The New Usury: The Ability-to-Repay Revolution in Consumer Finance

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Abstract

American consumer credit regulation is in the midst of a doctrinal revolution. Usury laws, for centuries the mainstay of consumer credit regulation, have been repealed, preempted, or otherwise undermined. At the same time, changes in the structure of the consumer credit marketplace have weakened the traditional alignment of lender and borrower interests. As a result, lenders cannot be relied upon to avoid making excessively risky loans out of their own self-interest.

Two new doctrinal approaches have emerged piecemeal to fill the regulatory gap created by the erosion of usury laws and lenders' self-interested restraint: a revived unconscionability doctrine and ability-to-repay requirements. Some courts have held loan contracts unconscionable based on excessive price terms, even if the loan does not violate the applicable usury law. Separately, for many types of credit products, lenders are now required to evaluate the borrower's repayment capacity and to lend only within such capacity. The nature of these ability-to-repay requirements varies considerably, however, by product and jurisdiction. This Article terms these doctrinal developments collectively as the "New Usury."

The New Usury represents a shift from traditional usury law's bright-line rules to fuzzier standards like unconscionability and ability-to-repay. Although there are benefits to this approach, it has developed in a fragmented and haphazard manner. Drawing on the lessons from the New Usury, this Article calls for a more comprehensive and coherent approach to consumer credit price regulation through a federal ability-to-repay requirement for all consumer credit products coupled with product-specific regulatory safe harbors, a combination that offers the best balance of functional consumer protection and business certainty.

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Introduction

American consumer credit regulation is in the midst of a doctrinal revolution. Since time immemorial, price regulation has been the primary mode of consumer credit regulation, protecting borrowers, lenders, and society from the adverse effects of unaffordable credit. Historically, such regulation was in the form of usury laws that cap the permitted interest rate on loans. Since the late 1970s, however, usury laws in the United States have been repealed, preempted, or otherwise undermined, such that they apply to only a limited set of consumer financial products and institutions.

Traditionally, usury laws were buttressed by a market alignment of borrower and lender interests that constrained excessively risky extensions of credit. In the traditional lending world, a lender made a

loan directly to a borrower and held the loan on its books, hoping that the loan would be paid off according to its terms. In this arrangement, lenders succeeded only when borrowers succeeded, so their interests were substantially aligned: lenders would not saddle borrowers with unmanageable obligations because a default on the loan would harm them as well. Lender self-interest limited excessive price terms—and the accompanying risk of borrower default.

At the same time that usury laws were being eroded through deregulation, the structure of consumer credit markets also began to change. The advent of securitization as a technique for financing consumer loans separated the decision to lend from the subsequent exposure to the risk to the loan.[1] Principal-agent conflicts between lenders and their misincentivized employees or agents encouraged riskier lending.[2] And some lenders adopted a "sweatbox" lending model that treats the principal of a loan as a loss leader for the recovery of high fees and interest that more than offset any unrepaid principal.[3]

As a result of these developments, the assumption of an alignment of borrower and lender interests no longer holds true in many consumer credit markets. The self-interest of the party making the lending decision can no longer be relied upon to limit the risk assumed by the borrower.

The relaxation of usury laws and the reduction in alignment of borrower and lender interests began in the late 1970s. It occurred precisely at a time when many American families were coming under additional financial stress due to stagnating wages and rapidly rising costs of housing, transportation, education, and health care.[4] Many households turned to credit to bridge the gap.[5] These households faced credit markets unconstrained by regulation or lender self-interest. The result was a predictable growth in riskier and costlier lending and the inevitable negative consequences from increased levels of consumer default.

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1 *See* Adam J. Levitin, *Rent-a-Bank: Bank Partnerships and the Evasion of Usury Laws*, 71 Duke L. J. 329, 353–56 (2021).

2 *See* 78 Fed. Reg. 11280 (Feb. 15, 2013) (noting how mortgage industry "compensation was frequently structured to give loan originators strong incentives to steer consumers into more expensive loans").

3 *See* Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 Ill. L. Rev. 375, 385–87 (describing credit card lenders' profitability increasing upon borrower delinquency); Final Statement of Decision after Court Trial at 25–26, de la Torre v. CashCall, Inc., No. 19CIV01235 (Cal. Sup. Ct. Aug. 21, 2023) (describing how CashCall did not need a borrower to pay a loan to maturity for the loan to be profitable); Complaint ¶¶ 8, 43–45, CFPB v. Credit Acceptance Corp., No. 23 Civ 0038 (S.D.N.Y. Jan. 4, 2023) (alleging defendant is profitable even with only collections of sixty-six cents on the dollar because it purchases loans at such a steep discount).

4 *See generally* Elizabeth Warren & Amelia Warren Tyagi, The Two-Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke (2003).

5 *See id.* at 5–7.

Law abhors a vacuum, and a set of doctrinal moves have emerged piecemeal over the last quarter century in the United States to fill the gap created by the erosion of usury laws and the traditional lender-borrower partnership. This Article refers to these doctrinal developments collectively as the "New Usury."[6]

This doctrinal shift has never previously been noted in the scholarly literature, in part because the New Usury coexists with what remains of the traditional old usury laws, but also because the New Usury is a set of reactive and uncoordinated doctrinal moves rather than a systemic, coherent vision of consumer credit regulation.[7] Nonetheless, as this Article explains, there is an undeniable logic undergirding the New Usury, a logic that when fleshed out can provide a comprehensive and cohesive regulatory approach.

The two primary doctrinal developments that make up the New Usury are: (1) a revived substantive unconscionability doctrine that holds high-cost loans substantively unconscionable, irrespective of compliance with usury laws, and (2) ability-to-repay requirements that require lenders to evaluate borrowers' payment capacity and only lend within it.

Unconscionability has historically played only a limited role in regulating the price terms of consumer credit, other than for retail installment sales.[8] Retail installment sales have long been exempt from general usury laws in most states,[9] which left courts with few tools for policing overreaching creditor behavior other than unconscionability.

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6 Other jurisdictions have also moved to adopt ability-to-repay requirements. *See, e.g.*, Directive 2008/48/EC, art. 8, 2008 O.J. (L 133) 76; Directive 2014/17/EU, art. 18(5)(a) & ¶ 55, 2014 O.J. (L 60) 43, 58; *National Consumer Credit Protection Act 2009* ch 3 pt 3-2 div 3 s 128 (Austl.) (obligation to assess unsuitability as part of responsible lending conduct); Credit Contracts and Consumer Finance Act 2003, s 9C(3)(a) (N.Z.) (Lender must "make reasonable inquiries, before entering into the agreement . . . so as to be satisfied that it is likely that . . . the borrower will make the payments under the agreement without suffering substantial hardship"); Consumer Credit Act of 1974, § 55B (later repealed by The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013, S.I. 2013/1881, arts. 1(2)(6), 20(22)) (UK); *see also* John Pottow, *Ability to Pay*, 8 Berkeley Bus. L.J. 175, 189–93 (2011) (citing various foreign suitability and ability to pay requirements).

7 The one partial exception is Pottow, *supra* note 6, at 189–93, who recognized the wealth of foreign cognates to some type of ability-to-repay requirement.

8 The classic unconscionability cases of *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 447–49 (D.C. Cir. 1965), and *Jones v. Star Credit Corp.*, 298 N.Y.S.2d 264, 265–66 (Sup. Ct. 1969) both involved retail installment sales contracts.

9 Under the much-criticized time-price doctrine, endorsed as a matter of federal common law by the Supreme Court in *Hogg v. Ruffner*, 66 U.S. (1 Black) 115, 118–19 (1861), an installment sale is not considered a loan and therefore is not subject to usury laws. *See* William D. Warren, *Regulation of Finance Charges in Retail Instalment Sales*, 68 Yale L.J. 839, 840–41 (1959); Raoul Berger, *Usury in Instalment Sales*, 2 L. & Contemp. Probs. 148, 148 (1935). The post-1938 status of federal common law decisions is unclear. Some states do have usury caps specific to retail installment sales. *See, e.g.*, Fla. Stat. § 520.34(6)(a) (2023).

Recently, however, some state courts—including two state supreme courts—have revitalized the doctrine in consumer credit transactions, holding that a high price term alone—even if not usurious—can still render a loan unconscionable.[10]

Meanwhile, ability-to-repay requirements have emerged in many consumer credit markets. The details of these requirements vary considerably, but they all require the lender to verify that the borrower has the capacity to repay the obligation or at least not ignore evidence of lack of such capacity. There are now federal ability-to-repay requirements for mortgage loans[11] and credit cards.[12] Some states have adopted their own ability-to-repay requirements for all mortgages,[13] some for auto loans,[14] and some for payday loans and other small dollar loans.[15] Others have ability-to-repay requirements, but only for high-cost mortgages.[16] There was also a now-repealed federal ability-to-repay requirement for payday and vehicle title loans.[17] Additionally, federal student loans have an income-driven repayment option that operates like a backend ability-to-pay provision.[18]

These ability-to-repay requirements have been developed haphazardly and without consistency in their substance or source. Ability-to-repay developed on a product-by-product basis and on a

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10 *See infra* Part III.

11 15 U.S.C. § 1639c(a)(1); 12 C.F.R. § 1026.43(d)(4).

12 15 U.S.C. § 1665e; 12 C.F.R. § 1026.51.

13 *See, e.g.*, Commonwealth v. Fremont Inv. & Loan, 897 N.E.2d 548, 560 (Mass. 2008) (ability-to-repay requirement under state unfair trade practices act); Md. Code Ann., Com. Law § 12-127 (West 2009); Minn. Stat. § 58.13(a)(24) (2022); N.M. Stat. Ann. § 58-21A-4(C) (2023); Ohio Rev. Code Ann. § 1345.031(B)(2), (14) (West 2017); Wash. Admin. Code § 208-620-506 (2022).

14 *See infra* Part III. Auto loan ability-to-repay requirements exist solely through state litigation settlements and complaints contending that failure to consider ability-to-repay violates the prohibition on unfair, deceptive, or abusive acts or practices. *See* 12 U.S.C. §§ 5531, 5536 (2018).

15 S*ee, e.g.*, Nev. Rev. Stat. § 604A.5011 (2022); Ohio Rev. Code Ann. § 1345.03(B)(4) (West 2017) (prohibiting loans where lender knows that consumer does not have a reasonable probability of repayment, but not imposing a duty of investigation on the lender).

16 *See, e.g.*, Conn. Gen. Stat. § 36a-760b (2023); 815 Ill. Comp. Stat. 137/15 (2004); N.C. Gen. Stat. § 24-1.1E(c) (2022); N.Y. Banking L. § 6-L(k) (2023); Wis. Stat. § 428.203(6) (2010).

17 Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54472, 54874 (Nov. 17, 2017) (promulgating an ability-to-repay requirement to be codified at 12 C.F.R. pt. 1041.5), *repealed by* 85 Fed. Reg. 44382, 44444 (July 22, 2020).

18 John R. Brooks & Adam J. Levitin, *Redesigning Education Finance: How Student Loans Outgrew the "Debt" Paradigm*, 109 Geo. L.J. 5, 11, 36, 73 (2020). Separately, a number of scholars have proposed back-end ability-to-repay requirements. *See* Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 Me. L. Rev. 1, 17–18 (1975) (proposing private civil liability for lending without reasonable determination of repayment capacity); John A.E. Pottow, *Private Liability for Reckless Consumer Lending*, 2007 Ill. L. Rev. 405, 408 (extending theoretical arguments for Countryman's proposal); Abigail Faust, *Regulating Excessive Credit*, 2023 Wisc. L. Rev. 753, 758 (proposing using bankruptcy claims disallowance to operate as an ex-post check on lending without verification of ability to repay).

state-by-state or sometimes federal level. The requirements vary considerably and stem from statutes, regulations, consent orders, judicial opinions, and even from regulatory complaints that establish when regulators are likely to bring suit in the future. As a result, ability-to-repay exists as a fragmentary and nonstandardized doctrinal concept.

Nor are usury laws totally dead. While *state* usury laws have been substantially eroded, they still bind for some nonbank products.[19] Moreover, the federal government has enacted a usury statute for military members and their dependents,[20] and, in recent years, several states have tightened or expanded their usury laws.[21]

What we see, then, are three distinct approaches for addressing the problem of excessively risky consumer credit transactions: (1) usury, (2) unconscionability, and (3) ability-to-repay. These three approaches fall neatly on the rules-versus-standards spectrum, with usury laws being a classic bright-line rule (e.g., no loans above 36% annual percentage rate ("APR")), unconscionability being a classic fuzzy standard (e.g., "shocks the conscience"), and ability-to-repay requirements, which are often accompanied by safe harbors, occupying a middle ground with some features of both rules and standards.

This Article explores the trade-offs among these three regulatory approaches. At first glance, the trade-offs would appear to track the well-trodden path of the rules-versus-standards debate. Bright-line usury rules have the benefits of certainty, clarity, and administrability, while unconscionability standards benefit from flexibility and discretion.[22] Ability-to-repay is narrowly a standard—there is some subjectivity to the analysis—but statutory ability-to-repay requirements are often

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19 *See* Faust, *supra* note 18, at 763 (describing state regulation of consumer finance transactions).

20 Military Lending Act, Pub. L. No. 109-364, § 670, 120 Stat. 2083, 2266–69 (2006) (codified at 10 U.S.C. § 987).

21 *See, e.g.*, Assemb. B. 539, 2019 Gen. Assemb., Reg. Sess. (Cal. 2019) (codified at Cal. Fin. Code §§ 22303, 22304.5) (cap of 36% over the Federal Funds Rate between $2,500 and $10,000); Proposition 111 (Colo. 2018) (codified at Colo. Rev. Stat. § 5-3.1-105) (36% APR cap for payday loans); S.B. 1792, 101st Gen. Assemb., Reg. Sess. (Ill. 2020) (codified at 815 Ill. Comp. Stat. 123/15-5-5 (2021)) (36% APR cap on all nonbank loans, calculated with military APR); S.B. 2103, 66th Leg. Assemb., Reg. Sess. (N.D. 2020) (codified at N.D. Cent. Code § 13-04.1-09.3) (36% APR cap on all nonbank loans); H.B. 132, 2022 Leg., Reg. Sess. (N.M. 2022) (codified at N.M. Stat. Ann. § 58-7-7) (36% APR cap on installment loans); Ohio Payday Lender Int. Rate Cap, Referendum 5 (2008) (28% rate cap on payday loans, but frequently evaded); H.B. 123, 132nd Gen. Assemb., Reg. Sess. (Ohio 2018) (codified at Ohio Rev. Code Ann. § 1321.40) (28% APR cap on payday loans, but with other fees permitted); S.B. 421/H.B. 789, 2020 Gen. Assemb., Reg. Sess. (Va. 2020) (codified at Va. Code Ann. § 6.2-1520(a)) (36% APR cap for installment loans); Va. Code Ann. § 6.2-1817 (36% APR cap for payday loans); Va. Code Ann. §§ 6.2-2216, 6.2-2216.4 (36% APR cap for vehicle title loans and limiting total fees and charges on vehicle title loans to 50% or 60% of loan amount, depending on loan size).

22 *See infra* Section IV.A.

accompanied by bright-line prohibitions on certain loan features other than interest rates and by safe harbors for loans with certain other features.[23] Ability-to-repay thus offers a standards-plus-rules combination that offers ex ante certainty to risk-averse parties through rule-based safe harbors.[24] At the same time, it allows risk-preferring parties to venture beyond the safe harbors, even as bright-line prohibitions on loan features protect against certain types of definitively undesirable behavior.[25]

Yet the choice here is not simply between a rule or a standard. Instead, the scope and nature of the inquiry are fundamentally different for usury laws, unconscionability, and ability-to-repay. Usury laws look to the terms of the loan, irrespective of the borrower's situation, the availability of market alternatives, or the broader interactions between the borrower and the lender.[26] In contrast, unconscionability looks at the totality of the transaction.[27] Thus, a lender's market power, its communications with a borrower, or the borrower's financial situation are irrelevant for usury but potentially quite important for unconscionability.

Ability-to-repay involves an intermediate inquiry that looks at the borrower's financial condition and the terms of the loan but not at the borrower's broader situation, the bargaining power between lender and borrower, or the course of dealing between the parties.[28] The lender's market power and communications with the borrower are not relevant for ability-to-repay, but the borrower's financial situation is.

This narrower scope makes ability-to-repay an easier question to evaluate, both ex ante and ex post, than unconscionability because it eliminates the need to resolve factual questions about market power or communications. Instead, there is only the more limited factual question of whether the lender undertook the required ability-to-repay evaluation and heeded it. Relative to unconscionability, ability-to-repay's intermediary inquiry makes it more administrable for courts and businesses' compliance personnel while still addressing the true policy concern animating consumer credit cost regulation—that consumers will find themselves caught in unduly burdensome obligations.

Most importantly, the choice between a rule and a standard is not merely a question of trade-offs between efficiency, predictability, and flexibility, such as the rules-versus-standards literature has emphasized. Instead, this Article argues that, in the economic and procedural context

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23 *See infra* Section IV.B.

24 *See infra* Section IV.C.

25 *See infra* Section IV.C.

26 *See, e.g.*, sources cited *supra* note 21 (providing examples of state usury laws).

27 *See infra* Section II.A.

28 *See infra* Section III.A.

of consumer finance litigation, which is usually regulatory enforcement, *the choice between a rule and a standard is often outcome determinative*. To that end, the theoretical tradeoffs among efficiency, predictability, and flexibility are of secondary concern. Rather, concerns regarding the exercise of regulators' discretion become paramount.

Consumer finance disputes involve relatively small amounts in controversy.[29] As a result, consumer finance regulations are generally enforced through governmental action rather than through private litigation.[30] Because regulators are able to credibly threaten to impose substantial penalties and reputational costs on businesses, defendants in regulatory enforcement actions are incentivized to settle even when they might have meritorious disputes. This dynamic makes it important to ensure that there are adequate checks on the exercise of regulatory discretion.

A rules-based system constrains regulatory discretion, but it is too often gameable by well-counseled businesses, resulting in underenforcement.[31] Conversely, a standards-based system may give regulators too much unchecked discretion, raising the possibility of overzealous enforcement that will chill lawful and socially beneficial behavior.[32]

It is possible, however, to combine the strengths of a rule with those of a standard by coupling an ability-to-repay requirement with regulatory safe harbors.[33] Unlike usury laws, ability-to-repay is capable of considering a broader variety of factors than merely price term, yet when it is coupled by safe harbors, ability-to-repay can produce greater ex ante certainty for businesses than unconscionability. The bright-line safe harbors provide shelter against regulatory overreach while ensuring that regulators still have the flexibility to bring cases when appropriate against lenders that are more aggressive and venture outside of the safe harbors.

Thus, in place of the New Usury's disjointed doctrinal grab bag approach, this Article suggests a more deliberate, considered tack,

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29 Richard Cordray, *Prepared Remarks of CFPB Director Richard Cordray at the Arbitration Field Hearing*, CONSUMER FIN. PROT. BUREAU (Oct. 7, 2015), https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-arbitration-field-hearing-20151007/ [https://perma.cc/5Q7K-J5K2] ("Many violations of consumer financial law involve relatively small amounts of money for the individual victim.").

30 Jean Braucher, *Form and Substance in Consumer Financial Protection*, 7 BROOK. J. CORP. FIN. & COM. L. 107, 117 n.52 (2012) (citing William C. Whitford, *Structuring Consumer Protection Legislation to Maximize Effectiveness*, 1981 WIS. L. REV. 1018, 1022 (1981)) (discussing the "mostly symbolic effect of vague, admonitory legislation that depends on private rights of actions for enforcement").

31 *See infra* Part IV.

32 *See infra* Part IV.

33 *See infra* Part IV.

namely the adoption of a general federal ability-to-repay requirement coupled with product-specific regulatory safe harbors. An ability-to-repay requirement married with safe harbors would provide the optimal approach for consumer finance price regulation and should be the regulatory model going forward.

This Article contributes to the consumer finance regulation literature in three ways. First, it identifies a previously unremarked shift in regulatory approaches to consumer credit price regulation, namely the shift from usury rules to the New Usury. Second, this Article provides an analysis of the tradeoffs among the three approaches to price regulation that considers the interaction of the rules-standards debate with the realities of regulatory enforcement.[34] Third, it presents a coherent and comprehensive doctrinal vision for consumer credit pricing regulation through a general federal ability-to-repay requirement with product-specific regulatory safe harbors.

This Article proceeds as follows. Part I explains the "Old Usury"—traditional usury laws and the alignment of lender and borrower interests—and its unraveling through deregulation and changes in market structure. Part II turns to unconscionability, a venerable old contract law doctrine that has been reinvigorated by recent legal decisions holding that a high but non-usurious price term alone can render a contract unconscionable. Part III addresses ability-to-repay requirements, showing how they have developed from a law meant to address solely a specific type of predatory mortgage lending into a broader phenomenon. Part IV compares the approaches and argues that in the contemporary context of consumer credit, where excessive price terms are policed primarily by regulators rather than by private parties, an ability-to-repay approach is the preferable one. Accordingly, the Article concludes with a proposal for a national ability-to-repay standard.

I. The Old Usury: Usury Laws and the Lender-Borrower Partnership

A. *A Brief History of Usury Laws*

Usury prohibitions are the oldest form of commercial regulation, dating back at least to the Code of Hammurabi (circa 1750 B.C.E.),[35] and prohibitions against usury appear in virtually every religious

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[34] To be sure, there is another approach to price regulation, namely not regulating prices at all. This Article takes the decision to engage in price regulation as a given as it is a long-established feature of consumer credit markets.

[35] James M. Ackerman, *Interest Rates and Law: A History of Usury*, 1981 Ariz. St. L.J. 61, 66–67; *see also* Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 Pepp. L. Rev. 151, 151 (1988) ("Usury is society's oldest continuous form of commercial regulation.").

tradition.[36] The roots of contemporary American usury laws stem from the medieval Catholic prohibition on usury, but modern Anglo-American usury laws are fundamentally different from the historical religious usury laws.[37]

Usury was historically synonymous with charging interest, and usury laws prohibited lending at *any* rate of interest, at least to coreligionists.[38] The Catholic perspective was that usury was sinful.[39] Indeed, usury was once seen as so deplorable that Dante Alighieri relegated usurers to the seventh and worst circle of hell in the *Inferno*, along with murderers, suicides, blasphemers, and Sodomites.[40] Four centuries later, William Noy, the attorney general for James I of England, following a long Roman and Scholastic tradition, declared that "[u]surers are well ranked with murderers" because usury consumes the life of the borrower.[41]

Yet by the time of Noy's statement, English usury laws had already fundamentally departed from historical norms of absolute prohibitions.[42] In 1545, during the Great Debasement (of currency, not morals!), the elderly Henry VIII, freed from papal authority, legalized lending on interest of no more than 10%.[43] The inflationary pressure from the debasement of the currency necessitated legalizing interest to ensure

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36 *See, e.g.*, *Exodus* 22:25 ("ye shall not oppress him with usury"); *Leviticus* 25:36–37 ("Thou shalt take no usury of him"); *Deuteronomy* 23:19–21 ("Thou shalt not give to usury to thy brother"); *Ezekiel* 18:17; *Psalm* 15:5 ("He that giveth not his money unto usury, nor taketh reward against the innocent"); *Matthew* 25:27; *Luke* 19:22–23; *Al-Baqarah* 2:275–80; *Al-'Imran* 3:130; *Al-Nisa* 4:161; *Ar-Rum* 30:39. Other usury prescriptions are to be found in Vedic and Buddhist texts. *See generally*, R.S. Sharma, *Usury in Early Mediaeval India (A.D. 400–1200)*, 8 Compar. Stud. in Soc'y & Hist. 56 (1965) (describing early attitudes in India toward usury).

37 *See* Ackerman, *supra* note 35, at 62–63, 80 (describing the history of usury laws).

38 *Id.* at 82.

39 *See* Arthur Vermeersch, *Usury*, *in* Cath. Encyc. (1912), https://www.newadvent.org/cathen/15235c.htm [https://perma.cc/GA4N-8JKF].

40 Dante Alighieri, Divine Comedy - Inferno Canto XI, XVII (Josef Nygrin, ed., Henry Wadsworth Longfellow, trans., 2008).

41 Calvin Elliott, Usury: A Scriptural, Ethical and Economic View 263–64 (1902); *see also* Marcus Tullius Cicero, De Officiis Book II:89 (Walter Miller trans., Harvard University Press 1990) (relating a story in which Cato compared usury to murder: "'How about money-lending?' Cato replied: 'How about murder?'"); Norman Jones, *Usury*, EH.net, https://eh.net/encyclopedia/usury/ [https://perma.cc/ERE7-JAGL] ("St. Jerome declared usury to be the same as murder, echoing Cato and Seneca, since it consumed the life of the borrower.").

42 To be sure, although lending at interest was absolutely prohibited historically, what constituted "lending" was often a matter of some dispute and created ample opportunities for evasion of usury prohibitions. *See* Raymond de Roover, The Rise and Decline of the Medici Bank 10–14 (1966) ("In fact, there were innumerable ways of circumventing the usury prohibition . . . .").

43 37 Hen. 8 c. 9 (1545). A 1540 Hapsburg statute permitted interest on commercial loans of up to 12% in the Austrian Netherlands. *See* Recueil des Ordonnances des Pays-Bas 232–38 (J. Lameere & H. Simont, eds., 1907); *see also* John H. Munro, *The Coinages and Monetary Policies of Henry VIII (r. 1509–1547): Contrasts between Defensive and Aggressive Debasements* 7 (Univ. of Toronto Dep't of Econ., Working Paper No. 417, 2010), https://core.ac.uk/

credit availability.[44] Henry VIII's successors repealed the statute,[45] but it was reenacted by Elizabeth I,[46] with subsequent amendments merely changing the legal maximum rate.

Since Elizabeth I, Anglo-American usury laws have been a matter of price rather than principle. This is the situation in the United States today, where interest and fees are allowed, but are sometimes capped by statute at a specified percentage rate or a total dollar amount.[47]

B. *Functions of Usury Laws*

Usury laws aim to protect both borrowers and society from the effects of overindebtedness.[48] Risk is the backbone of capitalism, and all credit involves risk, but excessive risk, particularly in the case of individual borrowers, is something society discourages through usury laws.

If a borrower cannot repay a loan or has to reduce consumption to repay the loan, the borrower may incur serious hardship. The borrower protection function of usury laws is unabashedly paternalistic, but usury laws are not mere paternalism. Usury laws also protect society from the negative externalities of overindebtedness. A borrower may have dependents. The more assets the borrower is forced to divert to repaying a loan, the fewer are available for those dependents, who could even end up becoming public charges.[49] Moreover, an overindebted borrower may lose the incentive to engage in productive activities because the fruit of the borrower's labor—over and above whatever minimum level is protected by state law property exemptions and garnishment limitations—will go to his creditors. Overindebtedness can thus deprive society of productive workers.

Although usury laws are first and foremost borrower protections, they also have an element of lender protection in them in that higher-cost loans are, all else being equal, riskier. This is not only a matter of riskier and more credit-constrained borrowers being willing to take on higher-cost credit, but also reflects an endogeneity of risk—the higher the cost of credit, the harder it will be for any borrower to repay. Usury laws accordingly also protect lenders from incurring excessive risk.

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display/9307415?utm_source=pdf&utm_medium=banner&utm_campaign=pdf-decoration-v1 [https://perma.cc/3P44-DJ9D] (describing the historical context of the Great Debasement).

44 *See* Munro, *supra* note 43, at 10 (describing the effect of the Great Debasement, including reduced purchasing power).

45 5 & 6 Edw. 6 c. 20 (1551–1552).

46 13 Eliz. c. 8 (1571).

47 *See infra* Section I.D.

48 Ackerman, *supra* note 35, at 110.

49 *See* Eric A. Posner, *Contract Law in the Welfare State: A Defense of Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEG. STUD. 283, 292 (1995) (describing credit as a threat "to the state's ability to enforce the minimum welfare level").

Society has an interest in protecting lenders—or at least bank lenders—from incurring excessive risk. If lenders fail, then there can be a contraction of credit and thus of economic activity. If borrowers at time 1 fail to repay their lenders, it might be difficult for other borrowers to get credit at time 2. At the very least, excessive risk-taking will lead to a more volatile economy, which is harder for individuals with fewer resources to self-insure against. When lenders are depositories, the concern is greater because the failure of a depository can have a domino effect on depositors.

Usury laws protect against overindebtedness in two ways, one of which polices the procedure of bargaining, and the other of which polices the level of risk allowed in society because of concern regarding spillover effects. First, usury laws protect borrowers from the results of a grossly unequal bargaining process.[50] Usury laws create "an irrebuttable presumption that the conditions necessary for efficient Coasean bargaining could not have existed, if the interest rate in a contract is above the specified usury level."[51] Usury laws treat the high cost of credit as a proxy for an extreme imbalance of power between lender and borrower such that the bargain they struck cannot be described as falling within the universe of enforceable contracts. Instead, it indicates the existence of some flaw in the bargaining process.[52] Such an extreme imbalance of power between lender and borrower could stem from lack of borrower understanding about costs.[53] Alternatively, it could stem from lack of borrower choice, such as due to monopoly, high borrower search costs, the urgency of borrower's credit needs that preclude searching, or borrower unawareness of alternative credit options.[54]

Second, usury laws aim to protect borrowers and society from undue risk. The higher the cost of a loan, the more risk there is that a borrower becomes saddled with obligations that are so burdensome that if enforced they would not only harm the borrower's welfare, but would also harm his or her dependents, potentially rendering them public charges.[55] This same policy concern also animates restrictions on wage garnishment[56] and property exemption statutes.[57] Indeed, this is why business-to-business loans are rarely subject to usury laws:

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50 Levitin, *supra* note 1, at 347–48.

51 *Id.*

52 *Id.* at 348.

53 *Id.*

54 *Id.*

55 *See id.* (describing the spillover effects of usurious lending).

56 *See, e.g.*, 15 U.S.C. § 1673 (federal wage garnishment restriction).

57 *See* Richard M. Hynes, Anup Malani & Eric A. Posner, *The Political Economy of Property Exemption Laws*, 47 J.L. & ECON. 19, 40 (2004) ("Historical evidence suggests that exemptions were initially popular as a way to protect existing debtors against creditors . . . .").

although there are externalities from a business failure, they are not seen as severe as with an individual debtor.[58]

Modern scholars often view usury laws with skepticism. The usury laws are seen variously as fusty, hoary vestiges of past unenlightened epochs, unwarranted paternalistic interventions in freedom of contract that harmfully restrict credit to borrowers, or exercises in futility that the market will simply structure around.[59] Usury laws are generally bright-line prohibitions on lending at above a specified, fixed rate of interest or, in some more modern versions, above a specified, fixed APR, as that term is defined by the Truth in Lending Act,[60] which is a measure that accounts for both interest and certain fees and charges.[61]

This sort of regulation smacks of paternalism against which some scholars bridle: Are not individuals better judges than the legislature of how much risk they can handle, especially because they internalize the consequences of failure in the first instance? Moreover, usury's one-size-fits-all approach is obviously poorly tailored to the differences among borrowers, some of whom may have compensating circumstances, such as wealth, that enable them to better handle risk than others. And usury laws inherently risk limiting credit availability, particularly to riskier borrowers, which can have a compounding effect because credit helps build wealth and credit history, which in turn facilitates obtaining future credit and on better terms.[62] This effect can play out intergenerationally.[63] Thus, usury laws may compound the difference between the haves

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58 Whether this is a reasonable policy position is another matter given that most small business lending is underwritten based on the small business owner's personal credit and involves a personal guaranty of the business's debts by the owner. *See, e.g.*, Dock Treece, *Personal Guaranties and Business Loans*, Bus. Daily News (Feb. 21, 2023), https://www.businessnewsdaily.com/16467-personal-guarantee.html [https://perma.cc/7QSJ-G9VC].

59 *See, e.g.*, Robert Mayer, *When and Why Usury Should Be Prohibited*, 116 J. Bus. Ethics 513, 513 (2013) ("Usury is a relic . . . attacked for centuries by advocates of *laissez-faire* . . . ."); Rudolph C. Blitz & Millard F. Long, *The Economics of Usury Regulation*, 73 J. Pol. Econ. 608, 613 (1965) ("While the oft-stated purpose of usury legislation is to help that class of debtors which includes the landless peasants, poor urbanites, and very small businessmen, maximum rates are likely to affect them adversely by excluding them from the market."); Theodore Baron, *Usury as a Defense to Corporate Bonds Sold Below Par*, 25 Wash. U. L.Q. 592, 603 (1940) (citing scholarship and examples of states abolishing usury laws).

60 Pub. L. No. 90-321, tit. I, 82 Stat. 146, 146–59 (1968).

61 *See* sources cited *supra* note 21 (providing examples of state usury laws). The APR calculation varies for open-end and closed-end credit, with fees not included in the open-end credit calculation. 12 C.F.R. §§ 1026.14(b), 1026.22(a)(1).

62 Blitz & Long, *supra* note 59, at 613. *See generally* Adam Gordon, Note, *The Creation of Home Ownership: How New Deal Changes in Banking Regulation Simultaneously Made Homeownership Accessible to Whites and Out of Reach for Blacks*, 115 Yale L.J. 186 (2005) (describing the inequitable effects of federal laws providing mortgage insurance in transforming middle-class household wealth).

63 *See* Gordon, *supra* note 62, at 219 n.166 (describing the effects of intergenerational wealth from homeownership).

and have-nots in society by denying the have-nots the opportunity to establish credit and build wealth. Simply put, usury laws trade freedom of contract for those who believe themselves the most capable of bearing risk for protection for those least capable of bearing risk. This is a policy choice about which there is considerable disagreement.

C. *Erosion of Usury Laws in the United States*

Historically, state usury laws formed the bedrock of consumer credit regulation in the United States, although they began to be supplemented by federal law with the 1968 Consumer Credit Protection Act.[64] Today, usury laws in the United States are a combination of both state and federal law, intersecting in a moth-eaten patchwork.[65] Every state has some type of usury law, but there is tremendous variation among them both in terms of what types of lenders, borrowers, and products are covered, and in terms of the level of the prohibited charge.[66]

State usury laws governed virtually all consumer transactions—and sometimes business transactions—from colonial times until 1978,[67] when usury regulation was fundamentally transformed by the Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corporation*.[68] *Marquette* held that the 1864 National Bank Act[69] entitled national banks to export the interest rate of their "home" state to any state in which they made loans.[70] Thus, in *Marquette* the Court held that a Nebraska-based national bank was subject to the Nebraska usury cap even when it made loans to Minnesota residents.[71]

Marquette created a federal choice-of-law rule regarding which state's usury law would apply to a national bank doing out-of-state business. Although *Marquette* is often referred to as a "preemption" decision,[72] *Marquette* did not void state usury laws so much as determine which one would apply to a national bank. In so doing, *Marquette*

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64 Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146 (1968). There were some limited earlier federal interventions in consumer credit markets. *See* Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 323–25 (2013).

65 *See* Ackerman, *supra* note 35, at 94.

66 *See* sources cited *supra* note 21 (providing examples of state usury laws).

67 *See* Ackerman, *supra* note 35, at 62.

68 439 U.S. 299 (1978).

69 National Bank Act of 1864, ch. 106, § 30, 13 Stat. 99, 108 (codified as amended at 12 U.S.C. § 85).

70 439 U.S. at 301. Technically, banks can export the greater of their home state's maximum allowed rate or 1% of the applicable Federal Reserve ninety-day commercial paper rate. 12 U.S.C. § 85.

71 439 U.S. at 313.

72 *E.g.*, Robert C. Eager & C.F. Muckenfuss, III, *Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System*, 8 N.C. BANKING INST. 21, 36 (2004).

set off a deregulatory race-to-the-bottom that enabled banks—but not other entities—to largely avoid usury laws altogether.

Marquette affected only federally chartered "national" banks, but in the wake of *Marquette*, state "parity" laws were passed to ensure competitive equality for state-chartered banks.[73] In 1980, Congress also passed a federal parity statute that gave *Marquette* interest rate exportation rights to all state-chartered banks unless a state chose to opt out of the provision.[74]

The federal parity law does not permit state-chartered insured banks to charge out-of-state rates in their home state.[75] To wit, if Illinois had an 8% usury limit, an Illinois-chartered bank could charge 8% in Illinois or in Michigan, even if Michigan had a 6% usury rate. But a federally chartered national bank based in Indiana, which has a 12% usury limit, could charge 12% in either Illinois or Michigan, as well as in Indiana. Thus, the Illinois-chartered bank would remain at a competitive disadvantage to the Indiana-based national bank, which could still charge higher rates.

States responded to protect their state-chartered institutions' competitive equality with state parity laws that permitted state-chartered banks to charge the maximum rate permitted to a national bank doing business in the state.[76] Accordingly, in the above example, the Illinois-chartered bank would be able to charge 12% in Illinois because an Indiana-based national bank could export the 12% Indiana rate into Illinois. When combined with the federal parity statute, this would mean that the Illinois-chartered bank could also export the Indiana 12% rate into Michigan, instead of being limited to exporting the 8% Illinois rate.

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73 NAT'L CONSUMER L. CTR., CONSUMER CREDIT REGULATION § 3.7.1 (3d ed. 2020) (describing state parity laws).

74 Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 521, 94 Stat. 132, 164–65 (codified at 12 U.S.C. § 1831d) (federal parity law). 12 U.S.C. § 1831u(f) separately addresses usury caps in state constitutions. The Depository Institutions Deregulation and Monetary Control Act ("DIDMCA") parity provision allows state-chartered, Federal Deposit Insurance Corporation ("FDIC") insured banks to charge the greater of the maximum rate allowed in the state in which the bank is located or 1% above the Federal Reserve ninety-day commercial paper discount rate for the applicable Federal Reserve District. 12 U.S.C. § 1831d. The opt-out provision, § 525 of DIDMCA, is not currently codified; it was previously codified at 12 U.S.C. § 1730g note. Puerto Rico and Iowa have opted out of the federal parity statute. Catherine M. Brennan & Nora R. Udell, *What's Old Is New Again: The Future of Bank Partnership Programs from Small Dollar Installment Loans to Mortgages to Everything*, 72 CONF. ON CONSUMER FIN. L.Q. REP. 425, 430 (2018).

75 *See* 12 U.S.C. § 1831d(a) (allowing state insured banks to charge at the rate allowed by the state in which the bank is located).

76 John J. Schroeder, *"Duel" Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions*, 36 IND. L. REV. 197, 202–03 (2003); *see also* NAT'L CONSUMER L. CTR., CONSUMER CREDIT REGULATION § 3.7.1 n.672 (3d ed. 2020) (listing parity statutes).

Notice that in this scenario, neither the Illinois usury law nor the Michigan usury law changes. They remain at 8% and 6% respectively, but the Illinois-chartered bank would now be able to charge 12% not just in Illinois, but also in Michigan because that is what *Indiana* allows. Parity statutes result in a bizarre situation in which one state's law enables a bank chartered by a second state to ignore a third state's usury rate. Bank usury law has therefore become a matter of conforming to the least constraining state's law.

Credit cards are among the highest-rate credit products offered by banks, so not surprisingly, national banks with major credit card lending operations began to relocate to states with no or liberal usury laws to take advantage of the *Marquette* decision.[77] These banks relocated (or created credit-card issuing national bank subsidiaries) in states with lax usury laws—notably Delaware,[78] Nevada,[79] South Dakota,[80] and Utah[81]—which permitted either whatever rate the parties agreed to by contract or had extremely high rate ceilings.[82] Indeed, "[b]y 1988, eighteen states had removed interest rate ceilings."[83]

Subsequent regulatory action expanded the scope of *Marquette*. The Office of Comptroller of the Currency ("OCC") defined "interest" under the National Bank Act as encompassing late fees,[84] an interpretation upheld by the Supreme Court.[85] This meant that most loan fees charged by national banks were not subject to state regulation.[86] State parity laws meant that states lost the ability to regulate not just interest rates, but also other fees charged by state-chartered banks.[87] The OCC also issued a set of opinion letters that interpreted the "location" of a national bank for the purposes of the interest rate provision of the National Bank Act as being the state of whatever branch of the bank had the closest nexus to the loan, rather than being the state where the

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77 *See* Robin Stein, *The Ascendancy of the Credit Card Industry*, PBS (Nov. 23, 2004), http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html [https://perma.cc/Q6R7-HT4V] (describing Citibank's relocation decisions based upon differing state usury laws).

78 Del. Code Ann. tit. 5, §§ 943, 953, 963, 965, 973 (2022).

79 Nev. Rev. Stat. § 99.050 (2022).

80 S.D. Codified Laws § 54-3-1.1 (2022).

81 Utah Code Ann. § 15-1-1 (LexisNexis 2022).

82 *See* Stein, *supra* note 77 (describing legislation in South Dakota and Delaware that lifted usury rates or other restrictions).

83 Randall S. Kroszner & Philip E. Strahan, *Regulation and Deregulation of the US Banking Industry: Causes, Consequences, and Implications for the Future*, *in* Economic Regulation and Its Reform: What Have We Learned? 503 (Nancy L. Rose ed., 2014).

84 61 Fed. Reg. 4849-03 (Feb. 9, 1996) (codified as amended at 12 C.F.R. § 7.4001).

85 *See* Smiley v. Citibank (S.D.), N.A., 517 U.S. 735, 744–45 (1996).

86 *See* 12 C.F.R. § 7.4001; *see also* Schroeder, *supra* note 76, at 207 ("In thirty-five states, if the parity law provisions are met, the federal law preempts even state laws that specifically prohibit particular powers or products.").

87 *See* sources cited *supra* note 86.

national bank is located on its charter certificate.[88] Thus, according to the OCC's opinion letters, a national bank no longer has to even change the location of its charter to export any particular state's usury rate. Instead, it needs only open a branch in that state and designate that branch as the one processing the loan.

D. Usury Laws Today

The *Marquette* decision set off a series of developments that undermined state control over bank pricing of consumer credit. But *Marquette*'s fallout was limited to banks. Nonbanks were unaffected by *Marquette*. In the 1980s, these nonbank lenders consisted primarily of finance companies, pawn shops, and retailers (including auto dealers) offering their own credit.[89]

Even for banks, the main impact of *Marquette* was in the credit card market.[90] Standard bank consumer loan products—mortgages, auto loans, and student loans—have lower interest rates and fees than credit cards, such that usury caps would rarely be an issue except in periods of extremely high market interest rates. In contrast, credit card interest rates frequently exceed many states' general usury caps, even when market rates are low.

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88 *See* Off. of the Comptroller of the Currency, Interpretive Letter No. 686 (Sept. 11, 1995), reprinted in [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-001 ("[W]hat is relevant in choosing the appropriate interest rate is the nexus between the loan and the office in the state whose interest rates are being imposed—whether that office is the main office or a branch office . . . ."); Off. of the Comptroller of the Currency, Interpretive Letter No. 707 (Jan. 31, 1996), reprinted in [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-022 ("[A] national bank is located for purposes of [s]ection 85 in each of the states where it has a main office and/or branches. We have also concluded that where a loan is originated and booked and loan funds are disbursed at a branch of a bank located in a state other than that bank's main office state, an appropriate nexus exists between that loan and the interstate branch office to justify imposition of interest rates permitted by the law of the state where the branch is located."); Off. of the Comptroller of the Currency, Interpretive Letter No. 782 (May 21, 1997), reprinted in [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-209; Off. of the Comptroller of the Currency, Interpretive Letter No. 822 (Feb. 17, 1998), reprinted in [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-265 ("[A]n interstate national bank may be 'located' for purposes of section 85 in both its home state and its host state or states."); Off. of the Comptroller of the Currency, Interpretive Letter No. 1171 (June 1, 2020).

89 *See* Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975–2000: Competition, Consolidation, and Increased Risks*, 2002 U. Ill. L. Rev. 215, 233–34 (providing that nonbank lenders such as finance companies had a large portion of the market up until the 1980s); Philip A. Klein, The Cyclical Timing Of Consumer Credit, 1920–67, at 4 (1971) (describing different types of nonbank lenders).

90 Lender Liability Law & Litigation § 10.03(3) (Matthew Bender ed., 2023) ("The *Marquette* decision applies to all types of consumer loans, but it had the greatest impact upon the credit card industry because credit card arrangements can be entered into entirely by mail with no need for the customer and lender to meet.").

The consumer credit product landscape changed in the mid-1990s, however, with the emergence of payday lending and auto title lending.[91] At the same time, the expansion of credit scoring and the development of automated underwriting technology started to facilitate a democratization of credit, meaning that institutional credit began to become available to more borrowers with weaker credit profiles.[92]

Usury laws have historically been a matter of state law; there has never been a general federal usury law.[93] There have, however, been federal usury laws for specific areas. Prior to 1980, there was a regulatory rate cap—generally 5%—on mortgages insured by the Federal Housing Administration ("FHA").[94] As interest rates rose in the 1970s, there was significant pressure to allow lending at higher rates; lenders would not lend at rates lower than their own cost of funds.[95] Thus, in 1983, following a period of extremely high market interest rates, the FHA's authority to restrict interest rates and eligibility criteria was repealed.[96]

Four specific federal usury laws are still extant. First, the National Bank Act's interest rate provision operates as a usury law. It permits national banks to charge the greater of the rate authorized by their home state or a 1% over the ninety-day commercial paper discount rate at the applicable Federal Reserve Bank for the bank's location.[97] Although this 1%+ provision rarely, if ever, applies, it is still in effect a federal usury law.[98]

Second, since 1980, the Federal Deposit Insurance Act[99] has had a parallel provision to the National Bank Act for Federal Deposit Insurance Corporation ("FDIC") insured state-chartered banks.[100] States are allowed to opt out of this provision,[101] but it otherwise operates like that of the National Bank Act, creating a federal usury limit for FDIC-insured state-chartered banks.

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91 *See, e.g.*, Gary Rivlin, Broke, USA: From Pawnshops to Poverty, Inc.—How the Working Poor Became Big Business 72–73 (2010) (describing rises in payday lending).

92 *See* Adam J. Levitin & Susan M. Wachter, The Great American Housing Bubble: What Went Wrong and How We Can Protect Ourselves in the Future 85 (2020) (describing how these changes led to increases in homeownership).

93 *See supra* note 65 and accompanying text.

94 *See* Levitin & Wachter, *supra* note 92, at 49, 79.

95 Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. Rev. 473, 486 (2000).

96 *See id.* at 483–92.

97 12 U.S.C. § 85.

98 *See* Coreen S. Arnold & Ralph J. Rohner, *The "Most Favored Lender" Doctrine for Federally Insured Financial Institutions—What Are Its Boundaries?*, 31 Cath. Univ. L. Rev. 1, 7 (1981) (describing "little use" of this provision).

99 Federal Deposit Insurance Act of 1950, Pub. L. No. 81-797, 64 Stat. 873 (codified as amended at 12 U.S.C. §§ 1811–1835a).

100 12 U.S.C. § 1831d.

101 DIDMCA, Pub. L. No. 96-221, § 525, 94 Stat. 132, 167 (1980) (codified as amended at 12 U.S.C. § 1730g) (repealed 1989).

Third, a federal usury cap of 15% annually—with a variance permissible by regulation—has applied to federal credit unions since 1980.[102] Since 1987, the National Credit Union Administration ("NCUA") has permitted federal credit unions to charge an additional 3% in interest rates, for an 18% actual rate ceiling.[103] Furthermore, since 2010, the NCUA has allowed credit unions to offer payday alternative loans that meet other various requirements at 28% annual interest.[104]

Fourth, in 2006, Congress passed the Military Lending Act ("MLA"),[105] which prohibits most extensions of credit to active duty military members and their dependents if the annual percentage rate on the financing is over 36%.[106] The MLA does not apply to mortgage loans or to secured purchase money loans for cars or personal property.[107] The MLA covers approximately 4.7 million people or roughly 1.5% of the U.S. population.[108] Although the MLA only covers a limited part of the population, it is the most modern federal usury law.

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102 DIDMCA, Pub. L. No. 96-221, § 310, 94 Stat. 132, 149 (1980) (codified as amended at 12 U.S.C. § 1757(5)(A)(vi)(I)) (replacing original limitation of interest rates of no more than 1% per month, that is 12% annually without compounding, with a 15% rate); 12 C.F.R. § 701.21(c)(7)(i)–(ii) (2022).

103 *See* Nat'l Credit Union Admin., 23–FCU–02, Permissible Loan Interest Rate Ceiling Extended (2023); *Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives: Hearing Before the Subcomm. on Fin. Insts. and Consumer Credit of the H. Comm. on Fin. Servs.*, 110th Cong. 110–36 (2007) (statement of The Hon. JoAnn M. Johnson, Chairman, National Credit Union Administration); *see also* Nat'l Credit Union Admin., 11–FCU–04, Permissible Interest Rate Ceiling 1 (2011) (authorizing 18% cap for 2012); Nat'l Credit Union Admin., 21–FCU–04, Permissible Loan Interest Rate Ceiling Extended (2021) (extending 18% usury ceiling for federal credit unions until 2023). The 18% is interpreted by the NCUA as covering an effective rate rather than a stated rate. *See* Nat'l Credit Union Admin., 09–FCU–05, Payday Lending 1–2 (2009); Nat'l Credit Union Admin., Off. of Gen. Counsel, Opinion Letter 00–1217 (Jan. 2001) (explaining that FCUs cannot charge transaction fees if they cause effective rate to exceed interest rate limit). *But see* Nat'l Credit Union Admin., Off. of Gen. Counsel, Opinion Letter 91–0412, at 1 (Apr. 30, 1991) (stating NCUA's position that late payment charges do not impact the effective rate that the interest rate ceiling limits).

104 12 C.F.R. § 701.21(c)(7)(iii)–(iv) (authorizing federal credit union payday alternative loans with 28% interest rates).

105 Military Lending Act, Pub. L. No. 109-364, § 670, 120 Stat. 2266–69 (2006) (codified at 10 U.S.C. § 987).

106 10 U.S.C. § 987(b). The MLA's limit is in reference to an "Annual Percentage Rate," which is defined as the APR from the Truth in Lending Act ("TILA")—an annualization of the finance charge as a percentage of the loan amount in 10 U.S.C. § 987(i)(4), but it includes certain items in the finance charge numerator that are excluded from TILA's definition of "finance charge." *Id.*; *see also* 32 C.F.R. § 232.4(c) (2022) (including in the MAPR credit insurance premiums, debt cancellation or debt suspension fees, ancillary product fees for credit-related products, most application fees, and credit plan or arrangement fees).

107 10 U.S.C. § 987(i)(6).

108 U.S. Dep't. of Def., Off. of the Deputy Assistant Sec'y of Def. for Mil. Cmty. and Fam. Pol'y, 2020 Demographics: Profile of the Military Community vi (2020), https://download.militaryonesource.mil/12038/MOS/Reports/2020-demographics-report.pdf [https://perma.cc/

In addition to these four federal usury statutes of limited scope, various federal statutes also preempt state usury laws. To the extent that there is no federal usury law supplanting the preempted state usury laws, federal preemption operates like a usury law that permits whatever the contractual rate might be.[109] Besides the National Bank Act[110] and Federal Deposit Insurance Act,[111] the National Housing Act includes provisions that preempt state usury laws for both FHA-insured mortgages[112] and for all first-lien residential mortgages made by institutional lenders.[113]

Finally, federal law specifically prohibits the Consumer Financial Protection Bureau ("CFPB") from enacting a "usury limit."[114] The term "usury limit" is not defined in the statute. Although it seems beyond peradventure that a flat rate cap of "no lending above X% APR" is prohibited, exactly how far the prohibition reaches is unclear.[115]

SQ98-VPYR] (describing the MLA coverage of 2.1 million military personnel and 2.6 million military family members).

109 *See supra* notes 72–73 and accompanying text.

110 12 U.S.C. § 85.

111 12 U.S.C. § 1831d.

112 12 U.S.C. § 1735f-7. This provision was necessary to ensure a national market in FHA eligible mortgages. Gordon, *supra* note 62, at 188–89, 194–95, 224 tbl.1. The National Housing Act was not expressing congressional opposition to usury laws. Instead, it was concerned with uniformity of usury laws when the federal government was involved. Thus, Congress also provided that the Housing and Urban Development Secretary could set a maximum interest rate for FHA insurance-eligible loans. 12 U.S.C. § 1701l. In other words, the National Housing Act changed usury laws for a class of mortgages from state law to federal, with the usury limit set by regulation and the penalty for violation being ineligibility for FHA insurance, as opposed to a defense to enforcement of part or all of the loan.

113 *See* 12 U.S.C. § 1735f-7a. This provision, section 501 of the Depositary Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), preempts any state law, including state constitutional provisions, that limits mortgage interest, discount points, and finance or other charges. The DIDMCA preemption applies to any "federally related mortgage loan," a term that includes mortgages that are federally insured, made by a FDIC-insured institution, made by a federally regulated institution eligible for purchase by Fannie Mae and Freddie Mac (government-sponsored secondary-market entities), or made by an individual who regularly extends more than $1 million annually in residential real estate loans. 12 U.S.C. § 1735f-5(b). In other words, DIDMCA preemption covers virtually all mortgage loans not made by individuals who are small-time lenders. The DIDMCA provision permitted states to opt out of preemption in a limited time window. 12 U.S.C. § 1735f-7a(b)(2). Fifteen states opted out, so their usury laws are only preempted by DIDMCA in regard to FHA-insured mortgages, which are a relatively small part of the market. *See* Donna C. Vandenbrink, *Usury Ceilings and DIDMCA*, 9 Econ. Persp. 25, 28 tbl.3 (1985) (listing the fifteen states which opted out).

114 12 U.S.C. § 5517(o).

115 For example, does the prohibition cover only limitations on interest or also on fees? Does it only prohibit a fixed interest or fee cap, or does it also cover floating, indexed caps? Does it prohibit rules that establish bright-line safe harbors for loans under a certain rate (without creating liability for loans over that rate)? Does it prohibit additional regulatory burdens for loans over a certain rate? Would an *in duplum* rule that limits the fees and interest outstanding at any point to no more than twice principal be prohibited? *See* Michelle Kelly-Louw, *The Common-Law Versus*

Despite these federal forays, in most instances it is state usury laws—including through their incorporation in the National Bank Act and Federal Deposit Insurance Act—that are the major limitation on consumer credit pricing. The state laws almost never constrain banks, but they do constrain all manner of nonbank lenders—auto finance companies, payday lenders, vehicle title lenders, signature lenders, and pawn shops.[116]

The particulars of state usury laws vary considerably, however, with different rates allowed for different kinds of lenders and products. Rate caps are sometimes expressed as a fixed percentage rate, sometimes as a dollar amount relative to a maximum loan amount, and sometimes as a fixed percentage rate over an index rate. State law usury laws are also sometimes accompanied by other substantive term regulations, particularly for small-dollar loans, such as limiting loan amounts, regulating the maturity terms of loans, restricting refinancings, and prohibiting certain types of fees, or limiting fees to certain specified categories.[117] Remedies for usury law violations also vary considerably, ranging from a disallowance of usurious interest to a recovery of a multiple of the usurious interest to a voiding of the entire indebtedness to even criminal sanctions in some states.[118]

In all cases, however, the key feature of usury laws and the accompanying term limitations is that they are bright-line, rule-based prohibitions: above rate *X* is prohibited; at or below rate *X* is allowed. There is no subjectivity in this analysis once it is determined that the usury law applies and what it covers.[119]

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the Statutory In Duplum *Rule*, 14 JUTA'S BUS. L. 141, 142 (2006) (explaining the *in duplum* rule). What one might call a "usury" law is capable of being structured in numerous ways.

116 *See* Levitin, *supra* note 1, at 351–52. This Article does not address the use of rent-a-bank structures to evade state usury laws. For a detailed discussion, see generally *id.*

117 *See* ADAM J. LEVITIN, CONSUMER FINANCE: MARKETS AND REGULATION 611 (2d ed. 2022) (discussing state regulation of payday loans).

118 *See, e.g.*, COLO. REV. STAT. § 5-5-201 (creditor liable for up to three times the amount of usurious finance charge paid), COLO. REV. STAT. § 5-5-301 (criminal penalties), COLO. REV. STAT. § 18-15-104 (criminal penalties); DEL. CODE ANN. tit. 6, § 2304(b) (2023) (creditor liable for up to three times the amount of usurious interest paid); FLA. STAT. § 687.04 (creditor liable for up to two times the amount of usurious interest paid); FLA. STAT. § 687.146 (criminal liability); 815 ILL. COMP. STAT. 123/15-5-10 (2021) (voiding entire loan and disallowing collection of principal, interest, and fees); N.Y. GEN. OBLIG. LAW §§ 5-511, 5-513 (Consol. 2022) (borrower may recover up to twice the entire amount of the interest paid); N.Y. PENAL LAW § 190.45 (Consol. 2022) (criminal penalties for usury); OR. REV. STAT. § 82.010(4) (2021) (forfeiture of usurious interest).

119 At first glance, it would seem, then, that as bright-line rules usury laws provide clear ex ante certainty about which transactions are legal and which are not. The problem is that because usury laws are so clear, they create an incentive for businesses to come up with transactional workarounds. To the extent that usury laws can be circumvented with clever transactional structures, they provide but limited protection to consumers and push parties into inefficient workarounds. Accordingly, statutory usury provisions have long been backed by a strong, judicially created anti-evasion doctrine. *See, e.g.*, Mo., Kan. & Tex. Tr. Co. v. Krumseig, 172 U.S. 351, 356 (1899)

E. Erosion of the Lender-Borrower Partnership

At the same time that traditional usury laws began to unravel, consumer financial markets also started to change in ways that undermined the traditional borrower-lender partnership. Even without usury laws, lenders' self-interest in getting repaid can act as a meaningful check on unsustainable lending. Specifically, if the lender lends to borrowers who lack the capacity to repay, the lender will lose money. Self-interested lenders, therefore, will not lend to borrowers who lack repayment capacity. Thus, the lender's interest is actually aligned with the borrower's regarding repayment capacity.

The alignment of lender and borrower interests may no longer hold in all consumer credit markets for a number of reasons. First, if the making and management of a loan is divided from the economic

("[T]he question always is whether it was or was not a subterfuge to evade the laws against usury."); Sachs v. Ginsberg, 87 F.2d 28, 30 (D.C. Cir. 1936) ("It was the duty of the trial court to look beyond the form . . . and, if found to be a loan and usurious, to bring it within the terms of the statute, no matter how righteous the cloak of formality which was used to conceal its real character."); Barry v. Paranto, 106 N.W. 911, 912 (Minn. 1906) ("It is elementary that no device or scheme intended for the purpose of evading the laws against usury will prevent the courts from giving force to the statute and declaring contracts made in violation thereof null and void."); First Nat'l Bank of Ada v. Phares, 174 P. 519, 521 (Okla. 1918) ("In deciding whether any given transaction is usurious or not, the courts will disregard the form which it may take, and look only to the substance of the transaction in order to determine whether all the requisites of usury are present." (quoting 39 Cyclopedia of Law and Procedure 918 (William Mack ed., 1912))); Bank of Lumpkin v. Farmers' State Bank, 132 S.E. 221, 221 (Ga. 1926) ("The ingenuity of man has not devised a contrivance by which usury can be legalized . . . . [T]he name by which the transaction is denominated is altogether immaterial, if it appears that a loan of money was the foundation and basis of the agreement which is under consideration."); Fid. Sec. Corp. v. Brugman, 1 P.2d 131, 136 (Or. 1931) ("The courts do not permit any shift or subterfuge to evade the law against usury. The form into which parties place their transaction is unimportant. Disguises are brushed aside and the law peers behind the innocent appearing cloaks in quest for the truth."); Beacham v. Carr, 166 So. 456, 459 (Fla. 1936) ("[C]ourts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that the mere form is immaterial, but that it is the substance which must be considered."); Milana v. Credit Disc. Co., 163 P.2d 869, 871 (Cal. 1945) ("The courts have been alert to pierce the veil of any plan designed to evade the usury law and in doing so to disregard the form and consider the substance."); Austin v. Ala. Check Cashers Ass'n, 936 So. 2d 1014, 1031–32 (Ala. 2005) ("[I]f . . . [the transaction] is in substance a receiving or contracting for the receiving of usurious interest for a loan or forbearance of money the parties are subject to the statutory consequences, no matter what device they may have employed to conceal the true character of their dealings." (quoting Hamilton v. York, 987 F. Supp. 953, 955–56 (E.D. Ky. 1997))). Some states also have statutory anti-evasion provisions in their usury laws. *See, e.g.*, 815 Ill. Comp. Stat. 123/15-5-15 (West 2021); Ga. Code Ann. § 16-17-2(b)(4) (West 2020) ("if the entire circumstances of the transaction show that the purported agent holds, acquires, or maintains a predominant economic interest in the revenues generated by the loan" the "purported agent" is to be considered a "de facto agent"), *upheld by* BankWest, Inc. v. Baker, 411 F.3d 1289, 1293 (11th Cir. 2005), *vacated and appeal dismissed as moot*, 446 F.3d 1358 (11th Cir. 2006) (*per curiam*). The antievasion doctrine adds a highly fact-specific ex post standard-based analysis to usury's universal bright-line ex ante rule.

interest in the loan, such as through securitization, the interests of the party making or managing the loan may not align with the borrower's, even if the interests of the party with the economic interest still do.[120]

Second, there may be agency problems that interfere with the lender-borrower relationship.[121] Lenders are corporate entities that act through their employees, and those employees' incentives may not align with the lender's. If loan officers are compensated based on lending volume, they may be more interested in increasing lending volume—making larger loans to more consumers—than in ensuring that the loans that are made are sustainable, as the losses will be the lender's, not the loan officers'.

Third, if there are other financial product relationships between a borrower and a lender, the lender might be willing to take a loss on one product if it will be more than offset by revenue from another product.[122] A product like "free" checking may in fact be a loss leader for other products like overdraft credit or for the ability to readily cross-sell credit cards, car loans, mortgage loans, and annuities and other investment products to the consumer.

Fourth, for some financial products, default may be more profitable than performance for the lender.[123] Defaults can generate additional revenue opportunities—penalty interest, late fees, and for collateralized loans, property inspection and preservation fees.[124] If default becomes a profit center for a lender, it encourages the lender to make riskier, nonsustainable loans with an eye toward maximizing the number of defaults and thus default-related revenue.

And fifth, a borrower who pays interest and fees for a long enough period might still be a profitable borrower, even if the borrower ultimately defaults. This situation is known as "sweatbox" lending.[125] In

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120 Levitin, *supra* note 1, at 355; *see also* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 69 (2011) (discussing how mortgage servicers' incentives diverge from those of mortgage-backed securities investors).

121 *See* Loan Originator Compensation Requirements Under the Truth in Lending Act (Regulation Z), 78 Fed. Reg. 11280 (Feb. 15, 2013) (noting how the mortgage industry "compensation was frequently structured to give loan originators strong incentives to steer consumers into more expensive loans").

122 *See* Adam J. Levitin, *The Financial Inclusion Trilemma*, 41 Yale J. on Reg. 109, 132–34 (2023).

123 Levitin & Twomey, *supra* note 120, at 50–51 (discussing how default can be a profit center for mortgage servicers).

124 *Id.*

125 The concept of "sweatbox" lending originated in a political economy theory posited by Professor Ronald Mann that attempted to explain the support of credit card issuers for a bankruptcy law reform that made it harder to file for bankruptcy. Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. Ill. L. Rev. 375, 384–92. Mann's insight was that delaying a bankruptcy filing could result in a borrower making a few more payments to a lender: the timing of the bankruptcy matters. *Id.* This Article uses "sweatbox" lending to describe

"sweatbox" lending, the lender's profitability does not depend on whether loans are paid to maturity. If a loan has sufficiently high fees and interest rates, the lender will recoup a sum equal to its principal and a profit, even if the borrower defaults before the loan is paid off.[126] Sweatbox lending aptly describes some credit card issuers' business models, but it also can apply to other types of credit with relatively high fees or interest rates.[127]

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a broader phenomenon in which a lender's profitability does not depend upon loans being paid to maturity.

126 To illustrate, suppose a lender makes a $2,000 loan with a sixty-month term at 90% annual interest, compounded monthly with a constant maturity amortization. Monthly payments on the loan would be $151.98. By the end of month fourteen, the consumer would have repaid a total of $2,217.72, or $217.72 more than the principal hazarded by the lender. If the consumer pays through twenty months—a third of the way to maturity—the consumer would have paid $3,039.60 on the $2,000 originally borrowed and would still have a balance of $1,914.13 because almost all of the payments would have been designated as interest under a constant maturity amortization.

Although the distinction between principal and interest payments matters for determining a loan's balance and its amortization, that is primarily an accounting matter about the future of the loan. From an economic perspective, a lender does not care whether a payment is designated as interest or principal—it is just money and is all fungible. From this perspective, even though most of the loan principal remains outstanding, the lender has received payments that exceed the original principal by month fourteen and are more than a time and a half the principal by month twenty. Thus, if the consumer were to default at month twenty, the lender would surely have already recovered enough to cover its lost principal, its cost of funds and other expenses, and also make a handsome profit. The fact that most of the principal remains outstanding due to the amortization schedule is just gravy for the lender, as it increases the size and hence value of the lender's claim if the consumer defaults. Even if the borrower only makes it a third of the way through the loan prior to default, the loan would still be profitable because of the high interest rate. *See* de la Torre v. Cashcall, Inc., No. 19-civ-01235, slip op. at 25–26, 30 (Cal. Super. Ct. Aug. 22, 2023).

The lender will, of course, make more money the longer any individual borrower performs prior to default. But the aggregate picture might be different. Underwriting borrowers based on ability to pay off the loan in full will result in fewer eligible borrowers than underwriting the borrowers to make only, say, the first third of payments. Lower underwriting standards will increase potential lending volume. Thus, in aggregate, the lender might prefer to have more borrowers who default sooner to fewer borrowers who default later.

To illustrate, if a borrower pays off the above loan in full, the lender will receive payments over sixty months totaling $9,119.80 on a loan of $2,000 principal. But that would require stricter underwriting standards than for ensuring that a borrower can make it just to month twenty. While the lender would need three borrowers who default at month twenty to generate the same revenue as one who pays in full, there is no trade-off required: if the lender lowers its underwriting standards, it can make both the loan to the consumer who will pay in full *and* the loans to the consumers who will default at month twenty. Although dollar profit per loan is reduced with lower underwriting standards, the lender's total revenue stream is increased, and it is the total revenue stream that actually matters. Lowering underwriting standards expands the lender's volume and total revenue.

The key to making the sweatbox work is having large upfront payments that will quickly offset the amount of principal hazarded. Higher interest rates, high up-front fees, and unfavorable amortization methods all increase the effectiveness of sweatbox lending. Thus, sweatbox lending is a model that appears primarily in extremely high-cost lending.

127 *See, e.g.*, Mann, *supra* note 3, at 391 (describing the application of sweatbox lending in the credit card context); Levitin & Twomey, *supra* note 120, at 50–51 (discussing the application of

All in all, then, there is good reason to question the assumption that lenders—even lenders that hold loans on their own balance sheets—are consistently incentivized to lend prudently based on borrowers' repayment capacity. This suggests the need for regulatory safety belts.

F. The Emergence of the New Usury

Traditional usury laws are one such regulatory safety belt. The erosion of traditional usury laws created a regulatory vacuum. A pair of doctrinal responses have arisen to fill the gap. These are a revived unconscionability doctrine and ability-to-repay requirements. This Article terms these doctrines collectively the "New Usury," but they are not a cohesive or even entirely coherent approach.[128] Instead, the New Usury is a set of jury-rigged doctrinal responses to the erosion of usury laws.

The New Usury has emerged from numerous sources—court decisions in private litigation, regulatory enforcement actions, statutes, and regulations—and its reach has also varied considerably by state and by product, even as it has continued to expand over the past quarter century. The New Usury did not arise as the result of a deliberate, considered consumer credit policy. Instead, it developed in an organic and sometimes haphazard manner, responding to particularly outrageous cases or product-specific crises. Despite emerging from various sources for different products in different jurisdictions, there has been a large degree of doctrinal convergence in the New Usury.

By identifying the New Usury as a collection of doctrinal responses to the attrition of traditional usury laws, this Article aims to provide focus on the tradeoffs among the doctrinal tools that are being used to address the problem of unmanageable consumer credit obligations. The following Parts of the Article review each of the New Usury's main doctrinal moves—unconscionability and ability-to-repay—in turn.

II. The New Usury: Unconscionability Revived

A. Elements of Unconscionability

Whereas usury laws are a classic example of an objective, bright-line rule, unconscionability doctrine is a prime example of a fuzzy, subjective standard, based on what shocks the conscience of a particular court. Courts vary in their precise formulation of unconscionability, but most require a finding of both "procedural" unconscionability and "substantive" unconscionability, frequently with a sliding scale such

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sweatbox lending in the mortgage context).

128 *See* Ackerman, *supra* note 35, at 94 (discussing the lack of cohesion in usury laws); Jacob Hale Russell, *Unconscionability's Greatly Exaggerated Death*, 53 U.C. Davis L. Rev. 965, 968 (2019) (discussing the lack of cohesion in unconscionability doctrine).

that a greater quantum of one type of unconscionability can substitute for a lesser quantum of the other.[129]

Procedural unconscionability, as one court has explained, refers to an analysis of whether there was

> a real and voluntary meeting of the minds. The relevant factors include the parties' age, education, intelligence, business acumen and experience, their relative bargaining power, who drafted the contract, whether the terms were explained to the weaker party, whether alterations in the printed terms would have been permitted by the drafting party, and whether there were alternative providers of the subject matter of the contract.[130]

The procedural unconscionability inquiry reflects a similar policy concern to that of usury statutes regarding whether there was such an imbalance of power between the parties such that the bargaining process could not be expected to protect the weaker party's interest.[131] Yet whereas usury laws take a price term that exceeds a specified level as an irrefutable proxy for an unacceptable imbalance of bargaining power, unconscionability analysis instead looks to a totality of the circumstances.[132]

Substantive unconscionability, in contrast, looks at whether the actual terms of the transaction are outside the reasonable expectations or unduly oppressive of the party with weaker bargaining power.[133] In other words, substantive unconscionability looks at whether the party with superior bargaining power has abused its market position and taken unreasonable advantage of its counterparty.

To be sure, counterparties in all transactions are always trying to take advantage of each other or at least drive hard bargains.[134] But the

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129 *See, e.g.*, Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 690 (Cal. 2000) (describing the "prevailing view" that "[procedural" and "substantive unconscionability] must both be present" (quoting Stirlen v. Supercuts, Inc., 51 Cal. App. 4th 1519, 1533 (Cal. Ct. App. 1997))).

130 Drogorub v. Payday Loan Store of WI, Inc., No. 2012AP151, 2012 Wis. App. LEXIS 1002, at *7 (Wis. Ct. App. Dec. 18, 2012).

131 *See supra* notes 52–53 and accompanying text.

132 *Compare* discussion *supra* notes 52–53 (usury), *with Drogorub*, 2012 Wisc. App. LEXIS 1002, at *7 (unconscionability).

133 *See, e.g.*, Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 689 (Cal. 2000) ("Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or adhering party will not be enforced against him . . . . The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or unconscionable." (quoting Graham v. Scissor-Tail, Inc., 623 P.2d 165, 172–73 (Cal. 1981))).

134 *See, e.g.*, Baltazar v. Forever 21, Inc., 62 Cal. 4th 1237, 1244 (Cal. 2016) ("the unconscionability doctrine is concerned not with a simple old-fashioned bad bargain" (quoting Schnuerle v. Insight Commc'ns Co., 376 S.W.3d 561, 575 (Ky. 2012))).

principle here is effectively "pigs get fat, hogs get slaughtered": driving a hard bargain is acceptable, but not an excessively hard bargain. Because substantive unconscionability is keyed to whether contract terms are "*unreasonably favorable* to the more powerful party,"[135] the substantive unconscionability analysis depends on the particular balance of power between the parties—itself part of the procedural unconscionability analysis—with a lesser power imbalance allowing for more favorable terms for the more powerful party.[136]

As a standard, unconscionability differs from usury laws in two key dimensions. First, as a standard, it involves an analysis that occurs ex post for any transaction, so it naturally imputes less certainty ex ante than a bright line rule.

Second, unconscionability is a totality of the circumstances analysis. The procedural element of the unconscionability analysis looks beyond the contract terms to consider the larger transactional setting—the identity and nature of the parties and the process by which they interacted.[137] Usury laws pay no attention to such details other than to the extent that different usury laws apply to different lenders or different loan products or that the transaction has been structured to evade the usury laws.[138] As the California Supreme Court has observed:

> [F]inding unconscionable a contract setting an interest rate is categorically different from imposing an unvarying cap on the interest rate. To declare an interest rate unconscionable means only that—*under the circumstances of the case*, taking into account the bargaining process and prevailing market conditions—a particular rate was "overly harsh," "unduly oppressive," or "so one-sided as to shock the conscience.". . . An unconscionability determination does not generally depend on a single factor, and tends to be "*highly dependent on context*." . . . This is a far cry from how a rate cap operates. If an interest rate exceeds a cap, then it will always exceed the cap, as will all rates above it, regardless of the circumstances under which those rates came about. A rate cap is uniform and rigid; unconscionability, on the other hand, is context-specific and malleable.[139]

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135 *Id.* (emphasis added) (quoting 8 WILLISTON ON CONTRACTS § 18:10 (4th ed. 2010)).

136 *See, e.g.*, Davis v. Kozak, 267 Cal. Rptr. 3d 927, 935–36 (Cal. Ct. App. 2020) (analyzing the balance of power between the two parties).

137 *See id.* (analyzing the totality of the transaction).

138 *See supra* note 119 and accompanying text.

139 de la Torre v. CashCall, Inc., 422 P.3d 1004, 1015 (Cal. 2018) (emphasis added) (citations omitted).

Similarly, the Connecticut Supreme Court has explained that:

> Whether interest rates are unconscionable is a question that should not be decided simply by judicial surmise about prevailing prime interest rates. The financial circumstances of the borrower, the increased risk associated with a second mortgage, and the income-producing capacity of the mortgaged property are some of the questions of fact that might appropriately be explored to shed light on whether a designated interest rate is or is not unconscionable.[140]

The broader totality-of-the-circumstances analysis in unconscionability is not simply a matter of the procedural element. The procedural element is concerned with the contracting process, but the substantive element considers characteristics of the parties and the entirety of the transaction terms, not merely the monetary price term that is the focus of usury laws.[141] This means that even a loan with a low monetary price term could, in theory, be unconscionable based on other provisions.

B. *Unconscionability's Limitations as a Regulatory Mode*

Unconscionability is an old legal doctrine, but historically it was not deployed to address excessive monetary price terms. Instead, monetary price terms were policed by usury in most cases, such that unconscionability only made an appearance in the contexts where usury law was inapplicable, such as retail installment sales contracts.[142] Indeed the classic unconscionability cases—*Williams v. Walker-Thomas Furniture Co.*[143] and *Jones v. Star Credit Corp.*[144]—were both retail installment sale contract cases where usury laws did not apply.[145]

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140 Hamm v. Taylor, 429 A.2d 946, 948–49 (Conn. 1980).

141 *See de La Torre*, 422 P.3d at 1014 ("In assessing the presence of substantive unconscionability, a court may also need to consider context. . . . When a price term is alleged to be substantively unconscionable . . . it is not sufficient for a court to consider only whether the price exceeds cost or fair value.") (citations omitted).

142 *See* Warren, *supra* note 9, at 841 ("Most jurisdictions have exempted credit sales from usury statutes by invoking the doctrine that a seller may offer an article at two different prices, one a cash price and the other at a time or credit price.").

143 350 F.2d 445 (D.C. Cir. 1965).

144 298 N.Y.S.2d 264 (Sup. Ct. 1969).

145 *See* Joseph P. Jordan & James H. Yagla, *Retail Installment Sales: History and Development of Regulation*, 45 Marq. L. Rev. 555, 560 (1962) ("The majority position in the United States is that the general usury statutes do not apply to installment sales."). In contrast to usury, which is generally both a free-standing cause of action and a defense, most jurisdictions limit unconscionability to being an affirmative defense to enforcement of a contract. *See generally* Brady Williams, *Unconscionability As a Sword: The Case for an Affirmative Cause of Action*, 107 Calif. L. Rev. 2015 (2019).

In recent years, however, a number of courts have held that a high—although not necessarily usurious—interest rate alone can be the basis for finding a loan substantively unconscionable.[146] Although courts are far from unanimous in this approach,[147] these decisions point to unconscionability as another doctrinal path for regulating consumer credit price terms.

Unconscionability, however, is problematic as a mode of regulation because it is so fact and circumstance specific that it provides little meaningful guidance about what behavior is lawful and what is not.[148] A regulatory system built on unconscionability creates little certainty for parties and frustrates reasonable business planning.

Part of the problem is that even today unconscionability doctrine remains unsettled regarding whether it is to be applied with an objective standard referencing a typical, ordinary, median, or "reasonable"

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146 *See, e.g.*, *de La Torre*, 422 P.3d at 1008–10 (holding that the high interest rates were in fact unconscionable even though the lender was careful to avoid the usury rates); James v. Nat'l Fin., LLC, 132 A.3d 799, 816–17, 826–37 (Del. Ch. 2016) (finding payday loan unconscionable based in part on its cost); State *ex rel.* King v. B & B Inv. Grp., Inc., 329 P.3d 658, 662–63 (N.M. 2014) (finding a 1,147.14% APR twelve-month signature loan unconscionable despite not violating state usury law); Drogorub v. Payday Loan Store of Wisc., Inc, No. 2012AP151, 2012 Wis. App. LEXIS 1002, at *11 (Wis. Ct. App. Dec. 18, 2012) ("[W]hile a 294% interest rate is not per se unconscionable, it is unconscionable under the facts of this case."); Danjanovich v. Robbins, No. 2:024-CV-623, 2005 WL 2457090, at *5 (D. Utah Oct. 5, 2005) (finding a monthly interest rate of 100% substantively unconscionable). Some isolated older cases have similar holdings. *See, e.g.*, Carboni v. Arrospide, 2 Cal. Rptr. 2d 845, 847 n.5 (Cal. Ct. App. 1991) ("We can see no reason why interest rate provisions should be exempt from the general rules of unconscionability . . . ."); Hamm v. Taylor, 429 A.2d 946, 947–49 (Conn. 1980) (interest rate can be unconscionable, even if nonusurious, but totality of circumstances must be considered); Jones v. Star Credit Corp., 298 N.Y.S.2d 264, 266 (Sup. Ct. Nassau City 1969) (holding in a case about high credit charges for a home freezer that unconscionability "is intended to encompass the price term of an agreement"); Spiotta v. William H. Wilson, Inc., 179 A.2d 49, 52–53 (N.J. Super. Ct. App. Div. 1962) (finding rate unconscionable); Feller v. Architects Display Bldgs., Inc., 148 A.2d 634, 639 (N.J. Super. Ct. App. Div. 1959) (finding the interest amount, when considered with the associated penalty, unconscionable); Levin v. Johnson (*In re* Chicago Reed & Furniture Co.), 7 F.2d 885, 885 (7th Cir. 1925) (applying general equitable principles).

147 Some courts refuse to find loans that comply with usury laws to be unconscionable on the basis of a high-interest rate. *See, e.g.*, Sims v. Opportunity Fin., LLC, No. 20-cv-04730, 2021 U.S. Dist. LEXIS 71360, at *26–27 (N.D. Cal. Apr. 13, 2021) (applying Utah law); Wright v. Oasis Legal Fin., No. 4:19 CV 926 RWS, 2020 U.S. Dist. LEXIS 50648, at *6–8, *10 (E.D. Mo. Mar. 24, 2020) (applying Missouri law); Peoples Fin. & Thrift Co. v. Mike-Ron Corp., 46 Cal. Rptr. 497, 501–02 (Cal. Dist. Ct. App. 1965); Barnes v. Helfenbein, 548 P.2d 1014, 1021 (Okla. 1976) (applying Oklahoma law); Williams v. Alphonse Mtge. Co., 144 So. 2d 600, 602 (La. Ct. App. 1962) (applying Louisiana law); *see also* Nathalie E. Martin, *Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap*, 34 N. Ill. U. L. Rev. 259, 288 (2014) ("[C]ases in which unconscionability has been applied to consumer loans are few and far between.").

148 Additionally, Professor Steven Bender has suggested that unconscionability could also potentially fail to protect borrowers from themselves because it could theoretically validate a high but nonetheless "fair" rate. Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates Under the Unconscionability Standard*, 31 Hous. L. Rev. 721, 740 (1994).

consumer of some stripe or whether it is to be applied as a subjective standard tailored to the circumstances of a particular borrower.[149] A more particularized inquiry will, of course, be harder to generalize into prospective legal guidance. Yet even if the doctrine were applied regarding an objective "reasonable" consumer of some sort, it would still leave unresolved substantial questions about exactly what behavior is proscribed because unconscionability is not simply a matter of the borrower's circumstances.

In recent work, Professor Jacob Hale Russell has argued for tailoring unconscionability to the particular circumstances of consumers, rather than applying an objective standard.[150] He argues that such a particularized approach tracks modern consumer markets "where merchants engage in micro-marketing, hyper-segmentation, and individualized pricing."[151] Russell revels in the fact that unconscionability is not "one-size-fits-all,"[152] but this is both a feature and a bug. The bespoke nature of unconscionability is its advantage as an interstitial doctrinal safety net but is also a serious limitation on its usefulness as a mode of regulation.[153]

To see the limitations of unconscionability as a workable mode of regulation, consider the lodestar of unconscionability law, *Williams v. Walker-Thomas Furniture Co*.[154] In that celebrated decision, the D.C. Circuit addressed whether enforcement of installment purchase contracts for household goods with payment pro ration provisions could be denied on the grounds of unconscionability.[155] Although one of the lower courts expressed sharp condemnation of the defendant's sales practices, it did not believe that it had the power to declare these acts and practices unconscionable.[156] The D.C. Circuit disagreed.[157]

Yet, what is often forgotten about the decision is that the D.C. Circuit did not ever rule on whether the defendant's practices were in fact unconscionable, much less why. Instead, the D.C. Circuit remanded

149 Russell, *supra* note 128, at 968.

150 *See id.* at 969.

151 *Id.* (citations omitted). The degree of individualization in the pricing of credit varies substantially by product, as not all products are underwritten for risk. The pricing of payday loans, for example, is not individualized; all borrowers are charged the same fee.

152 *Id.* at 970.

153 *See id.*

154 350 F.2d 445 (D.C. Cir. 1965).

155 *See id.*

156 *See* Williams v. Walker-Thomas Furniture Co., 198 A.2d 914, 916 (D.C. 1964) ("We cannot condemn too strongly appellee's conduct. It raises serious questions of sharp practice and irresponsible business dealings."). The appellate decision was a consolidated opinion on the appeal of two separate cases.

157 *See* 350 F.2d at 448–49.

because the lower courts had not made any findings about whether the contracts at issue were unconscionable.[158] On remand, the cases settled.[159]

It is easy enough to read between the lines in *Walker-Thomas Furniture Co.* and recognize that the defendant was likely to lose on remand. Yet the question remains exactly why the defendant would lose.[160]

What precisely was unconscionable with Walker-Thomas Furniture Co.'s practices? Was it having installment purchase contracts where title did not pass until payment in full?[161] Was it having multiple contracts with payment proration provisions?[162] Was it the combination of the payment proration with the retained title?[163] Was it the cost of the contracts? Was it that Walker-Thomas Furniture Co. did aggressive door-to-door sales?[164] Was it the particular methods used by its salesmen, such as physically covering up language in the contract, so that only the signature line was visible?[165] Was it complex and difficult to read contract language?[166] The extremely small print?[167] Was it dealing with consumers with low levels of education?[168] Dealing with consumers with low incomes or on public assistance?[169] Dealing with consumers who might be living beyond their means?[170] Or was it some combination of these multiple factors? Or something else, such as the race of the parties, unstated in the opinion, but obvious to everyone involved in

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158 *Id.* at 450.

159 Anne Fleming, *The Rise and Fall of Unconscionability as the "Law of the Poor,"* 102 Geo. L.J. 1383, 1432 (2014).

160 *See id.* (noting that the case created a degree of uncertainty that would likely lead to additional settlements).

161 *See Walker-Thomas Furniture*, 198 A.2d at 915 (noting that title to the first purchase would not pass to Williams until the fourteenth purchase was fully paid).

162 *See Walker-Thomas Furniture Co.*, 350 F.2d at 447.

163 *Id.*

164 *See* Fleming, *supra* note 159, at 1392.

165 *Id.* at 1395.

166 *Walker-Thomas Furniture Co.*, 350 F.2d at 449 (Did each party "considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices?").

167 *Walker-Thomas Furniture Co.*, 198 A.2d at 915 (noting the contracts at issue "were approximately six inches in length and each contained a long paragraph in extremely fine print").

168 *Id.*; *see also* Fleming, *supra* note 159, at 1409, 1414 (noting Thorne's third grade education and Williams' eighth grade education).

169 *Walker-Thomas Furniture Co.*, 198 A.2d at 915 (noting that Williams was supporting herself and seven children with public assistance).

170 *See Walker-Thomas Furniture Co.*, 350 F.2d at 448 ("Significantly, at the time of this and the preceding purchases, appellee was aware of appellant's financial position. The reverse side of the stereo contract listed the name of appellant's social worker and her $218 monthly stipend from the government. Nevertheless, with full knowledge that appellant had to feed, clothe and support both herself and seven children on this amount, appellee sold her a $514 stereo set." (quoting Williams v. Walker-Thomas Furniture Co., 198 A.2d 914, 916 (D.C. 1964))).

the case given the demographics of 1960s Washington, D.C.? We do not know.

Imagine, however, that on remand the trial court had said that the contract was unconscionable due to one factor or another or some combination. What guidance would this have given to other businesses that sought to act lawfully? If the unconscionability was merely the matter of having a payment proration clause or retaining title until payment in full, that would be a bright-line of unacceptable conduct, but if the unconscionability was about the combination of the contract terms with the particular situation of the consumers, then it would provide only the most limited guidance. For example, would the same contract with the same consumer be acceptable without the payment proration? Or would the same contract, including the payment proration provision, have been acceptable with a better educated consumer or one with greater financial means?

Part of the problem with *Walker-Thomas Furniture Co.* is that the court does not distinguish between elements of the dealings that would be substantively unconscionable and those that are procedurally unconscionable.[171] It remains unclear if the case was primarily about the forfeiture-like impact of the payment proration (the substantive unconscionability) or the disparity in bargaining power (the procedural unconscionability).

The problems with unconscionability can be seen in how *Walker-Thomas Furniture Co.* is often taught and in its interpretation by the Federal Trade Commission ("FTC"). The practice Walker-Thomas Furniture Co. engaged in is often described (although not by the decision) as "cross-collateralization,"[172] a term that suggests that Walker-Thomas Furniture took a security interest in collateral owned by the debtors.

Yet, there was no actual security interest to speak of in *Walker-Thomas Furniture Co.*, and thus there was no collateral. Instead, the transaction involved an installment purchase contract with the title retained by the seller until payment in full.[173] That meant that at least formally the goods were not the property of the buyers, and thus collateral for loans. Instead, they were at all times purported to be the property of the Walker-Thomas Furniture Co., even when in the possession and use of the consumers.[174] Accordingly, there was no cross-collateralization, at least formally. Instead, Walker-Thomas Furniture Co. had come up with a transactional design that created an effect very similar—but not

171 *See* 350 F.2d at 447–50 (remanding because the lower court had not made a finding on unconscionability).

172 *E.g.*, Russell, *supra* note 128, at 971.

173 *See Walker-Thomas Furniture Co.*, 350 F.2d at 447.

174 *Id.*

identical—to cross-collateralization through payment proration among multiple contracts and retained title to the goods.[175]

This distinction is important because the FTC's Credit Practices Rule forbids nonpurchase money security interests in household goods.[176] The Credit Practices Rule does not seem to prohibit the actual practice in *Walker-Thomas Furniture Co.*[177] To be sure, a court might well deem Walker-Thomas Furniture Co.'s arrangement to be a disguised security interest, but that is not a matter of unconscionability. The point is that lawyers can readily design transaction structures that are formally distinct but that have similar economic effects.

For example, imagine a lender that makes numerous loans to a borrower. Each loan is secured by a purchase money security interest, and each contract has a cross-default clause, making a default on one loan a default on another. Although payments would not be prorated, a default on any outstanding loan would result in the ability of the lender to repossess the collateral from all the loans, an outcome not so different from that in *Walker-Thomas Furniture Co*. Whether a cross-default clause would be interpreted by a court as equivalent to cross-collateralization is unclear. And that's the point: a ruling holding one structure unconscionable does not provide clear guidance on the use of another.

C. *Summarizing Unconscionability Revived*

Some courts—including the California and New Mexico Supreme Courts—have been willing to extend unconscionability doctrine to reach high-cost loans, even if the loans do not violate usury statutes.[178] These courts have been responding to egregious factual situations: unsecured loans with a 96% or 135% interest rate in California[179] and

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175 Among the distinctions, a nonpayment breach of one contract would not have entitled Walker-Thomas Furniture Co. to replevy its goods on the other contracts. 350 F.2d at 447.

176 16 C.F.R. § 444.2(a)(4) (2018). *But see* Unif. Consumer Credit Code § 3-303 (Unif. L. Comm'n 1974) (stating that payments made on debts secured by a security interest will apply to the first sales made).

177 Indeed, the original proposed version of the Credit Practices Rule had a provision prohibiting the "encumber[ing] [of] goods purchased on different dates from a retail installment seller on a deferred payment basis, unless the contract provides that payments made by the consumer will be credited in full to the earliest purchase to release the goods from encumberance [sic] in the order acquired." 40 Fed. Reg. 16437 (Apr. 11, 1975). That provision was dropped in the final rule, however. *See* Jean Braucher, *Delayed Disclosure in Consumer e-Commerce As an Unfair and Deceptive Practice*, 46 Wayne L. Rev. 1805, 1814 n.32 (2000) (noting that the Credit Practices Rule does not prohibit payment pro ration, although some state laws do).

178 *See, e.g.*, de la Torre v. CashCall, Inc., 422 P.3d 1004, 1022 (Cal. 2018); State *ex rel.* King v. B & B Inv. Grp., Inc., 329 P.3d 658, 676 (N.M. 2014).

179 *Id.* at 1008.

a jaw-dropping 1,147.14% APR unsecured loan in New Mexico.[180] The courts appear to be making the most of the limited doctrinal toolkit available to them. These cases do not present any guidance, however, for what would be a conscionable interest rate. Would a rate 1% lower have produced a different outcome? 10% lower? No one knows. Thus, the judicially administered unconscionability doctrine still presents a problematic framework for regulating consumer credit pricing.

The same can be said for codified versions of unconscionability doctrine in the form of state or federal unfair and deceptive act or practices ("UDAP") or unfair and deceptive and abusive acts or practices ("UDAAP") laws.[181] This sort of codification of unconscionability sometimes has more a constraining definition than courts' requirements for unconscionability, but it is generally a broad, open-ended inquiry that considers more than just one contract term or even the four corners of a contract. Thus, even in its codified statutory forms, unconscionability still leaves considerable uncertainty for businesses about what conduct is permitted, particularly given that the line could vary with political control of regulatory agencies.

This critique of unconscionability does not mean that unconscionability lacks a role in the legal system. Unconscionability has much to commend as a gap-filling, interstitial doctrine that provides a catchall for practices that in their sum total and context are problematic, but which may not be so when their components are considered individually or outside of the context of the particular borrower and lender and their interaction. In other words, unconscionability polices behavior that would be broadly condemned, but which might be so unique or particularized as to escape the attention or imagination of the legislature.

Unconscionability doctrine carries on the spirit of medieval courts of equity, where a petitioner could come to the Chancellor seeking justice when there was no remedy at law. But such Chancery decisions

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180 State *ex rel.* King v. B & B Inv. Grp., Inc., 329 P.3d 658, 663 (N.M. 2014).

181 *See, e.g.*, 12 U.S.C. §§ 5531, 5536, 5552 (UDAAP); 15 U.S.C. § 45(a)(1) (UDAP); Cal. Civ. Code § 1.200 (unfair competition law); Ohio Rev. Code § 1345.03 (prohibiting any "unconscionable act or practice in connection with a consumer transaction"); FTC v. Sperry-Hutchinson Co., 405 U.S. 233, 244 n.5 (1972) (upholding the FTC's interpretation of "unfair" as including "'(1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise—whether, in other words, it is within at least the penumbra of some common-law, statutory, or other established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers (or competitors or other businessmen)'" (quoting Statement of Basis and Purpose of Trade Regulation Rule 408, Unfair or Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking, 29 Fed. Reg. 8355 (1964))). Unconscionability is only a private right of action or affirmative defense, which is in contrast to usury violations, which are enforceable not just by private parties, but by regulatory agencies. *See generally* Williams, *supra* note 145, at 2015 (arguing "that the doctrine of unconscionability must be recrafted into an offensive sword that provides affirmative relief to victims of unconscionable contracts").

were always limited to their facts and not binding precedent.[182] They were simply a way of dealing with the most egregious mismatches between the law and the world.[183] In other words, unconscionability is best reserved for dealing with outlier cases that are not meant to establish precedents for regulating an industry as a whole, but for dealing with unusual, oppressive, ugly situations.

III. The New Usury: Ability-to-Repay Requirements

Ability-to-repay requirements reflect a third mode of regulating price terms in consumer credit contracts. Ability-to-repay is a much more recent concept than usury or unconscionability, making its first appearance—as far as research indicates—just a bit over a quarter century ago, in the Home Owners Equity Protection Act of 1994 ("HOEPA").[184] Ability-to-repay has subsequently expanded to many other product markets, but the expansion has been piecemeal and haphazard, sometimes led by regulators through rulemaking or enforcement actions, sometimes by legislatures, and sometimes by courts.[185]

A. *Asset-Based Lending Prohibitions*

HOEPA is an antipredatory mortgage lending statute.[186] Its provisions target specific practices of subprime mortgage lenders in the 1990s. Among these practices was "asset-based lending," meaning lending to borrowers based solely on the value of the collateral property without regard to the borrower's ability to repay the loan from income or other assets.[187] Such asset-based lenders would often seek to lend to borrowers who specifically lacked an ability to repay.[188] The goal was for

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182 *See* Joseph Hendel, *Equity in the American Courts and in the World Court: Does the End Justify the Means?*, 6 Ind. Int'l & Compar. L. Rev. 637, 641 (1996) (discussing how courts of equity were not originally subject to guiding precent but eventually "began to adhere to precedent rather than only 'natural justice'").

183 *Id.*

184 Home Owners Equity Protection Act of 1994, Pub. L. No. 103-325, §§ 151–157, 108 Stat. 2160, 2190–98 (Sept. 23, 1994) (codified in scattered sections of 15 U.S.C.).

185 *See infra* Section III.G (summarizing this development and the resulting doctrine).

186 Home Owners Equity Protection Act of 1994, Pub. L. No. 103-325, §§ 151–157, 108 Stat. 2160, 2190–98 (Sept. 23, 1994) (codified in scattered sections of 15 U.S.C.).

187 *See, e.g.*, OCC, Advisory Letter 2003-2 on Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, at 3 (Feb. 21, 2003), https://tinyurl.com/yckpjs9n [https://perma.cc/R7YS-VSSW] ("A national bank that makes a loan to a consumer based predominantly on the liquidation value of the borrower's collateral, rather than on a determination of the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources, is engaging in a fundamentally unsafe and unsound banking practice that is inconsistent with established lending standards.").

188 *Id.*; *see also* Press Release, Fed. Trade Comm'n, *Home Equity Lenders Settle Charges that They Engaged in Abusive Lending Practices* (Jul. 29, 1999) ("These subprime lenders appear to

the borrower to default on and then lose the property in a foreclosure sale at which the lender would credit bid and capture the borrower's home equity.[189]

In response to this practice, HOEPA prohibits lenders from engaging in a pattern or practice of making covered loans "based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment."[190] HOEPA's focus on the borrower's ability to repay is not really about ensuring that the loan is affordable for the borrower so much as prohibiting lenders from lending solely based on collateral values. The HOEPA ability-to-repay provision is meant to be a prohibition on asset-based consumer mortgage lending, not a broader regulatory move. Were it otherwise, HOEPA's numerous other requirements and restrictions—additional disclosures and prohibitions on negative amortization, balloon payment structures, prepayment penalties, and default interest rates[191]—would not be necessary.

HOEPA coverage is triggered either by the APR on a mortgage loan exceeding a spread over a maturity-matched Treasury security or by total up-front points and fees exceeding a certain percentage of the total transaction amount.[192] In other words, HOEPA coverage is triggered by the pricing of a loan, whether in the form of a floating rate limit or a particular percentage of initial costs.

HOEPA has both elements of a usury law and an ability-to-repay law. HOEPA resembles a usury law in that its coverage is triggered by the price point of a loan.[193] Yet HOEPA does not prohibit loans at particular interest rates. Instead, it merely adds regulatory burdens and prohibits certain features on such loans.[194]

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care little about a borrower's ability to pay, so long as he/she has enough home equity to secure the new loan. The lenders are able to prey on homeowners because mortgage transactions are often very complicated and difficult to understand.").

189 HOEPA's original scope of coverage is indicative of the initial goal of the legislation. Originally, HOEPA did not cover all residential mortgages. It only covered refinancings of closed-ended loans, excluding both purchase money loans and home equity lines of credit from its coverage. Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, § 152, 108 Stat. 2160, 2190 (codified at 15 U.S.C. § 1602(aa)(1) (2006)). This indicates that HOEPA was concerned about predatory, equity-stripping refinancings and nonpurchase loans, such as for home improvement.

190 15 U.S.C. § 1639(h).

191 *See* 15 U.S.C. § 1639(a), (c)–(f) (imposing additional disclosure requirements and prohibitions).

192 15 U.S.C. § 1602(bb).

193 *Compare id.* (establishing HOEPA's rate trigger), *with* sources cited *supra* note 21 (providing examples of state usury laws).

194 *See* 15 U.S.C. § 1639(a), (c)–(f) (imposing additional disclosure requirements and prohibitions).

At the same time, HOEPA has a prohibition on making loans without regard for borrowers' ability to repay.[195] This provision differs from other, later ability-to-repay requirements in that it does not require an ability-to-repay analysis for making any particular loan; instead, it prohibits having a general pattern or practice of doing so.[196]

Still, given that most mortgage lenders lend to multiple borrowers and have common practices and procedures, HOEPA is effectively requiring an ability-to-repay analysis of some sort for every loan, but it is not clear if an individual borrower can invoke this provision regarding his own loan. More importantly, HOEPA never defined what was required in the ability-to-repay analysis. The Federal Reserve Board, which was initially entrusted with implementing HOEPA regulations, did not detail ability-to-repay requirements until 2008—but in so doing removed the "pattern or practice" requirement in the regulation.[197] Nonetheless, HOEPA can be viewed as the origin of the ability-to-repay move in consumer credit regulation.

Beginning in 1999 and continuing for the next decade, states began to adopt their own mini-HOEPA, antipredatory mortgage lending statutes.[198] These mini-HOEPAs often had lower trigger thresholds than HOEPA for coverage and covered certain types of transactions originally excluded by HOEPA.[199] Nevertheless, they all followed the same basic pattern of a price-based trigger, a set of prohibited terms for covered loans, and a prohibition on lending without regard for ability to repay.[200] Some of these mini-HOEPA statutes included a presumption of ability-to-repay if the borrower's back-end debt-to-income ratio—the ratio of the debtor's total monthly obligations, including those on the loans to the borrower's monthly gross income—did not exceed a specified threshold, such as 50%.[201] These mini-HOEPAs were still focused on ability-to-repay as a way of limiting asset-based lending, however, rather than seeing it as a broader regulatory requirement to ensure sustainable loans.[202]

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195 15 U.S.C. § 1639(h).

196 *Id.*

197 *See* 12 C.F.R. § 226.34(a)(4) (2008); 12 C.F.R. § 1026.34(a)(4) (2020) (amending the 2008 regulation and focusing on individual loans rather than the "pattern or practice" language of 15 U.S.C. § 1639(h)).

198 Baher Azmy, *Squaring the Predatory Lending Circle*, 57 FLA. L. REV. 295, 361–65 (2005) (reviewing mini-HOEPA statutes).

199 *Id.* at 364–65.

200 *Id.*

201 *See, e.g.*, N.C. GEN. STAT. ANN. § 24-1.1E(c)(2) (West 2023).

202 *See* Azmy, *supra* note 198, at 361–65 (reviewing mini-HOEPA statutes).

B. Expansion Through Federal Bank Regulators' Guidance

The next developments in the ability-to-repay space were from guidance and rules promulgated by federal bank regulators. In 1995, federal bank regulators issued the Interagency Guidelines Establishing Standards for Safety and Soundness ("1995 Interagency Guidelines").[203] These are guidelines for bank supervision, setting forth regulators' expectations for banks; no private right of action exists under them.[204] The 1995 Interagency Guidelines provide that banks "should establish and maintain loan documentation practices that: . . . [i]dentify the purpose of a loan and the source of repayment, and assess the ability of the borrower to repay the indebtedness in a timely manner."[205]

The 1995 Interagency Guidelines also provide that banks:

> should establish and maintain prudent credit underwriting practices that: . . . Provide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources, the financial responsibility of any guarantor, the nature and value of any underlying collateral, and the borrower's character and willingness to repay as agreed.[206]

The 1995 Interagency Guidelines apply only to banks, and they have never been interpreted as an ability-to-repay requirement. They merely require banks to engage in underwriting of loans but do not mandate any particular metrics or documentation for evaluating borrower capacity.[207]

In 2003, however, the OCC, the primary regulator of national banks, issued a nonbinding Advisory Letter regarding predatory and abusive lending practices focused on consumer lending based on the liquidation value of collateral rather than ability-to-repay.[208] The 2003 Advisory Letter states that lending based on collateral value rather than ability to repay is an "unsafe and unsound banking practice" and advised national banks to "adopt policies and procedures to ensure that an appropriate determination has been made that the borrower has the capacity to make scheduled payments to service and repay the loan, including principal, interest, insurance, and taxes," in order to "mitigate the risk of lending without regard to ability to repay."[209] Although the 2003 Advisory Letter is not formally restricted to mortgage lending, it is

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203 60 Fed. Reg. 35674, 35679 (July 10, 1995) (codified at 12 C.F.R. pt. 30, app. A).

204 *Id.*

205 12 C.F.R. pt. 30, app. A. § II.C.2. (2022).

206 *Id.* § II.D.3.

207 *Id.*

208 Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices. Off. Comptroller Currency, Advisory Letter 2003-2, at 2 (Feb. 21, 2003).

209 *Id.* at 7–8.

clearly tied to concerns about predatory mortgage lending rather than to other types of lending.[210]

In 2004, the OCC went further and issued a formal regulation ("OCC Mortgage Rule") regarding national bank mortgage lending.[211] The OCC Rule applies to all mortgage lending by national banks, not just the high-cost loans covered by HOEPA.[212] The OCC Mortgage Rule prohibits national banks from making residential mortgage loans "based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms."[213] The OCC Mortgage Rule provides:

> A bank may use any reasonable method to determine a borrower's ability to repay, including, for example, the borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors.[214]

Thus, the OCC Mortgage Rule prohibits lending solely on residential mortgage value; it did not specify what "ability to repay" meant or how it should be determined.[215]

Although the OCC Mortgage Rule is broader in product reach than HOEPA, it only covers a limited group of lenders—national banks—and left "ability to repay" entirely up to the national banks, imposing only a "reasonable method" requirement.[216] Moreover, no private right of action attaches to the OCC Mortgage Rule; it is enforceable solely by the OCC, which has never brought an enforcement action under the rule.[217] The OCC Mortgage Rule, like HOEPA and mini-HOEPAs, still focused on preventing asset-based lending.[218]

In 2006, two years after the OCC Mortgage Rule, a consortium of federal banking regulators issued non-binding guidance regarding

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210 *See id.* at 3 (discussing actions taken to reduce abusive loans in the secondary market for mortgages).

211 Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1916–17 (Jan. 13, 2004) (codified at 12 C.F.R. § 7.4008).

212 *Id.* at 1917.

213 *Id.*

214 *Id.*

215 *Id.* at 1904.

216 *Id.* at 1904, 1912.

217 *See Enforcement Actions Search*, OCC, https://apps.occ.gov/EASearch/Search/Table?Search=ability%20to%20repay&Category= [https://perma.cc/L3SM-VD2Q] (finding no enforcement actions that mention "ability to repay").

218 *See* 69 Fed. Reg. 1,904, codified at 12 C.F.R. § 7.4008 (Jan. 13, 2004) (explaining the purpose of the rule).

"nontraditional" mortgages ("2006 Interagency Guidance").[219] In it, the regulators advised that for these loans "analysis of borrowers' repayment capacity should include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule."[220]

The 2006 Interagency Guidance, while still limited to HOEPA or HOEPA-like mortgages, started to move ability-to-repay to mean something more than simply a prohibition on asset-based lending.[221] Its reference to repaying the debt "by final maturity at the fully indexed rate" began to push ability-to-repay into an analysis of whether the consumer could be reasonably expected to perform the contract according to its terms.[222]

C. *Fremont Investment and Loan*

Applying the 2006 Interagency Guidance and the 1995 Interagency Guidelines, the FDIC entered into a consent order in 2007 with a subprime mortgage lender, Fremont Investment and Loan.[223] The consent order directed Fremont to cease and desist from unsafe and unsound practices, including "making mortgage loans without adequately considering the borrower's ability to repay the mortgage according to its terms."[224] This included: qualifying borrowers solely on ability to pay a teaser rate instead of the fully indexed rate; underwriting loans that would "likely to require frequent refinancing to maintain an affordable monthly payment and/or to avoid foreclosure"; containing prepayment penalties that lock borrowers into the mortgage beyond the teaser rate; "approving borrowers for loans with inadequate debt-to-income analyses that do not properly consider the borrowers' ability to meet their overall level of indebtedness and common housing expenses"; and making loans at loan-to-value ratios approaching or exceeding 100%.[225]

Notice how far the Fremont consent order is from HOEPA. An asset-based loan of the type with which HOEPA is concerned would have been at well less than 100% loan-to-value ratio ("LTV") because

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219 Interagency Guidance on Nontraditional Mortgage Product Risks, 71 Fed. Reg. 58,609 (Oct. 4, 2006).

220 *Id.* at 58,610–11.

221 *Id.*

222 *Id.*

223 Order to Cease and Desist, at 4, *In re* Fremont Inv. & Loan, Brea, California, FDIC-07-035b (Mar. 7, 2007), https://www.fdic.gov/bank/individual/enforcement/2007-03-00.pdf [https://perma.cc/7SY8-9JWT]. The consent order does not specifically reference either the Guidance or the Guidelines.

224 *Id.*

225 *Id.* at 3–4. FDIC also brought another enforcement action under the guidance. *See* Order to Cease and Desist, *In re* Citizens Bank, New Tazewell, Tennessee, No. FDIC-07-147b, 2007 FDIC Enf. Dec. LEXIS 168 (Oct. 10, 2017).

the whole point of predatory asset-based lending is to capture the borrower's equity stake, which only exists if the LTV is less than 100%. The Fremont loans, however, were at 100% LTV or more, the very antithesis of asset-based lending.[226]

Instead, the problem with the Fremont loans was that they were all but doomed to foreclosure. Fremont was not looking to capture the borrowers' equity; it merely wanted to qualify more borrowers for mortgages than otherwise because that would increase the number of loans it would have to sell into securitizations. Because Fremont was transferring the credit risk on the loans through securitization, it had little reason to care about the sustainability of the loans as long as they were sellable.[227]

Fremont's problems were not limited to federal bank regulators. The Massachusetts Attorney General also sued Fremont for violating the state's unfair trade practices law regarding non-HOEPA loans.[228] In *Commonwealth v. Fremont Inv. and Loan*,[229] the Massachusetts Supreme Judicial Court found that "the origination of a home mortgage loan that the lender should recognize at the outset the borrower is not likely to be able to repay" was an unfair trade practice.[230] The Massachusetts *Fremont* decision did not focus on the particular pricing of the loans, but instead on a combination of features: (1) the loans in question were made to low-income borrowers, (2) the loans had adjustable rates with an initial two-to-three year teaser period well below the fully indexed rate, (3) the loans were underwritten solely to the teaser rate, with the expectation that they would be refinanced, and (4) the loans either had prepayment penalties that extended beyond the teaser period or had such high LTVs that they could only be refinanced if property values increased.[231]

The Massachusetts Supreme Judicial Court's decision was in the context of mortgage lending by a bank, but nothing in the ruling was limited to mortgages or to banks. The state's unfair trade practices law is equally applicable to nonbanks and nonmortgage lending. As explained

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226 Order to Cease and Desist, *supra* note 224, at 4.

227 *Compare* Ryan Bubb & Alex Kaufman, *Securitization and Moral Hazard: Evidence from Credit Score Cutoff Rules*, 63 J. Monetary Econ. 1 (2014) (analyzing the relationship between credit score cutoff rules and securitization), *with* Benjamin J. Keys, Tanmoy Mukherjee, Amit Seru & Vikrant Vig, *Financial Regulation and Securitization: Evidence from Subprime Loans*, 56 J. Monetary Econ. 700 (2009) (analyzing subprime loans), *and* Benjamin J. Keys, Tanmoy Mukherjee, Amit Seru & Vikrant Vig, *Did Securitization Lead to Lax Screening? Evidence from Subprime Loans*, 125 Q. J. Econ. 307 (2010) (discussing lender screening and subprime loans), *and* Benjamin J. Keys, Amit Seru & Vikrant Vig, *Lender Screening and the Role of Securitization: Evidence from Prime and Subprime Mortgage Markets*, 25 Rev. Fin. Stud. 2071 (2012) (same).

228 Commonwealth v. Fremont Inv. and Loan, 897 N.E.2d 548, 550–51 (Mass. 2008).

229 897 N.E.2d 548, 550–51 (Mass. 2008).

230 *Id.* at 560 (applying Mass. Gen. Laws. ch. 93A (2023)).

231 *Id.* at 552–58.

in the following Section, the Massachusetts Attorney General has subsequently used the *Fremont* precedent to push an ability-to-repay requirement in auto lending.

D. Expansion Beyond Mortgages

By 2008 ability-to-repay was well-established as a requirement for at least high-cost mortgage loans, and the OCC rule plus the *Fremont* case pointed to the expansion of the requirement to all mortgage loans at the very least. Additionally, in the wake of the 2008 global financial crisis, some states adopted statutory ability-to-repay requirements for all mortgages, not just high-cost loans.[232]

In 2009, ability-to-repay was also extended to credit cards as part of the Credit Card Accountability, Responsibility, and Disclosure Act ("CARD Act"),[233] the first federal consumer finance legislation to follow the financial crisis. The CARD Act prohibits a card issuer from issuing a card "unless the card issuer considers the ability of the consumer to make the required payments under the terms of such account."[234]

The CARD Act does not spell out in detail what this means, however, and its regulatory implementation by the Federal Reserve Board—and since carried on by the CFPB—is exceedingly weak. The regulatory implementation defines the requirement as merely ensuring the ability to make the minimum monthly payment on the card[235] rather than to pay off the balance in any particular period of time, such as the thirty-six-month period required to be disclosed under the CARD Act.[236] A typical monthly payment is around 2% of the balance,[237] so

232 *E.g.*, S. 270, 2008 Gen. Assemb., 425th Sess. (Md. 2008) (amending Md. Com. Law §§ 12-127, 12-311, 12-409.1, 12-925, 12-1029); New Mexico Mortgage Loan Originator Licensing Act, S. 342, 49th Leg., 1st Reg. Sess. (N.M. 2009) (enacting N.M. Stat. § 58-21A-4(C)); H.R. 1840, 91st Leg., 91st Sess. (Minn. 2019) (codified at Minn. Stat. § 58.13(a)(24)).

233 Credit Card Accountability, Responsibility, and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734.

234 15 U.S.C. § 1665e.

235 *See* 12 C.F.R. § 1026.51(a)(1)(i) (card issuer shall not issue a card "unless the card issuer considers the consumer's ability to *make the required minimum periodic payments* under the terms of the account based on the consumer's income or assets and the consumer's current obligations" (emphasis added)).

236 15 U.S.C. § 1637(b)(11)(B)(iii). There is no general requirement of a particular minimum payment amount or amortization period. A specific requirement exists for closed accounts. *See* 15 U.S.C. § 1666i-1(c).

237 *See* Off. of the Comptroller of the Currency, OCC Bull. 2003-1, Credit Card Lending: Account Management and Loss Allowance Guidance, at 3 (2003) (indicating that national banks should set minimum payment requirements to ensure that accounts amortizing positively over a reasonable period of time). "Informally, . . . the OCC has indicated that it believes that a minimum monthly payment that covers 1% of the initial monthly balance plus new interest charges and fees is sufficient." Declaration of Adam J. Levitin in Support of Plaintiffs' Motion for Class Certification, at ¶ 12, *In re* Chase Bank USA, N.A. "Check Loan" Cont. Litig., No. 3:09-md-02032

the regulatory implementation of the CARD Act's ability to repayment requirement is not particularly demanding, requiring a fairly low level of financial capacity. The official commentary to the regulatory implementation also allows the requirement to be satisfied by reference to the income and assets of the cardholder's spouse and others who are not co-liable on the card,[238] and lets the card issuer satisfy the requirement through models[239] rather than requiring the use of actual verified income and assets and obligations.

In 2010, a year after the enactment of the CARD Act, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[240] Title XIV of Dodd-Frank contains a more muscular ability-to-repay requirement than the CARD Act, applicable to all close-end mortgage loans.[241] Title XIV prohibits the making

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(N.D. Cal. Oct. 15, 2010), ECF No. 102. Actual requirements vary by card issuer but are generally in the range of 2% of the balance. *See id.* ¶¶ 18–21 (empirical review of cardholder agreement minimum payments).

238 *See* 12 C.F.R. § 1026.51, cmt. 51(a)(1)(i)-4.iii ("Consideration of the income or assets of authorized users, household members, or other persons who are not liable for debts incurred on the account does not satisfy the requirement to consider the consumer's current or reasonably expected income or assets, unless . . . the consumer has a reasonable expectation of access to such income or assets even though the consumer does not have a current or expected ownership interest in the income or assets."); *see also* 12 C.F.R. § 1026.51, cmt. 51(a)(1)(i)-6.iii ("The non-applicant's salary or other income is deposited into an account to which the applicant does not have access. However, the non-applicant regularly uses a portion of that income to pay for the applicant's expenses. A card issuer is permitted to consider the amount of the non-applicant's income that is used regularly to pay for the applicant's expenses to be the applicant's current or reasonably expected income for purposes of § 1026.51(a) because the applicant has a reasonable expectation of access to that income.").

239 12 C.F.R. § 1026.51, cmt. 51(a)(1)(i)-5.iv ("[A] card issuer may consider the consumer's current or reasonably expected income and assets based on . . . Information obtained through any empirically derived, demonstrably and statistically sound model that reasonably estimates a consumer's income or assets, including any income or assets to which the consumer has a reasonable expectation of access."). Some card issuers claim that the Office of the Comptroller of the Currency has expressed supervisory concerns regarding reliance on models, such that they do not use them. Joint Comment Letter from Fin. Servs. Roundtable & Consumer Bankers Ass'n to CFPB re: Request for Information Regarding Credit Card Market (May 18, 2015), https://www.consumerbankers.com/cba-issues/comment-letters/joint-comment-letter-cfpb-re-request-information-regarding-credit-card [https://perma.cc/GRP9-MBNK] ("Regulation Z commentary clarifies that issuers may use an empirically derived, demonstrably and statistically sound model of consumers' income or assets to assess their ability to pay in connection with the issuance of a credit card. However, several of our members are not using these models due to confidentially expressed supervisory safety and soundness concerns from [OCC], often despite very high levels of statistical accuracy. Since income and asset models are explicitly permitted by Regulation Z, we encourage the Bureau to coordinate with the OCC on this issue, so that consumers who can repay their credit lines consistent with the requirements of 12 C.F.R. 1026.51 can obtain access to credit.").

240 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

241 *See* 15 U.S.C. § 1639c(a)(1) (imposing an ability to repay requirement on the making of a "residential mortgage loan"). Home equity lines of credit are not covered by the Dodd-Frank Act's

of residential mortgage loans "unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments."[242] The CFPB's Qualified Mortgage ("QM") Regulation provides a safe harbor for compliance that requires the loan to have certain characteristics, including, originally, a debt-to-income ratio, and currently, a price cap.[243] Dodd-Frank also amended HOEPA, extending its coverage to purchase money and open-ended mortgages.[244]

In the decade since Dodd-Frank, ability-to-repay requirements of various sorts have been extended to other types of consumer credit products. On the federal level, the CFPB promulgated—and subsequently repealed—an ability-to-repay requirement for payday, vehicle title, and certain high-cost signature loans ("Payday Rule"),[245] which provided that it was "an unfair and abusive practice for a lender to make covered short-term loans or covered longer-term balloon-payment loans without reasonably determining that the [borrowers] will have the ability to repay the loans according to their terms."[246] The CFPB's Payday Rule also set forth in detail how ability-to-repay could be determined.[247]

On the state level, Nevada adopted in 2017 requirements that lenders of title, payday, or high-interest loans must verify borrowers' ability to repay based on enumerated factors.[248] Likewise, California in 2018 adopted an ability-to-repay requirement for its statutory pilot program for affordable small-dollar loans.[249] Nevada and California's choice of an ability-to-repay approach in these contexts contrasts with that of

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ability to repay requirement. *See* 15 U.S.C. § 1602(dd)(5) (defining "residential mortgage loan" as excluding open-end credit plans).

242 15 U.S.C. § 1639c(a)(1).

243 12 C.F.R. § 1026.43(e) (2022).

244 *See* 15 U.S.C. § 1602(bb)(1).

245 82 Fed. Reg. 54472 (Nov. 17, 2017), *codified at* 12 C.F.R. pt. 1041 (2018), *repealed in part by* 85 Fed. Reg. 44,382, 44,444 (July 22, 2020).

246 12 C.F.R. § 1041.4 (2018), *repealed by* 85 Fed. Reg. 44,382, 44,444 (July 22, 2020).

247 *See* 12 C.F.R. § 1041.5(b)(2) (2018), *repealed by* 85 Fed. Reg. 44,382, 44,444 (July 22, 2020).

248 *See* 2017 Nev. Stat. 1438 (codified at Nev. Rev. Stat. §§ 604A.5065, 5011, 5038 (2017)) (specifying verification requirements of title loans, deferred deposit loans, and high-interest loans respectively); Nev. Rev. Stat. §§ 604A.5037, 0703 (2017) (defining "high-interest loan" to mean short-term loans with an annual percentage rate of over 40%). Since 2005, Nevada has required title lenders to obtain an affidavit from borrowers stating that the borrower has the ability to repay the loan. *See* 2015 Nev. Stat. 1692 (codified at Nev. Rev. Stat. § 604A.5076 (2015)). High-interest loans also have limitations on loan amounts keyed to borrower income. *See* Nev. Rev. Stat. § 604A.5045(1) (2019) (prohibiting high-interest loans which require monthly payment "that exceeds 25 percent of the gross monthly income of the customer").

249 H. 237, 2017 Cal. Assemb., Reg. Sess. (Ca. 2018) (codified at Cal. Fin. Code § 22370(i)(4)(A)). Ohio had previously adopted in 2007 a prohibition on making small dollar loans if the lender knew the consumer did not have a reasonable probability of repayment, but the Ohio law did not

several states—including California in 2019—that have tightened their usury limits generally for small dollar credit.[250]

Other states have advanced ability-to-repay requirements through litigation settlements. For example, ability-to-repay has been extended to the auto finance sector through consent orders with state attorneys general. Thus, Delaware and Massachusetts have both entered into consent orders with Santander Consumer Holdings USA, Inc., that require Santander to consider borrower ability-to-repay when making loans.[251]

Santander subsequently entered into separate consent orders with another thirty-four state attorneys general.[252] These subsequent consent orders also included the requirements that "[i]n its evaluation of an application for a Loan, Santander shall account for a Consumer's ability to pay the Loan on its specific terms," and that "Santander shall set a reasonable Debt to Income threshold to ensure that Santander is reasonably evaluating a Consumer's ability to pay."[253] Moreover, Santander is required to reevaluate the debt-to-income threshold annually.[254]

Although such consent orders do not formally bind any parties other than the defendants who consented to them, they set a marker for the rest of the industry regarding the expectations of state attorneys general and, therefore, what sort of acts and practices might trigger a lawsuit.[255] Thus, within a few years, Massachusetts had entered into

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put any duty of inquiry on the lender. S. 185, 126th Gen. Assemb., Reg. Sess. (Ohio 2007) (codified at OHIO REV. CODE ANN. § 1345.03(B)(4) (2007)).

250 *See supra* note 21 (providing examples of state usury laws).

251 *See* Cease and Desist by Agreement at ¶¶ 36, 56, *In re* Santander Consumer USA Holdings Inc., CPU Case No. 17-17-17001637 (Del. Consumer Prot. Dir., Mar. 28, 2017) (noting that "[i]n some instances, borrowers were not likely to be able to repay the loans that [Santander Consumer ("SC")] purchased, in part because the income data provided by the dealers was overstated. SC was thus reckless with respect to unfairness under [the Delaware UDAP statute]" and therefore requiring Santander to "establish screens adequate to prevent the sale to third parties of Delaware Loans that SC identifies as being out of compliance with Delaware law, for reasons including but not limited to unfair or deceptive dealer conduct and the associated risk that the borrower will be unable to repay the loan according to its terms."); *see also* Assurance of Discontinuance at ¶ 57, *In re* Santander Consumer USA Holdings Inc., 17-CV-0946E (Suffolk Cnty. Super. Ct. Mass., Mar. 29, 2017) (requiring SC to "develop procedures such that, when . . . there appears to be income inflation or power booking . . . SC will not waive such screens or documentation requirements related to proof of income").

252 *See* Press Release, Santander Consumer USA, Coalition of 34 State Attorneys General Announces over $550 Million Settlement with Nation's Largest Subprime Auto Financing Company (May 19, 2020), https://santandermultistateagsettlement.com/Press-Release [https://perma.cc/Y67E-WWEV].

253 *E.g.*, Final Consent Order and Judgment at § 18.d, e, New York v. Santander Consumer, USA, Inc., No. 451265/2000 (N.Y. Sup. Ct. June 18, 2020); Final Consent Judgment at § 18.d, e, Commonwealth v. Santander Consumer USA, Inc., No. GD-20-005905 (Penn. Ct. of Common Pleas, Allegheny Cnty., May 19, 2020).

254 *See* orders cited *supra* note 253.

255 *See* Comm. on Fed. Regul. of Sec., *Report of the Task Force on SEC Settlements*, 47 BUS. LAW. 1083, 1171–72 (1992) (discussing the impact of consent orders on the public, industry, and courts).

a consent order with three other subprime auto lenders for making loans without regard to borrowers' ability to repay.[256] Massachusetts also sued a fifth subprime auto lender, Credit Acceptance Corporation ("CAC"), alleging among other things, that CAC was violating the state's prohibition on unfair and deceptive acts and practices in trade or commerce by making loans without regard for borrowers' ability to repay.[257]

E. CFPB v. Credit Acceptance Corp.*: A General Ability-to-Repay Requirement?*

In January 2023, the CFPB, together with the New York Attorney General, took a major step toward announcing a general ability-to-repay requirement. The CFPB and New York Attorney General brought suit against CAC, alleging, *inter alia*, that CAC violated the prohibition on UDAAP by a person that offers or provides a consumer financial product or service.[258] Specifically, they alleged that:

> In using a lending model that is indifferent to whether consumers are unable to repay their loans in full and end up in default, CAC took unreasonable advantage of consumers' lack of understanding of the risk of default, and the magnitude of harm in the event of default, as well as consumers' inability to protect their interests in selecting or using CAC's loans . . . .[259]

The complaint against CAC can be read in one of two ways. It can be read as claiming that lending without regard to ability to repay is a UDAAP violation. Alternatively, it can be read as claiming that lending without regard to *known inability to repay* is a UDAAP violation. The former, broad reading would imply an affirmative duty to determine ability to repay, while the latter, narrow reading would merely prohibit ignoring known *in*ability to repay.

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256 *See, e.g.*, Assurance of Discontinuation at § 4, Commonwealth v. Exeter Finance LLC, No. 1984-CV-01079E (Suffolk Cnty. Super. Ct., Mass. Apr. 5, 2019) (alleging violation of M.G.L. ch. 93A and referencing Comm. v. Fremont Inv. & Loan, 452 Mass. 733, 750 (2008)).

257 Complaint at ¶ 171, Commonwealth v. Credit Acceptance Corp., No. 2084-CV-01954 (Suffolk Cnty. Super. Ct., Mass. Aug. 28, 2020) (alleging violation of Mass. Gen. Laws ch. 93A, § (2)). After defeating a motion to dismiss, Opinion, Commonwealth v. Credit Acceptance Corp, No. 2084-CV-01954 (Suffolk Cnty. Super. Ct., Mass. Mar. 15, 2021), Massachusetts settled the litigation for $27 million, but no injunctive relief relating to ability to repay. Assurance of Discontinuation, In the Matter of Credit Acceptance Corp., Civil Action 21-1996A (Suffolk Cnty. Super. Ct. Mass. Sept. 1, 2021). At the time of the settlement, the Massachusetts Attorney General was running for governor.

258 *See* Complaint at ¶¶ 179–187, CFPB v. Credit Acceptance Corp., No. 23-CIV-0038 (S.D.N.Y. Jan. 4, 2023) (alleging violations of 12 U.S.C. §§ 5531 and 5536).

259 *Id.* ¶ 186.

The complaint against CAC is, of course, merely an allegation at this stage; it is not law. Unlike a consent order, it does not even bind CAC. Nevertheless, the complaint provides a strong indication of how the CFPB or the office of a state attorney general view the matter. Regulators' views, expressed in litigation positions, provide guidance to other companies of the type of behavior that will likely result in litigation. Regardless of ultimate legality, a risk-averse company will shy away from such behavior because it does not wish to get entangled with an enforcement action. Moreover, in view of the ambiguity about the scope of the complaint—whether the CFPB and New York Attorney General view UDAAP as having a broad or narrow ability to repay requirement—risk-averse companies are likely to adopt the broad reading. Thus, irrespective of the actual position of the CFPB and New York Attorney General, the message that the consumer finance industry—and bar—takes from the CAC complaint is that UDAAP may include a general ability-to-repay requirement, so risk-averse companies should behave accordingly.

F. Income-Driven Repayment as Back-End Ability-to-Repay

Federal student loans include a type of ability-to-repay provision, but it is a back-end ability-to-repay option rather than a requirement.[260] Federal student loans do not feature any front-end, pre-lending underwriting.[261] By their very nature, federal student loans are made "without any consideration of [borrowers'] ability to repay."[262] This is because the nature of student borrowers is that they are generally young and therefore have few assets and limited income and little, if any, credit history; they are borrowing to finance an education that will hopefully increase their earnings potential.[263] Moreover, the public purposes of federal student loans mean that they incorporate a cross-subsidy so that they are available on the same terms to all qualifying borrowers; were it otherwise, the availability of federal student loans would be greatest for the borrowers who need them the least.[264]

While there is no front-end ability-to-repay analysis for federal student loans, various income-based repayment options have been available since 1993,[265] with options expanding in 2007[266] and then further

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260 Brooks & Levitin, *supra* note 18, at 11.

261 *Id.* at 10.

262 *Id.* at 11.

263 *Id.* at 18, 35–36.

264 *Id.* at 35.

265 Student Loan Reform Act of 1993, Pub L. No. 103-66, 107 Stat. 341 § 4021 (adding new Higher Education Act § 455(e)) (codified as amended at 20 U.S.C. § 1001 et seq.).

266 College Cost Reduction and Access Act, Pub. L. No. 110-84, §§ 203, 401, 121 Stat. 784 (codified as amended at 20 U.S.C. § 1001 et seq.).

expanding in 2010,[267] 2012,[268] 2015,[269] and 2023.[270] These various income-based repayment options base repayment amounts on the borrower's income and provide substantial debt forgiveness. This sort of back-end underwriting is not automatic, however, and instead requires the borrower to opt in and annually recertify eligibility for the programs.[271] As a result, these programs are underutilized, with many borrowers making larger loan payments—and having higher default rates—than should occur, but they are still an ability-to-repay move.[272]

G. Summarizing Ability-to-Repay Doctrine

What we see, then, is that over the past quarter century, there has been a movement toward adopting ability-to-repay requirements for many types of consumer financial products: mortgage loans, credit cards, payday, title, and high-cost signature loans, auto loans, and, in a very different form, federal student loans.

A few things are notable about this trend in regulation. First, there is enormous variation in terms of what ability-to-repay regulations require in terms of what sort of repayment is involved: the full repayment of the loan according to its terms or simply the minimum required payments on a revolving line of credit. For example, the statutory ability-to-repay requirement for mortgages requires an evaluation of the ability to pay off the entire loan at its fully indexed rate,[273] whereas for credit cards, the only requirement is the ability to make the required monthly payment,[274] which is just a fraction of the total loan balance.[275]

Second, there is variation regarding how the inquiry is to be undertaken: whether specific types of information must be considered and documented or whether the nature of the inquiry is left to the lender. For example, the 1995 Interagency Guidelines give no direction about what sort of information is to be considered for mortgage lending,[276] while the CFPB's QM Regulation details acceptable types of

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267 Health Care and Education Reconciliation Act of 2010, § 2001 et seq., Pub. L. No. 111-152, 124 Stat. 1029, 1071 § 2213 (codified at 26 U.S.C. § 1098e(e)).

268 *See* 34 C.F.R. § 685.209(a) (2019) (Pay As You Earn repayment plan).

269 80 Fed. Reg. 67,204 (Oct. 30, 2015).

270 88 Fed. Reg. 43820 (July 10, 2023).

271 34 C.F.R. §§ 685.209, 685.221 (2019).

272 Brooks & Levitin, *supra* note 18, at 10.

273 12 C.F.R. § 1026.43(c)(5) (2022).

274 12 C.F.R. § 1026.51(a)(1)(i) (2022).

275 *See* Off. of the Comptroller of the Currency, *supra* note 237, at 3 (describing low required monthly payments).

276 60 Fed. Reg. 35674, 35679 (July 10, 1995) (codified at 12 C.F.R. Part. 30, App. A, §§ II.C.1, II.C.2. (2022)).

documentation for qualifying for the safe harbor from the Dodd-Frank Act's title XIV ability-to-repay requirement for mortgage loans.[277]

Third, some ability-to-repay requirements are coupled with bright-line prohibitions on particular product terms. For example, the ability-to-repay requirements in HOEPA, the CARD Act, and Dodd-Frank title XIV all contain prohibitions on particular product terms, as did the CFPB's now defunct Payday Rule.[278] In contrast, no such product term prohibitions are to be found in the ability-to-repay requirements created by judicial decision (*Fremont*)[279] or litigation settlement (*Santander*).[280]

Lastly, the statutory ability-to-repay requirements are sometimes coupled with a safe harbor of some type. For HOEPA, it is the triggers themselves that function as safe harbors—HOEPA's ability-to-repay requirement can be avoided by ensuring that the cost of the loan is beneath the HOEPA trigger.[281] For Dodd-Frank title XIV, the CFPB's QM Regulation operates as a safe harbor,[282] and Congress subsequently added in a statutory safe harbor for certain loans held on balance sheet by depositories.[283] The now-defunct CFPB Payday Rule also contained a safe harbor.[284] These safe harbors are all bright-line rules that temper the standards-based nature of the ability-to-repay requirement.

IV. Evaluating the New Usury

At this point we have seen three different approaches to regulating consumer credit that all aim to prevent consumers from ending up in contracts that are unduly burdensome. Which of these paths is the optimal approach for consumer credit regulation?

As an initial matter, a choice may not be strictly necessary. It is possible for usury laws, unconscionability doctrine, and ability-to-repay requirements to coexist for the same product, and there might be good reason to prefer a belt-and-suspenders-and-elastic-waistband approach to any single approach. Given that unconscionability stems from a different source—equity—than usury laws and ability-to-repay requirements—primarily state and federal laws, respectively—there is

277 12 C.F.R. § 1026.43(c)(4) (2022).

278 *See* 15 U.S.C. § 1639h (HOEPA); 15 U.S.C. § 1665e (CARD Act); 15 U.S.C. § 1639c(b)(2)(F) (Dodd-Frank title XIV); 12 C.F.R. § 1041.2(d) (CFPB's now defunct Payday Rule).

279 *See supra* Section III.C.

280 *See* cases cited *supra* notes 251–54 and accompanying text.

281 15 U.S.C. § 1602(bb)(1).

282 12 C.F.R. § 1026.43(e).

283 Pub L. No. 115-174, § 101, 132 Stat. 1297 (May 24, 2018) (adding 15 U.S.C. § 1639c(b)(2)(F)).

284 12 C.F.R. § 1041.6 (2020), *repealed by* 85 Fed. Reg. 44,382, 44,444 (July 22, 2020).

limited ability to coordinate the deployment of the three approaches.[285] Nevertheless, a rationalization of consumer credit regulation suggests that there should be consideration of the trade-offs among the approaches.

A. The Rules-versus-Standards Debate

A comparison of the three approaches is, in the first instance, illuminated by the rules-versus-standards debate. The rules-versus-standards debate is a familiar old chestnut from legal scholarship.[286] In the frequently used example, a speed limit of sixty-five miles per hour would be a "rule," whereas a standard would be a requirement of "maintaining a reasonable speed" under the circumstances.[287]

Usury laws are examples of bright-line rules—e.g., no lending over 36% annual interest.[288] In contrast, unconscionability is a standard *par excellence*, irrespective of whether it is applied on an objective reasonable person basis or tailored to the specific consumer(s) at issue.[289]

Ability-to-repay is harder to characterize neatly. The core ability-to-repay requirement is a standard that would seem to be tailored to the specific consumer. There is a subjective and speculative nature to the inquiry about whether a consumer's current income and assets will be sufficient to pay off a debt in the future. Yet statutory ability-to-repay

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285 *Compare* discussion *supra* note 182 (describing unconscionability's equitable origin), *with* sources cited *supra* note 21 (providing examples of state usury laws), *and supra* Section III.G (summarizing statutory sources of ability-to-repay).

286 *See, e.g.*, Cass R. Sunstein, *Problems with Rules*, 83 Cal. L. Rev. 953, 971–78 (1995) (examining three arguments against rules); Richard A. Posner, The Problems of Jurisprudence 42–61 (1990) (summarizing the debate); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 621 (1992) (arguing that, from an economic perspective, "[t]he central factor influencing the desirability of rules and standards is the frequency with which a law will govern conduct"); Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. Chi. L. Rev. 1175, 1178–81 (1989) (arguing "[t]he common-law, discretion-conferring approach is ill suited, moreover, to a legal system in which the supreme court can review only an insignificant proportion of the decided cases" and that rules would provide the advantage of predictability); Carol M. Rose, *Crystals and Mud in Property Law*, 40 Stan. L. Rev. 577, 600 (1988) ("[C]rystalline rules seem less the king of the efficiency mountain than we may normally assume."); Pierre Schlag, *Rules and Standards*, 33 UCLA L. Rev. 379, 379 (1985) ("Every student of law has at some point encountered the 'bright line rule' and the 'flexible standard.'"); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 Harv. L. Rev. 1685, 1687–1713 (1976) ("The jurisprudence of rules . . . is premised on the notion that the choice between standards and rules of different degrees of generality is significant, and can be analyzed in isolation from the substantive issues that the rules or standards respond to."). *But see* Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 Or. L. Rev. 23, 25–30 (2000) (arguing that rules and standards lie along a spectrum rather than in a clear dichotomy); H.L.A. Hart, The Concept of Law 124 (1961) (noting that rules "will, at some point where their application is in question, prove indeterminate").

287 *See, e.g.*, Korobkin, *supra* note 286, at 23 (summarizing the speed limit example).

288 *See* discussion *supra* note 119.

289 *See* discussion *supra* notes 139–41.

requirements are often accompanied by safe harbors that operate as bright-line rules.[290] For example, there might be a safe harbor presumption that ability-to-repay has been met if a loan has a debt-to-income ratio below a certain level.

The core takeaway from the rules-versus-standards literature is that there are arguments in favor of and against both rules and standards.[291] Bright-line rules create ex ante certainty for parties about legality, which enables them to efficiently adjust their behavior and engage in resource allocation decisions.[292] Moreover, rules help parties avoid the need for litigation, and, when litigation arises, rules reduce the role for judicial discretion and the possibility of misadjudication.[293] Additionally, rules enable issues to be resolved on a wholesale basis without inquiry into individual situations.[294] This reduces litigation expense.[295] Rules thus have efficiency benefits over standards in terms of their administrability and predictability.

On the other hand, rules can be over- or underinclusive, undermining their overall efficiency. In particular, rules can fail to account for unusual circumstances.[296] Moreover, bright-line rules encourage the proverbial "bad man" to walk right up to the line of what is legal.[297] In the credit cost context, this would mean that creditors would charge the maximum rate permitted by law. To the extent that a legislature

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290 *See supra* Section III.G (summarizing safe harbors).

291 *See, e.g.*, Schlag, *supra* note 286, at 400 (describing the traditional "virtues" and "vices" of rules and standards).

292 *See* Richard Posner, Economic Analysis of Law, 554–66 (4th ed. 1992) (analyzing through an economic lens how rules affect a litigant's decision to settle a case before trial); Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 Yale L.J. 950, 951 (1979) (analyzing "how the rules and procedures used in court for adjudicating disputes affect the bargaining process that occurs between divorcing couples *outside* the courtroom"); Schlag, *supra* note 286, at 383–90 (summarizing the relative pros and cons of rules and standards); Kennedy, *supra* note 286, at 1687–1701 (summarizing how rules affect both the form and substance of law).

293 *See* sources cited *supra* note 292.

294 *See* Kaplow, *supra* note 286, at 563 ("If there will be many enforcement actions, the added cost from having resolved the issue on a wholesale basis at the promulgation stage will be outweighed by the benefit of having avoided additional costs repeatedly incurred in giving content to a standard on a retail basis.").

295 *See* Adams v. Plaza Finance Co., Inc., 168 F.3d 932, 939 (7th Cir. 1999) (Easterbrook, J., dissenting) ("It is more expensive to apply and litigate about standards than to apply rules.").

296 *See, e.g.*, Kaplow, *supra* note 286, at 561–62 (describing the relationship between the decision of a rule or standard and human behavior); Sunstein, *supra* note 286, at 957–58 ("Often general rules will be poorly suited to new circumstances that will be turned up by unanticipated developments . . . ."); Schlag, *supra* note 286, at 384–89 (summarizing the relative pros and cons of rules and standards).

297 Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 Harv. L. Rev. 457, 459 (1897) (developing the concept of the "bad man"); *see also* Schlag, *supra* note 286, at 385 ("By predesignating and quantifying the magnitude of the penalty to be applied, rules allow Holmes' proverbial bad man to treat the deterrent as a fixed cost of doing business.").

is unsure exactly where within a range of rates the usury limit should be, the concern about the "bad man" who goes to the very edge of the legal precipice counsels for setting a lower usury limit but that lower limit might actually be suboptimal, at least for some borrowers, because it might prevent mutually beneficial lending relationships that do not generate undue risk.

Worse still, the "bad man" can sometimes cleverly structure his dealings around a bright-line rule, because the clarity of the rule lets him know exactly what he must do to avoid its application. A loan might be characterized as a sale, for example.[298] This has always been a major challenge for usury laws,[299] and the bright-line rules of usury laws have long been accompanied by a standards-based, anti-evasion doctrine.[300]

Standards, in contrast, have the advantages of greater flexibility, less arbitrariness in line drawing—why limit speed to sixty-five miles per hour and not sixty-four miles per hour or sixty-six miles per hour?—and potentially greater accuracy of outcomes.[301] Standards are more adaptable, fair, and practical.[302] Whereas rules are likely to be both over- and underinclusive, a standard is capable of sorting between technical and flagrant violations and meting out justice accordingly.[303]

Standards, however, are often vague and unpredictable.[304] To the extent that standards reduce certainty about where the limes of legality lies, they may chill permissible or even desirable conduct.[305] Yet that chilling effect may be precisely the point; muddy standards discourage a risk-averse "bad man" from walking up to the edge because a "bad man"

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298 *See, e.g.*, Lateral Recovery LLC v. Capital Merchant Services, LLC, 2022 U.S. Dist. LEXIS 181044 (S.D.N.Y. Sept. 30, 2022) (finding purported sale of future receivables to be a disguised loan); Fleetwood Services v. Ram Capital Funding LLC, 2022 U.S. Dist. LEXIS 100837 (S.D.N.Y. June 6, 2022), *aff'd*, Fleetwood Servs., LLC v. Richmond Capital Grp. LLC, 2023 U.S. App. LEXIS 14241 (2d Cir. 2023) (same); CapCall, LLC v. Foster (In re Shoot The Moon, LLC), 635 B.R. 797, 816 (Bankr. D. Mont. 2021) (same); Davis v. Richmond Capital Group LLC, 194 A.D.3d 516 (N.Y. App. Div. 1st Dep't 2021) (same).

299 *See* Bender, *supra* note 148, at 739 ("Because usury regulation typically recognizes a violation only when certain discrete elements are present, lenders can skirt usury by structuring transactions so as to avoid one or more of these elements." (footnote omitted)).

300 *See supra* note 119 (discussing in greater detail how bright-line usury rules are accompanied by more normative standards to prevent evasion).

301 *See* Schlag, *supra* note 286, at 383–90 (summarizing the benefits and drawbacks of rules and standards); Kennedy, *supra* note 286, at 1687–1701 (summarizing the benefits of standards).

302 *See* sources cited *supra* note 301.

303 *See* sources cited *supra* note 301.

304 *See* Kaplow, *supra* note 286, at 561–62; (describing how standards, relative to rules, can be imprecise and fail to capture other criteria "relevant in adjudicating" a particular issue); Sunstein, *supra* note 286, at 957–58 (arguing that specific, particularized rules may be better than standards because standards are so general that relevant information about an individual's action is left out).

305 Schlag, *supra* note 286, at 385 (describing how because of generalized standards, "some risk-averse people will be chilled from engaging in desirable or permissible activities").

does not exactly know what is permitted to him.[306] On the other hand, if the "bad man" is risk preferring, then a standard will liberate him to engage in more aggressive antisocial behavior.[307] And because standards depend on ex post application by courts, they are less efficient in this regard than rules, which allow parties more ex ante certainty and facilitate transaction planning.[308]

Finally, rules and standards differ in terms of their allocation of decision-making authority.[309] A rule retains almost all decision-making authority in the hands of the body that promulgated it.[310] Thus, if a state legislature promulgates a speed limit of sixty-five miles per hour, there is little discretion for regulators or judges to decide that the cap does not apply in certain situations. At most, there is discretion in prosecution. In contrast, if a legislature were to promulgate a "reasonable speed" standard, discretion would be vested in the judiciary—and not just the current judiciary, but future iterations thereof, which may have a different political composition—to apply the standard.[311] There is thus less certainty about how a standard will be applied or whether it will be applied consistently over time.[312]

B. Rules-versus-Standards in Consumer Credit Regulation

Applying these insights to the choice among usury laws, unconscionability, and ability-to-repay, the tradeoff between usury laws and unconscionability neatly tracks the rules-versus-standards divide. Usury laws have the benefits and drawbacks of rules, even if they rely on a standards-based, anti-evasion doctrine to be effective, while unconscionability has the benefits and drawbacks of standards. Ability-to-repay requirements are also standards, but they operate somewhat differently than unconscionability—addressed anon—and are often paired with rule-based safe harbors.

Just characterizing these three modes of regulation as rules or standards does not tell the full story, however, for they all involve different types of inquiries. Usury laws look only to the level of an interest rate or fees, which can generally be determined within the four corners of the

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306 *Id.*

307 *Id.*

308 *See* Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 173–74 (1988) (noting that unconscionability standards have high transaction costs because of the need for judicial involvement).

309 *See* Schlag, *supra* note 286, at 386 (describing the relative benefits of rules and standards as they relate to the concept of delegation).

310 *Id.*

311 *See, e.g.*, Korobkin, *supra* note 286, at 23 (summarizing the speed limit example).

312 *See* Schlag, *supra* note 286, at 400 (describing certainty as a "virtue" of rules relative to standards).

loan contract. In contrast, unconscionability is a standard that involves a holistic inquiry that considers both the terms of the contract and the process of dealings between the borrower and lender. Whether it considers individual borrower attributes or uses a reasonable borrower standard of some sort depends on the court.[313]

Ability-to-repay is different still. Like unconscionability it is a standard that involves a holistic inquiry, but the ability-to-repay inquiry is always a borrower-specific inquiry of the borrower's income, assets, and obligations.[314] Ability-to-repay also looks at loan terms more broadly than usury; ability-to-repay considers not just the interest rates and fees but also other potentially problematic lending practices relating the loan amortization, rate resets, fees, extended refinancings, and costs not paid to the lender, such as taxes, insurance, and homeowners' association dues.[315] Ability-to-repay thus addresses the potential misalignment of lender and borrower interests in situations where the misalignment might not be reflected in the interest rate.

The ability-to-repay inquiry does not, however, extend to the nature of the bargaining process in the way procedural unconscionability does;[316] ability-to-repay is not concerned with imbalances in power between lender and borrower or the details of their communications. Ability-to-repay reflects an implicit assumption that there will always be a power imbalance between lender and borrower such that verification of borrower repayment capacity is a necessary safeguard.[317] Thus, ability-to-repay is focused on the very practical question of whether consumers are likely to find themselves caught in unduly burdensome obligations, not on the bargaining process by which consumers found themselves facing such obligations.[318] Put another way, ability-to-repay is concerned with a narrow type of process—verification of ability to repay—and then only because of its concern about outcomes.

Unlike judicially created ability-to-repay requirements, such as in the *Fremont* case,[319] statutory ability-to-repay requirements are often coupled with safe harbors.[320] These safe harbors have the effect of making ability-to-repay more rule-like. The safe harbors provide ex ante certainty for risk-averse lenders yet still allow freedom of contract for risk-preferring lenders, who are still required to verify borrowers' ability to repay. This allows for risk-preferring lenders to specialize in dealing with higher-risk borrowers and possibly develop economies of

313 *See supra* Section II.C.
314 *See supra* Section II.A.
315 *See supra* Part III.
316 *See supra* note 130 and accompanying text.
317 *See supra* Section III.G.
318 *See supra* Part III.
319 *See* Commonwealth v. Fremont Inv. & Loan, 897 N.E.2d 548, 560 (Mass. 2008).
320 *See supra* Section III.G (summarizing safe harbors).

scale for verifying their ability to repay. It also ensures that the safe harbor rules do not prevent mutually beneficial lending relationships that do not generate undue risk.

Each of these approaches has merits and drawbacks as a method of consumer credit regulation. As a method for regulating a consumer credit system, the lack of ex ante certainty engendered by unconscionability standards renders them unsuitable as the primary regulatory mode. Given the enormous number of consumer credit transactions and the tremendous variation in how any particular lender interacts with borrowers, much less on what terms, relying on unconscionability to be the primary policing mechanism rather than a tool for targeting extraordinary cases would inject too much transaction-chilling uncertainty into the consumer credit system.

Usury laws, for all of their arbitrariness, provide substantial certainty benefits for credit transactions. In this regard, usury laws are to be preferred over unconscionability as the primary mode of regulation, but with unconscionability providing a backstop for egregious cases where the problem stems from either nonmonetary price terms or contracting process (market power and communications) or the interaction of these terms or process with other features of the loan, even if the interest rate complies with the usury statute.

Yet, although usury laws might be preferable as a primary regulatory mode relative to unconscionability, ability-to-repay requirements have much to commend them relative to usury laws. Because the ability-to-repay inquiry is broader than the monetary price terms, it captures the totality of the loan terms, such as amortization schedules and rate resets.[321] This means that the ability-to-repay is more likely to capture situations like sweatbox lending, where the interests of the lender and borrower are not substantially aligned.[322]

Unlike unconscionability, however, ability-to-repay does not account for the bargaining process that led up to the contract.[323] It thus does not capture the situation where the borrower can repay the loan, but the loan would not have been advisable, and the borrower lacked the wherewithal to decline the offer. Nor does it address the situation where a borrower failed to fully understand the offer, such that the borrower would not have entered into the loan had he fully understood. Thus, ability-to-repay is also well served with an unconscionability doctrine backstop.

Ultimately, the combination of ability-to-repay plus safe harbors gains virtually all the benefits of a usury law while maintaining

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[321] *See supra* Section III.G.

[322] *See supra* Section I.E.

[323] *Compare supra* Section II.C (summarizing unconscionability), *with supra* Section III.G (summarizing ability-to-repay).

flexibility. If backstopped by unconscionability, ability-to-repay would seem to provide the best approach to consumer protection.

C. Rules-versus-Standards is Outcome Determinative

The rules-versus-standards debate has strangely operated as if the choice is merely a procedural matter of efficiency and administrability with no effect on actual outcomes.[324] Yet, the rules-versus-standards choice is always potentially outcome determinative to the extent that the outcomes with a standard do not align with those of a rule. For example, if a usury rule prohibits interest at more than 36% APR, and an unconscionability standard holds that a 30% APR loan is unconscionable, then the rule-versus-standard choice is outcome determinative. So, too, if the unconscionability standard were to hold that a loan at 40% APR were not unconscionable.

In other words, depending on the baseline (rule or standard), both approaches can produce type 1 errors (false positives) and type 2 errors (false negatives). To be sure, one cannot say in the abstract whether the choice of a rule or a standard will result in any particular result, but the idea that they are outcome equivalent is dubious, as is underscored by the literature's emphasis on the unpredictability of standards.[325]

In the context of consumer credit regulation, however, there is an additional aspect to the outcome-determinative nature of rules-versus-standards, namely how the choice of a rule versus a standard interface with the economics and procedural posture of regulation.

From the perspective of a consumer, the choice between rules and standards is messy. A consumer will bear the burden of proof either if the consumer is the plaintiff or if the consumer raises an affirmative defense, like unconscionability or ability-to-repay. This means that the consumer has a hurdle to surmount under either a rule or a standard.

On the one hand, a consumer might prefer a rule to a standard because it is much cheaper to enforce rules than standards.[326] Proving a usury violation is much more straightforward than proving that a practice is unconscionable. A usury violation can generally be shown from the four corners of the loan contract. And because compliance is much easier for a rule, a consumer might never need to take action to enforce a rule; the lender will simply comply.

On the other hand, because rules are easier to evade than standards, a consumer might more often be confronted with problematic

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324 *See* sources cited *supra* note 286 (summarizing the rule-versus-standards debate).

325 *See, e.g.*, Korobkin, *supra* note 286, at 25–26 ("Standards, in contrast, require adjudicators (usually judges, juries, or administrators) to incorporate into the legal pronouncement a range of facts that are too broad, too variable, or too unpredictable to be cobbled into a rule.").

326 *See* Adams v. Plaza Finance Company, Inc., 168 F.3d 932, 939 (7th Cir. 1999) (Easterbrook, J., dissenting) ("It is more expensive to apply and litigate about standards than to apply rules.").

business practices under a rule-based regime. Moreover, if a consumer finds herself in litigation, a standard might be preferable because it is harder for a business defendant to dismiss a standards-based claim on a pre-discovery motion to dismiss.

At the same time, however, to the extent the consumer is proceeding as part of a class, a standards-based approach presents an obstacle if the standard looks to the characteristics of individual consumers within a class, as it might prevent class certification. Given the economics of consumer finance litigation, which usually involves relatively small amounts in controversy, litigation by consumers is often not economically feasible, unless it can be brought as a class action.[327] All told, the rules-versus-standards choice is not obvious from the perspective of an individual consumer.

Yet this perspective is not the most important in consumer credit regulation. The reality of consumer credit contracts is that they are rarely litigated by individual consumers precisely because the dollars at stake are too small to justify litigation in most cases.[328] Consumers with credit problems can rarely pay for counsel except on contingency fee, and the potential recoveries are often too low to merit representation given the odds of success, even with statutory attorneys' fees and fee shifting statutes.[329]

Because of the small amounts in controversy, the economics of consumer credit litigation often preclude consumers from bringing affirmative litigation except in the context of class actions.[330] But class actions are all but impossible because of the prevalence of binding mandatory arbitration clauses in most types of consumer credit contracts—excluding mortgages, federal student loans, and loans covered by the MLA.[331] Thus, affirmative private litigation about consumer credit is quite rare.[332] Likewise, most suits against consumers seeking to collect on consumer credit result in default judgments, such that private litigation plays a limited role in the law of consumer credit.[333]

Instead, the key perspective in consumer credit regulation is that of public regulators—the CFPB, the FTC, the federal banking regulators, and state attorneys general and banking supervisors. The choice of a rule versus a standard looks quite different from a public regulatory agency's perspective: a standard gives the agency immensely more

327 *See* Levitin, *supra* note 117, at 46–47 (discussing the economics of consumer finance litigation).

328 *Id.*

329 *Id.*

330 *Id.*

331 *See id.* at 59–65 (discussing arbitration).

332 *Id.* at 47.

333 *Id.*

discretion and hence power than a rule. Moreover, a standard-based regime virtually dictates the outcome if the agency takes action.

If a financial regulator were to bring litigation in court, the burden of proof would be on the regulatory agency, which would likely prefer a rule in such a situation. But financial regulatory enforcement is rarely decided in court. Instead, it is usually decided in the context of regulatory agency investigations, supervisory actions, or enforcement actions that are never actually litigated but result in consent decrees that are summarily approved by courts.[334]

In situations that fall short of full-blown litigation, the regulatory agency has the whip hand. It faces no barrier of arbitration clauses or class certification and can often recover far greater damages than a private litigant—restitution plus civil monetary penalties. Additionally, liability may have collateral regulatory consequences—loss of licenses, or further regulatory scrutiny—and there are serious reputational consequences for a regulated entity.[335] All this means that the mere threat of enforcement creates a powerful incentive for a regulated entity to settle rather than litigate even if it may have meritorious defenses.

In such situations, private litigation's dynamic regarding the burden of proof is flipped. A standard gives the regulator tremendous discretion regarding whether to claim a legal violation. Even if the lender has some reasonable defenses, it may not matter given the heavy enforcement hammer wielded by the regulator. Indeed, this raises the danger of overzealous enforcement because a regulator empowered to enforce a standard that faces little meaningful judicial review can become a law unto itself.

In contrast, a bright-line rule provides a lender with substantial certainty regarding the likelihood of regulatory enforcement—either the lender has violated the usury law, or it has not. The choice of rules versus standards may well be outcome determinative in a regulatory enforcement context because if there is a standard, the lender will generally lose or, more precisely, be forced to settle, while if there is a rule, the lender will only face an action if there is a clear violation. Thus, the political economy of rules-versus-standards flips depending on whether usury laws are enforced primarily through public rather than private action.[336]

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334 *See generally* Kelly Thompson Cochran, *The CFPB at Five Years: Beyond the Numbers*, 21 N.C. Banking Inst. 55 (2017) (describing CFPB enforcement through both court filings and agency investigations).

335 *See* Levitin, *supra* note 64 at 357–58 (describing CFPB enforcement authority).

336 Judge Easterbrook's insight regarding the cost of standards does not address who bears the costs of litigating about standards. *See* Adams v. Plaza Finance Company, Inc., 168 F.3d 932, 939 (7th Cir. 1999) (Easterbrook, J., dissenting) (acknowledging that standards are often costlier without analyzing who bears such costs). In the context of private litigation, added costs inure to well-heeled defendants. But in the context of public litigation, added costs inure to the benefit of the government.

The ability-to-repay approach with safe harbors helps address this dynamic. Safe harbors help protect against an overzealous regulator while giving the regulator a freer hand to act against egregious violations and encouraging parties that do not rely on safe harbors to seek pre-clearance of their practices through no-action letters and the like. And because of the UDAAP prohibition in the Consumer Financial Protection Act, the CFPB and state attorneys general are still able to use an unconscionability-like standard to address problems in the contracting process or contract enforcement outside of the credit terms of a loan.[337]

In contrast, the choice of rule or standard is largely irrelevant for the concern about underenforcement. This is because a regulator that does not wish to bring enforcement actions because of its political worldview will not bring them irrespective of whether it administers a rule or a standard, although it will find it easier to hide behind a standard.

Ability-to-repay requirements with safe harbors help harness the best of both rules and standards, particularly given the dynamics of consumer credit regulation, where safe harbors offer risk-adverse parties certainty while maintaining flexibility to allow risk-preferring lenders to serve consumers so long as they ensure compliance with the standard.

D. *Toward a National Ability-to-Repay Requirement*

In light of this Article's insights about the preferability of an ability-to-repay standard with safe harbors, this Article argues that Congress should enact a national ability-to-repay requirement for all consumer credit, excluding student loans, which are a product premised on future rather than present, earning power.[338] The CFPB should then be empowered to implement the requirement with product-specific safe harbors that ensure statistically low (but not zero) default rates.[339] A national ability-to-repay requirement would transform the doctrinal grab bag of the New Usury into a coherent and comprehensive approach to consumer credit regulation. A national ability-to-repay requirement would have the effect of creating a uniform playing field for national

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337 *See generally* Adam J. Levitin, *"Abusive" Acts and Practices: Toward a Definition?* 10–11 (June 19, 2019), https://ssrn.com/abstract=3404349 [https://perma.cc/Q932-S8LP] (explaining the relationship between "abusive" and unconscionability).

338 Excluding federal Direct Loans from ability-to-repay does not raise a policy concern, however, because federal Direct Loans already have the most consumer-friendly terms of any financial product on the market, have an interest rate set by federal law, and have a back-end ability-to-repay feature through income-driven repayment options. Private student loans are a more problematic situation; addressing them is beyond the scope of this Article.

339 To be sure, the existing prohibition on unfair, deceptive, or abusive acts or practices already arguably encompasses an ability-to-repay requirement for which the CFPB could promulgate safe harbors. *See supra* Part III.E. But it remains unclear exactly how far the UDAAP power reaches. Express legislation would resolve the uncertainty.

consumer credit markets, enabling broader and more efficient markets than fragmented local regulations.

A national ability-to-repay requirement would punt the hard work of detailed requirements and safe harbors to the regulators, particularly the CFPB. The devil is very much in the details of regulatory implementation of defining what is necessary to evaluate ability-to-repay and creating safe harbors, but this is something the CFPB has already implemented for mortgages and credit cards,[340] two of the largest consumer financial product markets, so expanding it to other markets such as auto loans or retail installment sales should be readily feasible.

Conclusion

The erosion of traditional usury laws through preemption and deregulation created a doctrinal vacuum regarding the treatment of high-cost credit. At the same time, changes in the structure of the consumer finance market undermined lenders' incentive to ensure the affordability of loans. Courts, legislatures, and regulatory agencies have all acted in their own ways to fill that gap with the set of doctrinal innovations this Article terms the "New Usury"—an expansion of traditional unconscionability doctrine to hold nonusurious loans unconscionable based on high cost, and various ability-to-repay requirements.

Because of its multiple sources, the New Usury has developed in a piecemeal and haphazard manner, often in response to particular market problems. As a result, the New Usury applies differently by product and jurisdiction. Moreover, some of the New Usury is not even formally binding law but rather merely akin to indications of when a regulatory agency might bring an enforcement action.

The different doctrinal approaches represented in the New Usury tee up the question of what is the optimal approach among traditional usury laws' bright-line rules, unconscionability's broad standards-based regime, and the narrower standards-based inquiry of ability-to-repay. Although many of the considerations track the well-established rules-versus-standards debate, the added twist is that in the consumer finance context the choice of a rule or a standard is often outcome determinative and must be evaluated with consideration of the dynamics of regulatory enforcement.

Based on this analysis, this Article calls for formalizing the New Usury in a national ability-to-repay requirement coupled with product-specific regulatory safe harbors. Combining an ability-to-repay standard with rules-based safe harbors would guarantee certainty for businesses while still ensuring that consumers are protected from unduly aggressive extensions of credit.

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340 *See supra* Part III.D.