest that the concept of interest occurred in pastoral and slave-owning societies unless land was also privately owned.

[2] Radin, Paul, Social Anthropology. McGraw-Hill Book Company, New York, 1932, pp. 115–116.

[3] Bellot, Hugh H. L., The Legal Principles and Practice of Bargains with Money-Lenders. Stevens and Haynes, London, 2d ed., 1906, p. 4.

[4] See the section on the Old Testament in the article on the Bible in the Encyclopaedia Britannica, 14th ed., vol. 3, p. 508.

[5] Leviticus 21:33. [6] *Ibid.*, 22:1. [7] *Ibid.*, 25:39.

Mosaic Code continued some communal customs typical of very primitive cultures: Hospitality[1] and loans without interest[2] were required to be given to the poor. Every seventh year all debts were cancelled;[3] and every forty-ninth year, slaves were freed.[4]

The law for cancellation of debts apparently had a disastrous effect on the availability of credit as the year of cancellation approached. To overcome this, the Mosaic Code required:

> If there be with thee a poor man, one of thy brethren, . . . thou shalt surely open thy hand unto him, and shalt surely lend him sufficient for his need . . . Beware that there be not a base thought in thy heart, saying, The seventh year, the year of release, is at hand . . . For the poor will never cease out of the land; therefore I command thee, saying, Thou shalt surely open thy hand unto thy brother, to thy needy, and to thy poor in thy land.[5]

It is perhaps significant, however, that while capital punishment was prescribed for an impressive list of crimes, observance of these restrictions on property rights was enforced only by threats of pestilence and famine which applied generally to all infractions of the Code.

The continued preachings against usury by the kings of Israel, and later by her prophets, indicate increasing resistance to the prohibition of interest. The principal cause was undoubtedly economic. Having ended their wanderings and having established themselves in the land of Canaan, the Israelites built cities and began to trade, both among themselves and with other nations. The ability of landowners and tradesmen to use credit profitably not only created a new class of productive borrowers quite different from the necessitous borrowers whom the Mosaic Code sought to protect, but also increased the unwillingness of the wealthy to lend without interest capital that could be invested at a profit. The Mosaic Code, however, recognized no distinction between productive and consumptive borrowing. Like so many social regulations, the injunction against interest-taking had become fixed and was not amenable to changed conditions under which money was lent.

[1] *Ibid.*, 25:35. [2] Deuteronomy 23:19. [3] *Ibid.*, 15:1–4. [4] Leviticus 25:10.
[5] Deuteronomy 15:7–11.

Lending in Ancient Babylonia and Assyria

The earliest civilization for which we have contemporary historical records is Sumerian Babylonia of 4000 B.C. Although chronologically earlier than Israel at the time of her invasion of Canaan, Babylonia was considerably further advanced in material culture. It had an established agricultural and trading economy; land and slaves were private property and interest-taking was common practice.[1] Estimates of interest rates vary from 20 to 360 per cent a year.[2] This variation is due in part to differences in interpretation of the terms of loans recorded in excavated documents, and probably, in part, to the period during which the contract was made. But it is clear that there was a wide range of interest charges depending on the nature of the contract and kind of security. Commercial loans were considered more hazardous, and interest rates were therefore much higher than for agricultural loans secured by land. Loans for seed also seem to have borne high interest rates. In Assyria interest rates were somewhat higher than in Babylonia, and in Persia and pre-Mohammedan Arabia loans at high interest rates were also common.

It is certain, however, that in all these countries some loans, particularly those to meet temporary embarrassment, were made without interest. Frequently these contracts carried penalties for failure to pay when the loan became due. They were usually stated in terms of money, but actual transfers were made in corn or in other agricultural commodities which must have dropped in price following the harvest. Consequently the lender had his reward in obtaining his money's worth when corn was cheap. Frequent references throughout subsequent history to the differences in money prices of farm products at times of borrowing and of repayment suggest that this fluctuation was as important a cause of distress among necessitous agricultural borrowers as high interest charges.

Interest-bearing loans among the Babylonians were subject to certain customary restrictions which later were incorporated and perhaps expanded in the Code of Hammurabi: Interest was

[1] Lutz, H. F., Money and Loans in Ancient Babylonia. University of California Chronicle, University of California Press, Berkeley, April, 1924, no. 2, vol. 26, pp. 125–142.

[2] Schaeffer, Henry, The Social Legislation of the Primitive Semites. Yale University Press, New Haven, 1915, pp. 118–123.

waived in case of flood or drought; though the debtor could be enslaved by the creditor, the creditor had to assure the livelihood of the debtor's family; if an ox given as a pledge were seized, the creditor had to pay a fee; when slaves were given as security, their work was evaluated and credited toward interest; penalties were provided for overworking or otherwise abusing slaves given as security; and the period of servitude for debt was limited.

One of the sources of non-interest-bearing loans was the temple storehouse which lent to distressed farmers from whom repayment was expected at the harvest. This idea of a public source of credit for the necessitous,[1] arising apparently out of communal food gathering, recurs frequently in Greece, Rome,[2] mediaeval Europe, and in modern times.

Lending in Greece

In Greece, before the time of Solon (638 B.C.), when lending at interest for many purposes was common practice, interest charges were frequently exorbitant and debtors were subjected to life servitude.[3] Solon, given dictatorial powers because of the revolutionary activity of debtors, attempted reforms. He abolished all debts upon the security of land, restored debtors to freedom, and prohibited the seizure of the person for debt.[4] While these reforms relieved debtors of some hardships, they did little to decrease the interest burden. J. W. Gilbart quotes from Abbe Barthelemy's Travels of Anacharsis in Greece as follows:

> But as the laws of Solon do not prohibit those who have money from demanding the most extravagant interest for it, some persons receive more than sixteen per cent,[5] and others, especially among the lower classes of people, exact every day the quarter of the principal. These extortions

[1] "Among the Creeks planting and harvesting were carried out in common. A portion was stored in the public granary for the use of the necessitous, the rest was divided among the households." (Hobhouse, Wheeler, and Ginsberg, The Material Culture and Social Institutions of the Simpler Peoples, p. 244, note 2.)

[2] Gilbart, J. W., The History, Principles and Practice of Banking. G. Bell and Sons, London, 1922, p. 8.

[3] Glotz, Gustave, The Greek City and Its Institutions. Kegan, Paul, Trench Trubner and Company, London, 1929, pp. 103–104.

[4] Calhoun, George M., The Business Life of Ancient Athens. The University of Chicago Press, Chicago, 1926, p. 28.

[5] Probably a monthly rate.

are not concealed, and cannot be punished, except by the public opinion, which condemns, but does not sufficiently despise those who are guilty of them.[1]

The later Greek philosophers dwelt at length upon the problem of usury.[2] Lycurgus, in Sparta, redistributed property and abolished currency; Plato, in Athens, suggested that legal protection should be refused to credit transactions in order to prevent the practice; and Aristotle sought to abolish not only usury in credit but profits in trade as well, arguing that money was unproductive and therefore not entitled to a return for its use. Aristotle's doctrine appears to have had little effect upon the practical business life of his time, for commercial banking continued to flourish in Greek cities and distressed farmers and necessitous city dwellers continued to pay high rates of interest for loans. In fact, the type of commercial banking which had developed out of "money-changing" in Greece extended throughout the Hellenized world.

Lending in Rome

Whereas the history of lending in Greece begins with complete freedom in money contracts, early Rome, on the other hand, maintained restrictions reminiscent of tribal life.[3] "Under primitive Roman law for recovery of loans," writes Bellot, "we find the Archaic idea that all interest is illegal. A demand for interest cannot be made." The leniency of this legal principle toward the debtor, however, was discounted considerably by the stringency of the rights of the creditor upon a default of principal. Gibbon described the treatment of debtors under the early Roman law of the Twelve Tables as follows:

After the judicial proof or confession of the debt, thirty days of grace were allowed before a Roman was delivered into the power of his fellow-citizen. In this private prison, twelve ounces of rice were his daily food;

[1] Gilbart, J. W., The History, Principles and Practice of Banking, p. 5.

[2] That is a charge for the use of money, which was the original meaning of the word; not as, at present, an illegal or extortionate charge.

[3] We can only speculate as to the reasons for this difference. The answer lies possibly in the fact that Greeks took over the land and apparently many of the customs of the highly developed material culture of their immediate predecessors while the tribes which finally became Romans replaced people of a still lower material culture. It is possible, also, that a further answer may be found in the comparative scarcity of fertile land on the Greek peninsula as compared with Italian plains.

he might be bound with a chain of fifteen pounds weight and his misery was thrice exposed in the market place to solicit the compassion of his friends and countrymen. At the expiration of thirty days, the debt was discharged by the loss of liberty or life; the insolvent debtor was either put to death or sold in foreign slavery beyond the Tiber; but if several creditors were alike obstinate and unrelenting, they might legally dismember his body and satiate their revenge by this horrid partition.[1]

Gibbon adds, however, that these provisions were modified considerably by the moderation of judges, witnesses, and creditors for whom death or dismemberment of the debtor was unprofitable. Later laws prohibited magistrates from inflicting on debtors any capital or even corporal punishment. Bellot comments that there is no example of the exercise of the gruesome privilege of dismemberment known to history, but adds that slavery for debt was common and the private prison for adjudicated debtors was an appendage to the Roman moneylender's house even in the third and fourth centuries A.D.

The necessities of the growing trade of Rome soon required recognition of the right to interest. This was accomplished by the *nexi obligatio*, a purely fictitious legal device, which extended the harsh rights of creditors to the satisfaction of claims for interest as well as principal. Interest charges, however, were limited at various times to 4, 6, 8⅓, 10, and 12 per cent a year, and for an interval were again abolished altogether. Limiting the maximum rate of interest was a new regulatory device,[2] but one which recurs frequently thereafter. It was not, however, entirely without historic precedent. Bellot reports that the idea of paying interest in perpetuity was repugnant to the Assyrians and the Egyptians, who would not permit interest to exceed the principal of the loan.

These interest regulations, however, failed in their purpose. In the first place, they were applicable only to Roman citizens. Money was lent abroad at rates which impoverished and even starved whole communities. Even among Roman citizens, also, the in-

[1] Gibbon, Edward, History of the Decline and Fall of the Roman Empire. Methuen and Company, London, 1925 ed., vol. 4, pp. 499–500.

[2] But a maximum rate of 3 per cent a month was fixed by law in China at about the same time and has continued to the present. See The Legal Principles and Practice of Bargains with Money-Lenders by Hugh H. L. Bellot, p. 6; The Contract of Pawn by Francis Turner, Stevens and Sons, London, 2d ed., 1883, p. 3.

terest restrictions were evaded by lending through foreign agents and by means of the legal devices of bottomry and damage for default. The principle of bottomry developed from loans against ship cargoes in which the lender was entitled to additional charges to cover the risk of loss by shipwreck. This principle was capable of expansion to cover a variety of transactions in which the lender accepted some trifling risk in order to evade the usury law. The claim for damages on default in loan contracts was equally useful to the lender. Since the lender was entitled to damages for any injury he suffered through the default of the borrower upon maturity of the loan, the terms of the loan were frequently fixed judiciously so that the borrower was unable to pay when due. In spite of the lack of documentary evidence regarding interest charges, it is certain that moneylending was a major social evil in the latter history of the Western Empire and that interest charges were exorbitant for people of small means.

Early Christian and Mohammedan Doctrines Concerning Interest-Taking

Both Christianity and Mohammedanism were deeply affected by the provisions of the Mosaic Code regarding usury. Mohammed is reported to have said: "Verily the wealth that is gained in usury, although it be great, is of small advantage.—Cursed be the taker of usury, the giver of usury, the writer of usury, and the witness of usury, for they are all equal."[1]

The early Christian church took a similar stand against interest on loans. Jesus had warned against the dangers of wealth and greed; He had driven the money-changers from the temple; and He had proposed to fulfil and not to destroy the law and the prophets.[2] The church fathers interpreted these teachings as an endorsement of the provisions of the Mosaic Code prohibiting interest. This interpretation, together with the Aristotelian economic theories, to which many of the mediaeval monastic orders were exposed, precipitated a controversy which lasted for more than a thousand years.

The canons of the church councils on the subject of usury in-

[1] Schaeffer, Henry, The Social Legislation of the Primitive Semites, p. 125.

[2] Matthew 5:17.

creased in severity as the church gained in strength. In the year 305 A.D., interest-taking was prohibited to clerics under penalty of deposition; in 345 interest-taking by laymen was declared to be reprehensible; in 789 it was declared to be an offense punishable by the bishops; in 1179 it was made subject to the penalty of excommunication; and in 1311 the Lateran Council declared that any civil law permitting interest-taking was ineffective against the church canon to the contrary. These doctrines prevented loans from being made to the needy. Loans made in defiance of the canon laws were for commercial purposes and bore high interest rates.

Monts de Piété

Realizing the need for some source of credit for the poor and necessitous, both clerical and temporal officials in mediaeval Europe attempted to provide charitable lending facilities. In France about 1326 the Bishop of Mende recommended that magistrates make pledge loans at low rates of interest to those in need; and in 1350 the city of Salins organized a public pawnshop to lend at low interest rates. In England about 1361 Bishop Michael Nothburg of London set aside 1,000 marks of silver from the church treasury for the establishment of a fund to make loans without interest to the poor. Both the Salins and the London funds were short-lived as remedial institutions for the poor. The Salins fund tended to avoid small necessitous loans in favor of larger ones on security that would assure the safety of principal and interest. The London fund was soon dissipated by losses. Similar funds were frequently recommended in other cities, but they either failed to reach the point of operation or met the fate of the Salins or of the London fund.

The first charitable loan funds to achieve permanence were those organized in Italy. Charitable pawnshops were established at Perugia in 1462, at Orvieto in 1463, at Monterubbiano in 1465, and at Viterbo in 1469. These institutions were known as *montes pietatis*[1] or *monti di pietà*. The first appears to have been estab-

[1] The Latin word *mons* (literally mountain, pile, or heap) was used frequently in mediaeval times to mean an accumulation of funds. It was the mediaeval equivalent of the modern joint stock company. Insurance companies, water companies, and other joint enterprises were known as *montes*. *Montes pietatis*, therefore, meant merely charitable fund or charitable corporation.

lished by two Franciscans, Brothers Barnabas and Fortunatus de Copolis. Later the preachings of another Franciscan, Father Bernardino di Feltre, led to the establishment of many other institutions. Through his efforts, *monti* were established at Assisi, Mantua, Parma, Padua, and Pavia.

Although inspired by members of the Franciscan order, the *monti di pietà* were controlled by the municipality in which they were organized. Funds were raised by municipal grants, private subscription, or both, and were administered by a board, of which members of the municipal council or other laymen were a majority and members of the clergy a minority. They lent on pledges of personal property, limited their loans to small amounts, and at first charged no interest.

The necessity for periodic appropriations or solicitations of funds in lieu of income to meet losses and expenses apparently led practical-minded members of the boards of these institutions to propose limited interest charges for loans. Papal sanction had been granted for the operation of *monti di pietà* without interest. Later, when the *monti* began to charge interest a storm of protest arose from the clergy, particularly from the Dominicans who were jealous of the popularity of the Franciscans' efforts. This opposition was undoubtedly encouraged by Jewish and native lenders whose business suffered from the competition of the *monti.* The issue was finally appealed to the Pope, and in 1515 the Lateran Council declared that the *monti di pietà* which charged low interest rates were not sinful or illicit but on the contrary were meritorious, and that those who opposed them were subject to excommunication. Following this decision, the number of the Italian *monti* increased steadily. By 1896 there were 556 such institutions in Italian cities.

In France the institutions took root more slowly. A *mont de piété* was organized at Avignon in 1577 and at Arras in 1624. In 1626 a similar institution was opened in Paris but met with such strong ecclesiastical opposition to interest charges that it was closed within a year. In 1777 a *mont de piété* was again established in Paris—this time by royal decree. The Paris institution, owned by the French government, has become the largest of the European pawnbroking establishments. *Monts de piété* now exist in almost every city in France.

The first *mont de piété* in Spanish Netherlands was established at Liège in 1618; in Spain, at Madrid in 1702; and in Austria, at Vienna in 1713. The extension of *monts de piété* to England was prevented by the separation of England from the authority of the Roman Church in the reign of Henry VIII and by the scandalous failure in 1731 of a certain charitable corporation which was organized in 1707 to lend money on pledges in London.

The Jews Become Moneylenders

Another circumstance of importance to the history of lending in the Middle Ages was the establishment of Jewish communities in all the principal European trading centers. Following the conquest of Canaan by the Israelites and the consolidation of their kingdom had come a long series of disastrous wars. The Israelites, beaten and subjugated by numerous invading nations, heavily taxed, enslaved, and even deported on a wholesale scale, had scattered throughout the cities of the Mediterranean basin, and beyond as the world of trade expanded.

In the first few centuries A.D., emigrating Jews appear to have engaged in a variety of occupations. They were metal workers, weavers, merchants, slave traders, shipping masters, farmers, moneylenders, and fiscal agents of governments. With the spread of Christianity, however, the occupations open to Jews were gradually limited. Discriminatory land laws entirely closed agricultural pursuits to them, and in the eleventh and twelfth centuries the merchant and craft guilds ousted the Jews even from trade and the handicrafts in England, and to some extent on the continent of Western Europe.[1] It is perhaps important to the history of moneylending during the Middle Ages that the provisions of the Mosaic Code concerning interest-taking could be interpreted to permit Jews to make loans at interest to Gentiles. By the twelfth century, moneylending was their principal occupation.[2]

The continued existence of Jewish lenders in continental cities, in the face of religious prejudice toward them and the canon laws prohibiting interest-taking, was chiefly due to two circumstances. First, there was an urgent need for an agency to finance the trade

[1] See article on Guilds in Encyclopaedia Britannica.

[2] See article on Pledges in Jewish Encyclopaedia.

of growing commercial cities. Since church doctrine prohibited native merchants from lending at interest, it was left by default to the Jews. Second, these Jewish lenders were very useful to monarchs of the day for financing local wars, crusades, or court festivals. The golden eggs of the Jewish lender were too desirable to make killing the goose profitable. In many kingdoms the Jewish community was given a special charter which permitted it to engage in pawnbroking under certain regulations. Some of these charters not only permitted such loans but required Jews to lend to any Christian applying to them.[1] The Lithuanian charter of Jewry, granted by Grand Duke Alexander in 1388, reads like a modern act for the regulation of pawnbroking.

Moneylending in Great Britain Prior to 1776

Later events on the European continent played little or no part in the development of the social and legal setting of the small loan business in the United States. On the other hand, events in Great Britain prior to the revolution of the American colonies contributed greatly to this development, and are consequently important to our review. The history of British moneylending has been reported in a companion volume[2] and we shall undertake to present here only a brief résumé of this history prior to 1776.

From the enactment of a law of King Alfred (about 900 A.D.) to an enactment of Henry VIII in 1545, English temporal law endorsed and sanctioned the canon-law doctrines against interest-taking and enforced this prohibition with penalties.

The needs of trade, developing rapidly toward the latter part of the period bounded by these dates, had forced several breaches in the prohibition of interest. First, the Jews, who were exempt from the canon laws of the church, were permitted to lend money at interest with certain restrictions under special charters granted in the twelfth and thirteenth centuries. The banishment of the Jews, in 1290, resulted in substituting papal agents, Lombards, and later, native Englishmen in the same capacity. These new lenders, being professed Christians, were not exempt from the usury laws

[1] See articles on Austria, Lithuania, France, Paris, and London in Jewish Encyclopaedia.

[2] Orchard, Dorothy Johnson, and May, Geoffrey, Moneylending in Great Britain. Russell Sage Foundation, New York, 1933.

and had therefore to find means of evading them. Evasions took the forms chiefly of confusing interest with rents from real property, of damages for failure to pay when the loan became due, and of partnership or risk-sharing contracts, which had been used successfully to evade the Roman law many centuries earlier.

The separation of England from the authority of the Roman Church cleared the way for a formal recognition of interest-taking, and in 1545 an act of Henry VIII permitted loans at interest not to exceed 10 per cent a year. This act was repealed in 1552 because of the opposition of the clergy, but was revived again in 1571. In 1623 the maximum rate was reduced to 8 per cent, in 1652 to 6 per cent, and in 1713 to 5 per cent.

The allowance of a limited interest charge made possible loans by two classes of lenders. The scriveners, being draftsmen of documents, were in an excellent position to act as brokers between borrowers and lenders in return for a commission. The goldsmiths, who had to maintain places of safe-keeping for their precious metals, were entrusted with the coin and valuables of others. The latter soon began to make loans with part of the money entrusted to them. By paying a lower rate of interest on deposits than the rate charged for loans, they found that they could make a satisfactory profit on their own capital at the interest rate fixed by law. From the scriveners came the commercial paper and investment brokers; from the goldsmiths, the commercial and deposit bankers.

Thus in England commercial and investment banking developed with a comparatively free hand and clear conscience. These agencies dealt with the large landowner and the substantial merchant but refused credit to the much more numerous group of applicants who needed small sums or could not offer acceptable security. The latter continued to be served by lenders who lent their own capital, and could not therefore lend profitably at the legal maximum rate. They consequently remained in disrepute and relied upon evasive practices to disguise the fact of usury.

Among these lenders whose transactions were usurious in fact if not in form, the pawnbrokers were the first to receive recognition of their necessity for a higher rate of charge. In 1757 loans by pawnbrokers in sums of £10 or less were exempted from the usury laws, and fees for storage and insurance for goods taken as security were permitted. These privileges were continued, though with some modification, by subsequent acts. Experience with public pawnshops in continental cities and the fact that the rights of the pawnbroker extended only against the article pledged undoubtedly had a great deal to do with early recognition of the pawnbroker's right to a special rate of interest.

The moneylender, by which name the remaining lenders were distinguished from the bankers, investment brokers, and pawnbrokers, continued to rely upon devices to conceal rates of charge. The most common of these devices was the annuity contract, which was related in form to the risk-sharing contracts of earlier days. A borrower in return for an immediate sum of money would agree to sell an annuity for the duration of his life to a lender. It would be understood, however, that the borrower could at any time buy back the annuity grant. The difference between the original sum received and the sum to be repaid was, of course, interest.

Lending in the United States Prior to the Civil War

The American colonies inherited British law at the stage of its development when the colonies were established. In the absence of special statutes, British law applied also to the colonies. Of the 13 original colonies, only New Hampshire failed to enact special usury laws[1] before the American revolution. These statutes provided somewhat higher rates than the 5 per cent a year allowed in England under the Statute of Anne,[2] presumably to attract British capital for investment in the colonies. With minor exceptions, such as the higher maximum interest rates, the law of the colonies closely resembled the law of Great Britain. As a result, colonial credit agencies resembled those of Great Britain prior to the revolt of the American colonies.

The American revolution, by severing the political relationship between the colonies and the mother country, removed the influences which had led to the similarity of their statutory and judicial law. In Great Britain enactments of Parliament in 1833 and 1837

[1] Ryan, Franklin W., Usury and Usury Laws. Houghton Mifflin Company, Boston, 1924, pp. 25–27.

[2] The Statute of Anne was enacted in 1713 and continued in effect until 1854.

exempted promissory notes and bills of exchange of certain maturities from the regulations of the usury laws. And in 1854, largely as a result of the spread of Benthamite philosophy[1] and laissez faire economic theory, the usury laws were repealed altogether. This change in British policy had but a slight influence upon the policy of the American states toward loan contracts.[2] Although repeal of these laws was debated in many states even before their repeal in Great Britain, none was repealed before the Civil War.

The principal development in regard to interest rate restrictions in the United States prior to the Civil War was the weakening of the penalties for usury. Most colonial statutes had provided for the forfeiture of the principal or treble the principal upon proof of usury, and these penalties were continued when the states became independent. These penalties were gradually modified, and by 1865 in most states only interest was forfeited.

There appear to be definite reasons for the unwillingness of most American states to relax their interest rate restrictions following the relaxation and final repeal of these laws in England. First, the two countries had diverse economic interests. Great Britain in 1854 was primarily an industrial and trading nation and the interest rate restriction led to a flight of capital when interest rates were higher on the continent. In the United States, on the other hand, the principal credit needs prior to the Civil War were for agriculture. Such loans were for long terms and interest rates were comparatively insensitive to the fluctuations in the market rate for short-term funds upon which the trading community relied. It is noteworthy that the first state to repeal its usury law was Massachusetts, in which industry and trade were relatively more important than in any other state prior to the Civil War.[3]

Second, banking practice and more liberal maximum rates appear to have led to easier bank credit in the United States. The

[1] Bentham, Jeremy, Letters in Defence of Usury. (Published originally in 1787.) J. M. M'Creery, London, 1916. Hayworth Publishing House, Washington, D. C., 1916.

[2] Many European countries, however, promptly followed the example of Great Britain. Usury laws were repealed in Denmark in 1855, in Spain in 1856, in Sardinia, Holland, Norway, and Geneva in 1857, in Saxony and Sweden in 1864, in Belgium in 1865, and in Prussia and the North German Confederation in 1867.

[3] The repeal of the Massachusetts usury law occurred in 1867. In addition to Massachusetts, Maine, Colorado, and New Hampshire have now repealed their usury laws.

British banking system consisted of a few large banks operating many branches whose traditional lending policies required both ample security and a high degree of liquidity. The clientele of the British moneylender in 1854 consisted almost entirely of small business men, rentiers,[1] and first sons of wealthy families, all of whom, though people of property, were refused credit by banks. In the United States, prior to the Civil War, a large number of highly competitive independent community banks, unfettered by a similarly conservative tradition, and permitted somewhat higher rates, appear to have accepted as credit customers many small business men who would have been refused by British banks under similar conditions. There were few who wished to anticipate their income from property or their inheritance from an estate, but these few usually found bank credit available to them.

It should not be concluded, however, that state usury laws were effective during this period. Business men and bankers in many states opposed the continuance of restrictions which they declared to be in defiance of economic law. It seems clear that the usury laws were evaded on a large scale. In 1834, 202 business men of Boston "having long experienced the inconveniences arising from the existing Usury Laws" signed a petition to the Massachusetts legislature urging their repeal. Concerning evasions, the petition states:

> We would respectfully direct the attention of the Legislature to the numerous modes that have been devised for evading the laws; modes of transacting business, which, besides being circuitous and inconvenient, and besides taking away the sanction and protection of the law from those who engage in them, leaving no security but what is termed honor, thus increasing the risk, and of course the premium paid—besides these evils, which are loss of time, money, comfort and security—produce a fearful disregard of the laws, and establish a precedent of the utmost danger, while they tend to throw pecuniary negotiations in the hands of unprincipled and dangerous men. We need not specify the various methods by which the law is now evaded, and by which interest above six per cent is taken, in defiance of law, under the various names of "premium," "exchange," and "commission"; for these are matters of notoriety, and need only be alluded to in order to secure the attention of the Legislature. So long as our laws remain unchanged, it is vain to hope for a better state of things.[2]

[1] Persons receiving a fixed income from property, pensions, annuities, and so forth.

[2] This petition, Massachusetts Senate Document 66, is reprinted in full in Usury and Usury Laws, Appendix C, pp. 197–200.

In 1859 a joint select committee of the Tennessee legislature reported upon the interest laws as follows:

> . . . comparatively but little money is now loaned out in Tennessee, at legal rates. In some portions of east and middle Tennessee, and occasionally by a conscientious guardian or private individual in other parts of the state, loans may be effected at the legal rate, but in these instances it is generally done more for accommodation to friends of known punctuality than for the sake of gain . . . It is impossible to ascertain the exact amount of money used in Tennessee in note-shaving transactions. The law . . . like most other enactments guarded by heavy penalties and unjust discriminations, has defeated its own object.[1]

The "note-shaving transactions" referred to by the Tennessee Committee were identical with those described in the Massachusetts report. The practice of discounting a note and charging fees, premiums, commissions, and so forth, in addition to interest was generally known as note-shaving. Since the proceeds of the note were paid in cash in order to leave no record of the amount of the extra charge, it was difficult to prove that the transaction was usurious. Note-shaving was the principal method of evading the usury laws prior to the Civil War, and it continues to be the principal method used today.

In the United States of the Civil War period the legal status of lending agencies was similar to that in Great Britain of a hundred years earlier. Banking and investment broking had developed rapidly in spite of some inconvenience from the usury laws. Pawnbroking, though not until later specifically authorized by statute, appears to have been carried on openly, by virtue of the recognition in common law of the pawnbroker's right to a storage charge. Like the building clubs in Great Britain, building and loan societies in the United States[2] had become recognized institutions for home-building loans, and in many states their right to interest rates exceeding the legal maximum had been recognized. Many business and agricultural loans, however, were made at excessive rates by private lenders who disguised their charges by various devices.

[1] Extracts from this report are reprinted in Usury and Usury Laws, Appendix D, pp. 203–204.

[2] Building clubs in England date from 1795; the first building and loan association in the United States was organized at Frankford, Pennsylvania, in 1831.

CHAPTER II

BEGINNINGS OF THE SMALL LOAN BUSINESS

Productive and Consumptive Borrowing

PERHAPS the most notable of the many changes which we have recorded in Chapter I was the change in the purpose for which loans were made. This change materially affected the regulations imposed upon lending.

The rules of hospitality and free lending among primitive tribes were intended to protect those who borrowed for consumptive purposes—for food, clothing, shelter, and other immediate necessities of life. These regulations were adequate as long as property had value only in use, but they outlived the economy for which they were designed. Long after some forms of property had become productive many societies attempted to prohibit a charge for its use. Strangely enough this prohibition became associated only with money loans. Rental for property was considered legitimate, but a return for the use of money, which could be exchanged for any form of property, was illegal. Finally, the prohibition of interest gave way inevitably under pressure from an economic system with which it was fundamentally at odds.

The allowance of limited interest rates permitted profitable lending for comparatively large business transactions, but it resulted in little change in the credit facilities of smaller business men. Usury throughout the Middle Ages and down to the middle of the nineteenth century was almost universally associated with loans to entrepreneurs—to the small farmer, tradesman, manufacturer, and property-owner. These borrowers were frequently in urgent need of cash, but they were nevertheless propertied borrowers. They borrowed to acquire more property or to hold what they had.

With the development of productive property, the borrower for consumptive purposes gradually disappeared. It seems improbable either that his need for credit was any less acute or that prohibition or limitation of interest charges caused his elimination. It is more likely that he could not successfully bid against the demand for productive loans. The earning capacity of property appears to have been high, and the earning capacity of labor low. The propertyless borrower probably could not have paid from his meager margin above the necessities of life the charges which the commercial lender would have demanded. He was, therefore, a bad credit risk at any price.

This lack of commercial borrowing facilities by the necessitous was compensated in part by the continuance, as far as loans for consumptive purposes were concerned, of some of the rules of primitive society. Under the feudal system, it was the responsibility of the manorial lord to provide for his vassals in their emergencies. Following the breakdown of feudalism, particularly in towns, where its economic vestiges disappeared more quickly, family and neighborhood groups assumed responsibility for assisting distressed members.[1] Fraternal orders, burial and mutual benefit societies frequently supplemented the less formal family or neighborhood organization for relief in specific emergencies.

Many factors seem to have contributed to the eventual development of commercial lending for consumptive purposes. Perhaps the most important was the gradual increase in real wages paid to labor, particularly to skilled labor. As standards of living among wage-earning classes increased, the margin between their income and the minimum necessities of life widened. This larger margin, by providing means of repayment, created a credit capacity which did not exist before. It seems likely also that there was a gradual increase in the supply of capital in relation to the demand for productive loans, which contributed to the willingness of lenders to make consumptive loans. On the other hand, the growth of cities tended to increase the need for commercial borrowing facilities for consumers. Not only did the relative number of wage-earners increase enormously, but the comparative security of the small town and village with their partially self-sufficient homes and

[1] A custom among French Canadian factory workers in Maine is an interesting specific instance. Bankruptcy is a frequent occurrence among these people and the authors have been told that it is the practice of neighbors to bring food and clothing to the family of a man who has filed a bankruptcy petition.

neighborly customs of mutual aid in emergencies gave way to the insecurity of modern industrial cities whose residents were dependent upon weekly pay envelopes and frequently did not know their neighbors.

At this point it seems necessary to define more carefully what we mean by productive and consumptive loans. By the use of the words "productive" and "consumptive" we have attempted to divide all forms of lending into two categories. These terms are highly inadequate but no terminology exists by which we may make a more satisfactory distinction. This classification implies more careful selection by the lender on a basis of purpose than actually occurred.

The selection by the lender was in fact based principally upon the kind of security offered. Productive loans were those made against productive security. These loans were secured by farms which yielded crops, businesses which produced profits, houses which earned rentals, and other property which returned an income. Loan values were measured by actual or potential earning capacity of the property used as security. There were, to be sure, some forms of property commonly used as security which had no productive value in themselves, such as raw materials and finished merchandise. But in a broader sense, both may be considered as elements in the productive process. Perhaps "capital" would be a better term than "productive" to describe this class of loans, but it also has its handicaps. The proceeds of loans secured by capital, or by productive property, might be spent for consumptive purposes or might be used to acquire more capital or productive property. The lender, particularly the banker, preferred to make loans which were used to acquire more capital, both because his security was thereby increased and because he doubted the productive capacity, and therefore the value, of the security when the loan was for another purpose.

By "consumptive loans" we mean loans whose proceeds are not used to acquire capital assets, and which are made to persons in their capacity as consumers. Consumptive loans are those used to meet emergencies of family life such as unemployment, fire, theft, childbirth, illness or death, or those used to acquire or to maintain one or more of the growing list of consumers' goods and services which families or individuals need or want. We exclude from this class loans for home building because they are used to acquire capital assets. Even though a home is bought for personal use, it has the capacity to yield a rental to its owner or to avoid the paying of rent by its owner.

Beginnings of Consumptive Lending

The line of demarcation between productive and consumptive loans is exceedingly fine. By any single criterion, these two classes merge and even overlap. The early lender made no such fine distinction between loans, and it is probable that consumptive lending began in the middle ground where distinction was almost impossible.

The businesses of moneylenders in England and of "note-shavers"[1] in the United States tended to be characterized principally by the size of their loans and by the kind of security demanded. The amounts which the lender preferred to lend were determined largely by the amount of his capital, by his experience, by the neighborhood in which he was located, and by the occupation and earning capacity of his clients. The kind of security demanded was affected by the size of loans and the nature of his clientele, as well as by the legal advantages of certain kinds of instruments and his experience with them.

In Great Britain the bill of sale was an effective instrument for securing either merchandise in the hands of dealers or household furniture in the hands of consumers. The moneylender who used this instrument gradually accepted both types of property as security. The moneylender who lent small sums on promissory notes gradually failed to distinguish between the entrepreneur and the substantial salaried applicant and, finding his collection experience satisfactory with the latter, he extended his transactions to smaller salaried people and wage-earners. In the United States the note-shaver who specialized in small loans probably found the chattel mortgages as effective an instrument for securing household furniture as for securing store fixtures, livestock, and factory equipment which had been his customary security.

[1] See p. 31.

Gradually some lenders both in Great Britain and in the United States became engaged almost entirely in the business of making consumptive loans. Later many other persons, recruited from other occupations in which they had become aware of the demand for consumptive loans, entered the consumer loan business. They were payroll clerks, who began by lending small amounts to fellow-employes until payday; storage and warehouse men who frequently were asked to make loans against stored furniture; pawnbrokers, to whom people without jewelry to pawn offered furniture as security, instalment furniture dealers, lawyers, bank clerks, insurance agents, and real estate agents.

It seems unlikely, however, that many lenders consciously specialized in consumptive loans. Specialization resulted from the application of other criteria by the lender or borrower. The productive borrower who had any security whatsoever avoided the lender whose rates were high and whose loans were small. On the other hand, the lender whose charges were high, knowing that any business man willing to borrow at such terms was a frightfully bad risk, preferred to lend to wage-earners. Those who lent on salaries automatically eliminated the entrepreneur, while those who lent larger sums on certified business statements automatically eliminated employes.

Commercial lending for consumptive purposes probably began first in England sometime before the middle of the nineteenth century. But there are no records by which we may determine the exact date. In 1854 Parliament enacted the Bill of Sales Act which greatly strengthened the bill of sale as a credit instrument and which required registration of bills whose maturity exceeded twenty-one days. But registration was expensive when small sums were involved, and moneylenders avoided registration of small bills by renewing them at short intervals. Consequently we cannot measure the growth of lending in those denominations which would indicate consumptive borrowing. In 1878 the Bill of Sales Act was amended to require registration of bills of less than seven days' maturity. During the following year, 1879, 16,505 bills of less than £20 were registered in England and Wales.[1] The small amounts and the fact that many bills involved household

[1] Moneylending in Great Britain, p. 49.

furniture indicate that many of these bills, perhaps the great majority of them, secured loans for consumption. Since the bill of sale was but one of several forms of security used by moneylenders, lending for consumptive purposes was unquestionably common by 1879. It is probable, however, that the beginnings of lending of this type occurred many years earlier. The enactment in 1870 of the Wages Attachment Abolition Act for England and Wales and a similar act for Scotland, by which the wages of certain classes of employes were exempt from attachment, suggests that loans to wage-earners were common enough by 1870 to command the attention of Parliament.

In Great Britain the existence of the word "moneylending" to distinguish a large number of heterogeneous transactions from pawnbroking, banking, and investment broking led naturally to the inclusion of consumptive loans under this title. Although the business of the British moneylenders today covers a wide variety of transactions within which lenders have developed a high degree of specialization, the term moneylender continues to apply to all lenders alike, and neither the law nor the public has developed distinguishing names for the kinds of business which it includes.[1]

In the United States lending for consumptive purposes appears to have begun only a few years later than in England. As in England, the exact dates of its beginnings cannot be determined. The small amounts lent tended to keep lawsuits concerning them out of those courts whose decisions are preserved. The borrower, ashamed of his need to borrow, and the lender, aware of the invalidity of his contract at law and of the widespread scorn for the usurer, joined in surrounding the transaction with as much secrecy as possible. The late Charles R. Napier, who served as counsel for several of the earliest lenders in Chicago, was told when he came to Chicago in 1882 that loans on household furniture had been made in that city as early as 1850. But we have been unable to find any evidence of consumptive loans in this country by professional lenders until some twenty years later. It is not only possible, but probable, that household furniture was occasionally mortgaged as additional security for business loans years before it was used to secure consumptive loans.

[1] *Ibid.*, pp. 148–149.

Contrary to the situation in Great Britain, no name had been developed in the United States to designate the business of unauthorized lenders. As we have already explained, there was no equivalent demand in the United States for the kind of loans upon which the moneylender thrived in Great Britain. Following the relaxation and final repeal of the usury laws in Great Britain, the moneylending business was carried on openly and on a large scale. But in the United States, transactions similar to those of the British moneylender were illegal and consequently they were surrounded with secrecy. There were few professional lenders. Many of the lenders were lawyers with funds to invest. Most were engaged in some other business in addition to that of lending money.

Lending in small sums for consumptive purposes soon exceeded by far all other forms of unauthorized lending both in number of transactions and in the public attention which it attracted. Since this business was most readily distinguished by the size and security of loans, it became known quite naturally as the small loan business, and its component parts, as the chattel (or furniture) loan business, the salary (or wage assignment) loan business, and the plain (or promissory or unsecured) note business. We shall refer hereafter to this business in the United States by these names.

Small Loans in Chicago, 1869 to 1890

The earliest small loan advertisement which we have been able to discover in this country appeared in the Chicago Tribune in 1869. The files of the Tribune begin with 1857, but they are incomplete before 1871 because the Chicago fire destroyed the original file in that year. Our examination of these files covered the period from 1857 to 1890,[1] but no advertisements referring to small loans were found until that in 1869 which was inserted twice during

[1] The method used in this examination was as follows: The issues for the last week in November were examined, or if these were not available those nearest to this period, at three-year intervals from 1857 to 1869 when the first advertisement was found. The last week in November was selected because the heaviest demand for small loans occurs around this week. Having found this advertisement, the issues for the same week of 1868 and 1867 were also examined. After 1869, issues were for a similar week in 1872, 1875, and thereafter at five-year intervals. Because of the rapid development between 1880 and 1885, issues for the last week in November were examined for each year during this period.

the last week of November and read: "Money to Loan in Small Sums on Short Time. Room 14, Major Block." This offer from Room 14, Major Block, was not repeated during the corresponding week of 1872, but in the issue for November 26 of that year seven other lenders offered:

Loans on furniture, jewelry, warehouse receipts, and houses.

Loans made on houses on leased ground, diamonds, pianos and other good securities, small sums, 3–12 months on real estate.

Money to loan on short time in amounts to suit parties.

Money to loan on household furniture, houses, pianos, and other chattel security.

Money to loan on good chattel security in sums of $200 to $500.

Money to loan—in moderate sums on houses, furniture or pawns.

To loan—money on houses, furniture and other good collateral.

While the advertiser in 1869 specialized in loans of small sums, the lenders in 1872 appear to have given a more general financial service. Several lenders offered loans on three kinds of security: on diamonds, watches, and other personal articles; on real estate; and on household furniture. Some lenders, particularly those who advertised loans on the security of both real estate and household goods, undoubtedly intended to attract applicants for fairly substantial sums. Certainly, the $200 to $500 limits set by one lender excluded most of the applicants who became the typical customers of later small loan companies, concerning whose business we have more definite information. It seems likely, however, that most of these advertisers made loans of very small sums in addition to their larger loans.

Persons who knew the small loan business after 1880 inform us that lenders specializing in very small sums, most of whom had but little capital, relied principally on other methods to attract customers. Handbills and cards, left on doorsteps or distributed at factory gates, were used frequently in preference to, and by some to the exclusion of, newspaper notices. Probably these lenders were imitators of the more substantial lenders who advertised in the newspapers. It seems safe to say that the date of the first newspaper notices is approximately that of the beginnings of the business which dealt only in small sums.

Early Changes in Lending Suggested by Lenders' Notices

Comparing the lenders' notices in Sunday editions of the Chicago Tribune during the period from 1872 to 1885, three developments seem noteworthy. First, there was a growing specialization by kind of security which is exemplified by Table 1.

TABLE 1.—PERSONAL LOAN ADVERTISEMENTS APPEARING IN SUNDAY EDITIONS OF THE CHICAGO TRIBUNE FOR THE LAST WEEK IN NOVEMBER IN CERTAIN YEARS, 1872 TO 1885, BY TYPE OF SECURITY MENTIONED

Year	Type of security mentioned					Total loan advertisements
	None	Real estate, personal articles, and furniture[a]	Real estate *or* personal articles, and furniture[a]	Personal articles only	Furniture only[a]	
1872	1	2	3	0	1	7
1875	1	2	2	2	2	9
1880	0	0	1	2	7	10
1883	0	0	1	4	8	13
1884	0	0	0	3	6	9
1885	0	0	1	3	9	13

[a] The term "chattel" appearing in these advertisements has been assumed to mean household furniture.

A second development, closely related to the first, was the distinction between the pledge and the chattel mortgage. It seems likely that those who advertised loans both on furniture and on diamonds, watches, jewelry, and so forth, in 1872 and 1875 expected the furniture to be delivered in pledge, and this may even have been expected by those who offered furniture or "chattel" loans only. In 1883, on the other hand, six of the eight notices offering loans against household furniture or chattels specified "without removal," and in 1884 five of the six notices offering furniture loans specified "without removal." Apparently by 1885, it was taken for granted that furniture used to secure loans would not be removed. In that year only five of the nine lending on furniture specified "without removal." By this time the pawnbroker seems to have been superseded entirely in the field of furniture loans by the chattel mortgage lender.

An interesting account of this development is contained in a letter to the authors from L. C. Harbison, who until his death in 1933 was the president of the Household Finance Corporation, one of the oldest small loan companies. He repeated the following story as it was told to him many years ago:

Before small loan companies entered the picture, the necessities of working classes compelled them to dispose of personal property. In many cases it was disposed of and delivered with the understanding that the purchaser would not sell it until a certain time, within which the seller hoped to buy it back by paying enough more for it than he got to reimburse the buyer for the investment and his trouble.

In other words, they literally pawned personal property. It might have been pieces of furniture or a piano or a horse and wagon or similar property.

From time to time the same people had occasion to sell and re-purchase property in this way until the buyer and seller got to know each other so well that the buyer said, "Instead of selling it and buying it back I'll lend you the money and charge you the same as it would cost to sell and buy back."

Mr. Harbison commented that he could not substantiate the accuracy of this story, but that it seemed reasonable and logical.

A third development was the increasing emphasis on the confidential nature of the loan. The first notices promising secrecy appeared in the Chicago Tribune in 1883. In the November 25 issue for that year, one lender specified that loans were confidential and another specified "without publicity." In 1884 three lenders, and in 1885, five promised secrecy.[1] In the issue of November 23, 1890, only four notices offering loans on personal property were inserted but all four emphasized the confidential nature of the transaction. One of these notices read as follows:

Any amount of money from $20 to $10,000 to loan on furniture, pianos, teams, etc.

The property to remain in your undisturbed possession.

At a lower rate of interest than you can get elsewhere. Everybody who wants money call and see us.

We are just as happy to make you a $25 loan as one for $2,500; we will give you plenty of time to pay the money back; in fact we let you make the payments to suit yourself; as we do not ask for references or make inquiries of your neighbors the transaction is sure to be private; no fear of losing your goods as we loan money for the interest and not to get the

[1] Chicago Tribune issues of November 23, 1884, and November 22, 1885.

goods; we take up loans from other loan men; if you now have a loan on your goods call and get our rates.

E. A. Erd and Company
115 Dearborn Street, Room 33.

Early Chattel Lenders Elsewhere

Outside of Chicago, the first record of a professional lender on household goods which we have been able to discover was a notice inserted in the Boston Globe for October 24, 1873. It appeared also in several later issues and read: "$75,000 to loan on watches, diamonds, pianofortes, all other personal property, also on furniture not to be removed. J. C. Davis, 12 School Street."

Davis was apparently a pawnbroker who, like the pawnbrokers in Chicago in 1872, had expanded his usual business to include household furniture. Unlike the Chicago pawnbrokers of 1872, however, he made chattel mortgage loans "on furniture not to be removed." In 1881 several issues of the Boston Globe contained three notices of lenders of small sums.

Between 1875 and 1885 the small loan business began to develop in a number of cities. The earliest lenders in Milwaukee are said to date from about 1875. We have record of a chattel loan office in Minneapolis in 1878.[1] There are reports of the existence of chattel mortgage lending in St. Louis, Kansas City, and Cincinnati before 1880 and in Cleveland, Indianapolis, Detroit, and Philadelphia before 1883. Except for the notices which continued to appear in the Chicago Tribune and Boston Globe, however, there is a gap in the evidence supplied by newspaper advertisements until 1883.[2] On September 6 of that year a notice in the Louisville Courier-Journal offered loans on furniture and pianos without removal. On January 26, 1885, the first notice of a furniture lender in New York appeared in the New York World; on April 18 of the same year a notice of a furniture lender in Baltimore appeared in the Baltimore Sun; and on May 8, 1888, a lender in Newark advertising in the Evening News offered loans "upon

[1] The Household Finance Corporation is the successor of a chattel mortgage office opened in that year by Frank J. Mackey in Minneapolis.

[2] In some instances examination of newspaper files for earlier dates yielded no lenders' notices, but more frequently newspapers for these dates were not available to us.

furniture without inconveniencing removal." In San Francisco the first lender's notice appeared on October 20, 1890, in the Evening Bulletin.

Beginnings of Wage Assignment Lending

Among the advertisements of personal loans appearing in the issues of the Chicago Tribune from 1869 to 1893 which were examined by us, there is not a single reference to salary loans. Some of these notices, to be sure, did not specify the kind of security, but it seems unlikely that any of the lenders who advertised made a practice of lending on salaries. The first newspaper reference to salary loans which we have found was an advertisement in the Boston Globe for May 2, 1881. It offered loans on furniture or on assignments of wages.

Outside of Boston the next reference to salary loans occurred in New York in 1885. The first small loan advertisement appearing in the New York World, on January 26, offered both furniture and salary loans. In its issues for February 12 and 13 of the same year, the number of notices had increased to five, of which three offered loans only on furniture and two on furniture and salaries. Throughout 1885 advertisements in the daily issues of the New York World in each instance offered loans on furniture and occasionally on salaries as well. It was not until 1890 that advertisements offering only salary loans began to appear. By 1900 the two businesses seem to have been completely separated in New York and all advertisements appearing in the New York World for the month of October offered loans either on household furniture or on salary assignments exclusively. In cities other than New York and Boston for which newspaper issues before 1890 were examined, only chattel loans were offered.

The absence of newspaper advertisements of salary lenders does not, of course, preclude the existence of such lenders. Mr. Napier has told us that in Chicago, salary assignments were the most common form of security for small loans when he came to that city in 1882. Although the first lender's advertisement which we found in Newark, in 1888, offered loans only on furniture, the enactment of the New Jersey legislature in 1884, prohibiting the use of wage assignments to secure loans at a greater rate of interest than the legal maximum, is adequate evidence of the earlier existence of wage assignment lending.

If we may base our opinions on the practices of more recent salary lenders, the reasons for the greater obscurity of the beginnings of wage assignment lending are quite clear. The salary lender could lend safely only to applicants whose employment could be readily ascertained. Consequently he was inclined to lend only to city policemen and firemen who could be identified by a shield or uniform and to those employed by companies to whose payroll records he had access.[1] This circumstance probably affected the advertising policies of the first salary lenders, and led them to rely on the distribution of handbills and cards among specific employe groups in preference to general newspaper advertising.

Another reason for the greater obscurity of the first salary lenders was that the capital of many appears to have been so small that they could neither afford to advertise nor handle the business which might come through general advertising. Whereas the first chattel lenders were business men who advanced small sums in connection with other undertakings, salary lenders seem usually to have been former employes who in many instances began lending to their fellow-employes and acquired their business capital almost entirely through profits from insignificant original investments.

It is probable that lending small sums on salaries began at about the same time as lending on furniture. While all evidence points to Chicago as the first city to develop lending on the security of chattel mortgages on household furniture, it is possible that lending on wage assignments was initiated in Boston and other New England cities. Wage assignments were used by New England merchants to protect themselves against impecunious factory-hands before 1870. They would therefore seem to have been a logical form of security for persons who lent money instead of goods.

The division between lenders on chattel mortgages and on wage assignments was not so absolute elsewhere in 1900 as it was in New York. Although almost every large city in the country in

[1] In the anti-salary-buying campaign which we will describe later (pp. 157–160), it was found that many salary buyers had access to or even had copies of the payrolls of certain companies.

1900 had men who lent only on chattels and (except where wage assignments were invalidated by statutes) those who lent only on salaries, there were a large number who made use of whatever type of security the economic status of applicants made advisable. Sometimes, also, in order to make the loan doubly safe the lender took both a chattel mortgage on furniture and an assignment of wages.

Still others took no security at all. In some states chattel mortgages were invalid unless they were filed, and some lenders preferred to sacrifice the security to save filing fees. In other states wage assignments could not be used conveniently. The most important reason for the existence of lenders on unsecured notes was that borrowers frequently preferred loans without security even at higher rates. It is probable that unsecured lending was of later origin than either salary or furniture lending and developed from a growing competition for desirable borrowers.

Early Growth of Lending in Small Sums

Once having begun in any community, lending in small sums whether on the security of household furniture or of wage assignments increased rapidly. One of the advertisers in Chicago in 1885 warned prospective borrowers: "Persons in need of money should patronize only reliable houses, and as so many new firms and self-styled loan companies are daily springing into existence, it is best to carefully consider with whom you deal."

The number of chattel mortgages against household furniture filed in Cook County (Chicago) increased fivefold between 1875 and 1887; and in other Illinois counties threefold between 1870 and 1887. This increase was accompanied by a decline in the average amount. Table 2 shows the changes in the number and average amount of recorded mortgages for these years. Since the average amount continued to be greatly in excess of the average amount reported to have been lent by small loan offices in those days,[1] chattel mortgages on household furniture in large amounts were probably used for many purposes, perhaps by bankers as additional security for business loans, by real estate firms selling houses for a small original payment, by instalment furniture companies, or by business creditors of various sorts. The decrease in average size, how-

[1] See pp. 55–56.

TABLE 2.—NUMBER AND AVERAGE AMOUNT OF MORTGAGES ON HOUSEHOLD GOODS AND WEARING APPAREL RECORDED IN COOK COUNTY AND IN OTHER COUNTIES OF ILLINOIS IN CERTAIN YEARS, 1870 TO 1887[a]

Year	Cook County		Rest of state	
	Number	Average amount	Number	Average amount
1870	. .	. .	516	$487
1875	4,549	$276	. .	. .
1880	9,691	152	947	228
1887	22,839	151	1,576	193

[a] Fifth Biennial Report of Illinois Bureau of Labor Statistics, 1888, pp. 70–71, 84–85, 98–99. The report presents tables for 1870, 1880, and 1887. Cook County records for 1870 having been destroyed by fire, figures for 1875 were substituted. The 1870 records of one other county were also destroyed and its 1875 figures for this county are substituted in the 1870 item here given for the rest of the state.

ever, means that the proportion of mortgages for small amounts was increasing.

Unfortunately the distribution by size of recorded mortgages on household furniture is available only for 1887. The distribution in this year, however, leaves little doubt that the majority of these mortgages were recorded by lenders of very small sums. The distribution by size of mortgages on household furniture and wearing apparel[1] recorded in Cook County in 1887 was as follows:

Amount	Number
$ 1 to $24	855
25 to 49	6,015
50 to 74	4,611
75 to 99	2,823
100 to 199	4,454
200 to 299	1,787
300 to 399	873
400 to 499	393
500 to 599	290
600 to 699	187
700 to 799	98
800 to 899	89
900 to 999	83
1,000 and over	400
Total	22,958

These figures are derived from a tabulation in the Fifth Biennial Report of Illinois Bureau of Labor Statistics, 1888, p. 49. In interpreting the tabulation of this report, it has been assumed that "to" in the amount designations (e. g., $1 to $10, $10 to $15) should be read "to, but not including."

[1] Mortgages on wearing apparel constituted a very small part of the total number.

After 1885 the number of advertisements in newspapers offering small loans increased rapidly. During January, 1885, in the New York World there were not more than two notices in any issue, while in the following month the number appearing daily varied between 2 and 13. During a week in October, 1890, the number of lenders' notices varied between 14 and 38, and during a week in 1900, 24 were inserted regularly, and for several days there were 27. Only one advertisement appeared in the issues of the Newark Evening News for 1888 that were examined. In 1890 there were two, in 1895 from six to eight were being inserted regularly, and in 1900 there were 10.

The spread of the small loan business from city to city and the increase in the number of lenders in every large city were due in part to the development of chain lending. By this method the successful technique developed in one community could be extended promptly to other cities. Frank J. Mackey, who had opened the chattel loan office in Minneapolis in 1878, was one of the first lenders to expand his business into a chain of offices. Soon there were many other such companies in the chattel mortgage business operating throughout the Middle West and later throughout the entire country.

The chains lending on chattel mortgages expanded slowly, however, compared with the amazing growth of several chains lending on wage assignments. One of these was developed by John Mulholland, who opened a salary loan office in Kansas City about 1893, established offices in neighboring cities on the profits of his Kansas City office, raised additional capital by the sale of stock, and within fifteen years had more than one hundred offices scattered throughout the country. It is said that he sold more than a million dollars' worth of stock from his New York office alone. A similar chain of salary loan offices was developed by Daniel H. Tolman who appears to have entered the salary loan business in the East about the time that Mulholland opened his Kansas City office. His offices also were soon extended to the principal cities of the East, South, and Middle West.

CHAPTER III

CHARACTER AND TECHNIQUE OF UNREGULATED LENDING

Investigation of Lending in Philadelphia

THE earliest published description of the small loan business is the report of Rudolph Blankenburg,[1] who during the winter of 1893–1894 investigated the small loan business in Philadelphia for the Citizens' Permanent Relief Committee. This report contains such interesting evidence of the extent of the business, rates of charge for loans, and hardships of borrowers that we reproduce large sections of it here:

During the investigation into the causes of suffering and distress among a worthy class of people who were compelled to come to our Committee for assistance, an effort was made to ascertain the origin of their trouble, as far as practicable.

While lack of employment formed the basis of nearly all complaints, a large number of the applicants voluntarily confessed that they would not be in such sore straits if it was not for the weekly payments they had to make to money-lenders, for money borrowed. These payments had to be met to save them from being ruthlessly deprived of a bed to sleep on, a table to eat from, and even a stove to keep them and their children from freezing.

The money was generally borrowed by people who had never asked for assistance, and who preferred to exhaust all the means at their disposal before they would accept charity. They were induced by alluring advertisements in our daily papers to place themselves in the power of a class of money-lenders who would have challenged the admiration and envy of Shylock for their ingenious methods, their skillfully drawn contracts and cold-blooded process of extracting the last drop of blood from their victims, holding them in their power like a vise.

After looking into a score or two of cases and being firmly convinced that a great wrong was being perpetrated upon hundreds and thousands of our

[1] Report of the Operations of the Citizens' Permanent Relief Committee of Philadelphia in Relieving Distress in the City during the Winter of 1893–1894. Loag Printing House, Philadelphia, pp. 31–55.

fellow citizens who could be helped if the attempt was made, a case of particular hardship was selected for an experiment. An electrician who had always made good wages, until severe sickness lost him his position, had been out of employment for five months, and after exhausting his savings, he applied for and received a loan of $50 from one of the numerous loan companies, giving as security a judgment note and bill of sale on his furniture. This loan was to be repaid in thirteen weekly instalments of $5.10 each, amounting in all to $66.30; a rate of interest equal to 240 per cent per annum (the payments averaging due in less than seven weeks). After paying back $35.70 he was unable to continue, and was threatened with a Sheriff's levy on his household goods. In her distress, the wife called on the President of her ward auxiliary branch, and was by him referred to our Committee with a recommendation, vouching for the respectability of the family (husband, wife and two daughters), their honesty and integrity, in every way deserving of assistance. Charity they did not ask, but if the constable could be kept off, their household goods saved, and they be enabled to rent a cheaper home, they would be very grateful. The two girls, fifteen and seventeen years of age, had the promise of positions where they could earn three or four dollars a week, sufficient to keep the family from actual suffering, provided they did not lose their home and household effects.

While there is no penalty for exacting usurious interest, it can be recovered through legal proceedings, and those guilty of charging usury, as a rule, prefer a voluntary surrender of their ill-gotten gains to a law suit for its recovery. Acting on this proposition, a call was made at the office of the loan company, with an offer to pay the note in question. The clerk politely informed us that the balance due on the note amounted to $30.60, but he was as politely told that that must be a mistake; that he was at liberty to accept the balance due on the original loan, plus legal interest, in full settlement. Quite taken aback, he retired to the room of the manager for consultation, returning in a few minutes with the request for us to see that gentleman. On his asking our business, he was in pointed language tendered payment plus legal interest, and after some hesitation accepted. The legal interest amounted to sixty cents, the usury charged was $15.70; thus saving a family who, through no fault of their own, were threatened with the loss of their home, $15.70, or enough to keep them from absolute want for a number of weeks.

This case was given publicity through the press, and resulted in a number of complaints being lodged next day at the Committee's headquarters, and in the appointment of the undersigned as a Committee of One, with power to investigate and prosecute cases of this character, and render such aid as circumstances might permit. To avoid any legal difficulty, authority was given to employ counsel, and it is with much pleasure that acknowledgment is here made of the valuable services rendered by Michael J. Ryan, Esq., who acted as counsel for the Committee, and who was ever ready to answer the many calls made upon him, and to give his time and able counsel without any charge whatever.

Meetings to hear complaints were held daily until May 18th. They were attended by as many as fifty or sixty complainants on a single day, and averaged perhaps eighteen persons, the total attendance being estimated at twenty-one hundred, quite a number calling several times. Of the complaints, a majority had to be ignored because they were beyond the province of the Committee; . . . Most of the refused cases were outlawed usurious interest, could, therefore, not be prosecuted, but cognizance was taken of five hundred and seventy-two complaints, and the result attending their prosecution is herewith given. While this Report may seem unnecessarily lengthy, the importance of the subject demands a full exposure of the manner in which one class of people live upon another, and it may thus, by fully exposing the subtle devices resorted to, assist in obliterating a crying evil.

HOW YOU CAN BORROW YOUR OWN MONEY

Of the many loan and brokerage companies that infest our city, bleeding honest and deserving people by exorbitant interest charges, or glittering promises of loans for a small consideration, The Commercial Loan and Trust Company, with an authorized capital of $500,000 has long been considered as one of the most artful, ensnaring, and dangerous. They have for several years past been watched with suspicion, and when the hard times materially increased the number of their customers, the conviction grew that some ingenious game was being played to gather in the lambs and shear them of what little wool they had left. . . .

Upon ascertaining that the Company was chartered under the laws of West Virginia, the Secretary of State of that Commonwealth was asked for a certified copy of their charter. The copy of this charter is printed in the equity and *quo warranto* proceedings against the Company, and it is a startling fact that one individual owned one hundred and ninety-six of the two hundred shares of $50 each, yet his name does not appear as one of the officers, while the remaining four shares are owned by four other persons. The capital subscribed for is $10,000; the paid-in capital, $1,000, while the authorized capital amounts to $500,000; thus banking with $1,000 on a credulous public to the extent of half a million dollars.

The story told by the victims is uniformly the same. The Company has a number of agents all over the city. These agents approach the unwary and tell them that, by subscribing to a bond of The Commercial Loan and Trust Company, and paying $2 weekly, they will within one or, at the latest, two weeks, be entitled to a loan of $100. When the victims make application for a loan, they are notified to offer a premium, and that the loan will be made to the highest bidder. The average premium, according to the statement of the secretary and treasurer, amounts to 55 per cent; in other words, a person wanting to borrow $100, has (if the loan is granted at all) $55 premium deducted, and receives only $45, but must sign and pay a judgment note of $100! In many cases, after the victims, who were in sore need of money, had paid in $50 or more, they secured a loan of $45, or really less than the amount they had paid in themselves. *Thus borrowing $45 of their own money,* and paying for the privilege of borrowing this, the sum of $100.

Nearly one hundred and fifty victims of the Company came to us for advice and relief, almost without exception people of refinement and intelligence, who, believing in the fair promises made, invested their last dollar (often borrowing the money) in the vain hope of securing a loan that might keep them from living on charity. . . .

SIXTY PER CENT A MONTH, SEVEN HUNDRED AND TWENTY PER CENT PER ANNUM

There are kinds and degrees in everything, and we found this to be the case among the money-lenders. While the average interest rate of so-called loan companies amounted to about 20 per cent a month, one individual was found who was not satisfied with such a moderate rate; his charges on first loans were about 60 per cent a month, or 720 per cent a year. To make this plain, his regular scale of interest on loans is hereby given:

For a loan of $10, he charges $19.50 in thirteen weeks.
For a loan of $15, he charges $29.25 in thirteen weeks.
For a loan of $20, he charges $39.00 in thirteen weeks.
For a loan of $25, he charges $48.75 in thirteen weeks.

As the money had to be repaid in weekly instalments, or on an average in less than seven weeks, the interest charges amounted to the enormous rate above stated.

This was not all the "banker" exacted from the poor borrowers, one of the terms of payment requiring that if the weekly dues were not paid by noon on a certain day a fine of $1 would be added, even if payment was tendered fifteen minutes after the stipulated hour! We have papers in our possession showing that some unfortunate people who could not pay the money on the hour were fined on a loan of $10, $3 or more, besides the $9.50 interest.

It is gratifying to be able to state that there was but one individual so utterly lost to all feelings of mercy and humanity, and in his case the most strenuous efforts were made to protect the poor victims. Unfortunately, a large number of the claims presented to us were outlawed, as usurious interest can be collected only within six months of its payment, and yet we were able, in the more than three hundred complaints lodged against the above concern, to either recover or save part of the usurious interest to the amount of $2,443.22, or stop the payment of the same by having the victim pay only the original loan plus legal interest, and of also securing two hundred and thirty judgments, amounting to $3,095, for excessive interest charges. . . .

TEN PER CENT A MONTH

One class of money-lenders confine themselves almost entirely to charging the small and easily calculated sum of 10 per cent per month, payable monthly, the principal to be kept as long as the interest is paid. A number of cases came to our notice, of which we will cite but one—enough to expose this mode of loaning money.

A woman who had borrowed $75 in October, 1891, had paid $7.50 a month until the total amount paid by her was $142.50. During the hard times last winter it was impossible for her to continue, and when her children found employment again in the early part of May, she called on the money-lender to get a statement of what she owed him, and was informed that she now owed seven months' interest, amounting to $52.50, and the original loan of $75, or a total of $112.50 (this after paying $142.50 interest on $75 in about two years). She visited our rooms to ask for redress. The money-lender on being called upon, not only for the surrender of the judgment note, but also for the recovery of the usurious interest, refused the latter, but on ascertaining that we were determined to bring the matter to an issue, agreed to return the judgment note of $75 without any further payment. Knowing that we could not recover the usurious interest, we accepted his proposition, thus saving the poor widow, who had to rely for her support on her children, the sum of $112.50 she would have been obliged to pay if the matter had not been taken up by our Committee.

We had a number of similar cases, one of which amounted to even a larger saving to the borrower, but this is a typical one and tells its own story. . . .

Summarizing the results of his activities, Mr. Blankenburg reported that 355 cases involving usurious loans from 13 lenders had been prosecuted. The total original amount of these loans was $14,393.50, or an average of about $40 each. The total amount of interest charged was $8,368.63. Since these loans were payable by instalments over an average period of seven weeks, the average rate of interest was 433 per cent a year. Of 123 loans made by one lender whose books were examined, the average amount lent was $17.10 and the average rate of interest was 720 per cent a year.[1]

Investigation of Lending in Atlanta

Several newspaper campaigns exposing the small loan business were undertaken during the years that followed the inquiry in Philadelphia. There was, however, no other investigation which had an official or semi-public character until that undertaken by the Fulton County Grand Jury in Atlanta in 1903. No written report of the Grand Jury appears to have been made, but the progress of the investigation was reported in detail in the Atlanta Constitution.

The investigation seems to have developed out of the killing of a Negro borrower by a bailiff making a levy for a lender, and its original purpose was to examine the relations between court officers and lenders of small sums. Shortly after the first meeting of the Grand Jury, the Atlanta Constitution[2] published a report of the seizure of the furniture of two young girls by a bailiff of a Justice of the Peace Court. The girls claimed that the bailiff had broken down the door of their apartment and had seized furniture worth several hundred dollars in the execution of a judgment for $15 held by a lender. It developed later that the furniture had been mortgaged without the knowledge of the girls by the father of one of them, who had borrowed to buy liquor. This story aroused a great deal of public indignation and spurred the Grand Jury's investigation. The Atlanta Chamber of Commerce passed resolutions urging a complete exposure of the small loan business.

In the first newspaper comment upon the Grand Jury's investigation there was no suggestion that the charges of those engaged in the small loan business were exorbitant. The Grand Jury, however, soon began to focus its attention upon the charges made for loans. On October 9 the Constitution reported the rates of charge

[1] Report of the Operations of the Citizens' Permanent Relief Committee, pp. 53–54.

[2] Issue of October 6, 1903.

that were prevalent in affidavits given by borrowers. These charges are as follows:

CHARGES ON LOANS REPAID IN INSTALMENTS WITH INTEREST

Amount of loan	Instalment payments required
$10	$1.50 for ten weeks
5	1.40 for five weeks
4	1.15 for five weeks
3	1.10 for four weeks
2	.75 for four weeks
1	.50 for three weeks

CHARGES ON LOANS NOT AMORTIZED

Amount of loan	Interest payments
$10	$3.00 a month
5	1.50 a month
4	1.00 a month
3	1.00 a month

Throughout the month of October, the Constitution referred by name to 22 companies engaged in the small loan business, and on November 3 it reported that 74 persons engaged in the business had been subpoenaed to appear before the Grand Jury. The usual amounts of loans reported by the Constitution were from $3.00 to $30 and the usual rates of charge ranged from 10 per cent a month on $30 loans to 50 per cent a month on loans of $3.00. Occasionally rates were even higher. One petitioner in bankruptcy is reported by the Constitution to have owed 16 loan companies a total of $102. The petitioner stated that the total annual interest charge on these loans amounted to $673.20.

Characteristics of the Small Loan Business, 1890 to 1910

It is probable that neither the Grand Jury investigation in Atlanta nor the Blankenburg investigation in Philadelphia covered a representative cross-section of the small loan business in those cities. Mr. Blankenburg explained that

> comparatively few complaints were made, many companies in active operation not being on our list and the complainants being mainly those who were by sheer necessity compelled to ask counsel and assistance. The

overwhelming majority of the unfortunate are unknown to us, and prefer to suffer even if it almost crushes them, rather than expose their affairs.[1]

It seems probable that lenders coming to the attention of investigators in Philadelphia and Atlanta were those who charged the highest rates and were the least ethical in their dealings with borrowers. In many other communities there were lenders who charged lower rates than those referred to in these investigations, who avoided harsh collection pressure when borrowers obviously could not pay, and who relied to a considerable extent on goodwill of customers for the continuation of their businesses.

For a description of the characteristics of the small loan business as a whole during the period from 1890 to 1910, we are compelled to rely, for want of other sources of information, on the recollections of men who knew the business at that time. They are, for the most part, lenders or attorneys associated with the business. Toward the close of this period the information concerning the small loan business was greatly augmented by the studies of Clarence W. Wassam[2] and Arthur H. Ham,[3] which were published in 1908 and 1909. Dr. Wassam studied the salary loan business; Mr. Ham, the chattel loan business. The circumstances under which these studies were made and the conclusions formulated by the investigators will be discussed in Chapter IV.

Size of Loans. The size of loans made by lenders on chattels, salaries, and unsecured notes covered a wide range. In general, wage assignment and unsecured loans were for smaller amounts than chattel loans, but the majority of loans of all three types were between $10 and $60. Wage assignment loans varied between $5.00 and $100 although they rarely exceeded $50. An analysis given by Wassam[4] of 310 applications for loans from a single salary lender in Philadelphia in 1907 suggests an average of approximately $25, with 83 per cent of the applications falling between $10 and $30 inclusive. Only five applications were for more than $50 and none exceeded $100. Chattel mortgage loans ranged be-

[1] Report of the Operations of the Citizen's Permanent Relief Committee, pp. 54–55.

[2] Wassam, Clarence W., The Salary Loan Business in New York City. Charities Publication Committee, New York, 1908.

[3] Ham, Arthur H., The Chattel Loan Business. Charities Publication Committee, New York, 1909.

[4] The Salary Loan Business in New York City, p. 137.

tween $10 and $300. An analysis of 710 loans of a company lending on household furniture in Philadelphia in 1907 showed that 70 per cent were between $10 and $30, 16 per cent between $31 and $50, 11 per cent between $51 and $100, and 4 per cent exceeded $100. The average loan was about $35.[1]

The size of unsecured loans ran the whole range from $5.00 to $300, depending on location, occupation of the borrower, and rate of interest charged.

Estimates by lenders of the size of loans during this period are usually somewhat higher than the averages of the single salary and chattel companies mentioned above. The chattel loan company referred to was probably one of those charging higher rates and making smaller loans. Many chattel lenders had a much larger proportion of loans above $50, and several chain companies lending on chattel mortgages are said to have made loans averaging $60 or $70.

In making any comparison between the size of these loans and those now made by such lenders, as we shall see in a later chapter,[2] the change in the level of prices must be kept in mind. Following the Civil War prices were falling until about 1896 and rose gradually thereafter until 1916 when a rapid increase began. Roughly speaking, we can assume that the size of loans may vary with changing price levels without changing their nature and purpose.

Rates of Charge. The rates of interest charged by lenders varied considerably. One large chattel loan company that operated in nearly all the important cities of the East and Middle West charged 10 per cent a month on loans under $50, and lower rates as the loan increased in size. The charge for $100 was about 6 per cent a month. One lender, who had been in the business in the days before any reform was brought about, told the authors that "legitimate" firms customarily charged 10 per cent a month. Legitimate did not mean lawful, but rather what is understood by the term "conservative." Salary lenders charged more, usually double the rate of chattel lenders. They claimed that their risks were greater and therefore required a higher rate. Some concerns dealing in both chattel and salary loans conducted, as one man put it, "a kind of curbstone business" at rates which varied with the security, size

[1] *Ibid.*

[2] See pp. 175–177.

of the loan, and necessity of the borrower, between 10 and 40 per cent a month. The Ham and Wassam reports quoted rate cards of both salary and chattel loan companies which showed rates varying between 100 and 700 per cent a year. It should be said, however, that the loans made at the higher rates were usually very small, ranging from $5.00 to $20, and the risk great.

We must not be misled by the rates charged by lenders who were operating on the fringe of the business. The testimony of responsible loan men is that 10 per cent a month was the prevailing rate in the chattel loan business on loans under $50, somewhat less than 10 per cent a month on loans from $50 to $100, and from 5 to 7 per cent a month on loans from $100 to $300; and that the usual rate on salary loans was 15 to 20 per cent a month, mainly on loans of less than $50. In the table which follows, an attempt has been made to summarize the information on rates which appeared in the leading newspapers of 40 cities in which loan-shark crusades occurred during the period from 1887 to 1922.

TABLE 3.—RATES OF INTEREST CHARGED BY LENDERS IN VARIOUS CITIES, COMPILED FROM NEWSPAPER REPORTS OF LOAN-SHARK CRUSADES, 1887 TO 1922

City	Year	Rate of interest
Boston, Mass.	1887 to 1888	3 to 10 per cent a month
" "	1908 to 1909	No rates reported
" "	1911	180 per cent a year; 200 to 300 per cent a year
" "	1915 to 1916	15 per cent a month prevailing on $10 or less; 8 to 10 per cent a month; 200 per cent a year
Kansas City, Kan.	1893 to 1894	10 per cent a month
Philadelphia, Pa.	1893 to 1894	10 to 60 per cent a month
" "	1908 to 1910	20 per cent a month; 120 to 200 per cent a year
Providence, R. I.	1895 to 1898	5 to 12 per cent a month
Toledo, Ohio	1897	10 per cent a month
Kansas City, Mo.	1902	10 per cent a month
Atlanta, Ga.	1903	3, 10, 20, and 33 per cent a month; 473 to 1,733 per cent a year
Milwaukee, Wis.	1905	120 to 400 per cent a year
" "	1910	110 per cent a year
Detroit, Mich.	1906 to 1907	88 per cent a year
Pittsburgh, Pa.	1908 to 1909	72 to 300 per cent a year

Table continued on following page.

TABLE 3.—RATES OF INTEREST CHARGED BY LENDERS IN VARIOUS CITIES, COMPILED FROM NEWSPAPER REPORTS OF LOAN-SHARK CRUSADES, 1887 TO 1922 *continued*

City	Year	Rate of interest
Washington, D. C.	1908 to 1910	10 to 25 per cent a month; 42 to 498 per cent a year
" "	1913 to 1914	10 per cent a month
" "	1915 to 1916	130 to 365 per cent a year; 10 per cent a week; 10 and 20 per cent a month
Baltimore, Md.	1909	180 per cent a year
Chattanooga, Tenn.	1910 to 1911	200 to 350 per cent a year
Memphis, Tenn.	1910 to 1911	10 to 25 per cent a month; 500 and 600 per cent a year on loans less than $5.00
San Francisco, Calif.	1910	3 to 10 per cent a month
Jackson, Tenn.	1911	480 per cent a year
Chicago, Ill.	1911 to 1913	5, 10, and 12 per cent a month; 185 to 400 per cent a year
Cincinnati, Ohio	1911 to 1912	60 to 140 per cent a year
Houston, Tex.	1911	20, 50, and 100 per cent a year
Knoxville, Tenn.	1911	240 to 300 per cent a year
New York, N. Y.	1911	50 to 400 per cent a year
" "	1912 to 1913	200 per cent a year
Duluth, Minn.	1912 to 1913	10 per cent a month
Birmingham, Ala.	1912 to 1913	10 per cent a month
Detroit, Mich.	1912 to 1913	100 to 300 per cent a year
Indianapolis, Ind.	1912	120 to 1,500 per cent a year
Nashville, Tenn.	1912	120 per cent a year
Portland, Ore.	1912	30 to 40 per cent a month
Providence, R. I.	1912	11 to 16 per cent a month, plus fees
St. Louis, Mo.	1912 to 1913	100 to 300 per cent a year
Bristol, Tenn.	1913	25 per cent a month; 240 per cent a year
Columbus, Ohio	1913	4 to 20 per cent a month
Fort Worth, Tex.	1913 to 1914	20 per cent a month to whites; 30 per cent a month to Negroes
Dubuque, Iowa	1913	250 per cent a year
Galesburg, Ill.	1913	70 to 100 per cent a year
Richmond, Va.	1914	120 per cent a year
Salt Lake City, Utah	1914	10 per cent a month; 240 to 287 per cent a year
Louisville, Ky.	1915	120 per cent a year
" "	1917	100 to 600 per cent a year
Oklahoma City, Okla.	1916	126 per cent a year
Bisbee, Ariz.	1917	10 per cent a month
New Orleans, La.	1922	As high as 600 and 1,700 per cent a year

Court records of the same period show a similar range of interest charges. Five cases occurring within this period, cited by the authors of Small Loan Legislation,[1] show interest rates of 120, 260, 360, 650, and 1,300 per cent a year.

[1] Gallert, Hilborn, and May, Small Loan Legislation. Russell Sage Foundation, New York, 1932, p. 54.

Terms of Repayment. There was a great diversity in terms of repayment. Each lender was a law unto himself, and each adjusted his payment schedule to the income of his client, usually, however, to suit himself. Some concerns made loans on a monthly extension plan, that is, a loan would be made for one month with the privilege to the borrower of extending it each month by the payment of the interest or the commission as it was then called. Most "extension-plan" loans in the nineties and earlier were for a period of six months, and an extra charge of from $2.50 to $3.00 was made for "papers" when the loan was extended at the end of six months. Interest on such loans was paid monthly, but no special effort was made to collect any of the principal, at least until the loan had been renewed several times. Often loans were renewed many times, and on each renewal there was added a new charge for papers. When the borrower had renewed a number of times and had shown a disposition to question the interest he was paying, to calculate how much he had paid, to complain of the charges, or to be slow in his payments, an effort would be made to switch the loan to another lender. In this way the borrower would have a fresh contract and would be in a different frame of mind, as the new lender had certainly lent him a sum of money upon which he had paid nothing. It was a common practice to do this, not only between affiliated offices, but between independent lenders who had come to some understanding on the subject.

In this connection it seems appropriate to mention a pirate organization that flourished for a few years about 1895 or 1896 in Chicago, which resembled the modern "highjacker." Representatives of this organization would look for borrowers whose loans had been extended several times so that renewal charges equaled or exceeded the original principal. The representative would tell the borrower of his own organization, claiming that it was established to relieve people who were paying extortionate rates and offer to take up the loan at the legal rate. If the borrower agreed, he and his wife were instructed to call at the office and sign papers. Among the papers signed was a specific power of attorney to settle the loan with the original lender. The borrower was then told that his old papers would be obtained and mailed to him. The representative of the pirate concern, armed with the power of attorney, would call upon the original lender, tender a dollar or two, or at most a small amount compared with what the lender claimed was due, and demand return of the borrower's papers. Legally the original lender could claim only the principal with lawful interest, both of which had been paid. All that the pirate could collect on his note was clear profit. The scheme worked at first, and the pirate organization obtained many good notes and mortgages for very small payments. If the lender refused to deliver the papers, suit was often brought in the name of the borrower to secure them.

The pirate organization failed largely by reason of the desire of borrowers to meet in full their contractual obligations. A determined stand was finally taken by lenders and no papers were delivered. Instead, a representative was sent to the home of the borrower, the scheme fully explained to him, and power of attorney to transfer the loan back to the original lender was secured. The loan was then renewed on the old terms, if possible, or at a lower rate if the borrower demanded it as a condition to transferring the loan. In some cases no more interest was charged, but the borrower was required to pay the principal as rapidly as he could.

As a rule, loans were made for a definite period of time and the amount of monthly or weekly payments was determined by dividing the sum total of the principal and interest by the number of weeks or months that the loan had to run. Naturally the payments that could be exacted under the scheme had to be small and had to coincide in point of time roughly with the payment of wages or salary of the borrower. The size of the loan affected the period of repayment. For the borrower, a loan contract which called for amortization of principal and interest over a definite period was preferable. Under the extension plan, he very often found it extremely difficult to pay off any of the principal, and his loan remained unpaid for years. With definite payments, which included both interest and principal, payable each week or month, the borrower usually paid off his loan.

But the variety of schemes of payment was well-nigh endless. Some of the more disreputable lenders deliberately set the terms of the bargain in such a way as to keep the borrower perpetually in debt. This was accomplished by making the final payment much larger than any of the others. As the borrower could not meet this, he was compelled continually to renew, paying further commissions or charges for papers and remaining so deeply in debt that his chances of finally shaking off his burden were slight.

Capital of Small Loan Offices. The amount invested in individual loan offices usually ranged from about $3,000 to $60,000, depending on the size of the city in which the office was located and business conditions of the time, on type of security and size of loans, and on the limits to the lender's available capital. Chattel loan offices were generally much larger than salary and plain-note offices. One man who has been in the chattel loan business for many years has written to the authors as follows:

> In 1883–1884 Minneapolis had about 75,000 inhabitants and the office had about $60,000 invested, upon which an excellent return was received. Times were good; in fact, were booming. In 1885–1886 the reaction set in and the bottom dropped out of everything and the losses in the loan business were very large. Because of these losses and the pursuing of a more conservative policy in making loans, the investment went down to about $20,000 and remained at that figure for several years with a reduction of income almost to the vanishing point.

It was customary for a chain company to have more than one office in the same city. On this point the lender quoted above writes:

> It was found—why it should be I could never understand—that after a certain amount was put out in an office, it was absolutely impossible, in spite of every effort that was known in those days to do so, to increase the investment beyond that figure. Whereas, another office could be started in the same town and with less effort and without in any way interfering with or lessening the business of the first office, and in a comparatively short period of time, have as large an investment as the older office.

Summarizing the published data and recollections of lenders concerning the amount of capital invested in small loan offices during the period from 1890 to 1910, it seems safe to conclude that the usual investment in chattel loan offices was between $15,000 and $60,000, and in salary loan offices between $5,000 and $25,000. There were, however, many exceptions to this generalization. A few chattel offices appear to have had as much as $80,000 of capital and some offices had insignificant sums invested. During the late nineties when the profits that could be made in the small loan business, especially in the salary loan business, began to be noised about, loan offices sprang up in the cities overnight like mushrooms. There are tales of chain salary lenders sending managers into new territory with $1,000 of capital and expecting them to rent an office, buy furniture, pay salaries, and conduct a paying business without more capital. If this be true, these lenders must certainly have charged as much as the traffic would bear.

The investment in individual offices must not be confused with the amount which the owner had invested in the business. For the most part, individual offices were units of chain systems. By 1910 there were several men, both in the chattel loan and in the salary loan businesses, who had from one to two million dollars invested.

With very few exceptions, the capital of the small loan business belonged to individual lenders. Loan offices were seldom incorporated and consequently no stocks or bonds were offered for sale. The first lender to increase his capital through the sale of securities to the public was John Mulholland to whom we have already referred. Occasionally a lender induced some wealthy person to put money in his business as a silent partner. Usually, however, a large proportion of the lender's capital had been made in the small loan business itself from a very small original investment.

Profits. While the gross income of lenders at prevalent interest rates was high, the extent of net profit depended upon many factors. Loan-shark campaigns caused lenders large losses where the legal standing of their notes or their security was questionable. Local or general business slumps could increase losses heavily. It is probable that the degree of experience and shrewdness of the lender and the extent to which he was willing to press borrowers to the limit of his contract affected profits as much as variations in the rate of charge. The large concerns that were built up from original investments are sufficient evidence that to the clever lender who charged high rates the business was enormously profitable.

Dr. Wassam wrote as follows of profits of the salary loan business in 1907 and 1908:

Many instances could be cited to give an idea of the profitableness of the salary loan business. The owner of a prominent office in the city recently offered to guarantee a young man $10,000 net profit per year if he would invest $8,000 in an office. He said he was almost certain that the returns would be much larger. A careful examination of the books of one of the offices in the city showed that in one month a net gain of $541 was realized upon loans aggregating $1,889, a clear profit of 28.64 per cent in one month. Based upon this rate of profit, the annual net income from an office with $10,000 capital would be $34,368. An owner of two large offices in the city is authority for the statement that a friend of his began business in New York City about three years ago with $25,000. Recently he was offered $60,000 for his three offices and in the meantime he has placed $75,000 to his credit in the bank, making $110,000 clear profit in addition to his living expenses, in the three years upon a capital of $25,000. Several of the men who have a large number of offices and are doing a very extensive business began with a small amount of capital and have been in the business only a short period of time. It is the belief of a number of the employes of D. H. Tolman that he began the business of loaning money on salaries a few years ago with practically no capital and today he is many times a millionaire with offices in all the principal cities of the United States and Canada.[1]

The most complete record of the earnings of a small loan office which has been available to the authors is a balance sheet and income statement, covering the period October 1, 1904, to April 26, 1913, for an Ohio office of a chain company, which came into the possession of the Department of Remedial Loans of the Russell Sage Foundation. This office lent chiefly on chattel mortgages but made some salary loans and a few pledge loans. The average investment was $8,000. The gross profit for the eight and one-half-year period was $99,000 and the net profit $31,000. By dividing the net return by the number of years covered, we arrive at an annual earning rate of 46 per cent. Because earnings were apparently withdrawn regularly, the effect of compounding on the rate of return is slight and this figure can be accepted as a fairly accurate statement of the annual earning capacity of this office during that period. Although a larger loan balance would undoubtedly have produced higher earnings, it is probable that this example is more typical of the earnings of the rank and file of lenders over a

[1] The Salary Loan Business in New York City, pp. 41–42. For a lender's financial statement, see also Appendix XXIX in the same volume.

period of years than those to whom Dr. Wassam refers. It must be borne in mind, however, that this was principally a chattel loan office and those which Dr. Wassam described were salary loan offices. The profits of salary lenders appear to have been generally higher than those of chattel lenders.

Scope of the Small Loan Business. It would be impossible to say how large was the total amount invested in the salary and the chattel loan business during this period. The Department of Public Welfare of Chicago reported that 139 loan companies were actively engaged in lending money in the city of Chicago on November 1, 1916.[1] The report estimated the average annual volume of business of each at $85,000. This would mean that the volume of business in this one city amounted to approximately $11,000,000 a year. Dr. Wassam's estimate of the annual volume of salary loans in New York in 1907 was considerably lower. He estimated the annual volume of 30 known offices at $1,200,000 but suggested that the actual volume was much larger.[2] Volume of business and amount invested are not the same; one must allow for turnover which in those days was certainly much higher than it is now. Mr. Ham estimated in 1911 that in every city of 30,000 or more population, one lender would be found for every five to ten thousand people.[3]

Lenders, themselves, did not know how much capital was invested in the small loan business. There was no organization of lenders either for the exchange of such information or for the general promotion of the business. Those engaged in the small loan business were complete individualists, trusting few and certainly not their competitors. Hence there was no way for anyone to obtain a picture of the business as a whole. Its magnitude can only be guessed.

The small loan business did develop a form of organization occasionally where conditions were especially favorable. This was the clearing house or central credit information exchange. The first one of which we can find any trace was organized in Indian-

[1] Eubank, Earle Edward, The Loan Shark in Chicago. Department of Public Welfare, Chicago, Bulletin no. 4, vol. 1, November, 1916, pp. 9–10.

[2] The Salary Loan Business in New York City, pp. 24–26.

[3] Ham, Arthur H., "Remedial Loans as Factors in Family Rehabilitation." In Proceedings of National Conference of Social Work, Boston, 1911, p. 305.

apolis about 1899. Its purpose was to enable lenders to secure information quickly concerning prospective customers and to protect themselves from non-paying borrowers. When an application for a loan was made, the lender immediately registered the name of the applicant with the exchange. If the applicant ever had been registered by another lender, the exchange at once communicated this fact to the lender making the inquiry, furnishing any other information available from the files. Every precaution was taken to prevent one member from obtaining a list of his competitors' customers. No information was given out by the exchange unless actually called for by a member. If a borrower patronized only one loan company, other loan companies would never hear of him. This association of lenders, taking its cue from the small loan business, worked in an inconspicuous way; no name appeared on the door of the office and its telephone number was not listed in the telephone book. Only the member loan companies knew what it was or why it existed.

Credit information exchanges developed in a few other cities, but so great was the determination of each lender to keep his business absolutely to himself that as a rule these seldom continued to exist for any length of time. Consequently they afforded little means of bringing lenders into contact with one another.

The Small Loan Business and the Law

In view of the laws regulating the rate of interest, the question naturally arises as to how a small loan business could be carried on at such exorbitant rates. Let us therefore consider these laws in relation to the small loan business.

With minor exceptions the general laws governing interest rates were the same during the period from 1890 to 1910 as now. The "legal rate" is intended primarily to enable courts to decide what interest is due in cases where no rate has been specified in the terms of the contract. These legal rates range from 5 to 8 per cent a year, 6 per cent being most common. With the exception of Colorado, Maine, Massachusetts, and New Hampshire, each state also provides a "maximum contract rate of interest," that is, the maximum rate which, if agreed to by borrower and lender, can be enforced at law. This rate in all but 11 states is higher than the legal rate, and five states have a maximum of 12 per cent a year. Table 4 shows the legal and contract rates in effect in 1932, and the penalties for excess charges.

Few of the general interest statutes provide any penalty other than the loss of interest or of excess interest for charging more than the contract rate. The percentage of contested cases has always been small, and since the lender could collect his principal in all but six states even if the matter were carried to court, he was in a most advantageous position. Even severe penalties, however, did not prevent lenders of small sums from exacting interest in defiance of these laws. High-rate lenders have long operated and continued to operate in Minnesota where the penalty for usury is loss of the entire principal of the loan.[1]

It was generally easy enough to get around these laws by subterfuge. Charges over and above the maximum interest rate allowed by law were frequently concealed as fees and costs for papers. Another scheme for avoiding maximum interest regulations was the charging of a commission for guaranteeing the notes of prospective borrowers. The money was then lent on the notes at the contract rate allowed in the state by a second concern having ostensibly no connection with the concern guaranteeing the notes but actually operating as one with it. There were also fines for delayed payments, notary fees, and fees for notice, protest, and collection. Occasionally, the interest charge was covered up by selling the borrower a watch or a ring at the time the loan was made. The interest charged on the loan was at the legal rate but the sale of the jewelry netted an enormous profit. Sometimes the borrower was compelled to buy insurance at an unusual premium which gave the lender additional compensation. Rarely did the professional lender find the law an unsurmountable obstacle. He learned that legal penalties were for those who did not know how to evade the law. Laws fixing legal and contract rates of interest did not prevent him from charging under one guise or another whatever rate his sense of adequate profit demanded or the traffic would bear.

[1] Report of the Interim Committee on Small Loan Legislation, Minnesota House of Representatives, 1929, p. 11.

TABLE 4.—LEGAL AND MAXIMUM CONTRACT INTEREST RATES, AND PENALTIES FOR EXCESS CHARGES, PROVIDED BY STATUTES IN EFFECT IN 1932, BY STATES[a]

State	Legal rate: per cent a year	Maximum contract rate: per cent a year	Civil penalty for excess charges	Criminal penalty for excess charges
Alabama	8	8	Forfeiture of interest	None
Arizona	6	10[b]	Forfeiture of interest	None
Arkansas	6	10[b]	Forfeiture of principal and interest	None
California	7	12[b]	Borrower may recover treble excess interest paid	Fine or imprisonment or both if charges exceed 12 per cent a year and certain fees
Colorado	8	None	None	None
Connecticut	6	12	Forfeiture of unpaid principal and interest	Fine or imprisonment or both
Delaware	6	6	Forfeiture of excess interest unless borrower is a corporation	None
Dist. of Col.	6	8[b]	Forfeiture of interest	None
Florida	8	10[b]	If unpaid, forfeiture of interest; if paid, borrower may recover twice the excess interest paid	Fine or imprisonment or both if interest exceeds 25 per cent a year
Georgia	7	8[b]	Forfeiture of interest	Taking interest in excess of 5 per cent a month punishable as a misdemeanor
Idaho	7	10[b]	Forfeiture of interest	None
Illinois	5	7[b]	Forfeiture of interest unless borrower is a corporation or loan exceeds $5,000	None
Indiana	6	8[b]	Excess interest uncollectible	None
Iowa	6	8[b]	Forfeiture of interest; borrower to pay 8 per cent interest to county school fund	Fine or imprisonment if interest exceeds 2 per cent a month on loans of $300 or less
Kansas	6	10[b]	Forfeiture of excess interest and part of principal and legal interest equivalent to excess interest	None
Kentucky	6	6	Excess interest uncollectible	None
Louisiana	5	8[b]	Excess interest uncollectible	None
Maine	6	None	None	None
Maryland	6	6	Excess interest uncollectible unless borrower is a corporation	None
Massachusetts	6	18[c]	Excess interest uncollectible on loans of less than $1,000	None

[a] Summarized from Digest of Personal Finance Laws, by Renah F. Camalier. Published by American Association of Personal Finance Companies, Washington, D. C., 1932.
[b] In written contracts.
[c] On loans of less than $1,000; none on larger loans.

TABLE 4.—LEGAL AND MAXIMUM CONTRACT INTEREST RATES, AND PENALTIES FOR EXCESS CHARGES, PROVIDED BY STATUTES IN EFFECT IN 1932, BY STATES[a] *continued*

State	Legal rate: per cent a year	Maximum contract rate: per cent a year	Civil penalty for excess charges	Criminal penalty for excess charges
Michigan	5	7[b]	Forfeiture of interest	None
Minnesota	6	8[b]	If unpaid, forfeiture of principal and interest; if paid, borrower may recover full amount of interest paid, half of which must be paid to school fund	Punishable as misdemeanor
Mississippi	6	8[b]	Forfeiture of interest if between 8 per cent and 20 per cent. Forfeiture of principal and interest if 20 per cent or more	None
Missouri	6	8[b]	Excess interest uncollectible	Fine and imprisonment if charges exceed 2 per cent a month
Montana	8	10[b]	Forfeiture of twice the interest charged	None
Nebraska	7	10	Forfeiture of interest	None
Nevada	7	12	Excess interest uncollectible	None
N. Hampshire	6	None	None	None
New Jersey	6	6	Forfeiture of interest unless borrower is a corporation	None
New Mexico	6	10[d]	If unpaid, forfeiture of interest and part of principal equal to legal interest; if paid, forfeiture of part of principal equal to the interest accrued and unpaid, and twice the interest paid	Fine or imprisonment or both
New York	6	6	Forfeiture of principal and interest unless borrower is a corporation or loan is for $5,000 or more on collateral security	None
N. Carolina	6	6	If unpaid, forfeiture of interest; if paid, borrower may recover twice the interest paid	Punishable as misdemeanor if loan is secured by household furniture or assignment of wages
North Dakota	6	9[b]	Forfeiture of interest; if paid, borrower may recover twice the interest paid	Fine or imprisonment or both

[a] Summarized from Digest of Personal Finance Laws, by Renah F. Camalier. Published by American Association of Personal Finance Companies, Washington, D. C., 1932.
[b] In written contracts.
[d] 12 on unsecured loans.

TABLE 4.—LEGAL AND MAXIMUM CONTRACT INTEREST RATES, AND PENALTIES FOR EXCESS CHARGES, PROVIDED BY STATUTES IN EFFECT IN 1932, BY STATES[a] *continued*

State	Legal rate: per cent a year	Maximum contract rate: per cent a year	Civil penalty for excess charges	Criminal penalty for excess charges
Ohio	6	8[b]	Excess interest uncollectible	None
Oklahoma	6	10	Forfeiture of twice the interest paid or contracted for	None
Oregon	6	10	Forfeiture of principal to school fund and interest, if paid, to the borrower	None
Pennsylvania	6	6	Excess interest uncollectible unless borrower is a corporation	None
Rhode Island	6	30[c]	Forfeiture of principal and interest	Fine or imprisonment
South Carolina	7	8[b]	If unpaid, forfeiture of interest; if paid, borrower may recover twice the interest paid	None
South Dakota	7	10[b]	Forfeiture of interest	Punishable as misdemeanor
Tennessee	6	6	Excess interest uncollectible	None
Texas	6	10[b]	If unpaid, forfeiture of interest; if paid, borrower may recover twice the interest paid	None
Utah	8	12[b]	Forfeiture of principal and interest	Punishable as misdemeanor
Vermont	6	6	Excess interest uncollectible except on certain kinds of contracts	None
Virginia	6	6	Forfeiture of interest unless borrower is a corporation	None
Washington	6	12	If unpaid, forfeiture of part of principal equal to the interest contracted for; if paid, forfeiture of part of principal equal to the interest accrued and twice the interest paid	None
West Virginia	6	6	Excess interest uncollectible	None
Wisconsin	6	10[b]	If unpaid, forfeiture of interest; if paid, borrower may recover treble the excess interest paid	Fine or imprisonment or both
Wyoming	7	10	Forfeiture of interest	None

[a] Summarized from Digest of Personal Finance Laws, by Renah F. Camalier. Published by American Association of Personal Finance Companies, Washington, D. C., 1932.
[b] In written contracts.
[c] On loans over $50; 30 to 60 on smaller loans.

Basis for Existence of the Business

In spite of everything that has been said relative to law or lack of law, the smallness of the loans, and the absence of reliable security, the business rested on the firm foundation of the borrower's necessity. The borrower had nowhere else to turn when he needed money. There was no choice open to him when he borrowed and he saw no alternative in the future. The crude lending agencies which we have described constituted the only financial resort he had or was likely to have. Knowing this, the borrower would not wittingly offend the only man who stood ready to help him out. Certainly, the lender's purpose was to make a profit, and frequently an unconscionable one, but he did furnish money when no other agency would. The great majority of borrowers, therefore, found it to their advantage to make payments when they could.

We must keep in mind too that the borrower was ignorant of his rights under the law and even when he knew them he had usually no means of obtaining redress. In the first place he lacked the necessary funds to hire a lawyer and to fight his case through the courts; in the second place, it was customary for the lender to take his cases before magistrates, who, if not actually paid by him, could be relied upon to give favorable judgments for the sake of the court fees which these suits brought.[1] It is true that some cases were fought by legal aid societies and other agencies, but the illegal loan contracts that were brought to their attention were an insignificant proportion of the total number.

In the case of salary loans, the attitude of many employers contributed greatly to the security of the lender. Many employers took the attitude that an employe who borrowed on his salary must be a hapless spendthrift whose debt to the loan company was good evidence that he was an unreliable employe. They therefore adopted the policy of discharging employes who borrowed from loan companies whenever a claim was filed against their wages. This policy played directly into the hands of the salary lender, who by the mere threat to file a claim against the wages of the borrower

[1] This continues to be a common abuse in Justice of the Peace Courts in which the justice is compensated by fees from cases coming before him. Action to collect loans is initiated by creditors and the justice is inclined to favor the plaintiff because to offend the person who initiates the suits might lead him to enter his actions elsewhere.

would compel him to stretch his small resources to the limit to pay his obligations. On the other hand, some large industrial plants and railroad corporations, in the prime of the salary loan business, had men in their legal departments who devoted full time to fighting wage assignments that were filed against employes by salary lenders. This eventually became one of the principal reasons why representatives of these companies lent support to campaigns against loan sharks. They were not so much interested in the welfare of their employes as they were in ridding themselves of the growing nuisance of either defending, or else recording, collecting, and disbursing wage executions.

The lender relied too on other devices to force the borrower to pay his loan. He made use of the social stigma that goes with being in debt. It is no disgrace for a business man to borrow. In many instances it is even a sign of reliability and credit worth. But such is not the case with borrowers of small sums. People of small means feel keenly a loss of social standing when their friends and neighbors learn that they are in financial difficulties. This is the reason why lenders insisted in their advertisements that no one would know about the loan, that it would be entirely confidential. The risk of neighborhood disgrace was a powerful weapon for collection in the hands of the lender. As the borrower fell farther and farther behind in his payments the lender struck harder and harder at his social standing. The envelopes which the lender used began to be adorned with the name of the company, with phrases indicating pretty clearly what was inside. One loan concern, it is said, would send a large moving van emblazoned with the name of the company to the door of a delinquent borrower so that all the neighbors would know about the debt. The driver would threaten loudly to load the man's furniture in it at once if he did not pay up. Some salary loan concerns employed "bawlers out" who visited delinquent borrowers at their places of employment and shouted abuse at them.[1]

In the course of time there developed a technique of dealing with borrowers that can be likened to that which politicians acquire.[2]

[1] Halsey, Forest, The Bawlerout. Desmond Fitzgerald, Inc., New York, 1912, pp. 1–18.

[2] Eubank, Earle Edward, The Loan Shark in Chicago, p. 18.

It comes from a knowledge of human nature and long practice in playing on the fears, passions, and motives that govern men. Some lenders even got together and printed for the use of their office managers bits of psychological knowledge that had been gleaned in lending and collecting money. The following are samples:

> The foundation and success of our business depends upon getting accurate and reliable reports. The proper time to find out about a customer is before we part with our money and managers can save fully three-fourths of their labor of running after delinquents and fully three-fourths of these losses by "skips" [borrowers who have moved without notice to the lender] and "out of works" by making proper investigations in the start.
>
> Managers should not refuse to loan customers again *who do pay* simply because they have had some unpleasant words or from any prejudice as they are in part what constitute our good business; our losses come from those who may treat you nicely but who never pay.[1]

Lenders relied too on the sense of honor which working classes possess in no small degree. A bargain was a bargain, and however hard it was, the borrower could generally be depended upon to try to carry it out. If once one gets away from the notion that people who patronize the small loan business belong to the good-for-nothing class, he can understand far better why it was that the notes and documents that would not stand a genuine test of law were yet honored by the men and women who signed them.

Causes of Anti-Social Lending Conditions

The causes of the unfortunate conditions in the small loan business during the period prior to 1910 are to be found in deep-rooted traditions concerning interest-taking. The relaxation in the historic, religious, and temporal prohibitions against a charge for loans had extended only to loan transactions which could be made cheaply in terms of rate of interest. The public, thinking of interest purely as a rental and not as rental plus the cost of completing the transaction, saw no reason for different rates of interest for different kinds of loans. In fact, many people felt that the borrower of small sums for consumptive purposes should pay less,

[1] From D. H. Tolman's instructions to his loan managers, lent by L. C. Harbison of Chicago.

certainly not more, than the one who borrowed for productive purposes. The difficulty in carrying out this worthy sentiment was one of economic fact: it costs more to make consumptive loans and get the money back than to make and enforce payment of larger productive loans. The salary and chattel loan businesses could not be conducted at banking rates; hence a public opinion that insisted, through laws and attacks of various kinds, that they must be so conducted could have but one result—the charging of still higher rates to offset the additional risk involved in an illegal and opprobrious business. The failure of the public to legalize rates at which lenders could carry on their business was a mistake that cost the borrowing classes dearly. It restricted the flow of capital into the small loan business and it drove the business underground and forced lenders to resort to all kinds of expedients to get around the law.

There is no desire here to excuse or condone the acts of lenders. Had many been less prone to exact the last farthing from unfortunate debtors, the public would sooner have come to appreciate the necessary part they play in our social and economic life as it is at present organized. As it was, the men who undertook to deal fairly with their customers, and there were several such, received no recognition and the name "loan shark" was applied to all alike.

It must be remembered too that a process of natural selection went on among those who remained in the business. Men who went into it either cared little for the opinion of their fellow-men or contrived to hide their occupation. The business, even when not positively illegal, carried so much public scorn that only the thick-skinned engaged in it, or remained in it for any length of time. Many employes of loan offices, no doubt, grew hard and cynical under pressure of owners who, while carefully avoiding the seamy side of the business themselves, had no hesitation in forcing their employes to press delinquent borrowers to the very limit.

CHAPTER IV

EARLY REMEDIAL EFFORTS

The First Regulatory Laws

THE conditions surrounding the small loan business during the loan-shark era had not gone unnoticed. Legislatures had frequently attempted remedies. New Jersey, as we have already pointed out, as far back as 1884 sought to protect its wage-earners by prohibiting wage assignments given to secure loans which bore a rate exceeding the general statutory maximum, which was then 8 per cent a year and by providing a $500 fine for infraction.[1] This penalty, however, was not extended to loans secured by other than wage assignments. Missouri in 1891 invalidated the pledge or mortgage of personal property given to secure loans on which interest was usurious.[2] Similar laws were passed in Maryland in 1894 and in Wisconsin in 1895.[3]

Massachusetts was the first state to attempt to bring all small loans under regulation by special statute. It was one of the few states which permitted freedom of contract in interest rates, but by an act of 1888[4] it modified this policy in respect to loans of $1,000 or less by limiting interest chargeable on such loans to 18 per cent a year with a fee of $10 for actual expenses and a minimum charge amounting to six months' interest regardless of the term of the loan. When applied to very small loans for short periods of time, this law was scarcely restrictive. Rather by means of the minimum charge it enabled lenders of small sums for short periods to charge legally about all that the traffic would bear.

The most noteworthy experiment with remedial legislation prior to 1900 was the New York act of 1895,[5] which contained many of the elements recommended for such legislation by later students

[1] New Jersey Acts of 1884, c. 166, p. 245.

[2] Missouri laws 1891, p. 70.

[3] For description of these laws see Small Loan Legislation by Gallert, Hilborn, and May. Russell Sage Foundation, New York, 1932, pp. 20–21.

[4] Massachusetts Acts and Resolves 1888, c. 388.

[5] New York, Laws of 1895, c. 326.

of the small loan problem, and it undoubtedly served to some extent as their guide. The act of 1895 was intended primarily as an enabling act for remedial loan societies, but it contained some general regulatory provisions as well. In cities of more than 300,000 population, corporations chartered under the act were permitted to charge 3 per cent a month for two months, and 2 per cent a month thereafter, on loans of $200 or less. These corporations were required to furnish a bond and to submit reports to the state banking department. Their dividends and accumulations of surplus were limited. No other person or corporation in these cities could charge more than the maximum legal rate of 6 per cent a year for loans of similar size secured by household furniture, tools, and other personal property defined by the act. Violation of the act was a misdemeanor, and a reward of $250 was offered for evidence of violation. The following year the act was extended to include all cities of more than 25,000 population, except those in Westchester and Monroe counties.[1]

The first decade of the twentieth century produced a variety of legislation dealing with the problem. Some states attempted general prohibitive statutes. North Carolina, Utah, and Connecticut, in 1907, limited contract interest rates to 6, 12, and 15 per cent a year, respectively, and prescribed penalties for charging more. But no lenders of small sums confined themselves to these rates. A few states attempted to fix a rate high enough to permit profitable lending in small sums but failed to provide sufficient penalties and supervision for enforcement. During this decade, California, Florida, Maine, Maryland, and Wyoming enacted such laws. Other states, including Delaware, Michigan, Pennsylvania, and Virginia, incorporated supervision of some sort in small loan statutes that were ineffective for other reasons.[2]

The net result of these sporadic legislative efforts up to 1910 was just about zero. Statutes which invalidated certain forms of security caused lenders merely to switch to other forms. Prohibitive regulations resulted in increased charges to borrowers to compensate the lender for his additional risk. Statutes which recognized the need for a commercial business in this field failed either to

[1] New York, Laws of 1896, c. 206.

[2] For description of these statutes see Small Loan Legislation, pp. 31–33.

provide sufficient gross income to the lender or to force him to comply. In all these states the loan-shark problem continued apparently without abatement. With a few exceptions, there was no effort nor opportunity to compare the results of these statutes, and little factual material on which remedial efforts could be soundly based was available.

Even before legislatures began to experiment with legal regulation, socially minded private citizens and charitable agencies had also undertaken to remedy the loan-shark evil by establishing loan funds to supply the need on which the high-rate lender thrived. In general, these may be divided into two classes: the philanthropic loan funds, whose charges, if any, failed to maintain the fund and bore little or no relation to the cost of lending; and the semi-philanthropic or remedial loan funds, whose charges were fixed at the cost of operation plus a limited return to those who supplied the capital.

Philanthropic Loan Funds

The philanthropic loan agencies were of no one type or character. Originating in the impulses of men to assist those less fortunate than themselves, they were maintained by fraternal lodges, churches, employers, charitable organizations, and individuals or groups of citizens organized for the single purpose of making small loans to needy borrowers. Money was contributed by charitably inclined people or set aside from the dues or income of some organization. Sometimes a moderate rate of interest was charged, sometimes none at all. There was little or no expectation of any financial return on the part of those who gave money to these enterprises. The contributor made a donation to this cause as he would to the home missionary society, the Young Men's Christian Association, or the Young Men's Hebrew Association. Losses had to be expected as a normal consequence and the capital had to be replenished from time to time by new appeals for contributions to the loan fund. Outstanding among the agencies in this group were the Hebrew free loan societies doing their quiet, helpful work in many cities of the country.

Most of the philanthropic loan agencies were unstable and depended upon the willingness and ability of benevolently inclined people to keep them going. But even when they went out of existence, new ones sprang up to take their places.

The Franklin Loan Funds. Two loan funds, designed to be more than self-supporting but destined to be purely philanthropic, were established by the codicil of the will of Benjamin Franklin, who died in 1790.[1] In this unusual document Franklin bequeathed to Boston and Philadelphia the sum of £1,000 each for loans "to such young married artificers under the age of twenty-five years as have served an apprenticeship . . . and faithfully fulfilled the duties required in their indentures." Loans were to be payable in annual instalments of not less than one-tenth of the principal, were to bear interest at the rate of 5 per cent a year, were to be secured by two endorsements on each bond, and were not to exceed £60 nor to be less than £15 in amount. The administration of the Boston fund was entrusted to the "Select Men united with the Ministers of the oldest Episcopalian, Congregational and Presbyterian Churches," while the Philadelphia fund was to be managed by the corporation of the city.

The codicil described the method of distribution of the enormous sums that were expected to result from the compounding of interest at 5 per cent a year. At the end of the first hundred years £131,000 from the Boston fund was to be used for fortifications, bridges, or other public improvements; and an equal sum was to be withdrawn from the Philadelphia fund for piping water from the Wissahickon River and for making the Schuylkill navigable. The codicil anticipated that at the end of the second hundred years the remainder of each loan fund would have grown to £4,061,000. The Philadelphia fund was then to be divided between the city of Philadelphia and the state of Pennsylvania, and the Boston fund between the city of Boston and the state of Massachusetts.

Collection difficulties entirely upset Franklin's nice calculations. The Boston fund began operation in April, 1791. By the end of August it had lent its available capital to 27 borrowers. In 1800 the treasurer of the Boston fund reported that there would probably be a loss of $300 due to the failure or death of all parties to certain bonds. In 1836 the treasurer reported that during the pre-

[1] The codicil of the will of Benjamin Franklin has been published in full by the Franklin Union, Boston, Massachusetts.

vious fifteen years "91 loans had been made, of which 50 at least had been repaid in whole or in part by sureties and on four of these are balances which cannot be collected." In 1836 only $1,428 was invested in loans because of the scarcity of applicants who could qualify, and $22,739 was deposited with an insurance company. The increment to the original fund had come entirely from interest on deposits with savings institutions and not from the income on loans to "young married artificers."[1]

The record of the Philadelphia fund is similar to that of the Boston fund. The only report available concerning its loans covers the period from 1870 to 1899, when the fund was under the management of the Philadelphia Board of Directors of City Trusts. During this time 64 loans amounting to $30,250 were made and only $29,170, including interest, was repaid on these.

The unfortunate repayment experience and the scarcity of applicants who could qualify led finally to a modification of the terms of the codicil by the courts.[2]

Employer Loan Funds. Loan funds organized by employers for the benefit of their own labor force may be included among the philanthropic agencies because there was no attempt to derive any direct net return on the capital invested in the enterprise.[3] The purpose of the employer was, however, purely enlightened self-interest. Drifting deeper and deeper into debt, employes often suffered such a loss in morale that their efficiency was seriously impaired. The employer found it to his advantage to supply a substitute for the high-rate lender even at the cost of loss of income on the money set aside for this purpose.

These funds were generally very simple in structure. The capital was furnished by the employer and little or no interest was charged. Applications for loans were made to a committee usually appointed by the employer or directors of the employing corporation. A representative of the personnel department was frequently the most important member of this committee. The applicant

[1] Reports of the Franklin Foundation and the Franklin Union, Boston.

[2] Reports on the Benjamin Franklin Fund by the Board of Directors of City Trusts, Philadelphia.

[3] For a description of employe loan funds in operation currently, see Employee Thrift and Investment Plans, National Industrial Conference Board, Inc., New York, 1929.

stated the amount he wished to borrow, his reason for borrowing, and the terms upon which he desired to repay the loan. If the loan was granted, the borrower was required to give a personal note and in some cases the names of from two to five of his fellow-employes as endorsers of his note.

Unfortunately this particular type of loan agency fell short of meeting the situation even within the group served by it. Most employes preferred to borrow elsewhere even at much higher interest rates rather than go through the ordeal of telling their troubles, often their mistakes, to their employer or his representative, and this was nearly always a necessary condition to obtaining the loan. Some far-seeing employers had the wisdom to inspire the founding of co-operative savings and loan organizations among their employes, leaving to members the direction and management of affairs. In so far as these were bona fide, self-controlled, and self-operated agencies, the employers who encouraged them may be given credit for stimulating the growth of the credit union movement in this country.

In spite of the relief which philanthropic loan funds brought to some borrowers, the lendable capital of these agencies continued to be insignificant as compared with the demand for small loans. The one service which all the philanthropic loan societies rendered toward the solution of the small loan problem was that they recognized the demand for small loans and realized that special facilities were necessary to meet it.

Remedial Loan Societies

The remedial loan societies, whose assets and numbers were still less impressive than those of the combined philanthropic agencies, deserve a far more prominent place in this history. These agencies tested in an experimental way methods that would insure the continuance of lendable capital under conditions approaching those prevailing in the business world. The first of these was the Collateral Loan Company[1] of Boston, a pawnbroking company which began business in 1857. In Boston also the Workingmen's Loan Association, the first remedial society to lend on chattels, was organized in 1888. St. Bartholomew's Loan Association of New

[1] Formerly the Collateral Loan Association of Boston.

York, for chattel loans,[1] and the Provident Loan Society of New York,[2] for pledge loans, were organized in 1894. Similar societies were organized in Worcester, Massachusetts, in 1896 and in Providence, Rhode Island, in 1898. By 1909 there were 15 such societies.

Out of the remedial loan movement came much of the experience on which students of the small loan problem relied in their efforts to find a workable solution for the loan-shark evil. The establishment of these institutions represented a change in the tactics of those fighting the loan shark. Exposures, denunciations, repressive legislation, and prosecutions had in only a small degree checked his abuses and had not in the least eradicated them. Assisting necessitous borrowers on a purely charitable basis did not begin to meet the need and was haphazard even at best. Some new scheme had to be devised if the evils in the chattel and salary loan business were to be eliminated. The proposal was to enter the small loan field and to lower the charges of existing lenders and improve the tone of the small loan business generally by competition. The chief proponents of this plan were the social workers, who were constantly in contact with victims of the loan shark.

Readers of this volume may recall that in the early days of the discussion of railroad rates in this country it was proposed that the federal government build a railroad from the Mississippi River to the Atlantic Seaboard. The underlying theory of this plan was that a railroad run by the government, charging not what the traffic would bear but only what was necessary to provide a normal income on the investment, would through competition force other railroads to reduce their rates and would, in addition, demonstrate what rates were just and necessary. A similar theory supported the plan for combating the loan shark.

An illustration of conditions existing in the early 1900's, of the attempted remedy, and of results either accomplished or expected is available in Arthur H. Ham's account, written in 1907, of the experience of the Chattel Loan Association of Baltimore:

> The state constitution, while it ordained that 6 per cent per annum should be the legal rate of interest, did not provide a penalty for charging

[1] For description see The Chattel Loan Business, by Arthur H. Ham, pp. 36–37.

[2] For description see The Provident Loan Society of New York, by Rolf Nugent, Russell Sage Foundation, New York, 1932.

more than this rate; the victim of the money lender was entitled to recover only the excessive interest paid and the lender otherwise went free. A reasonable fee was also allowed the lender for drawing papers, etc., and gradually it became the practice to charge a minimum fee of $3.50 for loans under $50 for papers, and as much more as could be collected on loans of larger amounts. The scale of rates for loans increased, until in 1898 charges were about as follows:

For loans under $50, 10 per cent per month for interest, from $3.50 to $5.00 for papers, and $1.00 to $2.00 for recording and acknowledgments before a notary; for loans not over $75, 8 per cent per month was charged for interest and from $6.00 to $7.50 for papers; while for loans of $100 or over 5 per cent per month for interest and from $10 to $15 for papers, etc., was exacted. No partial payments were ever accepted on account of principal, which was to be repaid in one lump sum, the charges above mentioned being for the use of the money only. A system of "extension" fees for granting additional time on loans was adopted. No loans were made for more than six months. A typical case is illustrative of the system: A. borrowed $125 at 5 per cent per month for six months. He was charged $10 for papers, etc., and by force of circumstances had the loan renewed by the same money lender no less than six times. At the end of the third year he had paid (exclusive of extension fees) for interest $225; for renewal fees (new mortgages) $60; total $285. When he was suddenly taken ill and was in consequence unable to meet the usual $6.25 monthly interest note, he received a notice to the effect that unless the entire original sum borrowed, $125, was repaid by noon on the ensuing Wednesday, his mortgage would be foreclosed and his furniture and effects sold to satisfy the debt. The worm turned at last, but the attorney he employed was not as quick as he should have been and it cost A. $28 more to get his mortgage released. The total amount borrowed was $125, the total repaid $313, in addition to further sums for extension fees.

Thousands of such loans were made annually in Baltimore at enormous profit to the lender and corresponding discomfort and suffering to the borrower. These conditions continued for a long term of years and naturally grew worse; in fact, no one seemed to know or care anything about the state of affairs, until in the fall of 1897 the late Rev. Maltbie B. Babcock became interested in the matter. He set on foot an investigation which brought to light the general situation as previously mentioned. Without loss of time a meeting of business men was called to consider the situation and devise ways and means of permanently correcting the existing evils. It was finally determined to start a business organization which would have for its sole object the lending of money upon security of a chattel mortgage, and which would charge only enough to pay running expenses and a fair dividend to its stockholders. At this meeting all needed capital was quickly subscribed and in due time a charter obtained under the general incorporation act of Maryland. The chartered capital was $30,000, all subscribed and half paid in. At the end of two years the capital stock was increased to $50,000, and two years later to $75,000. The rates charged at the start were experimental, but by the time the legislature convened in 1900 it was seen that they could be lowered, and accordingly the Loan Association proposed the first chattel act for Maryland, in which the rates for loans on furniture were fixed at a figure averaging $1.00 less per loan than the Association had been charging from the time it began business. The bill was passed without amendment and became a law. After two more years of experience the law was slightly amended in 1902. This amended law stands today (1909). It allows 6 per cent interest and an additional inclusive charge of $5.00 for examination and valuation of property offered as security for the loan, and for preparation of the papers, where the amount loaned does not exceed $50; $6.00 where the amount exceeds $50 and equals $100 or less; 5 per cent additional of the excess over $100 where the amount loaned exceeds $100 and equals $1,000 or less, and 2½ per cent additional of the excess over $1,000 where the amount exceeds $1,000; for additional papers, the amount actually paid for same. These charges are to be deducted at the time of making the loan.

In ten years the Association has made over nine thousand loans, paid 5 per cent on its capital and 1 per cent to surplus. But the real test of the work of the Association is found in the results produced in the community. Two of the largest loan offices in the city have been driven out of business; a search of the dockets in both law and equity courts proves that during the past four years not a single suit in either law or equity has been filed by a victim of a mortgage money lender, nor has any money lender brought suit against a customer. It should not be inferred that there is no extortion practiced in the city, but it has been very considerably reduced. Several new loan offices have been opened since 1902, where loans can be obtained at the legal rate. This experience shows that much can be accomplished by legislation, but that more real help can be afforded by lending money at low rates, and that such a business is a fair paying, safe investment for capital.[1]

The remedial loan societies were also called semi-philanthropic loan companies, because those who contributed funds ran the risk of loss of their principal and yet were entitled only to a limited

[1] Ham, Arthur H., The Chattel Loan Business, pp. 34–36.

return if the enterprise were successful. Any increase in profits was to be absorbed by a decrease in the charges made to borrowers. Certainly capital raised on this basis, at least in the early existence of these institutions, did not come from purely commercial impulses. The twenty-fifth anniversary report of the Provident Loan Society of New York describes the conditions under which capital was subscribed as follows:

> The original contributors did not expect that interest would be paid upon their contributions, certainly not at the start. Contributions were not solicited upon any such expectation. The founders hoped, however, that it might ultimately be possible to pay interest regularly, for they realized that only by paying interest, could the Society ever expect to secure any large increase of loanable funds.[1]
>
> The funds employed by the Society consist of Bonds ($1,400,000) paying interest at the rate of 4½ per cent per annum; Certificates of Contribution ($7,200,000) on which interest has been paid at the rate of 6 per cent per annum, and Profit and Loss Surplus ($4,201,500). Certificates of Contribution are issued in denominations of $500, $1,000, and $5,000. The return to contributors is strictly limited to 6 per cent annually, if earned. The members of the Society can have no interest in its property under the constitution. The trustees can receive no salaries or compensation for their services. It is strictly a charitable institution with power vested in the trustees to make distribution, out of surplus earnings from time to time, to charitable organizations located in the City of New York as they may deem expedient.[2]

Indeed, those who furnished the capital for remedial loan societies were for the most part board members of philanthropic institutions or citizens interested in welfare projects.

The organization of the early remedial loan societies was frequently made difficult by the absence of proper enabling legislation. In Baltimore the right under the Maryland law to charge fees in addition to the regular interest charge of 6 per cent a year made it possible for the Chattel Loan Association to start in at once without any special legislation. A special enabling act was secured later when experience had shown under what rates it could do business. By 1913 Minnesota, Missouri, New Jersey, and New

[1] The Provident Loan Society of New York, Twenty-fifth Anniversary, 1894–1919. Provident Loan Society of New York, 1919, p. 11.

[2] *Ibid.*, p. 15.

York had small loan laws[1] which, while inadequate for commercial lenders, were satisfactory enabling acts for the remedial loan societies. Societies in other states found it necessary to get special legislative charters. Many recent remedial loan societies have from the beginning operated under laws for the regulation of commercial lenders.

The promotion of remedial loan associations was greatly stimulated in 1909 by the organization of the National Federation of Remedial Loan Associations. In March of that year W. N. Finley, manager of the Chattel Loan Association of Baltimore, wrote to representatives of other remedial loan associations proposing a convention at Buffalo in June when the National Conference of Charities and Correction, now the National Conference of Social Work, would be in session. This suggestion was found acceptable and the representatives of the remedial loan associations met and formed a national organization. Eleven societies responded to the roll call at this meeting. These were: Citizens Mortgage Loan Company, Cincinnati, Ohio; Provident Loan Society, Detroit, Michigan; Workingmen's Loan Association, Providence, Rhode Island; St. Bartholomew's Loan Association, New York City; Provident Loan Society, New York City; Chattel Loan Association, Baltimore, Maryland; Workingmen's Collateral Loan Company, Cleveland, Ohio; Worcester Collateral Loan Association, Worcester, Massachusetts; Provident Loan Society, Milwaukee, Wisconsin; First State Pawners' Society, Chicago, Illinois; Collateral Loan Association, Boston, Massachusetts.

The object of the National Federation can best be given in the words of the constitution adopted at its first meeting:

> The object of the organization shall be to encourage the formation of local organizations and to aid and direct persons interested in the work and who contemplate organizing remedial [loan] societies giving such information and advice concerning legislation, finance, problems of administration and general information necessary for organization and management.[2]

[1] For description of these laws see Small Loan Legislation, by Gallert, Hilborn, and May, pp. 28–30.

[2] Constitution of the National Federation of Remedial Loan Associations, in Proceedings of the National Federation of Remedial Loan Associations, May 20–21, 1910.

Participation of the Russell Sage Foundation

At this point the work of the Russell Sage Foundation must be mentioned because its activities in this field were for the next few years closely associated with the work of the remedial loan societies.

The Foundation was incorporated by a special act of the New York legislature in April, 1907, "for the improvement of social and living conditions in the United States of America." The charter provides that "it shall be within the purposes of said corporation to use any means to that end which from time to time shall seem expedient to its members or trustees, including research, publication, education, the establishment and maintenance of charitable or benevolent activities, agencies and institutions, and the aid of any such activities, agencies or institutions already established."

W. Frank Persons tells of the beginnings of the association of the Foundation with the small loan problem as follows:

> When Russell Sage died (1906) and Mrs. Sage inherited his vast estate, she employed me to administer her personal charities. She had announced . . . that she hoped to give away this vast sum of money in good works, during her lifetime, and not alone to institutions but, so far as practicable and warrantable, to individuals.
>
> In two years, I handled sixty thousand letters written by individuals to Mrs. Sage, asking for assistance. Early in that experience, I began to discover and to segregate letters written by victims of . . . "loan sharks." Letters came in from men and women, earnestly desirous of being self-respecting and self-supporting, who had pledged their credit, their future earnings, and were paying at the rate of 25 and 30 per cent a month interest charges, so-called, on those small necessity loans.
>
> Having personally arranged for the discharge of a number of these borrowers from the grasp of such lenders, I made a report to Mrs. Sage's legal adviser, Robert W. de Forest, and pointed out the apparent great demand for an organized business, which would take care of this obvious need in the community, under regulated and decent auspices.[1]

While the experience described by Mr. Persons was undoubtedly a principal reason for the interest of the Foundation in small loans, there were other circumstances which contributed to this

[1] Persons, W. Frank, "Personal Finance in the Credit Field." Address delivered before the convention of the National Retail Credit Association, Washington, D. C., June, 1932. Reprinted in Personal Finance News (American Association of Personal Finance Companies, Washington, D. C.), September, 1932, p. 8.

interest. Robert W. de Forest, one of the original trustees of the Foundation and later its president, had been one of the organizers, and for many years president of the Provident Loan Society of New York. Although this Society was engaged in making pledge loans, it had assisted in the formation of societies elsewhere to make chattel mortgage and wage assignment loans, and the idea of forming a remedial loan society in New York to make such loans had been discussed many times at meetings of its executive committee. Mr. de Forest, through his close association with the Provident Loan Society and the Charity Organization Society, was well aware of the loan-shark problem before the Foundation was incorporated.

Still another circumstance which related the Foundation to the small loan problem was more fortuitous than otherwise. Shortly after its incorporation in 1907, it supplied funds for fellowships for special studies on social problems under the auspices of the Bureau of Social Research, New York School of Philanthropy. Fellowships were granted to Clarence W. Wassam in 1907 and to Arthur H. Ham in 1908. Both were graduate students at Columbia University. Each was given a list containing a large number of subjects from which to choose his research project and each elected to study a phase of the small loan business because it appealed to him as a fertile and unexplored field of research.

The Foundation published these studies in 1908 and 1909. We have already quoted liberally from them in describing the unregulated small loan business. Their publication not only focused the attention of the Foundation on the problem, but made available to the public for the first time a description of small loan conditions and suggested several remedies.

In July, 1909, immediately following the organization of the National Federation of Remedial Loan Associations, the Foundation employed Mr. Ham as special agent to continue his study of the small loan business in the United States and to attempt to increase the legitimate facilities for borrowing small sums at reasonable rates of interest. Of this appointment Chairman W. N. Finley of the National Federation of Remedial Loan Associations wrote:

> Very soon after the Buffalo meeting of last year it was made plain to me that what was most needed was an active man, trained to the work,

who would devote his entire time to it, not waiting for things to turn up, but himself turning things up through active propaganda carried on with as much publicity as was obtainable.

An appeal to Mr. John M. Glenn, Managing Director of the Russell Sage Foundation, resulted in the appointment of Mr. Arthur H. Ham, as a special agent for the study of remedial loan problems, with a view especially to helping in the formation of remedial societies wherever the need for these was ascertained. . . .[1]

In October, 1910, the Russell Sage Foundation established its Division of Remedial Loans. The name was changed in 1924 to the Department of Remedial Loans and in order to prevent confusion hereafter we shall refer to it as the Department. Mr. Ham was made director, and continued in this capacity until 1918. This action by the Russell Sage Foundation increased the effectiveness of the National Federation of Remedial Loan Associations.

Findings of the Ham and Wassam Studies

In the beginning at least, the policies both of the National Federation and of the Russell Sage Foundation were greatly influenced by the Ham and Wassam studies of the chattel and salary loan businesses. Consequently, it seems desirable at this point to note very briefly some of the important facts brought out by these investigations. On most points the investigators were in accord:

1. Both recognized that the demand for small loans was great; that existing lawful credit institutions did not, and probably could not, supply this demand; and that the lack of legitimate agencies to make small loans had created a vast outlaw business whose dimensions could only be guessed.
2. Both believed that the business as conducted was enormously profitable, and could certainly exist at much lower rates than those usually charged; but both recognized thoroughly that the business could not be carried on at ordinary banking rates of interest. The report on the chattel loan business explained:

A profitable business at 6 per cent [a year] is impossible. The usual loan of $40 or $50, plus interest charges, is divided into equal payments, payable in from three to six monthly installments. The interest on a $50

[1] Proceedings of the National Federation of Remedial Loan Associations, May 20–21, 1910, pp. vii–viii.

loan at 6 per cent per annum for six months would be $1.50.[1] There must be offset against this the salary of an investigator who will examine the security and pass upon its acceptability, that of a collector to call for the payments as they fall due and look up those who are seeking to dodge their settlements, an office with its attendant expenses for bookkeeping, cashier, stenographer, and maintenance, as well as the usual losses and necessary fees to attorneys. All of these expenses must be paid out of the gross returns from loans. Apart from direct evidence bearing on the point, it is clear that a 6 per cent rate would not cover expenses.[2]

3. Both investigators recognized that restrictive legislation had been of little or no avail; that lenders managed to evade repressive laws; and that borrowing conditions were made worse rather than better by repression.

4. The investigators were in accord in recommending two principal remedies: (a) the organization of remedial loan societies to make loans at the lowest possible interest rates consistent with a limited return upon capital, and (b) the enactment of legislation regulating, but permitting profitable operation of, a profit-making small loan business under state supervision.

Indeed, a regulatory small loan law embodying the ideas of both investigators had already been drafted by Samuel McCune Lindsay, and Frank Tucker, at that time the executive officer of the Provident Loan Society of New York, before these studies were published. This draft was prepared for introduction in the 1908 session of the New York legislature but was not introduced. It proposed to place lenders of small sums under the supervision of the superintendent of banks; to compel them to file a certificate showing the name of the lender, amount of his capital, number of loans made, and rates of interest charged; it provided penalties for conducting a small loan business without complying with the law; it gave the superintendent of banks the power to determine maximum rates of interest; it grouped salary loans, chattel loans, and pledge loans under the same regulation.

The only point on which the investigators differed materially was on the effectiveness of publicity as a means of eliminating the high-rate lender. Dr. Wassam reported:

The salary loan business thrives upon secrecy and any effort which

[1] But if repaid, as was customary, by instalments over a similar period, interest at 6 per cent a year would amount to 88 cents.

[2] The Chattel Loan Business, p. 15.

tends to destroy this secrecy will in so far aid in regulating the business. The manager of a prominent loan office, when asked the reason for the company's refusing to assume any attitude which would make the business public, replied that the company would much rather lose the money involved in any individual loan than to have anything done whereby the rates charged and the methods of business would be made known. She added further that the entire success of the salary loan business depended upon their ability to keep the general public uninformed as to their methods.[1]

Mr. Ham, on the other hand, reported that publicity was valueless unless used as a means of awakening a community to the need for remedial action, and that unscrupulous practices of lenders continued without abatement in spite of publicity.

Credit Unions and Morris Plan Companies

Almost concurrently with the organization of the National Federation of Remedial Loan Associations and the beginnings of the interest of the Russell Sage Foundation in the small loan problem, two other developments of considerable importance to the later history of the small loan business were taking place independently.

As early as 1890 Alphonse Desjardins, a Canadian journalist of Levis, Quebec, had become interested in the small loan problem. For ten years he studied the literature of the European co-operative credit societies and corresponded with leaders of this movement.[2] In 1900 he organized a co-operative credit society in the parish of Levis, across the St. Lawrence River from the city of Quebec. It was known as La Caisse Populaire de Levis. Seven years later, encouraged by the progress of the Levis institution, Mr. Desjardins began to organize similar societies in other parishes throughout the province of Quebec, and in 1909 he helped to organize La Caisse Populaire Ste. Marie among French-Canadian parishioners living in Manchester, New Hampshire. This was the first such society in the United States.

[1] The Salary Loan Business in New York City, p. 88.

[2] The first European co-operative credit societies were formed in Germany around 1850. Shortly thereafter the movement spread to most other European countries. For a description of these societies, see The Evolution of People's Banks by Donald S. Tucker, Columbia University Press, New York, 1922; and People's Banks by Henry W. Wolff, P. S. King and Son, London, 1910.

In the meantime, Pierre Jay, then Massachusetts bank commissioner, had heard of the success of the Levis society and recommended in his annual report for the year 1908 that the Massachusetts legislature authorize the organization of similar societies. In 1909 a bill drafted by Mr. Jay and Mr. Desjardins was introduced in the Massachusetts legislature. Both men appeared before the legislative banking committee to explain the bill, and many prominent citizens of Boston, including Judge A. K. Cohen, Edward A. Filene, Max Mitchell, and Felix Vorenberg, gave it their support. The bill became law.[1]

This act permitted the incorporation of co-operative credit societies, known as "credit unions," and provided for their supervision by the bank commissioner. Credit unions were to be organized within groups of people who had some common interest, such as labor unions, employe associations, fraternal orders, or neighborhood groups. The credit union was authorized to accumulate the savings of its members by selling shares and accepting deposits, and to make loans from these funds to members for provident purposes. The only restriction which the law placed upon rates of charge for loans was that they be reasonable. Each member was to have one vote regardless of the number of shares held. At the annual meeting of members, the credit union was to elect a board of directors, which had responsibility for general management; a credit committee, which passed upon applications for loans; and an auditing committee, which examined the books of the credit union periodically.

The second development was of a different character, but resembled in some particulars the credit union movement. While Pierre Jay was proposing a credit union law for Massachusetts, Arthur J. Morris, an attorney of Norfolk, Virginia, was studying the banking law of his state in an effort to find a practical method of lending to applicants for loans on salaries and wages. Because he was counsel for several banks, he was aware that banks refused loans to many worthy applicants who could not offer the kinds of security customarily required. He considered the lack of credit facilities by these applicants to be a distinct weakness of the American banking system.

[1] Laws of 1909, c. 419.

Mr. Morris worked out a plan by which he believed loans could be made profitably by a banking institution under existing legislation. He raised capital among business men of Norfolk and applied to the Virginia State Corporation Commission for a bank charter. The charter was granted, and on March 23, 1910, the Fidelity Savings and Trust Company opened its doors.

The technique of this institution was ingenious. Funds were to be acquired by the sale of three classes of certificates. Common stock was represented by class A certificates, which were entitled to the earnings of the corporation. Class B certificates, which resembled the certificates of deposit used by some banks, bore interest at a fixed rate. Class C certificates, which were to be purchased by instalment payments, bore interest after a certain amount had been paid unless hypothecated as security for a loan.

Two or more endorsements were required as security for loans. Interest was discounted in advance at the legal rate plus an investigation fee amounting usually to $2.00 for each $100 borrowed. The borrower was required to repay the loan by weekly instalments which were credited, not to the principal of the loan, but to the purchase of non-interest-bearing class C certificates. The par value of each certificate was $50. If the face value of the loan was $200, the borrower contracted to buy four certificates at the rate of $4.00 a week for fifty weeks. When the purchase was completed, the certificates were cancelled and the proceeds used to liquidate the loan. Fines were levied for delinquency at the rate of 5 per cent a week on the amount in arrears.[1]

The purpose of this elaborate mechanism was to increase the amount of interest charged without conflicting with the usury law. The maximum interest rate in Virginia was 6 per cent a year, but the courts had occasionally allowed banking institutions to charge in addition certain expenses of investigation. Mr. Morris relied upon these decisions to validate his proposed investigation fee. The device of crediting payments to a non-interest-bearing certificate was designed to disguise the increase in the true rate of interest which results from instalment repayments of principal when interest is discounted in advance. Stripped of these technicalities,

[1] Herzog, Peter W., The Morris Plan of Industrial Banking. A. W. Shaw Company, Chicago, 1928, pp. 12–23.

the actual interest rate on a loan discounted at $8.00 per hundred and payable in 50 equal weekly instalments amounted to 17.7 per cent if the contract was met promptly[1] and a higher rate if the borrower was delinquent in his payments.

Although the validity of these devices for increasing interest income was doubtful in most jurisdictions, the Fidelity Savings and Trust Company organized by Mr. Morris and his associates was quite secure because of its incorporation under the banking law. In order to protect depositors of banks, banking legislation generally limited the penalties for usury when banks were involved, and in most states only the portion of interest which was in excess of the legal rate could be recovered from banking institutions. The amount recoverable was so small that an action to recover excess interest was unprofitable. Moreover, the company had the moral support of the community. However high the actual rate of interest in terms of the legal maximum, the charge was small when compared with the cost of borrowing from the loan shark. The institution provided a decent source of funds for large numbers of borrowers who had no credit elsewhere except at far greater rates.

There were several points of similarity between credit union technique and the Morris plan. Both relied upon endorsed notes as the principal means of security. Both required repayment by small periodic instalments, and charged fines for delinquency. Both accumulated the savings of salary- and wage-earners for loans

[1] In the calculation of this rate, it is assumed that each instalment payment is to be credited toward both principal and interest in the proportion which the amount lent bears to the amount of interest charged. The formula is as follows:

$$i = \frac{d}{A} \times \frac{2m}{N+1}$$

i—interest rate per annum
d—amount of interest discounted
A—amount of advance
m—ratio between one year and the length of the uniform intervals between instalment payments
N—number of equal periodic payments

For example: A note of $100 payable in fifty weekly instalments bears interest of $8.00 discounted in advance and the borrower received $92.

$$i = \frac{8}{92} \times \frac{2(52)}{50+1} = \frac{832}{4692} = 17.7$$

If it is assumed that all payments are to be credited to principal until the principal is paid and thereafter to interest, the following formula applies:

$$i = \frac{2md}{x(N+1)-2md}$$

x—face value of note
Other symbols represent the same elements as above

When applied to the same transaction, this formula results in a rate of 19.5.

to members of the same class. Both also were remedial institutions in that they were intended to supply a source of credit at relatively low cost which would not otherwise have been available.

In these regards both institutions resembled the European co-operative credit societies. The cultural relation of the credit union to the co-operative credit movement in Europe is clearly established. Whether or not Mr. Morris knew of the European co-operatives before the establishment of the Norfolk bank is not definitely established,[1] but the publicity used in the promotion of his plan in later years frequently referred to the success of the co-operative credit societies in Europe and described the plan as a modification of their successful technique for American use.

In its motives, however, the Morris plan differed both from the credit union and from the European credit society. The Norfolk institution was a bank, run for profit, controlled by comparatively few stockholders, and managed on a purely commercial basis. This, of course, was not necessarily to its discredit. But it was essentially different from the credit union which adopted the co-operative and democratic principles of the European credit societies. The services of the credit union were limited to its membership and each member, regardless of the amount of his investment in the credit union, had but one vote in the election of its officers and in the determination of its policies.

The difference in the motives of the two institutions, however, made comparatively little difference in their rates of charge during the next few years. Reports of 17 Massachusetts credit unions for 1911 showed that two had fixed the maximum interest rate for loans at 52 per cent, one at 18 per cent, two at 16 per cent, three at 12 per cent, four at 10 per cent, and two at 8 per cent a year. Three fixed no maximum limit on rates. Several of the credit unions which limited interest rates to 8 and 10 per cent a year charged this rate as a discount in advance so that the actual rate of charge was much higher.[2] Most credit unions charged fines ranging between 2 and 5 per cent a month on delinquent payments.

[1] The Morris Plan of Industrial Banking, p. 12.

[2] Annual Report of the Massachusetts Bank Commissioner for the Year 1911, Part II, pp. 323–339. The report of the bank commissioner in this and in subsequent years fails to distinguish between rates charged on balances and rates of discount. An indication of the actual rate of charge may be had by comparing the amount of interest collected with an estimate of the average amount of outstanding loans.

At the close of the year 1910, the credit union and the Morris Plan of Industrial Banking[1] were little more than potential forces. The Fidelity Savings and Trust Company was the only Morris plan bank. Massachusetts was the only state which had enacted enabling legislation for credit unions and but five unions had been organized under this act. The business of these institutions was very small; the outstanding loans of all five probably amounted to less than $5,000. Except for the single credit union in Manchester, New Hampshire, these constituted the entire credit union development in this country. Both types of institutions, however, spread rapidly in the next few years and we shall refer to them again in a later chapter.[2]

Close of the Loan-Shark Era

In Chapters II and III we described the small loan business during the period from its beginnings to the close of the year 1910. In the present chapter we have recorded the efforts made by forces outside the small loan business during this same period to improve the conditions under which borrowing took place. We shall refer to the period covered by these three chapters as the loan-shark era.

Closing these chapters with the year 1910 implies a finality to the loan-shark era which is not literally correct. Certainly the loan shark did not disappear during the year 1910. On the contrary, in spite of widespread anti-loan-shark campaigns, and to some extent because of them, small loan conditions were at their worst. Charges were higher, lenders more grasping, and borrowers seemingly more numerous than at any previous time in the history of the business.

The characteristics of the loan-shark era were the direct consequence of repression by society. Throughout the period covered by these chapters the attitude of society had been changing—slowly at first and then with increasing rapidity. The experience of the first remedial loan societies undoubtedly convinced many of their organizers of the futility of repression as a solution to the problem. As similar societies and other remedial agencies were

[1] This is the name by which institutions similar to the Fidelity Savings and Trust Company later became known.

[2] See pp. 149–157.

organized elsewhere, still other people were made aware of the extensive and urgent demand for small loans and the inadequacy of banking interest rates as compensation for the lender. The publication of the studies of the salary loan and chattel loan businesses gave enormous impetus to this change of attitude.

The organization of the National Federation of Remedial Loan Societies was still another influence toward this rapid change in attitude. The National Federation brought together men who, by the very fact of their association with member societies, were committed to a change in the policy of repression of the small loan business. Regardless of the social purpose of the remedial loan societies, their executive officers were primarily lenders charged with the responsibility of lending the funds of their societies at a profit. They knew the costs and risks of lending, and they were not likely to be swayed by sentimentalities in proposals for reform. Through the directorates of member societies, the National Federation united in a common program influential citizens in many cities who had already demonstrated interest in the small loan problem. The organization of the Department of Remedial Loans of the Russell Sage Foundation gave direction and stability to this program.

Although the close of the year 1910 marked no change in the nature or characteristics of the small loan business, it did mark the end of the period in which the prevailing social attitude looked upon lending to small borrowers as an anti-social, if not an illegal, business. For the reason that the principal cause of the loan-shark era had been removed the loan-shark era was ended.

CHAPTER V

DEVELOPMENT OF THE UNIFORM SMALL LOAN LAW

WE SHALL now consider the development of events in the small loan field between October, 1910, and November 29, 1916. The first date, as has been indicated, was that of organization of the Department of Remedial Loans of the Russell Sage Foundation; the second marked the formulation of an agreement on legislative policy entered into by the Foundation, the National Federation of Remedial Loan Associations, and certain lenders engaged in the small loan business who had formed the American Association of Small Loan Brokers.

Widespread Interest in the Small Loan Problem

Throughout this period of a little over six years, public interest in the small loan business was at its height. The Russell Sage Foundation and the National Federation became centers of information on all phases of the subject. The relationship between the Department of Remedial Loans and the National Federation was very close. The Department published the reports of the Federation and served practically as its headquarters. The director of the Department held no office in the National Federation at that time, but from the beginning he acted as de facto secretary. To him fell a very large part of the work of answering inquiries, making speeches, and advising and consulting with those interested in bringing about reform. In 1910 he was "carrying on an active correspondence with interested people in 85 cities located in 30 states."[1] But Mr. Ham was much more than the de facto secretary of the National Federation. He was an independent investigator digging deeper and deeper into the intricacies of the various forms of lending in small sums.

[1] Ham, Arthur H., "A Year's Progress in Remedial Loan Work." In Proceedings of the National Federation of Remedial Loan Associations, May 20–21, 1910, p. 17.

Every effort was made to promote the establishment of additional remedial loan associations. The subject was presented before the National Conference of Charities and Correction in 1911.[1] Local bodies, such as charity organization societies, were urged to take up the problem in their home cities and to bring about the establishment of institutions that would compete with loan sharks by furnishing loans at reasonable rates to necessitous borrowers. Opportunities to present the subject of small loans to employers were utilized to the fullest, and attention was directed to the genuine need for small loans and the possibilities of supplying these through employes' loan associations and credit unions.

Legislative Activity

This period was also one of pronounced legislative activity; in 1911, 22 states and the District of Columbia attempted to deal with the subject by legislation. Two years later 60 bills affecting the business had been introduced in the legislatures of 24 states. Much of the legislation of this period, as was to be expected, was hasty and ill advised. Whenever possible, however, the ideas that came out of the salary loan and chattel loan investigations and the experience accumulated by the remedial loan associations were presented to legislators and others interested in the problem.

The Department of Remedial Loans believed at first that the interest rate permitted to lenders should not be over 2 per cent a month. The majority of bills introduced during 1911 allowed a rate of 2 per cent a month or more. Only a short time before, it will be remembered, much of the proposed legislation gave no indication that this business of making small loans could not be carried on at ordinary banking rates of interest.

Two years later, in 1913, the Department of Remedial Loans listed eight provisions which it considered to be fundamental to any law designed to regulate the small loan business. These were:

1. License for all money-lenders engaged in the business or charging more than the banking rate of interest, inclusive of fees and charges of all kinds.
2. Bond to insure observance of law.

[1] *Idem*, "Remedial Loans as Factors in Family Rehabilitation." In Proceedings of the National Conference of Charities and Correction, June, 1911.

3. Adequate interest rate (two or three per cent per month) reckoned on unpaid balances. Fees prohibited or, if allowed, safeguarded against undue repetition.

4. Supervisory office to enforce the law.

5. Adequate penalties for violations, including revocation of license, fine and imprisonment and recovery of excess payments by borrower.

6. Notice to employer and consent of wife to an assignment of wages.

7. Adequate records kept by licensees and inspected by supervisory officer.

8. Copy of the law and memorandum regarding the loan given to each borrower.[1]

The conception of what was an adequate maximum interest rate was being modified by experience. In 1910, 2 per cent a month had been considered sufficient. In 1913 "two or three per cent per month" with the possibility, at least, of additional fees was suggested. The Committee on Legislation of the National Federation presented to the 1913 convention in more detail the provisions considered necessary to a satisfactory regulatory law. On the matter of rate, this committee reported, "The rate of interest should be 2 per cent per month with an additional fee of about $1.00 to partially cover the cost of examining the security, or a flat rate of 3 per cent per month without additional fees of any character. The flat rate without fees is preferable."[2] A bill drafted for introduction in New York State, "published for its suggestive value to other states" in the Bulletin of the same year, provided:

Sec. 324. Interest on loans. No licensee shall, directly or indirectly, charge or receive for the use or sale of his personal credit or for making any advance or loan of money, in sums of two hundred dollars or less amounts, a greater sum than at the rate of three per centum per month, which shall not be payable in advance or deducted from the amount of the loan, and shall be computed on unpaid balances. No charges, bonus, fees, expense or demands of any nature whatsoever other than interest as above provided shall be made for such use or sale or upon such advances or loans except upon and for the actual foreclosure of the security or entry of judgment as established and fixed by law. In calculating the amount so charged or received there shall be included all sums paid or to be paid by or on behalf of the borrower, to any person, association, partnership

[1] Ham, Arthur H., "Report of the Year's Progress." In Bulletin of the National Federation of Remedial Loan Associations, 1913, p. 8.

[2] *Ibid.*, Appendix III, p. 84.

or corporation or charged against him by any person, association, partnership or corporation which directly or indirectly relate to the loan.[1]

The period from 1910 to 1913, therefore, saw in the National Federation and in the Russell Sage Foundation the crystallization of ideas concerning an adequate maximum rate of interest and the emergence of quite definite principles of legal regulation of the small loan business that were being vigorously pushed into the foreground by these agencies.

Opposition of Lenders

The opposition of lenders other than the remedial loan societies to regulatory laws sponsored by the National Federation and the Russell Sage Foundation was unanimous and determined. In justice to the lenders, it must be said that the rate of 2 per cent a month that was first urged upon legislatures by the Federation and the Department of Remedial Loans was unquestionably too low, and laws providing a maximum of 2 per cent a month proved very unsatisfactory.[2] The opposition of the lenders was scarcely less strenuous to bills providing a flat 3 per cent a month. The charges of even the least objectionable companies far exceeded this maximum and few, if any, of the lenders at that time foresaw the extent to which operating economies would be possible under modern regulatory laws through lessening of risk, concentration of capital, increase in size of loans, and increase in volume. They took the natural position of most business men, preferring known evils to changes at the hands of reformers.

Against the stubborn opposition of the lenders, the legislative proposals of the National Federation and the Russell Sage Foundation were making little progress. In 1912 Mr. Ham in his annual report to the National Federation said:

> I have little to report in the matter of remedial loan legislation enacted. That we are preparing the way, through study and the dissemination of information for satisfactory legislation in the future, is shown by the fact that an increasing number of bills that were introduced, though failed of passage, contained many of the provisions which we have advocated as essential to adequate legislation.[3]

[1] *Ibid.*, Appendix II, p. 80. [2] See pp. 247–250.

[3] Ham, Arthur H., "Report of the Year's Progress." In Bulletin of the National Federation of Remedial Loan Associations, 1912, p. 17.

Much of this early legislation proved ineffective, and lenders found loopholes in the legal defenses. As one remedial loan man said:

> We found that the loan shark had discovered a way of escaping even before the bill was signed. He was not slow to take advantage of this when we began to enforce the law, and in place of becoming a prohibition our bill became merely an enabling act without sufficient restrictions and penalties for its violation and the loan shark was not much affected by it.[1]

Massachusetts Act of 1911

Prior to 1913 only one serious breach had been forced in the lenders' defense by the forces of reform. This occurred in 1911 when Massachusetts passed a small loan law.[2] Control and supervision of lending had previously been entrusted to local police departments under very general restrictions.[3] Lack of penalties and ineffective supervision combined to make these regulations practically useless. The Boston Chamber of Commerce succeeded in having the Committee on Banks and Banking of the Massachusetts House of Representatives commissioned to investigate the small loan business. After holding several hearings, the Committee issued a report[4] in which it recommended:

1. The establishment of the office of supervisor of small loan agencies with powers to license and examine those engaged in the small loan business and to refuse or revoke such licenses.
2. That all lenders of sums of $300 or less whose rates exceeded 12 per cent a year must be licensed.
3. That annual reports should be made to the supervisor who in turn should report annually to the legislature.
4. That the supervisor should "establish the rate of interest to be charged, having due regard however to the amount of the loan and the nature of the security and the time for which the loan is made, and that said rate shall not exceed in any event more than 3 per cent a month."
5. That violation of the provisions of the act or the regulations of the supervisor should be punishable by fine or imprisonment.

[1] Cone, H. A., "Situation in Detroit." In Bulletin of the National Federation of Remedial Loan Associations, 1912, p. 20.

[2] Acts and Resolves, 1911, c. 727.

[3] For further description of these regulations, see Small Loan Legislation by Gallert, Hilborn, and May, Russell Sage Foundation, New York, 1932, p. 39.

[4] Massachusetts House Document, no. 2084.

6. That wage assignments to secure loans to be valid must be accepted by the employer, recorded with the town clerk, must provide for a $10 exemption and must be consented to by the wife if the borrower is married.

One sees in these proposals the recommendations of Mr. Ham who was consulted by the Boston Chamber of Commerce and by the investigator of the Massachusetts Banking Commission. Sponsored by Representative James F. Cavanaugh, and endorsed by the Boston Chamber of Commerce, the governor, the banking commissioner, the press, the Boston Legal Aid Society, and many other social agencies, a bill embodying the recommendations of the Commission was introduced and became law. In a statement issued by Representative Cavanaugh after its passage, he said:

> There was a powerful lobby at work in opposition to the bill. Attempts were made by lobbyists to get members of the legislature to introduce amendments hostile to it. But the fact that these amendments were not offered and the bill went through in the manner it did is principally due to the great work of the newspapers.

In accordance with the recommendation of the Banking Commission, the law provided that:

> . . . the supervisor shall establish the rate of interest to be collected and in fixing said rate shall have due regard to the amount of the loan and nature of the security and the time for which the loan is made, but said rate shall not exceed 3 per cent per month and no licensee or regulated company shall charge or receive upon any loan a greater rate of interest than that fixed by the supervisor.[1]

The appointee to the position of supervisor of loan agencies interpreted this section with startling liberality. He announced that charges would be permitted on certain loans as follows:

> 10–c. When a loan of $10 or less is required by a borrower for one month, a flat charge of 15 per cent for that period, to include all charges and interest, may be made by the lender; but the payment of said loan shall not be enforced within a period of six weeks from the date of borrowing. The borrower shall have the privilege of returning the same in weekly payments if he desires, in which case the only additional cost to the borrower will be 3 per cent per month interest on portions of principal remaining unpaid.

[1] Massachusetts, Laws of 1911, c. 727, sec. 7.

11–a. For the "expense of making and securing a loan," a lender may make a charge not exceeding 10 per cent of the amount borrowed except as provided in c, Rule 10, but no such expense charge shall exceed $10. This percentage may be paid by the borrower out of the sum borrowed or it may be added to the amount of the loan and become a part of the principal. Charges are not to be imposed upon a borrower who makes a secured loan more often than once in four months or who makes an unsecured loan more often than once in three months.[1]

These administrative provisions for fees, for which the law seemingly contained no justification, allowed exorbitant interest which made the legislative maximum of little use. So, in spite of the excellence of the Massachusetts act of 1911, its passage resulted in no immediate loss of territory to the high-rate lender.[2]

In 1913, however, the tide definitely began to turn. Small loan laws were enacted in Colorado, District of Columbia, Illinois, Indiana, Minnesota, Missouri, Nebraska, and Oregon over the opposition of lenders. The influence of the correspondence and literature of the Russell Sage Foundation is clearly evident in much of this legislation. Some of the regulatory proposals of the National Federation were incorporated in all these laws. But in their general effect, little can be said in favor of them. All were drafted locally. Many omitted important regulatory features. Many had essential provisions eliminated by amendment. The Illinois and Minnesota laws were in effect nothing more than enabling acts for remedial companies. Some of these bills were severely restrictive, provided an insufficient interest rate to lenders, and added to the hazards of operation outside the pale of the law but did not prevent it.

The Oregon bill was the one exception to this general charge of inadequacy. It authorized a maximum interest rate of 3 per cent a month, required license and supervision by the superintendent of banks, and provided adequate penalties. Its principal shortcoming was that it exempted unsecured loans of less than $30.[3]

[1] Information, Rules and Regulations Relating to the Business of Making Small Loans. Commonwealth of Massachusetts, January 1, 1913.

[2] Fees were specifically prohibited later by an amendment to the 1911 act passed in 1916.

[3] For further discussion of these laws, see Small Loan Legislation by Gallert, Hilborn, and May, 1932, pp. 60–63, 72–74.

The Egan Act in New Jersey

The first decisive and important defeat of the lenders occurred in New Jersey in 1914. For several years lenders in that state had been able to ward off effective regulatory legislation. Charles M. Egan, promising an effective small loan bill, was elected to the New Jersey Senate on this issue. On December 9, 1913, the secretary of the Jersey City Chamber of Commerce called a meeting on the loan-shark problem at which the director of the Department of Remedial Loans and the manager of the Newark Provident Loan Association (a remedial loan society) met with members of the Anti-Loan-Shark Committee of the Chamber. At the request of this group Mr. Ham drafted a regulatory bill which was later introduced by Senator Egan and Assemblyman Branegan, the majority leader. On March 23, 1914, the bill became law.

The New Jersey Act of 1914, known as the Egan Act, contained all the salient features which the Committee on Legislation of the National Federation had recommended. Interest was limited to 3 per cent a month on balances and fees of all kinds were prohibited. The lenders fought its passage to the last ditch. Some would have been willing to accept the law if additional fees had been allowed. But the sponsors refused to compromise when they were shown the dangers of allowing fees. The Foundation took the leadership in the campaign for passage of the act.

Active participation in the New Jersey campaign represented a change in the Foundation's policy. Its activities heretofore had been confined to encouraging the organization of remedial loan societies, to studying small loan conditions, and to advising on legislation. In 1914, however, it began to take the lead in drafting legislation. It helped to organize support for regulatory bills and informed supporters of the reason for each provision. More than that, it watched the bill in process of enactment and guarded its essential features against emasculation. The old trick of offering innocent-looking amendments, together with the advantages of solidarity and self-interest in their ranks when matched against sincere but ill-organized and poorly informed forces of reform, had heretofore stood the lenders in good stead. Now these began to fail. Representatives of the Foundation recognized the tricks of lenders for defeating or crippling regulatory legislation and attempted to meet them head on.

In New York the same year Mr. Ham took a similarly active part in amending the personal loan article of the banking law. With Ansley Wilcox, president of the Charity Organization Society of Buffalo, and H. A. Wright of the New York Globe, he drafted a bill, urged its acceptance by the commission then revising the banking law, and followed it through to enactment.[1]

Although the lenders fought the legislative proposals of the Russell Sage Foundation and the National Federation with all their strength, this did not mean that they were as a unit opposed to regulatory legislation. All lenders would probably have preferred to accept supervision and regulation in return for legitimacy and security from prosecution. The point of contention was the amount of interest chargeable under regulation. On this point the lenders themselves were divided. The business had tended toward specialization in type of security and size of loans.

The difference in charges on these classes of loans has already been discussed. It is quite apparent that a rate satisfactory to one class of lenders might be insufficient for other classes. Those lending very small amounts for short periods of time on plain notes or wage assignments had little hope that under regulation a rate profitable to them would be permitted. It was the lender who made fairly large chattel loans who was most ready to accept regulation. His investment was larger and he had more to lose from invalidation of his loans by the courts. Larger loans had to be repaid over long periods of time and he was less able to adjust his business to periodic attacks. His rates, moreover, were moderated by his own self-interest—a rate as high as that made by lenders of smaller sums would have broken the borrower's ability to repay the principal. In several states this group of lenders had been important partisans in campaigns for regulatory legislation, hoping thereby to secure an interest rate under which they could operate at a profit.

[1] For discussion of the legal provisions of this amendment, see Small Loan Legislation, pp. 63–67. The maximum rate of interest allowed by this act, 2 per cent a month and small fees, proved to be inadequate to attract sufficient private capital (see pp. 249–250).

The Lloyd Act in Ohio

In Ohio as early as 1911, following concerted newspaper campaigns against loan sharks, a group of lenders had attempted to draft a regulatory act under which they could operate. There were in Ohio, unlike most other states, a few prominent lenders who openly admitted their occupation, lived in the communities in which they did business, charged lower rates than the usual ones, and constantly urged the necessity for legalizing a commercial small loan business.

This group, co-operating with social agencies and remedial loan associations of the state, drafted and succeeded in passing the Haas bill requiring licensure of lenders and permitting a 10 per cent commission in addition to the legal maximum interest of 8 per cent a year. The Department of Remedial Loans warned that the penalties for infraction were inadequate and that the 10 per cent fee would be repeated by renewals to increase the interest to exorbitant levels. But its advice was not followed by attorneys for the sponsors of the law, because they questioned the constitutionality of a flat rate of interest exceeding the legal maximum.

Contrary to the hopes of the Ohio social agencies, the Haas Act did little to improve conditions. Many lenders operated in defiance of the new law. Others found that they could get their old charges by repeating the fee permitted by law.

In two years a new clamor for reform was begun by social agencies, civic groups, labor unions, and the press under the active and able leadership of Hugh Huntington, a young Columbus attorney. The governor promised to make small loan regulation part of his message in calling a special session of the legislature in 1914, and the whole state was thoroughly awakened to the need for a change in the law. Again the leading group of lenders and the remedial loan associations undertook to propose a remedy. The bill then before the New Jersey legislature was used as a model and a similar bill was drafted for introduction in Ohio. In the Ohio bill, however, a fee of $2.00 on loans of $50 or less was added to the flat 3 per cent a month provided by the New Jersey bill.

In a voluminous correspondence with remedial loan societies, social agencies, and members of the legislature, the Department of

Remedial Loans objected to the fee and suggested greater authority for the supervisor and other technical improvements. An impasse between lenders and social agencies developed over the retention of the fee and the bill failed to pass. In the 1915 session, however, a compromise was effected by which the fee was fixed at $1.00 on loans of $50 or less and was guarded against repetition. The bill passed in this form.

This law, known as the Lloyd Act, remains today, with some changes, the regulatory small loan statute of Ohio. With the exception of its failure to limit the size of loans to which the act applied, it was a satisfactory piece of legislation according to the standards of the time. This difficulty has since been removed by an amendment limiting the application of the act to loans of $300 or less.[1]

Legislation in Pennsylvania

The record of legislation in Pennsylvania is nearly parallel to that of Ohio. In 1911 leading newspapers in Harrisburg, Philadelphia, and Pittsburgh were demanding legislation to curb loan sharks. In Philadelphia a special force of city detectives had been assigned to loan-shark operations and spectacular raids were being made. Representative C. R. Cox of Philadelphia introduced and succeeded in passing in the Pennsylvania legislature a bill designed to eliminate lenders of small sums by prohibitive restrictions. Governor John K. Tener, however, vetoed the bill. He said, quite justly, that if the provisions of the bill proposed to correct abuse of necessitous borrowers where remedies under existing laws were inadequate "it would receive my unhesitating approval, but I am unable to see how, under the broad prohibitory terms of this bill, any good can be accomplished."

The fight for remedial legislation continued, and at the next session of the legislature in 1913 many anti-loan-shark bills made their appearance. The three leading bills were introduced by Representatives Cox, Wildman, and Walnut. Each of these bills sought to meet the governor's objection to the 1911 bill by permitting the business to exist under regulation and to charge rates considerably in excess of the general statutory maximum.

[1] Ohio, Acts of 1929, p. 43.

The Cox bill of 1913, like the Haas Act in Ohio, permitted a 10 per cent fee in addition to the legal interest rate, but limited fee-taking to once in four months. An examination charge of $1.00 was also allowed on loans of $50 or less. Mr. Walnut had the advice of the Russell Sage Foundation in drafting his bill. It provided a flat rate of 3 per cent a month and was otherwise similar to the bill which the Foundation had recommended for New Jersey. The Wildman bill was modeled after the Maryland act of 1912[1] which provided a liberal scale of fees varying with the size of the loan.

As in Ohio certain lenders in Pennsylvania favored regulatory legislation. Several chain lenders whose Baltimore offices had proved quite profitable under the act of 1912 appeared in support of the Wildman bill and objected to the Walnut bill only on the ground that it provided insufficient income. It was the Cox bill, however, which became law. Although the return to licensees under the Walnut bill would have been less than under the other bills, the legislature balked at legalizing an obvious interest rate of 3 per cent a month.

The Cox Act of 1913 had two serious defects. First, like the Haas Act in Ohio, it attempted to side-step the prohibition of the state constitution against special interest laws by the dangerous fiction of permitting brokerage fees instead of higher interest rates. This fiction had long been used by lenders to conceal usurious interest charges. The position, of course, was untenable because those making loans were obviously lenders, not brokers, and the fees were, in effect, additional interest. Second, the act, relying upon this fiction for its validity, made no attempt to establish a classification of loans to which it applied—a provision upon which the constitutionality of all such laws has rested.[2] To void the Cox Act it was necessary only to prove that the brokerage fees were actually additional interest.

This the lenders quickly proceeded to do. The Cox Act provided unsatisfactory income and required extensive changes in their

[1] This act is discussed briefly on pp. 110–111.

[2] For a full discussion of the constitutionality of small loan legislation, see The Constitutionality of Small Loan Legislation by Frank R. Hubachek, Russell Sage Foundation, New York, 1931. This monograph forms a chapter of Small Loan Legislation by Gallert, Hilborn, and May.

methods of doing business. On the advice of Frank R. Hubachek, counsel for Frank J. Mackey, among whose interests was a large chain of loan offices, test cases on the constitutionality of the act were brought to trial in Philadelphia[1] and Pittsburgh.[2] T. Henry Walnut and George Wharton Pepper defended the act in the Philadelphia case, but after two years of litigation the Supreme Court of Pennsylvania declared it unconstitutional on March 15, 1915.

The invalidity of the Cox Act left Pennsylvania without a regulatory small loan law and the legislature was then in session. In anticipation of a decision in his favor, Mr. Hubachek, who represented the successful litigant, had already drafted a bill to replace the Cox Act. Since the Mackey loan offices were widespread, he was well acquainted with the attempts at regulation elsewhere. Few at that time were better able than he to draft a workable bill which would meet the constitutional test.

Mr. Hubachek's bill was not unlike the one prepared by the Foundation for New Jersey. It applied to loans of $300 or less. It provided licensure, supervision, and adequate penalties. It required all the protections of the borrower that the National Federation had recommended such as receipts, copies of the contract, and so forth. It provided, however, for fees protected against undue repetition in addition to 3 per cent a month. The bill was introduced on April 6, 1915, by Representative Cox and became law June 16. It had the approval of the Remedial Loan Association of Philadelphia, many social agencies, and the majority of lenders. The Foundation, while objecting to the fees which it permitted, acknowledged it to be a satisfactory act in other respects.

In a criminal action to test its constitutionality, the act of 1915 was held good successively by the Court of Quarter Sessions, the Superior Court, and finally by the Supreme Court of Pennsylvania in a decision handed down April 22, 1918.[3] T. Henry Walnut, Thomas Raeburn White, H. D. Wescott, and Frank R. Hubachek defended the act. Owen J. Roberts, now a member of the United States Supreme Court, represented the defendant lender in the action.

[1] Foster's Application, 23 Pa. Dist. Rep. 558, 60 Pa. Sup. Ct. Rep. 8.

[2] Commonwealth *v.* Young, 57 Pa. Sup. Ct. Rep. 521.

[3] Commonwealth *v.* Puder; 261 Pa. St. 129 and 139.

Thus Pennsylvania, during a period of eight years, had been the scene of conflict between sound and unsound legislation, between those seeking to protect their own private interests and those seeking protection of the public, between theories of regulation and of prohibition. The battle grounds were the lower courts and courts of appeal, the floor and hearing rooms of the legislature, the press, the directorates of social agencies, city governments, and the councils of lenders. In no state had more energy been expended in the trial and error process of securing regulation of the small loan business. Nowhere had better minds been brought to bear on the problem.

The final passage of a workable regulatory law in Pennsylvania was materially aided by partial destruction of that portion of the small loan business which could not have been reconciled to the act as it passed. The salary lenders were bearing the brunt of the continuous campaign waged against the loan shark by social agencies, the press, and public officials in Pennsylvania cities. An old law of 1891[1] had invalidated the assignment of future wages payable semi-monthly and most salary loans were legally uncollectible. Borrowers were advised not to pay the salary lender; employers refused to honor wage assignments; and newspapers refused to accept salary loan advertising. Besides, most of the complaints coming to prosecutors resulted from the salary loan business, which had attracted the most greedy and unethical lenders by the opportunity for large profits from small investments. Not only were the salary lenders discredited and without opportunity to present the merits of their case, but their incomes were so reduced that they could hardly undertake their defense by the time-honored method of letting cash do their talking.

Those lenders who lent on the security of household furniture, on the other hand, had not been seriously affected beyond the unpleasant disrepute which attached to the whole industry as a result of anti-loan-shark publicity. Without additional legislation comparatively little could be done against these lenders. Their security, protected by early laws intended to assist credit sales of farm machinery, could not be invalidated. The only recourse open to the borrower was to tender the principal and interest at 6 per

[1] Laws of 1891, no. 71.

cent in full payment of the contract. But this seldom happened. Even if the borrower were informed of his rights, proof of the amounts received and paid was difficult and few borrowers could raise the necessary cash to tender payment in full.

The initiative of lenders on furniture[1] in sponsoring the Pennsylvania law must be explained also in relation to events elsewhere. Regulatory small loan acts had already been passed in Massachusetts and New Jersey over the unanimous opposition of lenders of small sums, who opposed them because they allowed far less than the customary charges of even the better-grade companies. These statutes produced two results. First, the majority of lenders began to perceive that regulation was inevitable and might as well be faced squarely. Second, while rates of profit came down under regulation, operations were more profitable than had been anticipated because losses were reduced, costs were cut, and better borrowers came to the loan offices. Thus, while the conception of a fair interest rate held by the National Federation and the Department of Remedial Loans was tending upward, the rate which chattel lenders were willing to accept was coming down.

Other Legislation Prior to 1916

The year 1915 witnessed the passage of regulatory laws in Iowa, Michigan, and Nebraska, in addition to the Ohio and Pennsylvania laws. The Michigan law was sponsored by two remedial loan associations operating in Detroit. As in Ohio, however, commercial lenders were able to make its passage dependent on the insertion of fees—$1.00 on loans of $50 or less, and $2.00 on loans of more than $50, in addition to the interest of 3 per cent a month on loans of $100 or less and 2 per cent a month on loans between $100 and $300, which had been recommended by the remedial agencies. The Nebraska act relied on the brokerage fiction and permitted 10 per cent commissions and an examination fee in addition to the general interest maximum. Iowa permitted 2 per cent a month and fees poorly protected against repetition.

Only in Maryland had the lenders been able to dictate the terms

[1] The chattel mortgage does not exist in Pennsylvania, but by taking a judgment note against household furniture the lender was in a very similar position to the chattel lender.

of a regulatory act satisfactory to those who made loans of very small amounts. An act of 1906[1] effectively prevented the use of wage assignments as security for loans, but those who lent smaller sums found ample income in the fees permitted by the chattel mortgage act of 1902.[2] In 1912, following widespread demand for reform, the lenders succeeded in passing a new law which applied to all lenders, required licensure and provided penalties, but otherwise offered little advantage to oppressed borrowers. By taking notary fees in addition to the fees authorized by the act, lenders of smaller sums were able to collect legally a rate as high as that charged by illegal lenders in other states.[3]

Lenders' Associations

Defensive and offensive campaigns had served in many states to unite groups of lenders. The 1911 legislative battle in Ohio had resulted the same year in the formation of an association of lenders. Less formal but none the less effective working organizations were formed in Maryland following the passage of the 1912 act, in New Jersey following the passage of the 1914 act, in Indiana in 1915, and in Pennsylvania following the passage of the 1915 Cox Act. In Pennsylvania, as in no other state, the small loan business was largely carried on by chain lenders. Companies with headquarters in Baltimore, Boston, Chicago, Cincinnati, Indianapolis, Minneapolis, New York, and Philadelphia met there on common ground. From the Pennsylvania association it was a natural step to the organization of a national association.

The impetus came from Clarence Hodson of New Jersey, who had formed a company to operate a licensed loan agency in Newark shortly after the passage of the New Jersey law. This company, the Beneficial Loan Society, whose securities Mr. Hodson was promoting, anticipated extending its operations to other states as rapidly as satisfactory enabling legislation should be adopted. He had learned of the operation of the Ohio association from correspondence with Joseph H. Dyer, a prominent Ohio lender. Mr.

[1] Laws of 1906, c. 399.

[2] Laws of 1902, c. 208.

[3] A bulletin issued April 5, 1916, by the general secretary of the Baltimore Federated Charities estimated that under the 1912 law lenders could charge as high as 450 per cent interest on loans of $50 or less for four months.

Hodson sent out invitations to the members of the five existing state associations to discuss the organization of a national association on April 19, 1916, in Philadelphia. This group met and formed the American Association of Small Loan Brokers. George W. Kehr became its first chairman; Charles G. Mueller, secretary; J. H. Aufderheide, treasurer; and Mr. Hodson, chairman of the Committee on Legislation.

The use of the word "broker" in the name of the national association is evidence of the reluctance of the lenders to give up the brokerage ruse, even though the Pennsylvania Supreme Court, on arguments presented in behalf of a loan company itself, had completely shattered this fiction. Two years later, in 1918, the name was changed to the American Industrial Licensed Lenders' Association and names of state organizations were similarly amended. Only then were the word "broker" and the claims on which it was based finally laid to rest.[1]

The Association met again on September 8 and 9, 1916, at Atlantic City to complete its organization. The national association contemplated the maintenance of state associations as the militant units for defending, policing, and elevating the business. The national association was to correlate and support these efforts and to secure adequate legislation in other states. Each state association was represented in the national by a vice-president, and the officers, with the chairmen of committees, constituted the National Council. The first constitution of the Association defined its purpose as follows:

> The objects of the American Association shall be to promote the welfare of all members of the Association; to protect the borrowing public against extortionate charges in procuring salary, chattel and other small loans; to cooperate with all small-loan brokers in the proper conduct of the small-loan business. The policy of the Association shall be cooperation with the state associations in respect to conducting the small-loan business on a fair and dignified basis, securing laws and judicial interpretations thereof that are fair and practicable, when called upon to do so; the mutual interchange of ideas and experiences that will tend to standardize the business and practices of loan brokers in dealing with the public, providing a strong national body that will enlist the services of the best men engaged in the

[1] Except in California, where in order to avoid the constitutional restriction upon interest charges lenders have recently revived the brokerage fiction.

business; providing occasions for pleasant and profitable social and business intercourse in relation to the common interests, and educating the public to freer use of the services and facilities which legitimately conducted small-loan brokers afford in an excellent manner.[1]

Mr. Ham, as a representative both of the National Federation of Remedial Loan Associations and of the Russell Sage Foundation, was invited to attend the last session of the convention to discuss the possibility of co-operation between the organizations he represented and the new association of commercial lenders. He accepted, commended the aims of the Association, and promised his co-operation.

Agreement on a Uniform Law

Events moved rapidly. On October 10, 11, and 12, 1916, a committee of the American Association met with the Executive Committee of the National Federation in New York. It was agreed that the two organizations should as far as possible determine a program to which both could subscribe. Subcommittees of both bodies, headed by Mr. Hodson for the commercial lenders and by Mr. Ham for the remedials, were appointed to consider a uniform regulatory law. At the same time the Executive Committee of the National Federation of Remedial Loan Associations passed a resolution permitting members of the Federation to join state associations affiliated with the American Association.

Mr. Hodson had already drafted and presented to the Atlantic City convention a copy of a model small loan law, which had been referred to the National Council of the Association. Following the New York meeting, Mr. Hodson sent copies of his model loan law to the subcommittees appointed by this conference and asked for their criticism.

The National Council of the American Association met in Philadelphia during the third week in November. The principal item on its agenda was discussion of the proposed model loan law. Much opposition to the Hodson draft had been developing and members of the Council were outspoken in their criticisms. Frank R. Hubachek, who was present at the request of L. C. Harbison and C. H. Watts, both representatives of his client, Mr. Mackey, pro-

[1] Mueller, Charles G., "American Association of Small Loan Brokers." In Bulletin of the National Federation of Remedial Loan Associations, 1917.

posed his own draft, quite similar to the one he prepared for Pennsylvania. The objections to the Hodson bill were principally:

1. It was far too long.
2. It proposed the inclusion of an explanatory preamble.
3. It included much extraneous and unnecessary matter and lacked the broad inclusive regulatory features considered essential to such legislation.
4. It required a minimum capital of $10,000 for licensees.

The National Council rejected the Hodson bill for Mr. Hubachek's draft.

The Hubachek draft was decidedly the better bill. It was broad, direct, and brief—free from unnecessary provisions or verbiage. It differed from the Hodson bill chiefly in its method of approach rather than in its intended effect. It applied to loans of $300 or less; it required licensure and license fees, bonds, supervision, and audit by a state official; it prescribed adequate records and receipts to borrowers; it regulated the use of wage assignments; and it provided adequate penalties for infraction. It provided a rate of 3 per cent a month and fees of $1.00 on loans from $15 to $50, and $2.00 on loans of more than $50 when the loan was made for four months or more.

A subcommittee of the National Council, composed of L. C. Harbison, chairman, J. H. Aufderheide, C. H. Watts, Clarence Hodson, and E. P. East, was appointed to:

> . . . confer with the National Federation of Remedial Loan Associations and such other persons as it deems advisable and endeavor to procure their approval of the uniform law regulating the small loan business which has this day been adopted by this Council, with power to make such changes in said law as it may deem necessary.[1]

The effect of the appointment of this committee was to discharge the Law Committee of the American Association and to nullify its earlier negotiations.

This committee arranged to present its proposed law to the Russell Sage Foundation in New York on November 27. At this meeting Walter S. Hilborn, assistant district attorney of New York County, who had assisted Mr. Ham in drafting the New

[1] Harbison, L. C., "Legislation." In Year Book of the American Association of Small Loan Brokers, 1917, p. 36.

Jersey and New York bills in 1914, was present at the request of the Foundation and Frank R. Hubachek was present at the request of the lenders' group.

The Hubachek draft in almost all respects met the tests which the Foundation had applied to previous legislation. Only the rate of interest was a subject of controversy. Messrs. Ham and Hilborn were unalterably opposed to a fee system and recalled the abuses where fees were in effect. They proposed a flat maximum rate of 3 per cent a month. Several lenders had brought with them figures on the results of their New Jersey operations where a 3 per cent rate without fees was in effect. They admitted that this rate would produce a reasonable profit in industrial communities where large volume was possible and comparatively large loans were in demand, but all contended that this rate was unprofitable in communities where a large volume of business was impossible and in those where the demand was for smaller loans. On the average loan of that time, the fee system proposed by the lenders would have yielded somewhat more than 4 per cent a month. Finally a compromise was effected by which 3½ per cent a month without fees was accepted as the maximum by all parties. Messrs. Ham and Hilborn conceded that smaller loans could not be made for less than this rate, and they believed that competition for the larger and less hazardous loans would result in lower rates in those classes of loans where profits might otherwise be excessive. The lenders promised to maintain freedom of competition and to sever the affiliation with the national association of any state association which attempted to protect interest rates against competition.

While the rate of interest was the chief point of disagreement, the majority of the sections of the Hubachek draft were redrawn by Messrs. Ham and Hilborn. These changes, however, were in form rather than substance. The negotiations lasted three full days, and at the end of that time, on November 29, 1916, a complete bill was evolved which all parties agreed to support. This model bill was called, and has continued to be known as, the Uniform Small Loan Law.

At the close of the conference the following agreement was made:

At a conference held in New York City, November 29, 1916, attended by Mr. A. H. Ham, of the Russell Sage Foundation, and Messrs. L. C.

Harbison, E. P. East, J. H. Aufderheide, C. H. Watts, a committee representing the American Association of Small Loan Brokers, the general form of uniform law regulating small loans was approved. (Colonel Clarence Hodson, a member of the committee, was not present, but approved.) It was understood that all those present will do whatever they can to secure the passage of this law in Illinois, Indiana, California, and in other states in which satisfactory legislation is not now in effect.

It was understood that this law is not to be introduced or its passage advocated in any state not enumerated above without due notice to all interested and ample opportunities for correspondence or conference. It was understood that in some states changes to this law may be advocated in order to make it conform to local laws or conditions, but none of those present at this conference or those whom they represent will advocate any change in the provisions of this law governing the rate of interest, the collection of fees or the regulation or supervision to be exercised by state officials without due notice to all parties interested and an opportunity for conference, and in no event until the present form shall have been energetically urged for passage in a number of states and given a fair test in any states in which it may be enacted.[1]

In regard to the maximum interest rate the Uniform Small Loan Law was a compromise between the views of the commercial lenders on one hand and those of the Department of Remedial Loans and the National Federation on the other. But in all other important respects it conformed to the law drafted by the legislative committee of the National Federation of Remedial Loan Associations and approved by the Federation.[2] It provided that all who lent money in sums of $300 or less at more than the legal contract rate must first secure a license from the state officer in charge of bank examinations and give bond of $1,000 to secure conformity to the law. The state bank examiner in addition was given the power to revoke the license of any lender who violated the act. Examinations of the books of lenders at any and all times by the licensing authority was provided for. The interest rate was fixed at 3½ per cent a month, but no fees, commissions, or charges of any kind were allowed except for filing and recording. Interest could not be

[1] The Loan Gazette (American Association of Small Loan Brokers), no. 4, January, 1917, p. 4.

[2] Ham, Arthur H., "The Year's Progress." In Bulletin of the National Federation of Remedial Loan Associations, 1917, p. 10. Harbison, L. C., "Legislation." In Year Book of American Association of Small Loan Brokers, 1917, p. 37.

collected in advance nor compounded and was to be reckoned on unpaid balances. In event of non-payment of loans made on salaries, not more than 10 per cent of the borrower's wages or salary could be collected at the time of payment of wages or salary. At the time of making a loan the borrower was to be given a plain statement in the English language of the exact terms of the loan. Charging more than the maximum rate allowed by the act was made a misdemeanor punishable either by a fine of $500 or by six months' imprisonment or by both fine and imprisonment.[1]

[1] The first draft of the Uniform Small Loan Law is reprinted in full in Small Loan Legislation by Gallert, Hilborn, and May, pp. 90–94.

CHAPTER VI

SMALL LOAN LEGISLATION, 1916 TO 1934

WHEN the Uniform Small Loan Law was agreed upon there were six states in which fairly satisfactory small loan laws were in force. These were, with their dates of passage:

Massachusetts	1911
Oregon	1913
New Jersey	1914
Ohio	1915
Pennsylvania	1915
Michigan	1915

Two of these laws, those of Ohio and Pennsylvania, had been the result of the efforts of lenders, prodded by public demand for remedial legislation. In Massachusetts, Oregon, and New Jersey, chambers of commerce had been the leading advocates of regulatory acts. In all six states member societies of the National Federation of Remedial Loan Associations had been strong factors in their enactment. In each state, also, the Department of Remedial Loans had influenced the nature of the act which was finally passed.

Legislation in 1917

In 1917, in accordance with the agreement of the American Association of Small Loan Brokers, the Russell Sage Foundation, and the National Federation, the uniform draft was introduced in the legislatures of California, Illinois, Indiana, and Maine with the support of all the parties to the agreement. The director of the Department of Remedial Loans endorsed these bills by correspondence and appeared in their favor before legislative committees.

In spite of well-organized support the course of this legislation was in all cases stormy. The bitterest fight occurred in Illinois, where the bill was endorsed by the Chicago Association of Commerce, Department of Public Welfare of the city of Chicago, Commercial Club of Chicago, Industrial Club of Chicago, Committee on

Local and State Charities of the Chicago City Club, United Charities of Chicago, First State Industrial Wage Loan Society (a remedial loan society), and the Illinois Committee on Social Legislation, which represented 42 local social agencies. The press generally supported the bill, and Kenesaw M. Landis, then judge of the Federal District Court in Chicago, was its active partisan.

The Illinois, Indiana, and Maine bills became law, while the California bill failed in the House by a few votes after passing the Senate.

The same year small loan bills were submitted independently to the legislatures of New Hampshire and Utah. The New Hampshire bill, sponsored by a chain loan company operating in that state, corresponded closely to the uniform draft but permitted fees in addition to an interest rate of 3 per cent a month. The Utah bill was based on the New Jersey law of 1914, a copy of which Mr. Ham had sent to an attorney in Salt Lake City two years before. Both bills became law.

Changes in the Uniform Draft

The following year, 1918, the draft of the Uniform Law was amended by mutual consent of the representatives of the lenders' association and the Russell Sage Foundation. The changes were chiefly in section numbering and in phraseology and affected but slightly the substance of the law.

Since then the proposed draft has been amended three times.[1] In November, 1919, the previous requirement that the borrower and his or her spouse must both sign wage assignments given as security for loans was extended to include chattel mortgages and other liens on household furniture as well as assignments of commissions and other compensation for services. In December, 1923, the limitation of loans to $300 was made to apply to contingent as well as to direct liabilities, and licensees were required to accept repayment of any loan in whole or in part before its maturity regardless of the terms of the contract, with interest only to the date of repayment. A new section was also inserted, which expressly brought all purchases of wages for $300 or less under the terms of the act. The latest change in the uniform draft, made in January, 1932, was more comprehensive than the previous ones. The 1932 draft re-

[1] A further change, made after the study was in type, is described on pp. 270–271.

quired stricter supervision, gave considerably more discretion to the licensing authority, and required the applicant for a license to have a minimum capital of $25,000.[1]

Enactments of the Uniform Law since 1917

Regulatory legislation modeled after the Uniform Law spread rapidly. In 1918 Virginia enacted the Uniform Law[2]; and Maryland, after a bitter fight between two groups of lenders, substituted the Uniform Law for its earlier statute. In 1919 Arizona and Connecticut enacted statutes modeled after the Uniform Law; and Pennsylvania amended its act of 1915 to conform closely to the uniform draft. Georgia in 1920, Iowa in 1921, and Rhode Island in 1923 enacted the law. In 1925 Florida, Tennessee, and West Virginia enacted modified forms of the fourth draft, while Michigan substituted the Uniform Law for its ineffective Act of 1915. Missouri and Wisconsin in 1927, Louisiana in 1928, California in 1931, New York in 1932, and Kentucky in 1934 were added to the list of states having the Uniform Law.

The Department of Remedial Loans participated in most of these legislative campaigns. Local charitable organizations and business men's associations frequently took an energetic part. In almost all instances the press also strongly supported the Uniform Small Loan Bill. It is probably important to the history of small loan legislation that many reporters, compositors, and pressmen were chronic borrowers. Editorial offices in unregulated states were well aware of the small loan problem, and many newspapermen had paid dearly for their schooling in the ways of the high-rate lender.

Those lenders who favored the Uniform Law fought eagerly for its passage, while those who were unwilling to submit to its restrictions opposed it stubbornly. The most effective means which the high-rate lender used to attack the Uniform Bill was to appeal to the old conceptions of a fair interest rate which had persisted so long in law and in custom to the detriment of the necessitous borrower. The high-rate lender, unwilling to be restricted to the in-

[1] For a detailed statement of the changes made in the Uniform Law from the first to the fifth draft, see Small Loan Legislation by Gallert, Hilborn, and May, Russell Sage Foundation, New York, 1932, pp. 90–98.

[2] Except that a higher interest rate (5 per cent a month) was allowed on loans of $50 or less. This rate was reduced to 3½ per cent a month on all loans in 1922.

terest permitted by the Uniform Law, pointed to this rate as extortionate and to the lenders favoring the Uniform Bill as wolves in sheep's clothing, attempting to deceive a trusting legislature by claims of benevolence. The motives of the Russell Sage Foundation in such an "unholy alliance" with the group of lenders supporting these bills were frequently maligned, particularly in states where other activities of the Foundation were not well known. Its representatives found it necessary to explain continually that the Foundation made no loans, and had no financial interest whatsoever in any commercial loan company. It was essential to the effectiveness of regulatory laws that there should be persons willing and able to lend money under these statutes. The Foundation saw no reason for discouraging the efforts of lenders to assist the passage of the Uniform Law.

It is the irony of fate that the chief opponents to the passage of the Uniform Law were, and indeed still are, on one hand, the high-rate lenders and on the other, well-meaning citizens. Frequently the agents of the former appeared in the guise of the latter. The high-rate lender wished to continue his business without supervision or restrictions on his charges. The well-meaning citizen shuddered at the thought of legalizing a rate for the needy borrower so much in excess of the rates charged by banks. An illustration of the kind of attack to which the Uniform Law was subject is afforded by the speech of a state senator in Kentucky during the legislative session of 1922. He said:

> I am surprised that any man would have the cheek and the audacity to come here nearly the last night of the session and attempt to pass a dishonest measure of this nature. There's not a bank that wants it. There's not a labor organization that wants it. There's not any one who wants it except a law-violator. You could take the Atlantic Ocean and convert it into holy water; you could take the bill and soak it therein for 1,000 years; you could bring it back and have the chiropractors and osteopaths work on it; you could put it under a magnifying glass of a ten-millionth capacity—then you couldn't find enough honest stuff to make a shade for a microbe.[1]

The senator was supported in his efforts to defeat the bill by other legislators, most of whom came from rural districts where the

[1] Industrial Lenders News, April, 1922 (American Industrial Lenders' Association, Harrisburg, Pennsylvania), p. 5.

problem could hardly be understood, and by the high-rate lenders who were reaping a rich harvest in Kentucky at rates from three to 15 times the rate allowed under the Uniform Small Loan Law, and continued to do so until March, 1934, when the Uniform Law was enacted.[1]

The Committee for Remedial Loans of the Kentucky Conference of Social Work printed for the benefit of members of this same legislature a handbook stating succinctly and lucidly its reasons for advocating the passage of the bill which the Kentucky senator scorned. But the effect of this reasoned argument was outweighed by invective oratory. The combined opposition of high-rate lenders and good citizens killed the bill.[2]

With the progress of the Uniform Law, the salary and plain-note lenders[3] fought harder and harder to keep for themselves the territory in which they could still operate. The pressure against the passage of the Uniform Law in recent legislative campaigns has been tremendous. In Louisiana, for example, when the Uniform Bill was before the legislature in 1928, the high-rate lenders openly maintained a large corps of lobbyists at Baton Rouge to fight the bill. When the bill was passed that year an appeal was immediately taken by the high-rate lenders on the constitutionality of the act, which had been weakened by an amendment exempting several special types of lending agencies. The bill was declared unconstitutional in that form, but the same year at a special session of the legislature it was reintroduced without the exemptions, passed, and, on another appeal by the high-rate lenders, was declared constitutional.

Rate Reductions in 1929

Bills to amend the Uniform Law or its equivalent were frequent. The rate of interest was particularly subject to periodic attack. In many cases these attacks were inspired by legislators who saw political advantage in this gesture, or by high-rate lenders in re-

[1] Data supplied by the Kentucky Research Council, Louisville, show that the rates charged for small loans in Kentucky in 1931 vary between 100 and 750 per cent a year.

[2] Similar bills were introduced in the Kentucky legislatures of 1924, 1928, and 1932 and these were defeated in the same way.

[3] Those lending on unsecured promissory notes.

taliation for campaigns against them in other states. There were also, however, many worthy legislators who could not be brought to understand the necessity for such high rates. Proposals for rate reduction, whether inspired by selfish or public interest, found a sympathetic hearing among a large number of responsible legislators who had no experience with the frightful conditions of unregulated lending nor knowledge of the long struggle for a workable method of regulation. Prior to 1929 all bills reducing the maximum interest rate provided in uniform acts failed to become law. But in 1929 four states reduced the maximum rate fixed by their small loan laws. Maine reduced its maximum rate from 3½ per cent a month to 3 per cent a month, Missouri from 3½ to 2½ per cent a month, West Virginia from 3½ to 2 per cent, and New Jersey from 3 to 1½ per cent.

In West Virginia and Missouri no data were offered in support of the rate-reduction bills. The Russell Sage Foundation advised the legislatures of these states that similar rates had been ineffective elsewhere, and recommended a careful study of costs and earnings to determine an adequate rate. In Maine the legislature requested cost and earning figures from the state banking commissioner. These figures were compiled hurriedly and were very incomplete. The Foundation pointed out important omissions, advised a study of the effect of a rate reduction on smaller loans, but agreed that the reduction to 3 per cent a month would not be destructive in that state.

In New Jersey the proposal to reduce the small loan interest rate came from the Joint Legislative Commission appointed "to conduct an investigation of the Department of Banking and Insurance concerning the issuance or rejection by the commission of charters to trust companies, state banks, and building and loan associations, and into any and all other matters relating to said department."[1] This Commission had political significance since a Republican legislature was investigating a Democratic administrative department. The attention of the Commission was attracted to the small loan business by the radio broadcasts of two small loan companies that were promoting the sale of their securities to the public and were making fabulous claims about the

[1] New Jersey, Joint Resolution no. 1, Laws of 1928.

profits that could be earned under the New Jersey small loan law. It was found later that these companies were promotional enterprises which relied on profits from the sale of securities and whose profits from the small loan business were negligible.

The Commission hired an accountant to study the reports of licensees to the Department of Banking and Insurance, and on a basis of figures presented by him reported to the legislature as follows:

> We have analyzed the actual figures representing the operations of several hundred of these small loan companies or lenders. The profits of those who have exploited this fertile field are astounding in many cases and certainly not contemplated by the framers of the act. Inordinate profit to the lenders means an exorbitant charge to the borrower. The apparent rate of profit made by the big chain companies, who for stock promotion and other reasons are interested in maintaining the present rate, has been obscured by loading expenses with arbitrary charges for supervision and auditing. Even then, the return on their invested capital is more than twice that on investments in ordinary industrial enterprises. . . .
>
> Our investigation has demonstrated by the experience of those lenders who have entered this field that the small loan business can be and has been profitably conducted at rates less than half the maximum now allowable.[1]

The New Jersey Industrial Lenders' Association vigorously denied the accuracy of these conclusions. It hired the firm of Pace, Gore and McLaren to make a parallel study of earnings and costs in the industry and Professor Willford I. King, of New York University, to make a study of the economic and social functions of the industry.[2] By these studies the lenders hoped to prove, first, that the business could not be conducted at the rate proposed and, second, that the service which the industry rendered was a necessary one. The findings of both reports fully supported these claims.

The figures upon which the Joint Legislative Commission based its recommendations were never made public, but the Pace, Gore

[1] Report of Joint Legislative Commission to Investigate Department of Banking and Insurance, State of New Jersey, 1929, pp. 37–38.

[2] King, Willford I., The Small Loan Situation in New Jersey in 1929. New Jersey Industrial Lenders' Association, Trenton, 1929.

and McLaren report[1] disagreed with the Commission's conclusions in all respects. It concluded:

1. If the proposed rate had been in effect, the aggregate net earnings of licensees in New Jersey for the previous fiscal year would have been 1.2 per cent of employed capital and 35 per cent of the licensees would have lost money.

2. Upon investigation, the charges for supervision and auditing made by the central offices of chain licensees were found to be "bona fide and justified by the nature and scope of the operations of the companies, and in our judgment they were apportioned equitably to the various offices throughout the country."[2]

3. Based on a study of earnings of chain enterprises in other fields, the earnings of the New Jersey offices of chain loan companies "were not only not double those of other enterprises but were, in fact, not as great."[3]

The Russell Sage Foundation joined in the protest that the conclusions of the Joint Legislative Commission were contrary to fact and predicted that the licensed small loan business would be destroyed in New Jersey by a reduction in maximum rate to 1½ per cent a month.

Rate Reductions in 1933 and 1934

During the four years of depression which followed 1929, legislative bodies were under pressure to relieve the burden which lower prices and reduced incomes had put upon debtors. Some of this pressure was naturally exerted for reduction of the charges permitted by small loan laws.

In Wisconsin where the interest rate permitted by the small loan law was subject to bitter attack, Professor John R. Commons of the University of Wisconsin proposed that the determination of maximum interest rates be delegated to a special fact-finding commission. This recommendation and others were incorporated in a bill which was introduced in the 1931 session of the Wisconsin legislature, but failed to become law.

In the 1933 legislature, however, a similar proposal known as

[1] Pace, Gore and McLaren, Financial Aspects of the Small Loan Business in New Jersey. New Jersey Industrial Lenders' Association, Trenton, 1929.

[2] *Ibid.*, pp. 15–16.

[3] *Ibid.*, pp. 17–18.

the Carroll Bill was introduced and was enacted.[1] Pending action by the banking commission, which was the rate-fixing body, this act fixed the maximum rates of interest for small loans at 3½ per cent a month on the first $100 and 2½ per cent a month on the remainder of the unpaid principal balance. Although it contained most of the structure of the fifth draft of the Uniform Law, the Carroll Act departed from the language and arrangement of the model act. It contained one feature that is not to be found in any similar legislation. It provided that the banking department might "appoint advisers from the employes, employers, social workers, legal aid bureaus, bankers, and other appropriate classes of persons in the state and in any locality, which advisers shall be consulted by and shall assist the department in the execution of its duties."

On November 9, 1933, the Wisconsin Banking Commission ordered "that the maximum rate of interest or charge on loans made on and after December 11, 1933 . . . shall not exceed 1¼ per cent per month computed in all cases on unpaid balances." No cost data were submitted in support of this order and the Commission announced that the rate was established for "an experimental period in which the Commission will make an audit of the operations of the small loan companies and closely observe the results of the reduction in interest rates." Because of the failure of the Commission to publish its order as required by law, the effective date was postponed until December 28. All licensees ceased making loans on that date. Following an unsuccessful appeal to the Banking Commission for reconsideration, licensees instituted injunction proceedings to set aside the Commission's order on the ground that the rate was inadequate to accomplish the declared purpose of the act. The injunction was granted on February 7, 1934, and the order of the Banking Commission suspended.[2]

On April 13, 1934, the Wisconsin Banking Commission issued a second order, fixing maximum interest rates at 2½ per cent a month on the amount of each loan not in excess of $100, 2 per cent

[1] Laws of 1933, c. 347.

[2] Personal Finance Company of Eau Claire *et al* v. Banking Department *et al.*, Circuit Court of Dane County, Wisconsin.

a month on amount of each loan exceeding $100 but not exceeding $200, and 1 per cent a month on amount of each loan in excess of $200. The Commission again failed to publish the facts upon which its decision was based. On June 4 this second order was appealed to the courts, and on June 9 the Banking Commission was restrained from enforcing its interest rate regulations pending court review of the validity of the order.[1]

In Indiana legislation somewhat similar to the Carroll Act in Wisconsin was enacted in 1933. The Indiana General Assembly in 1931 had created the Study Commission for Indiana Financial Institutions, which recommended the amendment of the small loan law to include the most important features of the fifth draft of the Uniform Law. During legislative debate upon the proposed changes in 1933, the rate control commission proposed by Professor Commons in Wisconsin was added to the Indiana amendments and the maximum rate of charge, pending the determination of rates by the Commission for Financial Institutions, was fixed at 3½ per cent a month on the first $150 of each loan and 2½ per cent a month on the balance.

The Indiana Commission undertook a careful study preparatory to fixing maximum rates. A well-trained research staff made an analysis of costs and earnings shown by the annual reports of small loan licensees. On July 11 the Commission issued an order effective August 1, fixing maximum interest rates at 3½ per cent a month on the amount of each loan not exceeding $100, 2½ per cent a month on the amount exceeding $100 but not exceeding $200, and 2 per cent a month on the amount exceeding $200. The Commission expects to publish in full the data upon which these rates were based.

In New Hampshire the 1931 legislature authorized the governor to appoint a special commission of five persons "to study and analyze the true net income of [small loan] licensees . . . and the effect of the rate of interest charged by said licensees upon the general welfare of the state of New Hampshire and its citizens."[2] This commission employed an accountant to analyze the reports of

[1] The second plea was filed by the same plaintiffs and in the same court as the first plea.

[2] Laws of 1931, c. 163.

small loan licensees and held five hearings. In 1932 the commission issued its report. The majority report, signed by four members, recommended that no change be made at that time in the maximum rate of 3 per cent a month but that certain fees permitted by the act should be eliminated.[1] The minority report signed by a single member differed from the majority report on the question of rate. It concluded: "It is recommended to the bank commissioner that the rate of interest said licensees be allowed on loans of $300 or less be 2½ per cent per month."[2] The legislature, however, discarded both these recommendations based on careful investigation and in 1933 enacted a rate reduction to 2 per cent a month.

Two other states reduced the maximum interest rate for small loans in 1933. In Connecticut, where various rate reductions were proposed, the rate was finally reduced moderately from 3½ per cent a month to 3 per cent a month. In Michigan a reduction in rate was accomplished by a very unusual procedure. The 1933 session of the legislature sought to amend the small loan act by cutting the maximum rate to 1¾ per cent a month. Governor William A. Comstock bravely vetoed the bill, saying that the proposed rate would drive licensed companies out of business and pave the way for the return of loan sharks. Prior to the veto, Governor Comstock met with representatives of the small loan licensees and obtained their agreement to a voluntary reduction of rates, pending action on the small loan bill at a future session of the legislature. The reduction agreed upon set the maximum charge of 3 per cent on loans of $100 or less, and 2½ per cent on loans in amounts above $100. This action by the state's chief executive was unprecedented in the history of small loan legislation, and undoubtedly was influenced by the destructive results of rate cuts in New Jersey and West Virginia.

In 1934 Iowa followed the lead of Wisconsin and put the determination of the maximum interest rate in the hands of the State Banking Board. Pending determination by this Board the

[1] Report of Special Commission on Small Loans, State of New Hampshire, September 1, 1932, unpublished.

[2] Minority Report of Special Commission on Small Loans, State of New Hampshire, unpublished.

maximum rate was fixed by law at 3 per cent a month on the first \$150 and 2½ per cent a month on the balance.

The opinion of the Department of Remedial Loans of the Russell Sage Foundation concerning proposals for rate reduction in 1933 and 1934 was asked in each instance by legislators. It endorsed the Indiana, Wisconsin, and Iowa enactments as interesting and worthwhile experiments. It continued to recommend 3 or 3½ per cent a month, depending upon the character of the state's population, as the most satisfactory maximum rate, but suggested that the rate could probably be lowered to 2½ per cent a month on balances above \$100 without destructive results. It disapproved the reduction to 2 per cent a month in New Hampshire and the proposed reduction to 1¾ per cent in Michigan. It disapproved proposals in Connecticut to cut the maximum rate to 2 and 2½ per cent a month, but offered no objection to the reduction to 3 per cent a month in that state.

Effect of Reductions in the Maximum Rate

However destructive they may have been to legitimate capital and to borrowing facilities, these experiments with reduced interest rates are invaluable to the student of small loan legislation. The rate cuts made in 1933 are too recent to permit a measurement of the results.[1] The four states which reduced their maximum rates in 1929, however, provide a gradation of rates that could scarcely have been improved upon if the experimentation had been planned. Maine tried 3 per cent a month; Missouri, 2½ per cent; West Virginia, 2 per cent; and New Jersey, 1½ per cent.

In Maine the reduction from 3½ to 3 per cent a month made little difference in the effectiveness of the small loan act. Although the number of licensees declined from 47 in 1929 to 33 in 1933,[2]

[1] A letter from the bank commissioner of New Hampshire to the Russell Sage Foundation dated January 23, 1934, says, however, "Due to the reduction in rate from 3 per cent to 2 per cent per month at the last session of the legislature, the presumption is that by April of this year, I will have practically no small loan licensees."

The Manchester Union, after an investigation of the effect of the rate reduction, reported on December 8, 1933, that only one or two of the 23 lenders previously licensed remained in business on that date.

[2] The number of licensees in Maine declined in each year after 1929. In states which did not reduce interest rates, the number of licensees increased in 1930 and 1931 and declined slightly in 1932.

the amount of loans outstanding from 1929 to 1932 closely followed the trend in states where no rate reduction occurred. Maine reports no data which would show the effect of the rate cut on small and poorly secured loans, but there is no evidence that any classes of borrowers were eliminated or that any high-rate lending was induced by the increased selectivity of licensees at the lower rate.

The results of the reductions to 2½, 2, and 1½ per cent a month in Missouri, West Virginia, and New Jersey, respectively, were the subject of a special study by the Department of Remedial Loans. The findings of this study were published in the Harvard Business Review for October, 1933,[1] and we shall refer here only briefly to its conclusions. They were:

1. The rate reduction in each state resulted in a contraction of lending roughly commensurate with the degree of reduction in the maximum rate of interest.
2. In eliminating loans which were unprofitable at the reduced rates the lender refused applicants for smaller and more poorly secured loans, who by this fact were presumably most in need of the facilities and protections which the act was designed to supply.
3. Bootleg lenders immediately began to make loans of the kind refused by licensed lenders, at exorbitant rates of interest.

In Missouri, where the reduction in maximum rate was least severe, the number of licensees decreased from 174 at the close of the year 1928 to 89 at the close of the year 1932. Since the Missouri small loan law had been enacted only two years before the reduction in interest rate, the volume of loans had been rapidly increasing. The rate cut stopped abruptly further increase in the aggregate amount of loans outstanding but did not immediately result in a decrease. Those lenders who made loans on endorsed notes and specialized in larger loans on chattel mortgages at rates of 2½ per cent or less prior to the rate reduction continued to increase their business. But most other licensees sold their offices, began to liquidate, or refused applicants for less than $100 or some higher limit. High-rate lending, which had been practically eliminated in the two years that the Missouri law had been in

[1] Nugent, Rolf, "Three Experiments with Small Loan Interest Rates." In Harvard Business Review, October, 1933, pp. 35–46.

force, immediately increased. Eighteen unlicensed salary lenders were reported in Kansas City and St. Louis in 1932. The commissioner of finance in Missouri concluded his report to the governor for the calendar year 1931 by saying: "It is, therefore, the belief of the department that if a higher rate were permitted on smaller balances, it would eliminate most of the unlicensed lenders who still charge from 10 per cent to 20 per cent a month."[1]

In West Virginia the number of licensees declined from 62 in 1929 to 22 in 1933. The estimated amount of outstanding loans declined from $3,600,000 at the time of the rate reduction to $900,000 at the close of the year 1932. The remaining licensees turned to loans against real estate and endorsed notes, while the loan shark returned to make at exorbitant rates the loans which licensees refused.[2] A questionnaire sent by the Russell Sage Foundation to local chambers of commerce in West Virginia cities in January, 1930, produced the information that 23 high-rate lenders charging 20 to 40 per cent a month were operating in West Virginia cities at that time. This number undoubtedly increased as the licensed lenders liquidated.

In New Jersey, where the reduction in maximum rate was most severe, the number of licensees declined from 437 in 1928 to 83 in 1932. Of the 83 remaining in 1932 several were in receivership and all but 19 were liquidating. The amount of outstanding loans declined from more than $20,000,000 in May, 1929, to $5,400,000 on November 30, 1931. More than 90 per cent of the loans outstanding at the latter date were secured by endorsed notes or had been made by the Household Finance Corporation, which had agreed to continue its eight offices in New Jersey and to submit the results of their operations to the commissioner of banking and insurance as a test of the necessity for a higher rate. In the spring of 1932 this company submitted its report and announced that it would be compelled to retire from the state unless a higher rate were authorized. In connection with this report, it submitted affidavits from borrowers who were paying interest rates

[1] Summary of Annual Reports of Personal Finance Companies of Missouri for the Year 1931.

[2] Huntington (West Virginia) Better Business Bureau, The High Rate Loan Situation in Huntington, October 21, 1922.

ranging from 36 to 4,000 per cent a year to 10 illegal loan companies.[1]

In 1932 the New Jersey legislature increased the maximum rate to 2½ per cent a month. This rate seems more likely to be effective in New Jersey than in any other state. Northern New Jersey has large compact areas of suburban population living principally in individual houses, with excellent transportation facilities between these areas and business centers. Its wage scales and educational standards are relatively high, and the principal demand has been for loans of larger denominations. Applicants for smaller sums will undoubtedly be neglected, but the aggressive supervision which New Jersey has enjoyed for several years will no doubt prevent any widespread lending at loan-shark rates. While a higher maximum for smaller loans would probably be preferable, it is possible that fairly satisfactory lending conditions may result from the present rate.

In 1933, on the strong recommendation of the West Virginia Federation of Labor, chambers of commerce throughout the state, and the Huntington Better Business Bureau, the West Virginia legislature increased the maximum rate of interest to 3½ per cent a month on the first $150 of each loan and 2½ per cent a month on the balance.

Repeated attempts to increase the maximum rate in Missouri have been unsuccessful.

Extent of Legislative Attention to Small Loans

We have referred in this and previous chapters to only a small portion of the legislation affecting the small loan business which was proposed during the period covered by these chapters. Certainly no subject of state legislation, unless perhaps it be public utility regulation, has had more widespread and continuous attention. Table 5 is furnished to show the number of bills affecting small loans which were introduced in each state and the District of Columbia from 1904 to 1933.

[1] Exhibits filed by the Household Finance Corporation with the New Jersey Small Loan Commission.

TABLE 5.—NUMBER OF SMALL LOAN BILLS INTRODUCED IN STATE LEGISLATURES EACH YEAR, 1904 TO 1933

STATE	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20	'21	'22	'23	'24	'25	'26	'27	'28	'29	'30	'31	'32	'33	Total
Alabama	.	.	.	.	.	1	.	3	.	.	.	1	.	.	.	.	.	.	.	1	.	.	.	5	.	.	.	1	.	.	12
Arizona	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	.	.	1	.	1	.	2	.	5	.	8	18
Arkansas	.	.	.	.	.	1	.	.	.	1	.	.	.	.	.	.	.	.	.	.	.	.	.	3	.	3	.	.	.	2	10
California	.	2	.	.	.	1	.	4	.	6	.	2	.	4	.	.	.	.	.	.	.	.	.	1	.	3	.	3	.	6	32
Colorado	.	.	.	.	.	1	.	1	.	3	.	1	.	1	.	2	.	.	.	.	.	1	.	.	.	1	.	3	.	.	14
Connecticut	.	.	.	1	.	.	.	1	.	1	.	.	.	.	.	3	.	.	.	1	.	1	.	4	.	2	.	6	.	12	32
Delaware	1	.	.	.	.	.	.	.	.	.	.	1	.	.	.	.	.	.	.	1	.	.	.	1	.	3	.	1	.	1	9
Florida	.	.	.	.	.	1	.	.	.	.	.	2	.	.	.	.	.	1	.	.	.	1	.	1	.	2	.	9	.	29	46
Georgia	2	.	.	.	1	.	.	.	.	.	.	1	.	.	.	1	1	.	1	1	1	1	.	8	.	.	4	3	.	6	31
Idaho	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	1
Illinois	.	1	.	.	.	1	.	5	.	1	.	2	.	4	.	1	.	1	.	1	.	1	.	2	.	8	.	8	1	20	57
Indiana	.	.	.	.	.	1	.	1	.	6	.	1	.	2	.	1	.	.	.	.	.	1	.	1	.	3	.	6	4	6	33
Iowa	.	.	.	.	.	.	.	.	.	3	.	2	.	.	.	.	.	1	.	2	.	.	.	1	.	2	.	8	.	9	28
Kansas	.	.	.	.	.	.	.	.	.	3	.	1	.	4	.	.	.	.	.	.	.	.	.	2	.	2	.	.	.	1	13
Kentucky	.	.	.	.	.	.	.	.	2	.	1	.	.	.	3	.	1	.	1	.	1	.	1	.	3	.	2	.	9	.	24
Louisiana	.	.	1	.	.	.	.	.	.	.	1	.	.	.	1	.	.	.	1	.	2	.	1	.	3	1	3	.	9	.	23
Maine	.	.	.	.	.	.	.	.	.	5	.	1	.	1	.	.	.	.	.	.	.	1	.	.	.	6	.	1	.	2	17
Maryland	.	.	1	.	1	.	1	.	2	.	.	.	2	.	2	.	1	.	.	.	1	.	.	1	.	4	.	3	.	5	24
Mass.	.	.	1	.	1	.	1	5	.	1	.	.	4	4	.	.	2	1	2	.	1	1	.	.	.	.	1	1	9	11	46
Michigan	.	.	.	1	.	.	.	1	.	1	.	4	.	1	.	1	.	1	.	.	.	1	.	1	.	1	.	5	4	11	33
Minnesota	.	1	.	.	.	.	.	.	.	2	.	.	.	1	.	.	.	1	2	1	.	1	.	7	.	1	.	4	.	7	28
Mississippi	.	.	1	.	.	.	.	.	1	.	2	.	.	.	.	.	.	.	.	.	.	.	1	.	2	.	1	.	2	.	10
Missouri	.	.	.	.	.	.	.	4	.	1	.	.	.	.	.	1	.	.	.	1	.	1	.	2	.	8	.	6	.	10	34
Montana	.	.	.	.	.	.	.	1	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	.	.	.	.	3	.	.	5
Nebraska	.	.	.	.	.	.	.	1	.	2	.	1	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	3	.	8	15
Nevada	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	2	2
N. Hampshire	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	.	.	1	.	.	.	.	.	.	.	2	.	4	8
New Jersey	1	.	.	.	.	.	1	.	.	2	1	1	.	1	.	1	1	.	.	1	.	1	2	1	4	3	4	8	4	6	43
New Mexico	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	2	.	1	.	1	4
New York	1	.	.	.	.	.	4	7	3	6	8	3	1	.	.	.	1	.	1	1	.	.	.	.	3	3	.	12	13	10	77
N. Carolina	.	.	.	1	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	2	.	1	.	2	.	1	8
N. Dakota	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	2	3
Ohio	1	.	.	.	.	.	.	5	.	.	.	1	.	3	.	1	.	1	.	1	.	1	.	1	.	3	.	6	.	8	32
Oklahoma	.	.	.	.	.	.	.	.	.	2	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	1	4
Oregon	.	.	.	.	.	.	.	.	.	1	.	1	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	3	.	15	20
Pennsylvania	.	.	.	.	.	1	.	3	.	5	.	2	.	1	.	1	.	.	.	2	.	2	.	1	.	7	.	12	.	14	51
Rhode Island	.	.	.	.	1	1	.	.	2	.	.	.	.	.	.	.	.	.	1	2	.	.	.	2	2	1	1	3	2	4	22
S. Carolina	.	.	.	.	.	.	1	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	2	1	2	.	1	.	8
S. Dakota	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	1
Tennessee	.	1	.	.	.	.	.	2	.	5	.	.	.	1	.	1	.	.	.	2	.	1	.	2	.	4	.	5	.	11	35
Texas	.	.	.	.	.	.	.	4	.	3	.	1	.	.	.	.	.	.	.	.	.	.	.	3	.	3	.	3	.	11	28
Utah	.	.	.	1	.	1	.	.	.	1	.	2	.	2	.	1	.	.	.	.	.	.	.	1	.	1	.	2	.	2	14
Vermont	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	.	1
Virginia	.	.	1	.	.	.	.	.	.	.	1	.	.	.	1	.	2	.	.	.	2	.	6	2	2	.	2	.	3	.	22
Washington	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	1	.	.	.	.	.	2	.	.	.	1	.	2	.	3	9
W. Virginia	.	.	.	.	.	.	.	.	.	1	.	.	.	2	.	1	.	1	.	1	.	1	.	5	.	2	.	5	.	9	28
Wisconsin	.	1	.	1	.	1	.	1	.	3	.	1	.	1	.	1	.	1	.	1	.	1	.	1	.	4	.	5	.	15	38
Wyoming	.	.	.	.	.	1	.	.	.	.	.	.	.	1	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	2	4
Dist. of Col.	.	.	.	1	2	1	.	1	.	.	1	1	1	1	.	1	.	.	.	.	.	.	.	.	1	1	1	1	2	5	21
TOTAL	6	6	5	6	6	13	8	50	10	65	15	33	8	36	7	20	9	9	9	23	8	21	12	62	22	91	21	152	63	282	1,078

TABLE 6.—STATES HAVING LAWS ON MAY 1, 1934, CONFORMING IN CHIEF RESPECTS TO THE UNIFORM SMALL LOAN LAW[a]

State	Nature of act	Present maximum rate of interest: per cent a month	Year of enactment
Arizona	Contains essential provisions of Uniform Law	3½	1919, revised 1925
Connecticut	Uniform Law, second draft	3	1919, amended 1929, 1933
Florida	Uniform Law, fourth draft with slight variations	3½	1925, amended 1933
Georgia	Uniform Law, second draft	3½	1920
Illinois	Uniform Law, first draft	3½	1917, amended 1925, 1933
Indiana	Uniform Law, modified fifth draft	3½, 2½, and 2[b]	1917, revised 1933
Iowa	Uniform Law, modified fifth draft	3 and 2½[c]	1921, revised 1934
Kentucky	Uniform Law, fifth draft	3½ and 2½[d]	1934
Louisiana	Uniform Law, fourth draft	3½	1928
Maine	Uniform Law, first draft	3	1917, revised 1930
Maryland	Uniform Law, fourth draft	3½	1918, revised 1929
Massachusetts	Contains essential provisions of Uniform Law	3[e]	1911, amended 1916, 1919
Michigan	Uniform Law, fourth draft	3½	1921, amended 1925
New Jersey	Uniform Law, fifth draft	2½	1914, revised 1932
New York	Uniform Law, fifth draft	3 and 2½[f]	1932
Ohio	Approximates Uniform Law, first draft	3[g]	1915, amended 1933
Oregon	Approximates Uniform Law, fifth draft	3[h]	1913, revised 1931, amended 1933
Pennsylvania	Approximates Uniform Law, second draft	3½	1909, revised 1915, amended 1919
Rhode Island	Uniform Law, third draft	3½	1923, amended 1927
Tennessee	Uniform Law, fourth draft with slight variations	3½[i]	1925, revised 1932
Utah	Approximates Uniform Law, first draft	3	1917, revised 1933
Virginia	Uniform Law, partly third and partly fourth draft	3½	1918, revised 1922, amended 1928
West Virginia	Uniform Law, fifth draft	3½ and 2½[j]	1925, revised 1933
Wisconsin	Uniform Law, modified fifth draft	3½ and 2½[k]	1927, revised 1933

[a] Discussion of the laws which were enacted prior to 1932 and statutory references to these laws are given in Small Loan Legislation, pp. 113–130.

[b] Three and one-half per cent a month on that part of any loan not in excess of $100, 2½ per cent a month on that part exceeding $100 but not exceeding $200, and 2 per cent a month on that part exceeding $200. This maximum rate has been fixed by the Indiana Commission for Financial Institutions and is subject to change by the Commission.

[c] Three per cent a month on that part of any loan not in excess of $150, 2½ per cent a month on that part exceeding $150. This maximum rate is fixed by law pending determination of the maximum rate by the Iowa Banking Board which is now making a study preparatory to fixing the maximum rate. (*Notes continued on p. 135.*)

Present Status of Small Loan Legislation

In concluding this history of legislation during the period 1916 to 1934, it seems appropriate to summarize briefly the status of small loan legislation on June 1, 1934. Twenty-four states have regulatory laws which conform to the Uniform Small Loan Law in all principal respects. They bring under regulation all loans of $300 or less; require the licensing and bonding of lenders engaged in the business of making such loans who are not otherwise regulated by specific enabling acts; require supervision and examination of licensees by a state official charged with the enforcement of the regulatory act; provide penalties for infraction of the act either by licensees or by non-licensees; and with the exception of New Jersey[1] permit licensees to charge a maximum rate of 3 or 3½ per cent a month on the first hundred dollars, at least, of each loan. These 24 states are listed in Table 6, which shows the degree of conformity of each state's act to the Uniform Law, the present maximum interest rates, and the dates of enactment, together with the dates of important revisions or amendments.

Four states have regulatory statutes which meet the standards of the Uniform Small Loan Law in all principal respects except interest rate. Table 7 concerns the present laws of these four states.

Eight states and the District of Columbia have small loan laws which fail to meet the standards of the Uniform Law in many or all respects. Table 8 relates to these states.

[1] As we have explained earlier (p. 132) a maximum rate of 2½ per cent a month may prove to be practicable in New Jersey, but appears to be unsatisfactory elsewhere. Hence New Jersey is included among the states which have adequate small loan laws and Missouri, where the maximum rate is also 2½ per cent a month, is included among the states which have inadequate small loan laws.

Notes to Table 6 continued from p. 134.

[d] Three and one-half per cent a month on that part of any loan not in excess of $150, 2½ per cent a month on that part exceeding $150.

[e] This rate is subject to change by the Massachusetts supervisor of loan agencies.

[f] Three per cent a month on that part of any loan not in excess of $150 and 2½ per cent a month on that part exceeding $150.

[g] An additional fee of $1.00 is allowed on loans of $50 or less.

[h] Charges on loans of $30 or less are not restricted.

[i] One-half per cent a month interest and 3 per cent a month in fees.

[j] Three and one-half per cent a month on that part of any loan not in excess of $150 and 2½ per cent a month on that part exceeding $150.

[k] Three and one-half per cent a month on that part of any loan not in excess of $100 and 2½ per cent a month on that part exceeding $100. This is the maximum rate fixed by law pending determination of the maximum rate by the Wisconsin Banking Commission. This Commission has ordered a lower rate, but has been temporarily enjoined from enforcing it.

TABLE 7.—STATES HAVING LAWS ON MAY 1, 1934, CONFORMING TO THE UNIFORM SMALL LOAN LAW IN CHIEF RESPECTS EXCEPT INTEREST RATE

State	Nature of act	Year of enactment	Present maximum rate of interest
California	Uniform Law, partial fifth draft	1931, interest rate section declared unconstitutional 1932[a]	12 per cent a year and fees
Colorado	Uniform Law, third draft	1919	1 per cent a month and small fees
Missouri	Uniform Law, fourth draft	1927, interest rate reduced 1929	2½ per cent a month
New Hampshire	Approximates Uniform Law, first draft	1917, interest rate reduced 1933	2 per cent a month

[a] In 1932 the California Supreme Court declared the interest rate section of the 1931 act unconstitutional, because the interest rate provision amended a previous initiative act, which could only be amended by another initiative act. By means of the legal fiction of brokerage, which has been supported by legislation in 1933 (Laws of 1933, c. 577), small loan licensees in California have continued to operate within the maximum rate contemplated by the 1931 act. The present arrangement, however, can by no means be considered an effective regulation.

TABLE 8.—STATES HAVING LAWS ON MAY 1, 1934, NOT CONFORMING TO THE UNIFORM SMALL LOAN LAW IN CHIEF RESPECTS

State	Year of enactment	Principal shortcomings of act
Alabama	1927	Inadequate interest rate; applies only to certain counties
Delaware	1929	Inadequate interest rate; supervision insufficient
District of Columbia	1913	Inadequate interest rate; applies only to secured loans
Minnesota	1913	Applies only to remedial societies
Mississippi	1906	Dangerous fees; exorbitant tax; inadequate supervision; no limit to size of loans
Nebraska	1915	Inadequate interest rate; dangerous fees; no limit to size of loans
North Carolina	1927	Inadequate interest rate; no supervision
Texas	1927	Inadequate interest rate; no supervision; no limit to size of loans
Wyoming	1909	Inadequate interest rate; no supervision or penalties

The remaining 11 states have no special small loan statutes. These are:

Arkansas	New Mexico	South Carolina
Idaho	North Dakota	South Dakota
Kansas	Nevada	Washington
Montana	Oklahoma	

Regulatory small loan legislation has been extended to all primarily industrial states. Among those that are partially industrial only California, Delaware, Minnesota, North Carolina, and Texas are still without adequate regulatory loan laws. Although these states have large industrial centers they are still predominantly agricultural. The balance of power is held by legislators from agricultural communities, who have little conception of the small loan problem and who oppose any relaxation of the general statutes restricting interest rates.

It should perhaps be recorded here that the agreement on legislation effected in 1916 between the national association of licensed lenders and the Russell Sage Foundation was cancelled amicably in 1930. The lenders were left free to introduce such legislation as they saw fit, while the Russell Sage Foundation announced that it would support any legislation which met the standards of the latest draft of the Uniform Law and that it would oppose bills which did not conform to these standards. A further modification of its position with regard to legislation was made in 1933, when the Foundation announced that it would take no position on proposed small loan legislation except in response to a definite request for its opinion and that it would be represented at legislative committee hearings only at the request of the committee.

CHAPTER VII

SMALL LOAN AGENCIES, 1910 TO 1934

IN THE two previous chapters we have described the most important legislation enacted during the period from 1910 to 1934. In this chapter we shall record the development during the same period of various types of agencies for supplying personal loans.

Acceptance of Regulation by Lenders

Within the ranks of the licensed lenders, progress was rapid in building a decent, self-respecting industry out of the confusion of the past. Whether the lenders who first accepted the principles of regulation proposed by the Russell Sage Foundation did so through sheer necessity or through conversion to a new conception of their business is of little importance compared with the fact that the great majority of licensed lenders, from the very beginning of their status as such, sought to meet not only the letter but the spirit of the law as well. The number who attempted to evade the law became smaller and smaller as pressure was exerted by supervising state officials or by the business practice committees of lenders' associations, which assumed responsibility for policing the industry as far as possible from within.

In any attempt to be fair to the lenders of the loan-shark era, one must admit that they were working under a system, or rather a lack of system, that tended to demoralize the business. Walter Bagehot, in speaking of the need to reform English finances, which in 1770 had become a reproach to public decency, is said to have remarked that "the statesmen who worked the system that was put up had themselves been educated under the system that was put down."[1] So in the small loan field in America, it was the system and not the individual that was chiefly to blame.

[1] Quoted by Henry Jones Ford in The Cost of Our National Government, Columbia University Press, New York, 1910, p. 37.

The early reports of state departments charged with supervision of licensed lenders frequently commented favorably on the character of small loan licensees. As early as 1916 in Ohio the state superintendent of banks reported:

The operation of the restrictive provision of this law (The Small Loan Act of 1915) has resulted in putting out of business many money-lenders who had for a long time lived by the unlawful profits of their investments. Men of high character and correct business methods, satisfied with the lawful returns upon their loans, have taken their place, so that we can now say with a great deal of assurance that there is not a licensee of this department who deserves to be called a "loan shark."[1]

And in 1920 the chief examiner of the same state reported that "the business of lending money on personal property is on a legal and proper basis and deserves to, and does, rank with any other business in the state."[2]

Reports of state supervisors also throw light on the changed attitude of lenders who had formerly used much of their energy in trying to evade or prevent the passage of regulatory laws. The chief examiner in Ohio reported in 1920:

It is clearly apparent that almost without exception the licensees have been manifesting their complete and whole-hearted desire to cooperate with the department in every way and the value of cooperation to all concerned has again been clearly demonstrated. It is proper in this report to commend most highly the officers and members of the Ohio Loan Association and the other licensees for their real enthusiasm in maintaining and furthering the objects aimed at in the law.[3]

In 1928 the Massachusetts supervisor of loan agencies reported:

The determination of the Massachusetts Industrial Lenders Association to do everything within its power to compel observance of the laws governing small loans in Massachusetts, by cooperating to the best of its ability with public officials, indicates that this Association finds our Small Loan Law fundamentally and economically sound, and that such a law is in the interest and for the welfare of all the citizens of the Commonwealth who borrow small sums. This Association pledges itself to a strict compliance with the law in spirit and letter: to the performance of every effort to

[1] Annual Report of Chattel Loan Bureau, State of Ohio, 1916, p. 5.

[2] Annual Report of Chattel Loan Bureau, State of Ohio, 1920, p. 17.

[3] *Ibid.*, pp. 5–6.

make industrial lending a beneficial public service and to work for the constructive problems which confront its business, so that the law, or any amendment thereof, may be supported and preserved as a recognized part of the economic structure of this State. Through its vigilance work in suppressing unlawful lending, calling to the attention of the Supervisor violations of the law, whenever occurring, and by prosecution of flagrant cases, the Association is helping to make Massachusetts supervision most effective. The amount of lending at unlawful rates that comes to the attention of the Supervisor is small, and complaints are few in comparison to the volume of business.[1]

In reply to letters written by one of the authors in 1925 to state officers charged with the supervision of small loan licensees in states then having the Uniform Law, the opinion was unanimous that licensees were conducting their businesses honestly and in compliance with the law, and that the law itself was successfully accomplishing its purpose.

The Russell Sage Foundation and the National Federation of Remedial Loan Associations undoubtedly looked upon the first lenders' associations with apprehension. The relationship of the Foundation and the Federation with the lenders was one of necessity and not of choice. The only immediate source of capital, organization, and knowledge of lending technique was the former high-rate lender. But it was unlikely that the Foundation or the Federation would have confidence immediately in associations composed principally of former high-rate lenders, in spite of the commendable aims contained in the constitutions of these bodies.

The straightforwardness and the sincerity of the licensed lenders gradually broke down this mistrust. In 1917 the National Federation authorized its member societies to join the state licensed lenders' associations if they wished, and many did so. The state and national associations of lenders realized that only the most careful observance of business ethics would shake off the odium that had been attached to the business in the past and would secure for the industry a position of respect among other legitimate businesses. To this end the leaders of the industry, as well as the great majority of its rank and file, bent every effort.

[1] Annual Report of Supervisor of Loan Agencies, 1928, Commonwealth of Massachusetts, Public Document no. 95, p. 3.

Independent and Chain Small Loan Offices

A large number of small loan offices during the loan-shark era appear to have been associated in chains. Ownership of these chain offices was usually disguised by recording the local manager or a dummy as the owner in order to make prosecution of the real owner difficult. With few exceptions local offices had names which bore no relationship to those under the same management in other cities. The chains were spoken of within the industry by the name of the generally recognized owner. There were, for instance, the Barrett, Mackey, and Aufderheide offices among the chattel loan chains and the Tolman, Wagner, Drake, and Cotton offices among the chains lending on plain notes or salaries. There are no records from which we may judge the relative number of chain and independent offices, and differences in name would probably have hampered identification of chain offices even if such records had been available.

Few salary and plain-note chains licensed their local offices when regulatory laws passed. They withdrew their high-rate offices from regulated territory as rapidly as they could be sold or their accounts liquidated and put the capital into additional offices in unregulated states. Other chains which submitted to regulation decreased the number of their offices by consolidations in order to increase the capital of individual offices.

Independent lenders were unable to move to unregulated states. They lent in the communities in which they lived and had established a clientele. Some of these lenders liquidated and quit the small loan business; some sold their offices to other companies; and still others continued as licensed lenders. The passage of regulatory acts appears to have eliminated more chain offices than independent offices, and in most states the first lists of licensees showed independent lenders to be predominant. In Ohio in 1916 about 20 per cent of licensees seem to have been chain offices and they had about 15 per cent of the total amount of outstanding loans. In Massachusetts chain offices probably had less than 10 per cent of the number of licensees, and similar proportion of the amount of loans in 1913. In New Jersey, where but few former high-rate lenders submitted to regulation, three large chain offices accounted for approximately 35 per cent of the amount of outstanding loans in 1915.

Prior to 1920 most of the new licensees were independents, but from 1920 to 1933 the great part of the increase in number of licensees and volume of business was supplied by the chains. Independent licensees are still numerous, but by far the larger part of the business is now done by chain loan offices. A few of these chains are nation-wide; others operate in sections of the country such as New England, the Central Atlantic states, the Middle West, or the South; still others confine their offices to a single state or to neighboring cities.[1]

Table 9 compares the number and volume of business of chain licensees in several states which have supplied data from which we can make roughly accurate estimates. Because errors are possible, our estimates are given at the nearest multiples of five.

TABLE 9.—RELATIVE IMPORTANCE OF CHAIN SMALL LOAN COMPANIES IN FIVE STATES IN 1931 OR 1932[a]

State	Year	Chain licensees as per cent of all small loan licensees	Loans of chain licensees as per cent of total loans outstanding at end of year
Massachusetts[b]	1931	40	65
New Hampshire	1931	40	65
Connecticut	1932	45	75
Wisconsin	1931	60	80
New York	1932	85	85

[a] For this purpose we have included as chains only those companies which operate five or more offices under completely centralized management. Licensed offices in which some stock is owned by a parent company or for which limited supervision is supplied on a fee basis are not included as chains.
[b] Morris Plan and chartered companies excluded.

For the close of the year 1932 we have estimated the division of outstanding loans between chain and independent offices in all states having effective regulatory small loan legislation as follows:

[1] For a list of the names and the number of offices of prominent chains of licensees, see Financing the Consumer, by Evans Clark, Harper and Brothers, New York, 1931, pp. 50–51. Some of the chains listed by Mr. Clark have expanded rapidly since the presentation of his list. Many new ones with an equal number of offices to those listed have also developed.

	Per cent
Two large national chains	30
Other national chains	20
Sectional and intra-state chains	16
Total chain offices	66
Independent offices	34
Total	100

The growth of the Household Finance Corporation and the Beneficial Industrial Loan Corporation, the two national chain companies which accounted for about 30 per cent of the total outstanding loans at the close of 1932, has been phenomenal. The Household Finance Corporation is the successor of the company organized by Frank J. Mackey, which opened its first small loan office in Minneapolis in 1878. In 1918 it had 35 offices; in 1927 it had 62 offices and outstanding loans of $10,818,000. At the close of 1932 it had 151 offices in 92 cities and outstanding loans of $39,367,000.[1] The Beneficial Industrial Loan Corporation is the successor of the company organized by Clarence Hodson in 1914, which opened its first office in New Jersey shortly after the passage of the first regulatory act in that state. On December 31, 1922, it reported outstanding loans of $3,537,000 in 54 offices. At the close of 1932 it reported outstanding loans of $39,637,000 in 303 offices in 252 cities in 24 states.[2]

Several circumstances led to the increase in the proportion of lending by chain offices: (1) The chain company can shift its capital from one office to another with changes in the demand for loans. (2) It is not dependent on the economic fortunes of one community. (3) The cost of highly skilled management may be apportioned among many offices. (4) Trained personnel may be transferred effectively to fill vacancies, and employes have larger opportunities for advancement. (5) National advertising is possible for attracting both borrowers and capital. (6) Capital is more readily secured. (7) The risk of loss through a statutory reduction of interest rates is spread over a number of states.

The independent lender is squarely up against still another problem in addition to the disadvantages suggested by this summary.

[1] Historical and Statistical Report of Household Finance Corporation, 1932, Chicago.

[2] Annual Report of Beneficial Industrial Loan Corporation, 1932, New York.

To compete profitably he must have large capital, and few individuals are willing to engage the necessary sum in a single enterprise. If, as is usual among larger independent offices, the capital is raised by the sale of stock and a manager is hired to run the business under a directorate of local business men, the company is almost at the mercy of the manager. There is little opportunity to evaluate the effectiveness of his work and it is very difficult to replace a manager once chosen where customer relationships are so important.

Some independent lenders, however, have an extremely favorable position. Chicago, Cincinnati, Detroit, Indianapolis, St. Louis, and many other large cities have one or two independent lenders who have been engaged in the small loan business for thirty years or more. In some cases the business has been handed down from father to son. Little or nothing is spent for advertising, and many expenses necessary to other licensed lenders are avoided. Close personal contact with borrowers over a long period of time has given these lenders a position in their communities from which no chain company can oust them.

The advantage of the personal element in the relationship between borrower and lender is so important that it might easily outweigh the advantages of chain operation, if the situation of these few independent offices could be duplicated. But apparently it cannot. The large capital of these few offices was accumulated in the days when a clever lender could double his capital every few years and still charge lower rates and give borrowers fairer treatment than most of his competitors. Lending technique was acquired over a period of many years. Lack of sufficient capital or knowledge of lending technique prevents the organization of new independent companies of this kind. The independent small loan offices licensed in recent years have comparatively small amounts of capital or have been organized by the sale of corporate shares, bonds, or both.

Personnel of Small Loan Companies

Contrary to general belief, the lender on chattels, wage assignments, and plain notes throughout the history of the licensed and unlicensed business has been, with few exceptions, of native Gentile stock. In genetic background neither the business nor its personnel had much relation to pawnbroking, which was of much earlier origin and in which lenders were predominantly of Jewish stock. Those who have entered the small loan business as entrepreneurs were lawyers, small shop-keepers, payroll clerks, real estate agents, or were engaged in other occupations in which they were approached by people needing cash or credit. Most lenders, however, began as employes of other lenders. Successful lending required a definite technique which was difficult to acquire except in the business itself. Those who entered the business either as owners or employes seldom left it for other occupations. Even the managers and independent owners of high-rate offices that were liquidated when regulatory laws were passed have generally been re-absorbed in the industry as employes of licensed offices.

The operating executives of the huge chain organizations of the present are usually men who have spent their lives in lending and who have acquired a high degree of skill in judging men and determining loan policies. The responsibilities of managing these companies now demand many other qualities than those immediately associated with lending and collecting money. Public relations, statistical analyses, intricate accounting studies, legal questions, corporate policies, and money-market relations require attention if the business is to prosper. Many executives have developed a familiarity with these new phases of the small loan business as the need has occurred. Most of them, also, have employed experts in these fields as full-time staff members or as consultants.

In recent years the industry has attracted many men from colleges and universities, who begin in minor capacities with the chain companies, expecting to make their careers in this field, just as others enter the employ of utility companies, large banks, manufacturing companies, or department stores. In commenting on the personnel of loan offices in New Jersey, Professor King said in 1929:

> Their managers are, in general, a fine type of business men, drawn usually from the older American stocks. The subordinate employes are of about the same grade as those found in banks. Dealings with customers are, so far as observed, marked by courtesy and consideration.[1]

[1] King, Willford I., The Small Loan Situation in New Jersey in 1929. New Jersey Industrial Lenders' Association, Trenton, p. 94.

Associations of Licensed Lenders

For many years George W. Kehr served as secretary of the American Industrial Lenders Association, carried on the business of the Association, and edited its official organ, the Industrial Lenders News, at his office in Harrisburg, Pennsylvania. The national organization continued to grow as additional states enacted regulatory legislation, and as new state associations were formed whose work was co-ordinated with the national association.

In 1929 the American Industrial Lenders Association was reorganized under a full-time staff with headquarters in Washington, and shortly afterward the name was changed to the American Association of Personal Finance Companies. W. Frank Persons, who had served as an executive of the American Red Cross and of the Charity Organization Society of New York, and more recently as an officer of the Milwaukee Public Service Corporation, was selected to fill the newly created office of executive vice-president of the organization. His wide experience in social work gave him an understanding of the problems of the necessitous borrower, and he contributed greatly to the further molding of the industry during the three years prior to his resignation in July, 1932.

One of the important accomplishments of the new national organization was the development of a standard accounting system for small loan offices and, in co-operation with the Department of Remedial Loans, of a standard form for reports of licensees to state supervisors. The standard report form has now been adopted in a majority of the states having regulatory laws.

The American Association of Personal Finance Companies has continued to publish a monthly trade paper, now called Personal Finance News.

Decline in Importance of Remedial Loan Societies

The remedial loan societies which figured so prominently in this history prior to the drafting of the Uniform Law have had but little place in the chronicle of later events. Following the passage of regulatory laws, commercial loan companies quickly overshadowed the remedial societies both as a source of small loans and as a progressive influence in the industry. The decline of these semi-philanthropic loan companies was not only relative but actual.

The following figures show the membership of the National Federation of Remedial Loan Societies from 1910 to 1933:

Year	Member societies	Year	Member societies
1910	16	1920	32
1911	21	1921	31
1912	25	1922	30
1913	34	1923	29
1914	37	1925	28
1915	40	1927	28
1916	36	1929	27
1917	35	1931	26
1918	34	1932	26
1919	34	1933	25

The membership of the Federation is a fairly accurate guide to the number of societies which are eligible to membership in it. In recent years only one society which meets its standards has failed to join.

The years in which new societies were organized from 1859, when the first was formed, until 1918, the date of organization of the latest, were as follows:

Year	New societies	Year	New societies
1859	1	1906	2
1888	1	1910	6
1889	1	1911	2
1892	1	1912	7
1894	1	1913	5
1895	1	1914	4
1896	1	1915	2
1898	2	1916	1
1899	1	1917	1
1900	1	1918	1
1905	3		

The greatest increase in the number of remedial loan societies occurred in the years in which Mr. Ham was actively engaged in encouraging communities to form these organizations to replace the loan shark. When he turned to legislative work in 1914, the new societies gradually ceased to appear and a normal mortality gradually thinned the ranks of those already in existence. Some few societies liquidated because of defalcations; others because of failure to meet expenses. Still others were sold to strictly profit-seeking interests or lost their semi-philanthropic character without change of ownership.

The most potent influence leading to the decline of the remedial loan societies was, however, the creation by law of a regulated commercial small loan business. A reform organization always loses its force as the reform for which it strives is effected. When the remedial loan society was the borrower's only alternative to the old high-rate lender charging unconscionable rates, there was a strong incentive to the socially minded to organize and maintain remedial societies even at the cost of considerable time and effort and the forbearance of part of the income which a similar investment might return elsewhere. When the choice to the borrower was between a remedial loan society and a licensed commercial lender the incentive was much weakened. Since both types of lender charged much higher interest rates than banks[1] and both insisted that the loan be repaid with interest, the borrower was inclined to make little distinction between them. And this lack of perception of the distinctions spread to the community at large. Directors of a number of remedial loan societies consented to the sale of their companies to commercial interests believing that with the advent of regulation of lending there was no longer any reason for the continuance of a semi-philanthropic company.

The National Federation declined in prominence even more completely than its individual members. The Department of Remedial Loans of the Russell Sage Foundation succeeded the National Federation as arbiter of standards of remedial legislation. This was to be expected when Mr. Ham became the director of the Department of Remedial Loans. In this capacity he made his decisions independently of the National Federation.

The National Federation had made an invaluable contribution to the movement for reform in the small loan business. It had furnished a forum for those interested in correcting small loan evils, where remedies could be proposed and criticized on a basis of the actual experience of the remedial societies. It had supplied a large mass of cost figures upon which studies to determine a fair maxi-

[1] Except for the Provident Loan Society of New York which lends on pledge at a rate of 1 per cent a month, the lowest rate is that of the Newark Provident Loan Company which charges 1½ per cent a month on chattel loans. Rates charged by most remedial societies range from 2 to 2½ per cent a month.

mum rate could be based. It had united a great many fine people serving on the boards of remedial societies who formed a nucleus for a national movement to better small loan conditions.

Only in rare instances have the remedial companies continued to be the dominant lenders in their own communities. The outstanding example is the Provident Loan Society of New York which has continued, because of the extraordinary size of its business, to dominate the pawnbroking business in New York. In lesser degree the Newark Provident Loan Company and the Detroit Provident Loan Company continue to be dominant chattel companies in their community. In spite of the lower charges of remedial loan associations, commercial lenders have seldom feared their competition. There are probably several reasons for this. In the first place the capital invested in remedial loan societies is but a small percentage of the amount needed to satisfy the demand for loans. Second, the remedial companies naturally lean toward conservatism. Having voluntarily limited return on the investment, there is little incentive to incur the risk of loss. Consequently the remedial loan society is frequently on the defensive, while the commercial lender is aggressively expanding his business. Parallel situations are common in many other fields of activity.

In spite of the declining importance of the remedial loan societies as leaders in the industry, these societies continue to perform a valuable service for the communities in which they operate. They save for some borrowers part of the interest a purely commercial company would charge. They are more inclined than commercial lenders to look carefully into the purpose of the loan, to lend only the amounts actually needed, and to make unusual efforts to furnish loans to those borrowers who are most necessitous. From this standpoint the decline in the number of remedial loan societies is regrettable.

Progress of Credit Unions, Morris Plan Banks, and Personal Loan Departments of Banks

We have described the beginnings of the development of credit unions and Morris plan banks in Chapter IV.[1] These two kinds of institutions, as well as personal loan departments of commercial

[1] See pp. 89–94.

banks, the first of which was not established until 1924, fall outside of the immediate area of this study. While we cannot present here an adequate discussion of these institutions, to which a separate volume might well be devoted, their close relationship to the small loan business and their importance as an additional source of small personal loans require some comment, even though brief, upon their progress.

Several characteristics set these institutions apart from the small loan business. First, they are generally trustees for funds of the public. In most instances they are chartered, examined as to solvency by state or federal governments, and permitted to take the savings of the public in one form or another.[1] Second, they are limited to small loans neither by law nor by practice. Morris plan institutions are frequently authorized to make loans up to $5,000; and credit unions in most states may lend $2,000 or more to individual borrowers. Personal loan departments of banks have no legal restrictions upon the size of their loans. The difference in the size of typical loans made by these three agencies and by the small loan business has led to differences in the characteristics of those who borrow from them. The size of the loan is a rough measure of the ability of the borrower to pay. Many credit unions deal almost entirely with small business men and a considerable part of the loans made by Morris plan institutions and personal loan departments are for commercial purposes. Third, each of these institutions lends principally on the security of endorsements by which means the principal risk of loss is carried not by the lender but by those who endorse for the borrower.

The cleavage between the clientele of credit unions, Morris plan banks, and personal loan departments on one hand, and the small loan business on the other, may be illustrated by conditions in the city of Louisville prior to the enactment of the Uniform Small Loan Law in Kentucky in 1934. Although this city had several credit unions, a Morris plan bank, and a relatively greater development of personal loan departments of commercial banks than existed in any other city in the United States, it was infested with loan sharks. More than 50 loan sharks lent small sums on chattel mortgages, plain notes, and wage assignments at rates ranging from 90 to 750

[1] With the exception of Morris plan companies in certain states.

per cent a year, in spite of the availability of an ample supply of funds for loans on endorsed notes at reasonable rates.

Regardless of these distinctions, the endorsed note agencies are important sources of consumer loans. These agencies and the companies lending on household furniture and salaries attract many customers from a broad common area, in respect to the purpose of borrowing and to the economic and social status of borrowers. In some instances, particularly in the case of credit unions among employe groups, the endorsed note lender may deal with exactly the same class of borrowers as the chattel, wage assignment, or plain note lender. The borrower's personal choice frequently determines the type of security on which he borrows.

Credit Union Growth. Following the year 1910, the number of credit unions in Massachusetts increased rapidly. The number and outstanding loans of these institutions on October 30 of the years 1910, 1913, and 1916 were as follows:[1]

Year	Number of credit unions	Amount of loans outstanding
1910	1	$ 1,743
1913	34	146,746
1916	53	652,389

The movement was stimulated in 1914 by the organization of the Massachusetts Credit Union, which undertook not only to operate as a credit union, but to encourage and assist the formation of additional unions throughout the state. This credit union, however, began to liquidate in 1915. Its credit union business appears to have been turned over to another credit union located in the same office, and its promotional activities were carried on by the Massachusetts Maintenance Society and later by the Massachusetts Credit Union Association, which was organized in 1917 "to disseminate information in respect to the benefit of credit unions . . . to assist in the organization of credit unions . . . and to make loans to credit unions." The directors of these agencies were almost identical. Among them were Judge A. K. Cohen, Edward A. Filene, Max Mitchell, and Felix Vorenberg, each of whom had sponsored the Credit Union Act of 1909.

New York was the second state to enact a credit union law. The Russell Sage Foundation had watched with interest the prog-

[1] Annual Reports of Massachusetts Bank Commissioner, Part II.

ress of the first few credit unions in Massachusetts. After consulting with Mr. Desjardins and Mr. Jay, who had come to New York as vice-president of the Bank of the Manhattan Company in 1909, Mr. Ham drafted a credit union bill for New York State. It was introduced and enacted in the 1913 session of the legislature. Following its enactment, the Department of Remedial Loans of the Foundation undertook to encourage the credit union movement in New York State.

In 1915 a credit union law was enacted in North Carolina under the sponsorship of John Sprunt Hill, a banker who had long been interested in agricultural credit problems. The University of North Carolina and the State Department of Agriculture attempted to stimulate credit union development under this act.[1]

The participation of the United States in the World War appears to have retarded the progress of the credit union movement. The energies of many who had fostered the movement were directed to other fields, and several excellent credit unions were liquidated in order that members might buy liberty bonds. In spite of this handicap, the number and resources of credit unions increased under the momentum which the movement had acquired. On October 30, 1920, there were 64 credit unions in Massachusetts, only 11 more than in 1916, but outstanding loans amounted to $3,334,000, five times the amount in 1916. Credit unions in New York had a larger rate of growth, partly because the Department of Remedial Loans continued its promotional work during this period. The number and outstanding loans of New York credit unions at the close of the years 1914, 1916, 1918, and 1920 were as follows:[2]

Year	Number of credit unions	Amount of loans outstanding
1914	2	..
1916	30	$ 151,000
1918	41	424,000
1920	70	1,961,000

[1] Oregon and Rhode Island in 1914 and South Carolina in 1915 also enacted credit union laws, but these laws were unsatisfactory in many respects. The Rhode Island law was enacted to authorize the operation of a Caisse Populaire among French Canadians living in that state similar to those already established in Quebec.

[2] Annual Reports of New York Superintendent of Banks.

In 1921 Mr. Filene established and financed the Credit Union National Extension Bureau in Boston to renew on a national scale the promotional activities which had been carried on by the Massachusetts Credit Union Association. The Bureau, under the direction of Roy F. Bergengren, undertook to extend credit union legislation to additional states and to encourage and assist the organization of new credit unions. Although Massachusetts and New York maintained a large lead in credit union development many other states soon had a considerable number of credit unions.[1] At the present time 38 states and the District of Columbia have such enactments, and federal legislation passed in 1934 permits the organization of credit unions under federal supervision throughout the country.

We have estimated the growth of credit unions throughout the nation at five-year intervals between 1915 and 1930 as follows:

Year	Number of credit unions	Membership	Outstanding loans	Assets
1915	48	7,600	$420,000	$471,000
1920	142	39,800	3,100,000	3,568,000
1925	257	130,700	19,000,000	21,165,000
1930	1,017	292,800	36,000,000	40,910,000

Following 1930 there has been a severe contraction in the amount of outstanding loans in spite of a continuous increase in the number of credit unions. No adequate estimates of the present status of credit unions are available, but it seems probable that at least 2,400 were in operation in September, 1934, with outstanding loans amounting roughly to $30,000,000.

Growth of Morris Plan Institutions. Following the organization of the first Morris plan bank in Norfolk in 1910, Arthur J. Morris recommended his plan to other cities. Morris plan institutions were organized in Atlanta in 1911, and in Baltimore, Washington, and Richmond in 1912. Nine such companies were established during the years 1913 and 1914, 12 in 1915, 28 each in 1916 and 1917, and eight in 1918.[2]

[1] For an estimate of the number and total assets of credit unions in each state in 1930, see A Credit Union Primer by Arthur H. Ham and Leonard G. Robinson, revised by Rolf Nugent, Russell Sage Foundation, 1930, p. 9.

[2] The Morris Plan of Industrial Banking, pp. 24–37.

At first Mr. Morris claimed the right to the sole use of his plan of operation, but this was denied in December, 1915, by the Supreme Court of the District of Columbia.[1] Following this decision competitors of the Morris plan companies became numerous. Today there are more than 100 companies operating under the Morris plan name and perhaps as many as 400 competitors doing a similar business under other names. Franklin W. Ryan has estimated the outstanding loans of these agencies at $135,000,000 on December 31, 1933.[2]

In 1912 Mr. Morris organized the Fidelity Company of America to hold stock in various Morris plan institutions, to control the use of the trade name, "Morris Plan," to promote the organization of Morris plan institutions, and to audit and supervise them. These functions were turned over in 1914 to the Industrial Finance Corporation, and in 1925 to the Morris Plan Corporation of America. These holding companies received a bonus of common stock for their services in organizing local companies and charged fees for supervision and for the use of the name and technique of the plan. Field agents were employed and a great deal of published material concerning the plan was distributed. In cities in which anti-loan shark campaigns were being carried on, these field agents represented the Morris plan as an effective cure for the loan-shark evil.

These activities led naturally to friction between the company promoting Morris plan institutions and persons interested in the extension of remedial loan societies. Since both institutions were recommended as an effective solution for the same problem, the principles of the remedial loan society, which included the limitation of dividends and the statement of charges in simple interest rates, were less attractive to prospective incorporators and investors than the principles of the Morris plan, which included the possibility of a greater profit, the prestige of a banking institution, and a seemingly lower rate of charge. The availability of professional organizers also made it possible for local people to establish a Morris plan company with much less effort than was required for the organization of a remedial loan society. In 1916 after an

[1] Industrial Finance Corporation *v.* Community Savings and Loan Corporation.

[2] Ryan, Franklin W., "Short Term Loans in the United States During 1932 and 1933." In The Journal of Business of the University of Chicago, vol. 7, no. 3, July, 1934.

informal discussion of the Morris plan, the annual convention of the National Federation of Remedial Loan Associations agreed that "the Morris plan is not in reality an active competitor of the loan shark," and regretted that the promoters of the Morris plan had been "willing to allow the public to obtain a mistaken impression of its scope and of the actual cost of loans to borrowers."[1]

When in 1916 the Department of Remedial Loans turned its energies from organizing remedial loan societies to the drafting and sponsoring of regulatory legislation, the interests of the Morris plan institutions were even more directly in conflict with its program. In many states Morris plan companies could not be organized as banks and they were therefore subject to regulatory small loan acts which interfered with their method of operation. To provide exemption of these institutions specifically in the provisions of the small loan act would have opened the way for an attack on its constitutionality. In some states exemption was accomplished by the enactment of special enabling statutes which authorized this type of lending.[2] But in other states Morris plan companies openly or covertly opposed regulatory legislation. Claims that the interest rate charged by Morris plan companies was but 6 per cent and that the plan was a complete solution for the loan-shark problem also hindered the Remedial Loan Department's program for regulatory legislation, which recognized the necessity for a much higher interest rate on small personal loans than on larger loans secured by marketable collateral.

One finds sympathy for both parties to this controversy. Many directors of local Morris plan institutions were sincerely interested in improving lending conditions in their communities and naturally resented any infringement upon the operation of their companies. This tension has been greatly relieved by the enactment of special industrial banking acts in many states, by better understanding among Morris plan people of the issues involved and of the limitations of endorsed note lending, and by a greater appreciation

[1] "The Organized Fight Against the Loan Shark." In the Survey, August 12, 1916, p. 497.

[2] Special enabling acts have been enacted in Arizona, California, Connecticut, Delaware, District of Columbia, Iowa, Kentucky, Maine, Minnesota, Missouri, Montana, Nebraska, New York, North Carolina, Oregon, Rhode Island, South Carolina, Texas, Utah, Virginia, Washington, West Virginia, and Wisconsin.

among those who supported the Uniform Small Loan Law of the value of these agencies to a large class of borrowers.

Morris plan institutions and their competitors have tended to become a specialized type of banks. Legislation in several states has been modified gradually to this end. In 1933 an amendment to the National Banking Act admitted many of these institutions to membership in the Federal Reserve System.[1]

Growth of Personal Loan Departments. No commercial bank seems to have entered the field of lending covered by the Morris plan institutions until 1924. In October of that year the Hudson County National Bank of Jersey City established a department for lending to salaried people on endorsed notes. Charges were $6.00 interest and a 50-cent investigation fee per $100, discounted in advance, and the borrower was to repay his loan by making regular periodic deposits in a savings account upon which interest was paid at the rate of 2 per cent a year. A year later the Louisville National Bank organized a similar department, but discounted its loans at the rate of $8.00 per $100, with no allowance of interest on instalment payments. In the next two years 25 or more banks in various cities established special departments for personal loans on endorsed notes.

This movement was given a strong stimulus in 1928 by the organization of a personal loan department of the National City Bank of New York, the announcement of which received widespread press notices throughout the country. Within a few months some 50 additional banks announced the opening of similar departments. This growth has continued. In 1930 Howard Wright Haines compiled a list of 147 banks which had personal loan departments.[2] No complete census of banks has been made, however, and it seems probable that this list was incomplete then and that the number of personal loan departments has later increased materially, particularly since the banking holiday of 1933. Most banks whose methods of operation have been reported to us discount their loans at the rate of $8.00 per $100 and charge fines for

[1] For a further discussion of the Morris Plan see "The Morris Plan" by Louis N. Robinson in the American Economic Review, vol. 21, no. 2, June, 1931.

[2] Haines, Howard Wright, The Small Loan Department. Bankers Publishing Company, New York, 1931, pp. 87–94.

delinquency. The lowest rate is that of the National City Bank, which discounts notes at the rate of $6.00 per $100, allows the current rate of interest upon payments to be applied to a savings account, and charges fines at the rate of 5 per cent a week on delinquent payments.

Salary-Buyers and Other Unlicensed Lenders

The territory in which the high-rate lender predominated was gradually limited by the enactment of regulatory laws in additional states. Following these enactments some lenders frequently attempted to continue their business in defiance of the law, but prosecutions by state banking departments and district attorneys, and the competition of licensed lenders at lower rates gradually eliminated most of these within a few years. It seems unlikely that lending at rates in excess of the maximum rate provided by these acts has been entirely eliminated in any state, since new devices are continually developed in an effort to evade the law. But in most states with adequate regulation illegal lending is small in amount and is carried on under cover.

Only one form of high-rate lending succeeded in developing to sizable proportions in states which had enacted the Uniform Small Loan Law. This business was known as salary-buying. The salary-buyer was the direct descendant of the salary-lender whose business had been practically eliminated by the Uniform Law. While the salary-lender admittedly lent money on the security of an assignment of wages, the salary-buyer claimed to buy wages that were earned but not due until a later date, hoping by this claim to avoid the regulations and interest restrictions of regulatory small loan laws. Railroad employes were the chief customers of the salary-buyer, because the railroads customarily delay the payment of wages until two weeks after the period during which they have been earned.

The salary-buying transaction was quite simple. The employe signed a paper acknowledging the sale of a definite amount of his wages and giving the salary-buyer a power of attorney to collect this sum from his employer. If he sold $6.25 of his wages, he usually received $5.00; if he sold $11.50 he received $10; for $22 he received $20; for $55 he received $50, and so forth. When the rate of discount is calculated in terms of annual interest, these charges range from 240 to 600 per cent a year without consideration of the effect of discounting or compounding.[1]

The employe, however, did not want to have the salary-buyer go to his employer to collect the wages purchased any more than the salary-buyer wanted to have to collect in this way. Consequently the "seller" promised to collect the salary himself and turn the "sold" portion over to the salary-buyer. It was a new and ingenious device among the multitude of devices by which unscrupulous lenders have tried to evade regulatory laws.

Regardless of the high cost in terms of interest, the actual charge for the loan in dollars was comparatively small. If the salary-buyer's customers had been able to repay the amounts borrowed at the end of two weeks, the business might not have caused the hardship that it did. The vicious part of the scheme was that the borrower usually did not repay the loan but constantly renewed it every payday, and sooner or later either increased the loan or borrowed concurrently from another salary-buyer, or both. As the amount borrowed increased, the cost of interest in dollars increased in proportion.

The salary-buying business had been begun on a very small scale about 1915 by two payroll clerks employed by a railroad in Atlanta. Their business expanded slowly at first and then more rapidly as it compounded its enormous profits. Since new offices could be started out of the annual net profit of an old office, the increase in the number of offices and volume of business was geometric, doubling annually. By 1925 salary-buying was thriving in two-thirds of the states in the Union and still expanding rapidly. In 1926 the Department of Remedial Loans estimated that one-third of all railroad employes in the country were borrowing, on an average, from two salary-buyers each.

The salary-buying business was largely controlled at first by four men, including the originators of the scheme. They lived in Atlanta and maintained their headquarters there. This quadrumvirate became known as the "Big Four" of salary-buying. Competition, however, sprang up rapidly. Managers of local of-

[1] Assuming that the term of the loan was one-half of a month, since most railroad employes are paid semi-monthly.

fices, who had been sending back profits to the home office at the rate of 50 per cent of the capital investment every six months, scraped together a few thousand dollars and opened their own offices. Salary-lenders in the few states in which they could still operate grasped eagerly at this device as a means of getting back into the territory from which they had been ousted.

Salary-buying was a real menace to the Uniform Law. If it persisted in states having the law, then the law failed to give borrowers the protection it promised. On statements of fact selected by salary-buyers, court decisions in Georgia[1] and Ohio[2] had apparently supported the claim that salary-buying transactions were not governed by regulatory small loan laws, notwithstanding decisions in many other jurisdictions to the effect that the courts would go behind the technique of the transaction and look to its purpose to determine the incidence of laws regulating loan transactions.

One of the principal reasons why salary-buying was able to make such marked progress was the relative inactivity of the Department of Remedial Loans between 1917 and 1925. Arthur H. Ham, who had been director of the Department since its establishment, left on leave of absence in the fall of 1917 to serve as director for New York State of the War Savings Division of the federal Treasury Department. In 1918 he accepted the vice-presidency of the Provident Loan Society of New York.[3] In January, 1919, Walter S. Hilborn, who had participated in shaping the first draft of the Uniform Law, was appointed acting director of the Department. His service, however, was on a part-time basis and was concerned principally with representing the Department at legislative hearings on small loan bills. In 1924 preliminary investigations in preparation for a study of lending under the Uniform Law revealed to the Foundation the importance of its fuller participation in the small loan field. In July, 1925, Leon Henderson, then director of

[1] Tollison *v.* Georgia, 153 Ga. 612, 1932.

[2] State *v.* Mehaffey, 112 Ohio St. 330 (1925).

[3] Since 1928 Mr. Ham has been its executive vice-president. Fortunately his duties have permitted and encouraged his interest in the work which he began and so ably carried on for a decade. The Russell Sage Foundation has continued to rely heavily upon his advice concerning the work of the Department of Remedial Loans.

accounts of the state of Pennsylvania, was appointed full-time director of the Department.[1]

Mr. Henderson's first efforts upon joining the staff of the Foundation were directed against salary-buying. He publicized the viciousness of the scheme, urged railroads to refuse to honor claims of salary-buyers, advised the railroad brotherhoods to tell their members not to pay the salary-buyers, and supplied prosecuting attorneys with court decisions from other jurisdictions which had invalidated salary-purchase contracts. He enlisted the support of better business bureaus, legal aid societies, chambers of commerce, and junior chambers of commerce in a nation-wide anti-salary-buying crusade. The American Industrial Lenders Association, state supervisors responsible for the enforcement of small loan acts, and representative newspapers also participated in the campaign. The work of the better business bureaus was particularly effective in the bitter fight that followed. They attacked the salary-buyer with the same vigor and persistence with which they have attacked their more usual enemies, the fake stock salesman and the fraudulent merchant.

At the same time, wherever an opportunity occurred, the Department of Remedial Loans urged the addition of a special section to existing small loan laws, which declared that purchases of wages and salaries were to be governed by the law and made the maximum interest rate applicable to the rate of discount on purchases of wages. This modification was also made in the Uniform Draft.[2]

By 1927 salary-buying was rapidly on the decline, having been beaten successively in the courts of almost every state in which the Uniform Law or its equivalent was in effect. Today in most states with adequate legislation, salary-buying has been completely eliminated and the practice is on the decline in the others.

In the cities of states which have no adequate regulatory legislation, the small loan business continues much as it did everywhere during the loan-shark era. It relies upon the borrower's desire for

[1] Mr. Hilborn has continued to serve as counsel to the Department of Remedial Loans.

[2] General Form of the Uniform Small Loan Law, as revised January 1, 1932, American Association of Personal Finance Companies, Washington, D. C., 1932, sec. 16.

secrecy and his ignorance of his legal rights and upon political alliances for protection. Although this business is advertised widely by means of handbills and newspaper notices, the general public is seldom aware of its existence or of its exorbitant rates of charge until some public or private agency undertakes an aggressive anti-loan-shark campaign which promises real assistance to distressed borrowers.

Such campaigns in recent years have revealed conditions as shocking as those of the loan-shark era. An Interim Committee of the Minnesota House of Representatives appointed to study the small loan problem reported that more than 50 loan sharks, charging from 120 to 400 per cent a year, were operating in Minneapolis in 1929. It estimated that there were 20,000 loan-shark victims in the city of Minneapolis alone.[1] In 1933 a state-wide campaign conducted by the Louisville Herald-Post[2] and the Kentucky Research Council[3] revealed similar conditions in Ashland, Covington, Lexington, Louisville, and Paducah, Kentucky. As a result of a campaign by the Rocky Mountain News, some 50 loan sharks in the city of Denver, Colorado, who charged rates which ranged up to 750 per cent a year were prosecuted and many were convicted.[4]

[1] State of Minnesota: Report of Interim Committee of the House of Representatives, 1929.

[2] Files of the Louisville Herald-Post from October 24, 1933, to April 6, 1934.

[3] The Kentucky Research Council was organized by leading citizens of the principal Kentucky cities to study and find a remedy for the loan-shark problem. Its findings were issued in mimeographed form and much of this material was later published in the Herald-Post (October, 1933, to May, 1934).

[4] Files of the Rocky Mountain News, Denver, Colorado, from February to June, 1934.

CHAPTER VIII

CHANGES IN THE SMALL LOAN BUSINESS UNDER REGULATION

THE regulation of the small loan business by the Uniform Law or its equivalent brought about striking changes in many characteristics of the business. We shall attempt in this chapter to describe those changes to which quantitative measurement can be applied. These are as follows:

1. Increase in size of individual offices
2. Increase in the total volume of lending
3. Change in the nature of the security taken
4. Increase in the size of individual loans
5. Increase in the length of time for repayment
6. Change in the distribution of licensees by size of city
7. Increase in competition
8. Change in rates of charge

The search for data to demonstrate these changes has been tedious. Prior to 1929 only a few states published reports concerning the small loan business with any degree of regularity and a few others published occasional reports. To supplement these we have examined a great deal of unpublished data in the files of the Department of Remedial Loans. In spite of occasional errors and the frequent omission of important information in these reports, they appear to be adequate for the purpose for which they have been used. In many respects the states for which reports are available may probably be taken as representative of those having regulatory statutes.

Since 1929 there has been a continuous increase both in the quantity and in the quality of the available data concerning this business. Several additional states have undertaken to publish annual reports and others have greatly improved their reports. In several states where no official report is published, associations of licensed lenders have engaged accountants to compile annual summaries of the reports of licensees to the state supervisor. While the student of the small loan business may still wish for improvement in these reports, there are few enterprises for which statistical information is as adequate as for the small loan business during the last few years.

The Chief Cause of Change

By far the most important single cause of change was the reduction of interest charges to the maximum rate of the small loan law. However high the profits of lenders may have been during the loan-shark era, it is probable that the costs of lending consumed a large proportion of the gross income. It is clear that the cost of unregulated lending necessitated high charges in order to permit the business to continue.

An indication of the expense of lending before the enactment of regulatory laws is given by current records of lenders in unregulated states whose business resembles that of the loan-shark era. Records of several such companies have been seized in connection with public prosecutions. Among these were records for the first half of 1932 of a chain company having branch offices in many unregulated states. The interest rates charged by this company approximated 250 per cent a year, but one-ninth of its numerous offices lost money during the six months' period. The net earnings recorded for all offices were at an annual rate of 36 per cent of estimated average employed assets.[1] The records available showed the amount of net earnings but did not give the amount of gross income or the amount of expense. If we should estimate the annual rate of gross income at 180 per cent of average employed assets (allowing a large shrinkage from the rate of charge), the ratio of expense to average employed assets for all offices would be 144 per cent a year.

There is reason to believe that the expense ratios of the offices of this chain may be typical of the expense ratios of high-rate lenders in general before the enactment of regulatory laws. Our estimate of gross income is scarcely more than an arbitrary guess, but any

[1] The estimates of average employed assets are ours. They are calculated at 1.15 times the average amount of outstanding loans. The necessity for such a method of estimating the assets in use in the small loan business as a basis for computing rates of earnings is discussed on pp. 216–223.

reasonable modification of this guess would still show that a reduction of charges to the rate provided by the Uniform Law meant the elimination of all profits unless costs could be cut severely. The first changes which followed regulation may be traced almost entirely to the search for means of reducing costs of lending.

Some of the costs of lending were reduced automatically by regulation itself. The cost of "buying" protection, almost as common among bootleggers of money as among bootleggers of liquor, was avoided; losses through punitive campaigns and legal defenses by borrowers were eliminated. Better classes of borrowers, who would have been unwilling to borrow under the conditions and at the price prevailing before the advent of regulation, became customers of the licensed lender.

In addition to the direct effort of lenders to reduce lending costs, and the automatic effect of regulation on the characteristics of the small loan business, certain general social and economic changes were in progress which also affected the business. That many influences contributed to change the nature of the small loan business may be assumed. In this chapter we shall attempt primarily to describe the changes which occurred and only secondarily to suggest some of the influences which led to change.

Increase in Loan Balance of Individual Licensees

The unlicensed lender, subject to recurrent attacks, avoided putting all his eggs in one basket and kept the capital of individual offices small. Although there were a few large chattel offices,[1] the average loan balance of unlicensed offices throughout the country was probably as low as $10,000 in 1912. The average loan balance of salary loan offices was even less.

The lenders who submitted to regulation rapidly increased the capital of their loan offices. Table 10 shows the increase in size of the lending unit in the four states for which such data are available over a long period.

Three states[2] have published reports for recent years which show

[1] One chain of chattel loan offices lending comparatively large amounts reported the loan balances of six unlicensed offices in 1915 at $24,000, $28,000, $32,600, $34,000, $52,500, $121,600.

[2] New Jersey also publishes such data, but because of recent changes in maximum interest rate in that state we have excluded its reports for purposes of this analysis.

TABLE 10.—AVERAGE LOAN BALANCE OF LICENSED SMALL LOAN OFFICES IN FOUR STATES, IN CERTAIN YEARS, 1915 TO 1932

Year	Ohio	Massachusetts[a]	New Jersey	Virginia
1915	$20,000[b]	$12,000	$19,000	..
1917	25,000[b]	14,000	27,000	..
1920	35,000[b]	21,000[b]	..	..
1923	..	..	37,000	$40,000[b]
1925	52,000[b]	36,000	..	52,000[b]
1928	..	50,000	55,000[b]	70,000
1930	100,000[b]	75,000	..	72,000
1932	105,000[b]	83,000	78,000	73,000[b]

[a] Excludes Morris Plan and chartered companies.
[b] Estimated from incomplete data. Amounts not so marked are reported by state officials.

the amount of outstanding loans of each licensed office. Table 11 shows that a very large proportion of outstanding loans in these states are in offices which have loan balances exceeding $100,000.

TABLE 11.—DISTRIBUTION OF TOTAL AMOUNT OF OUTSTANDING LOANS IN THREE STATES, BY SIZE OF LOAN BALANCE OF INDIVIDUAL OFFICES, 1930 OR 1931

Size of loan balance of individual office	Connecticut, 1931		Massachusetts,[a] 1930		Wisconsin, 1931	
	Amount	Per cent	Amount	Per cent	Amount	Per cent
$100,000 or more	$5,009,000	54	$7,839,000	65	$5,774,000	84
50,000 to $99,999	1,660,000	18	2,484,000	21	598,000	9
25,000 to 49,999	1,871,000	20	1,065,000	9	362,000	5
10,000 to 24,999	670,000	7	494,000	4	72,000	1
Under 10,000	123,000	1	99,000	1	33,000	1
All offices	$9,333,000	100	$11,981,000	100	$6,839,000	100

[a] Excludes Morris Plan and chartered companies.

In order to increase the size of loan balances it was necessary for the lender to increase the capital available for loans in each office. Chain companies having several offices in the same city frequently consolidated them in order to increase the size of individual offices. One large chain company with eight unlicensed offices in New Jersey, for instance, consolidated these into three offices when the regulatory act passed. Other chains withdrew offices from communities where competition was severe or where the community was too small to permit an increase in the volume of lending, and used the capital thus made available in offices more favorably located.

Other lenders raised additional capital for their individual offices by issuing securities. No money was available through recognized investment houses because of the odium attached to the business in the past, the bad accounting methods generally used, and the utter lack of contact between lenders and those who controlled the usual channels of distributing securities to the public. But many small loan companies secured additional capital from the sale of bonds, preferred stock, or common shares in the ownership to friends or associates in the communities in which they lived and did business. Others sold bonds directly to the general public. Frequently these securities were sold, with high selling costs, from house to house in cities and in rural districts. The bonds bore high rates of interest and frequently carried the right of participation in profits.

It seems worthy of comment that in spite of the necessity for paying high rates to get capital and of the unconventional method of distributing these securities, most obligors paid interest promptly and the principal sum in full on maturity. Where investors suffered loss, the promoters were usually interested solely in the profits of a separate company organized to sell the securities of the operating company for a large commission, and the bondholder was left with a claim against a poorly operated loan company whose assets had been severely depreciated by selling costs and underwriting profits.

The year 1928 marked a change in the method of financing small loan enterprises. In that year Lee Higginson and Company, investment bankers of Boston and New York, underwrote an issue of participating preferred stock of the Household Finance Corporation. During the next three years the normal capital markets opened up rapidly to licensed lenders and four or five prominent investment banking houses underwrote and distributed the security issues of chain loan companies. Sales of small loan company securities were stopped abruptly, however, by the disruption of the market for capital issues in 1931.

Better commercial bank credit quickly followed this recognition of the industry by investment bankers. While a few lenders have for many years enjoyed borrowing privileges at banks with which their individual or branch offices had checking accounts, the tendency to maintain credit lines with large banks in financial centers is a very recent development. Since 1930 some of the most prominent commercial banks in New York, Chicago, and Boston have extended substantial short-term credits to the larger chains of licensed offices.

Those lenders who had but one small office and could not raise additional capital were usually unable to earn a satisfactory profit. Some sold their assets to other lenders, who consolidated these loans with their own businesses. Others struggled along, postponing liquidation, which necessarily meant a considerable contraction of the net worth of the business. Among this group of lenders some attempted to make illegal charges, and state supervisors and lenders' associations were kept busy protecting the law against infraction.

The mortality among small lenders following adoption of the regulatory law is clearly evidenced by a comparison of the Ohio reports for 1916 and 1921. Twenty-three of those who were licensed in 1916 had given up their licenses by 1921. Of these, two licensees appear to have sold their businesses and three were chain offices which were consolidated with other offices. Only one of the 18 other licensees who went out of business had a loan balance of more than $20,000 in 1916, and the average balance was only $10,000.

Experience in New Jersey was quite similar. Seven of the 23 lenders licensed in 1915 were missing from the list of licensees in 1923. All seven reported loan balances of less than $20,000 in 1916. In comparing the licensees of 1923 with those of 1928 in New Jersey, 27 who were licensed in 1923 failed to appear in the 1928 list.[1] All but three of these had loan balances of less than $20,000 in 1923, and the three with larger volumes were mutual organizations dealing with racial groups.

A few of the smaller lenders still survive. Some operate their businesses from their homes; some have a small clientele in a

[1] Some licensees appeared to have been supplanted by others, but actually had only changed names. It is quite possible that there were others which we failed to recognize that changed names instead of going out of business.

neighborhood where borrowers can be investigated with little expense, and others have made a loan business of small proportions profitable by combining it with other associated businesses such as mortgage loans, insurance, or real estate. Many states, however, wisely prohibit other businesses from being carried on in the same office, in order to prevent the lender from compelling applicants for loans to buy insurance, merchandise, or services as a condition precedent to granting the loan.

Increase in Demand for Loans from Licensed Lenders

The reduction of interest rates to conform to the law and legalizing of the business were in themselves the source of an immediate additional loan demand. Many who formerly depended upon help from friends and relatives, or accepted the alternative of going without when the cost was higher and the business sordid, were willing and able to borrow at the reduced rates of the licensed lender.

Besides this addition to the clientele of the licensed lender, the demand for loans appears to have been expanded by the increase in the borrowing needs of large numbers of people throughout the period of regulated lending. Among the causes of this increased demand for loans were: increasing technological unemployment, the continued growth of large industrial cities and the consequent decline of neighborhood and family units which formerly absorbed in some part the emergencies of individual households, the increase in instalment buying and other forms of consumer credit, the increased cost of medical care, and the breakdown of the fear of debt and conventional conceptions of thrift. The reader of modest income will no doubt find in his own experience additional reasons for the increase in borrowing.

The relative importance of the various factors influencing the increase can only be guessed, but the increase itself is a startling reality. The estimated amounts of outstanding loans of licensed lenders during the period of regulation in states which had regulatory acts at the close of 1932 are shown in Table 12. These estimates are based on the available official data.

TABLE 12.—ESTIMATED AMOUNTS OF OUTSTANDING LOANS OF LICENSEES DURING THE PERIOD OF REGULATION IN 26 STATES HAVING THE UNIFORM SMALL LOAN LAW OR A SIMILAR REGULATORY STATUTE AT THE CLOSE OF THE YEAR 1932[a]

(In thousands of dollars)

State	1915	1916	1917	1918	1919	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931	1932
Massachusetts[b]	2,350	2,190	2,555	2,591	2,611	2,786	3,279	3,900	4,650	5,500	6,400	7,500	8,900	11,000	15,000	17,700	18,900	18,000
New Jersey	436	570	737	756	1,141	1,479	2,959	3,778	4,614	5,818	7,885	9,722	13,309	19,001	20,549	7,948	5,398	6,253
New York	645	761	881	791	876	887	985	950	985	1,024	1,173	1,307	1,544	1,803	1,986	2,993	8,233	10,102
Oregon[c]	70	80	100	120	145	170	200	240	290	330	380	440	600	900	1,500	2,341	2,757	2,223
Ohio[c]	3,300	3,000	2,800	2,850	3,000	3,400	4,000	4,900	6,000	7,500	9,800	13,000	18,000	25,000	34,000	39,000	38,000	35,000
Pennsylvania	1,400	1,650	1,800	2,300	2,700	3,400	4,600	6,000	7,800	10,000	13,500	18,500	25,000	34,000	46,500	53,000	54,000	50,000
Maine	..	..	150	160	150	153	160	170	185	250	500	850	1,150	1,420	1,760	1,940	1,980	1,800
Illinois	..	..	3,300	3,350	3,400	3,600	4,000	4,800	5,800	7,000	8,600	10,800	14,000	18,500	25,500	31,000	32,200	29,100
Indiana[c]	..	..	2,500	2,300	2,350	2,600	2,900	3,300	3,900	4,700	5,700	7,000	8,700	11,000	14,500	16,500	17,000	15,500
New Hampshire	..	..	100	90	95	100	105	115	130	180	250	350	530	700	900	1,122	1,250	1,200
Maryland	..	..	..	850	840	860	950	1,150	1,400	1,750	2,100	2,600	3,600	5,000	7,000	7,800	8,000	7,500
Virginia	..	..	..	500	600	750	1,050	1,420	1,460	1,540	1,770	2,050	2,350	3,000	4,050	4,700	4,930	4,600
Connecticut	..	..	..	..	500	700	900	1,200	1,600	2,400	3,150	3,800	4,900	6,400	8,400	9,200	9,300	8,450
Arizona	..	..	..	..	..	35	70	111	160	240	320	430	460	500	600	950	1,200	1,000
Georgia	..	..	..	..	..	300	350	430	540	650	800	1,000	1,400	2,200	3,800	5,100	5,200	4,900
Iowa	..	..	..	..	..	..	800	850	950	1,100	1,300	1,600	2,100	3,200	5,500	7,200	7,775	6,667
Michigan	..	..	..	..	..	..	1,200	1,500	2,000	2,700	3,800	5,500	8,500	13,000	19,000	23,500	24,800	21,653
Rhode Island	..	..	..	..	..	..	..	..	1,200	1,300	1,500	1,800	2,100	2,800	3,800	4,100	4,200	3,800
Tennessee	..	..	..	..	..	..	..	..	..	..	300	420	600	850	1,200	1,400	1,500	1,400
West Virginia	..	..	..	..	..	..	..	..	..	..	800	1,500	2,300	3,200	2,800	2,000	1,400	1,000
Florida[c]	..	..	..	..	..	..	..	..	..	..	50	250	500	900	1,400	1,850	2,155	2,142
Missouri	..	..	..	..	..	..	..	..	..	..	..	..	3,500	6,142	10,452	10,823	10,704	8,441
Wisconsin	..	..	..	..	..	..	..	..	..	..	..	..	2,000	4,170	6,101	7,116	7,140	6,557
Louisiana	..	..	..	..	..	..	..	..	..	..	..	..	..	2,100	5,400	6,500	7,100	6,800
Utah	..	..	..	..	..	..	..	..	..	..	..	..	..	..	80	220	500	600
California[d]	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	2,500	3,500
Total	8,201	8,251	14,923	16,658	18,408	21,220	28,508	34,814	43,664	53,982	70,078	90,419	126,043	176,786	241,778	266,003	278,122	258,188

[a] This table is reproduced from "Small Loan Debt in the United States," by Rolf Nugent, in the Journal of Business of the University of Chicago, vol. 7, no. 1, January, 1934, pp. 1–21. An explanation of the methods used in developing these estimates and sources of reported data are given in this article.
[b] Including two companies operating under special legislative charters which are not licensed but whose loans are regulated by the small loan act.
[c] Excluding licensees engaged solely in the pawnbroking business.
[d] Excluding licensees engaged solely in the instalment finance business.

Change in Type of Security

Regulation of lending quickly brought about a distinct change in the kind of security required by lenders. The higher rates for loans secured by wage assignments and plain (unsecured) notes before the advent of regulation were evidence of a differential in cost between lending on these securities and on chattel mortgages. The natural tendency under a statute which allowed a flat rate of interest regardless of security was to seek the best security that the borrower had to offer.

No recorded information is available to show what proportion of the unregulated small loan business used plain notes, wage assignments, chattel mortgages, or endorsed notes as security. Lenders and social workers who knew small loan conditions at the turn of the century inform us that, while the proportion varied greatly between states, the division was fairly equal, with salary loans perhaps predominating in point of number of loans. In large cities, particularly in New York and in Chicago, salary loans constituted the largest class of loans not only by number but by amount.

Laws preventing or limiting the use of wage assignments[1] and campaigns against loan sharks, however, cut gradually into the salary loan business, and by 1916, when the Uniform Law was drafted, the chattel lenders appear to have been definitely predominant. In most states comparatively few of the salary lenders or plain-note lenders submitted to regulation, and many of those who did quickly switched to chattel mortgages as security.

Massachusetts and Ohio are the only states for which information relative to the type of security for loans made by licensed lenders is available for early years. Table 13 compares the distribution of loans in Ohio by type of security for 1916 and 1929.

Table 14 shows the number of licensees in Massachusetts lending on various forms of security in 1913 and in 1929. The distribution of outstanding loans by forms of security in Ohio in 1916 is probably more typical of the licensed business as a whole in its early days than is the distribution in Massachusetts. In the latter state

[1] For a description of laws affecting wage assignments, see Small Loan Legislation by Gallert, Hilborn, and May, Russell Sage Foundation, New York, 1932, pp. 189 to 217.

TABLE 13.—DISTRIBUTION OF TOTAL AMOUNT OF OUTSTANDING LOANS IN OHIO AT THE END OF THE YEARS 1916 AND 1929, BY TYPE OF SECURITY

Type of security	1916		1929	
	Amount[a]	Per cent	Amount[b]	Per cent
Chattel mortgages	$2,400,000	80	$23,320,000	98
Plain notes	250,000	8	36,000	0
Wage assignments	350,000	12	329,000	1
Endorsed notes	..	..	170,000	1
Total	$3,000,000	100	$23,855,000	100

[a] Estimated from data contained in the report of the Ohio Chattel Loan Bureau for 1916.
[b] Reported in a summary of annual reports of Ohio small loan licensees for 1929 by Haskins and Sells, Cincinnati.

TABLE 14.—DISTRIBUTION OF LICENSEES AND OF AMOUNT OF OUTSTANDING LOANS IN MASSACHUSETTS[a] AT THE END OF THE YEARS 1913 AND 1929, BY TYPE OF SECURITY

Type of security	1913			1929		
	Number of licensees	Outstanding loans		Number of licensees	Outstanding loans	
		Amount	Per cent		Amount	Per cent
Chattel mortgages	14	$234,000	22	66	$7,496,000	82
Wage assignments or plain notes	45	453,000	42	7	310,000[b]	3
Mixed chattel, salary, and plain notes	48	388,000	36	3	27,000	..
Mixed chattel and endorsed notes	..	..	..	16	445,000	5
Endorsed notes	..	..	..	17	920,000	10
Total	107	$1,075,000	100	109	$9,198,000	100

[a] Data for 1913 are given in the annual report of the Massachusetts supervisor of loan agencies; data for 1929 were estimated by the Massachusetts supervisor of loan agencies at the request of the authors. Morris Plan and chartered companies are excluded.
[b] Of this volume 73 per cent is lent by two companies specializing in school-teacher loans.

the fees permitted by the ineffective license act of 1908[1] encouraged the making of very small loans and led naturally to the preponderance of wage assignment and plain-note loans. Lenders of smaller sums tended to avoid the expense of visiting the home of the borrower to identify the furniture mortgaged and took the less bothersome, if also less secure, method of lending on salaries or plain

[1] Small Loan Legislation, p. 39.

notes. The allowance of fees by the supervisor under the more effective regulatory act of 1911 continued to encourage very small loans; this accounts for the preponderance of unsecured or wage assignment loans during the first years of regulation under this act, and for the decimation of the business that occurred when the fees allowed by the supervisor up to 1916 were prohibited.

In recent years the proportion of outstanding loans against various forms of security differs somewhat between states, but chattel mortgages are much the most common form of security in all states. Where special enabling acts for industrial banking companies exist, endorsed note lenders usually prefer to incorporate under these statutes, and the proportion of loans on endorsed notes under the small loan act is consequently small. In other states special regulations for wage assignments given to secure loans make this form of security unpopular with lenders. The maximum rate of interest also governs to some extent the amount of lending on less desirable security. Table 15 shows the variation in the proportion of loans outstanding against various forms of security in four states at the close of the year 1932.

TABLE 15.—DISTRIBUTION OF TOTAL AMOUNT OF OUTSTANDING LOANS IN FOUR STATES AT THE END OF THE YEAR 1932, BY TYPE OF SECURITY

Type of security	Per cent of total amount of outstanding loans			
	Illinois	Iowa	Rhode Island	Wisconsin
Chattel mortgages	81	95	73	95
Plain notes	8	1	5	1
Wage assignments	4	2	2	1
Endorsed notes	6	1	20	2
Other security	1	1	0	1
Total	100	100	100	100

Effect of Interest Restrictions on Wage Assignment and Plain-Note Loans

Many who continued to lend on plain notes under regulation in recent years have changed their businesses considerably and are lending only larger sums to selected risks. Two licensees in Massachusetts, for instance, do a large business solely with school teachers without any security beyond a plain promissory note. Customers are solicited by circularizing teachers throughout the country and loans are made by mail. Most of the current unsecured loans of other licensees are made to borrowers of similar economic status. An unsecured loan business with professional people having regular income, long tenure, and generally a high sense of financial responsibility is utterly different, however, from the business of the plain-note lender of the loan-shark era. Unsecured loans of the kind made by the latter had been slowly but surely eliminated by the restrictions of regulatory laws upon interest charges. Wage assignment loans declined in use in a lesser degree.

In the early days of regulation there were many complaints of the unfairness of the rate provided by the Uniform Law or its equivalent to the salary and plain-note loan business. In several states supervisors of licensees recognized the difficulty and probable impossibility of lending profitably smaller sums against wage assignments or without security at the rate provided by regulatory laws. The chief inspector of the Department of Banks and Banking in Ohio reported on this point in 1916: "The percentage of loss incurred by the companies doing entirely a salary loan business is many times that of those taking chattel mortgages only."[1] And in 1917: "There is no doubt that a larger proportionate charge whether for interest or in fees is required on salary loans than on chattel mortgages."[2]

The supervisor of loan agencies in Massachusetts in support of his ruling permitting fees in addition to interest said:

> To group companies that supply the demands of only a portion of those who are asking for small loans, and to make that portion those only who could furnish security in the shape of pledges or chattels, enlarges the gulf that marks the difference between the rate at which such a remedial loan business can be conducted, as compared with the high rate that must be made to induce a lender to engage in a business of making small loans that consist only of those loans without security in which the element of risk is so much larger. A "reasonable" rate would warrant the introduction of a reasonable percentage of cost for this element of danger of loss resulting from no security. It is not sound reasoning to argue that the rate of the

[1] Annual Report of Chattel Loan Bureau of the State of Ohio, 1916.
[2] Annual Report of Chattel Loan Bureau of the State of Ohio, 1917.

first class loaning with security indicates that the rate of the second class loaning without security should be approximately the same. As well might we argue that speculative corporations should obtain capital at approximately the same rate commanded by unquestionable investments.[1]

And after a review of the costs of lending of the remedial loan societies, he concluded: "These figures should demonstrate the truth of the conclusion that 3 per cent a month will not invite sufficient capital into the business of making small loans without security to create the competition essential to develop the best results for the borrowers."[2]

It cannot be denied that regulatory laws permitting 3 or 3½ per cent a month interest drove out of business the majority of plain-note and wage assignment lenders who were unwilling or unable to change the nature of their business materially. The Russell Sage Foundation was fully aware of this but made no effort to modify its recommended rate. The reasons for its position appear to have been:

1. It believed that the great bulk of necessitous loans could be made at the rates provided by the Uniform Law and that it was in the borrower's interest to furnish the best security available when he needed to borrow.
2. It believed that the maximum rate provided in the Uniform Small Loan Law approximated the point at which the interest burden put upon borrowers would cause more hardship than inability to borrow.
3. Any attempt to provide higher rates only on smaller loans would lead to the practice of splitting loans or lending to the same customer through two or more associated offices.
4. To modify the broad general regulatory character of the act by exceptions for lenders who could not operate profitably under it was to destroy its constitutional basis.
5. The salary lender was generally in disrepute and to a large extent justly so. While the Foundation did not expressly try to prevent the use of salaries as security, salary-lending had caused so much hardship in the past that it looked with equanimity on the limitations which the rate put on the use of this form of security.
6. The Foundation was partially convinced, though the matter was not subject to proof, that the ease with which salary loans were negotiated led to thoughtless and perhaps unnecessary borrowing.

[1] Annual Report of the Supervisor of Loan Agencies, 1913, Commonwealth of Massachusetts. Public Document no. 95, 1914, pp. 22–23.

[2] *Ibid.*, p. 28.

Recent studies[1] of current loan-shark conditions in unregulated states have strengthened this conviction.

The case for the salary-lender, however, has probably never been adequately studied. The persistence of salary-lending in unregulated states and the ability of salary-buyers in regulated states to build up huge businesses in a few years show that the demand for small salary loans still exists where lenders are available to make them.

Changes in Size of Loans

The cost of investigation and of making, recording, and collecting loans varies in proportion to the number of loans made. With the exception of the additional care which would naturally be given to larger loans, these costs were similar whether the loan was for $10 or $300, while the income at a fixed rate of interest was thirty times as great from the larger loan as from the smaller. Only losses, taxes, and the cost of borrowed money or the profit the lender expected to make on his own capital were proportionate to the volume of money lent. One way of decreasing the costs of lending was therefore to increase the size of loans.

Our estimates of the average size of loans made by licensed and unlicensed lenders are as follows:

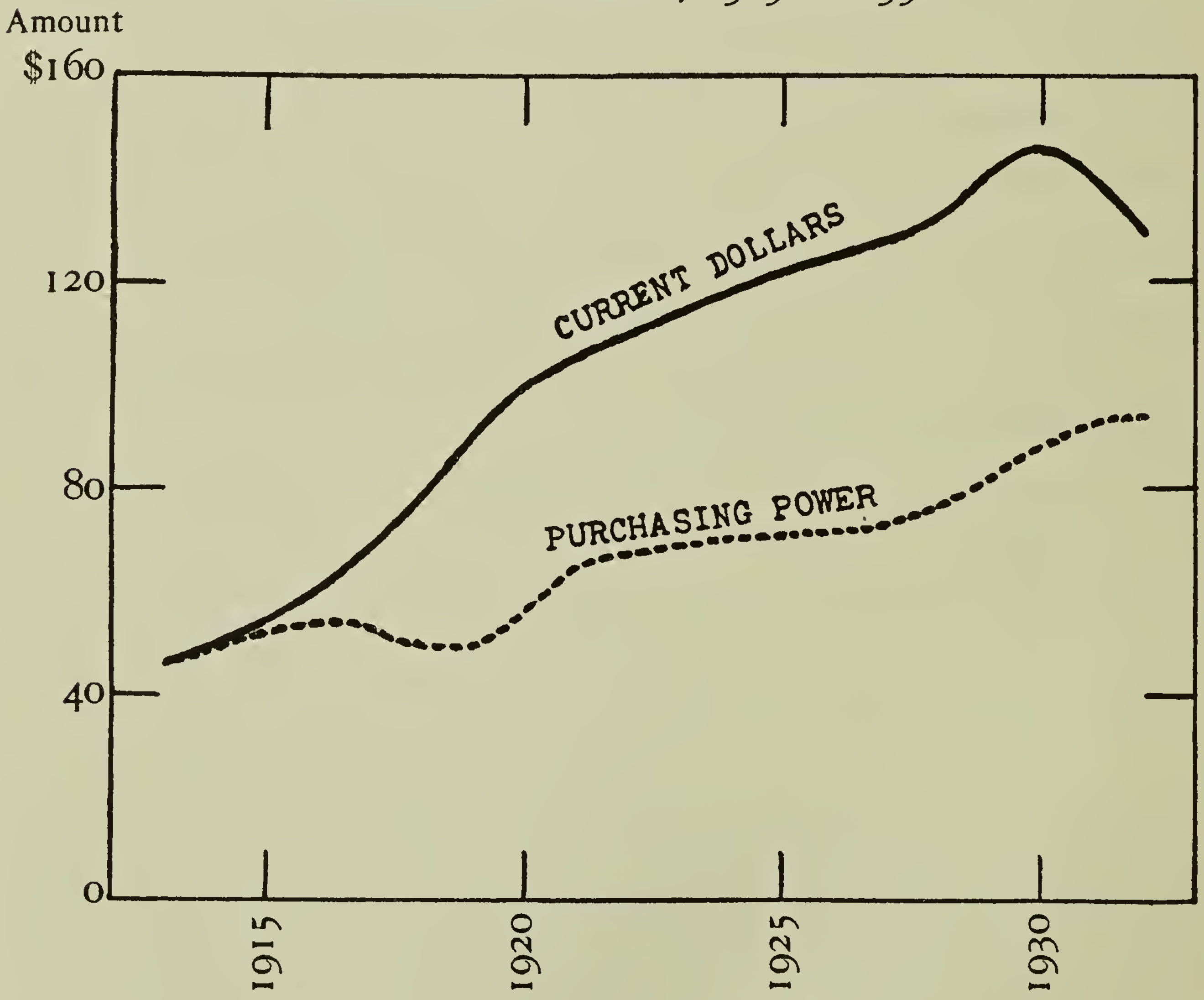
Year	Unlicensed lenders	Licensed lenders
1910	$40	..
1915	38	$55
1920	35	100
1925	32	122
1930	32	145
1932	25	130

The averages for unlicensed lenders are based upon exceedingly sparse data. A downward trend, however, is indicated by available data and would be even more clearly defined if these average loans were converted from current dollars into purchasing values. The principal causes of the decline are probably: (1) the lenders

[1] Unpublished study of consumer credit conditions in Kentucky cities made by the Russell Sage Foundation in 1929; studies of loan-shark operations in Kentucky issued by the Kentucky Research Council, Caryl Spiller, executive secretary, Louisville, Kentucky.

of larger sums removed their offices from unregulated territory and expanded in legal territory; (2) recurrent anti-loan-shark attacks made large loans increasingly dangerous since borrowers of larger sums were more likely to seek means of avoiding payment; (3) where the Uniform Law or its equivalent was not in force, other agencies, such as personal loan departments of banks, Morris plan banks, or other endorsed note loan companies had frequently developed to make many of the larger loans; (4) the territory where industrial wage scales and standards and costs of living were high had generally adopted regulatory laws.

DIAGRAM I.—ESTIMATED AVERAGE SIZE OF SMALL LOANS IN STATES HAVING REGULATORY LEGISLATION, IN CURRENT DOLLARS AND IN PURCHASING POWER, 1913 TO 1932



The licensed small loan business, on the other hand, immediately increased the size of its average loan upon submitting to regulation and this increase continued up to 1930. From the available material concerning the size of loans in state reports and reports of individual licensees, we have estimated the size of the average loan made by small loan licensees in all states having regulatory laws from 1913 to 1932. These estimates, in current dollars and in purchasing power,[1] are shown in the diagram on page 176.

The deflation of loans in dollars to 1913 purchasing power modifies considerably the extent of the increase in their size and shows that lenders during the first few years of regulation did not increase the size of their loans as fast as the inflation took place. But it is apparent that a material increase in size of loans has occurred for which the increase in the price level is not accountable. The sudden increase in 1929 and 1930 is probably due to the specialization of many lenders in larger loans at reduced rates of interest.[2]

TABLE 16.—AVERAGE SIZE OF LOAN MADE BY SMALL LOAN LICENSEES IN CERTAIN STATES, 1913 TO 1932

Entries begin with year in which regulatory law was enacted

Year	Massachusetts	New Jersey	Ohio	Illinois	Virginia
1911	..[b]	..	..	..	..
1912	..[b]	..	..	..	..
1913	$21	..	..	..	..
1914	22	..[b]	..	..	..
1915	26[c]	$55	$51	..	..
1916	38[c]	66	60[c]	..	..
1917	52[c]	72	..[b]	..[a]	..
1918	58[c]	79	..[b]	..[b]	..[b]
1919	65[c]	93	..[b]	$89	..[b]
1920	80[c]	123	..[a]	..[b]	..[b]
1921	90[c]	147	..[b]	..[b]	..[b]
1922	..[b]	149	..[b]	..[b]	..[b]
1923	..[b]	150	..[b]	..[a]	..[b]
1924	..[b]	150	..[b]	..[a]	$92[c]
1925	107[c]	..[a]	..[b]	..[b]	97[c]
1926	113	..[a]	..[b]	..[b]	100[c]
1927	122	..[a]	..[b]	..[b]	103
1928	124	165	..[b]	133[c]	101
1929	150	..[a]	162[c]	145[c]	111
1930	152	..[a]	168[c]	150[c]	117
1931	150	240	158	149	..[a]
1932	145	..[a]	143	138	..[a]

[a] Available data not satisfactory for estimate. [b] No data available.
[c] Estimated from official data. Amounts not so marked are reported in accounting studies made for licensees or in reports of state officials.

[1] In computing the purchasing power of the average loan, we have used the Bureau of Labor Statistics' index of the cost of living in the United States.

[2] See pp. 185–188.

A comparison of the trend of average loan for separate states is still more enlightening. Table 16 shows the average loan made during each year in those states for which any early reports are available.

The nature of the increase in the size of loans is more adequately demonstrated by a study of the averages of individual licensees. The average size of loan made is important to the accountant because of its bearing on the relation of certain costs of lending to income.[1] It is therefore interesting to note the concentration of individual licensees in the higher average loan brackets in the more recent years.

Table 17 shows the distribution of individual licensees in several states by the average size of loans made for the earliest and latest years for which such data are available.

The upper section of the table shows a concentration of licensees in the brackets for comparatively small average loans. In Ohio 80 per cent, in New Jersey 82 per cent, and in Massachusetts 98 per cent of licensees made loans averaging less than $100 during the years specified. The smaller averages reported for licensees in Massachusetts were undoubtedly due to the fees permitted on very small loans by the supervisor prior to 1916.

The lower section, on the other hand, shows a concentration in the higher brackets. In New Jersey 89 per cent, and in Massachusetts 93 per cent of licensees made loans averaging $100 or more during the years specified. Differences in the distribution of licensees in New Jersey and in Massachusetts are probably due both to the difference in the years for which data were available and to the exclusion of licensees charging less than the maximum rate from the Massachusetts figures. The size of the average loan made in New Jersey has continued to increase since 1923, which suggests further concentration of licensees in the higher average loan brackets for later years. The greater percentage of New Jersey licensees which made loans averaging more than $200 is probably due to the exclusion from the Massachusetts figures of licensees charging less than the maximum rate. Licensees making only loans of large denominations generally charged less than the maximum rate.

[1] The relationship of costs of lending to size of loan is discussed on pp. 266–270.

The shift to larger loans was in part planned by the lender and in part the natural consequence of regulation. The first increases probably resulted from the infiltration of new classes of borrowers who wanted larger sums, and from the willingness of lenders to supply their old customers with the larger loans which as unlicensed lenders they had refused.

TABLE 17.—DISTRIBUTION OF LICENSEES BY AVERAGE SIZE OF LOANS MADE DURING THE EARLIEST AND MOST RECENT YEARS FOR WHICH SUCH DATA ARE AVAILABLE

Average size of loans made	Per cent of total licensees in each state		
	Massachusetts	New Jersey	Ohio
	In early years		
	1915[a]	1915[a]	1916[a]
Under $19	40	4	6
$20 to 39	35	13	15
40 to 69	15	52	38
70 to 99	8	13	21
100 to 149	2	9	14
150 to 199	0	9	4
200 to 300	0	0	2
Total	100	100	100
	In recent years		
	1929[b]	1923[a]	
Under $19	0	0	Data not available
$20 to 39	0	0	
40 to 69	0	2	
70 to 99	7	9	
100 to 149	46	47	
150 to 199	43	29	
200 to 300	4	13	
Total	100	100	

[a] Data from annual reports of supervising officials for the years specified.
[b] Licensees charging the maximum rate only; data furnished to the Russell Sage Foundation by the Massachusetts supervisor of loan agencies.

There is much evidence to support the belief that the small sums lent by high-rate lenders did not represent the amounts needed by applicants. The supervisor of loan agencies in Massachusetts made an analysis of 37,500 loans of less than $10 made by Massachusetts licensees during a four months' period in 1914. The number of loans was more than four times the number of borrowers. Many of these loans by the same borrower represented renewals, loans paid off and made again, and loans from one lender to pay off another. But many other loans by the same borrower were concurrent borrowings from two or more lenders. Among 6,804 borrowers whose loans had not been paid or charged off at the close of the period studied, concurrent borrowing from different offices was reported as follows:[1]

Number borrowing at one office only	4,219
" " " two offices	1,208
" " " three "	637
" " " four "	326
" " " five "	185
" " " six or more offices	229

Apparently 38 per cent of these borrowers found it necessary to borrow from two or more lenders at the same time, while 11 per cent borrowed from four or more lenders concurrently.

In unregulated states today a similar situation exists. The records of the Louisville (Kentucky) Legal Aid Society show that clients who came to that organization in reference to loan accounts almost invariably had borrowed very small sums from many lenders at nearly the same time. The petitions in bankruptcy of wage-earners in Kentucky also show that several concurrent loans were usually made by those who later found bankruptcy necessary in order to cancel their high interest-bearing debts.[2]

While most lenders in the early years of regulation were aware that the size of loans was directly related to profits, it was not until recent years that precise knowledge of this relationship has been made available by elaborate cost accounting systems. Part of the recent increase in the size of loans is unquestionably due to a more widespread use of cost accounting methods.

Change in the size of loans was not general in the first few years. Some lenders at the time of passage of regulatory acts were already lending sizable amounts, and for them submission to regulation required but little readjustment. These lenders expanded their business almost immediately. Others who were making smaller loans gradually increased the size of their loans to the

[1] Annual Report of Massachusetts Bureau of Loan Agencies, 1914, p. 16.

[2] Data from an unpublished study of consumer credit in Kentucky made by the Russell Sage Foundation (1929).

point of satisfactory profit. Still others, however, were unable or unwilling to change, or failed to recognize the necessity for change. Most of the last group finally went out of business. The increase in the average size of loans was probably due to the gradual elimination of the lender of very small sums as well as to a general increase among all licensees.

TABLE 18.—COMPARISON OF TREND OF BUSINESS IN SECURED AND IN UNSECURED LOANS IN MASSACHUSETTS,[a] 1913 TO 1929

Close of year	Business in secured loans			Business in unsecured loans		
	Number of licensees	Amount of outstanding loans	Average loan made	Number of licensees	Amount of outstanding loans	Average loan made
1913	14	$234,000	$52	45	$453,000	$18
1914	16	400,000	62	59	622,000	18
1916	..	765,000	70[c]	..	675,000	21[c]
1918	..	816,000	78[c]	..	305,000	28[c]
1920	..	965,000	89[c]	..	321,000	39[c]
1929	130	8,875,000[c]	154[c]	7	64,000	58[c]
				2[b]	259,000	121[c]

[a] Excludes Morris Plan and chartered companies.
[b] Plain-note lenders dealing solely with school teachers.
[c] Estimated from incomplete data. Amounts not so marked are reported by the Massachusetts supervisor of loan agencies.

The lists of licensees in Ohio and Massachusetts furnish some interesting evidence on this point. Ten of the 19 licensees who went out of business in Ohio between 1916 and 1921 had average loans of less than $25, and only two of the other nine having average loans of $25 or more had loan balances exceeding $12,000. Small volume and small size of average loan were probably the reasons for withdrawal of these licensees.

In Massachusetts the early reports of the supervisor do not show the average loan of individual licensees but they do show the average loan for lenders taking security, for those lending without security,[1] and for those doing a mixed business. Since the average loan of the unsecured lenders was consistently very low, the trend of the business of the unsecured lenders is probably indicative of that of the lender of very small sums.

[1] The Massachusetts reports classify wage assignment loans as unsecured loans because the salary-lender rarely complied with the requirements of the wage assignment laws of the state and few such assignments were legally valid. In spite of their invalidity, however, they were effective means of enforcing collections.

Term of Loan

A fourth change in lending following regulation was an increase in the period of time over which repayment extended. Although the lender profited by reducing the number of investigations of new borrowers necessary to keep his money at work, it is probable that the increase in the term of loans was caused mainly by the larger loans which required a longer time for repayment. While many unregulated lenders, particularly those lending on salaries, made loans repayable on the borrower's next payday and anticipated renewing the loan at that time by the payment of interest only, many other lenders used a plan which amortized the loan in full over a period of time varying with the size of the loan and the income of the borrower. The average term of these contracts was in all cases comparatively short, ranging from four weeks in the case of some plain-note lenders specializing in very small sums to approximately six months in the case of some lenders making unusually large loans on chattel mortgages.

In states where lending on chattel mortgages was predominant when regulatory acts passed, the term of the loan immediately increased. In Ohio the minimum average term for individual licensees in 1916 was four months and the maximum one year. The most common average term was six months.[1] In Massachusetts where smaller loans were made, the average term of all lenders submitting originally to regulation seems to have been less than three months, with the unsecured lenders lending for an average of about two months.

The average term for which loans were made has continued to lengthen in all states because of the increased proportion of large loans. Today only the very small loans are made for less than five months, and most of the large ones are made on repayment contracts covering from twelve to twenty months. The average term of loan contracts probably exceeds twelve months at the present time.

Change in Distribution of Licensees by Size of City

Since there was a need for increasing the volume of business of all but very few licensees who had satisfactory volumes when

[1] Annual Report of Chattel Loan Bureau of the State of Ohio, 1916, pp. 20–26.

regulation became effective, there soon occurred a considerable shift in the location of lenders. Small communities which furnished a sufficient loan demand to engage the $5,000 or $10,000 capital of a high-rate lender did not immediately produce sufficient loan demand to employ the larger volume of capital essential to profitable operation as a licensee. In Massachusetts, where the rate restriction was the most severe owing to the prevalence of very small loans, there was a rapid exodus of licensees from the smaller towns as well as considerable contraction in the total number of licensees as the unsecured lenders gave up their unsuccessful efforts

TABLE 19.—DISTRIBUTION OF LICENSEES IN MASSACHUSETTS, 1913 TO 1931, BY SIZE OF COMMUNITY SERVED

Number of Licensees in Communities of Specified Size

Size of community[a]	1913	1915	1919	1921	1925	1927	1929	1931
300,000 and over[b]	78	71	35	36	34	37	61	76
100,000 to 300,000	30	31	19	21	26	33	41	49
30,000 to 100,000	18	18	8	8	13	19	28	37
Under 30,000	6	3	0	0	2	11	31	38
Total	132	123	62	65	75	100	161	200

Number of Communities of Specified Size Served by One or More Licensees

Size of community[a]	Number of communities in state	Number of communities served							
		1913	1915	1919	1921	1925	1927	1929	1931
300,000 and over	1	1	1	1	1	1	1	1	1
Boston suburban area	..	2	1	0	1	1	3	9	11
150,000 to 300,000	2	2	2	2	2	2	2	2	2
100,000 to 150,000	4	4	4	4	4	4	4	4	4
50,000 to 100,000	5	5	5	3	3	3	5	5	5
30,000 to 50,000	6	3	3	3	3	4	5	6	6
20,000 to 30,000	6	2	0	0	0	1	4	6	6
12,000 to 20,000	9	2	2	0	0	1	3	7	9
Under 12,000	..	2	1	0	0	0	2	4	8
Total	..	23	19	13	14	17	29	44	52

[a] Population figures from the 1930 census were used to make these classifications. In almost all cases the population of the city or town in which the licensee was located was considered as the measure of the size of the community served. The two exceptions were Springfield and Pittsfield for which the 1930 census gives populations of 149,900 and 49,677 respectively. Because the populations of these cities were close to the margin of the next higher population group and because of the larger population of the immediate trade area of these cities they were put into the groups of communities having populations of 150,000 to 300,000 and 50,000 to 100,000 respectively. The distinction between suburban communities and independent cities within the Boston commuting area is of course difficult to establish accurately. The decision has been based purely on the authors' opinion regarding the dependence or independence for trade purposes on the city of Boston of communities in this area. For instance, Dedham, Newton, Chelsea, Revere, and Norwood were considered dependent suburban communities, while Lynn and Malden, scarcely further distant from Boston, were considered independent communities for this purpose.

[b] Includes Boston suburban area.

to operate profitably. Table 19 shows the number of licensees in communities of different size in Massachusetts from 1913 to 1931.

One of the first effects of regulation was to drive licensees out of the smaller communities. By 1919 no licensed lenders were left in towns of less than 30,000 population or in the Boston commuting area. Following the year 1925, however, licensed offices began to return to the smaller communities.

TABLE 20.—DISTRIBUTION OF LICENSEES IN NEW JERSEY, 1915 TO 1931, BY SIZE OF COMMUNITY SERVED

Number of Licensees in Communities of Specified Size

Size of community[a]	1915	1917	1923	1925	1927	1929	1931
300,000 and over	13	15	76	114	168	174	47
100,000 to 300,000	5	7	22	38	58	73	22
30,000 to 100,000	3	4	27	47	89	101	19
Under 30,000	2	2	4	12	38	66	17
Total	23	28	129	211	353	414	105

Number of Communities of Specified Size Served by One or More Licensees

Size of community[a]	Number of communities in state	Number of communities served						
		1915	1917	1923	1925	1927	1929	1931
300,000 and over	2	2	2	2	2	2	2	2
100,000 to 300,000	4	4	4	4	4	4	4	4
50,000 to 100,000	9	1	1	6	8	9	9	7
30,000 to 50,000	8	2	2	5	6	8	8	3
20,000 to 30,000	5	0	0	1	3	4	5	2
12,000 to 20,000	12	0	0	0	3	8	12	5
Under 12,000	. .	2	2	2	3	13	25	6
Total	. .	11	11	20	29	48	65	29

[a] Population figures from the 1930 census were used to make these classifications. Because of their importance as trade centers for nearby towns, Hackensack, Asbury Park, and Millville, whose populations were close to the maximum for one classification, were moved into the next higher population class. The population of South Orange was included with that of Orange and the population of Roselle Park with that of Roselle in classifying these communities.

In Ohio a somewhat similar contraction of the number of licensees occurred, but the licensees in smaller towns were not so severely affected because they found an additional market in comparatively large loans to farmers and dairymen in the surrounding country.

New Jersey, prior to the destructive interest rate cut in 1929, was fairly typical in regard to the distribution of licensees among communities of various size. But few lenders in the smaller towns of New Jersey submitted to regulation when the regulatory small loan act passed. At first, almost all new licensees located in larger cities, but following 1925 the search for new territory brought licensees even to very small communities. Table 20 shows the number of licensees in communities of different size in New Jersey from 1915 to 1931.

The penetration of Virginia licensees into smaller communities is similar to that of New Jersey lenders prior to 1929. With but one exception, all communities of more than 15,000 population in Virginia were served by licensees in 1931. The single exception was Charlottesville, a college town with a negligible industrial population.

The licensed offices opened in small towns after 1928 were for the most part branches of chain companies. The opening of these offices in towns where profitable volume was difficult to secure signified growing competition in the more favorable communities.

Effect of Competition on Interest Rates

For a number of years after the passage of the first regulatory small loan laws the demand for loans probably far exceeded the supply of funds available for making them. Although the licensed lenders promptly undertook to find additional capital, little was available. Their capital had been accumulated almost entirely through profits from unlicensed lending and the small loan business consequently was unknown to investors. It was not until 1921 that any considerable amount of new capital came into the business.

From 1921 to the close of 1928 the flow of capital into the small loan business was increasingly rapid. Part of this new capital was absorbed by the increased demand for loans, part went into states which passed regulatory laws during this period, and part found an outlet in communities which had not previously had small loan licensees. It was apparent, however, that the non-competitive areas for lending small sums were rapidly closing up and that small loan offices could not be extended indefinitely into still smaller communities.

Beginning with the fall of 1928 and continuing throughout 1929 and 1930, the flow of additional capital into the industry was increased by the sale of small loan company securities through investment banking houses. During 1929 the amount of capital of licensed lenders increased by approximately 30 per cent. These new funds no longer found an undersupplied market for loans. The extension of chain companies to small communities had reached the limit of practicability. No additional legislation had opened new territory to licensed lending during 1929 and 1930, while legislative rate reductions in New Jersey and West Virginia had actually reduced the field for profitable lending. Since the demand for loans, like the demand for many other commodities, expands with decreases in price, the natural outcome of increasing competition was a reduction in interest charges.

Although the average rate of charge made by all licensees probably declined very slightly and gradually after the first few years of regulation, this downward movement prior to 1928 was principally due to an increment in that portion of licensees lending on endorsed notes. Most such licensees, from the time of their organization, charged rates materially below the maximum permitted by regulatory statutes. The going rate on chattel, wage assignment, and plain-note loans, which involved considerably greater expense, remained with negligible exceptions solidly at the maximum. Late in 1928, however, simultaneously with the sale of a large issue of its preferred shares, the Household Finance Corporation reduced its rate to 2½ per cent a month but limited its loans to sums of $100 or more. The offices of this company were mostly in sizable cities where a satisfactory volume of larger loans was available. In a short time many of its competitors were forced to make similar reductions. These rate reductions affected only the larger chattel loans. Wage assignment and plain-note loans and smaller chattel loans continued to be made at the maximum rate.

Competition in rates made a decided difference in the cost of chattel loans to borrowers in states where large chattel loans predominated. At the close of 1929 approximately 40 per cent of the volume of loans in Illinois was being lent at 2½ per cent a month,[1] and in Wisconsin at the close of the year 1930 the commissioner of the State Banking Department reported that "the rates of interest charged and collected by lenders range from 1½ to 3½ per cent with the bulk of the business being done at about the 2½

[1] David Himmelblau and Company, accountants, Auditors' Report on Annual Reports of Small Loan Licensees in Illinois, Chicago, 1929, p. 8.

per cent rate."[1] A study by the Household Finance Corporation of the interest rates of its competitors in July, 1931, indicated that 37 per cent of all licensees in the cities in which that corporation maintained licensed offices were charging less than the maximum rate. Some of these were endorsed note companies, but the great majority were chattel mortgage lenders.[2]

Competition in rate expanded the market for small loans in two directions. First, the availability of cheaper loans attracted new classes of borrowers. Second, many lenders who continued to charge the maximum rate were forced to lend on less desirable security in order to keep their funds employed. During 1929 and 1930 there appears to have been a considerable expansion of loans secured by automobiles, by wage assignments, and by plain notes.

Some lenders, however, were unable to reduce their interest rates or to modify their loan standards since either alternative would have resulted in lower earnings. Expenses of selling high interest-bearing securities and of organization had not, in general, been amortized from earnings, because immediate dividends were considered necessary to the development of markets for later stock and bond issues. Reduced earnings meant receivership to many of these lenders. Instead of accepting smaller loans to poorer classes of borrowers which were avoided by their lower rate competitors, they attempted, in order to maintain their rate of earnings, to lend in the same units and to the same classes of borrowers to whom they had lent in the past. Competition for the more desirable borrowers became intense in some states.

Although competition was beneficial to borrowers in reducing interest costs and in extending loan service to classes of borrowers who perhaps would have been refused loans several years earlier, many of its consequences were not salutary. Competitive advertising, some over-lending, and need for increased collection pressure all followed. It is possible that these practices had considerable responsibility for reductions in maximum interest rates in 1929.

The legislative rate reductions in New Jersey and West Virginia in 1929 had the effect of increasing still further competition among

[1] Report of the Commissioner of the State Banking Department to the Senate of Wisconsin for the Year 1930. In Senate Journal, March, 1931, pp. 825–834.

[2] Unpublished study by the Household Finance Corporation, Chicago.

licensed lenders. Although many local small loan companies in these states liquidated and dispersed their capital, the chain offices liquidated and transferred their funds to other states. Part of these funds found employment in Oregon, Utah, and Arizona, which had been considered unattractive locations for chain companies because of their isolation from the principal industrial areas. Another part, however, went into states where competition for borrowers was already severe.

Unforeseen developments supplied a breathing space in this competition. Money market conditions reduced in 1931 and completely shut off in 1932 the flow of new capital into the small loan business; higher losses and greater delinquency reduced the balance available for new loans; and many lenders, influenced by the increased risks of lending, liquidated bank loans or maintained large cash reserves. The enactment of small loan laws in California in 1931 and in New York early in 1932 opened up new markets for surplus funds, and the increase in the maximum interest rates in West Virginia and New Jersey in 1933 added a larger market for loans than that eliminated by the destructive rate reduction in New Hampshire.

Competitive decreases in small loan charges were stopped abruptly in 1931 by higher losses, by increasing collection costs, and by this relief from severe competitive pressure. Before the end of 1932 most of those licensees who had reduced their rates had raised them again. During 1931, however, the demand for small loans from acceptable borrowers began to contract. The number of potential borrowers was rapidly reduced by unemployment, and many of those who would have borrowed in earlier years to meet emergencies considered all possible expedients before entering into high interest-bearing contracts. The decline in demand for loans continued throughout 1932 and became more precipitate in 1933. Whenever possible, the large chain companies purchased the assets of licensed offices that were offered for sale, but in spite of these acquisitions and the consequent removal from the business of considerable amounts of capital, the pressure of idle funds became increasingly severe. Toward the close of the year 1933, competition in interest charges was renewed vigorously. During 1934 loans in larger denominations were offered in many communities at rates which were 30 per cent less than the legal maximum.

CHAPTER IX

CHARACTERISTICS OF BORROWERS FROM LICENSED AND UNLICENSED LENDERS

THE changes in the small loan business which we have described in the previous chapter raise a serious question concerning the effectiveness of regulation. The Uniform Small Loan Law was designed to regulate the business of lending to the necessitous borrower. Its sponsors have claimed that it has replaced the loan shark with a legitimate, decent substitute and that it has reduced the interest rates prevailing during the loan-shark era to a maximum of 3 or 3½ per cent a month. Did regulatory legislation reduce interest charges on the same type of loans, or did it instead put the loan shark out of business and enable a new type of lender to lend to a class of borrowers different from those whose necessity drove them to the loan shark?

At first glance, much of the data presented in the previous chapter would seem to suggest the latter. In this chapter we shall undertake, so far as the sparse data available permit, to discover differences between the borrower from the loan shark and the borrower from the licensed lender.

Amount of Money Borrowed

First, let us re-examine the size of loans made by unregulated and by licensed lenders from this point of view. However proper the use of the average size of loan may be for accounting purposes, its usefulness for our present purpose is limited. We need to know what variation in the size of loans lies behind the average. Table 21 shows the proportion of loans of various size made by certain lenders and groups of lenders, before and after regulation.

In spite of the considerable increase in the proportion of large loans, many borrowers of small sums are evidently still being served. Indeed, considering the tremendous increase in the volume of lending, the absolute number of loans of less than $50 is prob-

TABLE 21.—SIZE OF LOANS MADE BEFORE AND SINCE REGULATION

Size of loan	Before regulation			Since regulation		
	Salary lender, 1903[a]	Salary lender, 1907[b]	Chattel lender, 1916[c]	Four chattel loan companies, 1918[d]	211 licensed lenders, 1922 to 1923[e]	One chain company, 1930[f]
	Per cent of total loans					
Under $10	0	0	1	0	0	1
$10 to 19	3	13	13	2	1	
20 to 29	31	47	19	5	5	5
30 to 49	33	30	19	12	10	
50 to 74	22	8	21	26	21	12
75 to 99	9	1	7	19	10	8
100 to 149	2	1	17	15	23	22
150 to 199	0	0	2	12	11	15
200 to 300	0	0	1	9	19	37
Total	100	100	100	100	100	100

[a] Data from books of a large salary loan company in New York City, in the possession of the Russell Sage Foundation.
[b] Data adapted from analysis of 310 applications for loans from a salary lender in Philadelphia quoted in The Salary Loan Business in New York City, p. 137.
[c] Data for 300 loans by an unlicensed chattel loan office in Chicago whose records are in the possession of the Russell Sage Foundation.
[d] Data for 600 loans by four offices of a chattel loan company in Michigan.
[e] Data from Ten Thousand Small Loans, p. 118.
[f] Data for 5,924 loans by all offices of Community Finance Service in August, 1930. This was the only company which reported the size of loans made in a recent year in sufficient detail for use in this table, except the Household Finance Company which specialized in large loans at lower rates. Community Finance Service also is probably not fully representative. It is believed that this company made larger loans than most other companies.

ably larger than in the loan-shark days in spite of the decline in the relative number. It should be borne in mind that the above table of distribution of loans by size has not been modified to compensate for the reduction in purchasing power of the dollar. If this were done it would be still more apparent that a considerable portion of the loans made by licensed lenders are of amounts corresponding to those of the high-rate lenders of the earlier period.

Borrowers' Incomes

What of the borrowers' income status? Table 22 attempts to compare the incomes of borrowers from a loan shark in 1907 with those of borrowers from licensed lenders in more recent years. Unfortunately we have records of only one unlicensed lender which permit an estimate of borrowers' incomes. There is no assurance that the clientele of this lender was typical of that of the unlicensed business

TABLE 22.—DISTRIBUTION OF BORROWERS BY AMOUNT OF MONTHLY INCOME, 1907 AND IN LATER YEARS

(Dollars adjusted to 1919 earnings level by use of average annual earnings of wage workers in all industries)[a]

Monthly income of borrower	Unlicensed salary lenders, 1907[b]	211 licensed offices, 1922 to 1923[c]	New Jersey licensees, 1929[d]	Household Finance Corporation, 1931[e]
	Per cent of total borrowers			
Under $100	20	25	15	10
$100 to 149	50	55	45	30
150 to 199	25	15	25	30
Over 200	5	5	15	30
Total	100	100	100	100

[a] Wage index used is that of Willford I. King in The National Income and Its Purchasing Power, p. 146.
[b] Estimate based on data for 310 applications for loans, quoted in The Salary Loan Business in New York City, p. 137.
[c] Estimate based on data from Ten Thousand Small Loans, p. 65.
[d] Estimate based on data from The Small Loan Situation in New Jersey in 1929 by Willford I. King, p. 41.
[e] Estimate based on data from Historical and Statistical Report (1931) of the Household Finance Corporation, Chicago, p. 7.

as a whole. However, it seems worthwhile to establish the fact that at least one salary lender of the loan-shark era lent to borrowers whose wage levels were approximately equivalent to those of borrowers from licensed loan agencies. The figures for licensed lenders are in each case based on large numbers of borrowers from many offices and therefore represent a large volume of borrowing. The larger proportion of borrowers of higher incomes in New Jersey and among borrowers from the Household Finance Corporation is probably due more to the lower interest charge for these loans than to the date at which the loans were made.

An earnings index for adjustment of incomes was chosen because we are interested in the position of borrowers in the economic scale rather than in either their nominal income or its purchasing power. Percentages given in Table 22 should not be relied upon absolutely, and a possible error of as much as 20 per cent of each figure must be conceded.

Occupation of Borrowers

It is also worthwhile to compare the nature of the occupations of borrowers from unlicensed offices with that of borrowers from licensed offices. Table 23 makes such a comparison.

TABLE 23.—DISTRIBUTION OF BORROWERS BY OCCUPATION, BEFORE AND SINCE REGULATION

Nature of occupation[a]	Before regulation		Since regulation		
	Salary lender, 1907[b]	Chattel lender, 1915[c]	211 licensed lenders, 1922 to 1923[d]	Beneficial Industrial Loan Corporation, 1929[e]	Household Finance Corporation, 1931[f]
	Per cent of total borrowers				
Business	0	5	3	3	3
Professional	0	3	3	2	9
Semi-professional	8	5	5	4	5
Highly skilled or supervisory	22	7	12	8	10
Skilled	27	27	22	28	32
Semi-skilled	35	33	37	28	30
Unskilled	8	20	18	27	11
Total	100	100	100	100	100

[a] In spite of rather elaborate classifications of occupations given by the sources used, the adjustment to a common classification for purposes of comparison is subject to considerable error. Our classification has been designed to show relative degrees of training and skill of borrowers in order to suggest differences both in earning capacity and responsibility for contracts among borrowers. Several of the analyses used have been based on classifications designed to show the distribution of borrowers among various industries. Our own classification needs to be explained:

Business includes owners of retail stores, restaurants, garages, factories, real estate offices, and so forth. Although independent taxi drivers and rooming-house keepers are entrepreneurs, the requisite investment and business technique is small and they are classified as "Semi-skilled."

Professional includes doctors, dentists, lawyers, professional engineers, editors, teachers, bank officers and non-owner executives of large businesses.

Semi-professional includes nurses, actors, draftsmen, minor executives, insurance agents and accountants. Salesmen were distributed equally between "Semi-professional," "Highly skilled" and "Skilled."

Highly skilled or supervisory includes foremen, railroad engineers and conductors, and chain store managers.

Skilled includes policemen, the building trades, automobile mechanics, machinists, chefs, city firemen, and the skilled clothing trades.

Semi-skilled includes telephone operators, taxi and truck drivers, street-car motormen and conductors, stenographers, office and store clerks, enginemen, miners, and machine operators.

Unskilled includes laborers, domestic servants, porters and messengers.

[b] Data for 250 applications quoted in The Salary Loan Business in New York City, by Clarence W. Wassam, p. 137.

[c] Data for 600 loans of an unlicensed chattel lender in Chicago, in possession of Russell Sage Foundation.

[d] Data from Ten Thousand Small Loans, by Louis N. Robinson and Maude E. Stearns, p. 52.

[e] Data supplied by Beneficial Industrial Loan Corporation, for 21,000 loans made to gainfully employed borrowers in New Hampshire in 1929.

[f] Data from Historical and Statistical Report of the Household Finance Corporation, Chicago, 1932, p. 8.

This table shows a noteworthy similarity between the occupations of borrowers before regulation and after regulation of the small loan business. Business owners do not occur among the applicants for loans from the salary-lender because they had no salaries to offer as security. This lender apparently either refused loans to salaried professional people or did not have applications from them.[1]

Reasons for Borrowing

Satisfactory data on the reasons for borrowing are difficult to obtain. Many analyses have been made of the reasons for borrowing from licensed lenders and several are available for unlicensed offices. All these studies have differed in method and many of them were inadequate. Even the more careful studies do not permit comparison of results and perhaps no such comparison could be made safely unless the investigations were made by the same person. There are probably primary, secondary, and even tertiary reasons for borrowing, and the assignment of reasons to these grades depends upon the interpretation of the investigator and the extent to which the borrower tells the full facts concerning his need for the loan. For instance, the applicant may apply for a loan to buy clothing for his children at the opening of the school term. While this may perhaps be the immediate reason for borrowing, the investigator might find upon inquiry that the money saved in anticipation of this need had gone for some other purpose or that, facing several needs for money which could not be met out of the next pay-check, the applicant preferred to mention the children's clothing as the most appealing of several purposes.

Consequently the degree to which the reasons for borrowing have changed since the regulation of the small loan business cannot be established. The existing studies show definitely, however, that both before and after regulation there were many applicants for loans whose budgets had been upset by sickness, childbirth, and death. Many borrowed to buy the winter's coal supply, to pay taxes on their homes or interest on mortgages, to refurnish a room for subletting, or to buy materials for a painting, carpentering, or plumbing job which would be paid for on completion. We may safely conclude that the needs stated by borrowers since regulation cover much the same range as the needs in the loan-shark era.[2]

[1] It should not be concluded, however, that salaried professional people did not borrow from high-rate lenders during the loan-shark era. School teachers, particularly, were frequent borrowers during this period.

[2] For analyses of reasons for borrowing, see Ten Thousand Small Loans by Robinson and Stearns, pp. 140–153; The Personal Finance Business by M. R. Neifeld, Harper and Brothers, New York, 1933, pp. 189–194; The Small Loan

Risk of Loss

Standards based on the size and purpose of the loan, and on the occupation and income of the borrower, could be applied by lenders as rules of thumb in selecting applicants for loans. Beyond these, of course, the loan shark as well as the regulated lender made more subtle distinctions of credit worth in choosing those applicants to whom he was willing to lend. To applicants of the same occupation and income, asking for identical amounts, some loans were made and others were refused. The reasons for refusing loans were noted by the Philadelphia salary-lender in 1907, to whom reference has been made before. Notations from his records indicate some of the other conditions which determined the lender's decision to grant or refuse the loan.

A clerk, for instance, was "turned down" because he had "too many loans"; a stenographer, "owes bills in the neighborhood"; a clerk was "too heavily involved in debt"; a plumber gave "bum references"; a machinist was "not considered safe"; a motor-man was refused a loan and was "N. G." because he is "only extra man"; a yard-master was "a dead-beat"; a machinist was "turned down" on "Gen. Prin." (this is believed to stand for General Principles); a polisher secured no loan because he was "slow pay"; a cashier because his "employer advised T. D.," and a clerk because he was a "fugitive from justice."

The occupation of other applicants and the reason for the refusal of the loan to them appeared in this "turned down" book as follows: Cashier, "nit"; electrician, "broke"; manager, "poor pay"; machinist, "skipped the town"; painter, "bad reputation"; clerk, "roving disposition"; brakeman, "gambler"; express-messenger, "drunken wife"; clerk, "liar"; car laborer, "too poor"; railroad clerk, "only two months in city"; fireman, "rotten"; wrapper, "minor"; conductor, "professional borrower"; carpenter, "drunk"; machinist, "ill health"; railroad leverman, "bum pay"; stable foreman, "old age"; telegraph operator, "unworthy"; electrician, "wages would not warrant a loan"; clerk, "mover"; salesman, "irresponsible"; porter, "lied about references"; clerk, "going to be fired"; time-keeper, "gave wrong name"; wire-weaver, "wire-workers are poor risk"; railroad employe, "wife says no good"; librarian, "dam slow."

Other reasons why applicants were "turned down" are as follows: "No steady work," "poverty," "bum appearance," "bad record," "owes every-

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Note continued from p. 193.

Situation in New Jersey in 1929 by Willford I. King, pp. 58–61; Consumer Loans in Wisconsin by Genevieve Townsend, Straus Printing Company, Madison, Wisconsin, 1932, p. 127.

body," "has loans at other places," "applied at too many other places," "?." This question mark appears after the names of quite a number of applicants. "No more, his wife left him," "he is poor as a church mouse and getting poorer," "do not loan again, mother paid this," "five months back in loan"; "careful again," "kicked hard on charges every time they paid," "husband an invalid for years and no help to her in paying loan," "unsatisfactory," "a bad risk," "too big a risk," "boozer," "not satisfactory," "living with bad lot," "had loan with . . . was slow"; "rascal," "beat," "rotten," "too shifty," "runs around too much," "poor," "don't touch," "he is a D. B. (dead beat)," "worst rep. (reputation) ever heard of." A fair proportion of the applicants "turned down" were found to have had loans from other moneylenders and this usually was indicated on the book by such references as ". . . has him," "has loan at . . ."[1]

It is entirely possible that the elimination of risks through careful investigation might result in a radical change in the kind of borrowers served by licensed lenders, which would be obscured by comparison of more obvious characteristics.

The logical method of measuring the effect of this more careful selection would be to compare the ratio of loans made to loans refused for licensed and unlicensed lenders, but unfortunately reliable data on this point are not available. Another method which suggests itself is to compare loss ratios of licensed and unlicensed lenders. Differences in loss ratios, however, involve other factors in addition to the degree of care in choosing borrowers. Losses of unregulated lenders were high partly because of the dubious or negative legal standing of their loans, and partly because of the sheer weight of the interest burden put upon borrowers. The effect of the interest burden upon the extent of loss cannot be isolated for purposes of comparison of losses of licensed and unlicensed offices. But the effect of illegal status can be eliminated by comparing losses of licensed lenders in Massachusetts during the period from 1911 to 1916 with losses of licensed lenders in other states. As we have noted in an earlier chapter, the fees permitted in Massachusetts from 1911 to 1916 resulted in such high rates of interest that the Massachusetts act of 1911 caused no material change in the nature of the small loan business.

[1] Wassam, Clarence W., The Salary Loan Business in New York City, Appendix XXIII, pp. 131–132. This material was supplied to Dr. Wassam by Frank J. Warne who examined the books of this company following the Philadelphia raid.

The most prominent of the companies which lent very small sums at high rates of interest in Massachusetts was the Chattel Loan Company. In 1911 this company reported losses amounting to 25 per cent of its average loan balance.[1] Income statements of this company for 1913 and 1914 were also published by the supervisor of loan agencies, but the 1913 statement is unreliable because the report covered periods of less than a year for several of its offices[2] and the 1914 statement does not distinguish losses from other expenses. In 1913 all Massachusetts licensees lending without security reported losses of 6.8 per cent of the aggregate outstanding loans at the close of the year, and those lending on mixed security reported losses of 6.1 per cent.[3] In 1914 licensees lending without security reported losses of 12 per cent of the aggregate average loan balance, and licensees lending on mixed security reported losses of 4.5 per cent.[4]

It seems probable that losses of unlicensed lenders were much higher than the aggregate loss of licensees in Massachusetts. Few lenders of the loan-shark era kept their books in such a way that loss ratios could be calculated. An uncollectible loan decreased the investment, while the renewal of a loan for the unpaid balance and delinquent interest added to the investment. These additions and subtractions from the capital account probably balanced out roughly over a period of years and avoided the necessity of journal entries.

A high loss ratio was inherent in the system of the loan-shark era. Most lenders limited individual loans to small amounts and charged rates which in the aggregate allowed plenty of leeway for mistakes in specific cases. They made only superficial efforts to determine the financial condition of the borrower or his ability to get out of debt, and they relied on the interest collected from month to month to return the principal before the borrower whose financial

[1] Annual Report of Supervisor of Loan Agencies, Commonwealth of Massachusetts, Public Document no. 95, January, 1912, p. 6.

[2] The loss reported for this year exceeded 50 per cent of the outstanding loan balance at the close of the year.

[3] Annual Report of Supervisor of Loan Agencies, Commonwealth of Massachusetts, Public Document no. 95, January, 1914, p. 33.

[4] Annual Report of Supervisor of Loan Agencies, Commonwealth of Massachusetts, Public Document no. 95, January, 1915, p. 7.

condition was hopeless finally defaulted. The lender who had collected 20 per cent interest each month for two years could write off the principal at the end of that time with little misgiving.[1]

To the licensed lender the risk of loss had a different significance. Even if interest were paid regularly over a period of two years, the licensed lender would have received an amount considerably less than the principal. The licensed lender, therefore, found it necessary not only to lend solely to borrowers who, he believed, could eventually repay, but also to show borrowers how to arrange their budgets in order to meet both their family expenses and periodic payments on their loans. This involved careful selection but was salutary for both lender and borrower.

Losses appear to have been reduced immediately following regulation of the small loan business. In New Jersey during 1915, the first full year of regulation, losses reported by small loan licensees were 4.8 per cent of the average amount of loans outstanding. In 1916 losses were 1 per cent, and in 1917 they were 1.4 per cent.[2] In 1917 the Chattel Loan Bureau in Ohio estimated annual losses of chattel lenders at approximately 2 per cent of the average amount at risk. Very few loss figures for other states are available prior to the year 1929. The few figures that have been found and the reports of individual licensed lenders suggest that endorsed note lenders, by combining several persons in the responsibility for the loan, kept their annual losses consistently below one-half of 1 per cent of the average amount of outstanding loans. Chattel lenders suffered considerably higher losses, which varied widely between states, but the aggregate loss in all regulated states seems to have been consistently less than 2 per cent of the average amount of outstanding loans in years prior to 1929. The rate of loss rose in 1929, and again in 1930 and in 1931, while in 1932 and 1933 aggregate losses in all regulated states exceeded 5 per cent of the average outstanding loan balance. Table 24 contains estimates of the rates of loss since 1929 in several states for which official data

[1] Petitions in bankruptcy in the federal courts in Kentucky show that most of the loan-shark debts were contracted from two to four years prior to filing the petition in bankruptcy.

[2] Annual Reports of the New Jersey Commissioner of Banking and Insurance for the years 1915, 1916, and 1917, pp. 11–12, 12, and 10 respectively.

are available. The suggestion of a relationship between the rate of loss and the maximum rate of interest is worthy of notice.

TABLE 24.—BAD DEBT LOSSES AS PER CENT OF ESTIMATED AVERAGE OUTSTANDING LOAN BALANCE IN NINE STATES, 1929 TO 1932[a]

State	Maximum rate of interest: per cent a month	1929	1930	1931	1932
New Jersey	..[b]	2.0	1.3	1.5	2.1
Massachusetts[c]	3	..[d]	1.7	1.9	..[d]
Ohio	3 and fees	1.5	1.8	2.2	3.5
Illinois	3½	2.5	3.1	3.6	6.0
Iowa	3½	..[d]	3.0	4.5	8.6
Michigan	3½	2.2	..[d]	2.9	6.6
Pennsylvania	3½	2.2	2.2	2.8	4.4
Rhode Island	3½	..[d]	2.3	3.5	4.1
Virginia	3½	4.3	4.3	4.3	6.5

[a] Ratios calculated from data in accounting studies to which we have already referred. These studies are based on annual reports of licensees in these states. The data do not distinguish between losses by lenders using different forms of security. Since many of these states include a large volume of endorsed note lending within the licensed small loan business and the losses of these agencies have been consistently small, it is probable that the rate of loss for the business which we are describing would be somewhat higher than these estimates.

[b] The rate varied during the four-year period. It was 3 per cent until February 15, 1930, then 1½ until April 12, 1932, then 2½.

[c] Excludes Morris Plan and chartered companies.

[d] Data not available.

However large a part legality of their instruments and reduction of their interest charges may have played in reducing the losses of licensed lenders, it is probable that greater care in selecting borrowers has also contributed to the reduction. In evaluating the effect of the refusal by licensed lenders of some applicants for loans to whom the unregulated lender would have lent, it is necessary to consider the meaning of losses from the standpoint of the borrower. A loan which cannot be paid is in the long run of no use to the borrower. Borrowing creates an interest-bearing obligation which if it cannot be paid must eventually bring the borrower to default. Since the lender can enforce collection where the borrower is able to pay, defaulted loans represent down-and-out borrowers and broken families.

Too many loans from the high-rate lender gave the borrower only temporary relief. High interest rates added another burden in his uphill struggle for financial rehabilitation. The rapidity with which the high-rate lender got back his money in the form of interest, and his prior claim to the borrower's income where wage assignments were taken, gave him the advantage over the growing list of the borrower's general creditors whose claims were non-interest-bearing and who could be stalled off for a considerable time. In the final analysis it was these general creditors, and the charitable agencies, relatives, and friends, to whom down-and-out borrowers eventually turned, who paid the interest bill prior to final default.

The variation in the loss ratios of licensed lenders from a small amount in good times to approximately 6 per cent in bad times seems to indicate that unemployment and the other hazards which increase with depression, rather than the weight of the interest burden which the borrower must pay the licensed lender, are the principal causes of loss. The lower loss ratio of the licensed lender is undoubtedly a favorable sign. It suggests the effectiveness of regulation in improving small loan conditions, rather than the contrary.

Not all loans by licensed lenders have been remedial in their effect. Many borrowers would have been far better off if they had not borrowed. The large number of cases in which loans of licensed lenders are renewed is evidence that the repayment of many loans requires a considerable struggle lasting in some cases for several years. We do conclude, however, that the increased care in lending required by restricted interest charges has lessened unwarranted borrowing. Undoubtedly some worthy applicants have been refused loans in this process. Certainly many to whom loans would be worse than useless are also among the rejected applicants.

Regardless of changes in the size of the loan and in the type of security, there is reasonable likelihood that the majority of necessitous borrowers to whom a loan promises to offer real relief are being served by licensed lenders today in states which have the Uniform Small Loan Law. Doctors, dentists, executives, and others who were infrequent among the customers of the high-rate lender, borrow in larger numbers from the licensed lender. But the rank and file of customers of licensed lenders, like those of the unregulated lender, are men in the skilled trades, employes of the local and federal governments, public utility employes, factory workers and clerks, together with probably an increased proportion of unskilled laborers. They are people of small and moderate incomes with little accumulation of worldly goods. They are people normally independent and self-sustaining, who are compelled by emergencies to borrow, but who expect to meet their obligations in full by their own resources, and in most cases do so.[1]

[1] For further analysis of the characteristics of the borrower from licensed lenders, see Ten Thousand Small Loans by Louis N. Robinson and Maude E. Stearns, Russell Sage Foundation, New York, 1930, pp. 28–116.

CHAPTER X

ORGANIZATION AND PROCEDURE OF A MODERN SMALL LOAN OFFICE

METHODS of operation of lenders licensed under small loan acts vary with the kind of security taken. Commercial companies lending on endorsed notes, for instance, usually reduce their investigations of applicants to routine correspondence and telephone inquiries. Having three or more income-earning obligors joined in the responsibility for each loan, these licensees need but assure themselves that the borrower and his endorsers or co-makers are employed at the salary claimed in the application.

The procedure of collection on endorsed note loans may also be reduced to repetitive clerical routine. Payments are received and recorded, and series of notices are sent to the borrower and later to his endorsers when instalment payments are overdue. The lender relies heavily in case of default on the right to collect through legal process against the income or property of any or all of the parties to the note and on the unlikelihood of the failure of all the parties to have attachable income or assets. Legal process is an important cog in the machinery for collecting delinquent endorsed note loans, and through it collection costs of defaulted loans may be added to each loan as legal fees and court costs. Since loans difficult to collect are turned over promptly to a legal department or to private attorneys, the volume of business which may be handled readily in one office is almost unlimited and the principal factors for success are large volume, cheap capital, and a highly organized routine.

The endorsed note lender is able to cut his charges considerably below the legal maximum in most states. Interest is usually discounted in advance and charges range generally from the equivalent of 1½ per cent a month to 2½ per cent a month on the outstanding balance.[1]

[1] Where endorsed note loan companies operate under industrial banking acts, however, the charge for larger loans is frequently somewhat less than 1½ per cent a month.

Licensees of the semi-mutual or axia type, as well as those lending purely for profit among people of foreign origin in immigrant communities, also confine themselves for the most part to endorsed notes as security and charge less than the maximum rate. Most of the loans of these agencies are for business purposes. Offices are usually small and expenses are kept at a minimum. Sometimes they are open for business only during certain hours of the day or on certain evenings of the week. Frequently the work of investigation and collection is done by officers of the licensed corporation who are also the principal shareholders. These licensees compensate for the lack of careful routine by their more intimate knowledge of the affairs of the borrower.

Our study is chiefly concerned, however, with licensees lending on chattel mortgages and wage assignments. Here again it is difficult to generalize in describing lending operations. Some independent licensed loan offices are operated from the homes of lenders, with poor records and little or no system of investigation or collection; and some are highly organized, with large volumes of business and offices in prominent locations. The former are gradually disappearing, and the latter have a procedure quite similar to that of chain offices which are now the dominant factor in the chattel mortgage and wage assignment business.

Location, Layout, and Equipment of Offices

The individual offices of chain loan companies are usually situated in the heart of the retail shopping district of smaller cities and towns or in smaller centers of neighborhood retail activity in metropolitan cities. As a rule lenders prefer to locate above the ground floor in large modern office buildings, particularly if there is nearby a gas or electric company office where monthly service bills are paid, a savings bank, or a large store dealing with low-income classes. In the past the ground floor has been avoided both for the purpose of privacy for customers, many of whom do not wish to be seen entering a small loan office, and for the sake of cheaper rents. In the last few years, however, an increasing number of lenders have turned to ground floor offices in the belief that the desire for privacy by the borrower has been mistakenly encouraged by the attitude of the lender, and that the business should avoid any suggestion that it is shameful or dishonorable to borrow.

Office layout is similar to that of a small bank, but considerably more emphasis is placed on privacy for the borrower. Usually one enters a general waiting room, part of which is fenced off as an office containing the records, the stenographer's desk, and a cashier's window for receiving payments. Adjoining this general room are private rooms for interviews with customers, and the manager's office.

In practically all offices the furniture and fixtures are simple and plain. There are, of course, files for the individual ledger cards and for correspondence folders, an adding machine and typewriter; and one is almost certain to find on the cashier's desk a machine for calculating interest on daily balances at the rate which the office charges. Generally there is a safe in the office in which borrowers' notes, the more important record books, and the small amount of cash that is kept on hand are locked when the office is closed. The office may also have as part of its equipment an automobile or a motorcycle for trips to the homes of delinquent borrowers or of prospective customers.

In addition to the capital invested in these items, loan companies find it necessary to keep some idle money in a bank and in their till. The repayment of loans one day cannot be expected to balance exactly the amount of new loans made on that day, and as the loan office usually remains open from eight-thirty or nine o'clock in the morning until five in the afternoon, it must have some cash on hand with which to make loans before and after banking hours. The amount of idle money, however, is small even in large offices. The loan company must carry a reasonable balance with its bank to compensate for its checking service. Beyond this it is the responsibility of the manager to keep his funds at work. Aside from the capital represented by furniture, fixtures, equipment, and bank balances or cash in the till, which at the most amounts only to a small part of tangible assets, all the capital of a loan office is invested in loans.

Size of Offices

Chain loan offices usually have from $50,000 to $300,000 in loans receivable. Few companies are willing to maintain for long an office which is unable to attain a loan balance exceeding $50,000. The necessity for a large volume in each office arises out of the fact that the minimum staff with which a chain office can be effectively operated consists of three persons. This minimum staff is able to handle approximately 750 current loans which would represent in most offices from $70,000 to $100,000 in loans receivable. A failure to reach a volume approximating the capacity of this staff results in the reduction or elimination of profits.

The capacity of employes to handle a given number of loans varies with their ability, the character of borrowers served, and the loan and collection policy of the office. The lender has constantly to decide whether or not it is more profitable to prevent losses by subjecting applicants to rigorous investigation and delinquent borrowers to constant pressure, or to accept higher losses and avoid the time and expense of more careful investigation and further pressure on borrowers whose ability to pay is dubious. The result of these decisions has an important effect on the capacity of the staff to handle a given number of loans.

The organization of a loan office is so simple that its staff can be expanded readily from the minimum to handle an increased volume of loans. Unlike the endorsed note business, however, there appears to be an effective limit to the number of loans which can be handled adequately from one chattel loan office.

The maximum is much less definite than the minimum limit of satisfactory volume; it arises out of the inability of a manager, regardless of the size of his staff, to supervise adequately an unlimited number of loans. The reason for this is the detailed attention necessary to chattel and wage assignment lending. Since this limitation is purely one of personal capacity, it varies widely among managers. In some offices efficiency seems to decline when more than 2,000 loans have accumulated. In others the manager seems quite capable of handling 3,000 or 3,500 loans. In general, chain companies have raised progressively their estimate of the practical limit to the size of the outstanding loan balance of a single office. Some years ago most lenders considered $150,000 as the most efficient maximum loan balance. Now there are several offices with loan balances of more than a half-million dollars. Contributing to this change are the increased size of individual loans, better educated and more highly trained managers, and better lending technique. It is quite possible that the practical limit to the size of the loan balance may be still further raised by further improvement in the qualifications of managers and staff.

Because they avoid certain overhead and supervision costs which chain offices must bear, independent offices are able to maintain satisfactory profits with smaller loan balances. The minimum profitable loan balance is normally around $35,000, but if some other business is combined with the loan business the effective minimum is still further reduced.

Personnel and Their Duties

The minimum staff of a small loan office consists of a manager who interviews applicants for loans and supervises the work of the office; an "outside man," who investigates applicants for loans, calls upon delinquent borrowers, or attempts to find "skips," and a stenographer-clerk who handles the correspondence of the office, accepts loan payments, maintains the office records, and acts as a reception clerk. As the volume of loans increases the first addition to this minimum staff is usually an assistant manager who spends part of his time interviewing applicants and the other part outside the office investigating applicants or calling on delinquent borrowers. An office with a loan balance as high as $300,000 usually employs a manager, an assistant manager, two or three clerks who act as stenographers, cashiers, or bookkeepers interchangeably, and four or five outside men.

The supervision of branch offices by the central offices of chain companies varies considerably, but in almost all cases it is detailed and frequent. Some chain companies have traveling supervisors assigned to small groups of offices who know the affairs of each office almost as well as do the managers themselves. Most supervisors have in their charge six to twelve offices and visit each at least once a month. In the large chain companies it is common for traveling supervisors to report to district supervisors, who in turn are responsible to the executive in charge of operations at the home office.

The supervisor acts as adviser to the office manager and as the instructor of his staff. Loan policies, advertising, office procedure, and even individual delinquent loans are discussed with him. The supervisor usually is required to approve all loans written off as uncollectible and frequently makes calls with the manager or outside men on customers who have defaulted. Most lenders believe that the secret of success of a small loan business lies in the caliber of supervisors.

In some instances the supervisor is also the auditor; in others the auditing is done by a separate staff distinct from the supervisory force or by independent accountants. Some chains require daily reports from each office including a description of each loan made and a record of the payments received. One purpose of the duplicate home-office record is to avoid the danger of loss of the local-office records through fire or theft. By the duplicate record the home office is also informed concerning the kind of loans made by each office, its cash position, and the progress of repayment of loans.

There is an increasing tendency to centralize many of the functions of office management in the home office. Purchasing of most equipment and supplies is now done centrally; advertising copy for local use is prepared more and more by home office staffs. Accounting, statistical work, reports to state supervisors, public relations, and intra-industry relationships are increasingly becoming functions of the home office.

Making a Loan

In many ways a small loan office is as standardized as a post-office, and yet there are few businesses whose participants are called upon to use more discretion in their work. The success of each office depends upon the aggregate correctness of the decisions of its staff.

Customers are secured by advertising in local papers, by circulars sent by mail or distributed from house to house, through reference by other borrowers, by radio broadcasts, or by national magazine advertising. When an applicant calls at the office he is interviewed by the manager or by one of his assistants, and the purpose of the loan, his financial condition, and his prospect of meeting the instalment repayments are discussed and an application form is filled in. In this preliminary interview many applicants are rejected promptly because the purpose of the loan is unsound, or because there would be little hope of repayment, or for other reasons that are readily determinable. If the application is otherwise satisfactory, the applicant is asked when an investigator may call to examine his security.

An outside man is then sent to the home of the borrower. If possible he talks to both the husband and wife of the family applying for the loan. He asks to see the receipted bills for household supplies, which are an excellent guide to the financial condition and the reliability of the applicant. If the file contains receipted bills from the butcher, the grocer, and the landlord which have been paid promptly in the past, the investigator is satisfied. If not, he may call on neighboring merchants to ask about the credit of the applicant.

The investigator then asks to see the bill of sale for the applicant's furniture. Frequently some of the applicant's furniture is still being paid for on the instalment plan and the applicant does not have title to his goods. The investigator lists each item of furniture to which the applicant has a clear title and which is to be used as security, and appraises it. Actually, almost all used furniture has negligible resale value and cannot be foreclosed profitably by the lender. The investigator assures himself, however, that the value to the applicant is considerably greater than the amount of the loan applied for.

The call of the investigator is usually brief. He has many such calls to make in a day and has no desire to detain the applicant, to whom this examination is usually an ordeal, any longer than necessary. His direct inquiry has given him some fairly reliable data regarding the applicant, but more than this, he is expected to have formed opinions on other qualities of the applicant, which he jots down after the interview is over. He has had opportunity to observe what kind of housekeeper the wife is, and whether her grocery and meat bills have been extravagant or economical. He knows how much rent the family is paying, and he has been able to judge how much teamwork exists between husband and wife. Back in the office again, the investigator reports the results of his call to the manager with his recommendation that the loan be granted or rejected.

The application may be subjected to further routine investigation from the office. A lenders' credit exchange or a retail credit bureau may be consulted, or records of judgment debtors or some other compendium of bad credit risks may be examined, or the record of the applicant on a previous loan with the same office or a competing office may be appended to the application.

This procedure is designed to eliminate those applicants who are chronically lax in the payment of their obligations, those who are overwhelmingly and hopelessly in debt, those whose households are likely to break up over domestic troubles, and those who are obviously unable to find the money to repay the loan. In normal times this process weeds out from 25 to 30 per cent of the applicants, but in 1932 and 1933 lenders appeared to be refusing from 50 to 70 per cent of applicants.

Terms of Repayment

Borrowers are unable to pay off their loans in lump sums for the same reasons that they are unable to meet emergencies out of their own funds. They must pay by small instalments. Most borrowers will repay if the conditions of payment are adjusted to their individual situations. It is useless, for instance, for a lender to expect payment from a borrower who is paid weekly or bi-monthly at the payday on which most of his other monthly family expenses are due.

Terms of repayment vary considerably among lenders. Some lenders have printed schedules in their offices showing in detail the plan of repayment by months or weeks on all loans from the smallest to the largest that the office makes. The schedule of one prominent loan company begins with a $10 loan which the borrower is allowed to repay in five monthly instalments of $2.00 and interest. The length of time of repayment gradually increases with the amount of the loan until the $300 limit is reached for which the terms are twenty monthly payments of $15 each plus the interest charge for the month. Other offices arrange to have the loan repaid in one year no matter how large it is. Some demand 5 per cent or 10 per cent of the loan each month, depending somewhat on the risk involved. One lender writes that all his loans are made for either ten or twenty months.

On the other hand, many lenders make no pretense of following a set schedule or plan of repayment. "We endeavor," writes one lender, "to make all of our loans to suit the paying ability of our customers. That is, if a person is paid weekly, we find that he prefers weekly payments, and if paid monthly, monthly payments." In practice all lenders, whether they have a set printed schedule or not, have to follow this plan in the majority of cases. It is a question of determining when and how much the borrower can pay and adjusting the terms of the loan to conform to his ability to pay.

In arranging the terms, lenders are torn between the desire to make long-term loans, thus avoiding the expense of acquiring new customers and making new investigations, and the desire to make their loans according to the best business principles. In the small loan business, unlike many others, the lower the turnover the greater the net profits. If, therefore, the lender were assured that the loan would be repaid and that the interest would be forthcoming, he would be inclined to make the loan for as long a time as possible. This practice, however, destroys the morale of the borrower and inevitably results in losses. The best way of collecting the principal of the loan is to insist on payments as large as the borrower can afford without crippling him in other ways. Between these two tendencies there is undoubtedly a golden mean which lenders attempt to find.

Size of Loans

Conflicting interests also affect the lender in determining how much money shall be lent to an applicant. The larger the loan, the less the relative cost of investigation and of collecting and recording payments. On the other hand, the amount which a borrower can pay readily is strictly limited by his income. To lend him an amount inconsistent with his income is to invite default and perhaps loss of the principal of the loan.[1] While the lender is inclined to lend the borrower whose income is substantial as much as he will take and perhaps more than he should borrow, there is an equal

[1] All studies of the size of loans and amount of the borrower's income show a direct correlation between these factors. See The Small Loan Situation in New Jersey in 1929 by Willford I. King, p. 39; Ten Thousand Small Loans by Louis N. Robinson and Maude E. Stearns, p. 135.

desire, where the borrower's income is smaller, to lend as little as will meet the borrower's most pressing needs.

The maximum loan under most regulatory small loan statutes is $300. Where there is no such maximum limit almost all chattel mortgage and wage assignment lenders restrict their loans to this maximum amount. Most loan offices make no loans of less than $25 except to old customers whose records are good and who need little further investigation. A few offices lend as little as $5.00, while others put their minimum at $50 and some at $100. Although it is perfectly clear that a business in $50 loans would not pay at the rates permitted by the Uniform Small Loan Law,[1] the lender hesitates to refuse the smaller loan. As in retail businesses handling certain items of low net profit, it is difficult to determine the point at which a single transaction produces a profit or loss even though a business based solely on that transaction would be definitely unprofitable. To refuse the smaller loan, also, might alienate customers who would want larger sums if and when they borrowed again.

Closing the Loan Contract

The closing of the loan contract between borrower and lender is an important part of loan office procedure. The borrower and the spouse are asked to come to the office to sign the necessary papers and get the loan.

The loan is closed in a private room. The manager reviews the applicant's financial condition and frequently sets down a tentative budget of necessary expenditures. If a reduction of expenses is necessary to create a margin for repayment, he suggests means of cutting expense items. He repeats the terms of the contract which is being made, the rights of the lender against the security, and the desirability of prompt payment both to the borrower and to the lender. He points out that the borrower has no legal right to move his furniture without the permission of the lender, and asks that if some unforeseen emergency arises which affects the borrower's ability to pay the required instalment, that he come to the office promptly to explain. He informs the borrower that he

[1] This is clearly demonstrated by private cost accounting studies of the operations of several small loan companies made by FAM Systems, Chicago.

may repay his loan at any time, with interest for the actual days elapsed. The whole import of this talk, frankly or subtly expressed, is that the borrower will find it easier to pay than not to pay as long as he is able to do so, but that the lender will be considerate if advised promptly of circumstances which make payment impossible.

The borrower is then given cash or, if he prefers, a check for the full amount of his loan, or occasionally, several checks payable to creditors and cash for the balance. Where the need to borrow is caused by the accumulation of past due bills, the lender frequently insists on turning over part or all of the principal of the loan to the borrower's creditors, to prevent him from spending the money for other purposes. Before granting a loan to a borrower overburdened with debt, the lender, with the applicant's permission, may occasionally call on the borrower's creditors, explain his inability to pay in full, and agree to make the loan and send checks to his creditors if they are willing to settle their claims for less than the amount of the debt. In this manner the small loan office has become not only banker but the receiver for many families, and in many cases has successfully reorganized the affairs of these family units.

Collection

Once the loan is made, the responsibility of the staff of the small loan office is to get its money back together with interest. In the majority of cases this is a simple matter. Several lenders report that in normal times approximately 70 per cent of their borrowers pay instalments promptly without prodding. Even among these borrowers, however, the original payment schedule is usually modified. Some borrowers are able to repay more rapidly, and others request and are granted the privilege of smaller payments before the loan is in default.

Another 15 per cent of the borrowers need to be reminded and entreated frequently by mail and telephone, but manage under this pressure to keep up to date in their payments. The remaining 15 per cent are chronically delinquent. Most loan offices put all delinquent accounts through a regular routine. If payment is not made on the date due, the account card goes automatically to the desk of a clerk who sends a form letter reminding the borrower that the account is unpaid. If this letter does not produce the payment or an explanation of the default, a second notice goes out within the next few days. If this notice fails the loan office sends a third letter, usually much stronger in tone, reminding the borrower of his contract, of the rights of the lender against his security, and of the damage to his credit that will be caused by neglect to pay promptly. If this does not produce results, a still stronger letter is sent, or the borrower is called by telephone, if he can be reached in this way. This fourth letter may be couched in legal terms and convey the idea that it is a formal notice of intent to foreclose. Some lenders have a series of as many as ten form letters which go to delinquents.

When the loan office exhausts its series of routine notices and its efforts by telephone, it sends the outside man to investigate. Some of these delinquent borrowers have reasonable excuses, and these are verified. Some have been laid off from their jobs, and others have had serious illness or other emergencies which have upset their ability to meet their contracts. With these borrowers the responsible lender is lenient. He reduces the amount to be paid in such a way that the borrower can meet it, or where payment is obviously impossible, he relaxes his pressure and postpones any payment until the emergency is over.

Other delinquents simply attempt to dodge payment, or yield to the temptation to spend for other things the money that should be available for the periodic instalments. All the resourcefulness of the loan office is used in bringing pressure for payment on these borrowers. The borrower usually agrees when he is visited by the outside man to come in and make payment the next day or the next payday. When he fails to appear, the outside man calls again the following day, asking for an explanation of his failure to keep his promise. The foreclosure of the mortgage on his furniture may be threatened and occasionally is carried through. The demands for payment, however, are so persistent that the borrower able to pay usually pays in the end.

Occasionally a borrower moves with all his belongings without notice to the lender. An outside man is then sent to discover his destination by inquiry in the neighborhood in which he has lived. If these borrowers are discovered in other cities, branch offices of the same chain, other licensed lenders, or attorneys located there are asked to attempt collection.

Foreclosure

Occasionally borrowers who have lost their jobs and cannot find work notify the lender that they are leaving town and wish to turn over their furniture to the mortgagee. This is the source of most of the furniture coming into the possession of licensed lenders. Foreclosures of furniture in use are rare.

Among lenders reporting on foreclosures in Ohio in 1931, there were only 400 foreclosures out of a total of 79,805 loans. Of these foreclosures 335 followed the abandoning of the furniture by the owner, and only 35 foreclosures occurred while the furniture was in use.[1] In 1932, among 129,132 loans, there were 561 foreclosures, and only 29 occurred while the furniture was in use.[2]

While less than eight-tenths of 1 per cent of the balance due on loans was represented by all foreclosures, and only six-hundredths of 1 per cent of the loan balance was represented by foreclosures of furniture in use, losses from bad loans in Ohio in 1931 amounted to 2½ per cent of the outstanding loan balance. In 1932 losses increased but the rates of foreclosure remained approximately the same. It is apparent, therefore, that foreclosures of furniture in use involve but a small portion of the total volume of uncollectible loans.

In Illinois, in 1931, out of 233,000 loans made by reporting licensees there were 468 foreclosures, of which only 35 involved furniture in use.[3] In 1932 there were 640 foreclosures among 275,000 loans. Of these foreclosures, 57 occurred while the furniture was in use.[4]

The experience of these two states is typical of those for which foreclosure data are available.

The unwillingness of lenders to foreclose on their security is not altruism. Because the business exists by virtue of state enabling

[1] Haskins and Sells, Personal Finance Companies of Ohio, Analysis of Annual Reports for the Year 1931. Cincinnati, 1932, p. 6.

[2] *Idem,* Report for the Year 1932, p. 6.

[3] Illinois Department of Trade and Commerce, Analysis of Reports Filed by Personal Finance Companies, 1931, p. 14.

[4] *Idem,* Report for the Year 1932, p. 14.

legislation, it is highly vulnerable. To foreclose on the chattels of an impoverished borrower would aid and abet an attack. The lender is a business man depending on goodwill in his community for a large part of his business. He is unlikely to sacrifice this asset if it can be avoided. Besides, the sale of chattels following foreclosure seldom brings any considerable part of the balance due on the loan.

In Ohio, in 1931 and 1932, sales of chattels following foreclosure brought less than one-third of the amount of the loan balances against these chattels.[1] In Illinois, during the same years, sales following foreclosures produced slightly more than one-third of the outstanding balance of the loans against these chattels.[2]

A considerable proportion of all loans, including those which are not delinquent, are refunded before the maturity of the loan. Other emergencies arise which require more cash or the borrower finds himself unable to repay as rapidly as he has agreed. The lender is usually quite willing to increase the size or modify the repayment terms of loans which have been repaid promptly in the past. In fact, many loan offices maintain the practice of writing to a borrower who has paid regularly for several months to tell him that in case he is in need of money the office will be glad to increase the size of his loan on the basis of his past record.

The reason is readily understandable. In the past, lenders have found that many loans were abruptly repaid in full after the loan had been partially paid by regular instalments. Investigations showed that many of these borrowers, needing additional money, had borrowed from competing loan offices and paid off the first lender. Since many loans which would require but perfunctory additional investigation were in this way being transferred to other loan offices, the lenders generally adopted the policy of letting the prompt borrower know that he could get more money when he wanted it without going elsewhere.

Whether or not this practice of encouraging renewals has delayed borrowers in getting out of debt or has merely kept them

[1] Haskins and Sells, Personal Finance Companies of Ohio. Reports for the Years 1931 and 1932, p. 6.

[2] Illinois Department of Trade and Commerce, Analyses of Reports Filed by Personal Finance Companies. Reports for the Years 1931 and 1932, p. 14.

from going elsewhere, renewal is all too frequent. Several lenders report that more than half of their loans are made by refunding loan accounts which have not been fully paid off.[1]

There is a limit, however, beyond which renewal is unprofitable to the lender. The borrower who renews indefinitely is an ultimate source of loss, and unquestionably the desire of the lender is to be repaid in full.

[1] For a description of refunded personal loan accounts of the Beneficial Industrial Loan Corporation and a comparison with refund operations of corporate borrowers see The Personal Finance Business, by M. R. Neifeld, Harper & Brothers, New York, 1933, chap. 11, "The Refunded Borrower."

CHAPTER XI

EXPENSES AND PROFITS IN THE SMALL LOAN BUSINESS

WHAT are the expenses and profits of small loan licensees in the various states that have special regulatory legislation? What has been the trend of profits? We shall endeavor to answer these questions in this chapter.

There is little available material concerning expenses and profits in the small loan business prior to 1929. New Jersey[1] has published yearly statements of income and expense of licensed offices since 1914, and Massachusetts,[2] similar data for most years since 1912. In 1932 Virginia published a study of the small loan business that gave itemized income and expense statements of licensees in that state for each year from 1927 to 1930.[3] The Massachusetts figures for the years before 1929 cannot be used for this purpose, however, because they neither identify interest paid on borrowed funds nor distinguish entrepreneur's capital from borrowed funds. As a result of the development of the standard annual report form, summaries of annual reports are available for nine states in 1929, for 13 states in 1930, for 15 in 1931, for 16 in 1932, and for 14 in 1933. Table 25 describes the available data[4] concerning expenses and profits of small loan licensees from each state for the years from 1929 to 1933. Many of these summaries are far from satisfactory. Some exclude reports of many licensees because of inaccuracies. In certain instances expenses are not adequately itemized, and in others, interest on borrowed money is not identified.

In spite of the difficulties which some of these summaries present, there are few businesses for which more accurate and complete data concerning expenses and profits are available. Although many

[1] Annual Reports of the New Jersey Commissioner of Banking and Insurance.

[2] Annual Reports of the Massachusetts Supervisor of Loan Agencies.

[3] The Small Loan Business in the State of Virginia. Virginia State Corporation Commission, Richmond, Virginia, 1932.

[4] See p. 218.

of the summaries were prepared by accountants for lenders' associations, they have been based in each case upon certified official reports of licensed offices to state supervisors. After a few adjustments, which will be explained in detail, we believe that these records can be relied upon for our purpose. Summaries have improved markedly from year to year and those for 1932 and 1933 are by far the most adequate.

Possible Denominators for Computing Rates of Profit

In order to compare expenses and profits of the small loan business by states and by years, it is obviously necessary to convert amounts of expense and profit into rates of expense and profit. The rate of profit is generally understood to mean the ratio of the amount of profit during a specified period, commonly a year, to the amount of capital employed in the enterprise.[1]

The term "capital employed in the enterprise" is subject to a wide variety of interpretations. Among these, however, three principal definitions may be distinguished. These are:

1. Entrepreneurial investment, or the sum of the par or stated balance sheet values of common and preferred stock and surplus.
2. Total investment, or the sum of the par or stated balance sheet values of capital claims due to all who have invested money in the enterprise, including bond and note holders.
3. Employed assets, or the total value of all assets employed in the business regardless of the source of the funds used to acquire them.

Entrepreneurial investment represents a narrower base than total investment or employed assets. If entrepreneurial investment is selected as the denominator, interest paid to bond and note holders and the amortization of financing costs must be subtracted from profits before computing rates of profit accruing to the entrepreneur. If, on the other hand, total investment or employed assets are used as denominators, charges for interest on borrowed funds must not be excluded from the numerator.

Total investment and employed assets are similar to each other

[1] Some students have preferred to relate profits to gross sales or to some denominator other than capital. This method is usually selected because of its greater accuracy in determining trends, but it is not practicable for our purpose.

TABLE 25.—SOURCES OF DATA USED IN ESTIMATING PROFITS OF SMALL LOAN LICENSEES

State	Year[a]	Source	Number of licensees included	Form of publication
Connecticut	1930	Seward & Monde, accountants, New Haven[b]	173	Privately issued (multigraphed)
	1931	Seward & Monde, accountants, New Haven[b]	176	Privately issued (multigraphed)
	1932	Seward & Monde, accountants, New Haven[b]	169	Privately issued (multigraphed)
	1933	Seward & Monde, accountants, New Haven[b]	150	Privately issued (multigraphed)
Florida	1931	Haskins & Sells, accountants, Jacksonville[b]	36	Privately issued (multigraphed)
	1932	Haskins & Sells, accountants, Jacksonville[b]	47	Privately issued (multigraphed)
	1933	Haskins & Sells, accountants, Jacksonville[b]	42	Privately issued (multigraphed)
Georgia	1930	Georgia State Banking Department	55	(Multigraphed)
	1931	Georgia State Banking Department	49	(Multigraphed)
	1932	Georgia State Banking Department	44	(Multigraphed)
	1933	Georgia State Banking Department	43	(Multigraphed)
Illinois	1929	David Himmelblau & Company, accountants, Chicago[c]	155[d]	Privately issued (multigraphed)
	1930	Illinois Department of Trade and Commerce	228[d]	Annual summary of reports of licensees (printed)
	1931	Illinois Department of Trade and Commerce	352	Annual summary of reports of licensees (printed)
	1932	Illinois Department of Trade and Commerce	372	Annual summary of reports of licensees (printed)
	1933	Illinois Department of Trade and Commerce	392	Preliminary statement, to be printed later in annual report
Indiana	1929	Indiana State Banking Department	272	(Multigraphed)
	1933	Indiana Department of Financial Institutions	323	Preliminary statement, to be printed later in annual report
Iowa	1930	Iowa State Banking Department	136[d]	(Multigraphed)
	1931	Iowa State Banking Department	164	(Multigraphed)
	1932	Iowa State Banking Department	167	(Multigraphed)
	1933	Iowa State Banking Department	155	(Multigraphed)
Louisiana	1930	Haskins & Sells, accountants, New Orleans[b]	47[e]	Privately issued (multigraphed)
Maine	1932	Lybrand, Ross Brothers & Montgomery, accountants, Boston[b]	16	Privately issued (multigraphed)
Maryland	1930	Haskins & Sells, accountants, Baltimore[b]	35	Privately issued (multigraphed)
	1931	Haskins & Sells, accountants, Baltimore	41	Privately issued (multigraphed)
Massachusetts	1929	Russell Sage Foundation, New York[c]	137[f]	(Unpublished)
	1930	Pace, Gore & McLaren, accountants, Boston[b]	165[g]	Privately issued (multigraphed)
	1931	Lybrand, Ross Brothers & Montgomery, accountants, Boston[b]	193[g]	Privately issued (multigraphed)
	1932	Massachusetts Supervisor of Loan Agencies	204[g]	Annual Report (printed)
	1933	Massachusetts Supervisor of Loan Agencies	192[g]	Annual Report (printed)
Michigan	1929	Haskins & Sells, accountants, Detroit[b]	88[g]	Privately issued (multigraphed)
	1931	Haskins & Sells, accountants, Detroit[b]	104	Privately issued (multigraphed)
	1932	Haskins & Sells, accountants, Detroit[b]	123	Privately issued (multigraphed)

Missouri	1929	Missouri Commissioner of Finance	107	Annual summary (printed)
	1931	Missouri Commissioner of Finance	85	Annual summary (printed)
	1932	Missouri Commissioner of Finance	84	(Multigraphed)
	1933	Missouri Commissioner of Finance	82	Annual Report (printed)
New Jersey	1929	New Jersey Department of Banking and Insurance	407	Annual Report (printed)
	1930	New Jersey Department of Banking and Insurance	183	Annual Report (printed)
	1931	New Jersey Department of Banking and Insurance	117	Annual Report (printed)
	1932	New Jersey Department of Banking and Insurance	83	Annual Report (printed)
	1933	New Jersey Department of Banking and Insurance	73	(Multigraphed)
New York	1932	New York State Banking Department	150	(Multigraphed)
	1933	New York State Banking Department	141	(Multigraphed)
Ohio	1929	Haskins & Sells, accountants, Cincinnati[b]	188	Privately issued (multigraphed)
	1930	Haskins & Sells, accountants, Cincinnati[b]	229	Privately issued (multigraphed)
	1931	Haskins & Sells, accountants, Cincinnati[b]	240	Privately issued (multigraphed)
	1932	Haskins & Sells, accountants, Cincinnati[b]	245	Privately issued (multigraphed)
	1933	Haskins & Sells, accountants, Cincinnati[b]	336	Privately issued (multigraphed)
Pennsylvania	1929	Pennsylvania State Banking Department	497	(Multigraphed)
	1930	Pennsylvania State Banking Department	410	(Multigraphed)
	1931	Pennsylvania State Banking Department	547	(Multigraphed)
	1932	Pennsylvania State Banking Department	531	(Multigraphed)
	1933	Pennsylvania State Banking Department	498	(Multigraphed)
Rhode Island	1930	Haskins & Sells, accountants, Providence[b]	43	Privately issued (multigraphed)
	1931	Haskins & Sells, accountants, Providence[b]	45	Privately issued (multigraphed)
	1932	Haskins & Sells, accountants, Providence[b]	47	Privately issued (multigraphed)
	1933	Haskins & Sells, accountants, Providence[b]	41	Privately issued (multigraphed)
Virginia	1929	Virginia Corporation Commission	[h]	Special report (printed)
	1930	Virginia Corporation Commission	[h]	Special report (printed)
	1931	T. Coleman Andrews & Company, accountants, Richmond[b]	62	Privately issued (multigraphed)
	1932	T. Coleman Andrews & Company, accountants, Richmond[b]	58	Privately issued (multigraphed)
Wisconsin	1930	Wisconsin Banking Department	68	Annual Report (printed)
	1931	Wisconsin Banking Department	63	Annual Report (printed)
	1932	Wisconsin Banking Department	84	Annual Report (printed)
	1933	Wisconsin Banking Department	68	Annual Report (printed)

[a] Data are for calendar years except for Massachusetts and Connecticut where the fiscal year ends September 30 and for New Jersey where the fiscal year ends November 30.
[b] Report to the state association of licensees.
[c] Report to the state supervising official.
[d] Excludes licensees engaged in business less than one year.
[e] Excludes licensees charging less than the maximum rate.
[f] Excludes Morris Plan companies and the Collateral Loan Company.
[g] Excludes Morris Plan and chartered companies.
[h] Number of licensees not given.

and distinguishable from entrepreneurial investment because they include all capital regardless of source. In regard to the method of computation, however, entrepreneurial investment and total investment are related to each other and are distinguishable from employed assets. Both of the former denominators are computed from items on the liability side of the balance sheet, while the latter is computed from items on the asset side of the balance sheet.

Although occasionally the student of corporate profits has an opportunity for a free choice between two or even among all three of these denominators, the choice is usually limited by the nature of the available data or by the character of the industry. In the banking business, for instance, where deposits bearing low interest rates comprise the major part of the funds used, ratios of net profit to total investment would be meaningless for the purpose of comparing earnings in the banking business with those in other businesses or industries. Consequently, the Federal Reserve Board uses entrepreneurial investment (capital funds) as its denominator for calculating profit ratios.[1] In manufacturing industries, where capital structures of individual companies vary enormously and no such proportion of borrowed capital is available at reasonable rates, the student of earnings may properly choose total investment as his denominator. In making this choice, William L. Crum says,

> The decisive objection to changing the denominator [from total investment to entrepreneurial investment] is that the resulting ratio—net income to net worth—would be influenced partly by the earning power and partly by the financial structure. Hence, differences in ratio, as between lines of industry, would not necessarily imply differences in earning power.[2]

Few would contend that reported balance sheet items are reliable measures of the true value of corporate assets. Laurence H. Sloan in his book, Corporation Profits, warned his readers that "a figure reporting invested capital always contains a certain leaven of opinion—the opinion of those who evaluate the assets."[3] Ralph

[1] Annual Reports of the Federal Reserve Board.

[2] Corporate Earning Power. Stanford University Press, California, 1929, p. 131.

[3] Corporation Profits. Harper and Brothers, New York, 1929, pp. 136–137.

C. Epstein, in a volume entitled The Source Book for the Study of Industrial Profits, said that the data offered were "subject to the vagaries of corporate accounting taken *en masse*."[1] There is considerable evidence that corporate accounting policies have been determined frequently by extremely arbitrary methods and occasionally for the purpose of disguising the true state of affairs.[2] There are, however, no adequate standards for revising reported valuations even if the enormity of the task did not prohibit such a procedure. Lacking an alternative means of constructing a denominator, the student of corporate profit is usually compelled to rely upon reported valuations.

In unregulated private enterprise there is probably no general nor consistent tendency either to overstate or understate balance sheet values or profits. Ultra-liberal balance sheets and income statements are probably no more frequent than ultra-conservative ones. There would appear to be two conflicting incentives: the first to understate valuations or profits in order to minimize taxes, and the second to overstate valuations and profits in order to present a favorable report to stockholders and creditors. These two incentives may be assumed to tend to offset each other where large numbers of individual reports are used.

Where reported balance sheet and income data are offered in support of rates of charge, however, the incentive to overstate balance sheet values in order to decrease the resulting rate of profit becomes predominant. Since the liability items constituting either entrepreneurial investment or total investment merely reflect the values placed upon asset items, it is necessary, if revaluation is to be attempted, to turn to the asset side of the balance sheet to reconstruct the denominator. Hence, public utility commissions usually rely upon a rate base representing the sum of revalued asset items.

Both the nature of the available data and the character of the business lead us to select employed assets as the most desirable

[1] Epstein, Ralph C., in collaboration with Florence M. Clark, The Source Book for the Study of Industrial Profits. U. S. Department of Commerce, Washington, 1932, p. 3.

[2] For an illuminating discussion of methods of revising valuations for corporation balance sheets, see "The Annual Corporate Report" by Anderson F. Fair, in Harper's Magazine, March, 1934, pp. 421–432.

denominator for computing rates of profit in the small loan business. First, it is impossible to identify entrepreneurial investment. More than half of the offices engaged in the business (representing perhaps three-fourths of the capital) are the branch offices of chain companies. In many instances these branch offices are separately incorporated and the capital structure is set up to obtain the most favorable result from the incidence of tax levies. Since all capital claims of these subsidiary corporations are frequently owned by the parent corporation, a summary of the financial structures of individual offices would not represent the true relationship of entrepreneur's capital to borrowed funds.

The inability to identify entrepreneurial investment is not, however, a material handicap to our study. By far the largest part of the capital used in the small loan business has been supplied by entrepreneurs. Markets have not been receptive to long-term borrowings, and among the fixed obligations which have been sold many have carried rights of conversion into common stock or profit-sharing provisions which relate these obligations to entrepreneurial investment. In all cases long-term borrowed funds are expensive and their cost tends to approach the anticipated earning rate on all funds.

The only intensive effort to determine officially the relation between entrepreneurial investment and total investment in the small loan business was made by the Indiana Department of Financial Institutions. The Department reported this relationship among small loan licensees in Indiana as of December 30, 1933, as follows:[1]

Source of capital	Independent companies	Indiana chains	Outside chains	Affiliated companies
	Per cent of total investment			
Notes payable	8.2	3.5	19.5	2.0
Other current liabilities	5.1	4.5	3.5	32.0
Funded liabilities	8.2	4.1	5.5	10.1
Sub-total (borrowed funds)	21.5	12.1	28.5	44.1
Capital stock, surplus, proprietorship, etc.	78.5	87.9	71.5	55.9
Total	100.0	100.0	100.0	100.0

[1] Annual Report of Indiana Department of Financial Institutions for the Year 1933.

The relation of entrepreneurial investment to total investment shown by the affiliated companies, as we have explained above, does not represent the true relationship on the books of the parent companies. The item "other current liabilities" represents principally advances from parent companies to subsidiaries. The relationships shown by these Indiana figures are undoubtedly similar to those in other states. It may be assumed that but slight differences in aggregate rates of profit for each state would result from the exclusion of borrowed funds from the denominator.

Second, although the small loan business, unlike the public utility, is a highly competitive business and cannot be subjected to the same sort of rate control that is imposed upon public utility companies, small loan licensees are well aware that the rates of profit which they report may affect legislative opinion concerning the maximum rate permitted by the small loan act. Since an incentive exists for exaggerating balance sheet items, it is desirable that revision of these appraisals be undertaken. Fortunately, also, the assets of small loan companies are so simple and so standardized that aggregate estimates of the value of employed assets may be made with little difficulty.

Method of Appraising Assets

The usual asset accounts reported by small loan licensees are loans receivable, cash, furniture and fixtures, accounts receivable, deferred charges, and other tangible assets. A negligible number report real estate or accrued interest. Many licensees also report intangible items of organization expense and cost of financing. We shall examine each of these items in turn in constructing our denominator.

Loans Receivable. The predominating item is the account "loans receivable." This is the essential income-earning asset of the small loan business. It is the sum of the outstanding balances of individual loans due from borrowers. Since interest may not be compounded or added to the principal under the regulation of small loan laws, this account is also the total of the amounts actually invested by the licensee in individual loans. For purposes of our denominator, reserves for uncollectible loans must be subtracted from the item "loans receivable," since these reserves are generally established out of earnings and the asset item has therefore been depreciated by the amount of the reserve.[1]

There remains the question of the adequacy of the reserve for uncollectible loans. Many state summaries report the total amount of outstanding loans on which no payment of interest or principal has been made for one month, two months, and for three months or more. Loans on which no payment either of principal or interest had been made for three months would seem to be extremely doubtful assets and perhaps should have been written off or covered by reserves. Six state summaries for 1933 identify both the amount of loans on which no principal or interest payment has been made for three months or more and the amount of reserve for uncollectible loans at the close of the year. These figures as well as the amount of loans outstanding at the close of the year and the amount charged off or transferred to the reserve for uncollectible loans are as follows:

State	Loans outstanding at the close of the year	Amount delinquent three months or more	Amount of reserve for uncollectible loans	Amount of charge-off or provision for uncollectible loans
Florida	$ 2,030,120	$ 214,688	$ 45,563	$ 94,519
Iowa	5,861,330	533,953	292,747	370,147
New Jersey	7,016,827	508,082	257,012	214,034
New York	16,107,749	192,504	374,727	382,484
Ohio	30,453,635	3,162,263	1,508,395	1,303,444
Rhode Island	2,996,736	234,787	124,864	158,418
Total	$64,466,397	$4,846,277	$2,603,308	$2,523,046

For the six states taken together, three months' delinquencies exceed considerably the amount of the reserve for uncollectible loans, but the amount of the excess is but 3½ per cent of the total amount of outstanding loans. This excess, however, is less than the current annual rate of charge-off or provision for uncollectible loans.

Although the inclusion of these doubtful accounts in our de-

[1] It is impossible to determine what part of the reserve for uncollectible loans has been established from surplus as an "appropriated" or "capital" reserve, but the practice of setting up reserves from earnings is so general that we have assumed that all reserves are "unappropriated" or "expense" reserves (i. e., reserves established out of earnings).

nominator tends perhaps to overstate slightly the real value of employed assets, it should be remembered that the reduction of this item by any device would require an increase in the expense item, "charge-off or provision for bad debts," and this increase in charge-off would result in lower earning rates than those resulting from present figures without adjustment. From 1929 to 1932 there appears to have been a general increase in three months' delinquency which was only partially offset by reserves. From 1932 to 1933 the increase in reserves appears to have approximated the increase in delinquency. The collectibility of delinquent accounts depends in large part upon the trend of unemployment, and we are not in a position to contest the belief of individual companies that many of their delinquent accounts will become collectible when borrowers are re-employed. We shall therefore accept the reported amount of outstanding loans less reserves as a true measure of the value of this asset item for the purpose of computing our denominator.

The amount of loans receivable at the close of the year is not a satisfactory measure of the amount of investment in this item throughout the year. The most satisfactory method of calculating the average amount would be to average the 12 monthly loan balances throughout the year. But monthly figures are rarely available and we have been compelled to rely in most instances on the average of outstanding amounts reported at the beginning and at the end of the year. Sample studies of monthly loan balances, however, showed that the monthly average closely approximated the average for the beginning and for the end of the year.[1]

The amount of other asset items is roughly proportionate to the amount of loans outstanding. Except in offices with very small loan balances, which by this fact are inefficient units, the amount of loans outstanding determines roughly the amount of necessary investment in equipment, the amount of cash required to pay operating expenses and to meet sudden increases in the demand

[1] Under some circumstances, however, the averages based on year-end figures are clearly inadequate. For instance, in New Jersey the amount of outstanding loans increased rapidly from the beginning of the fiscal year, November 30, 1928, until the legislative rate reduction in May of 1929, after which the loan balance began to decline rapidly. Consequently, the average of the year-end figures was undoubtedly lower than the monthly average would have been.

for loans, the amount necessary for deferred expenses and for other tangible assets. For purposes of computing our denominator, we shall therefore estimate the value of all other assets in terms of ratios to the average amount of loans outstanding.

Cash. Cash is the second largest tangible asset item in consolidated state balance sheets of the small loan business. This item would appear at first to need no modification. Two circumstances, however, lead us to place a restriction upon the amount of cash allowable for this purpose:

1. Banks generally require their credit customers to maintain compensating balances against lines of credit. Furthermore, because bank credit used in the small loan business is not self-liquidating in the sense that bank credit used in financing of trade acceptances is self-liquidating, its extensive use necessitates the maintenance of large cash balances to protect the borrowing company against calls for repayment. The relationship of cash balances to bank loans is clearly shown by the annual reports of the Household Finance Corporation from which the following data have been obtained:

Year	Ratio of bank loans to outstanding loans	Ratio of cash to outstanding loans
1927	.02	.04
1929	.23	.08
1930	.37	.11
1931	.44	.14
1932	.35	.17
1933	.23	.14

These figures show that when the corporation expanded its bank credit it also materially increased its cash balances. Except for the year 1932,[1] cash balances tended to vary roughly with bank loans. So far as we are aware, no other small loan company has used bank credit to the extent that it has been used by the Household Finance Corporation during this period. These figures are not therefore representative of the use of bank credit by the small loan business at large.

[1] The failure of 1932 figures to conform to this pattern is partly due to the fact that large calls were made upon the corporation for the repayment of bank loans just prior to the close of this year. The company limited its small loans and built up cash balances in anticipation of further calls.

The sacrifice of income on large cash balances is part of the cost of the use of bank credit. Since we have decided to relate net profits to employed assets, regardless of the source of funds used to acquire these assets, it is necessary to exclude all elements of the cost of borrowing from our denominator.

2. In recent years some small loan companies have tended to accumulate increasingly large cash balances. Although some liquid funds may be held in periods of depression awaiting more favorable lending conditions, or at all times to meet current expenses or a sudden increase in the demand for loans, part of these large accumulations, particularly among independent licensees, may be considered to be actually withdrawn from the small loan business. It would undoubtedly be invested elsewhere if there were favorable opportunities for investment in other fields. It would be unreasonable to include these abnormally large investments in cash and government bonds[1] as assets used in the small loan business.

How much allowance should be made for cash? The relationship in percentages between reported cash balances and reported outstanding loans for some representative states is as follows:

	1929	1930	1931	1932	1933
Massachusetts	5	4	4	..[a]	6
Pennsylvania	..[a]	3	3	4	4
Illinois	5	7	7	9	5
Iowa	..[a]	4	4	6	7
Ohio	4	9	10	13	14
Virginia	3	4	2	3	..[a]

[a] Information not available.

In many of these reports cash balances held in the home offices of chain companies are not prorated among branch offices, and this probably accounts in part for the very low aggregate cash balances maintained in certain states. In other reports the cash balance is clearly excessive in relation to the probable needs of the business within a reasonable period of time.

Through the courtesy of several state banking departments, we have made sample studies of monthly cash balances of individual licensees. Although there was considerable variation in the size of

[1] In small loan accounting as in most other accounting fields, no distinction is made between cash and government securities.

cash balance both by companies and by months, monthly averages were only slightly in excess of the year-end averages. On a basis of these studies of monthly cash balances of individual companies and the reported amounts in state summaries, we have concluded to allow 5 per cent of the total amount of loans receivable as the value of cash balances used in the small loan business for the purpose of our denominator.

Furniture and Fixtures. It is probable that the value of furniture and fixtures on the books of small loan licensees is understated rather than overstated by their balance sheets. The reported item usually ranges from 1 to 2 per cent of the amount of outstanding loans. Owing to the conservative practice of rapidly depreciating these items in the past, many companies carry their furniture and fixtures account at $1.00 or some other nominal figure. The rate of depreciation on furniture and equipment has tended toward standardization at 10 per cent a year since the development of the standard report form, and expenses during the subsequent period have therefore not been materially affected by a too rapid write-off. We have examined the expenditures for equipment for several small loan offices and we believe that 2 per cent of the average amount of loans outstanding is a conservative figure for the value of necessary equipment. Replacement value would materially exceed this allowance.

Real Estate. It has never been common practice in the small loan business to own the buildings in which small loan offices are housed. But each state summary contains an item of real estate. With the exception of a few states, the aggregate reported value (cost less depreciation) is usually very small in relation to the amount of loans outstanding.[1]

We shall eliminate the real estate item entirely from our denominator for two reasons: first, it is impossible to ascertain the extent to which such properties are actually used in the small loan business. Most of the licensees which report this item have very small loan balances and it is possible that in some cases homes are listed as assets used in the business because lending is done from

[1] The largest relative item of real estate was reported in Rhode Island. In 1932 and 1933 this item amounted to 6 per cent of the amount of loans receivable. In most other states it amounted to less than 1 per cent of loans receivable.

an office in the home. Second, where an office building is owned, space is usually rented to other tenants and rentals are reported under "other income" in the income statement. In order to exclude income from securities and inter-office loans, we shall exclude the item "other income" from gross income in computing profits of the small loan business. Since income from rentals is to be excluded from the numerator, it is necessary also to exclude from the denominator the investment from which this income is received.

It is impossible, of course, to remove from consolidated state reports all the concomitants of the real estate item. Taxes paid on real estate cannot be segregated from expenses. The rent item is also affected since the ownership of real estate avoids rent payments. We believe, however, that the error resulting from the removal of real estate from our denominator is small in all instances.

Other Tangible Assets. The item "deferred charges" includes insurance premiums, license fees, and other expenses for which payment is required in advance of the period to which the expenses apply. The amount of such deferred charges is generally small in relation to outstanding loans.

Accrued interest is also a true asset item, since interest is payable after the expense of making the loan and maintaining the account has been incurred. Since interest charges are generally payable monthly in the small loan business, the delay in receiving compensation for small loan services is slight, and only a small allowance for this item need be added to our denominator. Interest due but not received is, on the other hand, an account of doubtful validity for purposes of our denominator. Since the collectibility of the principal of poorly secured accounts is uncertain, delinquent interest would appear to be an exceedingly doubtful asset. This account appears only rarely among the reported assets of small loan companies and we have excluded it from consideration here.

The amount reported for the item "accounts receivable" is also unreliable. It is the practice of certain chain companies to arrange transfers of cash from affiliated offices which have surplus funds to those which require more capital to meet an immediate demand for loans. Such transfers are frequently credited as accounts receivable on the books of the office making the transfer. Since such funds appear as cash or as loans receivable upon the books of the company receiving the transfer, the inclusion of the accounts receivable item would be a duplication of this asset.

On the other hand, some part of the aggregate accounts receivable item may well be considered to be a true investment in the small loan business. Loans to employes, for instance, are frequently included in this item. But such sums are negligible in terms of the amount of loans outstanding.

We have combined all of these other tangible assets and allowed 2 per cent of the average amount of loans outstanding for their value in our denominator.

Organization or Development Expense. Many small loan licensees include in their balance sheets an item for organization expense. Technically, this is an intangible item, but from the broader point of view of making our denominator comparable to appraisal values in other fields, it may be considered to be a tangible asset. The reason for its inclusion in our denominator can perhaps be illustrated by comparing our appraisal of the assets of a small loan company with an appraisal of a factory or an apartment house. Cash, outstanding loans, furniture and fixtures, and other tangible assets are to the small loan business what bricks, mortar, and steel are to the factory or apartment house. But a proper valuation of a small loan office, like that of a building, must give consideration to many additional elements. In the construction of a building, labor is an important element of cost. There are, in addition, architects' and engineers' fees, the builder's profit, and the cost of financing the structure prior to completion, all of which go into the value at which the building would be carried on the books of the corporation which owns it.

So also in the small loan business, before an office is opened in any community the demand for loans must be surveyed and competition measured; then an office must be rented, employes hired, and money spent for equipment, for advertising, and for the investigation of borrowers, before any income begins. A satisfactory loan balance is acquired gradually and an office begins to be profitable only after a period of operation, the length of which depends on the extent of competition, the amount spent for development purposes, the quality of management, and the extent of the demand. The period of unprofitable operation may range from several months to two years or more.

The comparison between the small loan business and a factory or office building is, of course, an exaggerated one. In the construction of a building, non-material costs constitute a large part of the total cost, whereas in the small loan business they are minor. The difference, however, is one of degree and not of principle. And we shall recognize this difference in degree in making an allowance for this item in our denominator.

Purchases of loan balances of one small loan licensee by another in the open market would seem to supply a measure of the additional value created by the development of a going concern. Such purchases have been reported in the past at prices ranging from 110 to 150 per cent of the aggregate face value of loans considered collectible. During the last two years, when many such transfers have been made, the evaluation of loan balances has generally followed a simple formula. Representatives of the seller and of the buyer go over each loan account and segregate accounts into four classes. For the first class, which includes all loans considered collectible, 110 per cent of the face value of the loan accounts is paid. For the second class considered doubtful, 50 per cent is paid. For the third class, those loan accounts which appear unlikely to be collectible, 25 per cent is paid. For a fourth class which includes those considered definitely uncollectible, nothing is paid.

Prices at which loan balances have been sold during 1933 and 1934 are neither typical of prices which prevailed in earlier years nor representative of historic costs of acquisition. This formula probably results in the lowest price at which loan accounts have been sold except following severe reductions in the maximum interest rate in certain states. Transfers at this price are accomplished almost entirely when the seller is under pressure. Most recent sales have been made by newly licensed offices which have not been able to develop loan balances of profitable size. There is also some expense to the purchaser in incorporating loans purchased in this manner with his own accounts. Borrowers must be notified of the transfer and additional resistance to collection frequently develops. The purchaser is further handicapped because he has not had personal contact with the borrower and therefore lacks first-hand knowledge of his circumstances.

Some accountants and officers of small loan companies assert that 15 per cent of the amount of loans outstanding is not too high a value for organization expense or cost of development, and use this figure in their balance sheets. While this may well represent present costs of developing a small loan office when the business is extremely competitive, it appears to us to be excessive as far as historic costs are concerned. Any value placed on the difference between the face value of loans receivable and the actual replacement value of these assets is, of course, extremely arbitrary. But some allowance for this asset item seems necessary. We have preferred to err on the side of conservatism in estimating its value. Consequently we have estimated the value of development—the cost of organizing the physical materials into a going unit—at 6 per cent of the average amount of loans receivable.

Intangible Asset Items. The cost of financing is an intangible asset listed by many small loan companies and one for which there is considerable justification.[1] A small loan office of profitable size requires an amount of capital which few single individuals are willing or able to supply. Capital must usually be assembled by the sale of securities, and up to the present time selling costs have been high, though certainly no higher than in many other kinds of enterprise. Many small loan companies have reported financing costs exceeding 25 per cent of their tangible assets. The State Corporation Commission of Virginia reports that "the testimony of experts was to the effect that such costs would necessarily be from 15 per cent to 20 per cent."[2]

However necessary to most small loan businesses an expenditure for assembling capital may be, it is impossible to appraise the investment in this asset item. Some licensed offices have had no costs of assembling capital. Among other companies, these costs have varied enormously, depending upon the financial standing and reputation of officers and upon methods of organizing. Costs have

[1] Public utility commissions generally make liberal allowances in rate bases to represent the cost of raising capital.

[2] The Small Loan Business in the State of Virginia. Virginia State Corporation Commission, Richmond, Virginia, 1932, p. 7.

varied in different localities and in different years. We have chosen, therefore, to eliminate this item entirely from our denominator.

The cost of assembling capital, however, should be considered in interpreting the earnings rates resulting from our denominator. These rates will show the earning capacity of large accumulations of capital funds, and they will not accurately represent the rate of return to those who supplied these funds. If the testimony before the corporation commission in Virginia is valid, rates of return resulting from the application of our denominator must be decreased materially in measuring the average rate of return to investors.

Few small loan companies report any other intangibles than the cost of financing and organization expense. Goodwill is unquestionably an asset of real value in the small loan business. But its value is so ephemeral that it would be foolhardy to attempt to evaluate it for all licensees in any state. We have, therefore, followed the general accounting practice in the small loan business and eliminated it from consideration in our denominator.

Formula for Average Employed Assets. To allow 5 per cent of the average amount of loans receivable for cash balances, 2 per cent for furniture and fixtures, 2 per cent for other tangible assets, and 6 per cent for cost of development is at best an arbitrary method of evaluating these items. In total, these amount to 15 per cent of the average amount of loans receivable. We believe that this figure represents a conservative allowance for asset items other than loans receivable necessary to the operation of a small loan business. Estimates of their value might vary without justifiable criticism from 12 to 20 per cent of average amount of loans receivable depending on the opinion and policy of the appraiser. This possible variation, however, has a comparatively small effect on the resulting rates of profit. And, by adopting a standard formula for estimating the value of these asset items, we are able to overcome differences in reported values between licensees in various states which are much more likely to represent the "leaven of opinion" than differences in fact.

In general, the allowance of 15 per cent for assets other than average loans receivable is considerably lower than the relative value of these assets reported in consolidated annual reports of small loan licensees. The relationship of the reported values of these other assets to loans receivable at the close of each year is shown in Table 26.

TABLE 26.—RATIOS OF REPORTED VALUES OF TOTAL ASSETS TO LOANS RECEIVABLE (LESS RESERVES) IN STATES FOR WHICH DATA ARE AVAILABLE,[a] 1929 TO 1933

	1929	1930	1931	1932	1933
Connecticut	..	1.22	1.44	1.50	1.54
Florida	..	..	1.32	1.36	1.44
Georgia	..	1.18	1.20	1.17	1.22
Illinois	1.12	1.15	1.16	1.19	1.20
Indiana	1.22	..	..	..	1.22
Iowa	..	1.16	1.22	1.31	1.37
Louisiana	..	1.18	..	..	..
Maine	..	..	..	1.44	..
Maryland	..	1.16	1.15	..	..
Massachusetts	..	1.11	1.16	1.27	1.33
Michigan	1.12	..	1.21	1.26	..
Missouri	1.13	..	1.17	1.24	1.27
New Jersey	..	..	..	..	1.18
New York	..	..	..	1.21	1.29
Ohio	1.17	1.23	1.41	1.48	1.52
Pennsylvania	1.16	1.19	1.21	1.28	1.34
Rhode Island	..	1.20	1.22	1.30	1.34
Virginia	1.17	1.18	1.17	1.19	..
Wisconsin	..	1.22	1.27	1.36	..

[a] In several states reported balance sheets included all corporate assets regardless of whether these assets were used in the small loan business. These were consequently excluded from this table.

We now have a simple formula for a denominator which can be applied to all small loan licensees. If LB equals the amount of loans receivable at the beginning of the fiscal year, and LE equals the amount of loans receivable at the end of the year, this formula may be expressed as follows:

$$\left(\frac{LB + LE}{2}\right) 1.15 = \text{denominator}$$

We shall refer to this denominator as "average employed assets."

Calculation of Net Profit

The calculation of the numerator for profit ratios in the small loan business is less complicated than the calculation of the denominator. Our numerator is the difference between gross income and expenses of operation of the small loan business.

Gross Income. The predominating income item is interest on small loans. All other income items combined rarely exceed 1 per cent of the gross income. In many states, fees charged by public officials for recording instruments may be charged to borrowers, although such instruments are rarely recorded; and in a few states fees are permitted on certain loans in addition to interest.[1] Interest on bank balances, collections on accounts previously charged off, and other income complete the usual list of income items.

We shall include only interest on loans and the two classes of fees in gross income for purposes of our computations. Since we have limited cash balances in our denominator, we have eliminated the slight income from interest on bank balances which accrued to those companies which maintained large cash balances. We have preferred to deduct "collections on loans previously charged off" from the expense item "bad debts, or provision against loss" rather than consider this as an income item. The item "other income" is omitted because it includes rentals and income from securities and inter-office loans. It may, of course, include some forms of income which we would add to our gross income figure if they could be identified. But such items are undoubtedly so small as to be negligible in their effect upon rates of profit.

Expenses of Operation. Most of the state summaries based upon the standard report form give itemized statements of expenses incurred in the operation of the business. The amount paid for salaries and wages is consistently the largest item of expense. Rent, advertising, and taxes are also important items. Loss from uncollectible loans is always a substantial item, and in periods of widespread unemployment it tends to approach the amount spent for salaries and wages. We have excluded from total reported expenses interest on borrowed funds, amortization of financing costs or bond discounts, and gifts and donations. In the few instances where interest paid for borrowed funds was not identified, we have attempted to estimate the amount of this item. Methods of estimating, which will be explained later, varied with the circum-

[1] Of the states for which we have data concerning profits in the small loan business, only Ohio permits such fees. On loans of $50 or less, a $1.00 fee is allowed.

stances and are admittedly crude. But the effect upon profit ratios of errors in these estimates is probably slight. Gifts and donations were itemized only in a few instances. While some such items may be included under "sundry expense" and "other expenses" in a few summaries, the policy of state licensing officials is generally to exclude them in making their summaries.

The two principal weaknesses of the reported expense data lie in the home office charges paid by chain licensees and salaries paid by independent licensees. Expenses charged to chain offices by parent companies for supervision, auditing, and other services are not reported in the same manner in all summaries. In some instances, home office charges are prorated among other appropriate expense items. In other instances, these charges are segregated under the item "home office charges" and in others they are reported under such items as "auditing" and "other expenses." The variation in the method of reporting such expenses adds difficulties to a comparison of expense items by states, but does not necessarily limit the reliability of reported profit figures. Several state supervisors who have examined the books of parent companies have reported that charges made by home offices correspond to the costs of the service rendered and that the methods of allocating these expenses to individual subsidiaries or branches were equitable. Like the public utility holding company, the holding company or the home office of a chain of small loan licensees might be used to disguise the profits of individual offices. The fact that the expenses of chain offices are generally lower than those of independent offices, however, leads us to believe that such an abuse, if it occurs at all, is uncommon in the small loan business and that its effect upon the reliability of our ratios is insignificant.

In independent offices which are managed by their owners, the amount of salary drawn by the owner is subject to his own estimate of the value of his services. Consequently, it is possible for owners of independent offices to take profits in salaries instead of in dividends, thereby increasing the amount of expense and reducing the amount of profit. This is true not only of the small loan business but of all other businesses which are owned and managed by an individual or by a small group of individuals, and students of profit in other businesses have frequently pointed out the possible error in profit ratios which may result from this cause.

We have had an opportunity to inspect the salary items of individual licensees in several instances. New Jersey published expense statements which identified the item of salaries and wages paid by each licensee each year from 1928 to 1932. Except for the year 1928, salaries paid to officers were distinguished from salaries and wages paid to employes. In Massachusetts also amount of salaries paid by individual licensees has been published for each year from 1925 to 1931. The reports of individual offices to the Massachusetts supervisor of loan agencies show the number of officers and male and female employes receiving salaries and the amount paid to each group. Through the courtesy of the Massachusetts supervisor, we were permitted to inspect the salary items of each licensed office in 1929. The Iowa Banking Department has also furnished us with the amount of outstanding loans and the amount of salaries paid in 1933 by each licensee under its supervision, without revealing the identity of individual offices.

Of these groups of data, the Massachusetts figures for 1929 permit the most specific observations. A salary schedule fixing a range of management salaries for size classes of offices was developed, and salary payments to officers and owners of independent offices which did not fall within the range were reduced to the maximum or increased to the minimum. Although salaries paid to officers and owners were clearly excessive in several instances, in other instances owners or officers received no salary, but took their compensation in the form of dividends. Adjustments to conform to the range were almost completely compensating and the net adjustment was a negligible increase in the salary item.

The New Jersey data are also useful, but permit less definite observations. Compensation paid to officers appeared to be excessive for 15 licensees in 1929 and for nine licensees in 1930. In our opinion, the amount by which these items might reasonably be reduced approximated $100,000 in 1929 and $85,000 in 1930. Although salary payments were obviously inadequate in many other offices, a reasonable readjustment for all independent offices would undoubtedly result in a net decrease in the item "compensation of officers." The decrease probably would not exceed $60,000 in either year. In the Iowa figures, which include all salaries in a single item, it was difficult to distinguish between the inefficient use of personnel and excessive owners' salaries. We believe, however, that a well-considered revision of salary items in that state would result in a small reduction in the total amount paid for salaries.

The effect upon profit ratios of any such adjustment would undoubtedly be slight, and consequently we shall use reported salary items in our tabulations.

The accountants who prepared the Ohio summaries adjusted items of rent, salaries, advertising, bad debts, and depreciation reported by individual licensees to conform to certain minima considered necessary to successful operation. But there was no effort to reduce other items to reasonable maxima. In the aggregate these adjustments resulted in material increases in expenses. Adjustments in the item of federal taxes revealed that the books of licensees were usually kept on a cash basis, and taxes reported in any one year were frequently applicable to operations of the preceding year. Although this fact tends to understate the items of taxes when volume and profits are increasing, we believe that an accurate estimate of current taxes is impossible without true balance sheets. We believe that the adjustments made in these summaries were arbitrary and poorly supported by facts. Consequently, while acknowledging the desirability of well-supported adjustments in reported items, we have eliminated the adjustments in the Ohio summaries.

Rates of Profit in New Jersey and Virginia

As was pointed out earlier, the only states for which useful data concerning profits are available prior to 1929 are New Jersey and Virginia. The New Jersey series begins with 1915, the first full year of operation, and extends to the current year. The New Jersey expense figures are often inadequately itemized and it is frequently impossible to reconcile completely expense items with total expenses. Because of the lack of attention given generally to reports of small loan licensees by state banking departments during the early part of the period covered by the New Jersey series, too great reliance should not be put on these figures. The reports become increasingly reliable after 1928. Table 27 shows the calculation of rates of profit in New Jersey during the period of existence of the regulated small loan business.

TABLE 27.—RATES OF PROFIT AND ITEMS USED IN THEIR CALCULATION FOR SMALL LOAN LICENSEES IN NEW JERSEY, 1915 TO 1933

Year	Loans receivable less reserves for uncollectible loans[a]		Average employed assets	Gross income	Expense	Net profit before interest	Rate of net profit
	Beginning of year	End of year					
	(In thousands of dollars)						(In per cent)
1915	*350.0*	421.9[b]	443.9	133.7	82.0	51.7	11.6
1916	443.5	570.2	582.9	155.5	87.4	68.1	11.7
1917	563.9	736.7	747.8	208.5	122.5	86.0	11.5
1918	733.3	756.1	856.4	250.9	138.2[c]	112.7	13.2
1919	747.3	1,140.6	1,085.6	301.9	168.7	133.2	12.3
1920	1,116.7	1,479.2	1,492.7	414.6	220.1	194.5	13.0
1921	1,467.6	2,958.6	2,545.0	662.5	375.5	287.0	11.3
1922	2,958.6	3,778.4	3,873.7	1,017.1	599.4	417.7	10.8
1923	3,778.4	4,613.7	4,825.4	1,282.4	756.0[d]	526.4	10.9
1924	4,613.7	5,817.6	5,998.0	1,581.8	910.6	671.2	11.2
1925	5,817.6	7,884.7	7,878.9	2,058.1	1,123.4[e]	934.7	11.9
1926	7,884.7	9,722.2	10,124.0	2,577.6	1,499.1	1,078.5	10.7
1927	9,722.2	13,309.0[f]	13,243.0	3,458.7	2,209.1	1,249.6	9.4
1928	13,309.0	18,906.1	18,523.7	4,910.4	2,979.9[dg]	1,930.5	10.4
1929	18,906.1	20,343.9	22,568.8	6,106.4	3,840.2	2,266.2	10.0
1930	20,343.9	7,868.5	16,222.1	2,130.7	1,685.1	445.6	2.7[h]
1931	7,868.5	5,291.3	7,566.9	1,001.9	977.1	24.8	0.3
1932	5,291.3	6,127.8	6,566.0	950.1	933.5	16.6	0.3[i]
1933	5,353.3	6,759.8	6,965.1	1,644.8	1,235.4	409.4	5.9

Figures in italics are estimated.

[a] Except for the year 1933, reserves for uncollectible loans were not identified. No deduction for estimated reserves was made for years prior to 1928; for the method of estimating reserves thereafter see Table 28, note a.

[b] The commissioner reported that $14,192 of uncollectible loans which were contracted several years earlier were written off by one licensee during this year. This sum was subtracted both from the amount of outstanding loans and from losses.

[c] The item of home office charges was omitted from expense in the 1918 report. The amount was estimated by averaging the amounts reported for 1917 and 1919.

[d] Losses were not reported. The amount of this item was estimated by averaging the amounts reported for the preceding and succeeding years.

[e] Two offices in 1925 reported an item of interest and supervision charges amounting to $38,756. We have assumed that one-half of this sum was interest.

[f] The report for 1927 gives the amount of outstanding loans at the close of the year as $938,934. This figure was in error and correct amount as given here was reported later.

[g] Interest on borrowed funds was not identified in 1928. This item was estimated by applying to the average amount borrowed at the beginning and at the close of the year the ratio which the amount of interest paid for borrowed funds bore to the average amount borrowed at the beginning and at the close of 1929.

[h] Reduction of maximum interest rate from 3 per cent to 1½ per cent a month, effective February 15, 1930.

[i] Maximum interest rate increased from 1½ per cent to 2½ per cent a month on April 12, 1932.

The available figures for Virginia cover the period from 1927 to 1932. Data for the years 1927 to 1930 were given in an official study by the State Corporation Commission. Data for 1931 and 1932 were given in a summary of annual reports made by a private accounting firm. Table 28 shows the calculation of rates of profit of Virginia licensees for these years.

TABLE 28.—RATES OF PROFIT AND ITEMS USED IN THEIR CALCULATION FOR SMALL LOAN LICENSEES IN VIRGINIA, 1927 TO 1932

Year	Loans receivable less reserves for uncollectible loans[a]		Average employed assets	Gross income	Expense	Net profit before interest	Rate of net profit
	Beginning of year	End of year					
	(In thousands of dollars)						(In per cent)
1927	2,163[b]		2,488	807	490	317	12.7
1928	2,589[b]		2,977	962	592	370	12.4
1929	3,682[b]		4,234	1,340	836	504	11.9
1930	4,302[b]		4,947	1,550	974	576	11.6
1931	*4,800*	4,928	5,594	1,746	1,137	609	10.9
1932	4,928	4,496	5,419	1,643	1,147	496	9.2

Figures in italics are estimated.

[a] Reserves were not identified and had to be estimated. Since the practice of establishing reserves for uncollectible loans was uncommon until 1928, we have made no deduction for reserves prior to that year. Reserves at the close of each year thereafter are estimated as follows: 1928, ½ of 1 per cent of loans receivable; 1929 and 1930, 1 per cent of loans receivable; 1931, 1932, and 1933, 2 per cent of loans receivable.

[b] Average of 12 monthly loan balances.

Rates of Profit since 1929

Since the development of the uniform report, a much larger number of states have furnished data concerning profits in the small loan business. Table 29 shows the calculation of rates of profit of the small loan business in each state for which reports are available from 1929 to 1933. Figures for outstanding loans at the beginning of the year were frequently not reported. Where the number of licensed offices at the beginning of the year approximated the number reporting at the close of the previous fiscal year, the amount of outstanding loans at the beginning of the year was assumed to be the same as the amount of outstanding loans at the close of the previous year. Where the number of individual reports differed materially, and where no report for the previous year was available we have estimated the amount of loans receivable at the beginning of the year.

In order to compute the rate of profit shown by all available reports for each year, the New Jersey and Virginia data for these years are repeated.

TABLE 29.—RATES OF PROFIT AND ITEMS USED IN THEIR CALCULATION FOR SMALL LOAN LICENSEES IN EACH STATE FOR WHICH DATA ARE AVAILABLE, 1929 TO 1933

State and year	Loans receivable less reserves for uncollectible loans		Average employed assets	Gross income	Expense	Net profit before interest	Rate of net profit
	Beginning of year	End of year					
1929	(In thousands of dollars)						(In per cent)
Illinois	12,309	16,288	16,443	5,264	3,021	2,243	13.6[a]
Indiana	*10,200*	13,393	13,566	4,382	2,828[b]	1,554	11.4
Massachusetts	7,702[c]	7,702[c]	8,857	2,361	1,229	1,132	12.8
Michigan	*12,200*	15,524	15,941	4,363	2,371	1,992	12.5
Missouri	6,111	9,959	9,240	2,644	1,885	759	8.2[d]
New Jersey	18,906	20,344	22,569	6,106	3,840	2,266	10.0
Ohio	*22,500*	27,459	28,726	8,045	4,494	3,551	12.4
Pennsylvania	*33,500*	45,067[e]	45,176	12,678	7,373[f]	5,305	11.8
Virginia	3,682[ce]	3,682[ce]	4,234	1,340	836	504	11.9
Sub-total 1929	127,110	159,418	164,752	47,183	27,877	19,306	11.7
1930							
Connecticut	7,545[e]	9,006[e]	9,517	3,020	1,723	1,297	13.6
Georgia	*3,700*	5,016	5,012	1,585	1,061[g]	524	10.4
Illinois	22,209	25,629	27,507	8,558	4,991	3,567	13.0[a]
Iowa	*5,300*	7,105	7,133	2,478	1,585	893	12.5[a]
Louisiana	*3,950*	4,781	5,020	1,517	939	578	11.5[h]
Maryland	4,300	5,081	5,394	1,513	912	601	11.1
Massachusetts	*9,100*	11,904	12,077	3,503	1,998	1,505	12.5
New Jersey	20,344	7,869	16,222	2,131	1,685	446	2.7[i]
Ohio	*27,500*	31,864	34,134	9,607	5,551	4,056	11.9
Pennsylvania	39,365[e]	45,244	48,650	13,042	7,199	5,843	12.0
Rhode Island	*3,100*	3,448	3,765	1,126	652	474	12.6
Virginia	4,302[ce]	4,302[ce]	4,947	1,550	974	576	11.6
Wisconsin	5,845	7,051	7,415	2,265	1,290	975	13.2
Sub-total 1930	156,560	168,300	186,793	51,895	30,560	21,335	11.4
1931							
Connecticut	9,006[e]	9,172[e]	10,452	3,085	1,916	1,169	11.2
Florida	*1,900*	2,107	2,304	722	463	259	11.3
Georgia	*4,100*	4,553	4,976	1,521	1,024	498	10.0
Illinois	28,368	31,742	34,563	10,290	6,526	3,763	10.9
Iowa	7,272	7,694	8,605	2,758	1,861	897	10.4
Maryland	5,081	5,887	6,306	1,835	1,086	750	11.9
Massachusetts	11,904	14,265[e]	15,048	4,238	2,643	1,595	10.6
Michigan	*16,000*	15,774	18,270	4,881	2,977	1,904	10.4
Missouri	*9,500*	10,415[e]	11,451	2,964	2,043	921	8.0
New Jersey	7,869	5,291	7,567	1,002	977	25	0.3
Ohio	31,220	29,213	34,749	9,156	5,542	3,614	10.4
Pennsylvania	*52,000*	52,348	60,000	15,605	9,093	6,512	10.9
Rhode Island	*3,400*	3,562	4,003	1,195	757	438	10.9
Virginia	*4,800*	4,928	5,594	1,746	1,137	609	10.9
Wisconsin	7,045	7,028	8,092	2,334	1,451	884	10.9
Sub-total 1931	199,465	203,979	231,980	63,332	39,496	23,838	10.3
1932							
Connecticut	9,172[e]	8,382[e]	10,093	2,882	2,107	776	7.7
Florida	2,107	2,085	2,410	753	562	191	7.9
Georgia	*4,600*	4,758	5,381	1,422	1,115	307	5.7
Illinois	30,357	28,230	33,688	10,116	7,209	2,907	8.6
Iowa	7,694	6,502	8,163	2,562	1,993	570	7.0
Maine	1,603	1,376	1,713	486	319	167	9.7
Massachusetts	14,265[e]	13,999	16,252	4,596	3,060	1,535	9.4
Michigan	23,947	20,985	25,836	7,050	5,131	1,919	7.4
Missouri	*9,000*	8,224[e]	9,904	2,544	1,999	545	5.5
New Jersey	5,291	6,128	6,566[j]	950[j]	933[j]	17	0.3[k]
New York	8,200	9,993	10,461	2,216	1,417	798	7.6
Ohio	29,213	27,495	32,607	8,311	5,708	2,603	8.0
Pennsylvania	*52,000*	44,551	55,517	13,595	9,181	4,414	7.9
Rhode Island	3,203	3,197	3,680	1,015	736	279	7.6
Virginia	4,928	4,496	5,419	1,643	1,147	496	9.2
Wisconsin	6,590	6,315	7,420	2,296	1,660	637	8.6
Sub-total 1932	212,170	196,716	235,110	62,437	44,277	18,161	7.7

See footnotes on p. 242.

TABLE 29.—RATES OF PROFIT AND ITEMS USED IN THEIR CALCULATION FOR SMALL LOAN LICENSEES IN EACH STATE FOR WHICH DATA ARE AVAILABLE, 1929 TO 1933 *continued*

State and year	Loans receivable less reserves for uncollectible loans		Average employed assets	Gross income	Expense	Net profit before interest	Rate of net profit
	Beginning of year	End of year					
1933	(In thousands of dollars)						(In per cent)
Connecticut	*8,100*	7,260[e]	8,832	2,174	1,708	465	5.3[l]
Florida	*2,050*	1,985	2,319	649	508	141	6.1
Georgia	4,758	3,881	4,967	1,242	979	263	5.3
Illinois	28,054	26,040	31,104	9,372	6,799	2,573	8.3
Indiana	*14,000*	12,488[e]	15,230	4,189	3,214	975	6.4
Iowa	5,986	5,569	6,644	2,027	1,585	442	6.5
Massachusetts	13,856	13,365	15,652	4,110	2,868	1,242	7.9
Missouri	*7,200*	6,853	8,081	1,995	1,535	460	5.7
New Jersey	5,353	6,760	6,965	1,645	1,235	409	5.9[a]
New York	9,993	15,733	14,792	3,656	2,621	1,035	7.0
Ohio	*31,000*	28,945	34,469	8,360	6,154	2,206	6.4
Pennsylvania	*44,000*	37,607	46,924	11,165	8,355	2,810	6.0
Rhode Island	*3,015*	2,872	3,385	945	699	246	7.3
Wisconsin	6,315	5,240	6,644	1,943	1,451	492	7.4
Sub-total 1933	183,680	174,598	206,008	53,472	39,711	13,759	6.7
Total for all years	878,985	903,011	1,024,643	278,319	181,921	96,399	9.4

Figures in italics are estimated.
[a] Excludes licensees engaged in business less than one year.
[b] Interest paid on borrowed funds was not identified, but was included under "other expenses." In the absence of any other Indiana data which would assist in estimating these data, the ratio of interest paid on borrowed funds to the amount of outstanding loans was assumed to be the same as that reported in Ohio for the same year. The sum resulting from the application of this ratio to outstanding loans in Indiana was subtracted from "other expenses."
[c] Average of 12 monthly loan balances.
[d] Maximum interest rate reduced from 3½ per cent to 2½ per cent a month, effective on August 31.
[e] The amount of reserve for uncollectible loans was not reported. The reserve was estimated and subtracted from the reported amount of loans receivable at the following rates: at the close of 1928, ½ of 1 per cent of loans receivable; at the close of 1929 and 1930, 1 per cent of loans receivable; at the close of 1931, 1932, and 1933, 2 per cent of the amount of loans receivable.
[f] Interest paid on borrowed funds was included in expense and was not identified. The amount of this item was estimated by applying to the amount of loans outstanding at the close of 1929 the ratio of the amount of interest paid on borrowed funds to the amount of loans outstanding reported in 1930.
[g] Interest paid on borrowed funds was not identified, but was included with home office management expense under "other expenses." In 1931, interest paid on borrowed funds and home office management expense were itemized. The amounts reported in 1931 for home office management and "other expense" were subtracted from the amount reported for other expense in 1930 and the difference was assumed to be the amount of interest paid in 1930.
[h] Excludes licensees charging less than the maximum rate.
[i] Maximum interest rate reduced from 3 per cent to 1½ per cent. Enacted May, 1929, effective February 15, 1930.
[j] Because of the change in the fiscal year which for previous years had closed on November 30 and in 1932 closed on December 31, the New Jersey expense and income figures are for thirteen months. This has been adjusted by reducing the reported income and expense items by one-thirteenth.
[k] Maximum interest rate increased from 1½ to 2½ per cent a month on April 12.
[l] Maximum interest rate reduced from 3½ to 3 per cent a month on June 9.

CHAPTER XII

THE QUESTION OF THE MAXIMUM RATE OF CHARGE

THE necessity for some agency to supply small loans is now almost universally recognized and recent controversy concerning small loan legislation has been confined principally to the question of the maximum rate of charge. This question has been the subject of much debate before legislative bodies, in the editorial and news columns of the press, and elsewhere.

The subject is essentially controversial. Deep-rooted prejudices and sympathies, which obscure a judicial view of the facts, are involved. And even when the facts are faced squarely and honestly, opinion must of necessity play an important part in their interpretation. The data upon which the rate question must be determined permit only relative appraisals. There can be no scientifically accurate maximum rate or mathematical formula for calculating it.

It is essential to a consideration of the rate question that we know what kind of institution is to be relied upon to supply a market for the small loan demand. Obviously a large amount of capital is necessary. Investors inspired by philanthropic impulse are all too scarce and limited-dividend capital has met but a small part of the demand. Credit unions, while increasing their importance as a means of accumulating the savings of homogeneous groups of people for loans to members of the same groups, have progressed but slowly in spite of the persistent efforts of subsidized promotional agencies. Few people have been bold enough to suggest that state or municipal governments should undertake to make these small necessitous loans, the collectibility of which depends in large measure on the judgment of the lender in selecting his borrowers.

If, as seems likely for the immediate future, profit-seeking enterprise must be relied upon to meet the demand for small loans, the considerations which may be applied in determining an adequate maximum rate are greatly restricted. It is as useless, for instance, to contend in criticism of a maximum interest rate that the lender is permitted a sizable profit at the expense of the borrower least able to pay as it is to extend this criticism to enterprises supplying housing, food, and clothing to the same clientele. The question of the maximum interest rate is practical rather than ethical. In its final analysis it resolves itself into the question, What is the lowest rate that will attract private capital to the business of making the kind of loans which the regulatory act contemplates?

In approaching the problem of the maximum rate of interest, two characteristics of the small loan business must be borne in mind. First, it is essentially a competitive business; second, expenses of lending are affected by a large number of variables.

In almost any locality a potential borrower may choose among several types of lending agencies. If he has collateral acceptable to a bank or if he is a depositor of long standing who might receive credit without collateral, he approaches his bank first. If he cannot meet its credit standards, he tries the agency that comes next in convenience or cheapness. If he can offer co-makers to his note, he may apply to the personal loan department of a bank, to a credit union, or to an industrial banking company. Or he may find a remedial loan society or a pawnbroker cheaper or more convenient. If he chooses, or is compelled because other agencies have refused him, to apply to a licensee under a small loan act, there are usually several such lenders from whom he may select the cheapest, or the most convenient, or the one with the best reputation for fair dealing. There is ample evidence that the borrower shops for favorable terms in making loans. Although price is but one of the criteria by which the borrower selects a lender, the lender who maintains a high standard of fair dealing, who charges less, and who advertises his lower charges will unquestionably attract customers as readily as the merchant who advertises lower prices for food or clothing—and more so because there is no question of a difference in quality. The money of all lenders bears the same trade-mark.

The lender, on the other hand, puts applicants for loans through a somewhat similar process of selection. There are wide variations in the cost of lending to different applicants. The most easily measured variable is the factor of size of the loan. There are also differences in cost depending upon the size and character of the community and the circumstances of the individual borrower, such as his annual income, the size of his family, the stability of his employment, his personal habits, reputation, and temperament, all of which affect his desirability as a credit risk. The small loan business, like all other credit businesses, involves fundamentally a selection of clientele. The lender chooses the borrower to whom he is willing to lend at a rate permitted by law.

Why a Maximum Rate?

The reader might reasonably ask, "Why a maximum rate at all? Why not legalize all contracts made by borrower and lender at the rate agreed upon by them?" Absolute freedom of contract for loans has been recommended many times, notably by Jeremy Bentham, whose classic Defence of Usury was published in 1787. Complete freedom of contract, however, has never produced decent conditions in the small loan field. The repeal of the usury laws in England in 1854 did not produce measurably beneficial results. In Massachusetts, also, where the repeal of the maximum contract rate in 1867 left parties to loan contracts free to make their own bargains, the continuation of the loan-shark problem led finally to the regulation of small loans by a special act in 1911. New Hampshire and Maine also repealed statutes restricting the maximum rate for general loan contracts, but found it desirable to enact the Uniform Small Loan Law to prevent extortionate charges for small loans.

A maximum rate high enough to permit legitimate lending to the necessitous borrower has three practical advantages. First, it delimits a market within which lending operations are given legal sanction, resulting in the removal of part of the odium that would attach to the lender left free to make his own contract even at the same rate. Second, a maximum rate prohibits lending to borrowers to whom an interest rate commensurate with the cost and risk of loss involved in making the loan would result in economic peonage. Those to whom the lender is unwilling to lend at the maximum rate must go without, find relief from private or public charities, friends, or relatives, or, if sufficient unsatisfied demand exists, from an unlicensed lender who is willing to risk the penalties of the law for a high rate of profit. Third, a fixed maximum rate under license permits the social effects of lending at that rate to be studied and the rate to be adjusted accordingly.

The maximum rate fixed by the Uniform Small Loan Law is in no sense an attempt to fix the price of loan service. It is purely an enforceable maximum which establishes a range within which borrower and lender may make their own terms.

What has been the experience under various maximum interest rates? Which rates have produced a legitimate market for small loans and which have not? We may immediately throw aside all maximum rates of less than 1 per cent a month as clearly ineffective. Within the range from 1 per cent to 3½ per cent a month, however, an elaborate variety of rates has been put to test.

Experience with Rates of 1 or 1½ Per Cent a Month

Since 1913 the District of Columbia has permitted a rate of 1 per cent a month to licensed lenders under an act resembling early drafts of the Uniform Law in all important respects but rate. In 1930, in connection with the hearings on a bill proposing the substitution of the Uniform Small Loan Law for this act of 1913, the Board of Commissioners of the District of Columbia wrote:

> Experience has shown that the present small loan law in the District of Columbia . . . is ineffective. This is largely due to the fact that the rate of interest which is permitted thereunder is so small as to prohibit persons from functioning pursuant to its terms. This is best evidenced by the fact that not one license has been taken out under this law since it came into existence.[1]

Six states permit general contract interest rates as high as 12 per cent a year, namely, California, Connecticut, Nevada, New Mexico, Utah, and Washington. In none of these states did this statutory maximum attract funds for small loans. California, Connecticut, and Utah have adopted the Uniform Law. In the few industrial cities of the other four states, as well as in California

[1] Letter from the Board of Commissioners of the District of Columbia to the chairman of the Committee of the House of Representatives on the District of Columbia, dated February 26, 1929, "Small Loans in the District of Columbia, Report of Hearings on HR 7628." U. S. Government Printing Office, Washington, D. C., 1930, p. 61.

after the rate section was declared invalid by the courts,[1] exorbitant interest charges on small loans are prevalent.

Colorado, under an act of 1919 somewhat similar to that of the District of Columbia, permits licensees to charge 1 per cent a month, and fees of $1.00 not more than four times a year. Of this act the state bank commissioner of Colorado wrote:

> In regard to [the maximum rate of] 12 per cent per annum, it never has been effective, due to various evasive policies which permit them [licensees] to make almost any charge agreeable to themselves. There has never been operative in this state any legal provision which was workable.[2]

Several states have experimented with maximum interest rates approximating 1½ per cent a month. New York since 1911, and Louisiana since 1915, have had statutes permitting 1½ per cent a month to be charged on loans secured by wage assignments.[3] No loans have been made under either of these acts.[4] New Jersey from 1929 to 1932 tried 1½ per cent as the statutory maximum for small loan licensees. The adverse effect of this rate on the small loan business in that state has already been described.[5]

Experience with Rates Approximating 2 Per Cent a Month

Mississippi, since 1906, has had a regulatory small loan law which permits 10 per cent a year and fees, varying with the size of the loan, which result in an aggregate rate somewhat in excess of 1½ per cent a month. Attempts to get official data concerning the operation of this act have failed, but a subsequent act of the legislature supplies a means of judgment. Whereas the act of 1906 provided a penalty for charging more than the maximum rate, an act of 1914 imposed a privilege tax of $2,000 a year on those who charged more than 20 per cent a year. This is a device whereby the state profits from a tax on those who break the law! Loan

[1] See p. 136, note to Table 7.

[2] Letter from Hon. Grant McFerson, Colorado State Bank Commissioner, dated November 10, 1932, to the Department of Remedial Loans of the Russell Sage Foundation.

[3] These laws should not be confused with regulatory small loan laws in these states which we have described elsewhere.

[4] With the exception of some loans by credit unions in New York.

[5] See pp. 131–132.

sharks operate in Mississippi cities and there is reason to believe that the regulatory act has been utterly ineffective.

Missouri in 1913 passed an act which permitted corporations licensed by municipalities of 30,000 or more population to charge 2 per cent a month on small loans.[1] We have been able to discover only four corporations that were so licensed. Two were commercial companies and these lasted less than two years; the third was an employes' loan fund; and the fourth was a remedial loan society. Hundreds of lenders at the same time charged the prevailing though illegal rates of 10 to 40 per cent a month.

Wisconsin, from 1895 to 1927 with brief interruptions, permitted any lender to charge a maximum rate of 24 per cent a year on small loans secured by chattel mortgages. The only agency known to have been engaged in the business of lending at these rates was a remedial loan society in Milwaukee. High-rate lending was widespread, and in 1927 the Uniform Law replaced the general permissive act. California and Colorado, for short periods, tried similar statutes permitting 2 per cent a month on small loans, with no better results.

In Wyoming a small loan act permitting 25 per cent a year on loans of $200 or less has been in effect since 1909. Correspondence with local chambers of commerce has failed to disclose any lenders engaged in the business of making such loans. A Florida statute of 1909 permitting the same rate was equally ineffective and this state enacted the Uniform Law in 1925.

West Virginia, from 1929 to 1933, tried 2 per cent a month as the maximum interest rate under its small loan act. The destructive effect of this rate on the small loan business in that state, which has already been described, led to the restoration of a higher rate in 1933. A maximum rate of 2 per cent a month since 1932 has been equally unsuccessful in New Hampshire.

There is but one exception to the general rule of complete failure of the 2 per cent a month rate to attract commercial lending. This is Delaware where, under a law of 1929 permitting a discount of 11 per cent for loans repayable by instalments (approximately 2 per cent a month on balances), a large volume of loans is made. A

[1] The 1913 act was repealed by the enactment of the Uniform Small Loan Law in 1927.

study made by a student in the Wharton School of the University of Pennsylvania under the direction of Dr. Frank Parker furnishes the only data available concerning lending in Delaware under this act.[1] A canvass of 27 lenders in Wilmington[2] made in connection with this study showed that 13 were industrial banking companies lending on endorsed notes, three were lending upon real estate mortgages, one combined loans on real estate and endorsements, and 10 were mutual associations, lending presumably on endorsed notes to small business men. Concerning the size of the loans of these Delaware lending agencies this study makes the following comment:

> Just what the average size of industrial loans is would be quite difficult to determine, but the answers of these lenders to varied questions indicate that this figure is well above that of the Chester Personal Finance Company offices.[3] One manager said that he made loans up to $20,000 on the industrial plan; others gave varying figures from $1,000 up to $5,000 and $10,000. These figures, however, seem to be the exception rather than the rule, and while it is difficult to set up an average industrial loan figure, the mean would probably be somewhat under $500.[4]

Even allowing for considerable inaccuracy in this estimate of the size of loans of Wilmington lenders, it seems apparent that they far exceed those of typical chattel mortgage lenders under the Uniform Small Loan Law. The success of the Delaware law in attracting a licensed loan business at the rate permitted by the act is undoubtedly explained by the opportunity to make sizable loans. Such loans, however, can scarcely be considered to be serving the small necessitous borrower, whom small loan laws are designed to protect.

New York in 1914 passed a regulatory act which permitted chartered lenders to charge a rate of 2 per cent a month and small fees, aggregating approximately 2¼ per cent. In spite of an

[1] Brenner, Milton, State Legislation and the Small Loan Business, a study of the Philadelphia, Camden, Chester, Wilmington area. Unpublished manuscript.

[2] Not all of these were licensed; some operated under bank charters, others without legal sanction.

[3] Licensees under the Pennsylvania small loan act, located in Chester, Pennsylvania, but lending a large part of their capital in Wilmington, Delaware. [Editor.]

[4] State Legislation and the Small Loan Business, p. 82.

enormous field for lending under unusually favorable conditions, the number of chartered lenders in that state declined from 27 in 1918 to 17 in 1928. Of these 17, three were remedial loan societies and one was organized as a remedial loan society but had been sold to commercial interests in 1927. Of the remaining 13, four with more than half of the remaining volume of loans outstanding lent solely on endorsed notes. Others combined chattel loans with endorsed note lending or pawnbroking, or made chattel loans as a side line to private banking or other enterprises. Excluding the remedial loan societies and the company that had been a remedial loan society, the outstanding amount of chattel, plain note, and wage assignment loans was but $350,000 for the entire state.

Against this background must be placed the findings of the loan-shark investigation of Attorney-General Ottinger in 1928. Hundreds of illegal lenders were exposed in the cities of New York State, and thousands of borrowers made statements of abusive treatment and enormous interest charges. There is unfortunately no official report of this investigation but its progress and findings were followed carefully by the press and filled many columns in all newspapers of the state during March, April, and May of 1928. In 1932 New York increased the maximum interest rate for small loans by the enactment of the Fifth Draft of the Uniform Small Loan Law.

In Michigan an act of 1907 permitted rates similar to those allowed by the New York act of 1914. Prior to an increase in the rate in Michigan in 1915, we have been able to discover but three licensees under the act of 1907. Two were remedial loan societies and one was a commercial lender. Only one remedial company appears to have confined itself to the maximum rate fixed by the act.

Range of Rates Which Have Attracted Commercial Capital for Small Loans

A maximum rate of 2½ per cent a month has produced varying results. In Missouri, as we have already pointed out, many licensees continued to make loans after the maximum rate had been reduced to 2½ per cent.

New Jersey, since the spring of 1932, has also permitted 2½ per cent a month. Although the experience with this rate is too brief to permit an analysis of results, we have already speculated upon the effectiveness of this rate in an earlier chapter.[1]

Another state offers experience with a rate somewhat in excess of 2½ per cent a month. In Rhode Island a general interest regulation of 1909, which was amended slightly in 1912, limited maximum interest rates on any contracts to 30 per cent a year on loans above $50, and 5 per cent a month for the first six months on loans of $50 or less.[2] As far as we have been able to discover the only lending agency which confined itself to these rates was one remedial loan society situated in Providence. Abuse of the law led to the passage of the Uniform Small Loan Act in 1923.

In states permitting 3 per cent a month a small loan business of large proportions is now being carried on under license. It should be remembered, however, that no capital was attracted into the small loan business in Utah until within the last few years, although the act has been in existence since 1917. Massachusetts similarly had years of delay before the 3 per cent rate attracted new capital for loans;[3] the volume of business and number of licensees declined steadily from 1916 until 1920. In Oregon, also, where one of the earliest satisfactory acts was passed, there was but little business carried on under the act prior to 1929. In New Jersey, on the other hand, although the volume of funds available for loans was very small at the start, the small loan business had expanded rapidly until 1929, when the rate reduction amendment was enacted.

A rate of 3½ per cent a month has obviously[4] attracted a large amount of private capital into the small loan business wherever this rate has been permitted to licensees. As with a rate of 3 per cent a month, general conclusions as to the effectiveness of a 3½ per cent rate are impossible. Judging from the small amount of illegal lending and from the number of borrowers of low income to whom loans are made, this maximum appears to have been ample in many

[1] See pp. 131–132.

[2] Public Laws 1912, c. 838.

[3] That is, for loans on security other than on endorsed notes; endorsed note lending increased rapidly from 1916.

[4] See p. 169.

states to provide funds for loans to practically all applicants to whom it is socially desirable that loans be made. In Georgia, Tennessee, and Florida, however, where the demand is for smaller sums than in the northern states, even a 3½ per cent rate tends to exclude many applicants for loans from the service of licensed lenders and continuous vigilance of state supervisors and prosecutors is necessary to prevent illegal lending at exorbitant rates to borrowers of very small sums. We will return later in this chapter to an examination of the differences in lending under maximum rates of 3 and 3½ per cent a month.

In this inquiry into the effectiveness of various interest rates, we have not mentioned all of the states which have experimented with interest rates exceeding 1 per cent a month. Some states permitted rates of interest exceeding 3½ per cent a month on small loans.[1] Other states to which we have not referred permitted for brief periods charges between 1 per cent a month and 3 per cent a month. We have selected for discussion all states in which rates ranging from 1 to 3 per cent a month are still in effect and others in which some basis exists for judging the practicability of rates which have since been discarded. Even in the states to which we have referred, the lack of official records or substantial data frequently limits the possibility of drawing conclusions.

Missouri Experience at 2½ Per Cent a Month

The dividing line between effective and ineffective rates appears to be not lower than 2½ per cent a month. Hence the experience of the state of Missouri since 1929 becomes of great importance. This is the single state[2] where the 2½ per cent rate has been tried under a law which, by requiring license and reports, permits analysis. Let us now look at lending operations in Missouri in greater detail.

The trend of the number of licensees and the amount of outstanding loans since the enactment of the Uniform Small Loan Law in 1927 is given in Table 30.

[1] Small Loan Legislation, pp. 80–81.

[2] With the exception of New Jersey where the experience at 2½ per cent began too recently to permit analysis of results.

TABLE 30.—AMOUNT OF LOANS OUTSTANDING AND NUMBER OF LICENSEES IN MISSOURI AT THE CLOSE OF EACH YEAR, 1927 TO 1933[a]

Date	Amount of loans outstanding	Number of licensees	Maximum rate (per cent a month) with effective date
1927	$3,500,000[a]	117	3½, April 5, 1927
1928	6,142,000	174	3½
1929	10,452,000	134	2½, August 29, 1929
1930	10,823,000	123	2½
1931	10,704,000	95	2½
1932	8,441,000	89	2½
1933	7,157,000	82	2½

[a] All figures reported by Missouri commissioner of finance except the amount of loans outstanding for 1927, which has been estimated.

First of all these figures must be related to the history of the Missouri act and to tendencies elsewhere. The Missouri small loan bill allowing 3½ per cent a month became law on April 5, 1927, and took effect immediately. The number of licensees and the volume of loans outstanding increased rapidly throughout the remainder of 1927 and 1928. The bill reducing the maximum interest rate to 2½ per cent a month was passed in May, 1929, and became effective on August 29 of that year. A further large increase in the amount of loans outstanding was recorded for the close of the year 1929. No mid-year figures are available, but the rapidity of the increase in the amount of outstanding loans in the earlier years and the negligible increase for 1930 over 1929 suggest that most of the 1929 increase may have occurred before the interest rate reduction.

Comparison of the course of the amount of loans outstanding in Missouri with the aggregate course for other states which did not reduce maximum interest rates demonstrates the depressing effect of the rate reduction in Missouri on the normal growth of the business.[1] It is significant, however, that the volume of loans continued to increase even though at a negligible rate and that the reduction to 2½ per cent a month did not lead to the rapid liquidation of loan balances that resulted from the more severe rate reductions in New Jersey and West Virginia. The sharp decline in the number of licensees, it is true, suggests a pathological condi-

[1] For a comparison of the course of outstanding loans in other states with that in Missouri, see "Three Experiments with Small Loan Interest Rates" by Rolf Nugent, in Harvard Business Review, vol. 12, October, 1933, p. 39.

tion in the small loan business, but the number of licensees is unimportant if the needs of borrowers were being met by those lenders who remained.

Why did the volume of lending increase in spite of a severe reduction in potential gross income? The answer requires a more detailed analysis of the course of outstanding loans. At the beginning of 1929, the average loan balance of individual offices in Missouri was approximately $35,000, an insufficient volume for satisfactory earnings in most offices even at the 3½ per cent rate. Individual licensees were rapidly increasing these balances during 1929. When the rate cut occurred, however, many licensees had to decide either to liquidate or to continue to expand the loan balances of individual offices to a profitable level. Many lenders found it to their advantage to sell their loan accounts to those who had decided to remain in business. The withdrawing licensee could sell his accounts at a discount and still lose less than by gradual liquidation.

For licensees who remained, on the other hand, the purchase of accounts at a discount was an extremely cheap means of increasing their loan balances. Consequently the rate cut subsidized the acquisition of larger loan balances by those licensees who remained in business at the expense of those who withdrew. This subsidy, of course, was temporary and the lenders who remained had to depend either upon an adjustment of their costs to a new level of income or upon a future increase in the rate by the legislature. The sale of the assets of one group of lenders to another rapidly increased the average outstanding loan balance of individual licensees. By the close of 1931, the average amount of outstanding loans per office was $113,000.

Lenders who remained in business following the rate cut in Missouri may be divided conveniently into four groups, which were differently affected by the reduction in maximum rate.

First, there were some licensees lending on endorsed notes who had charged 2½ per cent a month or less throughout the period of their existence. To these lenders the rate cut caused no inconvenience. The amount of outstanding loans made by them continued to expand and was reported by the commissioner of finance for the close of each year as shown in Table 30.

Second, there were a few chain licensees lending on chattel mortgages who, prior to the legislative rate reduction in Missouri, had voluntarily reduced their rates on larger loans to 2½ per cent a month in all states regardless of higher legislative maxima. To the extent that there was demand for larger loans, these licensees also were unhampered by the rate cut. This group included three chain companies having 12 offices in Missouri at the close of the year 1931. These companies reported the amount of outstanding loans in their Missouri offices as shown in Table 30.

A third group of licensees, who lent almost entirely on chattel mortgages, immediately followed the example of those who had already specialized in large loans at lesser rates. They increased the average size of their loans and refused loans of less than $100 or $150. Since loan contracts made before the effective date of the rate reduction law bore interest at the rate contracted for until they were repaid, these lenders suffered only a gradual decline in income during the period of adjustment of their businesses to a much larger average loan and to a more careful selection of applicants. Had the small loan business been established in Missouri for a longer time, such a change in their business would probably not have been possible without a considerable decrease in the amount of outstanding loans. As it was, the period between the enactment of the Uniform Small Loan Law and the date of the reduction in maximum interest rate was so brief that the capital of small loan licensees at the time of the interest rate reduction was probably insufficient to meet the demand for small loans that could be normally anticipated. It seems likely that the demand for loans continued to expand while the amount of capital available for loans leveled off. Consequently, this third group of licensees was fairly successful in obtaining larger loans and presumably a better class of borrowers.

It is impossible to identify all those licensees who eliminated applicants for smaller amounts. In response to inquiries, however, we have received reports on the amount of outstanding loans and average size of loans made from three of the largest companies representing this group. The outstanding loans of the 13 Missouri offices of these companies were as given in Table 30. The average size of loans made in the several offices of each of these three companies was reported as follows:[1]

Year	Company A	Company B	Company C
1928	no report	$135	$129
1929	$167	160	149
1930	177	165	159
1931	173	173	182

The fourth group of licensees included those who attempted to struggle along at the reduced interest rate without changing the nature of their business. For want of a better means of identifying them we have included in the fourth group all licensees in Missouri who have not been identified with the other three groups. Among the remaining licensees, however, there are undoubtedly many who would be included in the third group were it possible to identify the nature of their business. When the amounts of outstanding loans of the three groups of licensees are subtracted from the total amounts of outstanding loans in Missouri at the close of each year, it is clear that the outstanding loans of the remaining licensees declined rapidly following the rate cut. Table 31 shows this trend.

TABLE 31.—AMOUNT OF LOANS OUTSTANDING IN MISSOURI AT THE CLOSE OF EACH YEAR, 1928 TO 1931, BY CLASS OF LICENSEES

(In thousands of dollars)

	1	2	3	4	5	6
Year	Companies lending on endorsed notes[a]	Three chain companies that reduced their rates elsewhere[b]	Three chain companies that shifted to larger loans[c]	Total for the three preceding groups	Total for all other licensees	Total for all licensees[a]
1928	83	1,162	1,199	2,444	3,698	6,142
1929	177	2,820	2,108	5,105	5,347	10,452
1930	369	3,334	2,124	5,827	4,996	10,823
1931	511	3,366	2,166	6,043	4,661	10,704

[a] Reported by Missouri commissioner of finance.
[b] Reported by Commonwealth Loan Company, Household Finance Corporation, and Metro Loan Company.
[c] Reported by Beneficial Operating Bureau, Fulton Industrial Securities Corporation, and Public Operating Corporation.

[1] Reported by Beneficial Operating Bureau, New York City; Fulton Industrial Securities Corporation, Atlanta; and Public Operating Corporation, St. Louis.

Since many licensees in the fourth group belong in reality with the licensees who shifted to larger loans, it is probable that the reduction in the outstanding loans of this group has been much more precipitate than the table would suggest. The extreme possibility of what the decline might be if a complete segregation could be effected is suggested by the decline in the volume of loans secured by wage assignments and plain notes. The loans that can be conveniently made on such security are small and this is the essential reason for the unwillingness of lenders to make such loans at the reduced rates. We give the volume of outstanding loans secured by wage assignments and plain notes reported by the Missouri commissioner of finance as probably indicative of the decline in the volume of lending in small amounts.

Year	Wage assignments	Plain notes
1928	$110,000	not reported
1929	204,000	not reported
1930	89,000	$242,000
1931	64,000	194,000

The general shift to larger loans in Missouri is shown by the change in the size of the average loan of all licensees.

Year	Average loan made
1928	$122
1929	140[a]
1930	150
1931	153[a]

[a] Reported by Missouri commissioner of finance. Other figures are estimated.

The discrimination against the borrower of smaller sums, who is generally the borrower with a low income,[1] led promptly to the return of high-rate lending. Both the Kansas City and St. Louis Better Business Bureaus reported an increase in unlicensed lending following the rate reduction. We have a record of 10 high-rate loan offices operating in the adjoining cities of Kansas City, Kansas,[2] and Kansas City, Missouri, in 1933. Eight unlicensed

[1] For a discussion of the relation of the size of loans to income, see The Personal Finance Business by M. R. Neifeld, Harper & Brothers, New York, 1933, pp. 194–196; also The Small Loan Situation in New Jersey in 1929 by Willford I. King, New Jersey Industrial Lenders Association, Trenton, 1929, p. 39.

[2] Kansas does not have a regulatory small loan law. The offices in Kansas City, Kansas, lend also to borrowers in Kansas City, Missouri.

salary loan offices were reported in St. Louis. All of these companies were charging rates from 10 to 40 per cent a month. Borrowers compelled to resort to these lenders certainly received no benefit from the reduction in the maximum interest rate.

On the other hand, it would appear at first that many applicants for larger sums able to meet the terms of licensed lenders have been benefited by getting loans at 2½ per cent a month instead of at 3½ per cent. It should be remembered, however, that immediately prior to the legislative rate cut in Missouri more than one-fourth of the total amount of outstanding loans bore interest at a rate of 2½ per cent a month or less. It seems likely that a considerable number of loans now made at 2½ per cent would have been made at that rate regardless of the legislative maximum. It is impossible to measure either the number of loans that are refused by reason of the reduced rate or the number of loans that are now made at 2½ per cent which would have borne a higher rate were such a rate authorized by law.

Chain lenders now make the largest part of the loans in Missouri and the capital of these offices may be transferred readily, though gradually, to other states. Lenders were unlikely to employ their capital in loans at the lower rate in Missouri unless, by a careful selection of borrowers, profits in Missouri offices can be made to approximate the profit possibilities in other states.[1] It is noteworthy that the rate of profit of licensees in Missouri has gradually approached the general rate of profit for the small loan business. In 1929 the percentage rate of profit in Missouri was 3.5 points less than the average rate of profit for all reporting states. In 1931 the difference was 2.3; in 1932, 2.2; and in 1933, but 1.0.

[1] Unpublished figures on the earnings of one chain company charging 2½ per cent a month in Missouri and 3½ per cent in some other states show that the Missouri offices of this company were as profitable as its offices in states in which 3½ per cent a month was charged. In fact, only a small percentage of the individual offices of this company exceeded the rate of earnings of the Missouri offices. The explanation for this similarity in earnings, in spite of the large difference in gross income, is loan selectivity. While size of loans is but one indication of this selectivity, a comparison of the size of loans made by this company in its Missouri offices and in offices in which 3½ per cent is charged is significant.

Average size of loans made by one chain company in Missouri and elsewhere

	1929	1930	1931
Missouri offices	$160	$165	$173
Offices in other states	116	122	132

The commissioner of finance of Missouri suggests the relation of the rate reduction to the return of the high-rate lender in his letter to the governor and the legislature transmitting the 1931 summary of the annual reports of small loan licensees. After pointing out the relation of costs to the size of the loan he says: "It is therefore the belief of the Department that if a higher rate were permitted on the smaller balances, it would eliminate most of the unlicensed lenders who still charge from 10 to 20 per cent a month."[1] A similar comment was made in his 1933 report.

Effectiveness of a 3 Per Cent a Month Rate

The same sort of considerations that have been used in examining the practicability of the 2½ per cent a month rate can be applied in comparing the effectiveness of a 3 per cent with a 3½ per cent a month rate. But the distinction is much finer and no such definite conclusions may be drawn.

Massachusetts has had a 3 per cent a month rate since 1916, and New Jersey had a rate of 3 per cent a month prior to 1929. Ohio, since 1915, has permitted a rate of 3 per cent a month with a fee of $1.00 on loans of $50 or less. In Massachusetts and New Jersey reports of the business of small loan licensees have been rendered for many years by state officials charged with their supervision and elaborate studies of costs and earnings have been made.[2] Summaries of annual reports of a large number of Ohio licensees are available for 1929, 1930, 1931, 1932, and 1933.[3] These accounting studies show beyond question that the small loan business in those states was profitable during the periods covered.

But the obvious prosperity (prior to 1932) of licensees under a 3 per cent a month maximum does not necessarily prove that 3 per

[1] Missouri Commissioner of Finance, Summary of Annual Reports of Personal Finance Companies of Missouri, 1931.

[2] Annual Reports of New Jersey Commissioner of Banking and Insurance;
Annual Reports of Massachusetts Supervisor of Loan Agencies;
Analysis of annual reports of small loan licensees in Massachusetts in 1930, Pace, Gore & McLaren, Boston (multigraphed).
Financial Aspects of the Small Loan Business in New Jersey in 1929, Pace, Gore & McLaren.
Summary of annual reports filed by licensed small loan lenders in Massachusetts. Lybrand, Ross Bros. & Montgomery, Boston, 1931 (multigraphed).

[3] Annual summaries of reports of personal finance companies, Ohio, Haskins and Sells, Columbus (multigraphed).

cent is socially a more desirable rate than a 3½ per cent rate. There are definite differences in the character of loans made under maximum rates of 3 per cent and of 3½ per cent a month. These differences are hidden sometimes by the use of averages, sometimes by variations in report forms among states, and sometimes by the inadequacy of available data. But they are none the less real in spite of the difficulties in identifying and measuring them.

Relation of Maximum Interest Rate to the Size of Loans

The difficulty of identifying differences in the characteristics of loans made under 3 and 3½ per cent maximum rates is illustrated by comparing the average size of loans made in various states. Other things being equal, the larger the loan the lower the ratio of expense to interest charges. Consequently, we would expect a higher average loan in states with a 3 per cent maximum than in states with a 3½ per cent maximum. Table 32 presents the available data concerning the average size of loans made in states permitting rates of 3 or 3½ per cent.

Although in general the average size of loans has been higher in "3 per cent" states than in "3½ per cent" states, one recognizes

TABLE 32.—AVERAGE SIZE OF LOANS MADE BY LICENSEES IN CERTAIN STATES, 1929 TO 1932

State	Maximum rate of interest: per cent a month	1929	1930	1931	1932
New Jersey	3—1½—2½	$168[a]	..[b]	$240	..[e]
Massachusetts[c]	3	150	$152	150	$145
Ohio	3[d]	162[a]	168[a]	158[a]	143
Illinois	3½	145[a]	150[a]	149	138
Pennsylvania	3½	158[a]	160[a]	153	147
Rhode Island	3½	..[e]	146[a]	144	125
Indiana	3½	122[a]	128[a]	..[e]	..[e]
Iowa	3½	..[e]	131[a]	128	116
Virginia	3½	111	117	..[e]	..[e]
Louisiana[f]	3½	114[a]	115[a]	..[e]	..[e]

[a] Estimated from incomplete data. Amounts not so marked are reported in accounting studies made for licensees or in reports of state officials.
[b] Rate reduced to 1½ per cent.
[c] Morris Plan and chartered companies excluded.
[d] Ohio permits in addition a fee of $1.00 on loans of $50 or less.
[e] Data lacking.
[f] Licensees charging less than 3½ per cent excluded.

immediately that other factors than the maximum rate of interest affect the size of loans. Pennsylvania has consistently had a higher average loan than Massachusetts, while Illinois and Rhode Island have had averages only slightly smaller than Massachusetts. Because of voluntary rate reductions, the average rate of interest collected in these three highly industrial "3½ per cent" states was almost identical with the average rate collected in the "3 per cent" states. In Pennsylvania, Illinois, and Rhode Island many licensees specialize in larger loans at reduced rates. This circumstance resulted in average rates of charge and average sizes of loans similar to those found in states where the maximum interest rate was 3 per cent a month.

In Iowa and Indiana, on the other hand, rate reductions to attract the more desirable loans were confined to a very few licensees in large cities. Consequently, the average loan was smaller and the average rate collected was higher. In Virginia, where the next smallest average loan occurred, almost all lenders charged the maximum rate. The reports for Louisiana exclude all licensees charging less than the maximum rate. Consequently this report shows the smallest average loan and the highest average charge. Table 33 compares the average size of loans with average rates of charge in certain states in selected years.

This table shows a consistently inverse relationship between the average size of loans and average rate of interest collected. Such a relationship undoubtedly exists in general, but it is probable that the rigid relationship shown by the table is fortuitous. To be fully comparable, the figures should be for the same year in all states. We attempted to select data for the year 1931 and substituted figures for other years only when 1931 figures were not available. The table has been limited to states which supplied fairly adequate data on the relevant points. Many states which reported the average rate of interest collected failed to report the average size of loans made.

Although figures for both these items are given in reports for Michigan in 1931, and for Wisconsin in 1930, these states have also been excluded from Table 33. The Michigan report[1] gives the

[1] Summary of Annual Reports of Personal Finance Companies in Michigan, Haskins and Sells, Detroit, 1931 (multigraphed).

TABLE 33.—AVERAGE SIZE OF LOANS MADE AND AVERAGE RATE OF INTEREST COLLECTED BY SMALL LOAN LICENSEES IN CERTAIN STATES DURING 1929, 1930, OR 1931

State	Year	Average loan	Average rate of interest collected: per cent a month
New Jersey[b]	1931	$240	1.45[a]
Pennsylvania[c]	1930	160[a]	2.61
Ohio	1931	158	2.72
Massachusetts[d]	1931	150	2.75[a]
Illinois	1931	149	2.78
Rhode Island	1931	144	2.84[a]
Iowa	1931	131[a]	2.99
Indiana[e]	1929	128[a]	3.02[a]
Virginia	1930	117	3.10[a]
Louisiana[f]	1930	115[a]	3.22

[a] Estimated from incomplete data. Averages not so marked are reported in official summaries of annual reports of licensees.

[b] The relationship of the size of loans to the average rate of interest collected in New Jersey is an abnormal one. Following the reduction in the maximum interest rate, which became effective February 15, 1930, licensees increased the size of their loans in order to adjust their expenses to a lower income. The low earning rates in New Jersey demonstrate that this adjustment was not and probably could not be completed because of the limit to the size of loans.

[c] The considerably lower rate of interest collected with only a slightly higher average loan in Pennsylvania is probably due to the lower costs of endorsed note lenders. Lacking both credit union and industrial banking enabling acts in 1930, a great many endorsed note lenders have been licensed under the small loan act. Almost a third of the outstanding volume of loans made by Pennsylvania licensees are secured by endorsements, whereas in the other states included in the table, endorsed note lending forms but a small portion of the total volume.

[d] Morris Plan and chartered companies excluded.

[e] The only available report for Indiana is for 1929. It is probable that for 1931 the average loan would be somewhat higher and the average charge somewhat less, owing to the progress of competitive rate reductions in that state since 1929.

[f] Licensees charging less than 3½ per cent excluded.

average loan made and the average rate of interest collected for different numbers of licensees. The average loan made by 98 licensees was $168.54. The average rate of interest collected by 80 licensees was 2.57 per cent. The Wisconsin report[1] gives the average original amount of loans outstanding on a given date, whereas the average loan for other states is based on loans made during the year. Since smaller loans are usually repaid in a shorter time than larger ones, the Wisconsin figure is not comparable with those for other states. The reported average original loan in Wisconsin was $164.58 and the average rate of interest collected was 2.65 per cent.

Unfortunately, detailed classifications of loans by size are not generally available. It would be valuable to know the proportion

[1] Annual Report of Wisconsin Commissioner of Banking for 1930.

of loans in small denominations that are made in "3" and "3½ per cent" states. Many states are including a classification of loans by size in their annual report forms for 1934, and this information when available will be exceedingly useful in distinguishing between the kind of loans made at various rates.

Kinds of Security for Loans in States with 3 and 3½ Per Cent Maximum Rates

Another indication of the difference in the kind of loans made under maximum rates of 3 and 3½ per cent a month is found in the kind of security required by licensees for loans. Wage assignments and plain notes are the form of security least desired by the lenders and they tend to be accepted only when the rate is high enough to compensate for the larger risk they involve. Table 34 offers some suggestion that there may be less use of these forms of security in states with a 3 per cent a month maximum than in states with the higher rate.

TABLE 34.—PER CENT OF TOTAL LOANS SECURED BY WAGE ASSIGNMENTS, PLAIN NOTES, AND OTHER SECURITY IN CERTAIN INDUSTRIAL STATES AT THE CLOSE OF 1931[a]

State	Maximum rate of interest: per cent a month	Wage assignments	Plain notes	Other security, including chattels and endorsed notes	Total
Massachusetts	3	0.0	0.8	99.2	100
Ohio	3[b]	0.3	0.7	99.0	100
Illinois	3½	5.6	9.3	85.1	100
Rhode Island	3½	1.9	21.7	76.4	100

[a] The Massachusetts figures are estimates based upon a division of licensees by kind of security customarily taken, given to the authors by the Massachusetts supervisor of loan agencies. The loans of two licensees in Massachusetts who specialize in loans to school teachers were not considered to be plain note loans because of the differences between the clientele of these lenders and those of other licensees lending on plain notes, and are therefore included under "other security."

The Ohio figures are taken from an analysis of reports for the year 1931 of personal finance companies in Ohio made by Haskins and Sells. Since this report excludes a large number of licensees who lend on endorsed notes, the proportion of loans secured by wage assignments and plain notes is in fact exaggerated somewhat.

The Illinois figures are taken from an analysis of reports filed by personal finance companies for the year 1931 issued by the Illinois Department of Trade and Commerce.

The Rhode Island figures are from an analysis of reports for the year 1931 of Rhode Island licensees made by Haskins and Sells.

[b] In Ohio a fee of $1.00 on loans of $50 or less is permitted in addition to the maximum interest rate.

These figures, again, cannot be taken at their face value. There are, for instance, differences in the legal status of wage assignments among these states. Because 50 per cent of the current wage may be taken by the assignee in case of default in Illinois, wage assignments are a more desirable security in that state than in other states. In Massachusetts, on the other hand, wage assignments are very unsatisfactory security because the employer must be notified of the assignment in order to make the instrument valid. While these legal differences partially explain variations in the extent of use of wage assignments, they do not explain the almost complete reliance upon preferred types of security in the two "3 per cent" states. We believe that the principal cause of the unpopularity of loans secured by wage assignments and plain notes among licensees in states having 3 per cent maximum rates is that loans that can be conveniently secured by these instruments are usually of small denominations, which cannot be made profitably at the lower rate. By avoiding the small loan, the lender also avoids the use of these securities.

In the foregoing discussion, we have attempted to bring to light some of the differences in lending in states allowing maximum interest rates of 3 per cent and 3½ per cent a month. Under a 3 per cent a month maximum, the average loan tends to be higher than under a 3½ per cent maximum. But in highly industrial states, the average rate actually charged under a 3½ per cent maximum tends to approximate the average rate charged under a 3 per cent maximum. Under a maximum rate of 3 per cent a month, wage assignment and plain-note loans appear to be practically eliminated, while under a maximum rate of 3½ per cent a month, many such loans are made. The implications are that very small chattel loans tend to be eliminated at 3 per cent a month but are made at 3½ per cent a month.

There are other evidences of increased selectivity on the part of lenders under the lower maximum rate. Losses, for instance, have been less in "3 per cent" states than in "3½ per cent" states.[1] The few studies which have been made of the distribution of borrowers by amount of income suggest that lower rates than 3½ per cent a month lead to additional selectivity in regard to borrowers' in-

[1] See p. 198.

comes. Differences in classifications make it impossible to compare the results of these studies, but the implication is clear that incomes are higher among borrowers at lower rates of interest.[1]

The Choice of a Maximum Rate

From the foregoing examination of the conditions which result from various maximum interest rates, it seems possible to postulate a theory for rate-making purposes: The range of rates which attract commercial capital to the business of lending money in sums of $300 or less begins with approximately 2½ per cent a month. As the maximum rate is increased beyond this point, lower strata of borrowers to whom loans cannot be made profitably at a lower maximum become eligible for loans from the licensed lender, and competition for the higher strata of borrowers tends to decrease the rate of charge for larger or better secured loans. Thus, within the range from 2½ to 3½ per cent a month, earning rates of licensees in each state tend toward a common level for the same year regardless of the maximum interest rate.

Although the available facts seem to support this theory, it must be regarded as tentative. The material upon which we have had to rely in making comparisons is far from satisfactory. If this theory be true today, it will not necessarily be true tomorrow. It should be checked continually as new facts become available. For the present, at least, this theory suggests that the determination of the most satisfactory rate is a social rather than an accounting problem. Are marginal borrowers who would receive loans at a higher rate but who would be refused at a lower rate better or worse off by being able to borrow? If applicants are refused by licensed lenders because such loans are unprofitable at the existing maximum rate, will these borrowers be forced to borrow from unlicensed lenders at much higher rates?

The answers to these questions are to be found in schedules of liabilities of wage-earner bankrupts in the federal courts, in the records of relief agencies, in the extent and persistence of illegal lending in the denominations refused by licensed lenders, and in the

[1] Historical and Statistical Report for the Year 1931, Household Finance Corporation, Chicago, p. 7; King, Willford I., The Small Loan Situation in New Jersey in 1929, p. 41; Neifeld, M. R., The Personal Finance Business, p. 201.

unrecorded history of family and neighborhood groups which assist in the financial crises of their individual members.

However adequate the study of these materials, definite factual conclusions will probably not be forthcoming. The answers must be relative, and within reasonable limits policy must be determined by opinion. It is probable also that the most socially satisfactory rate will vary from state to state. It is possible, for instance, that a maximum rate of 2½ per cent will be found to be satisfactory in New Jersey, while in Missouri the same maximum appears unlikely to bring satisfactory lending conditions. In the New England states a 3 per cent maximum appears to be satisfactory, while in southern states, where the principal demand is for loans of small denominations, a maximum rate even of 3½ per cent a month appears to induce outlaw lending by excluding many borrowers from the clientele of licensed lenders.

The most satisfactory rate probably varies also from year to year in the same state. In general, the maximum rate necessary to encourage the accumulation of capital for the small loan business is higher than the maximum necessary to maintain the business once established. Lower maximum rates would probably have been effective in many states in 1928 and 1929 when losses and delinquencies were low, and ineffective in 1931, 1932, and 1933 when losses and delinquencies were high.

Possible Usefulness of Graduated Rates

Although the tendency of certain licensees to specialize in loans of larger denominations at lower interest rates is unmistakable in states which permit a maximum rate of 3½ per cent a month, it cannot be contended that all applicants who receive loans at 2½ per cent a month where this rate is fixed as the maximum would be able to borrow at 2½ per cent a month if 3½ per cent were the maximum rate. Effective competition in interest rates is confined principally to the larger communities where there are several aggressive licensed lenders, and to a considerable extent borrowers of larger sums pay part of the cost of lending to borrowers of smaller and therefore less profitable sums.

The widespread use of cost accounting methods by small loan licensees in recent years has fully demonstrated to the small loan business the relation of the size of loans to profits. There has been an increasing tendency of licensees to avoid smaller loans and frequently to lend larger sums than the borrower is able to repay without hardship. As a result most cases of unsound lending involve loans of larger denominations. In order to offset this tendency and to apportion charges more equitably among borrowers of large and small sums, it would seem proper to fix maximum rates on a sliding scale varying with the size of the loan. There are several regulatory devices whereby this may be accomplished.

One is the "step" rate, so called because the maximum rate is decreased in steps as the loan increases in size. Thus the regulation of maximum rates might permit a charge of 3½ per cent a month on loans of $100 or less, a charge of 3 per cent a month on loans of more than $100 but not exceeding $200, and a charge of 2½ per cent a month on loans of more than $200 but not exceeding $300. A second device is known as the "combination" rate because it combines an initial or periodic fee fixed in dollars with a maximum rate on outstanding balances fixed in per cent. Since the most practical cost accounting formulae used in the small loan business allocate various expense items either to costs which vary with the number of loans or to costs which vary with the number of dollars lent, the combination rate can be made to conform closely to these cost accounting formulae. A third device is known as the "aggregate" rate because it combines two or more interest rates in the regulation of charges. A higher maximum is allowed on that part of any loan not in excess of a certain sum, and a lower rate of charge is allowed on that part in excess of this sum. Thus, the regulation of charges might permit 3½ per cent a month on the first $100 of a loan and 2½ per cent a month on the portion of the loan in excess of $100.

The principal defect of the "step" rate is that it results in absurd differences in charges near the dividing points. For instance, in the example cited, it would be possible to borrow $115 more cheaply than $100 for the same period of time. The "step" rate increases the temptation for licensees to lend in the most profitable denominations regardless of the amount which the applicant needs. Under such a regulation of maximum rates, one might expect the great majority of loans to be in maximum denominations to which each rate applied, i. e., $100, $200, and $300.

The combination rate avoids this difficulty and results in a smooth progression from a higher to a lower rate as the loan increases in size. It assumes, however, the availability of an accurate and generally applicable cost accounting formula. Even if a standard formula could be found, rate fixing on a cost accounting basis would be difficult. If all overhead items properly chargeable to individual loans are allocated equally to each loan, expense ratios for very small loans become exceedingly high. It seems unlikely that legislatures or rate-fixing commissions would be willing to permit these rates on small denominations, and it is probably socially undesirable that they should do so.

As in retail merchandising, it is difficult to determine the actual point of division between profit and loss on single items. For instance, it would probably be impossible to conduct a profitable retail business in matches and yeast cakes alone at the price currently charged for these articles. Selling costs would probably far exceed the grocer's mark-up, if overhead costs were allocated equitably to these single transactions. Yet these items are generally considered to be profitable when combined with other kinds of merchandise in the grocery business. Similarly, in the small loan business it is possible to make loans of small denominations profitably in conjunction with larger loans at a considerably lower rate than that necessary to a business which was confined to loans of low denominations. If, however, loans of very small denominations are not to bear their proportionate share of overhead expense, larger loans must be allowed to bear more than their share of overhead expense.

At best, cost accounting formulae result in arbitrary approximations. The strict application of a standard formula for rate-fixing purposes would imply a similarity of security for loans, a similarity of lending conditions in various communities, and a similarity of operating policies among various licensees, which do not exist at present and are unlikely to develop in the future. Highly accurate measurements, distinctions between communities and kinds of security, and continued readjustment to changes in the conditions governing costs of lending would undoubtedly be necessary. If rates determined upon were too low, loans would not be made. If they were too high, there would be little likelihood of competition in rate since lower charges would lead to a revision of the schedule. The possibility of error in rate-fixing or delay in revising the formula to new conditions would increase the risks to capital and would perhaps further increase the rate of return necessary to attract investment in the small loan business.

The third device, the "aggregate" rate, appears for the present at least to be the most satisfactory method of fixing a maximum rate varying with the size of loans. It represents a compromise between the "combination" rate and the flat maximum rate applying to all loans of $300 or less. By allowing a given rate to be charged upon the portion of a loan less than a certain amount (for instance, $100, $125, or $150) and a lower rate on the portion in excess of this amount, the combined rate of charge on loans exceeding the sum at which the higher rate becomes effective is decreased regularly as the loan increases in size.

Although cost accounting analyses are necessary to a proper choice of an aggregate rate, it is probably undesirable to attempt to make the scale of rates chargeable on larger balances conform strictly to a cost accounting formula. The scale of charges on larger loans should be designed to make these loans less attractive to the lender, and to relieve the interest burden of borrowers of larger sums, but these loans should probably continue to bear somewhat more than their proportionate share of overhead expenses. Considering lending conditions during the loan-shark era and in unregulated states at the present time, we seriously question the wisdom of providing the lender with an incentive to lend only in sums of $5.00, $10, or even $25.[1] Competitive forces should be relied upon to compel reductions in rate for the more profitable loans and in communities where lending costs are low.

Six states have adopted "aggregate" maximum rates. In 1932 New York fixed the maximum interest rate for small loans at 3 per cent a month on balances of $150 or less and 2½ per cent on that part of a loan in excess of $150. In 1933 West Virginia fixed the maximum at 3½ per cent a month on the first $150 of any loan and 2½ per cent on the balance. In the same year Indiana

[1] See pp. 174–175.

and Wisconsin established aggregate rates by law pending determination of rates by rate-fixing commissions. In March, 1934, Kentucky enacted the Fifth Draft of the Uniform Small Loan Law with a maximum interest rate provision identical with that of West Virginia; and in the same month Iowa, in a revision of its earlier small loan law, fixed the maximum rate at 3 per cent a month on the first $150 and 2½ per cent on balances in excess of this sum.

Experience with these "aggregate" rates is too short to permit evaluation of results. They are, however, exceedingly interesting and worthwhile experiments, and it is possible that the aggregate rate will prove to be a more effective method of regulating maximum rates than a flat maximum. The principal drawback to this method of rate control is the temptation of the lender to "split" loans in order to secure a higher total income. In the past, where higher charges have been allowed on small loans, it has been difficult to prevent some lenders from making small loans to several members of a single family in order to secure a higher rate of return on the total amount lent. The aggregate rates in effect at the present time, however, result in but moderate reductions of income on larger balances, and are incorporated in recent drafts of the Uniform Law which provide state supervisors with highly discretionary powers for granting and revoking licenses. There is no evidence at present of any tendency to split loans. If, however, aggregate rates should be fixed to conform more closely to a cost accounting formula, the effectiveness of such a rate control would probably be contingent upon a grant of wide discretionary powers to the supervising officer.

Although the history of events in the small loan field for purposes of this volume closed with December 1, 1934, it seems desirable to record here one subsequent event of importance to the foregoing discussion. In January, 1935, after completing studies of expenses and profits in the small loan business and after examining the results of the several experiments with graduated rates, the Department of Remedial Loans of the Russell Sage Foundation issued a Sixth Draft of the Uniform Small Loan Law. In this latest draft the Department recommended as an initial maximum a rate of

3½ per cent a month on that part of any loan not in excess of $100 and 2½ per cent a month on that part in excess of $100.

The Department further recommended that the initial maximum rate be reconsidered by each state after a reasonable period of experience with it. Concerning the determination of maximum rates thereafter, the Department said:

> From the experience with various maximum rates in many states, it is clear that it is no longer possible to make generalizations with reference to an adequate maximum rate for all states. The distribution of population, the character and stability of the industries in urban areas, costs of lending revealed by reports of licensees, local legislation and tradition affecting the forms of security available to licensees, the extent of unlicensed lending, the size of loans in which it occurs, and many other factors should be considered in revising the maximum rate in any state. . . .
>
> It seems probable that reductions below the initial maximum recommended here would be found to be generally possible in the northern industrial states, while reductions below the initial rate would probably prove to be generally undesirable in southern and western states where urban areas are distant from each other and the existing demand is for relatively small loans.[1]

[1] Sixth Draft of the Uniform Small Loan Law as Revised January 1, 1935, and Citations of Small Loan Statutes, Russell Sage Foundation, New York, 1935.

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