

## California Usury Laws

By June L. Lin\*

### I. Introduction

Usury is defined as the charging of interest in excess of that allowed by law. Interest is defined as any compensation or benefit received by the lender as part of a loan or forbearance, other than specific charges for services or expenses that are incidental to making the loan.

The basic usury laws in California are in the state Constitution at Article 15. For consumer loans, the parties may contract for interest on a loan primarily for personal, family or household purposes at a rate not exceeding ten percent per year. A loan to be used primarily for the purchase, construction or improvement of real property is not regarded as a loan for personal, family or household purposes.

For all other loans, the allowable rate is the higher of ten percent or five percent over the amount charged by the Federal Reserve Bank of San Francisco (FRB) on advances to member banks on the twenty-fifth day of the month before origination of the loan. As of June 15, 2007, for example, the applicable FRB rate was 6.25 percent, meaning that any non-exempt loan bearing interest at greater than 11.25 percent would be usurious.

Maximum interest rates refer to the simple interest rate on the unpaid balance.

### II. Examples of Exemptions

The California usury laws do not apply to loans made or arranged by a California-licensed real estate broker and secured in whole or in part by a lien on real property, regardless of whether the real estate broker was acting in that

capacity.<sup>1</sup> Usury laws also do not apply to loans made by or obligations of most depository financial institutions such as banks, savings and loan associations, and credit unions.<sup>2</sup> The California Financial Code applies this exemption to: (1) state banks and other states' banks and national banks with an office in California if the bank is authorized to engage in the trust business and is acting in its fiduciary capacity; (2) certain foreign banks with assets of at least \$100 million; (3) bank holding companies and their nonbank subsidiaries; (4) commercial finance lenders licensed to engage in the business of making commercial loans (*i.e.*, loans of \$5,000 or more which the borrower intends to use primarily for other than personal, family or household purposes); (5) consumer finance lenders (*i.e.*, entities engaged in the business of making consumer loans) making loans with principal amount of \$2,500 or more; and (6) mortgage bankers making loans to corporations with a principal amount of \$100,000 or more secured by a lien on real property.

The Constitution partially exempts from the usury laws certain lenders who are likely to lend to the most vulnerable borrowers. Consumer finance lenders making loans with a principal amount of less than \$2,500, personal property brokers (*i.e.*, persons in the business of lending money and receiving as security a contract calling for a forfeiture to the lender of rights in personal property), licensed pawnbrokers (*i.e.*, persons in the business of receiving goods as security for loans), and industrial loan companies have higher interest rate restrictions than the usury laws.

The usury laws also do not apply to loans made by insurance companies, and do not apply to corporations or associations engaged exclusively in the business of marketing agricultural, horticultural, viticultural, dairy, livestock, poultry, or bee products on a cooperative non-profit basis when lending to members thereof or when securing credit from any federal intermediate credit bank.<sup>3</sup>

The usury laws do not apply to time payment contracts, *e.g.*, when a seller finances the purchase of real or personal property by extending payments over time. Other state laws may impose limits on the finance charges imposed by credit sellers (*e.g.*, a retail installment contract between a buyer and seller for the payment for consumer goods and services in installments, where the buyer pays a service charge). Usury laws do not apply to bank charges for third party credit cards (Visa, MasterCard, American Express, etc). The usury laws do not apply to evidence of indebtedness (*e.g.*, promissory notes or bonds):

- rated by S&P as AAA, AA, A, BBB, or investment grade commercial paper or by Moody's as Aaa, Aa, A, Baa, or investment grade commercial paper;
- where the issuer has any security listed on a national securities exchange or NASDAQ;
- where the issuer is a reporting company under the Securities Exchange Act of 1934, had total shareholders' equity of at least \$1 million at the end of its most recent fiscal year, and had consolidated net income of

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1. Calif. Const. Art. 15.

2. *Id.*

3. *Id.*

at least \$500,000 for three of its last four fiscal years;

- issued pursuant to a costly and time consuming "qualification," requiring a permit for the issuance of the securities from the California Department of Corporations; or
- where (1) neither the borrower nor a guarantor is an individual, (2) the lender has a pre-existing relationship with the borrower or guarantor or reasonably appears to the borrower to have the capacity to protect its own interests in the transaction, (3) the loan is not primarily for personal, family or household purposes, and (4) the borrower has assets of at least \$2 million or the face amount of the loan is at least \$300,000.<sup>4</sup>

Usury laws do not apply to bonds issued by a state or local government.<sup>5</sup> Usury laws do not apply to broker-dealers acting pursuant to a certificate which is then in effect. Usury laws do not apply to any loans made by, or evidences of indebtedness purchased by, any licensee.<sup>6</sup> Usury laws do not apply to pension funds and retirement systems subject to ERISA, as well as state or local public retirement systems. Lenders making shared appreciation loans (*i.e.*, secured loans giving the lender a right to receive a share of the appreciation in the value of the security property) from ERISA pension funds are exempt from the usury laws.<sup>7</sup>

Usury laws do not apply to funds held in trust by physicians' and surgeons' cooperative indemnity corporations for indemnifying members for medical malpractice claims. Usury laws do not apply to loans made by business and

industrial development corporations (*i.e.*, California corporations licensed to provide financial and management assistance to business firms).

Usury laws do not apply to "federally related" loans secured by a first lien on residential property. "Federally related" loans are loans made by any lender whose deposits are insured by any federal agency, loans made by any lender regulated by any federal agency, loans made by any lender approved by the Secretary of Housing and Urban Development (HUD) for participation in any mortgage insurance program under the National Housing Act, and loans made or guaranteed by HUD or eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corp.

### III. Penalties and Statute of Limitations

The originator of a usurious loan is subject to severe civil penalties. These include:

- forfeiture to the borrower of all interest on the loan; not just the usurious part; and
- payment to the borrower of triple the amount of interest collected in the year before the borrower brings suit (subject to the court's discretion).

A lender who willfully receives interest in violation of the usury laws is guilty of loan sharking, a felony punishable by imprisonment for up to five years. It is, however, rare to have a conviction for loan sharking.

The statute of limitations for recovering interest paid on a usurious loan is two years--and only the amount of interest paid within that two year period is recoverable. Exceptions include:

- cases where the statute does not begin to run until after the borrower repays the loan;

- if the lender sues to enforce a usurious loan contract, the borrower may assert a usury cross-complaint for all the interest paid on the loan as an offset without regard to the statute of limitations.

The statute of limitations for recovering treble damages on a usurious loan is one year, regardless of whether the loan has been satisfied or whether the lender is attempting to enforce a usurious loan.

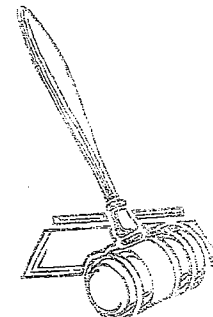
### IV. Conclusion

As a practical matter, California usury law does not seriously inconvenience most lenders, and offers little protection to most borrowers. Most creditors are either totally or partially exempt. However, the harsh penalties mean that it is important for creditors to check the law.

California usury law is not easily accessible. The relevant legislative provisions are scattered throughout various sections of the Civil Code, the Financial Code, the Insurance Code, and the California Constitution. Federal statutes and regulations are also pertinent. Criminal penalties are provided in the Civil Code rather than the Penal Code.

If you are an individual or a corporate lender and do not fall under one of the above exemptions, you must look carefully at the usury laws.

If you are a company that issues a non-investment grade promissory note and you are not a reporting company and the notes are not listed on a securities exchange, you may be subject to the usury laws and may need to warn investors that the note may not be enforceable.



4. Corps. Code § 25116, 25117, 25118.

5. Gov. Code § 5906.

6. Corps. Code § 28405 and 31410.

7. Calif. Civil Code § 1917.067.