TESTIMONY OF SENATOR BLANCHE LINCOLN
before the Committee on Banking, Housing, and Urban Affairs
June 22, 2004

Thank you Mr. Chairman, Senator Sarbanes, colleagues.

I am here to testify in support of my bill, S. 904, allowing non-bank lenders in Arkansas, who are currently subject to a state usury restriction, to charge the same rates of interest that their out-of-state competitors are legally importing into Arkansas under Federal law. It is my hope that this bill will be included in the Regulatory Relief bill. The most important thing I would ask the members of this Committee to take from my testimony today is this: The question of whether a state usury law is good for consumers or bad for consumers is not at issue. With the passage of the Riegle-Neal Interstate Banking Act, the debate concerning the consumer benefits of state usury laws came to an end because lenders were then allowed to import their home state interest rates across state lines. The only issue now left to consider is whether in-state lenders who were placed at a competitive disadvantage because of this Federal law should be able to compete on a level playing field with out-of-state lenders. For my state this is an issue of jobs and I intend to fight very hard for the legislation that I have proposed with a unified Arkansas delegation and our Governor.

At this point, I would like to submit a copy of a letter from our Governor. I also ask that a copy of an article by two Professors of Finance and one Professor of Economics from the University of Arkansas also be placed in the record. Their article is entitled "The History of Usury Law in Arkansas: 1836-1990." I encourage all of my colleagues, particularly those who are critical of the current efforts of the entire Arkansas Congressional delegation to free Arkansas' non-bank lenders from unfair out-of-state competition, to read this article. It is an excellent account of how Arkansas has struggled with this issue over the years before the passage of the Riegle-Neal Interstate Banking Act in1994. I will go over some of the history of this issue in my testimony today, but I would like to highlight at this point two of the conclusions made by these scholars.

These gentlemen state, and I quote . . .

- "To avoid the massive outflow of funds that the state has experienced in the past, any new constitutional usury provision must be structured so that both the business and financial communities are allowed a reasonable differential between their cost of funds and what they can charge for those funds."

They continued, and again I quote . . .

- "Other costs, in the form of a higher unemployment rate, higher prices, and the inability of borrowers to gain access to needed funds have occurred as a result of the restrictive nature of the state's usury law. If all these costs were converted into dollar amounts there is no doubt that the price of having an artificially low interest rate at various times throughout the state's history would run into the millions of dollars."

The Constitution of Arkansas was rewritten in 1874 after Reconstruction was ended. Among the provisions written into the Arkansas Constitution at that time was a 10% cap on interest rates. From the very beginning, this cap on interest rates has been a limitation on capital that has hindered progress in the State. Caps on interest run counter to the economic realities of lending and have thus served not as a protection of consumers, but a hindrance. The cap on usury in Arkansas has limited the availability of capital for start-up businesses, high risk loans, and low income families.

In 1982, Arkansas voters changed their Constitution by adopting Amendment 60, and created a two tiered interest rate cap. The opponents to Amendment 60 were led by the Arkansas State AFL-CIO, the NAACP, and the Arkansas Community Organizations for Reform Now (ACORN). Endorsing the amendment were over seventy organizations as well as Governor Frank White, Senator Pryor, Senator Bumpers, and former and future Governor Bill Clinton. The Amendment which passed with 59% of the vote provided a cap of 5% over the federal discount rate for "general loans" and a 17% above-the-Federal-discount-rate for "consumer loans." However, as is common with voter initiatives that do not move through an ordinary legislative process, the Amendment was not properly designed. The Arkansas Supreme Court subsequently decided that the general loan provision overrode the consumer loan provision, thus all loans in Arkansas were, at that time, capped at 5% over the discount rate. The clear intent of the people to lift the usury cap for consumer loans to something more in line with other states was struck down on a technicality. I have included a copy of the court's decision in Bishop versus Linkway Stores in my testimony.

Arkansas has thus been left as one of the few states that is still burdened by an antiquated and anti-capitalistic usury restriction. In his book on economic development in the states, "Laboratories of Democracy" David Osborne wrote of Arkansas that, quote "The Usury law, which limits interest on loans to five percentage points above the Federal Reserve Board's discount rate, continues to inhibit both long-term, fixed-rate loans and riskier short-term loans." He continues by saying that "[Governor] Clinton's economic team recommended that it be abolished."

In the 1980's, the damaging impact of Arkansas' usury cap was limited to economic growth and capital availability in the state. In1994 Congress got involved. That is when the viability of Arkansas-based lenders was put at risk by the actions of Congress. In 1994 Congress passed the Riegle-Neal Interstate Banking Act. This law gave interstate lenders the authority to charge either their home state or their host state interest rates. This Federal law eliminated the practical effectiveness of Arkansas' cap on usury for out-of-state lenders and put Arkansas lenders, who remained subject to the law, at a competitive disadvantage to out-of-state lenders.

At this point I would ask that a November 1998 article from "The Economist" magazine be placed in the record. This article highlights the sad effect that the Riegle-Neal bill had upon Arkansas lenders and jobs.

The inequity of this Federal law created an immediate crisis for Arkansas Banks competing with existing out-of-state bank branches in their communities. This prompted a unified Arkansas delegation to push to give Arkansas chartered banks the authority to charge the same interest rates as the host state of interstate bank branches as part of the 1999 Gramm-Leach-Bliley Financial Modernization Act. This provision was specific to Arkansas. In 1999 other lenders, non-bank lenders, with less established competitors did not feel the pressure as acutely as the Arkansas bankers. However, competition from out-of-state non-bank lenders has begun to take its toll on Arkansas lenders and jobs.

In 2000, with the support of former Senator Hutchinson, I introduced legislation to allow non-bank lenders the ability to import the rates of their competitors. This bill was modeled after the provision passed in 1999 for banks. Democratic Congressman Mike Ross, along with the entire Arkansas House delegation introduced identical language in the House of Representatives. The Senate Bill was reintroduced in the 108th Congress with Senator Pryor as a cosponsor. The bill enjoys the support of the Democratic legislature, the Republican Governor, and countless groups in Arkansas who are concerned about jobs losses resulting from the current state of the law. The House Banking Committee has approved of the legislation twice since introduction, and recently the full House approved of the measure as part of the "Regulatory Relief" bill.

I would like to close by addressing the three main criticisms I have heard about the legislation I and the Arkansas Delegation have proposed.

Number one: Doesn't the Arkansas Usury provision protect consumers?

Some argue that the usury cap in Arkansas serves a useful purpose for consumers and prevents discriminatory actions by lenders. However, because the Arkansas usury law only applies to Arkansas based lenders, consumers are not protected by this cap at all. An out-of-state lender is contacted any time a person's credit ranking is too low to justify a capped rate. As a result of Federal law, out-of-state lenders are allowed to give credit that Arkansas lenders can't give.

In fact, the Arkansas usury cap combined with the power of out-of-state lenders to import their rates actually leads to discriminatory actions by unscrupulous merchants. In order to prevent sales from leaving the state and their stores, sellers in Arkansas have begun charging far higher prices for products in order to compensate for their inability to charge interest. Further, Consumers in Arkansas are now often victims of so-called "note-and-tote" schemes where unscrupulous salespersons steer high-risk borrowers to an outrageously, overpriced item and offer to loan them the money to purchase it. The high-risk credit consumer can be lured into this scheme because he or she has no other access to credit in Arkansas.

Number 2: Shouldn't Arkansas fix this problem at home?

The problem at hand was created by Congress with the passage of the Riegle-Neal Interstate Banking Act. It is unlikely that this Committee or the Senate would recommend repealing

Riegle-Neal or imposing a usury cap on all states. It was Congress that created a comparative disadvantage for Arkansas lenders by allowing out-of-state lenders to import rates. Congress has chosen to occupy the field of interstate rate restrictions and should act responsibly to negate inequities.

Further, in an environment where federal laws and regulations have substantively occupied the field, the organizing document of a state is not flexible enough to keep up with the fluid changes of Federal law. For example, the current Arkansas constitutional provision concerning usury ties interest rates in Arkansas to the Federal Reserve Bank's "discount rate." The calculation of the "discount rate" was discontinued by the Federal Reserve Bank, the term "discount rate" is no longer used, and the inflexible Arkansas Constitution is left subject to interpretation.

There are also other practical reasons why Congress should act to fix this problem. The Arkansas legislature meets every two years and can offer only a limited number of proposed amendments to the Constitution. The proposed amendment would then go to the ballot in the ensuing statewide election. This process takes time and money, neither of which come easy to the people in need of this change in the current competitive environment.

Number 3: The lenders to whom we would extend the usury override are not regulated like banks and so we can't trust them with the power to charge a higher price for borrowed capital, can we?

Out-of-state non-bank lenders are importing rates into Arkansas in acts of interstate commerce. If critics of these lenders believe that Congress should regulate non-bank lenders operating in interstate commerce they should propose legislation. However, there is nothing righteous in giving non-regulated lenders a competitive advantage over other non-regulated lenders because regulation does not exist.

This concludes my testimony Mr. Chairman, and I appreciate the opportunity you have given me to appear here today.