



The Moral Hierarchy of Debt

Why America's Most Trusted Loan Is Its Most Expensive, and Who Decided Otherwise

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Debt

"Scores don't distinguish between what we define as good debt and bad debt."

— Rod Griffin, Experian

This paper, in its entirety, can be found at <https://southwestpolicy.com/sppi14>

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EXECUTIVE SUMMARY

The loan Americans are taught to call good debt carries the largest finance charge in consumer finance, and the loan they are taught to call predatory carries one of the smallest. The instrument that sorts them, the annual percentage rate, cannot tell the difference. This paper explains why the ranking persists anyway, who built it, and whom it serves.

On April 28, 2025, one of this paper's authors signed a 30-year FHA mortgage for \$414,346 at a 5.625% note rate. Page 1 of the Closing Disclosure announced the rate. Page 5, in a box labeled Loan Calculations, disclosed an APR of 6.548%, a finance charge of \$503,367.13, and a Total Interest Percentage of 107.282%. The borrower will pay more in finance charges than he borrowed. The amortization schedule that shows this, month by month, began on page 71.

The same disclosure framework describes a \$45 fee on a two-week \$300 payday loan as a 391% APR. It describes a \$24 compliance fee on a \$6 unpaid parking charge as a 146,000% APR if the motorist pays the next morning, and 8,922% if he waits a month. Under the Truth in Lending Act's governing metric, the slower a short-term borrower pays, the cheaper his loan appears, and a half-million-dollar finance charge disappears behind a single digit.

The paper's argument proceeds in two movements.

Part I: the engineering is real, and it is symmetric. Oren Bar-Gill's behavioral analysis of consumer credit shows that lenders compete on their ability to exploit complexity, present bias and overoptimism. Every one of those mechanisms operates in the mortgage market at least as powerfully as in the small-dollar market. Todd Zywicki's deliberate parody of behavioral law and economics, which condemns the 30-year fixed-rate mortgage using the field's own methods, demonstrates that the framework can indict any product chosen in advance. Behavioral economics therefore cannot explain why regulators aimed it at payday lenders and not at mortgage lenders. The asymmetry is a choice made outside the framework.

Part II: the hierarchy was built, not discovered. Anne Fleming’s legislative history shows that the APR standard was the residue of an eight-year congressional fight in which disclosure drifted from a complement to price regulation into a substitute for it, largely by accident. Mehrsa Baradaran’s institutional history shows that the distinction between productive and consumptive credit was manufactured when the New Deal attached federal insurance, subsidy and a secondary market to one product and left the other to the fringe. The FHA’s own underwriting manual rationed the virtuous debt by race. Communities excluded from it were then stigmatized for using what remained. The 2023 FDIC household survey still records the result: 1.9% of white households are unbanked, against 10.6% of Black households, 9.5% of Hispanic households and 12.2% of American Indian and Alaska Native households.

The paper accepts Baradaran’s history and rejects her remedy. A public option that prices credit below cost would reproduce the subsidy logic that created the hierarchy in the first place. The alternative is a single standard: disclose total cost in dollars and as a share of principal for every credit product, with the same prominence TILA gives the APR; measure harm by what borrowers actually pay rather than by an annualized abstraction; and stop writing moral thresholds into law, whether the 36% caps that states keep adopting or the 10% credit card cap proposed in S. 381, on the strength of a number that cannot distinguish a parking ticket from a payday loan.

The moral hierarchy of debt is not a description of how Americans borrow. It is a record of which borrowers the regulatory state decided to protect, and which products it decided to bless.

INTRODUCTION: THE GOOD DEBT THAT COSTS HALF A MILLION DOLLARS

The word debt does not sound like praise. It names an obligation, a thing owed, and in older usage a sin. Yet nearly every trusted source of financial advice in America insists that some debt is not merely tolerable but virtuous. JPMorgan Chase’s consumer education center tells prospective borrowers that good debt “is geared toward leaving you in better financial shape after you pay it off than you were before taking it on,” that it builds credit history, earns tax breaks and creates equity, and that “a mortgage is generally regarded as good debt.” Among the mortgage’s listed advantages is that it “amortizes longer” than other loans.¹

Equifax, one of the three national credit bureaus, places the mortgage at the top of its list of good debts and places payday loans at the bottom of its list of bad ones.² Robert Kiyosaki's *Rich Dad Poor Dad*, the best-selling personal finance book in American history, teaches the same taxonomy in simpler terms: good debt buys assets, bad debt buys liabilities.³

At the summit of this hierarchy sits one instrument, the American 30-year fixed-rate mortgage. It is the foundation of middle-class wealth-building, the product federal policy has subsidized for ninety years, and the debt that financial educators hold up as the model of responsible borrowing. At the bottom sits the two-week payday loan, the product that roughly twenty states have capped out of existence, that federal law effectively prohibits for service members, and that the same educators present as the model of what to avoid.

One of this paper's authors signed the paradigm of good debt on April 28, 2025.⁴ The loan was a 30-year FHA fixed-rate mortgage on a \$421,990 house: a base loan of \$407,220, the 96.5% of price that the FHA's 3.5% minimum down payment allows, plus a financed upfront mortgage insurance premium of \$7,126, for a note amount of \$414,346. Page 1 of the five-page Closing Disclosure announced the terms a borrower is trained to look for: an interest rate of 5.625%, a monthly principal-and-interest payment of \$2,385.21, no prepayment penalty, no balloon. Page 5, in a box headed Loan Calculations, disclosed four more figures. The annual percentage rate was 6.548%. The amount financed was \$398,006.63. The finance charge, defined on the form as "the dollar amount the loan will cost you," was \$503,367.13. The total interest percentage, the share of the loan amount the borrower will pay in interest over the term, was 107.282%. The total of payments, counting principal, interest, mortgage insurance and loan costs, was \$920,650.69. The amortization schedule that walks through those payments one month at a time began on page 71 of the closing packet.⁵

Six of those terms recur throughout this paper and are fixed here once. The **loan amount** is the note: \$414,346. The **amount financed** is the loan amount less the finance charges collected at closing: \$398,006.63. **Interest** is what the note rate produces on the declining balance over 360 payments, about \$444,330, which is the **Total Interest Percentage** of 107.282% applied to the loan amount. The **finance charge** is interest plus mortgage insurance and the other charges Regulation Z counts as the cost of credit: \$503,367.13, equal to 121% of the loan amount and 126% of the amount financed. The **total of payments** is principal plus finance charge: \$920,650.69. Where this paper ranks products by finance charge as a share of principal, principal means the loan amount.

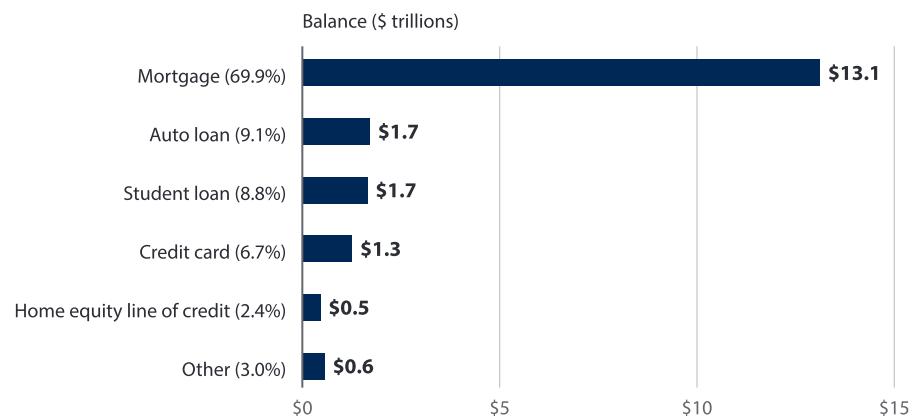
Read those figures again. The borrower will pay more in finance charges than he borrowed. He will pay more in interest alone than in principal. The first monthly payment sends 81 cents of every dollar to the lender as interest and 19 cents to the borrower as equity, and the monthly payment will not send more to principal than to interest until month 213, nearly eighteen years in. A house that cost \$421,990 will have cost \$920,650 by the time it is owned outright. None of this was hidden. All of it was disclosed, in the format federal law prescribes, on a page the borrower was required to sign. And the number given pride of place on that page, the number that financial journalism reports every week and that borrowers compare when they shop, was 6.548%.

This borrower is not unusual. He is close to the median. Bankrate's June 2026 analysis of 3.2 million mortgage originations found that 87% of American borrowers pay above the competitive rate available to them, at an aggregate cost of \$65 billion a year across loans originated since 2022, roughly \$3,343 per household per year and \$78,186 over the life of a typical 30-year loan, more than the median household's total retirement savings. More than 90% of purchase borrowers overpay. The most creditworthy overpay most often.⁶ The 30-year fixed rate averaged 7.28% in the first week of October 2026, its highest reading since 2023 and nearly three times the record low of 2.65% recorded in January 2021.⁷ Americans owe \$13.1 trillion on their mortgages, 70% of all household debt, against \$1.26 trillion on credit cards and \$1.71 trillion on auto loans.⁸ The median home sold for \$410,700 in the second quarter of 2026.⁹ At 7.28%, a borrower who finances that median home with the FHA's 3.5% minimum down payment will repay about 2.5 times what he borrowed in principal and interest alone.

Meanwhile the people signing these documents understand them less well each year. The TIAA Institute-GFLEC Personal Finance Index, which has tracked American financial literacy since 2017, reported in June 2026 that adults answered 47% of its questions correctly, the lowest result in the survey's history, with the sharpest declines in the areas of borrowing and consuming and with a quarter of adults now scoring in the very-low category.¹⁰

So a puzzle. If the mortgage is so unambiguously good, why does the typical borrower lose \$78,000 to a product that is supposed to be building his wealth? Why does a loan whose finance charge exceeds its principal carry the endorsement of every bank, bureau and bestseller in American personal finance, while a loan whose fee is \$45 carries the stigma of usury? And why, as financial literacy falls, does the cost of navigating the most consequential contract most Americans ever sign fall almost entirely on the borrower?

FIGURE 1 Household debt by type, second quarter 2026



Federal Reserve Bank of New York, Quarterly Report on Household Debt and Credit, 2026:Q2 (Aug. 11, 2026).

The answer this paper gives is not that borrowers are irresponsible. It is that the instrument designed to protect them is built to produce exactly this result. The annual percentage rate, the standardized disclosure the Truth in Lending Act has required of every lender since 1968, was intended to make the cost of credit transparent and comparable across products.¹¹ In practice it makes a two-week loan appear to carry a rate of 391% and a 30-year loan appear to carry a rate of 6.5%, a comparison that generates moral outrage about the first while concealing that the second costs the borrower more than the house.

We argue two things. First, behavioral economics is right that consumer credit is engineered to exploit cognitive biases, but the engineering is symmetric: it operates in the mortgage market at least as powerfully as in the small-dollar market, and behavioral economics by itself cannot explain why regulators have aimed their remedies at one and not the other. Second, the moral hierarchy of debt, the cultural and regulatory framework that treats mortgage debt as virtuous and short-term consumer credit as sinful, is not a reflection of economic harm. It is a political outcome, accumulated over a century of contested legislation and institution-building, that tracked class and race rather than cost, and that behavioral science later arrived to furnish with scientific cover. Understanding how that outcome came to be, and whose interests it serves, is the first step toward an honest account of what American consumer finance actually costs.

The paper proceeds in two parts. Part I examines what behavioral economics reveals about the design of credit contracts, using Oren Bar-Gill's account of

consumer markets and Todd Zywicki's study of the fixed-rate mortgage, and then uses Zywicki's own methodological critique to show why that framework cannot by itself explain the hierarchy. Part II goes outside economics into political history: Anne Fleming's account of how the APR standard was assembled, and Mehrsa Baradaran's account of how the distinction between productive and consumptive credit was institutionalized and racially rationed. A final section draws out what follows for disclosure law, for rate caps now before Congress, and for the federal subsidy of the mortgage itself.

WHAT THE MORAL HIERARCHY OF DEBT IS

The moral hierarchy of debt is the ranking of credit products by presumed virtue rather than by measured cost. It is the set of judgments, embedded in consumer education, in journalism and in law, that sorts borrowing into good and bad before anyone has asked what the borrowing actually costs. Three features define it.

First, it treats duration as virtue. A loan that runs thirty years and attaches to a house is "productive." A loan that runs two weeks and attaches to a paycheck is "consumptive." Chase lists the mortgage's longer amortization among its advantages. No financial educator lists the payday loan's brevity among its advantages, though brevity is the single feature that most limits what the borrower can be made to pay.

Second, it treats the annualized rate as the measure of harm. The threshold is explicit: NerdWallet, among the most widely read personal finance sites in the country, defines "toxic debt" as "payday loans with APRs above 36%."¹² That number, as Part II shows, was not derived from any study of borrower harm. It descends from the monthly rate the Russell Sage Foundation negotiated in 1916 for a \$300 loan. The hierarchy inherited the threshold and forgot where it came from.

Third, it treats the status of the borrower as a proxy for the quality of the decision. The mortgage borrower is presumed prudent because he is the kind of person who qualifies for a mortgage. The payday borrower is presumed desperate because he is the kind of person who does not. Experian's director of public education has acknowledged that credit scoring itself makes no such distinction: "Scores don't distinguish between what we define as good debt and bad debt."¹³ The distinction lives in culture and in regulation, not in the underwriting.

The hierarchy did not spring from nowhere. It sits downstream of five older ways of thinking about debt, each of which still has adherents and each of which this paper draws on or argues against.

TABLE 1 Five traditions of thought about debt

Tradition	Representative works	What it says about the hierarchy
All interest is suspect	Aristotle, <i>Politics</i> I.10; Aquinas, <i>Summa Theologiae</i> II-II, q. 78; Qur'an 2:275–280; Norman Jones, <i>God and the Moneylenders</i> (1989) ¹⁴	There is no good debt; the hierarchy is a late rationalization of a practice once condemned whole
Debt is a power relation	Veblen, <i>The Theory of the Leisure Class</i> (1899); Brandeis, <i>Other People's Money</i> (1914); Baradaran, <i>How the Other Half Banks</i> (2015) and <i>The Color of Money</i> (2017) ¹⁵	The hierarchy ranks borrowers, not loans; it reflects who holds power over whom
Debt is a price, not a morality	Friedman and Schwartz, <i>A Monetary History of the United States</i> (1963); Posner, <i>Economic Analysis of Law</i> ; Zywicki on credit cards and title lending; Sowell, <i>Basic Economics</i> ¹⁶	Interest is the price of risk and time; the hierarchy mistakes a price signal for a moral verdict
Debt exploits cognitive bias	Thaler and Sunstein, <i>Nudge</i> (2008); Bar-Gill, <i>Seduction by Contract</i> (2012); Mullainathan and Shafir, <i>Scarcity</i> (2013); Skiba and Tobacman on payday loans and bankruptcy ¹⁷	Some products are engineered around predictable errors; the hierarchy should track that engineering
The hierarchy is politically constructed	Krippner, <i>Capitalizing on Crisis</i> (2011); Hacker and Pierson, <i>Winner-Take-All Politics</i> (2010); Tooze, <i>Crashed</i> (2018); Fleming, <i>City of Debtors</i> (2018) ¹⁸	Which debts are blessed and which are stigmatized is decided by institutions and interests, not discovered by analysis

This paper accepts the third tradition's account of what interest is, uses the fourth tradition's tools, and arrives at the fifth tradition's conclusion. Price is the honest measure of credit. Behavioral economics correctly identifies how contracts are built around human error. And the ranking that American culture and American law have placed on top of that economics was constructed by people with interests in the outcome.

The ladder as the culture draws it

Set out as a ladder, the conventional hierarchy runs from the long, collateralized and federally supported at the top to the short, unsecured and state-regulated at the bottom. The annual percentage rate climbs as one descends. Everything else about the ranking is presumption.

Two things about this ladder deserve notice before the paper takes it apart. The ranking is monotonic in APR: no product with a lower rate sits beneath a product

TABLE 2 The conventional ladder of consumer debt

Rung	Product	Conventional label	Indicative APR (2026)	Typical term	Stated reason for the ranking
1	30-year fixed-rate mortgage	Good debt	6–7.5%	30 years	Builds equity; interest tax-deductible; federally insured and securitized
2	Federal student loan	Good debt	6.4–9%	10–25 years	Investment in future earnings
3	Small-business loan	Good debt	Varies	1–10 years	Return on investment
4	Auto loan	Good or bad, depending	6–10%	5–7 years	Necessary but depreciating
5	Credit card balance	Bad debt	21–24%	Revolving	High rate; discretionary spending
6	Payday loan or cash advance	Bad debt; “toxic” above 36%	300–400%	2–4 weeks	“Temporary relief” with no return

Labels follow Chase, Equifax and NerdWallet (notes 1, 2 and 12). APR ranges are indicative market rates in 2026, not disclosures for any particular loan.

with a higher one. And the ranking is also monotonic in federal involvement: the top rung is insured by the FHA, guaranteed by Fannie Mae and Freddie Mac, and subsidized through the tax code, while the bottom rung is the only one whose price has been directly capped by federal statute, under the Military Lending Act, and by roughly twenty states. The question the rest of this paper pursues is whether either of those correlations has anything to do with what borrowers pay.

THE APR PROBLEM

The annual percentage rate is not a price. It is a price divided by time. That single fact explains why the metric that federal law chose to make credit comparable produces a ranking of credit products that runs backwards.

The Truth in Lending Act requires every consumer lender to express the cost of credit as a yearly rate computed by the actuarial method, and Regulation Z prescribes the formula down to the tolerance for rounding. The same regulation also requires lenders to disclose the finance charge, the total dollar cost of the credit, in the same box. For mortgages, since 2015, the Closing Disclosure must also show the Total Interest Percentage.¹⁹ The dollar figures are therefore not secret. But the APR is the number the statute was built around, the number rate caps are written in, the number journalists report and the number borrowers are

FIGURE 2 The moral hierarchy of debt as Americans are taught to rank it

Conventional label	Rung, product and stated reason for the ranking	Indicative APR, 2026, and typical term
Good debt	RUNG 1 30-year fixed-rate mortgage <i>Builds equity; interest tax-deductible; federally insured and securitized</i>	6–7.5% 30 years
	RUNG 2 Federal student loan <i>Investment in future earnings</i>	6.4–9% 10–25 years
	RUNG 3 Small-business loan <i>Return on investment</i>	Varies 1–10 years
Good or bad, depending	RUNG 4 Auto loan <i>Necessary but depreciating</i>	6–10% 5–7 years
Bad debt	RUNG 5 Credit card balance <i>High rate; discretionary spending</i>	21–24% Revolving
	RUNG 6 Payday loan or cash advance <i>“Temporary relief” with no return</i>	300–400% 2–4 weeks <i>“Toxic” above 36%</i>

From Table 2. Labels follow Chase, Equifax and NerdWallet (notes 1, 2 and 12). APR ranges are indicative market rates in 2026, not disclosures for any particular loan.

taught to compare. It is the organizing metric of American consumer credit, and it cannot tell a cheap loan from an expensive one.

Annualizing a fee

Consider the canonical bad debt. A borrower takes a \$300 payday loan for two weeks and pays a \$45 fee, the \$15 per \$100 the Consumer Financial Protection Bureau describes as typical.²⁰ The APR formula divides the fee by the principal, then divides again by the fraction of a year the loan is outstanding: \$45 over \$300 is 15%, and 15% over 14/365 of a year is 391%. The borrower did not pay 391% of anything. He paid \$45. The 391% figure expresses the two-week price as though it persisted for a full year, twenty-six two-week periods laid end to end, and reports that hypothetical as a rate.

The Southwest Public Policy Institute has made this point before. In *No Loan For You!*, its 2023 investigation of New Mexico's 36% rate cap, the Institute borrowed Thomas Sowell's illustration: by the logic of annualization, "you could quote the price of salmon as \$15,000 a ton or say a hotel room rents for \$36,000 a year, when no consumer buys a ton of salmon and few people stay in a hotel room all year."²¹ Sowell called it clever propaganda. It is also, under federal law, the required disclosure.

A parking ticket, annualized

The distortion does not require a lender. On May 16, 2026, one of the authors found a parking invoice on his windshield in Albuquerque.²² A private enforcement company had recorded \$6.00 in unpaid parking and attached a \$24.00 compliance fee, for a subtotal of \$30.00 before tax. If unpaid after ten days the amount rose to \$40.00; after twenty days, \$50.00; after thirty, referral to collections.

A parking obligation is not credit, and its fee is not a finance charge under the Truth in Lending Act. Treat them as though they were, and subject them to the same annualizing arithmetic that Regulation Z prescribes for a loan.

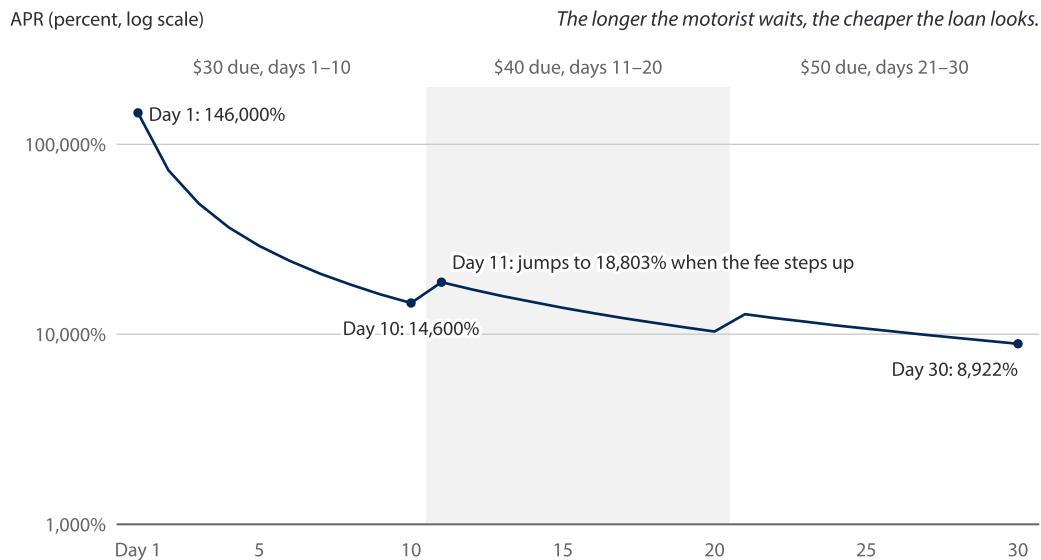
The motorist who pays the next morning has paid the equivalent of a 146,000% APR. The motorist who ignores the invoice for a month has paid the equivalent of 8,922%. Between them the fee rose from \$24 to \$44, nearly doubling in dollars, while the APR fell by more than ninety percent. The metric moves in the opposite direction from the cost. It punishes the borrower who pays promptly and rewards the one who delays. A statute that caps this charge at 36% APR would permit a fee of about half a cent on the first day and about eighteen cents on the thirtieth,

TABLE 3 A \$6 parking charge, annualized by day of payment

Day paid	Amount due	Finance charge on \$6.00	Charge as share of principal	APR
1	\$30.00	\$24.00	400%	146,000%
5	\$30.00	\$24.00	400%	29,200%
10	\$30.00	\$24.00	400%	14,600%
11	\$40.00	\$34.00	567%	18,803%
20	\$40.00	\$34.00	567%	10,342%
21	\$50.00	\$44.00	733%	12,746%
30	\$50.00	\$44.00	733%	8,922%

APR computed as $(\text{finance charge} \div \text{principal}) \times (365 \div \text{days outstanding})$. Source: parking invoice on file with the authors; authors' calculations.

FIGURE 3 The APR of a \$6 parking debt falls as the fee rises



Parking invoice on file with the authors; authors' calculations. $APR = (\text{fee} \div \$6) \times (365 \div \text{days})$.

which is to say it would prohibit the fee, which is to say it would prohibit private parking enforcement, which no legislature has shown any interest in doing.

The parking company is not a lender and nobody thinks of it as one. That is the point. The APR produces usurious-looking numbers wherever a flat charge meets

a short interval, and the regulatory state has decided which of those numbers to care about. The CFPB's own analysis of bank overdraft programs found that the typical debit-card overdraft is \$24, that most are repaid within three days, and that the median fee is \$34; the Bureau itself translated this into "a 17,000 percent annual percentage rate."²³ Overdraft fees fall outside the Military Lending Act's 36% cap. Payday loans fall inside it.

The mortgage, annualized

Now run the formula the other way. The author's mortgage carries a finance charge of \$503,367.13 on an amount financed of \$398,006.63, a charge equal to 126% of the money he actually received.²⁴ The 6.548% on his disclosure is not that ratio divided by thirty. Regulation Z's actuarial method finds the yearly rate that equates the amount financed with the stream of 360 scheduled payments, a different calculation from the one applied to the parking fee. But the same thought experiment runs here in reverse and reaches the same conclusion. A charge equal to 126% of principal, spread across thirty years of level payments, yields a single-digit yearly rate. The same 126% charge on a loan repaid in one sum after a year would be a 126% APR. On a two-week loan it would be about 3,300%. The charge is the same in every case. Only the time over which the formula spreads it changes.

This is the asymmetry the moral hierarchy rests on. Annualization inflates the apparent cost of anything short and deflates the apparent cost of anything long. The payday loan looks like a 391% product because it lasts two weeks. The mortgage looks like a 6.5% product because it lasts thirty years. Neither number describes what the borrower pays. The first borrower pays \$45. The second pays half a million dollars.

The rejoinder

Mehrsa Baradaran and the Pew Charitable Trusts offer the obvious objection: payday borrowers do not borrow once. Pew's 2012 survey found that the average borrower takes out eight loans of \$375 a year, is in debt for five months of the year and pays \$520 in fees.²⁵ The CFPB found that four in five payday loans are rolled over or followed by a new loan within two weeks.²⁶ On this view the two-week framing is the distortion, and borrowers end up paying something close to the APR after all.

The objection is fair and it does not rescue the hierarchy. Grant every rollover. The average payday borrower in Pew’s data paid \$520 in a year. The author’s mortgage charged \$23,168 in interest in its first year, before mortgage insurance. The gap is a factor of forty-five, and the mortgage borrower is also rolled over: as the next section shows, the typical American mortgage is paid off by sale or refinance within a decade, and the next loan, in a market where the large majority of originations are 30-year fixed-rate mortgages, starts the amortization clock over at its most interest-heavy months. If repeated borrowing is what makes a product expensive, the mortgage is repeated too, at sums a thousand times larger.

The ladder, re-ranked

Rank the same products by what the borrower pays rather than by the annualized rate, and the ladder inverts.

TABLE 4 The ladder re-ranked by finance charge as a share of principal

Product	Principal	Finance charge	Term	APR	Charge as share of principal
Parking invoice, paid day 10	\$6	\$24	10 days	14,600%	400%
Bank overdraft (CFPB typical)	\$24	\$34	3 days	17,000%	142%
Payday loan (CFPB typical)	\$300	\$45	14 days	391%	15%
Credit card balance, repaid over 36 months	\$5,000	\$1,865	3 years	21.9%	37%
Auto loan, new car	\$40,000	\$7,523	5 years	7.0%	19%
Federal undergraduate loan, standard repayment	\$30,000	\$10,676	10 years	6.39%	36%
30-year FHA mortgage (author’s, 2025)	\$414,346	\$503,367	30 years	6.548%	121%
30-year mortgage at October 2026 rate, interest only	\$414,346	\$606,256	30 years	7.28%	146%

Parking, overdraft and payday rows use the disclosed or agency-reported fee. Credit card, auto and student rows are illustrative loans at indicative 2026 rates, amortized by the authors. The FHA row is the author’s Closing Disclosure; its finance charge includes mortgage insurance and prepaid finance charges. The final row applies the Freddie Mac rate of October 1, 2026 to the same principal and counts interest alone.

Read down the APR column and the hierarchy is intact: the payday loan is sixty times worse than the mortgage. Read down the last column and it collapses. The payday borrower pays 15 cents on the dollar. The mortgage borrower pays \$1.21 on the dollar, and at today’s rates \$1.46 before insurance. Read in dollars, the comparison is not close: \$45 against \$503,367. The one product the culture calls

good debt is the only amortizing loan on the ladder whose finance charge exceeds its principal.

The parking invoice and the overdraft sit at the top of the re-ranked table, and that is instructive too. They carry the highest charges relative to principal because the principal is trivial and the charge is flat. No 36% ceiling, state or federal, reaches either of them. The APR is applied selectively, and the selection, not the arithmetic, is where the hierarchy lives. The next two parts of this paper ask who did the selecting.

PART I: WHAT BEHAVIORAL ECONOMICS REVEALS

Behavioral economics has supplied the most influential modern account of why consumer credit looks the way it does, and the account is largely correct. Its error is not in what it sees but in where it has been pointed.

Bar-Gill: competition on misperception

Oren Bar-Gill's *Seduction by Contract* begins from a claim about market structure rather than consumer psychology. In ordinary markets, firms compete on price and quality. In consumer markets where buyers are imperfectly rational, firms also compete on their ability to exploit misperception, and a firm that declines to do so loses customers to one that does not. The result is a race in which the contract that best obscures its own cost wins market share. Consumers, Bar-Gill writes, "are seduced by contracts that increase perceived benefits, without actually providing more benefits, and decrease perceived costs, without actually reducing the costs that consumers ultimately bear."²⁷

Bar-Gill developed this account on three markets: credit cards, cell phones and mortgages. His mortgage work concentrated on the subprime contracts of the 2000s, with their teaser rates, interest-only periods, prepayment penalties and payment resets.²⁸ He identified three mechanisms, and each operates in the prime, fixed-rate mortgage market as well, though Bar-Gill himself did not press the point.

Complexity. The 30-year mortgage is among the most complex instruments an ordinary household will ever sign. Interest rate, points, origination charges,

mortgage insurance, escrow, prepayment rights, amortization and tax treatment interact in ways that require financial modeling to evaluate. Bar-Gill's insight is that this complexity is not an accident of the product. It persists because it serves lenders: a borrower who cannot compute the total cost of competing loans cannot discipline lenders through choice, and Bankrate's finding that 87% of borrowers accept a rate above the competitive one is what that failure of discipline looks like in aggregate.²⁹ The author's closing packet ran to more than seventy pages. The rate was on page 1. The amortization schedule was on page 71.

Present bias. Consumers overweight immediate costs and benefits relative to deferred ones, and lenders design around the tendency: low payments now, high costs later. In the subprime market this took the form of teaser rates and payment resets. In the prime market it takes a form so familiar that nobody calls it by its name. A level-payment, self-amortizing loan is itself a deferred-cost structure. The payment is constant, but its composition is not. On the author's loan the first payment is 81% interest; the payment does not become majority-principal until month 213.³⁰ "The monthly payment feels manageable," the borrower says, and he is right, and the manageable payment is the mechanism by which \$444,000 in interest is collected before he notices. Chase lists the longer amortization as a benefit. In Bar-Gill's framework it is the seduction.

Overoptimism. Consumers overestimate future income and house-price appreciation and underestimate the probability of job loss, illness or divorce. Mortgage products are priced for the optimistic case. The 30-year loan is rational on the assumption that the borrower will stay thirty years, that the house will appreciate, that the household will remain intact. Lenders know those assumptions will be made and build products that are purchases of thirty years of interest-rate insurance by people who, as Part I's next section shows, hold the product for a fraction of that time.

The irony of disclosure

Bar-Gill's own prescription for seductive contracts is disclosure, and specifically disclosure of total cost of ownership: show the consumer what the product will actually cost him over the period he will actually use it, and the seduction loses its grip.³¹ That is precisely what the Truth in Lending Act claimed to do. Congress enacted TILA in 1968 to promote "the informed use of credit" by requiring "a meaningful disclosure of credit terms so that the consumer will be able to compare

more readily the various credit terms available to him.”³² It was, and remains, the landmark of American consumer-protection law.

In the narrow sense of imposing a uniform format, it delivered. In the sense Bar-Gill cares about, it did the opposite. TILA did not neutrally standardize information. It elevated one piece of information, the annualized rate, to the status of the comparison metric, and that metric systematically understates the cost of long contracts and overstates the cost of short ones. For the product with the largest aggregate finance charge in American consumer finance, the statute’s headline disclosure reads 6.5%. For a product whose finance charge is \$45, it reads 391%. The Act that was passed to expose seductive contracts gave the most seductive of them a federal certificate of reasonableness, and the behavioral framework that later arrived to diagnose consumer exploitation inherited that certificate as a premise. This is the first half of the paper’s argument: the engineering behavioral economics describes is real, and it is at least as present in the mortgage market as anywhere else.

The second half asks why nobody aimed the framework there.

ZYWICKI ON THE PRODUCT

Todd Zywicki’s 2013 article in the *Supreme Court Economic Review* opens with a factual account of the 30-year fixed-rate mortgage that is uncomfortable for the hierarchy and not seriously contested by housing economists: the product is economically suboptimal for a large share of the consumers who hold it and systematically dangerous for the financial system that holds the other side.³³

American exceptionalism

The United States is, in Zywicki’s words, “unique in the world for standardizing on a mortgage product” that is thirty years long, fully self-amortizing and prepayable without penalty. Other developed economies use shorter fixed periods, adjustable rates, or prepayment penalties that reduce lender risk and borrower cost together.³⁴ The American structure loads interest-rate risk onto the lender for three decades while giving the borrower a free option to walk away from the rate whenever rates fall. Someone has to pay for that option, and the borrower does, in a higher rate from the first month. The same mismatch between long fixed-rate assets and short-term liabilities was a principal cause of the savings and loan

collapse of the 1980s, when thrifts' funding costs rose above the yield on their fixed-rate portfolios. And in the 2008 crisis, fixed-rate loans made up a majority of foreclosures, partly because they were a majority of the market; the point is not that the product caused the crisis but that it offered borrowers no protection from it.³⁵

Thirty years of insurance, seven years of use

The product's internal economics are no more flattering, because almost nobody holds a 30-year mortgage for thirty years. Two measures matter here and they are often confused. Homeowner tenure is how long a household stays in a house. Mortgage life is how long a loan survives before it is paid off by a sale or a refinance, and it is shorter, because a refinance ends the loan without anyone moving. Zywicki, writing in 2013 after two decades of falling rates, put the average life of a mortgage at about five years. Testimony before the Senate Banking Committee in 2011 put the highest fifty-year average at twelve. The rule of thumb in mortgage finance has long been seven to eight years, which is why the 30-year rate is priced off the ten-year Treasury rather than a thirty-year bond.³⁶

The rate shock of 2022 lengthened both measures. Households holding sub-3% mortgages have little reason to refinance and a strong reason not to move, and the lock-in effect that FHFA economists and the *Journal of Finance* have measured since then has pushed tenure to record highs. Redfin's median homeowner tenure, 6.5 years in 2005, reached 13.4 years in 2020 and stood at 12 years in 2025; ATTOM reports that homeowners who sold in the first quarter of 2026 had owned for an average of 8.4 years.³⁶

TABLE 5 How long mortgages and homeowners last

Measure	Figure	Source
Average life of a mortgage before payoff	About 5 years	Zywicki, 2013
Highest fifty-year average life of a 30-year mortgage	12 years	Senate Banking Committee testimony, 2011
Median homeowner tenure	6.5 years (2005), 13.4 years (2020), 11.8 years (2024), 12 years (2025)	Redfin
Average tenure of homeowners who sold, Q1 2026	8.4 years	ATTOM
Term of the contract	30 years	Closing Disclosure

Even the longest of these figures is a fraction of the contract. The typical borrower buys thirty years of interest-rate insurance, pays for it in a premium of roughly half a percentage point on his rate, and uses between a quarter and two-fifths of it. The remainder is an option premium paid in full and, on average, exercised only in part. Lenders and the investors who hold the loans price and hedge that option rather than pocket it, which is exactly why the borrower pays for it from the first month whether or not he ever uses it.

What he does use, he uses at the most expensive point in the contract. The amortization schedule the author found on page 71 of his closing packet is a schedule of front-loaded interest. The table below is that loan.

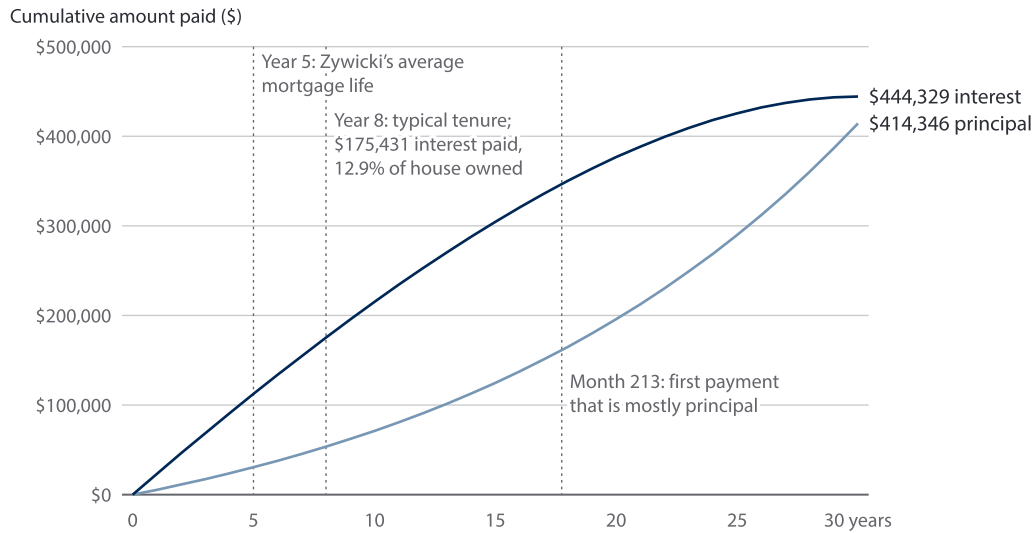
TABLE 6 Amortization of the author's mortgage, selected years

End of year	Cumulative interest paid	Cumulative principal repaid	Remaining balance	Share of loan retired
1	\$23,168	\$5,455	\$408,891	1.3%
5	\$112,503	\$30,609	\$383,737	7.4%
8	\$175,431	\$53,549	\$360,797	12.9%
10	\$215,091	\$71,134	\$343,212	17.2%
15	\$304,553	\$124,785	\$289,561	30.1%
18	\$350,213	\$164,992	\$249,354	39.8%
20	\$376,637	\$195,814	\$218,532	47.3%
25	\$425,713	\$289,850	\$124,496	70.0%
30	\$444,329	\$414,346	\$0	100%

Authors' calculations from the Closing Disclosure: \$414,346 at 5.625% over 360 months, principal and interest only, excluding \$185.53 per month in FHA mortgage insurance.

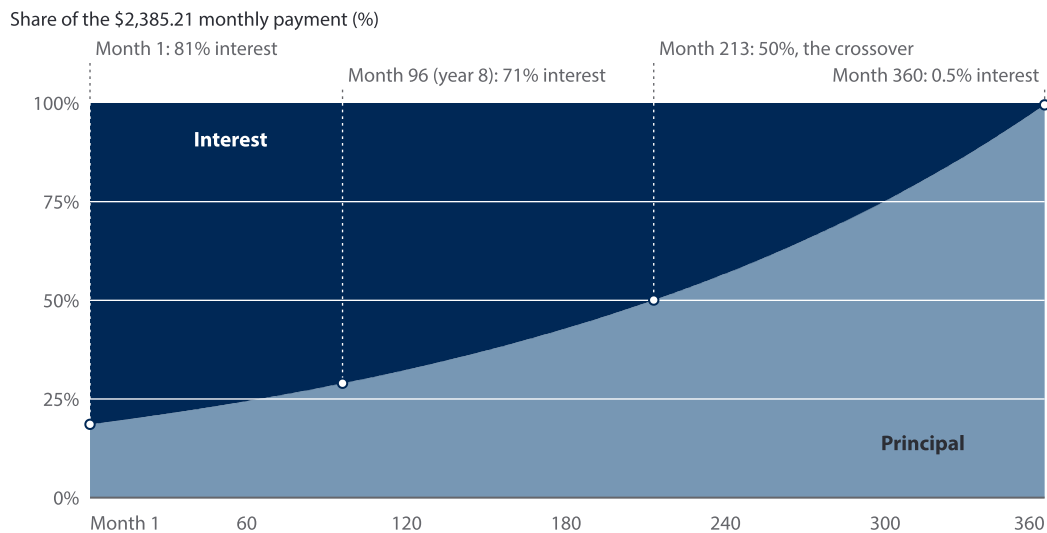
A borrower who sells or refinances at year five has paid \$112,503 in interest to retire \$30,609 of principal. At year eight, close to the long-run average tenure, he has paid \$175,431 in interest and owns 12.9% more of his house than the day he bought it. When he borrows again, as most sellers and every refiner does, the next loan is in all likelihood another 30-year fixed-rate mortgage, the product that accounts for the large majority of American originations, and the schedule starts over at its steepest point. The hierarchy's good debt is a product that, as actually used, consists almost entirely of its most interest-heavy years, repeated.

FIGURE 4 Cumulative interest and principal on the author's mortgage



Authors' calculations from the Closing Disclosure: \$414,346 at 5.625%, 360 months, principal and interest only; excludes \$185.53 monthly FHA mortgage insurance (\$66,791 over the term) and \$7,126 upfront mortgage insurance premium.

FIGURE 5 What each monthly payment buys



As for Figure 4.

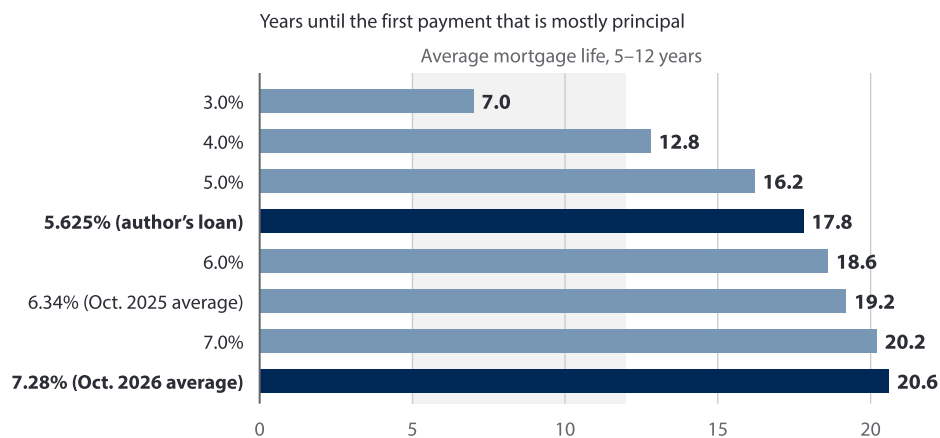
It is often said that a mortgage borrower does not “break even” until year fourteen or fifteen. The claim is directionally right and imprecise, and it can be made exact. The month in which a payment first sends more to principal than to interest depends only on the rate.

TABLE 7 First majority-principal payment on a 30-year loan, by note rate

Note rate	First majority-principal payment	Years into the loan
3.0%	Month 84	7.0
4.0%	Month 153	12.8
5.0%	Month 195	16.2
5.625% (author’s loan)	Month 213	17.8
6.0%	Month 223	18.6
6.34% (October 2025 average)	Month 230	19.2
7.0%	Month 242	20.2
7.28% (October 2026 average)	Month 247	20.6

Authors’ calculations for a 30-year level-payment loan. Rates from Freddie Mac’s Primary Mortgage Market Survey (note 7).

FIGURE 6 Years until a payment is mostly principal, by note rate



Authors’ calculations for a 30-year level-payment loan; rates from Freddie Mac PMMS.

At the rates prevailing when most of today's borrowers signed, the majority of every monthly payment goes to the lender for the first seventeen to twenty-one years of the contract. Set against an average tenure of five to twelve years, the conclusion is unavoidable: the representative American mortgage borrower never reaches the half of the contract in which he is mostly buying his house.

Who subsidizes whom

The distributional consequences follow. The free prepayment option is valuable only to borrowers who exercise it, and exercising it requires cash for closing costs and enough equity to qualify. Keys, Pope and Pope estimate that roughly a fifth of households who would have benefited from refinancing in December 2010 failed to do so, forgoing a median of about \$11,500 in present-value savings; those who failed were disproportionately less educated and lower-income.³⁷ Federal Reserve economists found that during the 2020–21 refinancing wave, Black and Hispanic borrowers refinanced at markedly lower rates than white borrowers with comparable loans, and captured correspondingly less of the housing-wealth gain.³⁸ Everyone pays the option premium in the rate. Those who can refinance collect on it. Those who cannot sit at above-market rates for the life of the loan, paying for insurance that protects the financial system more than themselves.³⁹

This is the product the hierarchy places at the top of its ladder: unique to one country, implicated in two financial crises, held for a sixth of its term, front-loaded so that its typical user never leaves its interest-heavy years, and structured so that its benefits flow upward from borrowers who cannot refinance to borrowers who can. Zywicki lays all of this out in the first part of his article. Then he does something unusual with it.

THE TURNING POINT: JUST-SO STORIES

At this point the behavioral account appears to have found something real and important. Mortgage contracts are engineered around cognitive biases. APR disclosure conceals rather than corrects the engineering. The regulatory architecture reinforces the race to the bottom Bar-Gill describes. On this account the moral hierarchy reflects genuine cognitive harm, and the harm falls hardest on borrowers least equipped to resist it.

Zywicki demonstrates that this account proves too much, and he does it by constructing it.

The spoof

The second part of Zywicki's article applies the full apparatus of behavioral law and economics to the 30-year fixed-rate mortgage. Working from the standard catalogue of biases, he shows that status quo bias and the endowment effect can explain why consumers prefer fixed rates when adjustable rates would serve many of them better; that loss aversion can explain why they pay for prepayment options they will never use; that overconfidence can explain why they commit to thirty-year terms they will not keep. From each bias he derives the regulatory prescription a behavioral scholar would derive. Given a five-year average life, for instance, the thirty-year default product is too long and should be shortened to stop consumers buying interest-rate insurance they will never collect on.⁴⁰ The analysis is rigorous, internally consistent, fully footnoted and indistinguishable in form from the behavioral literature on credit cards and payday loans.

Then Zywicki discloses that the exercise was a demonstration. He had assumed, for the sake of argument, that the underlying psychology was sound. He had chosen his target in advance. And the method had obligingly produced a condemnation of the product and a set of interventions to fix it. The behavioral law and economics framework, he concludes, is flexible enough to indict any financial product its practitioner selects. The analyst begins with the conclusion, identifies the biases that could explain observed behavior, and generates policy to correct the purported irrationality. Because the catalogue of biases is long and the biases point in every direction, the method does not produce falsifiable hypotheses. It produces post hoc rationalizations retrofitted to predetermined ends: just-so stories, in Kipling's sense, about how the mortgage got its term.⁴¹

What the spoof does and does not destroy

Zywicki's critique does not refute Bar-Gill's observations. Complexity, present bias and overoptimism are real; the amortization table on page 71 does not become less front-loaded because a methodology has been exposed. What the spoof reveals is more useful for this paper than a refutation would be. Behavioral law and economics applies with equal force to the fixed-rate mortgage and to the payday loan. The framework does not discriminate between products. The scholars who deploy it do.

And they have deployed it in one direction. The behavioral literature on consumer credit, from Bar-Gill and Elizabeth Warren’s “Making Credit Safer” to the Consumer Financial Protection Bureau’s 2017 payday rule, aimed its apparatus at small-dollar, short-term credit and generated the regulatory proposals that became rate caps.⁴² Those caps have done what price controls do. The Illinois 36% cap of 2021 reduced the number of loans to subprime borrowers by 44% and raised the average loan size by 40%, and in a survey of affected borrowers only 11% said their financial well-being had improved while 79% wanted the option of returning to their previous lender. New Mexico’s cap, effective January 2023, took the state’s licensed small-loan companies from 452 to 418 within five months and drove a national buy-now-pay-later provider out of the state; the Institute’s own attempts to obtain a replacement loan from fifteen credit unions produced a single approval, and the three national banks’ sub-36% products were gated behind account tenure.⁴³ Meanwhile the product exhibiting equivalent or greater cognitive exploitation continued to receive federal insurance, federal guarantee, a tax deduction, a Chase education module and moral sanction.

This choice cannot be explained by the framework itself, because the framework condemns both products equally. The explanation for its asymmetric application must come from outside behavioral economics: from the political and institutional history that decided, long before anyone had heard of loss aversion, which financial products the American regulatory state would protect and which it would condemn.

The moral hierarchy of debt is not a map of cognitive exploitation. It is a record of what the behavioral establishment chose to point its instruments at. That choice, as Part II argues, tracks class interest, political power and a century of statute and institution-building that encoded the hierarchy into American finance before behavioral economics existed to lend it the authority of science.

PART II: AN ABBREVIATED HISTORY OF CONSUMER FINANCE

The hierarchy was built in statute before it was described in theory. A century of American credit law, read as a sequence, shows the same two moves repeated: one product is lifted into respectability by federal subsidy, preemption and tax preference, and the other is pressed downward by a price ceiling that the first

product was exempted from. Neither move was ever justified by a comparison of what borrowers paid.

TABLE 8 A century of consumer credit law, 1916–1978

Year	Event	Effect on the hierarchy
1916	Russell Sage Foundation and the American Association of Small Loan Brokers draft the Uniform Small Loan Law: licensed lenders may charge up to 3.5% per month on loans of \$300 or less in exchange for state regulation ⁴⁴	Creates the legitimate small-loan industry; sets the rate that becomes 42% when annualized and the ancestor of today's 36% cap
1933–34	Home Owners' Loan Corporation refinances a million distressed mortgages into long-term amortizing loans; National Housing Act creates the FHA, which insures long-term, low-down-payment mortgages	Federal government standardizes the long amortizing mortgage and takes its default risk onto the Treasury
1938	Fannie Mae chartered to buy FHA-insured loans	A federally sponsored secondary market gives the mortgage liquidity no other consumer loan has ⁴⁵
1939	Russell Sage Foundation publishes <i>Consumer Credit and Economic Stability</i> , the taxonomy of consumer debt still used by the Federal Reserve ⁴⁶	Codifies the categories within which “productive” and “consumptive” credit will be sorted
1950	Diners Club issues the first general-purpose charge card; BankAmericard follows in 1958 ⁴⁷	Revolving consumer credit becomes a mass product and the future bottom of the ladder
1968	Truth in Lending Act requires uniform APR disclosure ⁴⁸	Annualization becomes the federal measure of credit cost; short loans look expensive, long loans look cheap
1978	<i>Marquette National Bank v. First of Omaha</i> : national banks may charge the rate of their home state to borrowers anywhere ⁴⁹	State usury caps on credit cards become unenforceable in practice; South Dakota and Delaware repeal theirs to attract issuers

Three threads run through this table.

The subsidy went up

The mortgage did not become good debt by outperforming other debt. It became good debt because the federal government, beginning in 1933, took its default risk, built it a secondary market, exempted it from state price controls and then from federal taxation of interest. By 1986 Congress had written the hierarchy into the Internal Revenue Code in so many words: interest on a mortgage is deductible, interest on a credit card or a car is not. The deduction now costs the Treasury roughly \$52.6 billion a year, and the Joint Committee on Taxation's 2025 distribution of that benefit is the hierarchy drawn in dollars.

TABLE 9 A century of consumer credit law, 1980–2026

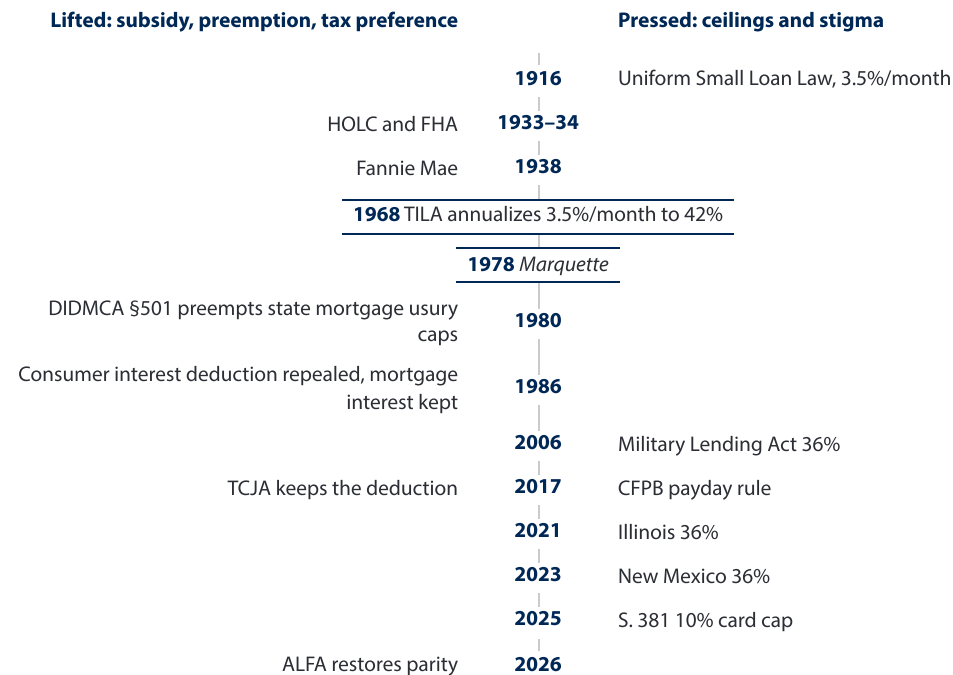
Year	Event	Effect on the hierarchy
1980	Depository Institutions Deregulation and Monetary Control Act: §501 preempts state usury ceilings on first-lien home mortgages; §521 extends <i>Marquette</i> parity to state banks; §525 lets states opt out ⁵⁰	Congress removes price controls from mortgages by statute while leaving caps on small loans to the states
1986	Tax Reform Act repeals the deduction for personal interest on credit cards, auto and other consumer loans, retaining it for mortgage interest ⁵¹	The tax code now subsidizes good debt and taxes bad debt by name; the home-equity loan industry is born converting one into the other
2006	Military Lending Act caps consumer credit to service members at 36% MAPR; Defense Department rules extend it to most products in 2015 ⁵²	First federal rate cap; residential mortgages and purchase-money auto loans are expressly exempted
2010	Dodd-Frank creates the CFPB; TRID rule (effective 2015) adds the Closing Disclosure with Total Interest Percentage ⁵³	Total cost is finally printed for mortgages, on page 5, beneath the APR
2017	Tax Cuts and Jobs Act caps deductible mortgage debt at \$750,000 and doubles the standard deduction; CFPB payday rule imposes ability-to-repay underwriting on small-dollar lenders (largely rescinded 2020) ⁵⁴	Mortgage subsidy survives, concentrated among itemizers; small-dollar credit gets an ability-to-repay rule modeled on the one Dodd-Frank wrote for mortgages, a rule that tests the payment and never the cost
2021–23	Illinois caps consumer loans at 36% (2021); New Mexico HB 132 lowers its cap from 175% to 36%, effective January 1, 2023 ⁵⁵	The Sage Foundation's 1916 threshold becomes a 21st-century prohibition on the products that replaced the Sage lenders
2025–26	S. 381 proposes a 10% federal cap on credit card interest; S. 3889 / H.R. 7866, the American Lending Fairness Act, would confine state DIDMCA opt-outs to loans made by a state's own chartered institutions, restoring rate-exportation parity for state banks ⁵⁶	Congress debates both tightening the ceiling on one product and shoring up the preemption that lifted the other above any ceiling

Ninety-seven percent of the subsidy for virtuous debt goes to households earning more than \$100,000, and 78% goes to households earning more than \$200,000. The Tax Policy Center estimates that about 8% of American households received any benefit from the deduction in 2024, and that the beneficiaries are disproportionately white because homeownership is.⁵⁷ A subsidy with that distribution is not consumer protection. It is a transfer to the upper fifth of the income distribution, labeled as encouragement of thrift.

The ceiling came down

The small loan traveled the other way. The Sage Foundation's 1916 bargain, which raised the permissible rate to attract honest lenders and regulated them in exchange, was the last serious attempt to hold a middle ground between prohibition and the loan shark. When TILA arrived in 1968 and annualized the Sage lenders' monthly rate into 42%, it reframed a regulated and functioning market as a moral outrage without changing a dollar of what anyone paid. The

FIGURE 7 A century of lifting one debt and pressing the other



Compiled from Tables 8 and 9.

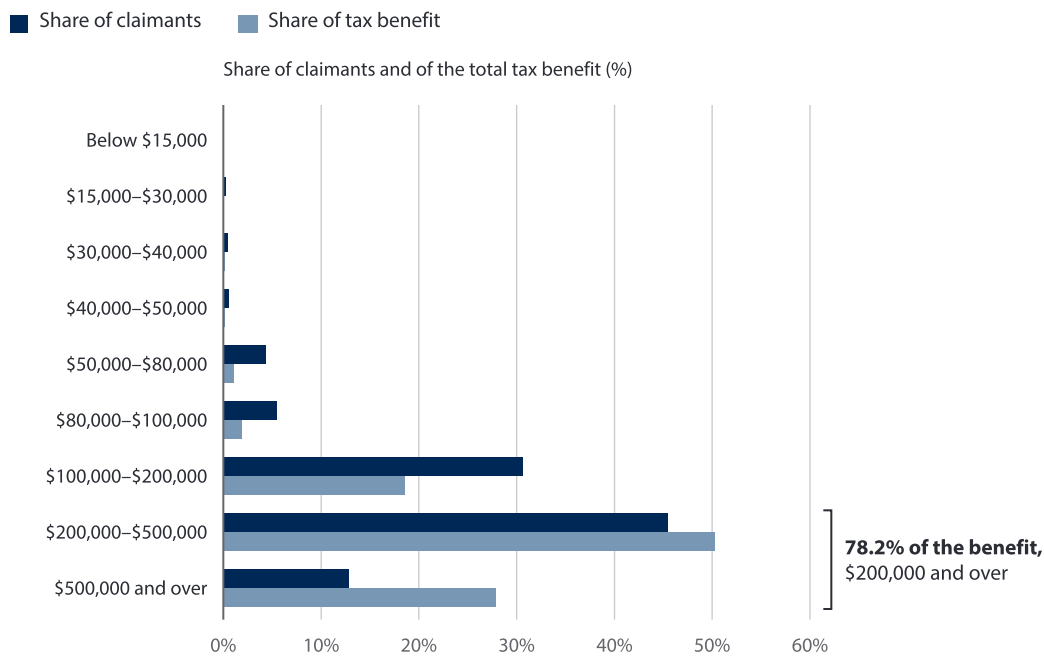
TABLE 10 Mortgage interest deduction by income class, 2025

Income class	Share of claimants	Share of tax benefit
Below \$50,000	1.4%	0.2%
\$50,000–\$100,000	9.8%	3.0%
\$100,000–\$200,000	30.6%	18.6%
\$200,000–\$500,000	45.5%	50.3%
\$500,000 and over	12.8%	27.9%

Source: Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2025–2029*, JCX-45-25 (Dec. 3, 2025), as condensed by the Congressional Research Service; 17.8 million returns, \$52.6 billion. The deduction is projected to cost \$261.1 billion over FY2025–2029.

consumer finance companies that had operated under the Uniform Small Loan Law exited the small-dollar market under that pressure and under competition from credit cards; banks followed through deregulation and consolidation. The

FIGURE 8 Who receives the mortgage interest deduction



Joint Committee on Taxation, JCX-45-25 (Dec. 3, 2025), as condensed by CRS, IF13190 (2026); 17.8 million returns, \$52.6 billion in 2025.

vacuum that payday lenders filled in the 1990s was created by policy. Then the 36% number came back, first for service members in 2006 and then state by state, to close the vacuum's replacement too. The Institute's two *No Loan For You!* investigations documented what that closure looks like on the ground in New Mexico: fourteen of fifteen credit unions tested could not or would not make a small loan to a borrower with an 800 credit score, and the three national banks' sub-36% products were available only to customers with an established checking account whose maintenance fees, \$59 to \$129 a year, are not counted in the loan's disclosed cost.⁵⁸

The route from 42 to 36 is documented. The Russell Sage Foundation's later drafts of the Uniform Small Loan Law, and the states that adopted them, lowered the permissible charge toward 3% a month, which is 36% a year, and the Uniform Consumer Credit Code of 1968 carried a 36% ceiling on the first \$300 of a consumer loan. When Congress chose 36% for the Military Lending Act in 2006 it took the figure from state small-loan law, not from any study of borrower outcomes, and the 36% that Illinois and New Mexico adopted a decade and a half

later is the same inherited number.⁴⁴ The threshold that today separates toxic debt from acceptable debt was negotiated in 1916 for a \$300 loan, rounded down over the following half-century, and has not been re-examined since.

The exemption was always for the mortgage

The federal price controls that exist carve out the mortgage. DIDMCA preempted state usury ceilings on mortgages the same year it let banks export credit-card rates. The Military Lending Act's 36% cap, the model for the state caps that followed, expressly excludes residential mortgages. The 2017 CFPB payday rule imposed on \$300 loans an ability-to-repay test borrowed from the rules Dodd-Frank wrote for mortgages, rules that ask whether the borrower can make the monthly payment and never what the loan will cost, while the FHA went on insuring 3.5%-down loans whose finance charge exceeds the principal. If the hierarchy reflected harm, the product with the half-million-dollar finance charge would be inside the cap and the product with the \$45 fee would not need one. The pattern is the reverse, and it has been the reverse at each of the major legislative turns since 1933. The two scholars examined next explain how that happened.

FLEMING: MANY TRUTHS IN LENDING

The Truth in Lending Act did not emerge from a coherent regulatory vision. It emerged from eight years of congressional contestation among lender factions, consumer advocates and legislators who understood disclosure differently and fought to write their version into federal law. Anne Fleming's history of mandatory disclosure, the first to begin before 1968, shows that the APR standard was not the inevitable product of enlightened consumer protection. It was what remained after a political compromise among parties with irreconcilable interests.⁵⁹

Disclosure as a complement to price control

The fight over how to tell the truth about credit began with the small-loan industry. In 1916 the American Association of Small Loan Brokers and the Russell Sage Foundation drafted the Uniform Small Loan Law to drive out loan sharks by legalizing and regulating their competitors. The Foundation's goal was a disclosure that distinguished legitimate lenders from predators by stating the full monthly cost of borrowing in a form a wage-earner could understand. Its method was a bargain: licensed lenders could charge more than the general usury ceiling, 3.5% a

month on small sums, in exchange for licensing, examination and a single transparent rate.⁶⁰

Lenders and the Foundation disagreed from the start over the form that disclosure should take, because the form determined how much could be charged and whether the borrower would know it. Lenders preferred to state a discount rate plus origination or investigation fees, which split the cost across numbers that did not add. The Foundation insisted on one monthly rate. Fleming's point is that this was not a technical dispute. Each faction claimed the mantle of truth, and the truth each claimed was the one that served it.

For the next three decades every disclosure rule in American consumer credit was paired with a direct constraint on price. The Morris Plan banks' discount-plus-fees, the add-on rate of installment sellers, the small-loan laws themselves: each carried a disclosure mandate embedded in a framework that also set a legal maximum. Disclosure told the borrower what he was paying. The usury law told the lender what he could charge. Nobody imagined that the first could do the work of the second.

The coalition dissolves

That framework came apart in the 1940s and 1950s. The Sage Foundation withdrew from policy advocacy in the mid-1930s and closed its lending division in 1946. The licensed lenders fractured over disclosure methods and departed from the uniform law. Commercial banks and sales-finance companies expanded aggressively after the war into markets where rate disclosure was avoided. By the time Senator Paul Douglas of Illinois introduced his Consumer Credit Labeling Bill in 1960, the institutions that had kept disclosure and price regulation together had largely disappeared.⁶¹

Douglas's bill required lenders to state the total finance charge and its relation to the unpaid balance "in terms of simple annual interest." His purpose was the older one: to prevent deception and to warn borrowers of the high cost of credit. Price competition was a secondary hope, and he did not expect the annual rate to deliver even that with precision. Fleming records his admission in 1961 that "we do not expect great accuracy" from the rate.⁶² Douglas wanted disclosure for its own sake, as a corrective to individual deception. The bill drew fierce opposition and languished for eight years.

During those eight years the dominant understanding of what disclosure was for shifted beneath it. The individual-protection rationale gave way to a market rationale: disclosure would make consumers compare, comparison would make lenders compete, and competition would discipline price without any need for a ceiling. Massachusetts enacted its own truth-in-lending statute in 1966 and showed the mechanism could function. Senator William Proxmire introduced a revised bill in 1967 reframed around strengthening competition. Congress enacted TILA in 1968 with a disclosure metric that had been redesigned around a purpose its author had not intended.⁶³

Once enacted, the statute acquired a third purpose nobody had planned: its rescission rights and statutory damages became a defense for consumers sued by debt collectors. A law that began as a warning label, was rebuilt as a competition mechanism and ended as a litigation shield had no stable regulatory logic. What it had was an APR standard that, as state usury laws eroded through the 1970s and 1980s under *Marquette* and DIDMCA, came to substitute for the direct price controls it had been designed to accompany. Fleming's central finding is that this substitution happened largely by coincidence, not by decision.⁶⁴ The moral architecture of American consumer credit was not designed. It was accumulated.

Accidental architecture, deliberate consequences

Accumulated is not the same as innocent. The truth that prevailed in 1968 encoded into federal law a standard that made short-term credit look uniquely predatory and long-term mortgage credit look benign. It did so not because that standard measured harm, but because the lenders who benefited from it were better organized to shape the statute than the wage-earners who would bear its costs, and because the one metric every faction could agree to was the one that happened to flatter the longest contracts. Fleming proves the construction mechanism. The behavioral framework Bar-Gill and others later developed to explain consumer exploitation did not discover the hierarchy of debt. It found one that federal law had already produced and applied its analysis within the lines that law had drawn.

BARADARAN: PRODUCTIVE CREDIT, CONSUMPTIVE CREDIT, AND WHO GOT WHICH

Fleming shows how the hierarchy was written into the disclosure statute. Mehrsa Baradaran shows how it was written into the institutions, and for whom. Her account is the one this paper finds most persuasive on history and least persuasive on remedy, and the two judgments need to be kept separate.

The manufactured distinction

Before the 1930s, Baradaran argues, the line between good and bad debt did not map onto mortgages and small loans the way contemporary financial culture assumes. The older tradition condemned interest as such. As commercial capitalism matured, a distinction emerged between “productive” credit, loans that funded commerce, investment and eventually homeownership, and “consumptive” credit, loans that helped wage-earners survive between paychecks. Productive credit was reframed as legitimate and then as virtuous. Consumptive credit inherited the stigma that had once attached to all lending.⁶⁵

The New Deal institutionalized that distinction. The Home Owners’ Loan Corporation refinanced a million distressed mortgages into long-term amortizing loans; the Federal Housing Administration insured new ones against default; Fannie Mae gave them a secondary market. The 30-year fixed-rate mortgage became the paradigm of virtuous, wealth-building debt not because it performed better than other debt but because federal insurance, federal subsidy and federal liquidity were attached to it and to nothing else.⁶⁶ The institutions built around long-term, collateralized credit carried an implication of community membership and mutual accountability. Short-term emergency credit carried the opposite implication: desperation, isolation, the absence of the social ideal. The moral vocabulary followed the subsidy.

Rationed by race

The institutionalization did not merely prefer mortgage debt over other debt. It preferred mortgage debt for particular borrowers and excluded others by rule. The FHA’s *Underwriting Manual*, the document that determined which loans the agency would insure, instructed appraisers that neighborhoods should be rated down where “inharmonious racial groups” were present or might enter, and

recommended restrictive covenants as a protection for property values. Because FHA insurance was what made a mortgage profitable to originate, lenders followed the manual, and the manual directed them away from Black neighborhoods and, across the Southwest, from Mexican-American ones, regardless of the individual borrower's capacity to pay.⁶⁷

The conventional account attributes this redlining to the Home Owners' Loan Corporation's color-coded residential security maps. Recent historical work has complicated that story: the HOLC itself refinanced loans in neighborhoods its maps colored red, and the FHA appears to have developed its own appraisal criteria and its own maps rather than borrowing the HOLC's.⁶⁸ The complication does not soften the conclusion. It sharpens it. The racial exclusion was not an artifact inherited from a sister agency. It was the FHA's own policy, written into the manual that governed the virtuous debt, and it operated with the same logic in Albuquerque, Los Angeles and San Antonio, where HOLC and FHA appraisers recorded Mexican populations as a hazard to be graded against, as in Chicago and Detroit.⁶⁹

The consequences compound across generations, and the Federal Deposit Insurance Corporation's 2023 National Survey of Unbanked and Underbanked Households makes them concrete.

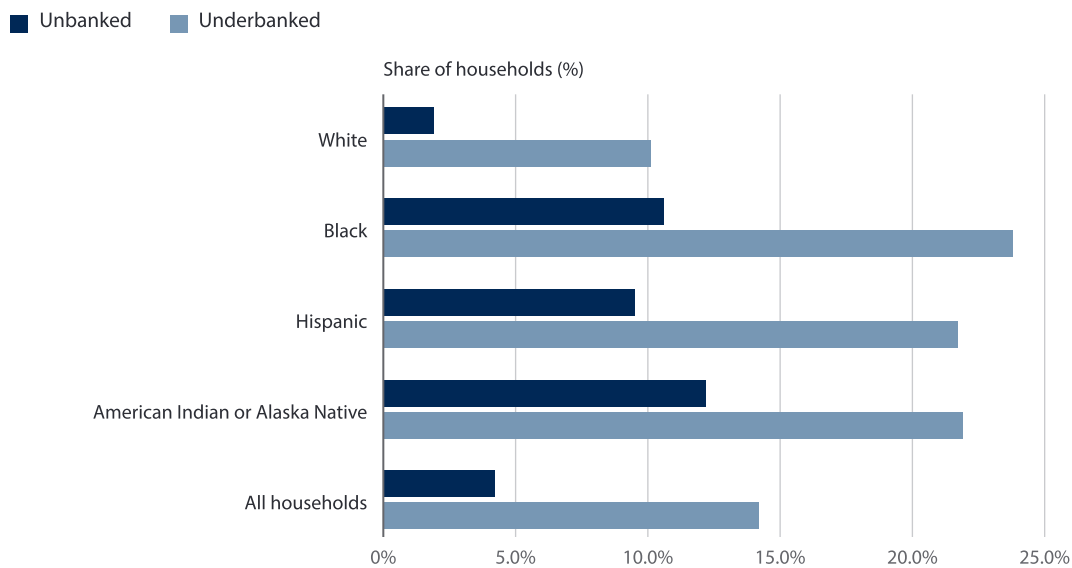
TABLE 11 Unbanked and underbanked households by race and ethnicity, 2023

Household group	Unbanked rate	Underbanked rate	Share of all households	Share of unbanked households
White	1.9%	10.1%	—	—
Black	10.6%	23.8%	12.9%	32.3%
Hispanic	9.5%	21.7%	14.8%	33.4%
American Indian or Alaska Native	12.2%	21.9%	—	—
All households	4.2%	14.2%	100%	100%

Source: FDIC, 2023 National Survey of Unbanked and Underbanked Households (Nov. 2024). Underbanked households have an account but relied in the past year on nonbank transaction or credit products. Shares of unbanked households as reported in survey coverage; dashes indicate figures not reported in the summary.⁷⁰

Black and Hispanic households are more than five times as likely as white households to have no bank account and more than twice as likely to be underbanked. Together they make up about 28% of American households and

FIGURE 9 Unbanked and underbanked households by race and ethnicity, 2023



FDIC, 2023 National Survey of Unbanked and Underbanked Households (Nov. 2024).

about 66% of unbanked ones. These disparities are not random, and this paper does not claim to have measured how much of them the FHA's exclusion produced. What it claims is narrower and documented at each step: the exclusion happened; homeownership has been the principal vehicle of intergenerational wealth transfer in the United States; the racial wealth gap that resulted persists in every Survey of Consumer Finances; and the households on the wrong side of it are the ones the FDIC finds outside the banking system.

The vacuum and the stigma

The hierarchy both reflected and reinforced the exclusion. As Baradaran documents, the banking industry's withdrawal from low-income and minority communities, through redlining, branch closures and the deregulation-driven consolidation of the 1980s and 1990s, created the market vacuum that fringe financial services filled. Payday lending, in the words of the industry economists she quotes, emerged in the 1990s "to serve a void created by the withdrawal of traditional lenders from the very small loan market."⁷¹ The communities most dependent on those services were not the ones with the least financial discipline. They were the ones most thoroughly excluded from the mainstream system by

deliberate institutional policy. The moral stigma attached to short-term credit therefore fell most heavily on precisely the communities that the banking system and federal housing policy had denied access to the virtuous alternative.

This is why the distinction that Chase codifies in its education materials, that TILA encodes in its APR, and that behavioral scholarship reproduces in its choice of targets cannot be treated as a neutral analytical finding. It is the ideological residue of a history in which the federal government subsidized homeownership debt for white Americans while excluding Black and Hispanic Americans from the same market, in which the banking industry then abandoned the communities that exclusion created, and in which the products those communities turned to in the absence of alternatives were then declared the problem. The moral hierarchy of debt does not describe a world in which some borrowers make virtuous choices and others make sinful ones. It describes a world in which race rationed access to virtuous debt, and the vocabulary of good and bad borrowing was formed to make the rationing look natural.

Accepting the history, rejecting the remedy

Baradaran draws from this history a prescription: a public option in banking, delivered through the Postal Service, that would offer small loans at cost to the communities the market abandoned.⁷² This paper accepts her diagnosis and declines her cure, for three reasons that follow from the diagnosis itself.

First, a public lender's cost is not a private lender's. A postal bank would fund itself at the Treasury's rate, hold no equity capital that must earn a return, and absorb losses against the public purse; a private lender serving the same borrowers must price the default risk, the capital and the overhead. "At cost" in a public lender therefore means a price below the full risk-adjusted cost of the credit, and the difference is a subsidy whether or not it ever appears as a line item. The history Baradaran recounts is a history of what credit subsidies do. The FHA subsidized one product, the subsidy attracted a constituency, the constituency defended the subsidy, and the result was a tax expenditure of which 78% now flows to households earning more than \$200,000. A postal lender would be a new subsidy with a new constituency, and nothing in the record suggests it would stay aimed at the people it was built for. The hierarchy was created by attaching federal money to one kind of debt. It will not be dismantled by attaching federal money to another.

Second, Baradaran's strongest empirical point, that most payday lenders charge the maximum rate the state allows rather than pricing to individual risk, is an argument about what binding price ceilings do to a market, not an argument against market pricing. When a ceiling binds for nearly every borrower, prices cluster at the ceiling; that is the signature of a price control, not of a market that has stopped working. The remedy is competition on transparent total cost, the thing TILA's APR has prevented for sixty years, and not a second ceiling or a state competitor. Fleming herself, whose history this paper relies on, publicly opposed the 2019 proposal for a 15% federal cap on the ground that it would cut off the borrowers it claimed to protect.⁷³

Third, the record of institutions designed to serve this market at cost is not encouraging. The FDIC's own small-dollar loan pilot of 2008 to 2010 found that participating banks could originate loans under a 36% ceiling but could not make them profitable as a stand-alone product.⁷⁴ The credit unions whose cooperative mission Baradaran rightly admires produced one approval in fifteen applications when the Institute tested them in 2023, and the one that said yes, at 17% over 90 days, said it to an existing member.⁷⁵ The institutions that work, work for insiders. A public option would have to decide whether to underwrite, and if it underwrites it will exclude the same people, and if it does not it will lose money that someone else must supply.

The better inheritance from the Progressive era is not the postal bank Baradaran favors but the bargain the Russell Sage Foundation struck in 1916: let the price rise to the level at which honest lenders will serve the market, license and examine them, and tell the borrower in plain terms what the loan will cost. That bargain built the regulated middle that the hierarchy later destroyed. The sections that follow set out what rebuilding it would require.

THE HIERARCHY RECONSIDERED

The argument can now be stated in full. The moral hierarchy of debt ranks credit products by annualized rate, treats that ranking as a ranking of harm, and attaches moral and legal consequences to the result. Every step in that chain fails.

The annualized rate is not a measure of cost; it is cost divided by time, and it inverts whenever a short loan is compared with a long one. The engineering that behavioral economics identifies in consumer credit is real but symmetric, present in the fixed-rate mortgage at least as powerfully as in the payday loan, and the

framework cannot explain its own asymmetric application. The asymmetry was built by statute: a disclosure standard assembled by compromise and then left to substitute for the price controls it was designed to accompany, and an institutional structure that subsidized one product for one population and stigmatized the product the excluded population was left with. The hierarchy is not a finding. It is a settlement, and the parties who settled it are not the ones paying for it.

The ladder, three ways

The same seven products, ranked by the three measures a borrower might reasonably care about. The conventional hierarchy is the first column. The other two are what the borrower actually pays.

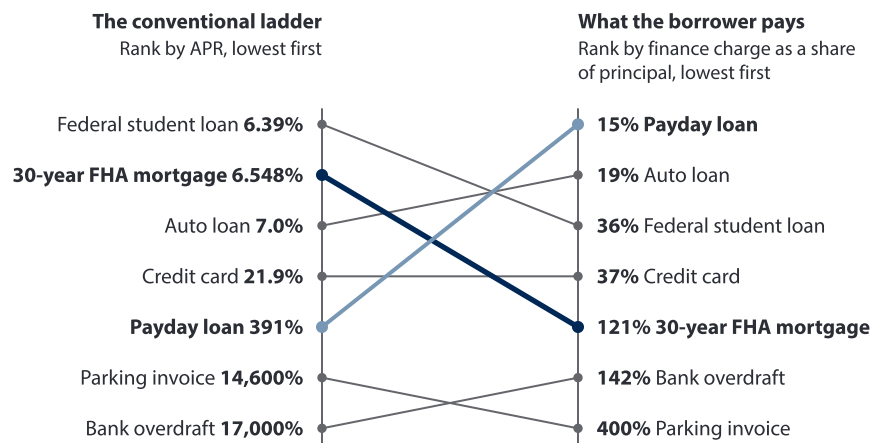
TABLE 12 Seven credit products ranked three ways

Rank	By APR (the conventional ladder, lowest first)	By finance charge as share of principal (lowest first)	By finance charge in dollars (lowest first)
1	Federal student loan, 6.39%	Payday loan, 15%	Parking invoice, \$24
2	30-year FHA mortgage, 6.548%	Auto loan, 19%	Bank overdraft, \$34
3	Auto loan, 7.0%	Federal student loan, 36%	Payday loan, \$45
4	Credit card, 21.9%	Credit card, 37%	Credit card, \$1,865
5	Payday loan, 391%	30-year FHA mortgage, 121%	Auto loan, \$7,523
6	Parking invoice, 14,600%	Bank overdraft, 142%	Federal student loan, \$10,676
7	Bank overdraft, 17,000%	Parking invoice, 400%	30-year FHA mortgage, \$503,367

Figures from the ladder in the APR section. The mortgage is the author's 2025 Closing Disclosure; parking, overdraft and payday use disclosed or agency-reported fees; the remaining rows are illustrative loans at indicative 2026 rates.

The product the culture places at the top of the first column sits at or near the bottom of the other two. The product the culture places at the bottom of the first column sits at the top of the second. The two charges that outrank the mortgage as a share of principal, the parking fee and the overdraft fee, are the two that no 36% ceiling reaches, because nobody has thought to call their issuers lenders. Which column a policymaker reads determines which product he regulates. American consumer credit law has read the first column for sixty years.

FIGURE 10 The ladder, two ways



Parking, overdraft and payday rows use the disclosed or agency-reported fee. Credit card, auto and student rows are illustrative loans at indicative 2026 rates, amortized by the authors. The FHA row is the author's Closing Disclosure; its finance charge includes mortgage insurance and prepaid finance charges. The final row applies the Freddie Mac rate of October 1, 2026 to the same principal and counts interest alone.

What the hierarchy is for

If the hierarchy does not track cost, it is fair to ask what it does track. The historical record suggests three things.

It tracks the organization of interests. Mortgage lenders, homebuilders, realtors and the securities industry that packages mortgage debt are among the most effective lobbies in Washington and have been since the 1930s. Small-dollar borrowers are among the least. The subsidies and exemptions flowed to the organized party, and the stigma and the ceilings flowed to the unorganized one.

It tracks the class position of the borrower. The 30-year mortgage is the product of people who qualify for it, and qualifying has always required income, documentation and, for most of the program's history, the right neighborhood. Treating the mortgage as virtuous is a way of treating its holders as virtuous. Treating the payday loan as sinful is a way of treating its holders as improvident. The hierarchy launders a judgment about people into a judgment about contracts.

And it tracks the convenience of the metric. Annualization made the small loan look like usury and the mortgage look like prudence, and every actor with power

over the system had reason to accept that result: lenders because it flattered their largest product, legislators because it gave them a villain, scholars because it gave them a target, and consumer educators because it gave them a lesson that was simple to teach. A metric that produces a conclusion everyone powerful can live with does not get revisited. It gets called the truth.

None of this means the payday loan is a good product or the mortgage a bad one. It means the question has never been asked in terms that could answer it. The final sections set out how to ask it.

IMPLICATIONS

A paper that argues the hierarchy is a political construction owes its readers an account of what a non-political standard would look like. The standard is one sentence long: measure every credit product by what the borrower pays, disclose it the same way for every product, and regulate, if at all, by the same rule for every product. Six things follow.

1. Put total cost on page 1

The Truth in Lending Act already requires lenders to disclose the finance charge in dollars, and the 2015 mortgage rule already requires the Total Interest Percentage. The problem is placement and prominence. Congress or the Consumer Financial Protection Bureau should amend Regulation Z so that every closed-end credit disclosure, for every product, states three figures in the same type size and the same position as the APR: the finance charge in dollars, the finance charge as a percentage of the amount financed, and the total of payments. For mortgages, those figures belong on page 1 of the Closing Disclosure beside the interest rate, not on page 5 beneath it. For open-end credit, the 2009 CARD Act's minimum-payment warning, which already tells cardholders what a balance will cost if paid down slowly, should be the model, extended to every revolving product.⁷⁶ This is Bar-Gill's own prescription, total-cost disclosure, applied without exemption. For closed-end loans it requires no new calculation; every figure already exists in the box the lender prints today. For revolving credit it requires a stated repayment assumption, which the CARD Act warning already supplies. It would have told the author, on the first page he signed, that his loan would cost \$503,367.

2. Stop legislating in APR

A rate cap written in annual percentage terms writes the time distortion into law. The 36% caps adopted by Illinois and New Mexico, and the 10% credit card cap proposed in S. 381, prohibit a \$45 fee on a \$300 two-week loan, permitting \$4.14 instead, while leaving a \$503,000 finance charge untouched, and they do so not because anyone compared the two but because the metric made the comparison impossible.⁷⁷ Legislatures that insist on regulating the price of credit should at least write the rule in a unit that measures cost: a maximum dollar charge per \$100 borrowed per period, which is how the Uniform Small Loan Law did it, or a maximum finance charge as a share of principal. Either rule would apply to every product by the same standard. A legislature unwilling to cap a mortgage whose finance charge is 121% of principal has no principled basis for capping a loan whose finance charge is 15%. The test of any proposed ceiling is whether its sponsors will apply it to the mortgage. If they will not, the ceiling is not consumer protection. It is the hierarchy, codified.

3. One rulebook for every lender

The hierarchy was built in part by exempting the mortgage from state usury law through federal preemption in 1980 while leaving every other loan to a patchwork of state ceilings that national banks could escape and state-chartered and nonbank lenders could not. The American Lending Fairness Act, S. 3889 and H.R. 7866, would confine a state's DIDMCA opt-out to loans made by that state's own chartered institutions, restoring the rate-exportation parity between state and national banks that Congress intended in 1980 and that the House Financial Services Committee voted 31 to 18 in September 2026 to advance.⁷⁸ The Institute supports it, for a reason consistent with this paper: a regime in which the same loan is lawful or unlawful depending on the charter of the lender is a regime that regulates lenders by status rather than loans by cost, and status regulation is how the hierarchy was built. Parity is not a complete answer. It does nothing about the APR. But it removes one of the mechanisms by which the law has sorted credit by who offers it rather than by what it costs.

4. Treat the mortgage as a loan

If the standard is cost, the product with the largest finance charge in consumer finance cannot remain the one product exempt from scrutiny. Three steps follow. The mortgage interest deduction, 78% of whose \$52.6 billion annual benefit flows

to households earning more than \$200,000, should be phased down and eventually eliminated, not converted into a new subsidy with a new constituency; the tax code should stop ranking debts by name.⁷⁹ The federal footprint that standardized the 30-year prepayable loan, FHA insurance at 3.5% down and the federal backing, through the GSEs, FHA, VA and USDA, that stands behind roughly 70% of American mortgages, should be narrowed so that shorter terms, adjustable structures and loans that trade prepayment rights for a lower rate can compete on even terms, as they do in most other developed mortgage markets.⁸⁰ And the FHA, which insured the author's loan, should be required to show its borrowers, on page 1, the lifetime cost of the mortgage insurance that the agency's low-down-payment program makes permanent.

5. Rebuild the regulated middle

The Russell Sage Foundation's bargain of 1916 is the only policy in this history that produced a legitimate, licensed, examined small-loan market and drove out the loan shark without driving out the loan. States that have capped that market out of existence should restore it on the Sage model: a price that reflects the cost of serving the borrower, licensing and examination in exchange, and disclosure in dollars. Regulators should also count what the Institute's investigations found uncounted. A bank's sub-36% small-dollar product that requires a year of checking-account tenure, at \$59 to \$129 in maintenance fees, is not a 36% product; the fee is part of the price and should appear in the disclosure.⁸¹ Bank regulators who credit such products under the Community Reinvestment Act should credit them only when a borrower in the Institute's position can actually obtain one.

6. Teach cost, not rate

Financial literacy is at a ten-year low, and the curriculum that remains teaches the hierarchy. Every module that tells a student the mortgage is good debt and the payday loan is bad debt because of the APR is teaching the metric that hides the cost of the first and exaggerates the cost of the second. Educators, including the banks and bureaus whose materials this paper has quoted, should teach borrowers to ask three questions of any loan: how much will I pay in total, how much of that is the cost of borrowing, and how long will I actually hold this contract. A student who learns those questions will understand his closing packet. A student who learns the APR will be surprised by page 5.

A note on what this is not

None of this is an argument that the payday loan is a good product, that borrowers should prefer it, or that the small-dollar market is free of abuse. It is an argument about the standard. The small-dollar market has been judged for sixty years by a metric that condemns it on sight, and the mortgage market has been exempted from judgment by the same metric. A single standard would be harder on both than the current arrangement is on either. That is the point of a standard.

CONCLUSION

On page 5 of a Closing Disclosure signed in April 2025, two numbers sit one above the other. The first is 6.548%. The second is 107.282%. The first is the number the law was built around, the number the borrower was taught to compare, the number that placed his loan at the top of the hierarchy of American debt. The second is the interest he will pay as a share of what he borrowed, and beside it sits the finance charge, \$503,367.13, the dollar amount the loan will cost. The distance between the first number and the other two is the subject of this paper.

We have argued that the distance is not an accident of arithmetic. The annual percentage rate divides cost by time, and in doing so it flatters every long contract and indicts every short one; a parking fee annualizes to 146,000% and half a million dollars of mortgage interest annualizes to six and a half. Behavioral economics correctly sees that credit contracts are built around the borrower's predictable errors, and it is unable to explain why its practitioners found those errors in the \$300 loan and not in the \$414,000 one, because the explanation lies outside the discipline. It lies in a disclosure statute assembled by compromise and left to do a job it was never designed for; in a New Deal settlement that attached federal insurance, subsidy and a secondary market to one kind of debt and rationed that debt by race; in a tax code that in 1986 named the debts it would subsidize and the debts it would not; and in a sequence of price ceilings, from 1916 to this year, each of which exempted the mortgage.

The moral hierarchy of debt is therefore not a description of how Americans borrow. It is a record of which borrowers the regulatory state decided to protect and which products it decided to bless, and the two decisions were the same decision. The households that received the virtuous debt built wealth across three generations and now collect 78% of a \$52.6 billion annual subsidy for it. The households that were excluded from it turned to what remained, were told that

what remained was predatory, and watched it capped out of existence in the name of their protection. Four percent of American households have no bank account. Two-thirds of them are Black or Hispanic.

We have accepted Mehrsa Baradaran's account of how this came to be and declined her remedy, because a new federal subsidy for credit is the mechanism that built the hierarchy, not a tool for dismantling it. What would dismantle it is a single standard: disclose what every loan costs in dollars and as a share of principal, as prominently as the law now discloses the rate; write any ceiling in a unit that measures cost and apply it to every product or to none; regulate loans rather than lenders; and subject the mortgage to the scrutiny that every other credit product has borne for sixty years. These are not radical proposals. They are what the Truth in Lending Act claimed to be.

The borrower on page 5 did not misunderstand his loan. He read every page, including the seventy-first. He signed because the house was worth it to him, and it may well be. But the number that told him his loan was good debt told him nothing about what it would cost, and the number that would have told him was printed in the same type, four pages later, where sixty years of federal policy had put it. The country that builds its consumer credit law around a metric that cannot distinguish a parking ticket from a payday loan, and cannot see half a million dollars in a mortgage, has not protected its borrowers. It has protected a ranking. The ranking is the thing that needs to go.

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