# ATTACHMENT A

*Amicus Curiae* Brief of Professor Adam J. Levitin

in Support of Plaintiffs' Motion for Summary Judgment

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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

OAKLAND DIVISION

PEOPLE OF THE STATE OF CALIFORNIA *ex rel.* Xavier Becerra, Attorney General of California,

PEOPLE OF THE STATE OF ILLINOIS *ex rel.* Kwame Raoul, Attorney General of Illinois, and

PEOPLE OF THE STATE OF NEW YORK *ex rel.* Letitia James, Attorney General of New York,

Plaintiffs,

v.

THE OFFICE OF THE COMPTROLLER OF THE CURRENCY, and BRIAN P. BROOKS, in his official capacity as Acting Comptroller of the Currency,

Defendants.

Case No. 20-cv-5200-JSW

**BRIEF OF PROFESSOR ADAM J. LEVITIN AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT**

Date: March 19, 2021
Time: 9:00 a.m.
Judge: Hon. Jeffrey S. White
Crtrm: Courtroom 5, 2nd Floor
1301 Clay Street
Oakland, CA 94612

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## INTRODUCTION

The Office of the Comptroller of the Currency ("OCC") has undertaken a rulemaking that if upheld will create a regulatory vacuum in which high-cost nonbank lenders will be free to prey upon consumers without regard for either state usury laws or federal regulation. Not only is the rulemaking bad policy, but it is also patently illegal under the Administrative Procedures Act because it conflicts with the statutory provisions of the National Bank Act of 1864 ("NBA"), fails to address relevant considerations, and is unsupported by evidence. The Court should strike down the OCC's ill-advised rule.

State usury laws have served as the cornerstone of consumer credit regulation since colonial times. *See* James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61, 85 (1981). State usury laws continue to bind all manner of lenders, including national banks, although national banks are subject to a special federal choice of law rule. Section 85 of the NBA, 12 U.S.C. § 85, provides that national banks are subject to the usury law of the state in which they are "located," rather than the usury law of the borrower's state. *Marquette Nat'l Bank of Minnea. v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978).[1] Section 85 enables national banks to "export" the usury law of the state of their "location" to other states.[2] Thus, if a national bank is located in a state with a high usury cap, it is that cap that applies to the bank, even when the bank lends in a state with a lower usury cap. The right of interest rate exportation—often

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[1] While this brief references only section 85 of the NBA, its arguments apply with equal or stronger force to section 4 of the Home Owners Loan Act, 12 U.S.C. § 1463(g), which provides a parallel provision that governs federal savings associations. The two provisions are read in *pari materia*, *Gavey Props./762 v. First Fin. Sav. & Loan Ass'n*, 845 F.2d 519, 521 (5th Cir. 1988).

[2] The OCC has interpreted the "location" of a national bank for the purposes of section 85 as being the state of whatever branch of the bank had the closest nexus to the loan, rather than being the state where the national bank is located on its charter certificate or where its main office is located. *See* OCC Interpretive Letter 686 (Sept. 11, 1995) *reprinted in* [1995-96 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-001; OCC Interpretive Letter 707 (Jan. 31, 1996), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-022; OCC Interpretive Letter 782 (May 21, 1997), *at* https://bit.ly/2KjSNMj; OCC Interpretive Letter 822 (Feb. 17, 1998), *at* https://bit.ly/2Kmk94q; OCC Interpretive Letter 1171 (June 1, 2020), https://bit.ly/2LQ87kp. In virtually all applications, however, the national bank's "location" for the purposes of section 85 will be a state that permits loans to be made at the contractually agreed upon rate of interest.

referred to by the shorthand of "preemption" of state usury laws—is part of a bundle of privileges and burdens that come with a national banking charter.

It is beyond peradventure that the privileges of a national banking charter do not extend beyond the national bank. Not even the subsidiaries and affiliates of national banks may shelter in the national bank's privileges. 12 U.S.C. § 25b(e). Maintenance of the strict distinction between national banks and all other entities—even those closely affiliated with them—is fundamental to the NBA because only national banks are subject to the full panoply of NBA regulation. Allowing the privileges of national banks to spill over to entities not regulated as national banks would undo Congress's carefully drawn regulatory boundaries and undermine the balance of privileges and obligations that attend a national banking charter.

The instant litigation has arisen because the OCC, the regulatory agency charged with oversight of national banks, seeks to puncture the legislative membrane separating national banks and all other entities, enabling the privileges—but not the obligations—of national banks to seep out to entities that are outside the scope of its regulatory ambit. Specifically, the OCC has promulgated a final rule on "Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred," 85 Fed. Reg. 33530 (June 2, 2020) ("Nonbank Usury Rule" or "Rule"). The Rule provides that "Interest on a loan that is permissible under 12 U.S.C. 85 shall not be affected by the sale, assignment, or other transfer of the loan." 85 Fed. Reg. 33530, *codified at* 12 C.F.R. § 7.4001(e).

The Nonbank Usury Rule extends section 85 to *nonbank* assignees of national banks, even though these assignees are beyond the scope of the NBA or OCC regulation. Under the Rule, both a national bank's statutory privilege of interest rate exportation and its choice of "location" are in effect deemed to be provisions any loan made by the bank. The result is that the usury cap applicable to the bank by virtue of section 85 of the NBA travels with the loan when it is assigned to nonbanks, even though the nonbank would not be entitled to charge the same interest rate if it had made the loan itself.

At stake with the choice of law question addressed by the Nonbank Usury Rule is the ability of states to protect their residents from predatory lending. The Rule would enable heavily regulated

national banks to transfer a statutory privilege—but not the concomitant statutory responsibilities—to nonbanks that are otherwise subject to the usury laws of the states in which they do business. While the OCC claims that the Rule is merely a clarification of the statutory privilege given to *national banks*, it is in fact a regulation of the law governing *nonbanks* and thus wholly outside the scope of the OCC's regulatory authority.

The Nonbank Usury Rule provides nonbanks with a ready method of evading state regulation, enabling the nonbank lenders to do indirectly that which they cannot do directly. Under the Rule, a nonbank would be exempt from state usury law for a loan that it purchased from a national bank, even if state usury law would cover an identical loan that the nonbank made itself.

Nonbanks have long attempted to exploit this sort of "shelter" argument to evade state usury laws. In particular, the Nonbank Usury Rule is an invitation for nonbanks to partner with banks to evade usury laws ("rent-a-bank partnerships"). In a rent-a-bank partnership, a nonbank lender partners with a complicit bank to originate high interest rate loans for it on spec. The nonbank then purchases the loans from the bank and claims to shelter from state usury laws by virtue of the bank having originated the loan.

This type of rent-a-bank scheme has previously been used extensively by payday lenders,[3] and is still utilized by marketplace lenders[4] and subprime small business lenders,[5] including with the involvement of OCC regulated institutions.[6] If upheld, the Nonbank Usury Rule would enable nonbank lenders to evade state regulation without subjecting them to an alternative federal

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[3] The OCC took action nearly twenty years ago to shut down payday lending rent-a-bank arrangements, OCC ANNUAL REPORT, 2003, p. 17, *at* https://bit.ly/3h2g1mn, but has not subsequently acted to shut down non-payday subprime rent-a-bank lending.

[4] *See, e.g.*, *Meade, Uniform Consumer Credit Code Administrator v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); *Meade, Uniform Consumer Credit Code Administrator v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).

[5] *See Transparency in Small Business Lending: Hearing Before the H. Comm. on Small Business*, 116th Cong. (Sept. 9, 2020) (statement of Professor Adam J. Levitin).

[6] National Consumer Law Center, *High-Cost Rent-a-Bank Loan Watch List*, https://bit.ly/3gOJ2lf (last visited Dec. 15, 2020 at 1:08pm) (listing Stride Bank, N.A. and Axos Bank F.S.A. as involved in high-cost rent-a-bank lending).

regulatory system; there is no general federal regulation prohibiting "high cost" or "predatory" lending. The result is a regulatory vacuum that is a recipe for abuse of consumer borrowers.

The full implication of the Nonbank Usury Rule is becomes apparent when it is viewed in conjunction with another OCC regulation regarding "National Banks and Federal Savings Associations as Lenders" (the "True Lender Rule"), which provides that a national bank is for purposes of section 85 conclusively deemed the lender on a loan if the bank "[i]s named as the lender in the loan agreement" or "[f]unds the loan." 85 Fed. Reg. 68742 (Oct. 30, 2020), *codified at* 12 C.F.R. § 7.1031(b). The True Lender Rule operates to cut off "true lender" usury claims against nonbanks that partner with national banks. "True lender" usury claims allege that given the totality of the circumstances of the lending relationship the nonbank is the "true lender," and the bank's involvement is a mere front to be disregarded for purposes of usury law.

The instant litigation does not involve a challenge to the True Lender Rule, but it is important to understand how the Nonbank Usury Rule interacts with the True Lender Rule to create a complete legal shield from state usury laws for nonbanks in rent-a-bank partnerships. The True Lender Rule provides that no matter the particulars of the relationship between the bank and the nonbank, the bank is the legal lender if its name is on the loan, so section 85 applies to the loan. The Nonbank Usury Rule then comes into play by providing that if the loan was not usurious under section 85 in the hands of the bank, it is not usurious in the hands of the bank's assignee.

If the Nonbank Usury Rule is allowed to stand, it will eviscerate the oldest and most fundamental form of consumer financial protection and unleash a wave of predatory lending on American consumers.

## INTEREST OF AMICUS CURIAE

*Amicus curiae* Adam J. Levitin is the Anne Fleming Research Professor and Professor of Law at Georgetown University Law Center in Washington, D.C. Professor Levitin's scholarship and teaching focuses on consumer finance regulation and commercial law, including the law of usury and the law of negotiable instruments.

Professor Levitin has previously written about the origins of the "valid-when-made" doctrine and the effects of preemption of state consumer protection laws in rent-a-bank

transactions. *See* Adam J. Levitin, *Rent-a-Bank: Bank Partnerships and the Evasion of State Usury Laws*, working paper, Dec. 21, 2020 (available at https://ssrn.com/abstract=3684244) (attached as Appendix A); Adam J. Levitin, *"Madden Fix" Bills Are a Recipe for Predatory Lending*, AMERICAN BANKER, Aug. 28, 2017; Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. REG. 145 (2009). He has also previously testified before Congress over thirty times, including at a hearing specifically addressing the "valid-when-made" doctrine. *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, Hearing Before the H. Fin. Servs. Comm., Subcommittee on Financial Institutions and Consumer Credit, 115th Cong., Jan. 30, 2018 (testimony of Professor Adam J. Levitin).

Professor Levitin believes that his expertise regarding the history of usury regulation in the United States will be helpful to the Court, particularly regarding the OCC's claims about the state of the common law in 1864. Professor Levitin also believes that his expertise in consumer finance and bank regulation generally will be helpful to the Court in understanding the implications of the Nonbank Usury Rule for both bank safety-and-soundness and consumer protection concerns.

Professor Levitin has authored and funded his brief entirely himself. He has no financial stake in the litigation.

**ARGUMENT**

The Nonbank Usury Rule must be set aside under the Administrative Procedures Act ("APA") because it is "not in accordance with law," "arbitrary and capricious," "in excess of statutory …authority," and "without observance of procedure required by law." 5 U.S.C. § 706(2).

The Nonbank Usury Rule is "not in accordance with law" because it is contrary to the common law in 1864 that was incorporated into the NBA. The OCC correctly observes in the rulemaking that NBA incorporates the common law as it existed in 1864 and must be interpreted consistently with that common law: "Because Congress is presumed to legislate with knowledge of, and incorporate, common law, it is reasonable to interpret section 85 in light of these tenets." 85 Fed. Reg. 33532 (citing *Astoria Fed. Sav. & Loan Ass'n* v. *Solimino,* 501 U.S. 104, 108 (1991).). *See also* 84 Fed. Reg. 64229, 64231 (Nov. 21, 2019). Specifically, the rulemaking claims that it is

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informed by and consistent with two "well established" common law doctrines, namely the "valid-when-made" doctrine and the common law of assignments. *See* 84 Fed. Reg. 64229, 64230.

The rulemaking incorrectly characterizes the common law background of the NBA in three ways. First, contrary to the OCC's claim in the rulemaking, the "valid-when-made" doctrine was not part of the common law background of the NBA. No "valid-when-made" doctrine existed in 1864 because the "valid-when-made" doctrine is a wholly modern invention. Nothing approaching the doctrine as described by the OCC can be found in cases, treatises, or scholarly articles prior to 1979, and there is not even a reported case referring to the doctrine by name until 2019. There is no basis for claiming that the NBA incorporated a doctrine that did not exist at the time of its enactment. The doctrine's supposed historical pedigree stands on selective and out-of-context quotations from a pair of 19th century Supreme Court cases that had nothing to do with the transferability of interest rate exportation rights or the effect of the assignment of a loan on the applicable usury law, but instead dealt with the question of whether the interest rate from one loan could be imputed to a previous loan to render the first loan usurious. *See Gaither v. Farmers' & Mechanics' Bank of Georgetown*, 26 U.S. 37 (1828); *Nichols v. Fearson*, 32 U.S. 103 (1833).

Second, the OCC errs in applying the common law of assignments. The OCC claim that the Rule is "supported by banks' ability to assign contracts". 84 Fed. Reg. 64231. This is a fundamental misunderstanding of the common law of contracts. The common law of assignments covers the assignment *of rights under a contract*. In other words, it only covers alienable property rights. It does not have any bearing on the question of alienability of statutory privileges like interest rate exportation. The idea of a national bank being able to sell its statutory privileges—much less without the concomitant statutory responsibilities—is absurd. It would undermine the entire national bank regulation system, which carefully limits who can obtain the benefits of a national banking charter, whether by issue of a *de novo* charter or the sale of a bank to new owners.

Third, the OCC ignores the most relevant element of the common law that existed in 1864, namely usury law's clearly articulated anti-evasion doctrine. The NBA must be interpreted consistently with the anti-evasion doctrine. The Nonbank Usury Rule, however, not only fails to include anti-evasion protections, but paves the way for evasion of usury laws. The rulemaking

failed to consider the anti-evasion doctrine when interpreting section 85, and the Rule does not attempt to distinguish between evasive and non-evasive transactions.

The OCC states that it undertook the rulemaking because of the need to protect a "core element of banks' ability to engage in safe and sound banking: The ability to transfer loans." Final 85 Fed. Reg. 33534. The Nonbank Usury Rule supposedly promotes the safety-and-soundness of national banks by ensuring the liquidity of their loan portfolios. 84 Fed. Reg. 64231; 85 Fed. Reg. 33532-33. This argument is also problematic in three ways.

First, while the OCC is charged with ensuring national bank safety-and-soundness, 12 U.S.C. § 1(a), it also has a co-equal statutory charge of ensuring "fair treatment of customers" by national banks. *Id.* The provisions of the NBA need to be interpreted in light of *both* of these provisions. The OCC acknowledged that the rulemaking could facilitate "predatory" rent-a-bank relationships, 85 Fed. Reg. 33534, but gave no explanation of how it would prevent that result other than by pointing to non-binding regulatory guidance. *Id.* Because the rulemaking is contrary to the "fair treatment of customers," it must be struck down as "not in accordance with law" because it conflicts with the statutory terms of the NBA itself. 5 U.S.C. § 706(2)(A). Moreover, because the OCC failed to even consider the relevant factor of consumer protection, *Motor Vehicle Mfrs. Ass'n v. State Farm Ins.*, 463 U.S. 29, 42-43 (1983), the Nonbank Usury Rule is "arbitrary and capricious" and therefore must also be struck down under the APA. 5 U.S.C. § 706(2)(A).

Second, the OCC's emphasis on the Nonbank Usury Rule being undertaken to ensure national banks' ability to exercise their power to transfer loans underscores that the Rule is not merely about national banks' interest rate exportation rights under section 85. Any OCC rulemaking that has the effect of preempting state law and involves national bank powers beyond section 85 is subject to the procedural requirements of section 25b of the NBA. 12 U.S.C. § 25b. The Nonbank Usury Rule involves *both* national banks' interest rate exportation power under section 85 *and* national banks' sales power under section 24 of the NBA. 12 U.S.C. § 24(3), (Seventh). As such, it is subject to the procedural requirements of section 25b.

The OCC does not even purport to have complied with section 25b's requirements. 85 Fed. Reg. 33533. Instead, it contends that the Nonbank Usury Rule arises only under section 85—

despite the OCC's clear statement that the Rule is meant to protect a "core element of banks' ability to engage in safe and sound banking: The ability to transfer loans", *id.* at 33534, and the fact that the Rule deals with the effect of the transfer of a loan by a national bank, rather than the making of the loan by the bank.

The OCC cannot have it both ways. Either the Nonbank Usury Rule must be evaluated without any reference to national banks' power to transfer loans, or it must comply with the procedural requirements of section 25b. Either way, the Rule must be struck down. If the Rule is evaluated without reference to national banks' power to transfer loans, then it must be struck down under the APA because it goes beyond anything authorized by the statutory text of section 85—which does not deal with the transfer of loans by a national bank. 5 U.S.C. § 706(2)(C). Alternatively, if the sales power is considered, the Rule must be struck down for failing to comply with the NBA's procedural requirements, which is a violation of the APA's prohibition on rules undertaken "without observance of procedure required by law." 5 U.S.C. § 706(2)(D).

Finally, the Rule's claims about its impact on bank liquidity are unsupported. The OCC presented no evidence in the rulemaking that the Nonbank Usury Rule is likely to have any meaningful impact on national bank liquidity. Additionally, the argument that bank liquidity would be at risk without the Nonbank Usury Rule is hard to square with both the adequacy of bank liquidity for over a century and a half in the absence of the Rule, the existence of the Federal Reserve's discount window for borrowing by solvent banks, the exemption of most mortgage loans from usury laws, and the existence of a potential secondary market of over 5,000 insured depository institutions that are not subject to state usury laws. FDIC, *Statistics at a Glance*, Sept. 30, 2020, *at* https://bit.ly/3nLASgl. Put another way, at most the Nonbank Usury Rule affects the size of the secondary market and the price at which national banks can sell loans; it does not affect their fundamental ability to sell loans.

## I. THE NONBANK USURY RULE IS INCONSISTENT WITH THE COMMON LAW INCORPORATED INTO THE NATIONAL BANK ACT

In the rulemaking, the OCC notes that "[b]ecause Congress is presumed to legislate with knowledge of, and incorporate, common law, it is reasonable to interpret section 85 in light of

these tenets." 85 Fed. Reg. 33532. *See also* 84 Fed. Reg. 64231. In particular, the rulemaking refers to two common law doctrines—the "valid-when-made" doctrine and the common law of assignments—"inform its reasonable interpretation of section 85" of the NBA. 85 Fed. Reg. 33532.

The OCC is correct that the common law as it existed in 1864 is incorporated into the NBA and that the NBA must be interpreted consistently with such common law. The OCC errs, however, in its characterization of the relevant common law. First, the valid-when-made doctrine was not part of the common law background of the National Bank Act of 1864. Indeed, this doctrine cannot be observed in *any* source prior to 1979. Second, the common law of assignments is irrelevant because the statutory privilege of interest rate exportation is not an assignable property right. And third, the OCC neglected to consider a relevant common law doctrine incorporated in the NBA in general and in section 85 in particular—namely, the usury anti-evasion doctrine.

### A. The "valid-when-made" doctrine is a 21st century invention and was not part of the common law background of the National Bank Act of 1864

The "valid-when-made" doctrine means that "if a loan is non-usurious at origination, the loan does not subsequently become usurious when assigned." 84 Fed. Reg. 64231. While this doctrine can be observed in some recent decisions, it was wholly unknown prior to the 21st century. There is not a single case consistent with the doctrine to be found prior to 1979, over a century after the enactment of the NBA, and the emergence of the modern doctrine stems from a misreading of older cases with unfamiliar transactional situations. The doctrine is entirely a modern invention. The valid-when-made doctrine was not part of the common law background of the National Bank Act. As a historical matter, the doctrine is not valid, but made-up.

#### 1. The "valid-when-made" doctrine could not have pre-dated and been incorporated into the National Bank Act, because it addresses a problem created by that statute

The most obvious flaw with the supposed historicity of the valid-when-made doctrine is that the issue in the current litigation—whether a note originated by a party that is exempt from the state usury statute is usurious in the hands of a non-exempt assignee—*could not* have arisen prior to the enactment of the NBA in 1864. Prior to the NBA, state usury laws applied to all entities equally. Therefore, it was not possible prior to 1864 for a loan to be non-usurious in the hands of

an original lender and subsequently become usurious in the hands of an assignee; there was no situation in which the "valid-when-made" issue could even have arisen. It could not, therefore, have been part of the common law background law of the NBA.

#### 2. The 19th century cases relied upon for the "valid-when-made" doctrine have nothing to do with the effect of assignment on usury

Despite supposedly being a "long longstanding common law principle" and a "cardinal rule[ ] in the doctrine of usury," 84 Fed. Reg. 64231, the doctrine is nowhere to be found in *any* 19th or early 20th century usury and banking law treatises or scholarly articles.[7] Likewise, there is not a single mention of the "valid-when-made" doctrine in any reported case until 2019.[8] All in all, there are only a handful of reported cases that are consistent with the doctrine. The first of these consistent cases is from 1979,[9] over a century after the enactment of the NBA. Most of the other consistent cases are from the 21st century.

Nonetheless, in recent years the "valid-when-made" doctrine has been taken as gospel by the OCC,[10] the FDIC,[11] and the Solicitor General's Office,[12] as well as by trade associations commenting in support of the Nonbank Usury Rule,[13] and even by a number of scholarly articles.[14] These various disciples of "valid-when-made" support their claim of the doctrine's historicity by citing to selectively lifted decontextualized quotations from various 18th and 19th century cases.

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[7] An annotator's footnote to an 1838 edition of BLACKSTONE's *COMMENTARIES ON THE LAWS OF ENGLAND* is sometimes cited for support for the doctrine, but an examination of the English cases cited shows that they have no relation to valid-when-made. *See* Appendix B at 66.

[8] Rent-Rite SuperKegs W., Ltd. v. World Bus. Lenders, LLC (*In re* Rent-Rite SuperKegs W., Ltd.), 603 B.R. 41, 66 (Bankr. D. Colo. 2019).

[9] Strike v. Trans-West Discount Corp., 92 Cal.App.3d 735, 745 (Cal. Ct. App. 4th Dist. 1979).

[10] *Amicus Curiae* of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency in Support of Affirmance and Appellee, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.).

[11] *Id.*

[12] Brief for the United States as Amicus Curiae, *Midland Funding, LLC v. Madden*, 136 S. Ct. 1484 (No. 15-160) at 8 (opposing petition for Petition for Writ of Certiorari).

[13] *E.g.*, Comment of the Structured Finance Association and Bank Policy Institute, Jan. 21, 2020, at 4, n.12 (see Appendix C).

[14] See Levitin, *Rent-a-Bank*, Appendix A, at 13, nn. 43-45 (detailing the uncritical scholarly embrace and more recent skepticism of the historicity of "valid-when-made").

A closer examination of the cases cited as support for the doctrine shows that they are all dealing with entirely different legal issues. For example, consider the two 19th century Supreme Court cases cited by the OCC in the rulemaking, *Gaither v. Farmers' & Mechanics' Bank of Georgetown*, 26 U.S. 37 (1828), and *Nichols v. Fearson*, 32 U.S. 103 (1833).

*Gaither* involved a non-usurious note that was pledged by the payee as collateral for an unrelated, usurious loan. 26 U.S. at 41. The Supreme Court observed that "the rule cannot be doubted, that if the note be free from usury, in its origin, no *subsequent usurious transactions respecting it*, can affect it with the taint of usury." *Id.* at 43 (emphasis added). The key point to note here is that *Gaither* is not does not say "no subsequent transactions," but no "subsequent *usurious* transactions." *Gaither* involved a situation in which there were *two* credit transactions—the making of a non-usurious note and the making of a usurious loan. The issue was whether the usurious interest from the second transaction could be imputed to the first transaction. In contrast, the "valid-when-made" situation deals with a *single* loan that is assigned. There is no "subsequent usurious transaction" to speak of in the "valid-when-made" context. *Gaither* did not involve an assignment and says nothing about the "valid-when-made" situation.

*Nichols v. Fearson* is similarly inapposite. *Nichols* involved a discounted sale of a note indorsed by the defendant. 32 U.S. 103 (1833). When a note is sold at a discount from face, the discount can be treated as imputed pre-paid interest. *Nat'l Bank of Gloversville v. Johnson*, 104 U.S. 271, 276-277 (1881); *Evans v. Nat'l Bank of Savannah*, 251 U.S. 108, 114 (1919). Indeed, section 85 of the NBA expressly covers not only interest on loans, but also interest on discounts.

When the defendant in *Nichols* indorsed the note, the defendant became jointly liable for the full face amount of the note, just as if it were the maker of the note.[15] The defendant then attempted to wriggle out of its obligation by raising a defense of usury on the basis that the stated interest rate on the note plus the additional implied interest rate from the discounting made the note usurious. The Supreme Court held that the usurious discounting did not void the original note, 32 U.S. at 110, 112, observing that among the "cardinal rules of the doctrine of usury…[is] that

[15] *Cf.* UCC § 3-415(a) (modern statutory analog).

a contract which in its inception is unaffected by usury can never be invalidated by any *subsequent usurious transaction*." *Id.* at 109 (emphasis added). *See also id.* at 106 ("the rule of law is everywhere acknowledged that a contract free from usury in its inception shall not be invalidated by any *subsequent usurious transactions upon it*.") (emphasis added).

Again, the key point to note is that the Supreme Court did not use the phrase "any subsequent transaction," but "any subsequent *usurious* transaction." As with *Gaither*, *Nichols* involved a situation in which there were *two* credit transactions—the making of a non-usurious note and a usurious discounting (effectively a second loan). All *Nichols* holds is that the interest from the second transaction (the discounting) may not be imputed to the first transaction (the note). *Nichols* has nothing to do with the question of whether a nation bank can transfer its statutory interest rate exportation privilege to an assignee to allow the assignee to purchase and enforce a loan that the assignee could not legally make itself.

While the OCC cited to no other cases in support of the doctrine in the rulemaking, it has done so in an *amicus* brief,[16] as have some comments in support of the rulemaking.[17] The doctrine described by the OCC is nowhere to be found in any of those other cases, however—only more decontextualized quotations. Again, these cases are dealing with entirely different legal questions than valid-when-made. Many are similar to *Nichols* and address the effect of a discounted assignment on the calculation of the interest rate on the loan.[18] As with *Nichols*, the question in

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[16] *Amicus Curiae* of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency in Support of Affirmance and Appellee, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.).

[17] *E.g.*, Comment of the Structured Finance Association & Bank Policy Institute, Jan. 21, 2020, at 4, n.12 (see Appendix C).

[18] *See, e.g.*, *Munn v. Comm'n Co.*, 15 Johns. 44, 55 (N.Y. Sup. Ct. 1818) ("The principle is too well settled to be questioned, that a bill, free from usury, in its concoction, may be sold at a discount, by allowing the purchaser to pay less for it than it would amount to at the legal rate of interest, for the time the bill has to run. The reason is obvious: as the bill was free from usury, between the immediate parties to it, no after transaction with another person can, as respects those parties, invalidate it."); *Taylor v. Bruce*, 21 Va. 42, 90 (Va. 1820) ("it is settled, that a bill or note which is free from usury, in its concoction, may be sold at an usurious discount, for that as it was free from usury between the original parties, no after transaction can, as to these parties, invalidate it"); *Tuttle v. Clark*, 4 Conn. 153, 157 (1822) (the note "not being usurious in its original

these cases is whether the discounted price paid by the assignee may be treated as imputed interest on the loan and thus added to the loan's stated interest rate when determining if the loan is usurious.

Of the remaining cases, most deal with the effect of the exercise of a payment option by the borrower on the calculation of the interest rate on a loan.[19] These cases do not even necessarily involve an assignment, underscoring that they in no way concern the valid-when-made issue.

Finally, there are a few cases that deal with the effect of a valid assignment on a usurious loan.[20] This "cleansing assignment" pattern is the reverse transaction of what is at stake with valid-when-made. In the event that the Court wishes to indulge the impulse of antiquarian curiosity,

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concoction, did not become so, by the subsequent [discounted] sale to the plaintiffs"); *Knights v. Putnam*, 20 Mass. 184, 185 (Mass. 1825) ("a note, valid in its inception, may be recovered against the maker, by an indorsee, although discounted by him at a rate exceeding legal interest. It is a well established principle, that if a note or security is valid when made, no usurious transaction afterwards between the parties or privies will affect its validity."); *Cram v. Hendricks*, 7 Wend. 569, 572 (N.Y. Ct. for the Correction of Errors 1831) ("The principle is too well settled to be questioned, that a bill free from usury in its concoction may be sold at a discount; because, as it was free from usury between the original parties to it, no subsequent transaction with another person can, as it respects those parties, invalidate it.").

[19] *See, e.g.*, *Tate* v. *Wellings* 100 Eng. Rep. 716, 721 (K.B. 1790) (Buller, J. seriatim) (effect on the usury calculation of a loan of stock that was repayable in stock or cash at the borrower's option); *Unity Plan Finance Co. v. Green* 155 So. 900, 905 (La. 1934) (effect on the calculation of the interest from the acceleration of a debt that the debtor had failed to repay on time); *FDIC v. Tito Castro Constr.*, 548 F. Supp. 1224, 1227 (D.P.R. 1982) ("it was only as a consequence of defendant's election to delay in repaying the principal amount of those [demand] notes that an effective rate of interest in excess of the Puerto Rico statutory ceiling may have resulted."); *Rangen, Inc. v. Valley Trout Farms, Inc.*, 658 P.2d 955, 959 (Id. 1983) (effect on usury calculation of a fee for late payment option); *Southwest Concrete Products. v. Gosh Construction Corp.*, 51 Cal.3d 701, 708 (Cal. 1990) ("a transaction that was not usurious at its inception cannot become usurious by virtue the debtor's voluntary default."); *Zang v. Schumann*, 262 Wis. 570, 577-579 (Wisc. 1952) (borrower's exercise of an option to pay an extra premium to be relieved from a lease was not to be considered in the calculation of the interest rate); *Saul v. Midlantic Nat'l Bank*, 572 A.2d 650, 658 (N.J. App. Div. 1990) (whether the value of a non-optional discounted stock sale accompanying the loan should be included in the interest for the loan); *Hoffman v. Key Federal Sav. and Loan Ass'n*, 416 A.2d 1265, 1269 (Md. 1979) (whether an optional prepayment should affect the calculation of the interest rate) ("[t]he virtually universal rule is that a contract legal at its inception will not be rendered usurious by voluntary prepayment.").

[20] *Highway Equip. & Supply Co. v. Jones*, 153 N.W.2d 859, 863 (Neb. 1967); *Coral Gables First Nat'l Bank v. Constructors of Fla., Inc.*, 119 So. 2d 741, 746 (Fla. Dist. Ct. App. 1960); *Waggener v. Holt Chew Motor Co.*, 274 P.2d 968, 971 (Colo. 1954).

these cases are addressed in detail in a publicly available working paper by Professor Levitin, attached as Appendix A.

### 3. The only court ever to consider whether valid-when-made was part of the common law background of the National Bank Act rejected the doctrine's supposed historicity

The only court to ever address the historicity of the valid-when-made doctrine has squarely rejected the OCC's claim that the doctrine was part of the common law background of the NBA. The OCC, however, failed to address this decision its rulemaking.

The District Court for the District of Colorado rejected the historicity of the valid-when-made doctrine in *Rent-Rite SuperKegs W., Ltd. v. World Bus. Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.), an appeal of a Bankruptcy Court decision. The Bankruptcy Court had raised the valid-when-made doctrine *sua sponte* in its opinion as grounds for denying the debtor's usury defense against a rent-a-bank lender. 603 B.R. 41, 66 (Bankr. D. Colo. 2019). The issue was only briefed in the appeal to the District Court. The OCC and the FDIC filed an *amicus* brief with the District Court arguing for confirmation of the Bankruptcy Court's decision on the basis of the valid-when-made doctrine. *Amici Curiae* Brief of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency in Support of Affirmance and Appellee, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.). Professor Levitin filed an *amicus* brief with the District Court arguing that the valid-when-made doctrine was utterly lacking in historical roots. *Amicus Curiae* Brief of Professor Adam J. Levitin in Support of Appellant, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.).

The District Court rejected the OCC's argument, stated that it was "convinced" by Professor Levitin's "compelling counterargument", and reversed and remanded the case to the Bankruptcy Court. Order on Bankruptcy Court's Determination, *In re: Rent-Rite Superkegs West Ltd.,* No. 19-cv-01552 (D. Colo. Aug. 12, 2020) at 9 (attached as Appendix B). The District Court's ruling on the historicity of the doctrine is based on a factual finding, namely that the doctrine did not exist in 1864.

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The *Rent-Rite* district court is the only court to ever address the historicity of the valid-when-made doctrine following briefing by the parties (and, in this case, *amici*), and it rejected the supposed historicity of the doctrine. The OCC, as an *amicus* in the *Rent-Rite* case, was well aware of the District Court's opinion before the rulemaking for the Nonbank Usury Rule was finalized, but failed to address it. The OCC is entitled to differ with a district court's interpretation of the law, but not with a factual determination on an issue it fully briefed. The Nonbank Usury Rule must be struck down as arbitrary and capricious because of the OCC's continued reliance on the historicity of the valid-when-made doctrine without addressing the *Rent-Rite* decision.

### B. The common law of assignments is irrelevant because interest rate exportation is a non-assignable personal privilege of a national bank, not a feature of a note

The Nonbank Usury Rule also purports to be based on the common law of assignments, which the OCC claims was incorporated into the NBA. The common law of assignments, however, has no bearing on the Rule because interest rate exportation is a non-assignable personal privilege of a national bank, not an assignable contract right.

In the rulemaking, the OCC stated that:

> [u]pon assignment, the third-party assignee steps into the shoes of the national bank and may enforce the rights the bank *assigned to it under the contract*. To effectively assign a loan contract and allow the assignee to step into the shoes of the national bank assignor, a permissible interest term must remain permissible and enforceable notwithstanding the assignment. The loan should not be considered usurious after the assignment simply because a third party is enforcing the contractually agreed-upon interest term.

85 Fed. Reg. 33532 (emphasis added). The common law of assignments relates solely to the assignment of rights under a contract or property rights, not an assignment of inalienable personal privileges. It is axiomatic that under the common law of contracts, an assignee takes all of the of the assignor under the contract. *See* RESTATEMENT (2D) OF THE LAW, CONTRACTS, § 317(2) ("A *contractual* right can be assigned....") (emphasis added); 29 WILLISTON ON CONTRACTS § 74:10 (4th ed.) ("Generally, all *contract* rights may be assigned….) (emphasis added). An assignee does not, however, assume the assignor's other rights extraneous to the contract, such as rights under

personal licenses or from status. While the assignee "steps into the shoes" of the assignor, it does not step into the assignor's "feet".

For example, if I sell my car, the buyer gets whatever property rights are appurtenant to the car, but does not also get my driver's license, the benefits of my American Automobile Association membership, my license to practice law, or my parental or spousal rights. Similarly, if a credit union sells a loan, the buyer does not assume the credit union's statutory tax-exempt status, and if a national bank sells a loan, the buyer does not obtain the national bank's exemptions from state licensing or state visitorial powers. *See* 12 U.S.C. §§ 24, 484(a); 12 C.F.R. § 7.4000. Indeed, if these privileges were freely assignable, there would be no point in having a special bank licensing regime because regulators would not exercise control over who ultimately gained the privileges attached to the license.

National banks' interest rate exportation right under section 85 is a statutory right; it is not a contractual term in a loan agreement. The section 85 exportation right is not an alienable property right. It is a personal and non-transferrable privilege that is part of a regulatory scheme that applies only to national banks. Thus, the common law of assignment has no bearing on a transfer of federal statutory status or privileges, because those are neither contract nor property rights.[21]

In the rulemaking the OCC also claims that "an assignment should not change the borrower's obligation to repay in any material way." 85 Fed. Reg. 33532. This statement is narrowly correct, but the OCC fails to recognize that it is not the obligation that is changed by virtue of the assignment, but the applicable state usury law. The borrower's obligation remains intact. Specifically, the borrower borrowed subject to applicable public law constraints on the note, including the applicable usury law. That condition remains constant, but by virtue of the assignment there is a change in the applicable usury law, which is always a background limitation on the borrower's obligation to repay. The common law of assignments simply has no applicability

[21] The Seventh Circuit simply erred in this regard in *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285 (7th Cir. 2005). In any event, the Seventh Circuit's pronouncements on state common law of contracts are not controlling here.

because a national bank's statutory privilege of interest rate exportation is not an assignable property right. As such, the Rule is not consistent with the common law of assignments.

### C. The common law incorporated into the National Bank Act includes a strong anti-evasion doctrine that the OCC failed to address

The Nonbank Usury Rule must be set aside under the APA because it is "not in accordance with law," 5 U.S.C. § 706(2)(A). Specifically, the Nonbank Usury Rule is not in accordance with the common law usury anti-evasion doctrine incorporated in the NBA. When the NBA was enacted in 1864 there was a well-articulated common law usury anti-evasion doctrine. The doctrine meant that courts would look through the form of a transaction to its substance to determine if the form is but a mere contrivance to evade usury laws.[22] *See, e.g.*, *De Wolf v. Johnson*, 23 U.S. 367 (1825) ("no subterfuge shall be permitted to conceal [usury] from the eye of the law."); *Scott v. Lloyd*, 34 U.S. 418, 419 (1835) ("The ingenuity of lenders has devised many contrivances by which, under forms sanctioned by law, the statute may be evaded….Yet it is apparent that if giving this form to the contract will afford a cover which conceals it from judicial investigation, the statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction. If that be in fact a loan, no shift or device will protect it."); *Andrews v. Pond*, 38 U.S. 65, 76 (1839) ("But although the transaction, as exhibited in the account, appears on the face of it to have been free from the taint of usury, yet if the ten per cent. charged as exchange, or any part of it, was intended as a cover for usurious interest, the form in which it was done, and the name under which it was taken, will not protect the bill from the consequences of usurious agreements…"). Indeed, just months before the passage of the NBA on June 3, 1864, the Supreme Court of the United States noted that its holding in a usury decision was

[22] *See also, e.g., Whitworth & Yancey v. Adams*, 26 Va. 333, 337-338 (Va. 1827) ("the only question in all [usury] cases like the present is, what is the real substance of the transaction, not what is the colour and form."); *Wetmore v. Brien & Bradley*, 40 Tenn. 723, 727 (Tenn. 1859) ("But if the note were made for the purpose of being sold, to raise money, or as an artifice to evade the usury laws, under the color of a sale and purchase of the paper, this will not avail; and the purchaser, under such circumstances, with knowledge of the facts, either actual, or inferable from the facts of the case, will be held guilty of usury, if the discount shall have been greater than the legal rate of interest.").

"subject to the qualification, that the parties act in good faith, and that the form of the transaction is not adopted to disguise its real character." *Miller v. Tiffany*, 68 U.S. 298, 310 (Jan. 11, 1864).

The anti-evasion doctrine is a key part of the common law incorporated into the NBA. The Nonbank Rule not only entirely ignores the anti-evasion doctrine, but it is entirely inconsistent with it as it facilitates a well-known method for evasion of state usury laws: the rent-a-bank partnership. As such the Rule is "not in accordance with law" and "in excess of statutory … authority", 5 U.S.C. § 706(2)(A), (C), and therefore must be struck down under the APA.

Additionally, for an agency's rulemaking to be legal, the agency must consider all "relevant factors." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 42-43. If an agency "entirely failed to consider an important aspect of the problem", *id.*, the rulemaking must be struck down as being "arbitrary and capricious" in violation of the APA. 5 U.S.C. § 706(2)(A). The OCC failed to give any consideration of the anti-evasion doctrine in the rulemaking. Instead, the OCC selectively (and incorrectly) determined the elements of common law that were incorporated in the NBA. The OCC cannot pick and choose what parts of the common law are incorporated in the NBA. Accordingly, the Nonbank Usury Rule must also be struck down as "arbitrary and capricious."

## II. THE OCC FAILED TO CONSIDER CONSUMER PROTECTION CONCERNS WHEN PROMULGATING THE NONBANK USURY RULE

### A. The Nonbank Usury Rule is inconsistent with section 1 of the National Bank Act

The Nonbank Usury Rule must also be set aside as "not in accordance with law" because it is inconsistent with section 1 of the National Bank Act. 5 U.S.C. § 706(2)(A). Section 1 of the NBA charges the OCC with ensuring the safety-and-soundness of national banks, as well as with ensuring "fair treatment of customers" by national bank. 12 U.S.C. § 1(a). This means that the OCC's promulgation of rules interpreting the NBA must account for *both* safety-and-soundness *and* consumer protection concerns.

Multiple commenters on the rule, including Professor Levitin, raised the concern that the rule would facilitate rent-a-bank schemes. *See, e.g.*, Comment of Professor Adam J. Levitin (Jan. 5, 2020), (included as Appendix D), Comment of the Center for Responsible Lending *et al*. (Jan.

21, 2020) (included as Appendix E), Comment of Senator Sherrod Brown *et al*. (Nov. 21, 2019) (included as Appendix F); Comment of AARP (Jan. 21, 2020) (included as Appendix G). Rent-a-bank schemes harm the customers of national banks by subjecting them to interest rates so high that the customers' states have deemed them to be usurious.

The OCC agreed with such commentators about the potentially "predatory" nature of such lending relationships, 85 Fed. Reg. 33534, yet nothing in the Nonbank Usury Rule is responsive to this concern. The OCC noted that it "has consistently opposed predatory lending, including through relationships between banks and third parties" and that "Nothing in this rulemaking in any way alters the OCC's strong position on this issue, nor does it rescind or amend any related OCC issuances." 85 Fed. Reg. at 33534.

The OCC's "strong position," against predatory lending, however, lacks legal teeth. There is no federal regulation that generally forbids "predatory" or "high-cost" lending, so the OCC can only act through moral suasion. To be sure, the OCC also noted that it has issued "guidance on how banks can appropriately manage the risks associated with" rent-a-bank partnerships. *Id.* The management of risks *for banks* is no way responsive to the OCC's mission charge of "fair treatment *of customers*". Instead, it is responsive solely to the "safety-and-soundness" mission charge. Moreover, the OCC does not consider this regulatory guidance actually binding. *See* Interagency Statement Clarifying the Role of Supervisory Guidance, September 11, 2018, *at* https://bit.ly/3nKKPu4. *See also* Proposed Rule on "Role of Supervisory Guidance," 85 Fed. Reg. 70512 (Nov. 5, 2020).

The Nonbank Usury Rule preempts bright line state usury laws, which can be raised by consumers as well as regulators, and replaces them with the discretionary regulatory pabulum of OCC moral suasion. There is no way to reconcile the Nonbank Usury Rule with the OCC's statutory charge of "fair treatment of customers." As such, the Rule must be struck down because it "not in accordance with law". 5 U.S.C. § 706(2)(A).

### B. The OCC failed to consider its statutory charge of consumer protection when promulgating the Nonbank Usury Rule

The Nonbank Usury Rule must also be set aside as "arbitrary and capricious" because it

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failed to consider the OCC's consumer protection charge. For an agency's rulemaking to be legal, the agency must consider all "relevant factors." *Motor Vehicle Mfrs. Ass'n*, 463 U.S. at 42-43. If an agency "entirely failed to consider an important aspect of the problem", *id.*, the rulemaking must be struck down as "arbitrary and capricious" in violation of the APA. 5 U.S.C. § 706(2)(A).

The OCC conceded that rent-a-bank relationships are potentially "predatory," 85 Fed. Reg. 33534, and did not dispute commentators' concern that the Nonbank Usury Rule would facilitate such relationships. Yet the OCC failed to even consider its statutory charge of consumer protection when promulgating the Rule.

In light of the OCC's mission of consumer protection and the fact that state usury laws often apply solely to consumer loans, the OCC's failure to consider consumer protection concerns—in particular the rent-a-bank problem—means that it "entirely failed to consider an important aspect of the problem." The Rule must therefore be struck down.

## III. THE OCC FAILED TO COMPLY WITH THE PROCEDURAL REQUIREMENTS OF THE NATIONAL BANK ACT WHEN PROMULGATING THE NONBANK USURY RULE

The Nonbank Usury Rule also violates the APA because it does not comply with the NBA's procedural requirements for preemption. The APA requires that a rulemaking be set aside if it was undertaken "without observance of procedure required by law." 5 U.S.C. § 706(2)(D). The OCC failed to follow the NBA's procedural requirements in the rulemaking.

The OCC states in the rulemaking that the Nonbank Usury Rule is meant "to clarify its position with regard to the proper interpretation of sections 85 and 1463(g)(1), which relates to a core element of banks' ability to engage in safe and sound banking: The ability to transfer loans." 85 Fed. Reg. 33534. Likewise, the OCC claims in the rulemaking that the Rule "promotes safe and sound operations, a core component of the OCC's mission as the prudential regulator of national banks" because it protects the liquidity of banks' loan portfolios. 85 Fed. Reg. 33532-33.

The OCC's claims about the Nonbank Usury Rule's importance for bank liquidity are a "tell" about the Rule's illegality. The Rule is not merely an interpretation of section 85 interest rate exportation, but also an interpretation of national banks' separate power to transfer loans. Because the Rule involves a power of national banks other than that granted by section 85, the

Nonbank Usury Rule must comply with the procedural requirements of section 25b of the NBA, 12 U.S.C. § 25b. It does not.

The Rule must be struck down because it fails to comply with the procedural requirements of section 25b of the NBA. Congress enacted section 25b in 2010. PUB. L. 111-203, § 1044, 124 Stat. 2014-17, July 21, 2010. Section 25b represented a major overhaul of the standard for NBA preemption of state law. The provision was a sharp congressional rebuke of the OCC's aggressive preemption campaign that undermined critical consumer protections in the lead up to the 2008 Financial Crisis. Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991, 2055-56 (2014).

Section 25b requires that the OCC undertake certain procedural steps prior to engaging in any activity that preempts state consumer financial laws. In particular, section 25b requires that if the OCC issues any regulation or order with a preemptive effect, it may be undertaken only (to the extent relevant here) upon a finding by the Comptroller himself, "made on the record of the proceeding," on the basis of "substantial evidence" that a state consumer financial law "prevents or significantly interferes with the exercise by [a] national bank of its powers". 12 U.S.C. §§ 25b(b)(1)(B), 25b(b)(6), 25b(c). The determination must be made on a "case-by-case" basis for each individual state law preempted absent consultation with the Consumer Financial Protection Bureau regarding the equivalence of state laws. 12 U.S.C. § 25b(b)(1)(B).

The Nonbank Usury Rule is premised on protecting national banks' power to sell loans, not merely their power to export interest rates under section 85. This is evident both from the OCC's claim that the common law of assignments is relevant to the analysis of the rule as well as from the OCC's argument that the rule is necessary to protect bank's power to sell loans: "a bank's well-established authority to assign a loan may be unduly curtailed if the bank cannot be certain that interest permissible prior to the assignment will remain permissible afterwards." 84 Fed. Reg. 64231. Indeed, the OCC states that the rulemaking is about protecting banks' ability to engage in safe and sound banking: "The ability to transfer loans." 85 Fed. Reg. 33534.

National banks' power to sell or otherwise transfer loans arises under section 24 of the NBA. 12 U.S.C. § 24(3), (Seventh). The power to transfer loans lies outside the scope of interest

rate exportation in section 85, so it is unquestionably subject to section 25b's procedural requirements. The OCC, however, concedes it has not complied with these procedural requirements in the rulemaking. 85 Fed. Reg 33533. Accordingly, the Nonbank Usury Rule must be struck down under the APA for failure to comply with the procedural requirements of the NBA. 5 U.S.C. § 706(2)(D).

The OCC contends that section 25b's procedural and substantive provisions are inapplicable to the Rule, which it claims is undertaken under section 85 of the NBA, which the OCC argues is carved out from section 25b's ambit by section 25b(f). 85 Fed. Reg. 33533. The language of section 25b(f) is opaque and circular, but even if the OCC's interpretation of section 25b(f) were correct, it would not matter because the Rule also fails to pass legal muster if it is considered solely under section 85 without regard to national banks' sales power.

The APA requires that a rule be set aside if it is "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right." 5 U.S.C. § 706(2)(C). Even if section 25b does not apply the Rule must fail because section 85 does not address the transfer of loans by national banks or the rights of assignees of national banks. Section 85 addresses only what interest a national bank may itself charge. As such, it provides no basis for an interpretative rule that about the rights of an assignee of a national bank. If the Rule is considered solely with reference to national banks' powers under section 85, it must be struck down because it goes well beyond the subject of the statutory text of that provision and therefore is "in excess of statutory…authority."

The OCC cannot have it both ways. Either the Rule arises solely under section 85, in which case it goes far beyond anything authorized by that provision, or the Rule also arises under section 24, in which case it fails because it does not comply with the procedural requirements of section 25b. Either way, the Rule cannot stand.

## IV. THE OCC'S CLAIMS ABOUT THE NONBANK USURY RULE'S IMPACT ON BANK LIQUIDITY ARE UNSUPPORTED.

The Nonbank Usury must be additionally struck down because it claims that it protects bank liquidity without any supporting evidence. Such an unsupported claim is "arbitrary and capricious," so the Rule must be set aside under the APA. 5 U.S.C. § 706(2)(A).

The OCC argues that the Nonbank Usury Rule is important for protecting the liquidity of national banks because it preserves their power to sell higher interest rate loans. This claim is entirely unsupported. The OCC presents no evidence that the Rule—or lack thereof—affects bank liquidity. Moreover, the OCC failed to address comments presenting evidence that bank liquidity would not be affected due to the structure and regulation of the banking market.

The OCC states that it undertook the "rulemaking to clarify that a bank may transfer a loan without impacting the permissibility or enforceability of the interest term in the loan contract, thereby resolving the legal uncertainty created by" *Madden v. Midland Funding LLC*, 786 F.3d 246 (2d Cir. 2015). 85 Fed. Reg. 33531. *Madden* held that a nonbank purchaser of loans from a national bank was not entitled to shelter in the bank's exemption from New York's usury law.

The OCC, however, presented no evidence about the impact of the *Madden* decision on bank liquidity. Instead, it noted that two commenters provided empirical studies regarding the impact of the *Madden* decision on a subset of high-risk borrowers. The OCC did not identify the studies, much less provide any analysis of them. Indeed, the OCC did not indicate in what way—if at all—it relied on studies in any way in the rulemaking. Moreover, there is no indication that the studies dealt with the impact of the *Madden* decision *on banks*. Indeed, the FDIC, in a parallel rulemaking, admitted that it is "not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision." FDIC, "Federal Interest Rate Authority," 85 Fed. Reg. 44146, 44156 (July 22, 2020).

Not only did the OCC fail to adduce any evidence about the effect of *Madden*—or the Nonbank Usury Rule, sometimes called the "*Madden*-Fix" rule—on bank liquidity, but a consideration of some basic features of the secondary market in bank loans suggests that no such evidence exists because the Rule would not likely have a material impact on bank liquidity. These features were raised in comments to the OCC on the Rule, *see, e.g.*, Comment of Professor Adam J. Levitin (Jan. 5, 2020) (see Appendix D), but the OCC failed to address them in any manner.

First, national banks—and secondary credit markets—have operated for over 150 years without a Nonbank Usury Rule. The OCC claims that the valid-when-made doctrine operated as an equivalent to the Nonbank Usury Rule prior to the uncertainty created by *Madden*. As noted

above, however, that doctrine did not even begin to emerge in case law until the late 20th century. Bank liquidity and secondary markets have never depended upon valid-when-made. Because of both credit risk and reputational risk, national banks have generally avoided making high interest-rate loans that would violate state usury laws. In any event, a concerned secondary market purchaser can always seek indemnification from the seller, a standard buyer protection in many secondary markets. Banks have not needed doctrinal shields to protect their ability to sell loans.

Second, while banks do rely on loan sales as a source of liquidity, they existence of the Federal Reserve's discount window, where a bank can borrow against its illiquid assets, ensures that a solvent bank will always have a source of liquidity. The OCC made no attempt to account for the variety of potential sources of bank liquidity in its rulemaking.

Third, the principal secondary market for bank loans is in home mortgages. State usury laws are specifically preempted for most mortgages, regardless of what entity that holds them. 12 U.S.C. §§ 1735f-7, 1735f-7a. Accordingly, the Nonbank Usury Rule has no effect on the liquidity of a major category of bank assets.

Finally, the OCC ignores the existence of a potential secondary market of over 5,000 insured depository institutions that are not subject to state usury laws. FDIC, *Statistics at a Glance*, Sept. 30, 2020, *at* https://bit.ly/3nLASgl. At most, then, the Nonbank Usury Rule affects the size of the secondary market and the price at which national banks can sell loans, but not their fundamental ability to sell loans. The Rule is not protecting bank *liquidity* but merely the price at which national banks can sell loans. The NBA, however, is not a minimum resale price guaranty for national banks. *See Madden*, 786 F.3d at 251 ("Although it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states…such an effect would not 'significantly interfere' with the exercise of a national bank power."). A lower sale price for certain loans is not a significant interference with the powers of national banks.

The Nonbank Usury Rule should be struck down as violating the APA because it is "arbitrary and capricious." 5 U.S.C. § 706(2)(A). The OCC failed to present *any* evidence about the Rule's impact on bank liquidity, despite that being a major policy justification for the Rule. Moreover, the OCC failed to address evidence indicating that bank liquidity would not be affected

as a result of the structure and regulation of the banking market.

## CONCLUSION

Contrary to the OCC's claims, the Nonbank Usury Rule does not comport with the common law as incorporated in the NBA, conflicts with section 1 of the NBA, fails to follow the applicable procedural requirements of section 25b of the NBA, and is not supported by evidence. Accordingly, under the Administrative Procedures Act, 5 U.S.C. § 706(2), the Rule must be struck down.

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# APPENDIX A

Adam J. Levitin, *Rent-a-Bank: Bank Partnerships and the Evasion of Usury Laws*

Working Paper, Dec. 21, 2020

***DRAFT VERSION—DECEMBER 22, 2020***

# <u>RENT-A-BANK:</u><br>BANK PARTNERSHIPS AND THE EVASION OF USURY LAWS

ADAM J. LEVITIN*

*"Rent-a-bank" arrangements are the vehicle of choice for subprime lenders seeking to avoid state usury, licensure, and other consumer protection laws. In a rent-a-bank arrangement, a nonbank lender contracts with a bank to make loans per its specifications and then buys the loans from the bank. The nonbank lender then claims to shelter in the bank's federal statutory exemptions from state regulation. The validity of such arrangements has been the most bitterly contested—and still unresolved—legal question in consumer finance for nearly two decades.*

*The rent-a-bank phenomenon is a function of a binary, entity-based regulatory approach that treats banks differently than nonbanks and that treats bank safety-and-soundness regulation as a substitute for usury laws. The entity-based regulatory system is based on the dated assumption that transactions align with entities, such that a single entity will perform an entire transaction. Consumer lending, however, has become "disaggregated," such that the discrete parts of lending—marketing, underwriting, funding, servicing, and holding of risk—are frequently split up among multiple, unaffiliated entities.*

*The binary, entity-based regulatory system is a mismatch for such disaggregated transactions involving a mosaic of entities, some bank and some non-bank. The mismatch facilitates regulatory arbitrage of usury laws through rent-a-bank arrangements, as nonbanks claim favorable regulatory treatment by virtue of the marginal involvement of a bank in a transaction.*

*The vitality of rent-a-bank arrangements depends on legal doctrine. This Article shows that the so-called "valid-when-made" doctrine used to support rent-a-bank arrangements, is not, as claimed, a well-established, centuries old, "cardinal rule" of banking law. It is a modern fabrication, entirely unknown historically. The doctrine is not valid, but made up. Because the doctrine never existed historically, it cannot be essential for the smooth functioning of credit markets. The better approach to disaggregated transactions is a presumption that bank regulation does not extend beyond banks, coupled with an anti-evasion principle that looks to substance over form. Such an approach would create greater certainty about the legality of transactions, while effectuating both state consumer protection laws and federal bank regulation policy.*

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* Anne Fleming Research Professor & Professor of Law, Georgetown University Law Center. This Article is based in part on Congressional testimony before the House Financial Services Committee and House Small Business Committee on rent-a-banks and on an *amicus* brief submitted in rent-a-bank litigation. It has benefited from a presentation at the National Consumer Law Center's Consumer Litigation Rights Conference and a panel hosted by the Columbia Law and Political Economy Society. Thank you to Anna Gelpern, and Bill Bratton for helpful comments and to Aliya Brown and Mitchell Mengden for research assistance.

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**INTRODUCTION**

How did a small business end up paying over 122% interest on a loan? Homes by DeRamo, a small, Sarasota, Florida, construction business owned by the DeRamo family, needed cash in 2015 for operating expenses.[1] An outfit called World Business Lenders, LLC,[2] offered a $400,000 loan, but required the DeRamos to personally guaranty the loan and pledge their home as collateral.[3] Florida's usury law caps interest charges at an 18% annual rate.[4] So how was World Business Lenders able to charge over 122% annually?[5] Because World Business Lenders had "rented" a bank.

Banks are effectively exempt from state usury laws.[6] Usury laws, which prevent high cost lending, still apply to nonbank entities like World Business Lenders.[7] High cost nonbank lenders engage in a range of transactional devices to evade state usury laws,[8] but their preferred mechanism is to partner with a bank in a "rent-a-bank" arrangement.[9] That is precisely what World Business Lenders did.

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[1] Complaint, *DeRamo v. World Bus. Lenders, LLC*, 2017-CA-2438-NC (Sarasota County, Fla. Circuit Court, June 16, 2017) at ¶ 7 (hereinafter "*DeRamo* Complaint").

[2] For background on World Business Lenders, *see* Zeke Faux, *Wall Street Finds New Subprime With 125% Business Loans*, BLOOMBERG, May 22, 2014.

[3] *DeRamo* Complaint at ¶ 8. The DeRamos took out an initial 300-day loan, refinanced it with another 300-day World Business Lenders loan (paying a 15% prepayment penalty), and then took out a supplementary loan from World Business Lenders.

[4] 39 FLA. STAT. § 687.02.

[5] The loan documents, included as attachments the complaint, all provide for a daily interest rate of between 0.331513939726% and 0.335945205479%. *DeRamo* Complaint at pp. 13, 55, 158. On an annualized simple interest basis with a 365-day year, this is between 121% and 122.6%. The DeRamos' loans were only for 300 days, however, so in their pleadings they annualized the ratio of finance charges to principal, which resulted in rates between 72% and 74% interest. *DeRamo* Complaint at ¶ 26.

[6] Federal law does not exempt banks from state usury laws so much as provide a choice of law rule that enables banks to "export" the usury cap from their home state to other states. *See* 12 U.S.C. §§ 85, 1463(g), 1831d. This means that a bank based in a state with no usury cap is not subject to other states' usury caps when it does business in those states. Florida law also specifically exempts banks from its usury laws. 39 Fla. Stat. § 687.12.

[7] States often have different usury limits for certain types of state-licensed lenders. Unlicensed lenders, however, like World Business Lenders, are subject to general usury laws.

[8] Examples of other devices include high cost lenders basing themselves offshore and claiming that foreign usury limits apply, *see* First Amended Complaint, *Consumer Fin. Protection Bur. v. NDG Financial Corp.*, No. 15-cv-5211 (S.D.N.Y., Dec. 11, 2015), or partnering with native American tribes or tribal members and sheltering in tribal immunity, *see infra* note 106; Complaint, *FTC v. AMG Services, Inc.*, No. 2:12-cv-00536 (D. Nev. Apr. 2, 2012); First Amended Complaint, *CFPB v. CashCall, Inc.*, No. 1:13-cv-13167 (D. Mass. Mar. 21, 2014).

[9] Financial services firms refer to these relationships solely as "bank partnership" relationships. Critics use the term "rent-a-bank" to describe the relationship. Neither is a neutral term. "Rent-a-bank" may seem inflammatory, but the anodyne "bank partnership"

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In a rent-a-bank arrangement, a nonbank contracts for a bank to make loans according to the its specifications and then sell it the loans. The nonbank then claims to shelter in the bank's exemption from state usury laws and other consumer protection laws, as well as the benefit of the choice-of-law provisions applicable to the bank. And because the loan is not directly made by the nonbank, the nonbank claims that it is exempt from state licensure requirements for nonbank lenders. In exchange for renting out its regulatory privileges, the bank collects a fee.

In the case of Homes by DeRamo, the loan terms were negotiated by World Business Lenders, but the loan was formally made by Bank of Lake Mills, a tiny two-branch community bank in Wisconsin with no presence in Florida. Within weeks of making the loans to the DeRamos' business, Bank of Lake Mills assigned the loans to World Business Lenders.[10] The assignment was signed by a Vice President of World Business Lenders with a Power of Attorney for Bank of Lake Mills.[11] The documentation of the DeRamos' loan bears indicia that World Business Lenders was the intended assignee from the get-go: World Business Lenders' address appears in numerous places in the loan documentation,[12] and the loan documentation

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terminology masks the true nature of the relationship and effectively accedes to these arrangements' legitimacy as a policy matter. Moreover, the contractual documents for these relationships often explicitly disclaim the existence of a partnership. *See, e.g.*, Participation agreement, dated July 1, 2015, by and between Elastic SPV, Ltd. and Republic Bank & Trust Company https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX991_HTM#D83122DEX991_HTM (hereinafter "Elastic Participation Agreement") § 18 ("This Agreement is not intended to constitute, and shall not be construed to establish, a partnership or joint venture among any of the Parties."), § 19.a ("This Agreement will not create a joint venture, partnership or other formal business relationship or entity of any kind, or an obligation to form any such relationship or entity."); Participation Interest Purchase and Sale Agreement, dated August 1, 2019, by and between EF SPV, LTD, and FinWise Bank, *at* http://d18rn0p25nwr6d.cloudfront.net/CIK-0001651094/c55a048e-f8bb-41b8-ad10-bafd47e130f9.pdf (hereinafter "Rise Participation Agreement") ("§ 4.02 Intent of the Parties. This Agreement will not create a joint venture, partnership or other formal business relationship or entity of any kind, or an obligation to form any such relationship or entity.").

Recognizing the absence of neutral terminology, this Article uses both terms, but generally uses the "rent-a-bank" terminology because it more accurately captures the true nature of the relationship, in which the bank effectively rents out its special regulatory privileges to a non-bank.

[10] *DeRamo* Complaint at pp. 152, 182. World Business Lenders, LLC subsequently assigned the loans to a securitization vehicle called WBL SPE II, LLC. *Id.* at pp. 184, 187. WBL SPE II, LLC is a wholly owned subsidiary of World Business Lenders, LLC, that World Business Lenders uses to obtain financing. Verified Petition, *World Business Lenders, LLC v. Arena Limited SPV, LLC*, No. 653229/2019 (N.Y. Sup. Ct. N.Y. County, May 31, 2019), ¶¶ 2, 6.

[11] *DeRamo* Complaint at ¶ 24.

[12] *See, e.g.*, *id.* at pp. 13, 31.

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even provides for venue and enforcement in New York, where World Business Lenders was located at the time.[13] The DeRamo case follows a pattern of other transactions undertaken by World Business Lenders with Bank of Lake Mills and pair of other banks.[14] In other words, Bank of Lake Mills was little more than a front for World Business Lenders to evade state regulation.

The DeRamos challenged the loans as usurious.[15] Because of the involvement of the Bank of Lake Mills, World Business Lenders was able to respond that (1) the loan documentation provided that they would be governed by Wisconsin law, which has no usury rate for business loans, not Florida law, and (2) as the bank's assignee it could shelter in the bank's

[13] *Id.* at p. 17.

[14] *See, e.g.*, Class Action Complaint, *Quantum-Mac Int'l, Inc. v. World Bus. Lenders, LLC*, No 1:20-cv-02353 (N.D. Ga. June 2, 2020) (Axos Bank, former BOFI Federal Bank, as rent-a-bank partner for World Business Lenders); Kaur v. World Bus. Lenders, LLC, 440 F. Supp. 3d 111, 116 (D. Mass. 2020) (BOFI Federal Bank as World Business Lenders' rent-a-bank partner); World Bus. Lenders, LLC v. 526-528 North Main St., LLC, 197 Conn. App. 269, 270-271 (2020) (120% interest rate loan made by Bank of Lake Mills and assigned to World Business Lenders); Complaint, *World Business Lenders, LLC v. Cloud & Willis, LLC*, No. 19-ev-007125 (Fulton County State Court, Ga., Dec. 27, 2019), ¶ 5 (noting that "Shortly after the Loan documents were signed, the Loan [made by Bank of Lake Mills] was sold and assigned to World Business Lenders."); Complaint, *B&S Medical Supply, Inc., N.Y. v. World Business Lenders, LLC*, No. 17-cv-03234-RMB (S.D.N.Y. 2017) (Liberty Bank, Utah, as rent-a-bank partner for World Business Lenders); Verified Complaint, WBL SPE I, LLC as Assignee of World Bus. Lenders, LLC and of Bank of Lake Mills vs. Jo Juice and Salad Bar, LLC, No. 32642/2017E (N.Y. Sup. Ct., Bronx Cnty, Oct. 26, 2017) (loan made by Bank of Lake Mills on October 20, 2016, and sold to World Business Lenders on December 2, 2014); Verified Complaint, *World Bus. Lenders, LLC v. Queens Medical Services, P.C.*, No. 600802/2016 (N.Y. Sup. Ct. Nassau Cnty, Feb. 5, 2016) (loan made by Bank of Lake Mills on March 10, 2015, sold to World Business Lenders on March 16, 2015); Verified Complaint, *World Bus. Lenders, LLC v. Michael's Landscaping Construction, LLC*, No. 611675/2016 (N.Y. Sup. Ct. Suffolk Cnty, July 26, 2016) (loan made by Bank of Lake Mills on December 9, 2015, and sold to World Business Lenders on December 14, 2015); Verified Complaint, *World Bus. Lenders, LLC v. ML Seafood Corp.*, No. 511151/2016 (N.Y Sup. Ct. Kings County, June 30, 2016) (loan made by Bank of Lake Mills on April 30, 2015, and sold to World Business Lenders on May 6, 2015)Verified Complaint, *World Bus. Lenders, LLC v. PM Recycling LLC*, No. 509595/2016 (N.Y. Sup. Ct., Kings Cnty, June 6, 2016) (loan made by Bank of Lake Mills on November 26, 2014, and sold to World Business Lenders on December 2, 2014).

[15] The DeRamos allege that they were also told that their refinancing of the loan and a subsequent additional loan would be at 15%. *DeRamo* Complaint at ¶¶ 14, 22. The only 15% figure in the loan documents is for the prepayment premium. *Id.* at Exhibit 1 (p.13). While the interest rate was in fact disclosed in the DeRamo's actual loan agreement, it was in the form of a miniscule daily rate with twelve decimal places. On the term sheet for the transaction, entitled "Business Loan Summary," no interest rate was quoted, only a total dollar figure for the interest charges. The only number given as a percentage on the term sheet was the prepayment penalty—15%. No annual percentage rate was ever given because as a business loan, the Truth in Lending Act's requirement of disclosure of the annual percentage rate, 15 U.S.C. § 1632, did not apply.

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exemption from state usury laws.[16] What's more, because the DeRamos had defaulted on the loan, World Business Lenders sought to foreclose on their home in a counterclaim.[17]

The DeRamos' case ultimately settled privately, but it is illustrative of a larger phenomenon in subprime lending. Rent-a-bank arrangements are common in on-line payday lending, consumer installment lending, "marketplace lending," and subprime small business lending. Moreover, rent-a-bank lending appears likely to expand in response to the tightening of state usury laws,[18] new federal regulations, and signals that federal banking regulators will tolerate rent-a-bank relationships.

The potential expansion of rent-a-bank lending threatens to gut state consumer protection laws, such that one consumer group has called it "the biggest threat in decades to states' historic power to prevent predatory lending".[19] Yet rent-a-bank lending stands on an uncertain and contested

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[16] Defendants, World Business Lenders, LLC's and WBL SPE II, LLC's Answer, Defenses, and Counterclaims, *DeRamo v. World Bus. Lenders, LLC*, 2017-CA-2438-NC (Sarasota County, Fla. Circuit Court, June 16, 2017) at pp. 6-7.

[17] *Id.* at pp. 9-14.

[18] On October 10, 2019, California enacted the Fair Access to Credit Act (A.B. 539), which created a rate cap of 36% on loans between $2500 and $10,000. Previously no rate cap had applied. In response, three nonbank fintech lenders, CURO, Elevate, and ENOVA, each indicated in an investor call that it were considering moving to the bank partnership model to avoid the usury cap. Elevate Credit, Inc., Q3 2019 Earnings Call, Nov. 4, 2019, https://finance.yahoo.com/news/edited-transcript-elvt-n-earnings-063934139.html ("...California passed a law that caps interest rates on personal loans between $2,500 and $10,000. …As a result, we will stop originating loans through a direct lending channel in California once the law goes into effect. However, we do not believe that it'll have a material impact on our business due to our diversified operating model and additional opportunities. One of those opportunities is to expand our underwriting and technology licensing to our 3 existing FDIC-regulated bank partners in new geographies. In addition, we are continuously looking for additional banks that share our commitment to providing innovative consumer-focused products."); Enova International (ENVA) Q3 2019 Earnings Call, Oct. 24, 2019, https://www.fool.com/earnings/call-transcripts/2019/10/26/enova-international-enva-q3-2019-earnings-call-tra.aspx ("And instead of originating near-prime loans, we plan to market and provide underwriting services for national banks originating in California."); CURO Group Holdings Corp. (CURO) Q3 2019 Earnings Call Transcript, Oct. 25, 2019, https://www.fool.com/earnings/call-transcripts/2019/10/25/curo-group-holdings-corp-curo-q3-2019-earnings-cal.aspx ("Hugh Miller -- *Buckingham – Analyst*: …So I guess assuming that you are successful at some point in potentially creating a substitute product with the bank in California, can you just give us a sense of kind of how we should think about the start-up process for that type of initiative?...

Don Gayhardt -- *President & Chief Executive Officer*: …we do have a signed agreement….").

[19] Testimony of Lauren Saunders, National Consumer Law Center on behalf of its low income clients Before the House Financial Services Committee on Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade

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legal foundation. A critical legal question remains unresolved: can a nonbank that acquires a loan from a bank shelter in the bank's exemption from state regulation? While this question applies first and foremost to usury laws, it also applies to other state laws regulating the substantive terms of loans and requiring nonbank lenders to be licensed and subject to state supervision.

When nonbank makes a loan itself, it is subject to state regulations. But what if the nonbank instead acquires an otherwise identical loan from a bank? Is the bank's exemption from state regulation laws entity-based and personal to a bank? Or is the exemption asset-based, such that it travels with a loan?

Courts have split on the issue, which has arisen primarily in the context of usury laws. Some have followed the "valid-when-made rule" that holds the nonbank can shelter in the bank's usury law exemption if the bank was itself the original lender.[20] Others follow the "*Madden* rule," from the Second Circuit's 2015 decision in *Madden v. Midland Funding, LLC*, arguably the most important financial regulation case in the past decade.[21] The *Madden* rule holds that the exemption is strictly limited to banks and not transferrable to nonbanks. Yet others hold that the issue depends on whether the bank or the nonbank was the "true lender."[22]

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State Consumer Protections and Interest Rate Caps February 5, 2020, at 2, *at* https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/Lauren-Saunders-Testimony-on-rent-a-bank-hearing-REVISED-2-5-20-1.pdf.

[20] *See, e.g.*, Hudson v. ACE Cash Express, Inc., 2002 U.S. Dist. LEXIS 11226 (S.D. Ind. 2002); Olvera v. Blitt & Gaines, PC, 431 F.3d 285 (7th Cir. 2005); Phipps v. FDIC, 417, F.3d 1006 (8th Cir. 2005); Krispin v. May Dep't Stores, 218 F.3d 919 (8th Cir. 2000); Munoz v. Pipestone Fin., LLC, 513 F.Supp.2d 1076 (D. Minn. 2007); Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359 (D. Utah 2014); *In re* Rent-Rite Superkegs West, Ltd., 603 B.R. 41 (Bankr. D. Colo. 2019). Procedurally, some of these cases were addressing the question of complete preemption in the context of removal from state court, while others were addressing substantive preemption in a merits context, but there is no indication that the analysis would be materially different.

[21] Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015).

[22] *See, e.g.*, Order on Bankruptcy Court's Determination, *In re: Rent-Rite Superkegs West Ltd.,* No. 19-cv-01552 (Aug. 12, 2020) (remanding for true lender determination); Dep't of Ins. & Fin'l Svcs. v. Comdata Network, Inc., 2019 WL 3857904 (Mich. Dep't of Ins. & Fin'l Svcs. Aug. 7, 2019) (finding that nonbank was the true issuer of credit card program so bank exception to state licensing requirement did not apply), *aff'd in part, rev'd in part by* Comdata Network, Inc. v. Mich. Dep't of Ins. & Fin. Serv. No. 19-747-AV (Mich. Inghan Cty., 30th Jud'l Cir. Ct. May 19, 2020); Fulford v. Marlette Funding, LLC, No. 2017-CV-30376), 2019 WL 4451038 (D. Colo. June 5, 2019); Meade v. Avant of Colorado, L.L.C., 307 F. Supp. 3d 1134, 1150–1152 (D. Colo. 2018); Consumer Fin. Prot. Bureau v. CashCall, Inc., No. CV-15-7522-JFW, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016); CashCall, Inc. v. Md. Comm'r of Fin. Regulation, 448 Md. 412, 436, 139 A.3d 990, 1005, 2016 Md. LEXIS 371, *36 (Md. Ct. App. 2016) (holding a party that was the de facto lender was a "credit services business" subject to Maryland usury law); Eul v. Transworld Sys., 2017 WL 1178537 (N.D. Ill. Mar. 30, 2017);

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Adding to the confusion, two federal banking regulators have issued non-identical rules that aim to codify "valid-when-made,"[23] and one of these regulators issued a rule that would overrule true lender doctrine by deeming a bank to be the lender for the purpose of usury laws for any loans it initially makes or funds.[24] Further complicating the debate is that the doctrines affecting rent-a-bank relationships affect other transactions in which banks sell loans to nonbanks, particularly bank sales of defaulted loans to debt buyers and securitization.

This Article shows how the rent-a-bank issue is a function of two features of the design of the financial regulatory system: (1) the entity-based nature of the system, which has left it vulnerable to regulatory arbitrage and (2) the absence of a general usury law for banks, which has made regulatory arbitrage inviting.

Key parts of the financial regulatory system are entity-based. The entity-based system is binary: either an entity is a bank and subject to bank regulation or it is not. Such a binary system makes sense when the regulated

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Commonwealth v. Think Fin., Inc., 2016 WL 183289 (E.D. Pa. Jan. 14, 2016); Community State Bank v. Knox, 523 Fed. Appx. 925 (4th Cir. 2013) (state-law usury claims not completely preempted by the FDIA merely because a state-chartered bank was the named lender); Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012) (noting that, "where a plaintiff has alleged that a national bank is the lender in name only, courts have generally looked to the real nature of the loan to determine whether a non-bank entity is the de facto lender"); CashCall, Inc. v. Morrisey, No. 12-1274, 2014 WL 2404300, at *1, *7 (W.Va. May 30, 2014); West Virginia v. CashCall, Inc., 605 F. Supp. 2d 781, 783 (S.D.W. Va. 2009); Discover Bank v. Vaden, 489 F.3d 594, 601, 603 n.9, 606 (4th Cir. 2007), *rev'd on other grounds*, 556 U.S. 49 (2009) (noting that the FDIA would apply only if the bank were the "real party of interest"); Spitzer v. County Bank of Rehoboth, 846 N.Y.S.2d 436 (N.Y. App. Div. 2007); BankWest, Inc. v. Baker, 411 F.3d 1289 (11th Cir. 2005) (upholding Georgia statute deeming a purported agent of a bank to be the de facto lender if it has the predominant economic interest), *reh'g granted, op. vacated*, 433 F.3d 1344 (11th Cir. 2005) (en banc), *op. vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006); Easter v. Am. West Fin., 381 F.3d 948, 957-959 (9th Cir. 2004) (applying true lender doctrine under Washington State law); Krispin v. May Dept. Stores, 218 F.3d 919 (8th Cir. 2000) (explaining that close relationship between bank and department store made the bank the real party in interest); Glaire v. La Lanne-Paris Health Spa, Inc., 528 P.2d 357, 363 (Cal. 1974); Dillard v. First Nat'l Bank of Birmingham, 227 F.2d 353, 355 (5th Cir. 1955), *reh'g denied with* opinion, 228 F.2d 803 (5th Cir. 1956). *See also* Fed. Deposit Ins. Corp. v. Lattimore Land Corp., 656 F.2d 139, 148, n.15 (5th Cir. 1981) (noting that there was no allegation that the assignee was the true lender and suggesting that analysis would be different if there were such an allegation).

[23] 85 Fed. Reg. 33530 (June 2, 2020) (OCC final rule on Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred); 85 Fed. Reg. 44146 (July 22, 2020) (FDIC final rule on Federal Interest Rate Authority). There are serious questions about the bank regulators' authority to prescribe rules governing nonbanks, as well about the procedural validity of these particular rules, but these administrative law questions are beyond the scope of this Article.

[24] 85 Fed. Reg. 68742 (Oct. 30, 2020) (OCC final rule on "National Banks and Federal Savings Associations as Lenders").

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economic activity corresponds neatly to entity type. That is frequently no longer the case in consumer lending, however.

Lending involves several discrete activities: designing a credit product; marketing it and prospecting for borrowers; underwriting borrowers; funding the loan; servicing the loan; and holding the credit risk and interest rate risk. Historically, these activities were all aggregated in the same institution, such that a bank would design, market, underwrite, fund, service, and hold a loan until maturity. The bank was the firm where the "nexus of contracts" existed for the entire lending activity.[25] The complete lending cycle existed in the bank.[26]

Over the past few decades, however, a new phenomenon has emerged in consumer lending: the different components of the lending cycle are split up and performed by multiple institutions, rather than by a single "lender,"[27] with banks often playing only a supporting role. While a bank might provide the initial funding for a loan, the underwriting, the servicing, and the holding of risk might all be performed by other entities or the bank might perform some of these functions not as a principal in its own capacity, but as the agent for another party.

This disaggregation frequently reflects the outcome of a make-or-buy decision. The efficiency of outsourced production may exceed in-house production, such that vertical integration of production may not be optimal

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[25] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,* 3 J. FIN. ECON. 305 (1976) (theory of the firm as a "nexus of contracts"). *See also* William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal,* 74 CORNELL L. REV. 407, 415 (1989) (defining the "nexus of contracts" approach as "the firm is a legal fiction that serves as a nexus for a set of contracting relations among individual factors of production"); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract,* 89 COLUM. L. REV. 1416, 1426 (1989) (describing the nexus of contracts theory as "a shorthand for the complex arrangements of many sorts that those who associate voluntarily in the corporation will work out among themselves").

[26] The bank might farm out some functions to affiliated entities, but they were all within the same firm. *See* Marquette Nat'l Bank v. First of Omaha Service Corp., 262 N.W.2d 358, 359-360 (Minn. 1977) (describing role played by bank affiliate in soliciting applications for credit card lending).

[27] "Disaggregation" of the lending function is a different phenomenon than the much-noted "disintermediation". Disintermediation refers to the shift from relying on banks to intermediate between sources of capital and borrowers to other funding channels, such as securitization and money market mutual funds. *See, e.g.*, Steven L. Schwarcz, *Regulating Shadow Banking,* 31 REV. BANKING & FIN. L. 619, 624-625 (2012); Zachary J. Gubler, *Regulating in the Shadows: Systemic Moral Hazard and the Problem of the Twenty-First Century Bank Run*, 63 ALA. L. REV. 221, 271 (2012); Steven L. Schwarcz, *Securitization, Structured Finance, and Covered Bonds*, 39 IOWA J. CORP. L. 129, 131-132 (2013). Disintermediation is concerned solely with the funding channel. Disaggregation, in contrast refers to a division of the components in the lending cycle. These components include the source of funding, but also marketing, underwriting, and servicing.

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for a firm.[28] It may be cheaper, for example, for a bank to pay for a third-party to provide a service than for the bank to produce the service itself. Yet disaggregation may not merely reflect a bank outsourcing factors of production and thus acting as a "buyer." Instead, when lending is disaggregated, it may reflect a *nonbank* outsourcing factors of production and buying them from the bank, such that the bank is acting as a "seller" of regulatory privileges to the nonbank.

The upshot of "disaggregation" of lending is that lending transactions often involve a mosaic of firms, some bank and some non-bank. Yet the regulatory system persists in a binary approach to regulation that enables transactions to claim "bank" treatment even when a bank is only minimally involved in a transaction that also involves several nonbanks entities. The entity-based regulatory system is vulnerable to regulatory arbitrages like rent-a-bank because of the ability to perform transactions through a range of entities and entity combinations.

The rent-a-bank arbitrage is appealing to subprime lenders because federal law effectively exempts banks from state usury laws without substituting an equivalent federal law. Federal law provides that banks are subject only to the usury law of their home state, no matter where they operate,[29] but banks have substantial ability to choose their "home" state, such that by picking a favorable home state that allows bank loans to be at the contractually agreed upon rate, such as Delaware,[30] Nevada,[31] or South Dakota, [32]or Utah,[33] a bank can functionally be exempt from usury laws. Unlike for credit unions,[34] there is no general federal usury law applicable to banks.[35] Federal law lacks a generally applicable usury limitation. Indeed, the Consumer Financial Protection Bureau is expressly forbidden from promulgating a federal usury provision.[36]

[28] The classic explorations of make-versus-buy are Ronald H. Coase, *Nature of the Firm*, 4 ECONOMICA 386 (1937) and Oliver Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 Am. Econ. Ass'n Papers & Proceedings 112 (1971).

[29] Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299 (1978); 12 U.S.C. §§ 85, 1463(g)(1), 1831(d).

[30] 5 DEL. CODE §§ 943, 953, 963, 965, 973.

[31] NEV. REV. STAT. § 99.50.

[32] S.D. COD. L. § 54-3-1.1.

[33] UTAH CODE § 15-1-1 ("The parties to a lawful written, verbal, or implied contract may agree upon any rate of interest for the contract, including a contract for services, a loan or forbearance of any money, goods, or services, or a claim for breach of contract.").

[34] 12 U.S.C. § 1757(5)(A)(vi) (15% limit, temporarily raisable via regulation).

[35] The Military Lending Act does cap the interest rate on certain loans made to military members and their dependents. 10 U.S.C. § 987(b) (36% military APR limit). Federal credit unions are also subject to a usury cap. 12 U.S.C. § 1757(5)(A)(vi) (15% usury cap, extendable by regulation).

[36] 12 U.S.C. § 5517(o).

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The conceit behind the special treatment for banks is that they operate nationwide and should not be saddled with compliance with inconsistent state usury laws because they are already subject to a strict, bank-specific regulatory regime focused on ensuring the bank's safety-and-soundness, ultimately meaning that the bank is solvent. While there is no general federal usury cap for banks, a key feature of the bank regulatory system is regulators' exercise of "soft power" through supervisory pressure. Regulators can practice informal moral suasion through the bank oversight process to ensure that banks will not make excessively risky loans[37] and can, if potentially, back up such suasion with cease and desist orders for unsafe banking practices.[38] Riskier loans generally have high—and perhaps usurious—interest rates to compensate for the risk.[39] Thus, by preventing banks from making risky (and therefore high cost) loans, the bank regulatory system is presumed to compensate or substitute for usury laws.[40]

The problem with this assumption is that even if borrower default rates are high, they can be offset by recoveries from high interest rates, such that a diversified portfolio of high risk/high rate loans can be profitable and therefore actually enhance bank safety-and-soundness. Thus, banking regulators are unlikely to use their soft supervisory power to stop high cost lending solely on the basis of its cost. Of course diversification mitigates the risk on high cost loans to the bank, but not to individual borrowers. Consumer protection and safety-and-soundness are thus actually in tension, as limiting high cost lending can limit bank profitability.

This Article relates to two separate areas of the financial regulation literature. First is the literature about the problems that have arisen from federal preemption of state consumer financial protection laws, particularly state usury laws.[41] Most of the preemption literature pre-dates the 2010

[37] This supervisory guidance is not formally legally binding, but functionally it operates as "law" in that banks will almost always follow the guidance lest they antagonize their regulator. *See Guidance, Supervisory Expectations, and the Rule of Law: How Do the Banking Agencies Regulate and Supervise Institutions?* Hearing Before the Senate Committee on Banking, Housing, and Urban Affairs (written testimony of Margaret E. Tahyar), Apr. 30, 2019, at 13.

[38] 12 U.S.C. § 1818(b)-(c).

[39] *See, e.g.,* Wendy Edelberg, *Risk-Based Pricing of Interest Rates for Consumer Loans*, 53 J. MONETARY ECON. 2283, 2284-85 (2006).

[40] *See, e.g.*, 85 Fed. Reg. 44223, 442227 (July 22, 2020) (listing a range of other federal regulations unrelated to the cost of a loan as allaying concerns about predatory lending).

[41] *See, e.g.*, Roderick M. Hills, Jr., *Exorcising McCulloch: The Conflict-Ridden history of American Banking Nationalism and Dodd-Frank Preemption*, 161 U. PA. L. REV. 1235 (2013); Carliss N. Chatman, *HOLA Preemption and the Original Intent of Congress: Are Federal Thrifts Necessary to Stabilize the Housing Market?* 18 FORDHAM J. CORP. & FIN. L. 565 (2013); Raymond Natter & Katie Wechsler, *Dodd-Frank Act and National Bank Preemption: Much Ado About Nothing,* 7 VA. L. & BUS. REV. 301 (2012); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets*

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Dodd-Frank Wall Street Reform and Consumer Protection Act, which substantially transferred legal standards for preemption,[42] but a sizeable literature has since emerged specifically focused on the *Madden* case.

*Madden* sent shockwaves through the financial services world, as the Second Circuit Court of Appeals, in the clearest circuit level decision on the merits to date, unambiguously rejected the "valid-when-made" doctrine that proponents claim is a "cardinal rule" of banking law that is required for banks to maintain liquidity and exercise their statutory powers to charge interest and sell loans.[43] Unfortunately, much of the scholarly writing about the *Madden* decision has taken for granted the supposed historicity and therefore importance for bank liquidity of the valid-when-made doctrine.[44] That

*Upstream*, 26 YALE J. ON REG. 143 (2009); Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110 (2008); Howell E. Jackson & Stacy A. Anderson, *Can States Tax National Banks to Educate Consumers About Predatory Lending Practices?* 30 HARV. J.L. & PUB. POL'Y 831 (2007); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 TEMP. L. REV. 1 (2005); Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518 (2004); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?* 87 MINN. L. REV. 1 (2002); Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589 (2000).

[42] Pub. L. 111-203, § 1045, 124 Stat. 1376 (July 21, 2010), *codified at* 12 U.S.C. § 25b.

[43] *See, e.g.*, 85 Fed. Reg. 33530, 33532 (June 2, 2020) ("Even in the mid-nineteenth century, the ability to transfer loans was recognized as an important tool to manage liquidity and enhance safety and soundness.").

[44] *See* John Hannon, Note, *The True Lender Doctrine: Function Over Form as a Reasonable Constraint on the Exportation of Interest Rates*, 67 DUKE L.J. 1261 (2018) (agreeing with, and even extolling, the historicity of valid-when-made); Lenore Palladino, *Small Business Fintech Lending: The Need for Comprehensive Regulation*, 24 FORDHAM J. CORP. & FIN. L. 77 (2018) (agreeing, in footnotes, with the historicity of the valid-when-made doctrine); Daniel Kaplan, Note, Madden v. Midland Funding, LLCl Ma*, 786 F.3d 246 (2d Cir. 2015): The Second Circuit Threatens to Disrupt Capital Markets*, 8 NEB. L. REV. BULL. 1 (2017) (agreeing with the historicity of valid-when-made); Brian Knight, *Federalism and Federalization on the Fintech Frontier*, 20 VAND. J. ENT. & TECH. L. 129 (2017) (agreeing with the historicity of the valid-when-made doctrine, describing it as, "one of the cardinal rules in the doctrine of usury"); Charles M. Horn & Melissa R.H. Hall, *The Curious Case of Madden v. Midland Funding and the Survival of the Valid-When-Made Doctrine*, 21 N.C. BANKING INST. 1 (2017) (accepting of the historicity of valid-when-made, describing it as a valid and dependable legal principle for loan origination, sales, and securitization markets); Angel Rzeslawski, Note, *The National Bank Act and the Demise of State Consumer Laws*, 68 HASTINGS L.J. 1421, 1437 (2017) (accepting the valid-when-made doctrine while suggesting that other circuits follow the Second Circuit's lead in *Madden*); Andrew Silvia, Note, *Madden v. Midland Funding LLC: Uprooting the National Bank Act's Power of Preemption*, 92 CHI.-KENT L. REV. 653 (2017) (agreeing with, and extolling, the historicity of valid-when-made as a cardinal rule of usury law); Zachary Adams Mason, Note, *Online Loans Across State Lines: Protecting Peer-to-Peer Lending Through the Exportation Doctrine*, 105 GEO. L.J. 217 (2016) (agreeing with the historicity of valid-when-made); Michael Marvin,

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includes a pair of empirical studies that attempted to gauge the impact of the *Madden* decision on consumer credit availability and consumer bankruptcy filings, but without engaging with the underlying doctrinal and policy questions.[45] More recent scholarship about the *Madden* decision has been more skeptical about the doctrine's historicity based on some of my previous writings on the topic in the form of Congressional testimony,[46] an amicus brief,[47] and an op-ed.[48] This Article presents a full and complete critical analysis of the underlying doctrinal and policy claims at stake in this critical decision and shows that valid-when-made is completely lacking in historical

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Note, *Interest Exportation and Preemption: Madden's impact on National Banks, the Secondary Credit Market and P2P Lending*, 116 COLUM. L. REV. 1807, 1832-35 (2016) (claiming that *Madden* ignores Supreme Court precedent on valid-when-made); Kevin Petrasic, et al., *Solicitor General in* Madden *Supports, But Fails to Ensure, the Application of Federal Preemption Doctrine to the Secondary Loan Market and Fate of "Valid-When-Made" Principle*, 29 J. TAX'N F. INST. 41 (2016) (agreeing with the historicity of valid-when-made, describing it as "long-established"); Kirby M. Smith, Comment, *Banking on Preemption: Allowing National Bank Act Preemption for Third-Party Sales*, 83 U. CHI. L. REV. 1631, 1669-1671(2016) (accepting valid-when-made as a historical doctrine, but stating that context makes older cases merely persuasive, not binding).

[45] Colleen Honigsberg, Robert J. Jackson, Jr., & Richard Squire, *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J. L. & ECON. 673 (2017); Piotr Danisewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* (July 5, 2018), *available at* https://ssrn.com/abstract=3208908.

[46] *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace Before the Subcomm. on Fin. Inst. & Consumer Credit of the H. Comm. on Fin. Servs.*, 115th Cong. 7–8 (2018) (written testimony of Adam J. Levitin, Professor, Georgetown University Law Center), https://financialservices.house.gov/uploadedfiles/01.30.2018_adam_levitin_testimony.pdf.

[47] Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant at 4–5, *Rent-Rite Super Kegs West, Ltd. v. World Business Lenders*, LLC, No. 1:19-cv-01552-REB (Appeal from Bankruptcy Adversary Proceeding No. 18-1099-TBM) (D. Colo. Sept. 19, 2019), https://www.creditslips.org/files/levitin-amicus-brief-rent-rite-super-kegs-west-ltd-v-world-business-lenders-llc.pdf (position adopted by court in Order on Bankruptcy Court's Determination, *In re: Rent-Rite Superkegs West Ltd.,* No. 19-cv-01552 (Aug. 12, 2020). *See also* Kaur v. World Bus. Lenders, LLC, 440 F. Supp. 3d 111, 121 (D. Mass. 2020) (citing Levitin amicus brief submitted in *Rent-Rite Super Kegs West, Ltd. v. World Business Lenders, LLC*).

[48] Adam J. Levitin, *"Madden Fix" Bills Are a Recipe for Predatory Lending*, Am. Banker, Aug. 28, 2017, *at* https://www.americanbanker.com/opinion/madden-fix-bills-are-a-recipe-for-predatory-lending. *See* Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477, 532 n.356 (2020) (agreeing with the historicity and "vital importance" of valid-when-made for Fintech companies); Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093, 1115 n.114 (2019) (taking a neutral position on the historicity of the valid-when-made doctrine while noting the detrimental effects it can have on low-income consumer loan customers); Jayne Munger, Note, *Crossing State Lines: The Trojan Horse Invasion of Rent-a-Bank and Rent-a-Tribe Schemes in Modern Usury Law*, 87 GEO. WASH. L. REV. 468, 488 n.132 (2019) (disagreeing with the acceptance and application of the valid-when-made doctrine as expressed by *Madden*); Christopher Baiamonte, Note, *Stopping Third-Party Debt Buyers From Using National Bank Act Preemption to Dodge State Usury Laws*, 69 SYRACUSE L. REV. 127 (2019) (questioning relevance of valid-when-made because of transactional dissimilarities and the *Erie* doctrine disavowing general federal common law).

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roots such that it could never have been essential for the operation of banking markets.

The other related literature is the one on regulation of "shadow banks"—nonbank entities that perform the same functions as banks, but outside the bank regulatory regime.[49] As bank-type activities have expanded outside of the confines of the bank-based regulatory system, the result has been dangerously unregulated markets that reproduce the very risks that bank regulation is meant to shield against. The shadow banking literature, which emerged after the 2008 financial crisis, has focused on wholesale markets such as money market mutual funds, repos, credit derivatives, and securitization and is primarily concerned with the systemic risks shadow banking poses to the overall financial system.[50]

This Article extends the shadow banking literature into the retail markets of consumer finance, where the risk posed is primarily not to systemic stability, but to consumer protection laws through abuse of federal preemption of state law. In consumer finance, however, shadow banking operates with a twist. Instead of nonbanks avoiding federal banking regulation while performing bank functions, in consumer finance, nonbanks also pretend to be banks to evade state regulation.[51]

The Article proceeds in six parts. Part I reviews the status of banks and nonbanks under state usury laws. It shows how banks have been effectively exempted from state usury laws, whereas nonbanks remain subject to them. It also shows how consumer lending has become disaggregated over the past

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[49] *See, e.g.*, David Min, *Housing Finance Reform and the Shadow Money Supply*, 43 IOWA J. CORP. L. 899 (2018); Kathryn Judge, *Information Gaps and Shadow Banking*, 103 VA. L. REV. 411 (2017) ; Iris H-Y Chiu, *Transcending Regulatory Fragmentation and the Construction of an Economy-Society Discourse: Implications for Regulatory Policy Derived from a Functional Approach to Understanding Shadow Banking*, 42 IOWA J. CORP. L. 327 (2016); Anna Gelpern & Erik F. Gerding, *Inside Safe Assets*, 33 YALE J. ON REG. (2016); Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357 (2016); MORGAN RICKS, *THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION* (Univ. of Chicago Press 2016); David Min, *Understanding the Failures of Market Discipline*, 92 WASH. U. L. REV. 1421 (2015); Chrystin Ondersma, *Shadow Banking and Financial Distress: The Treatment of "Money-Claims" in Bankruptcy*, 2013 COLUM. BUS. L. REV. 79; Jonathan Macey, *It's All Shadow Banking, Actually*, 31 REV. BANKING & FIN. L. 593 (2012); Morgan Ricks, *Money and (Shadow) Banking: a Thought Experiment*, 31 REV. BANKING & FIN. L. 731 (2012); Stephen L. Schwarcz, *Regulating Shadow Banking*, 31 REV. BANKING & FIN. L. 619 (2012); Erik F. Gerding, *The Shadow Banking System and Its Legal Origins,* (January 24, 2012) *at* https://ssrn.com/abstract=1990816.

[50] *See, e.g.*, MORGAN RICKS, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION (Univ. of Chicago Press 2016); Anna Gelpern & Erik F. Gerding, *Inside Safe Assets*, 33 YALE J. ON REG. (2016).

[51] Other methods of achieving similar ends are obtaining an industrial loan company charter or the new "fintech" charter offered by the Office of Comptroller of the Currency. These methods both bring with them federal safety-and-soundness regulation.

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several decades such that the role of banks has diminished and the role of nonbanks has increased, albeit often working in tandem with banks, but that the regulatory system is still based on the binary bank vs. nonbank division.

Part II turns to the phenomenon of rent-a-banks. It explains how rent-a-banks work and how they differ from mere outsourcing of production by banks. This part also reviews the evolution of rent-a-bank arrangements and the incomplete nature of past regulatory efforts to address the issue.

Part III presents a detailed case study of a pair of state-of-the-art rent-a-bank arrangements used by Elevate Credit, Inc., a subprime "fintech" lender. This section is the first detailed profile of a fintech lender in the scholarly literature.[52] This case study, which delves into the contractual minutiae of Elevate's relationships with its bank partners, represents the first extended examination of the workings of a rent-a-bank business model in the scholarly literature. The case study underscores the replication of the firm via contract in rent-a-bank schemes, the high level of transactional sophistication used for little purpose other than evasion of usury laws, and the ability for non-public firms to entirely mask the existence of a rent-a-bank arrangement simply by using derivative contracts rather than outright loan sales.

The remainder of the Article turns to the hotly contested doctrinal status of rent-a-bank transactions, which remains unresolved after nearly two decades of cases. Part IV lays the ground by reviewing the *Madden* litigation where the issue came to a head. It presents the *Madden* rule, the "valid-when-made" doctrine, and "true lender" doctrine as three different approaches to the question taken by courts and regulatory agencies.

The Article then turns to a close inspection of the "valid-when-made" doctrine, which is used to defend rent-a-bank arrangements. The valid-when-made doctrine's claim to legitimacy rests primarily on its supposed historicity and incorporation in the National Bank Act of 1864 as part of its common

[52] A small literature has emerged about fintech in the consumer finance space, but it does not include a detailed examination of the contractual structure of any fintech lending operation. *See* Matthew A. Bruckner, *Preventing Predation and Encouraging Innovation in Fintech Lending*, 72 CONS. FIN. L.Q. REP. 370 (2019); Matthew Adam Bruckner, *The Promise and Perils of Algorithmic Lenders' Use of Big Data*, 93 CHI. KENT L. REV. 3, 37 (2018); Matthew A. Bruckner, *Regulating Fintech Lending*, 37 BANKING & FIN. SERV. POL'Y REP. 1 (2018); Christopher K. Odinet, *Consumer Bitcredit and Fintech Lending*, 69 ALA. L. REV. (2018); Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. Rev. 232 (2018); Robert P. Bartlett et al., *Consumer-Lending Discrimination in the Fintech Era*, NBER working paper No. w25943; Anupam Chander, *The Racist Algorithm?*, 115 MICH. L. REV. (2017); Frank Pasquale, *Democratizing Higher Education: Defending & Extending Income Based Repayment Programs*, 28 LOY. CONSUMER L. REV. 1 (2015). A contemporary article by Christopher K. Odinet, *Predatory Fintech and the Politics of Banking*, IOWA L. REV. (forthcoming 2021), contains an extended consideration of the structure of rent-a-banks, including a high-level case study of Elevate Credit that relies on Elevate's 10-K, rather than the underlying contracts.

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law background. The doctrine's proponents argue that it is a well-established doctrine, endorsed by early 19th century Supreme Court cases, and the "bedrock" of banking law. This supposed historicity is the basis of the claim that the doctrine is essential for maintaining bank liquidity and therefore safety-and-soundness.

In fact, as Part V shows, the valid-when-made doctrine is utterly lacking in a historical basis. Despite claims that the doctrine is "centuries" old,[53] there is actually not a single case consistent with the doctrine or other indication of the doctrine's existence until 1979. Instead, the supposed support for the doctrine comes from decontextualized quotations pulled from historical cases about the calculation of the interest rates for usury purposes. Simply put, the doctrine is not valid, but made up. The doctrine's lack of historicity undermines the claim that it is critical for protecting bank liquidity; banks have in fact operated without difficulty for centuries in the absence of the doctrine.

Part VI turns to a consideration of the policy trade-offs among the doctrinal approaches. The Article argues that the best approach as a matter of consumer protection policy and as bank regulatory policy is the *Madden* rule, buttressed by the anti-evasion principle evinced by true lender doctrine. The *Madden* rule prevents a regulatory vacuum, has substantial administrability and certainty benefits, while the anti-evasion principle protects against sophisticated transactional attempts to evade the *Madden* rule through derivative transactions such as those illustrated by the Elevate Credit case study. In order to effectuate application of the anti-evasion principle, banks seeking to enforce loans in court should be required to disclose any transfer of an economic interest in such loans to nonbanks. A conclusion considers the effects of recent regulations on the doctrinal debate and shows that they do not resolve the issue.

[53] *See, e.g.*, Sullivan & Cromwell LLP, *OCC Proposes a Rule to Establish When a Bank Is the "True Lender" of a Loan*, July 24, 2020, https://www.sullcrom.com/files/upload/sc-publication-occ-proposes-rule-establish-bank-as-true-lender.pdf ("For centuries—predating the enactment of the NBA in 1864—caselaw and market practice had established that an interest rate valid at the origination of the loan remained valid even after the originator (whether or not a bank) sold or assigned the loan to another party (whether or not a bank)."); Davis Polk, *Federal Banking Regulators Can and Should Resolve Madden and True Lender Developments*, white paper, Aug. 14, 2018, *at* https://www.davispolk.com/files/madden-true-lender-federal-regulatory-fix-whitepaper_final.pdf ("A long-settled legal principle known as the "valid-when-made" doctrine has served for almost two centuries as the bedrock for bank lending.").

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## I. THE DISAGGREGATION OF CONSUMER LENDING

Usury laws have been the cornerstone of consumer financial protection in America since colonial times.[54] Every state has a usury statute of some sort that caps the level of charges on a loan. These statutes vary considerably in their design and application, with some covering only "interest," and others extending to various types of loan charges.[55] Frequently states have different limitations for different types of loan products or different types of lenders and borrowers. Thus, the permitted rate on payday loans or other small dollar loans might be different than that for auto loans or for installment loans, or the permitted rate might be different for banks than for nonbanks, or the permitted rate might be different for consumers and businesses. This Part briefly reviews the function of usury laws as a borrower protection, before turning to a history of the unraveling of usury laws for banks in the United States. It then considers how the disaggregation of consumer lending has interfaced with the entity-based structure of usury laws.

### *A. Functions of Usury Laws*

Usury laws are fundamentally a borrower protection, even though they can protect a reckless lender as well. Usury laws—like unfair and deceptive acts and practices statutes—involve a paternalistic intervention into freedom of contract by creating an irrebuttable presumption that the conditions necessary for efficient Coasean bargaining could not have existed if the interest rate in a contract is above the specified usury level. This presumption protects borrowers from lender market power and informational asymmetries, and it helps prevent negative externalities from overindebtedness.

First, usury laws shield borrowers from situations in which the lender has market power, such as from limited competition in a market.[56] Alternatively,

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[54] *See* Drysdale & Keest, *supra* note 40, at 604 ("Usury laws are, at core, the earliest form of consumer protection law.").

[55] For purposes of this Article, I refer to all manner of regulated charges on a loan as "interest." State laws vary considerably in how they define such charges. Some refer to "interest," which is not always defined. Others use the federal Truth-in-Lending Act terminology of "finance charge," while others include charges that lie outside that of the TILA "finance charge," but which might be within the ambit of the federal Military Lending Act's broader definition of "finance charge."

[56] Such limited competition might be a function of market structure, such as situations where lenders compete for a loan broker's business, not the borrower's business directly. That is the situation in indirect auto lending, Adam J. Levitin, *The Fast and Usurious: Putting the Brakes on Auto Lending Abuses*, 108 GEO. L.J. 1257 (2020), online lending through lead generators, Adam J. Levitin, *Led Down the Financial Garden Path*, working paper 2020, and was historically the situation with mortgage loan brokers and yield spread premium compensation. Laurie Burlingame & Howell E. Jackson, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J. L. BUS. & FIN. 289 (2007).

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the lender's market power might also stem from the consumer's financial duress or consumer's misperception of limited credit options. If a consumer needs funds immediately or if a consumer thinks that he is such a poor credit risk that he is lucky that anyone will lend to him, then the consumer might simply take the first offer available and not shop for better terms.

Second, usury laws protect consumers from lenders taking advantage of informational asymmetries. A consumer might fail to understand a deal, either because she is misinformed or because of a cognitive issue. Or a consumer might simply be unduly optimistic about repayment possibilities.

Finally, usury laws protect not just consumers themselves, but also third parties from negative externalities of over-indebtedness. To the extent that a usurious interest rate leads a consumer to get stuck in a debt trap, such that the consumer is spending all disposable income on debt service, rather than on other investments, it may harm the consumer's dependents and ultimately the public fisc if it results in the consumer becoming a public charge.[57]

While usury laws prevent lenders from exploiting market power or informational problems and may also reduce negative externalities of over-indebtedness, they also restrict credit to a subset of borrowers who because of their riskiness cannot obtain credit at non-usurious rates. Indeed, the typical neoclassic economic analysis of usury regulations is that they merely cut riskier borrowers out of the market, which may actually be detrimental to those would-be borrowers' welfare.[58] Usury laws might also fairly be critiqued as arbitrary in regard to the specific interest rate that triggers the presumption of unreasonable advantage taking and as poorly tailored, given that they are one-size-fits-all for all consumers. Some consumers may be able to responsibly assume greater risk than others because of their greater resources or sophistication.

The point here is not the ultimate policy merits of usury laws, but that they reflect a legitimate consumer protection concern that certain loans may reflect fundamentally unfair contracting conditions and that repayment would be sufficiently deleterious to the welfare of borrowers that it should not be required.

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[57] Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283 (1995).

[58] *See, e.g.*, Rudolph C. Blitz & Millard F. Long, *The Economics of Usury Regulation*, 73 J. POL. ECON. 608, 613 (1965) ("While the oft-stated purpose of usury legislation is to help that class of debtors which includes the landless peasants, poor urbanites, and very small businessmen, maximum rates are likely to affect them adversely by excluding them from the market.").

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### *B. <u>Marquette</u> and the Race to the Bottom*

While state usury laws were the traditional bulwark of consumer credit protection, they were substantially undermined in the 1970s and 1980s. Banks are either federally chartered (national banks) or state chartered (state banks). Usury deregulation started with national banks. In 1978, in *Marquette National Bank v. First of Omaha Service Corporation*, the Supreme Court held that under section 85 of the National Bank Act,[59] a national bank was allowed to export the interest rate allowed in its "home" state to other states in which it did business.[60] Thus, when a Nebraska-based national bank made loans in Minnesota, it was still subject to the Nebraska usury cap rather than the lower Minnesota usury cap. *Marquette* did not void state usury laws, but created a federal choice-of-law rule regarding which state's usury law would apply to a national bank doing out-of-state business.

National banks' newfound ability to "export" their home state's usury rate to other states gave national banks a substantial competitive advantage over state-chartered banks, particularly in the high interest rate environment of the late 1970s and early 1980s, when prime interest rates veered close or even over state usury caps. Among the highest rate bank credit products are credit cards, so not surprisingly national banks with major credit card lending operations began to relocate to states with no or liberal usury laws to take advantage of the *Marquette* decision. These banks relocated (or created credit-card issuing national bank subsidiaries) in states with lax usury laws—Delaware, South Dakota, Utah, and Nevada.[61] These states permitted either

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[59] 12 U.S.C. § 85.

[60] 439 U.S. 299 (1978). Technically, banks can export the greater of the maximum rate allowed in the state in which the bank is "located" or 1% of the applicable Federal Reserve 90-day commercial paper rate. 12 U.S.C. § 85. Subsequent OCC opinion letters interpreted the "location" of a national bank for the purposes of section 85 as being the state of whatever branch of the bank had the closest nexus to the loan, rather than being the state where the national bank is located on its charter certificate or where its main office is located. *See* OCC Interpretive Letter 686 (Sept. 11, 1995) *reprinted in* [1995-96 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-001; OCC Interpretive Letter 707 (Jan. 31, 1996), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-022; OCC Interpretive Letter 782 (May 21, 1997), *at* https://www.occ.treas.gov/topics/charters-and-licensing/interpretations-and-actions/1997/int782.pdf; OCC Interpretive Letter 822 (Feb. 17, 1998), *at* https://www.occ.treas.gov/topics/charters-and-licensing/interpretations-and-actions/1998/int822.pdf ("For purposes of section 85 a national bank may be located in both its home state and its host states"); OCC Interpretive Letter 1171 (June 1, 2020), https://www.occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1171.pdf.

[61] *See supra* notes 29-32. *See also* Robin Stein, *The Ascendancy of the Credit Card Industry*, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html.

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whatever rate the parties agreed to by contract. By 1988, 18 states had removed interest rate ceilings for bank transactions.[62]

*Marquette* only governs national banks, but in 1980, Congress also passed a federal parity statute that gave parity to all state banks equal treatment with national banks, unless a state chose to opt-out of the provision.[63] The federal parity law does not permit state-chartered insured banks to charge out-of-state rates in their home state. To wit, if Illinois had an 8% usury limit, an Illinois-chartered state bank could charge 8% in Illinois or in Michigan, even if Michigan had a 6% usury rate. But a national bank based in Indiana, which has a 12% usury limit, could charge 12% in either Illinois or Michigan. Thus, under the federal parity statute, the Illinois state bank would remain at a competitive disadvantage to the Indiana-based national bank.

States responded to protect their state-chartered institutions' competitive equality with state parity laws permitted state banks to charge the maximum rate that could be charged by a national bank doing business in the state. Accordingly, in the above example, the Illinois chartered bank would be able to charge 12% in Illinois because an Indiana-based national bank could export the 12% Indiana rate into Illinois. When combined with the federal parity statute, this meant that the Illinois chartered bank could also export the Indiana 12% rate into Michigan. Given that several states have no usury limit for bank loans when there is a written loan agreement, bank usury law became a matter of the lowest common denominator.

The *Marquette* decision thus set off a race-to-the-bottom among states with the result that state usury laws were effectively gutted *for banks*. Notably, the erosion of state usury laws in the wake of *Marquette* did not extend to *nonbanks*. While states lost the ability to control pricing of consumer credit issued by banks, their ability to regulate nonbanks remained intact.

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[62] Randall S. Kroszner & Philip E. Strahan, *Regulation and Deregulation of the US Banking Industry: Causes, Consequences, and Implications for the Future,* in ECONOMIC REGULATION AND ITS REFORM: WHAT HAVE WE LEARNED? (NANCY L. ROSE, ED.) 485, 503 (2014).

[63] Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA"), Pub. L. No. 96-221, § 527, 94 Stat. 132, 167 (Mar. 31, 1980), *codified at* 12 U.S.C. § 1831d (parity). 12 U.S.C. § 1831u(f) separately addresses usury caps in state constitutions. The DIDMCA parity provision allows state-chartered, FDIC-insured banks to charge the greater of the maximum rate allowed in the state in which the bank is located or 1% above the Federal Reserve 90-day commercial paper discount rate for the applicable Federal Reserve District. The opt-out provision, § 527 of DIDMCA is not currently codified; it was previously codified at 12 U.S.C. § 1730g (note). Puerto Rico and Iowa have opted out of the federal parity statute. Catherine M. Brennan & Nora R. Udell, *What's Old Is New Again: The Future of Bank Partnership Programs from Small Dollar Installment Loans to Mortgages to Everything*, 72:4 CONF. ON CONSUMER FIN. L. Q. REP. 425, 430 (2018).

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### *C. The Changing Institutional Landscape of Consumer Credit*

In 1978, when *Marquette* was decided, the fact that it only directly affected banks seemed to little importance, because banks comprised the substantial majority of the non-mortgage consumer credit market.[64] Indeed, in 1978, banks and other depositories made up 73% of the US consumer credit market in terms of receivables outstanding.[65] At that time, nonbank lenders consisted primarily of finance companies, pawn shops, and retailers offering their own credit (including auto dealers). Thus, the most immediate impact of *Marquette* was in the credit card market because most other types of standard bank loan products—mortgages, auto loans, and student loans—have lower interest rates than credit cards, such that usury caps would rarely be an issue except in periods of extremely high market interest rates.

Yet 1978 also happened to be the highwater mark for banks' role in consumer credit. In particular, by the 1990s, securitization began to play a major role in financing non-mortgage consumer credit, rising to a third of the market by the early 2000s. (See Figure 1, below.) As of 2008, banks' share

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[64] Separate usury laws have often applied to mortgages, and federal law preempts state usury laws for virtually all first lien mortgages. 12 U.S.C §§ 1735f-7, 1735f-7a.

[65] Bd. of Gov. of the Fed. Reserve Sys., Financial Accounts of the United States, Statistical Release Z.1, table L.222.

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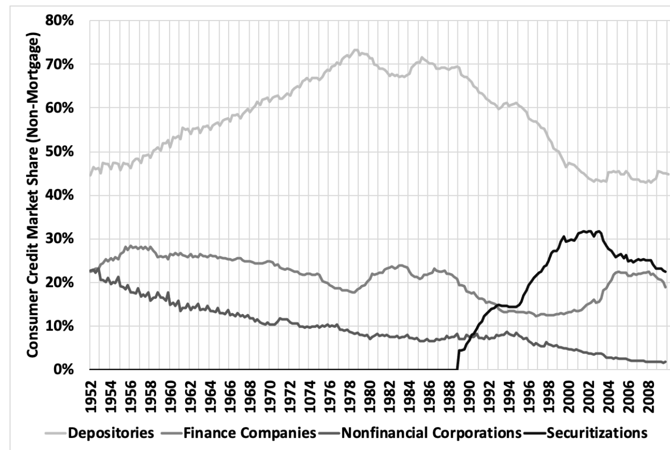
of non-mortgage consumer credit outstanding had fallen from its 1978 height of 73% to just 43%.[66]

**Figure 1. Market Share of Non-Mortgage Consumer Credit Obligations Outstanding by Institution Type[67]**




The shift in that occurred in the consumer finance market place was not simply one of nonbanks replacing banks. Instead, it also involved a disaggregation of the consumer lending cycle.

The financial regulation literature has long focused on securitization as one of the exemplar forms of financial "disintermediation," meaning a shift away from bank intermediation between sources of capital and borrowers.[68] But securitization is not just an example of financial of disintermediation. It is also, but its very nature a type of "disaggregated" consumer lending, as the following section explains, because securitization structures inherently split the lending function into discrete functions played by separate entities. While banks are often still involved in consumer lending, many of the key activities in the lending cycle are performed by nonbanks.

### *D. Disaggregation of Consumer Lending*

Consumer lending consists of a set of separate activities. First a credit product must be designed—how will the product operate and be priced? Then the product must be marketed and potential borrowers identified and wooed. Once actual borrowers apply for the product, they must be

[66] *Id.* Data subsequent to 2009 is not comparable to earlier years because an accounting change in 2010 brought most securitized consumer credit back onto banks' balance sheets.

[67] Federal Reserve Statistical Release Z.1, table L.222. Depositories is the sum of U.S. chartered depository institutions and credit unions. Data stops in 2009 because an accounting change in 2010 renders subsequent data non-comparable.

[68] *See, e.g.*, Schwarcz*, supra* note 27.

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"underwritten" meaning that they must be qualified and priced according to their risk profile. If the borrower qualifies and agrees to the loan, the loan must be funded, meaning that the borrower will receive the money. After the loan is made, it must still be serviced—billing statements must be sent out and payments collected, as well as other ministerial tasks, and any defaults managed. And someone must hold both the credit risk and interest rate risk on the loan.

Historically, the entire lending cycle was conducted by the same institution—often a bank—that would design, market, underwrite, fund, service, and hold the loan. Nothing, however, requires that the entire lending cycle be conducted in a single institution. Thus, the consumer lending cycle can be disaggregated and with different functions spread among different parties that are joined by a web of contracts.

Today, consumer lending is increasingly disaggregated. Securitization, a financing technique that funds most mortgages in the United States,[69] represents a classic example of disaggregation in consumer lending. While securitization transactions can be quite complex, the basic idea is straightforward. A financial institution (bank or nonbank) that "sponsors" the securitization owns a pool of loans that it either made itself or purchased. The sponsor then sells the loans to a special purpose entity (SPE) it has set up. The SPE engages in no business other than owning the loans. The SPE then issues bonds that are to be repaid solely from the collections on the loans. The SPE uses the proceeds of the bond issuance to pay the sponsor for the loans. The loans have thus been effectively funded by the bond investors, not the sponsor.

One of the attractions of a securitization transaction is that it enables investors to invest solely in the risks related to the securitized loans—whether they will prepay or default—and not have to worry about all of the risks of the sponsor as an operating entity. If the bonds were issued by the sponsor itself, the investors would be exposed to the total picture of the sponsor's finances—all of its assets and all competing liabilities, including involuntary liabilities like tort and tax creditors. Because the SPE carries on no business and is nothing more than a "box" to hold the loans, the investors are taking

[69] Bd. of Gov. of the Fed. Res. Sys., *Financial Accounts of the United States, Statistical Release Z.1*, table L.218. Securitization historically also funded a large share of the credit card market, but today no longer does so both because of a change in accounting rules, SFAS 166 and 167, that went into effect in 2010. These new accounting changing the treatment of variable interest entities, such as securitization vehicles. Additionally, securitization-dependent monoline card issuer have largely disappeared, having either failed (Advanta), been purchased by a full service bank (MBNA, purchased by Bank of America) or become full service retail banks with a deposit funding base, such that they do not need to rely on capital markets funding (Capital One).

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on solely the risks associated with the loans, but not the risks associated with an operating entity that might engage in other types of business, commit torts, etc.

By separating the loans from the sponsor, the securitization structure inherently separates the front-end of the lending process—designing a loan product, marketing it, underwriting borrowers, and providing the initial funding for the loan—from the back-end of the lending process—holding the economic exposure (credit risk and interest rate risk) on the loan. The sponsor handles the front-end of the process, while the bond investors handle the back-end.

On the back-end, securitization also further separates the economic exposure to the loan from legal title to the loan; the bond investors have the economic exposure, while the SPE has legal title. Additionally, someone has to manage the loan—invoices must be sent out, payments collected, defaults managed, etc. The SPE cannot do this work itself because the whole point of the transaction is to isolate the economic risk on the securitized loan from operational risks. Therefore, the SPE has to hire an agent called a servicer to manage the loan. The servicer is typically compensated with some of the collections from the loan. The servicer might be an affiliate of the sponsor or it might be an unaffiliated entity. Either way, the need for a servicer further disaggregates the lending process. Now the front end is split off from the legal title to the loans, which is split from practical control over the loans, which is split from economic exposure to the loans.

Both the front-end and back-end exposure can be further split, as can the servicing. The sponsor can handle the entire front-end itself, but it might have purchased the loans from another entity. And it might have underwritten the loans using automated underwriting software provided by a third-party. Indeed, that is how most mortgage lending works, with lenders using Fannie Mae and Freddie Mac's automated underwriting platforms and underwriting to Fannie and Freddie's underwriting criteria, rather than to their own.

On the back-end, securitization structures commonly divide interest rate (prepayment) risk from credit risk and allocate them differently, with credit risk frequently being assumed by a guarantor (that may or may not be affiliated with the sponsor). And servicing rights are sometimes divided, such that one entity services performing loans, while another one handles defaulted loans. The variation, if not endless, is extensive. Securitization inherently disaggregates the lending cycle to some degree.

Disaggregation exists outside of securitization too. For example, even without securitization, both the initial funding and economic exposure might ultimately be provided by a party other than the nominal lender. For example,

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most auto loans are "indirect loans" in which the consumer enters into a retail installment sale contract with the dealer, who then sells the contract to a financial institution.[70] Depending on the timing of the sale to the financial institution, the funding may be coming from the dealer (who floats the loan initially) or from the purchaser. Likewise, many online payday and installment loans operate through lead generators that advertise the loans and collect loan applications, which are then auctioned off to prospective funders. Various types of "fintech" firms present another type of disaggregation.[71]

Disaggregation presents an application of Jensen and Meckling's theory of the firm as a "nexus of contracts."[72] Jensen and Meckling understood the "firm" as a single entity or set of affiliated entities, with all of the contracts occurring implicitly within the entity or among affiliated entities bound by corporate control. This arrangement enabled corporate agents to fill in omitted terms in incomplete and implicit contracts, now occurs with explicit contracts among unaffiliated entities.[73] Disaggregation means that the firm now consists of a set of formally unaffiliated entities, bound together by contract such that they operate as a single unit. The "firm" for purposes of disaggregated lending has become nothing more than a nexus of contracts.

### *E. Disaggregated Lending's Effect on Consumer Protection*

Rent-a-bank arrangements represent yet another version of the disaggregation of the lending cycle, with the bank providing only the initial funding of the loan and perhaps some servicing support in most cases. The regulatory problem presented by rent-a-banks is a function of disaggregated lending colliding with an entity-based approach to financial regulation. The mismatch creates an opportunity for regulatory arbitrage, and the differential treatment of banks and nonbanks for usury purposes (as well as for state licensure and other consumer protections) creates a motive for engaging in the regulatory arbitrage.

The financial regulatory system is a mix of entity-based and activity-based regulation. For example, there are regulatory regimes specific to consumer

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[70] *See* Levitin, *The Fast and the Usurious*, *supra* note 55 (explaining structure of indirect auto lending market).

[71] *See* Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235, 242, 276 (2019) (describing fintech's role in the "fragmentation" of the "financial supply chain").

[72] *See* Jensen & Meckling, *supra* note 25.

[73] *See* William W. Bratton & Adam J. Levitin, *A Transactional Genealogy of Scandal: from Michael Milken to Enron to Goldman Sachs*, 86 S. CAL. L. REV. 783, 825, 859, 865, (2013) (describing collateralized debt obligations as the "apotheosis" of the nexus of contracts firm); Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075, 1121-22 (2009) (describing securitization as an attempt to create a contractually complete firm).

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credit, such as Truth in Lending Act disclosures, that apply irrespective of entity type. But other parts of the regulatory regime are specific to particular entity types, such as banks or money transmitters, because of the special functions these entities play in the financial system and the types of activities in which they are presumed to engage. Thus, banks are the only type of entity allowed to hold insured demand deposits, an activity that necessitates regulation of the risk of bank lending to ensure that the bank will be able to honor its deposit liabilities: if the bank's loans go bad, it won't be able to repay the depositors.

Entity-based regulation presents a risk of a mismatch if there is an expansion of the type of entity performing an activity. The limitations of entity-based regulation are precisely why "shadow banking" has raised so much regulatory concern in wholesale financial markets. Shadow banking refers to the various institutions and transactions that replicate the financing functions traditionally provided by banks.[74] Because prudential regulation—regulation to ensure the safety-and-soundness of financial institutions—is an entity-based regulatory system, the rise of shadow banking has posed a major challenge to regulators ability to guaranty the safety-and-soundness of the financial system and to protect against system risk.[75]

Disaggregation of consumer lending has led to a parallel problem in consumer protection. The banks are treated differently than other entities for purposes of usury laws. The unstated logic behind the different treatment is that banks, which can operate nationwide, should not be saddled with compliance with inconsistent state usury laws because the federal bank regulatory ensures that they will not make excessively risky loans, and thus high cost, loans. Riskier loans generally have higher interest rates to compensate for the risk. Thus, by preventing banks from making risky loans, the bank regulatory system is presumed to also prevent loans with excessively high cost, effectively substituting for usury laws.

To be sure, nothing in the federal bank regulatory expressly prohibits banks from making high cost loans. Rather, the federal regulatory system relies on the "soft" tools of bank supervision to dissuade banks from engaging in practices deemed excessively risky.[76] Herein lies the first flaw in the idea that federal bank regulation is a substitute for usury laws: there is no guaranty that a bank regulator will actually use these tools. Whereas usury laws can be raised as a defense or even as a private rights of action, consumers cannot force bank regulators to use their supervisory powers.

[74] *See, e.g.*, Steven L. Schwarcz, *Regulating Shadow Banking,* 31 REV. BANKING & FIN. L. 619, 624-625 (2012).
[75] *Id.*
[76] *See* Tahyar testimony, *supra* note 36.

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Even aside from discretion regarding supervisory actions, there is a bigger flaw in the logic of federal preemption. Federal bank regulator supervision is not a substitute for usury laws because the key bank regulatory concern is not about *consumer* protection. Instead, it is about *bank* protection—protecting the safety-and-soundness of the *bank*.

Bank safety-and-soundness is not synonymous with consumer protection. Among other things, banks can diversify their risks in a way consumers cannot. If a bank makes thousands of high cost loans knowing that a percentage will default, the revenue on those that perform (or perform for a while) may outweigh the losses from defaults. Indeed, high cost lending might be profitable, and it is hard for a regulator concerned with safety-and-soundness to tell a bank to cease engaging in a profitable activity because a bank is only safe-and-sound if it is profitable. From a consumer protection perspective, however, diversification is irrelevant. If a consumer's loan is the one that defaults because of an excessively high cost, it does not matter to the consumer that other consumers were able to pay off the loan. The welfare loss of one consumer cannot be offset by another consumer's welfare gain. In this regard, consumer protection resembles Pareto efficiency, not Kaldor-Hicks efficiency. Simply put, supervision by federal bank regulators is not a substitute for usury laws.

The disparate treatment of banks and nonbanks under usury laws creates a motivation to exploit the regulatory arbitrage set up by the mismatch between disaggregated consumer lending transactions and the binary, entity-based regulatory system. In this arbitrage, nonbanks attempt to shelter in banks' exemption from usury laws. That is precisely what the rent-a-bank structure is about.

The next Part considers the bank contours of rent-a-bank relationships and provides a history of their development as a response to regulation of payday loans, and the subsequent and incomplete regulatory pushback against rent-a-bank relationships. It also examines the structure of rent-a-bank arrangements in detail through a case study of Elevate Credit, Inc., which has perhaps the most sophisticated and publicly observable rent-a-bank arrangements in the market at present.

## II. RENT-A-BANK ARRANGEMENTS

The basic design of a rent-a-bank transaction is straightforward. A nonbank lender contracts with a bank to (1) make loans according to the nonbank lender's specifications and then (2) sell the loans to the nonbank lender. Typically, the nonbank will market and service the loans, although the allocation of marketing and servicing is not essential to rent-a-bank arrangements. Instead, the key features are the bank taking its underwriting

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marching orders from the nonbank and the nonbank acquiring the lion's share of financial exposure on the loans.

The precise details of rent-a-bank arrangements can vary substantially, but the variations are often driven by a desire to make it look as if the bank actually has greater involvement in the transaction that it does. For example, the bank may maintain nominal control over underwriting decisions, but in practice, the bank is unlikely to ever second-guess the nonbank, lest the nonbank decline to purchase the loans and leave the bank holding a bunch of loans that it would never have made on its own account.

Similarly, it is common in rent-a-bank arrangements for the bank not to sell *all* of the loans to the nonbank lender. The bank might retain $1 million exposure on the loans. Or it might sell the loans only after holding them for a limited time period—perhaps only two days.[77] Or a bank may sell only a derivative interest (or partial derivative interest) in the loans. The idea is that a partial sale or a delayed or derivative sale strengthens the claim that the bank is the real lender in the transaction. Yet the bank's retained *de minimis* exposure or a *de minimis* holding period would seem to underscores the sham nature of the transaction: what is their purpose other than to enable the bank to claim that it is the true lender?

### *A. Rent-a-Bank Distinguished from Outsourced Production*

It is important to distinguish rent-a-bank relationships from run-of-the-mill outsourced production. Banks are no different than other businesses in that they face a buy-or-make decision regarding any particular good or service they use, and the efficiency of vertical integration versus outsourcing will depend on myriad factors. For example, banks require various types of computer software to operate their businesses, such as loan servicing software that enables them to keep track of balances and payments and legal notices for particular borrowers. A bank could have its own employees code the software or it could purchase the software from a third-party that specializes in writing such software or the bank could contract with a third-party to handle all the loan servicing, leaving the software issue up to that third-party. If the third-party can provide the software or handle the servicing more efficiently than the bank, the bank will likely opt for some manner of third-party provision.

From an economic standpoint, the choice of internal versus external production is irrelevant. What matters from an economic standpoint is that the bank is a nexus of contracts among the various factors of production.[78]

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[77] Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359, 1360 (D. Utah 2014).

[78] *See generally* Coase, *supra* note 28; Williamson, *supra* note 28; Jensen & Meckling, *supra* note 25.

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Those contracts may be either explicit contracts with outsourced providers or implicit ones within the firm.

From a regulatory standpoint, however, things look somewhat different. Banks are different than regular businesses. Whereas a regular business corporation can be created more or less as a matter of right, the issuance of a banking charter is discretionary to the chartering authority and requires consideration of various factors, including the public interest.

The issuance of banking charters is regulated because the charter carries with it privileges not granted to regular businesses, most notably the right to take money deposits, pay checks from deposits, and lend money.[79] While nonbanks engage in lending and payments, they require a special license to engage in these activities,[80] and, more importantly, they are not permitted to combine the activities: nonbank lenders cannot accept deposits, and nonbank money transmitters cannot make loans. The combination of deposit taking, payments, and lending activities is of particular regulatory concern because of the risks they pose to the monetary system and to the economy writ large—because banks fund loans with deposits, bank lending poses a risk to deposits and to the payment system on which the economy depends. Restricting the set of institutions that are allowed to engage in the combination of core banking activities facilitates regulatory oversight because it defines the set of institutions on which regulators must focus their supervisory efforts. If wildcat banking were permitted, regulators would not even know which businesses to supervise.

The difference between internal and external production matters from a regulatory standpoint because of the regulatory concern about keeping the entire "business of banking" within the four corners of regulatory oversight. To the extent that external production shifts the business of banking outside of the scope of regulatory vision and authority, it undermines the regulatory system. To this end, it very much matters from a regulatory perspective which factors of production are internal versus external at a bank. If all factors of production are external, and the bank merely coordinates among them—literally serving as the nexus of contracts—the entire regulatory regime's design is undermined, as the coordination role does not itself pose any particular regulatory concern, while the areas of regulatory concern shift outside the ambit of bank regulatory authority.

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[79] OCC, *Exploring Special Purpose National Bank Charters for Fintech Companies*, Dec. 2016 at 3 (identifying "three core banking functions: receiving deposits, paying checks, or lending money.").

[80] *See,* 18 U.S.C. § 1960 (criminal prohibition of unlicensed money transmission). Lending is licensed under a range of state statutory regimes varying by the type of loan.

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This is not to say that bank regulation cannot tolerate external production. But it requires that the bank be the entity ultimately answerable for the product, meaning that the bank must be acting as the principal in the production relationship, rather than the agent.[81]

Likewise, the nature and extent of outsourcing also matter from a regulatory perspective. Some activities are so fundamental to the business of banking that their outsourcing begs the question of what is left for the bank to do. In particular, the design and underwriting of loans, the taking of deposits, and the payment of checks is so fundamental, that if it is outsourced by a bank, it undermines banking as a regulatory category. It does not matter that nonbanks may engage in any one of these activities. Instead, the point is that if the bank has been licensed to perform these activities, the license is granted with the expectation that it is the banks—and not some other party—that will be performing the activity, as the license is personal to the bank. Relatedly, this suggests that the extent of outsourcing matters. For example, banks regularly rely on credit scores purchased from third parties as part of their underwriting, but this is different from outsourcing the pricing of the product or the applicable credit score cutoffs or determination of what other factors should be considered in underwriting.

The forgoing discussion points to four ways in which rent-a-bank relationships differ from mere outsourcing of factors of production. In rent-a-bank relationships there is:

(1) a loan product design is proposed by a nonbank to the bank;

(2) an outsourcing of all or nearly all factors of production of loans (marketing, underwriting, funding, servicing);

(3) an outsourcing of the various factors of production of loans to a single nonbank or its affiliates; and

(4) the transfer of most or all of the credit risk on the loans either to the nonbank and its affiliates or to third-parties in a transaction arranged or facilitated by the nonbank.

In other words, in a rent-a-bank relationship, a single nonbank and its affiliates provides all or nearly all of the factors necessary to make the loans and either acquires most of the economic exposure to the loans or facilitates the transfer of the economic exposure to a third-party.

[81] Banks are, of course, permitted to act as agents for nonbanks, but when they do, their powers are limited to those of the principal, as they are acting on its behalf. For example, when a bank services loans on behalf of a nonbank, the nonbank is not entitled to federal interest rate exportation merely by virtue of having hiring a bank as a servicing agent.

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The first point emphasizes that the bank is not the true nexus of contracts in the rent-a-bank relationship. Rather than the bank being the entity that outsources production to various vendors, it is the nonbank that outsources parts of the production of its own loan product. It is the nonbank that sponsors the transaction and serves as the hub for the various contractual relationships. The nonbank is always the party that approaches the bank with the idea for the partnership and that coordinates exactly who will provide what service in production process. This is a completely different situation than a bank that deciding that it has a loan product that it wishes to make and contracts with an advertising firm to provide marketing services and with a technology provider for a software made to the bank's specifications, and then separately transfers some or all of the risk on the loans to investors. Instead, in a rent-a-bank situation, the non-bank approaches the bank with a proposed loan product and a turnkey solution for the product—marketing, underwriting, servicing, and possibly funding.

The second and third points emphasize that in the rent-a-bank situation, the nonbank and its affiliates provides all or nearly all of the factors of production. The bank typically does little other than provide the initial funding for the loan, and sometimes not even that, although sometimes the bank retains nominal approval over external factors of production. Instead, in a rent-a-bank arrangement, the factors of production come nearly entirely from the nonbank and its affiliates. That indicates that the bank is not simply outsourcing based on searching for the best external solution for any particular factor of production, but is instead buying an entire loan product from the nonbank, such that the nonbank is the real lender. In other words, the bank is adding little or nothing to the production itself other than the privileges that come with its charter. If the bank's only material contribution to the lending process other than coordination of factors of production is the privileges of its charter or initial funding (but with a near immediate and substantial shift in economic exposure), the transaction should be deemed an attempt to evade usury laws.

The final point emphasizes that in the rent-a-bank situation, the bank always transfers most or all of the economic risk on the loans to other parties. While banks frequently engage in risk transfers in non-rent-a-bank situations, it is the combination of outsourced production and risk transfer is the hallmark of rent-a-banking. This is particularly obvious when the risk is transferred to a party affiliated with the nonbank. When the risk is transferred to an unaffiliated party the situation is more complicated, but if that risk transfer has been arranged or facilitated by the nonbank, it should not matter other than in terms of the question of which entity should be deemed the "true lender" in the relationship.

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### B. *Payday Lending*

Rent-a-bank partnerships first emerged in the context of payday lending. Payday lending involves making short-term, small-dollar loans with maturity dates designed to coincide with the borrower's payday or government benefit distribution date. The idea is that on payday the borrower will have an influx of funds that can be used to repay the lender. Payday loans typically have a maturity of between one week and one month, although some payday loans are longer-term, installment loans with periodic payments scheduled to align with the borrower's payday.

Payday loans are unsecured, but come with a "leveraged payment mechanism" that enables the lender to take funds out of the borrower's bank account without having to first get a judgment and writ of execution or garnishment. The standard leveraged payment mechanisms involve the lender taking a post-dated check from the borrower (dated for the borrower's payday) or getting an automated clearing house (ACH) authorization from the borrower. If the borrower fails to repay voluntarily, the lender can then exercise its right to draw on the borrower's bank account, which it hopes will be replenished with funds on payday. A payday loan thus gives the lender accelerated repayment ability through a self-help right against the borrower's bank account.

Payday loans first emerged as a product in the mid-1990s.[82] They developed out of the informal practice of some check cashers of purchasing a consumer's personal check, rather than a check from a third party, and agreeing to hold it for a period of time before cashing it. This process was known as "deferred presentment" or "check holding." Typically, check cashers would agree to hold the check until the borrower's next payday in exchange for a fee. By calling the transactions check cashing, rather than lending, payday lenders sought to evade state usury and other consumer credit laws, but eventually some states legitimized the practice and allowed regulated "deferred presentment" transactions.

Payday loans are effectively or expressly prohibited in fourteen states and the District of Columbia.[83] In other states, payday loans are a highly regulated product. In states that allow payday lender, regulations vary considerably, but they generally require payday lenders to obtain a license from the state, be subject to state examination, make certain disclosures to borrowers, and also restrict the terms of products, particularly the types, amounts, and frequency

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[82] GARY RIVLIN, *BROKE, USA: FROM PAWNSHOPS TO POVERTY, INC.—HOW THE WORKING POOR BECAME BIG BUSINESS* 73 (2011).

[83] *See* Pew Charitable Trusts, *State Payday Loan Regulation and Usage Rates*, *at* https://www.pewtrusts.org/-/media/data-visualizations/interactives/2014/state-payday-loan-regulation-and-usage-rates/report/state_payday_loan_regulation_and_usage_rates.pdf.

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of fees, the length of loan maturities, and the frequency of loan renewals. Thus, even in states that allow payday lending, there are usury caps specific to the payday loans.

This regulatory landscape set the scene for rent-a-bank partnerships because lenders that did not want to be subject to state regulations sought out bank partners that were not subject to state usury laws. Banks have never had much interest in making payday loans themselves both because of skepticism about the profitability of the product except at extremely high interest rates that would trigger reputational risk and regulatory animosity,[84] but a number of (generally small) banks have been willing to partner with payday lenders on terms that turn a tidy profit for the bank with little investment or effort. The first instance of a rent-a-bank arrangement is not clear, but such arrangements began to appear by 1997.[85] While rent-a-bank arrangements were most common for payday lending, they also appeared in their first phase in the early 2000s with nonbank subprime credit card issuers and tax refund anticipation lenders.[86]

### *C. Regulatory Pushback on Payday Rent-a-Bank*

The original wave of rent-a-bank arrangements met with substantial pushback from both state and federal regulators. A number of states brought suit against rent-a-bank lenders,[87] as did private litigants.[88] More significantly, federal bank regulators acted to discourage banks from partnering with payday lenders. The actions by the federal bank regulators did not occur in concert; the Office of the Comptroller of the Currency (and the defunct Office of Thrift Supervision) acted first and most strongly, while the Federal

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[84] *See* Sheila Bair, *Low-Cost Payday Loans: Opportunities and Obstacles*, Report Prepared for The Annie E. Casey Foundation, June 2005, at https://www.cfsponline.com/uploads/LowCostPaydayLoans.pdf.

[85] Decision and Order, NY v. County Bank of Rehoboth Beach, No. 6046-03 (N.Y Sup. Ct. Albany Cty, Jan. 2, 2007) at 4, *at* https://www.nclc.org/images/pdf/unreported/NY_v_County_Bank_Decision.pdf, *aff'd Matter of People of State of New York v. County Bank of Rehoboth Beach, Del.*, 45 A.D.3d 1136, 1138 (N.Y. App. Div. 3d Dept. 2007).

[86] Complaint, *FTC v. CompuCredit Corp.*, No. 1:08-cv-1976 (N.D. Ga. Jun 10, 2008) at ¶ 11 (subprime credit card loans); Anderson v. H & R Block, Inc., 287 F.3d 1038, 1040-1041 (11th Cir. 2002), *rev'd sub nom.* Ben. Nat'l Bank v. Anderson, 539 U.S. 1 (2003) (tax refund anticipation loans).

[87] *See* Jean Anne Fox, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury,*" Consumer Federation of America, Mar. 30 2004, *at* https://consumerfed.org/wp-content/uploads/2010/08/pdlrentabankreport.pdf at 12, 25-28 (listing state enforcement actions).

[88] Ironically, one upshot of these suits was a Supreme Court decision clarifying that no state law usury claim could stand against a national bank that was a partner in a rent-a-bank arrangement. *See* Anderson v. H & R Block, Inc., 287 F.3d 1038, 1040-1041 (11th Cir. 2002), *rev'd sub nom.* Ben. Nat'l Bank v. Anderson, 539 U.S. 1 (2003).

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Deposit Insurance Corporation acted later and hesitantly, and the Federal Reserve Board never took any formal action at all.[89]

In 2000, the OCC issued an Advisory Letter highlighting its concerns about rent-a-bank relationships, noting that would closely review bank activities in this regard, and explaining its expectations for how banks would responsibly structure payday lending activities.[90] The next year, the OCC issued a Bulletin regarding third-party relationships that emphasized proper risk-management and oversight of third-party lending programs.[91] Critically, both the Advisory letter and the Bulletin emphasized the safety-and-soundness concerns rent-a-bank lending poses to a bank, rather than the consumer protection concerns.

Neither of these non-binding documents ever forbade payday rent-a-bank relationships outright, much less non-payday rent-a-bank relationships. Instead of prohibiting payday rent-a-banking expressly, the OCC acted through "soft power," making clear its expectations of banks not through the formal notice-and-comment rulemaking process, but through non-binding guidance and supervisory actions. Thus, in January of 2002, on the heels of the Bulletin, the OCC ordered a national bank to cease its rent-a-bank payday lending program out of safety-and-soundness concerns.[92] The next month, the Comptroller gave a speech directly addressing rent-a-bank relationships. He noted:

> Let me raise one other caution about preemption. The benefit that national banks enjoy by reason of this important constitutional doctrine cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank. Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.[93]

After detailing the problem of rent-a-bank arrangements, the Comptroller went on to state that:

> Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity

[89] One large partnering bank left the Federal Reserve System to avoid scrutiny. Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 872 (2007).

[90] OCC Advisory Letter AL 2000-10, Nov. 27, 2000.

[91] OCC Bulletin OCC 2001-47, Nov. 1, 2001.

[92] Press Release, "OCC Orders Eagle to Cease Payday Lending Program," January 3, 2002, NR 2002-01.

[93] John Hawke, OCC speech given February 12, 2002, available at www.occ.treas.gov/ftp/release/2002-10a.doc.

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> to manage effectively a multi-state loan origination operation that is in reality the business of the payday lender.[94]

Over the following year, the OCC brought supervisory actions against another three national banks for rent-a-bank payday lending.[95] By 2003, the OCC could brag in its Annual Report that:

> All national banks with known payday lending activities through third-party vendors were ordered in FY 2003 to exit the payday lending business. By undertaking enforcement actions against those banks, the OCC addressed safety and soundness concerns about the management of these payday loan programs, and ended significant consumer protection violations.[96]

The FDIC moved more slowly. The FDIC Chair expressed concerns about rent-a-bank in 2000, noting, "It may be legal—but I don't like it."[97] The FDIC, however, took no action until 2003, when it FDIC issued examination guidelines for state-chartered banks partnering with payday lenders.[98] The guidelines required that payday loan portfolios be classified as substandard for regulatory risk management, and loan loss reserving purposes and subjected them to higher capital requirements (up to dollar for dollar capital). Yet the bark was much worse than the bite for a rent-a-bank: the requirements only applied to loans on the bank's books. If the bank were selling the loans regularly, such as on a daily basis, the impact would be negligible. In 2005, however, the FDIC issued stronger guidelines,[99] which limited the number of frequency of loan rollovers, making it more difficult for state-chartered banks to engage in payday rent-a-bank relationships. This guidance combined with enforcement actions in 2007,[100] ended most payday rent-a-bank arrangements.

### *D. The Incomplete Regulatory Pushback*

Like the OCC, the FDIC it did not outright forbid payday rent-a-bank arrangements, much less rent-a-bank relationships for things like installment

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[94] *Id.*

[95] Office of Comptroller of the Currency, Notice of Charges for Issuance of an Order to Cease and Desist, *In the Matter of Peoples National Bank, Paris, TX*, AA-EC-02-03, May 17, 2002; Press Release, "OCC Takes Action Against ACE Cash Express, Inc. and Goleta National Bank," October 29, 2002, NR 2002-85; Press Release, "Peoples National Bank to Pay $175,000 Civil Money Penalty and End Payday Lending Relationship with Advance America," January 31, 2003, NR 2003-06.

[96] OCC Annual Report, 2003, p. 17.

[97] FDIC, *Chairman Tanoue Denounces "Charter Renting" as a Means of Funding Predatory Payday Lenders*, June 14, 2000, PR-41-2000.

[98] FDIC Examination Guidance for Payday Lending, PR-70-2003.

[99] FDIC, Guidelines for Payday Lending, FIL-14-2005.

[100] *See In the Matter of First Bank of Delaware*, FDIC-07-256b and FDIC-07-257k (2008).

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loans, which are not implicated by the rollover limitations. Nonetheless, as a practical matter, the FDIC shut down most rent-a-bank operations by state-chartered banks, such that two scholars, writing in 2007 observed that, "by early 2006, the 'rent-a-charter' era had come to an end."

These scholars wrote prematurely, however. Not only did some rent-a-bank payday lending persist after 2006,[101] but the rent-a-bank model was ultimately adopted by other types of subprime lenders: "marketplace lenders,"[102] subprime installment lenders,[103] and subprime small business lenders.[104] At most, the FDIC ended an era of payday-focused rent-a-banking, only for the model to shift to other sectors of the subprime lending market. The following section presents a deep dive into a rent-a-bank arrangement that traces a lender from origins as a rent-a-bank payday lender through a rent-a-tribe model and into its reinvention as a "fintech" installment lender with a new rent-a-bank structure. The story illustrates the Whak-a-Mole nature of attempts to address rent-a-bank via litigation.

## III. <u>CASE STUDY OF ELEVATE CREDIT, INC.</u>

Elevate Credit, Inc. ("Elevate") is a nonbank "fintech" firm that specializes in subprime lending represents the state-of-the-art in rent-a-bank arrangements. A close examination of Elevate's business is instructive for understanding the how sophisticated rent-a-bank arrangements can be and the challenges posed to an entity-based regulatory system.

Critically, the case study of Elevate is possible only because it is a reporting company under the Securities Act. If Elevate were not a reporting company it would be impossible to discern the details of its relationship with its bank partners or even that such a relationship existed.

### *A. ThinkCash's Rent-a-Bank Model*

Elevate is a publicly-traded Delaware corporation,[105] that was spun-off in 2014 from a privately held entity called Think Finance, Inc. ("Think"). The

[101] *See infra* section II.D.1.

[102] *See, e.g.*, Fulford v. Marlette Funding, LLC, No. 2017-CV-30376), 2019 WL 4451038 (D. Colo. June 5, 2019); Meade v. Avant of Colorado, LLC, 307 F. Supp. 3d 1134, 1150-1151 (D. Colo. 2018); Meade v. Marlette Funding LLC, 2018 U.S. Dist. LEXIS 46814, *8-9, 2018 WL 1417706 (D. Colo. Mar. 21, 2018).

[103] *See infra* section II.D.3.

[104] *See infra* Introduction (discussing World Business Lenders, LLC, and its rent-a-bank relationships with Bank of Lake Mills, Wisconsin and Axos Bank).

[105] Second Amended and Restated Certificate of Incorporation of Elevate Credit, Inc., https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-17-124695.html?hash=812823670e6bb47b5f812754a7feedb6bbf62f5af5e2475a7c663d58fe37a176&dest=D376675DEX31_HTM#D376675DEX31_HTM.

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company's history is itself instructive, as it presents a study of the cat-and-mouse dynamic of regulation and its circumvention.

Think started off around 2001 as PayDay One Holdings, LLC, an internet payday lender named based in Fort Worth, Texas.[106] In 2005, PayDay One Holdings changed its name to PayDay One Holdings, Inc.[107] In 2007 it changed its name yet again to ThinkCash Inc, and then once more in 2010 to Think Finance.[108]

Prior to 2007, Think made only direct payday loans.[109] Starting in 2007, however, Think began to engage in indirect lending in states where usury laws were a binding constraint using a rent-a-bank arrangement through both Urban Trust Bank FSB (now renamed Axiom Bank) and First Bank of Delaware.[110] The details of the Urban Trust Bank relationship are not public other than the name of the product—Elastic—which is still one of Elevate's main products and is discussed in detail below. In contrast, the details of the First Bank of Delaware product, known as "Think Cash" are public as the result of litigation brought against Think by the Commonwealth of Pennsylvania.

For the Think Cash product, different Think affiliates entered into three related contracts with the First Bank of Delaware: (1) a marketing and servicing agreement; (2) a master participation agreement; and (3) a guaranty agreement. Pursuant to the marketing and servicing agreement, a Think subsidiary marketed the Think Cash product, using First Bank of Delaware's name and trademarks, took loan applications from consumers, and serviced the loans in exchange for a $100/loan fee for each funded loan from First Bank of Delaware.[111] The loans were formally made and funded by First Bank of Delaware, but marketing, underwriting, and technology platform were all provided by Think.[112]

Under the master participation agreement, another Think subsidiary agreed to purchase on a daily basis 99% participation interest in each

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[106] Statement of Undisputed Facts in Support of the Plaintiff's Motion for Partial Summary Judgment Against Defendants Kenneth Rees and National Credit Adjusters, LLC, *Commonwealth v. Think Finance, Inc.*, Case No. 2-14-cv-07139 (E.D. Pa. Aug. 14, 2019) at ¶¶ 1, 4 (hereinafter "Think Finance Undisputed Facts").

[107] Plaintiff's Motion for Partial Summary Judgment Against Defendants Kenneth Rees and National Credit Adjusters, LLC, *Commonwealth v. Think Finance, Inc.*, Case No. 2-14-cv-07139 (E.D. Pa. Aug. 14, 2019) at Exh. A, Table of Disputes, at 1.

[108] Think Finance Undisputed Facts at ¶ 2.

[109] *Id.* at ¶¶ 4, 6.

[110] *Id.* at ¶¶ 6-8, 11, 25.

[111] *Id.* at ¶ 33.

[112] *Id.* at ¶ 6.

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"ThinkCash" loan made by First Bank of Delaware.[113] Think was also obligated to pay a monthly participation fee of $100/loan plus a percentage of the revenue generated by the 99% participation interests to First Bank of Delaware.[114] Additionally, Think was required to maintain a reserve account at First Bank of Delaware that could be used to offset its obligations.[115] Think later reduced its participation purchase percentage to 90%, but indemnified First Bank of Delaware for any losses that exceeded 2.5% of the loan balance.[116] Finally, under the guaranty agreement, Think's holding company guarantied the obligations of the subsidiaries under the other contracts.[117] Because Think was not the formal lender on the loans—it did not fund them nor was it the creditor of record—Think claimed that it was merely a servicing agent of First Bank of Delaware.

In 2008, the Federal Deposit Insurance Corporation (FDIC) initiated an enforcement action against First Bank of Delaware for its unsafe and unsound third-party lending activity, including with Think.[118] First Bank of Delaware entered into a consent order with the FDIC in which it agreed to discontinue its various rent-a-bank relationships.[119] Nevertheless, First Bank of Delaware continued to work with Think until 2011, albeit through a restructured program. Specifically, a pair of new Think subsidiaries began to provide the marketing, underwriting, technology platform and loan servicing to First Bank of Delaware, while the participation interests were purchased

[113] *Id.* at ¶ 34. A participation is a type of a derivative interest. ADAM J. LEVITIN, *BUSINESS BANKRUPTCY: FINANCIAL RESTRUCTURING AND MODERN COMMERCIAL MARKETS* 113-14 (2nd ed. 2018). In a participation, the participation seller owns a loan and sells off an undivided fractional economic interest in the loan, but retains complete legal title to the loan. This means that the purchaser of a participation interest is economically exposed to the performance of the loan, but does not have contractual privity with the borrower on the loan. Instead, its only contractual privity is with the seller of the participation interest, such that its remedies in the event of non-performance on the loan would lie solely against the seller, not the borrower.

The use of participation interests, rather than outright sales of loans can be found even in the earliest days of rent-a-bank arrangements. *See Goleta Nat'l Bank v. O'Donnell*, 239 F. Supp. 2d 745, 747 -78 (S.D. Ohio 2002) (noting that Goleta National Bank would sell payday lender ACE Cash Express, Inc. a 90% participation in each loan).

[114] Think Finance Undisputed Facts at ¶ 35.

[115] *Id.* at ¶ 36.

[116] *Id.* at ¶ 38.

[117] *Id.* at ¶ 37.

[118] *See In the Matter of First Bank of Delaware*, FDIC-07-256b and FDIC-07-257k (2008). I served as an expert witness for the FDIC in this matter. First Bank of Delaware dissolved in 2012. Complaint, *Commonwealth v. Think Finance, Inc.*, Case No. 2-14-cv-07139 (E.D. Pa. Dec. 17, 2014) at ¶ 43 (hereinafter "Think Finance Complaint").

[119] Think Finance Undisputed Facts at ¶ At 40.

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by a newly created special purpose vehicle, Universal Finance II, LLC that was funded by outside investors.[120]

Universal Finance promised its investors a 17% annual return, which was guaranteed by Think Finance.[121] Think Finance also agreed to purchase Universal Finance interest in any defaulted loans in exchange for receiving all residual net income as an "administrative fee".[122] Additionally, pursuant to an administrative agency agreement, a Think Finance entity managed Universal Finance.[123]

Think Finance found itself needing an additional source of funding for the loans, and in the summer of 2010, Think contracted with a Chicago-based private equity firm called Victory Park Capital was found to provide the funding for the loans. Victory Park Capital purchased the right to purchase up to $90 million in participation interests in various Think Finance products from Universal Finance, with Think Finance guarantying Victory Park Capital a 20% return.[124]

In October 2010, however, the FDIC ordered First Bank of Delaware to cease its relationship with Think.[125] Think contacted 80 banks seeking a partner to replace First Bank of Delaware[126] before it embarked on a new strategy for evading state usury laws: rent-a-tribe.

### *B. Think Finance's Rent-a-Tribe Model*

As the rent-a-bank model collapsed in the face of federal regulatory pressure, Think Finance began partnering with Native American tribes,[127] which are themselves not subject to state usury laws because of sovereign immunity, although tribal members and tribal commercial entities may still be subject to state usury laws.[128] Think formed partnerships with three tribes.

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[120] *Id.* at ¶¶ 42-43. Universal Finance II, LLC's owner and managing member was the brother of a First Bank of Delaware director. *Id.* at ¶ 45.

[121] *Id.* at ¶ 44, 51.

[122] *Id.* at ¶ 51.

[123] *Id.* at ¶ 52.

[124] *Id.* at ¶¶ 58-60.

[125] *Id.* at ¶ 62.

[126] *Id.* at ¶ 65.

[127] *Id;* Think Finance Complaint at ¶ 47.

[128] *Cf.* Otoe-Missouria Tribe of Indians v. New York State Dep't of Fin. Servs., 769 F.3d 105 (2d Cir. 2014) (upholding denial of motion for preliminary injunction against state regulators from interfering with tribal lending business allegedly taking place off tribal lands); Williams v. Big Picture Loans, LLC, 929 F.3d 170 (4th Cir. 2019) (dismissing suit because 6lending entities affiliated with Native American tribe were entitled to sovereign immunity as "arms of the tribe").

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In these "rent-a-tribe" partnerships,[129] Think again provided the infrastructure for marketing, underwriting, funding, and collecting the loans, including provision of customer leads, a technology platform, investors to fund the loans, and payment-processing and collection platforms.[130] Think also trained customer service agents to handle calls, drafted call scripts, drafted and administered contracts, hosted websites, monitored tribal employees, identified third party collection agencies, and facilitated the sale of delinquent accounts.[131]

When consumers obtained credit through the rent-a-tribe arrangement, the loan agreements purported to be loan agreements with the tribes and to be subject solely to tribal law and jurisdiction. Yet the tribes maintained only a minimal economic interest in the loans. Instead, a Cayman Islands company called GPL Servicing Ltd., which was controlled by Victory Park Capital Advisors, LLC,[132] would purchase a participation interest of between 90% and 99%.[133] In exchange for the participation interest, the tribes were paid a fee based on the gross revenue from the enterprise.[134] The arrangement depended on the tribe, with one tribe getting 4%, another 4.5%, and the third a graduated amount.[135]

GPL Servicing was structured so that Victory Park exercised all of the voting shares and thus all of the management rights, but the non-voting shares were held by various investors, including a Think affiliate.[136] Think guarantied GPL Servicing a 20% annual return.[137] Any return above the 20%

[129] *See generally* Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?* 69 WASH. & LEE L. REV. 751 (2012).

[130] Think Finance Complaint at ¶ 48.

[131] Complaint, *CFPB v. Think Finance, LLC*, Case No. 4-17-cv-00127 (D. Mont. Nov. 15, 2017), at ¶ 30 (hereinafter "CFPB Complaint").

[132] Disclosure Statement Accompanying Second Modified First Amended Joint Chapter 11 Plan of Reorganization of Think Finance LLC and Its Subsidiary Debtors and Debtors in Possession, *In re Think Finance LLC*, No. 17-33964 (Bankr. N.D. Tex. Sept. 26, 2019), at 4 (hereinafter "Think Finance Disclosure Statement"). GPL stands for Great Plains Lending, the first of the tribal lending entities with which Think Finance partnered. Second Amended Think Finance Complaint at ¶ 94. GLP Servicing, Ltd. was originally named VPC/TF Fund II Ltd. *Id.*

[133] Complaint, *CFPB v. Think Finance, LLC*, at ¶ 45.

[134] Second Amended Complaint, *Commonwealth v. Think Finance, Inc.*, Case No. 2-14-cv-07139 (E.D. Pa. Dec. 21, 2017) at ¶¶ 101, 103, 104.d (hereinafter "Second Amended Think Finance Complaint"); CFPB Complaint at ¶ 46. For a period of time, the tribes' expenses were also reimbursed. *Id.* at ¶ 47.

[135] Second Amended Think Finance Complaint at ¶¶ 101, 103, 104.d.

[136] Think Finance Disclosure Statement at 4-5.

[137] Second Amended Think Finance Complaint at ¶¶ 90.a-b-91 (hereinafter "Second Amended Think Finance Complaint"); CFPB Complaint at ¶ 48 (listing an 18% guarantied return).

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went to Think.[138] In other words, Victory Park was simply providing the funding through a structure that imitated a loan, while Think held the equity interest in the venture.

Think flew high for a while. In 2013, Forbes ranked it as number two on its list of America's Most Promising Companies,[139] and from 2010-2015 it was on the Inc. 5000 List of List of Fastest Growing Companies.[140] Think even bragged that it was the original "fintech," noting that "Before the term 'fintech' was coined, Think Finance was an established leader and innovator in the marketplace for online lending."[141]

Think's days were numbered, however. In 2013, the Department of Justice commenced Operation Choke Point, an anti-consumer fraud operation that targeted banks that provided automated clearinghouse processing for consumer fraudsters.[142] While the Department of Justice brought only a handful of prosecutions as part of Operation Choke Point, it spooked the banking industry. As a result, during the summer of 2013, many banks cut ties with payday lender and high-cost installment lenders. Think found it difficult to find banks to continue processing payments for the tribal lending entities,[143] and had to eventually turn to a Canadian payments processor.[144]

Around the same time, the State of New York sent a cease-and-desist letter to one of Think's tribal partners, which responded with a lawsuit, funded by Think,[145] seeking an injunction against the State.[146] The District Court denied the request for a preliminary injunction in an opinion that cast doubt on tribe's claim of sovereign immunity.[147]

As a result of Operation Choke Point and the New York litigation, Victory Park Capital started to get cold feet about its arrangement with

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[138] Second Amended Think Finance Complaint at ¶¶ 90.a-91. *See also* CFPB Complaint at ¶ 49.

[139] Think Finance Disclosure Statement at 3.

[140] *Id.*

[141] *Id.*

[142] *Guilty Until Proven Innocent? A Study of the Propriety and Legal Authority for the Justice Department's Operation Choke Point, Before the Subcomm. on Regulatory Reform, Commercial, and Antitrust Law of the H. Comm. on the Judiciary.*, 113th Cong. 7–8 (July 17, 2014) (written testimony of Adam J. Levitin, Professor, Georgetown University Law Center).

[143] Second Amended Think Finance Complaint at ¶¶ 110-112.

[144] Think Finance Undisputed Facts at ¶ 129.

[145] Think Finance Undisputed Facts at ¶ 213.

[146] Second Amended Think Finance Complaint at ¶ 112.

[147] *Otoe-Missouria Tribe of Indians v. New York State Dep't of Fin. Servs.*, 974 F. Supp. 2d 353 (S.D.N.Y. 2013), *aff'd Otoe-Missouria Tribe of Indians v. New York State Dep't of Fin. Servs.*, 769 F.3d 105 (2d Cir. 2014).

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Think.[148] As consumer class actions and state and federal enforcement actions against Think piled up, Victory Park eventually pulled the plug on Think's financing, precipitating Think's bankruptcy filing in October of 2017.[149]

Around the time that Think Finance's troubles with the ACH system were emerging, Think Finance undertook two important developments. First, it developed an installment loan product called "Rise" that it would offer directly in states in which usury caps were not a binding constraint.[150] Rise was a replacement of Think's original PayDay One product.[151]

Second, in May 2014, Think Finance spun off its both its direct lending (Rise) and branded consumer products portfolio into a new, independent company called Elevate Credit, Inc.[152] Think Finance continued to provide technology and administrative services to the tribal lenders up until its 2017 bankruptcy. In the face of a new regulatory environment, however, Elevate moved back to a revamped rent-a-bank model that continues as of the time of the writing of this Article. The remainder of this section examines the current Elevate rent-a-bank model in detail.

### *C. Elevate Credit, Inc.*

Elevate operates as a state-licensed lender making loans directly itself in several states, but it primarily operates through bank partnerships with two small state-chartered, FDIC-regulated banks, Republic Bank & Trust Company of Kentucky ($6.4 billion in total assets, 1,094 employees), and FinWise Bank of Utah ($267 million in total assets, 89 employees).[153] Not coincidentally, both Kentucky and Utah allow for unlimited interest on smaller contractual loans.[154] The fact that Elevate makes the loans itself in

[148] Second Amended Think Finance Complaint at ¶¶ 111-113.

[149] Think Finance Disclosure Statement at 6-7.

[150] Second Amendment Think Finance Complaint at ¶ 115.

[151] Think Finance Undisputed Facts s, ¶ 18.

[152] Think Finance Disclosure Statement at 3; Think Statement of Undisputed Facts ¶ 224. The spin-off has subsequently been challenged as a fraudulent transfer While the complaint was filed under seal, the court order granting the sealed filing motion inadvertently gives away the nature of the suit. *See* Order Granting Emergency Motion to For Leave to File Complaint Under Seal, Think Finance Litig. Trust v. Elevate Credit, Inc., *In re Think Finance, LLC*, No. 17-33964 (Bankr. N.D. Tex. Aug. 13, 2020) ("The Clerk of Court's Office is directed to accept as filed under seal the Trust's Complaint to Avoid and Recover Transfers Pursuant to 11 U.S.C. §§ 544, 548 and 550, and §§ 24.001 et seq. of the Texas Uniform Fraudulent Transfer Act.").

[153] FDIC, Statistics on Depository Institutions, https://www7.fdic.gov/sdi/main.asp (data as of June 30, 2019).

[154] KY. REV. STAT. § 286.3-214 ("Notwithstanding the provisions of any other law, a bank may take, receive, reserve, and charge on money due or to become due on any contract or

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states where there the usury cap does not present an obstacle underscores that its relationship with the banks is solely about evasion of state usury laws and not because of any particular other value the banks bring to the enterprise.

Elevate lends to non-prime consumers and consumers with thin credit files or no credit scores. It offers two credit products, Elastic and Rise, in the United States.[155] Elastic is a line of credit product for loans between $500 and $3,500 for up to 10 months. Elastic is offered in some 40 states, solely through a bank partnership with Republic Bank. The weighted average effective APR on Elastic loans is 98%,[156] well above most states' usury caps.

The Rise product varies by state—it is sometimes an installment loan product and sometimes a line of credit product. Elevate is a licensed nonbank lender in several states, where it offers Rise directly, and it also offers Rise through a credit services organization in one state,[157] but in 19 states it offers Rise through a partnership with FinWise bank.[158] The partnership Rise product is for a loan between $500 and $6, with a maturity of 7-26 months. The weighted average effective APR on the Rise loans is 129%, again,[159] well above most states' usury caps.

Elevate's "secret sauce" for all of its products is its proprietary underwriting technology platform. Elevate boasts that:

> Our proprietary risk analytics infrastructure utilizes a massive (approximately 80+ terabyte) Hadoop database composed of more than ten thousand potential data variables related to each of the 2.4 million customers we have served and about 8.6 million applications that we have processed. Our team of over 50 data scientists uses our proprietary technology to build and test scores and strategies across the entire underwriting process, including segmented credit scores, fraud scores, affordability scores and former customer scores. We use a variety of analytical techniques from traditional multivariate regression to machine learning and artificial intelligence to continue

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other obligation in writing, where the original principal amount is fifteen thousand dollars ($15,000) or less, interest at any rate allowed national banking associations by the laws of the United States of America."); UTAH CODE § 15-1-1 ("The parties to a lawful written, verbal, or implied contract may agree upon any rate of interest for the contract, including a contract for services, a loan or forbearance of any money, goods, or services, or a claim for breach of contract.").

[155] Elevate Credit, Inc., Form 10-K (2019) at 7.

[156] *Id.* at 15.

[157] This is another, Texas-specific method of evading state usury and licensure laws.

[158] *Id.* at 14.

[159] *Id.*

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> to enhance our underwriting accuracy while complying with applicable US and UK lending laws and regulations.[160]

In other words, Elevate represents something beyond a run-of-the-mill storefront payday lender (and it is not actually a payday lender), but instead represents a cutting edge fintech firm that uses a massive database and team of data scientists to extend credit to borrowers that might not otherwise be well-served by the financial system because of their credit profiles.

### *D. The Rent-a-Bank Nexus of Contracts*

Elevate has separate, but similar rent-a-bank arrangements for both its Elastic and Rise products. The arrangements differ primarily in the identity of the partner bank and the extent of the partner bank's retained interest in the loans, but are otherwise materially the same.

Elevate's relationships with Republic and FinWise each consists of three contracts (and amendments thereto): (1) a joint marketing agreement;[161] (2) a technology license and support agreement;[162] and (3) a participation interest purchase and sale agreement.[163] Notably, while the bank is a party on each of the agreements, a different Elevate-affiliated entity is the counterparty:

- The joint marketing agreements have either Elevate@Work, LLC or EF Marketing, LLC, as the Elevate parties.[164] Both are single-member LLCs, the sole member of which is another Elevate entity (Elastic Financial,

[160] *Id.* at 8.

[161] Amended and Restated Joint Marketing Agreement, dated July 1, 2015, by and between Republic Bank & Trust Company and Elevate@Work, LLC, https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX105_HTM#D83122DEX105_HTM (hereinafter "Elastic Joint Marketing Agreement"); Joint Marketing Agreement, dated October 15, 2018, by and between FinWise Bank and EF Marketing, LLC (hereinafter "Rise Joint Marketing Agreement").

[162] Amended and Restated License and Support Agreement, dated July 1, 205, by and between Republic Bank & Trust Company and Elevate Decision Sciences, LLC, https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX106_HTM#D83122DEX106_HTM (hereinafter "Elastic Technology License Agreement"); Technology and Support Agreement, dated October 15, 2018, by and between FinWise Bank and Elevate Decision Sciences, LLC (hereinafter "Rise Technology License Agreement").

[163] Elastic Participation Agreement, *supra* note 9; Rise Participation Agreement, *supra* note 9.

[164] Elevate@Work, LLC, subsequently changed its name to Elastic Marketing, LLC.

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LLC, or EF Financial, LLC, respectively), which are themselves both single-member LLCs, with Elevate Credit, Inc. as the sole member.)[165]

- The technology license agreements are between the banks and an Elevate Credit, Inc., subsidiary called Elevate Decision Sciences, LLC.[166] Elevate Decision Sciences is another single-member LLC, with Elevate Credit, Inc. again as the sole member.[167]
- The participation interest purchase and sales are between the banks and special purpose vehicles (SPVs) structured as Cayman Island exempted companies, Elastic SPV, Ltd., and EF SPV, Ltd., respectively.[168] The SPVs are not formally part of Elevate Credit, Inc.'s corporate group; their nominal equity is held in trust, but they carry on no business other than facilitating Elevate's financing of Elastic and Rise loans and are consolidated for financial reporting purposes.[169] Elevate provides the all management services for the SPVs through administrative services agreements with the SPVs.[170]

### 1. *The Joint Marketing Agreements*

The joint marketing agreements are the lynchpin of the relationship between Elevate and its partner banks. The joint marketing agreements set forth Elevate's responsibility to design and market the loans, but give the

[165] Schedule D to Financing Agreement, dated Feb. 7, 2019, by and among EF SPV, Ltd. the Guarantors thereto, the Lenders, and Victory Park Management, LLC as Agent (attached to Elevate Credit, Inc. 10-K at p.325); Exhibit H (Victory Park-Elevate Credit, Inc. Fifth Amended and Restated Elevate Transaction, Feb. 7, 2019), Schedule 7.7 (attached to Elevate Credit, Inc. 10-K).

[166] Schedule D to Financing Agreement, dated Feb. 7, 2019, by and among EF SPV, Ltd. the Guarantors thereto, the Lenders, and Victory Park Management, LLC as Agent (attached to Elevate Credit, Inc. 10-K at p.325).

[167] Schedule D to Financing Agreement, dated Feb. 7, 2019, by and among EF SPV, Ltd. the Guarantors thereto, the Lenders, and Victory Park Management, LLC as Agent (attached to Elevate Credit, Inc. 10-K at p.325).

[168] Elevate Credit, Inc., Form 10-K (2019) at 41, 77. The ownership of Cayman Island exempted companies is not public, but Cayman Islands SPVs are generally "orphan" SPVs with the equity held by a charitable or purpose trust. *See* Conyers, Dill & Pearman, *Securitisation in the Cayman Islands* 4, https://www.conyers.com/wp-content/uploads/2016/07/Securitisation_in_the_Cayman_Islands-CAY.pdf (explaining orphan SPV structures).

[169] Elevate Credit, Inc., Form 10-K (2019) at 87.

[170] Administrative Services Agreement, dated July 1, 2015 between EF SPV, Ltd. and EF Financial, LLC (10-K at 739); Administrative Services Agreement, dated July 1, 2015 between Elastic SPV, Ltd. and Elevate@Work, LLC, https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX107_HTM#D83122DEX107_HTM.

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banks the right to approve the terms of the loan. For example, the joint marketing agreement provides that FinWise Bank may offer loans who apply:

> at one or more websites, direct mail or other marketing channels operated or identified by [EF Marketing, LLC] and approved by FB who meet applicable credit standards and other qualifications established by [FinWise Bank]. [FinWise Bank] may change the terms, and conditions applicable to the Loans, fees charged to Borrowers, maximum amount of credit lines, the Program Guidelines, the Credit Policy, the Credit Model Policies and the Underwriting Criteria.[171]

At first blush it would seem, then, that FinWise Bank controls the terms of the loans and the underwriting criteria, but an inspection of the definitions for the contract shows that it is more complex. "Program Guidelines" are defined as:

> guidelines proposed by [EF Marketing, LLC] and approved by [FinWise Bank]…including…the Credit Policy or Underwriting Criteria…[and] the Credit Model Policies….[172]

In other words, the entire design of the Rise product, including the underwriting guidelines, are created and proposed by Elevate. While FinWise Bank does have to ultimately sign off on the product, it is not the product's designer, and presumably FinWise would not have entered into the joint marketing agreement with Elevate without having a good idea about what the Rise product would look like.

How the contractual relationship has played out in fact is not clear. For example, has FinWise has ever refused a proposal from Elevate? Has FinWise ever sought to change the program's terms? The contract contemplates the possibility that the answer to both questions could be no, with FinWise merely rubber stamping Elevate's proposals. Indeed, if Elevate is the entity with the expertise in the lending with the enormous database and team of data scientists who almost outnumber FinWise's entire workforce, it is hard to see how FinWise would possibly exercise any material input on the terms of the lending. Elevate's agreement with Republic Bank for Elastic is materially similar.[173]

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[171] Rise Joint Marketing Agreement, § 1(a) (10-K at 679).

[172] *Id.* at App. A (10-K at 701).

[173] Elastic Joint Marketing Agreement §§ 1(a), App. A ("'Program Guidelines' shall mean those guidelines established by RB for the administration of the Program, including, but not limited to, underwriting standards for the Accounts (which shall include, without limitation, specific criteria for evaluating an Applicant's ability to repay the Account, including the Initial

EF Marketing, LLC, has some obligations itself under the joint marketing agreement. Not only is it to propose all the guidelines for administration of the program, but it is also obligated to "perform services reasonably required to market the Program," including:

> (A) acquiring, scrubbing and managing lead lists, (B) preparing and distributing product offerings and associated marketing materials, including pre-qualified offers, as approved by FB, (C) developing and placing internet, print media, radio and television advertising, (D) designing and developing websites, (E) compensating third parties that provide marketing services in relation to the Program, (F) subject to FB's approval, delivering all notices and disclosures required by applicable Law with each solicitation, and (G) contracting with mutually agreed third parties to offer the Program to their clients.[174]

In exchange for these services, FinWise Bank pays EF Marketing, LLC a marketing fee for each new loan that is made.[175] As we will see, this fee is offset by other fees paid by Elevate entities to FinWise Bank. Thus, pursuant to the joint marketing agreement, Elevate proposes the design of the loan product and the underwriting criteria and handles all the marketing of the loan in exchange for a fee from FinWise Bank. Again, the terms of Elevate's agreement with Republic Bank for Elastic are materially similar.[176]

### 2. *Technology License Agreement*

The technology license agreements are licenses for the banks to use Elevate's software in exchange for a per-loan fee. The software is described as "an internet-based consumer credit platform that permits the collection, verification, scoring, evaluation, funding, and account management of installment loans" and includes "an internet website landing page," "an accounting and loan tracking system" to ensure compliance with all applicable laws, "internet-based financial wellness materials for Borrowers", and also generate credit bureau reporting files in the standard Metro II format.[177] The software is hosted on hardware located in a data center under

Advance and all Subsequent Advances thereunder), the credit, charge-off and collection policies for the Accounts, and all other operating procedures for the Accounts, as such guidelines may be amended, modified or supplemented from time to time by RB in accordance with the terms of this Agreement.").

[174] Rise Joint Marketing Agreement, § 2(a) (10-K at 680).

[175] *Id.* at § 2(d) (10-K at 682).

[176] Elastic Joint Marketing Agreement §§ 2(a), 2(d).

[177] Rise License Agreement, Exhibit A, § A (10-K at 719); Elevate License Agreement, Exhibit A, § A. First Amendment to Amended and Restated License and Support Agreement,

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contract with Elevate.[178] For Elastic, the software also enables automatic draws on the borrower's bank account.[179] The software automates virtually the entire loan process from the time a consumer applies for a loan to the underwriting, funding, and servicing of the loan. All the bank needs to do is press "go."

The Rise technology license requires Elevate to provide the bank with "reasonable access to its Technical Information, credit and business models underlying the Credit Model Policy, including all pricing, credit, and underwriting assumptions thereto and the Credit Model Documentation", and the bank has a right to test and validate the information.[180] The Elastic license merely requires Elevate to provide "reasonable cooperation" in connection with Republic Bank's testing and validation of the software.[181] Republic Bank does not have a contractual right to access to the underlying software's coding, etc. for Elastic.

It is unclear whether the banks have ever in fact exercised their access, testing and validation rights under the contract. Given that Elevate is the party with the technical expertise, it is not clear that the partner banks would even have the wherewithal to test and validate the software. Notably, the reasonable access provision is somewhat at odds with another provision of the technology license, which forbids the bank to look under the hood at the software's code.[182] The structure of the license agreement means that the

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dated July 18, 2018, at https://content.edgar-online.com/ExternalLink/EDGAR/0001651094-18-000043.html?hash=7f84a129fe5adb4240ee1471eba000fd08164520bc75f508ac46b1242739e029&dest=A102FIRSTAMENDMENT-LICENSE_HTM#A102FIRSTAMENDMENT-LICENSE_HTM, § 4.

[178] Rise License Agreement, at Exhibit A, § A (10-K at 707) (for Rise, this was Amazon Web Services as of the contract date. See *id.*, at § 2.2(b)); Elastic License Agreement, Exhibit A, § A.

[179] First Amendment to Amended and Restated License and Support Agreement, dated July 18, 2018, at https://content.edgar-online.com/ExternalLink/EDGAR/0001651094-18-000043.html?hash=7f84a129fe5adb4240ee1471eba000fd08164520bc75f508ac46b1242739e029&dest=A102FIRSTAMENDMENT-LICENSE_HTM#A102FIRSTAMENDMENT-LICENSE_HTM, § 4.

[180] Rise License Agreement, Exhibit A, § E (10-K at 721).

[181] Elastic License Agreement, Exhibit A, § D.

[182] Amended and Restated License and Support Agreement, dated July 1, 205, by and between Republic Bank & Trust Company and Elevate Decision Sciences, LLC, § 4, https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX106_HTM#D83122DEX106_HTM ("Licensee shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part…"); Technology and Support Agreement, § 4 ("FB shall not

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loans are made using software that can remain a black box to the bank, such that the bank does not actually understand the underwriting decisions.

The technology license agreement also includes an account servicing provision in which Elevate undertakes to perform most of the loan servicing duties, including maintaining account information, providing initial account opening disclosures, periodic billing statements, posting payments to borrowers' accounts, and producing reports on the accounts.[183]

*3. Participation Agreement*

The third leg of the contractual rent-a-bank nexus is the participation purchase and sale agreement. Elevate's participation purchase and sale agreements are technically option contracts that give Elastic SPV and EF SPV an option, but not an obligation, to purchase participation interests in the loans made by Republic Bank and FinWise Bank respectively. Specifically, Elastic SPV has the option to purchase a 90% participation interest, while EF SPV has the option to purchase a 96% participation interest for the outstanding principal amount of the loan times the participation percentage plus a purchase premium and a participation fee.[184] This fee offsets the marketing the technology license fees paid to the banks by the Elevate entities.

The participation agreements mean that Republic Bank retains the Elastic loans on its books and is outwardly the legal party in interest in the loans, but it only has a 10% economic interest in the loans, while FinWise Bank retains the Rise loans on its books and is outwardly the legal party in interest in the loans, but it only has a 4% economic interest in the loans.[185]

By structuring the participation purchases as options, it would appear that Republic Bank and FinWise Bank could find themselves in a position where they make Elastic or Rise loans, only to discover that they are holding 100% of the economic exposure on those loans because the Elevate entities have elected not to exercise their purchase option. A closer look at the participation agreements, however, show that there is virtually no chance that Elevate will not exercise the option.

itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part….") (p.708 of 10-K).

[183] Elastic License Agreement, Exhibit A, § D; Rise License Agreement, Exhibit A, § D. The Elastic Participation Agreement says that Republic will service loans or arrange for a third party to service the loans. Elastic Participation Agreement § 3(a).

[184] Elevate Credit, Inc., Form 10-K (2019) at 76, 77; Elastic Participation Agreement, § 2(b).

[185] Elevate Credit, Inc., Form 10-K (2019) at 76, 77.

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Using the Elastic participation agreement as the paradigm, we see that Elastic SPV's "option" is to purchase a participation interest in any advance funded at least three business days prior.[186] But Elastic SPV must notify Republic of its election to purchase "no less than three (3) Business Days prior to the related Purchase Date."[187] In other words, Elastic SPV must notify Republic at the time of origination if it will be purchasing the loans. While the actual purchase does not happen for three days,[188] Elastic SPV is already contractually obligated for the purchase. This means that Republic never has to loan without knowing if Elastic SPV will buy the participation interest. Moreover, if ESPV has purchased an interest in an initial advance to a borrower, it deemed to have agreed to purchase an interest in any Subsequent Advance.[189] For a revolving line of credit, this means that once $1 is advanced, Elastic will buy all subsequent advances. The original Rise participation agreement is not publicly available, only amendments thereto, but presumably it has similar terms.

### 4. *The Funding Agreements*

The final piece of Elevate's rent-a-bank structure involves the source of the funding for the loans. While the banks are the nominal lenders, the purchase of the participation interests makes the SPVs the real funders of the loans. Where do the SPVs get their money?

The SPVs are themselves nothing more than pass-through conduits used for bankruptcy remoteness purposes so that the investors in the SPV will not have to compete with Elevate's other creditors for rights in the participation interests in the event of Elevate's bankruptcy (hardly an impossibility in light of Think Finance's fate). The funding for the SPVs comes through a credit agreement with none other than the same entity that funded Think Finance—the Victory Park Capital hedge fund family. Specifically, Elastic SPV and EF SPV each have a loan facility with Victory Park Capital (multiple Victory Park Capital funds are lenders to each SPV). Those loan facilities are guaranteed by Elevate Credit, Inc. through a credit default protection agreement, such that any credit losses on the loans fall on Elevate Credit, Inc., in exchange for a fee.[190] In other words, the funding comes from Victory Park Capital,

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[186] Elastic Participation Agreement, § 2(a).

[187] *Id.* at § 2(b).

[188] Part of the purchase price is paid on the purchase date (the principal balance times the participation percentage), with the participation fee and purchase premium paid within 10 business days of the end of each calendar month. Elastic Participation Agreement, § 2(b). In other words, the *funding* of the loan comes from the Elastic SPV within three business days of the loan being made, while the payment to Republic Bank for participating the partnership is made on a monthly basis.

[189] Elastic Participation Agreement, § 2(a).

[190] Elevate Credit, Inc., Form 10-K (2019) at 135.

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but Victory Park Capital is taking on the credit risk of Elevate as a going concern, not the Elastic loans themselves. The SPV is just functioning to provide the investors with priority for the participation interest collateral through entity structuring. The funding of the SPVs is effectively a securitization of the participation interests in the subprime consumer loans done through a set of privately-placed notes.

### *E. Contractual Doublespeak*

Looking at the entirety of Elevate's relationships with Republic Bank and FinWise Bank, it is impossible to conclude that the banks play any meaningful role in the lending process. To be sure, they nominally retain the entire loan, but the sale of the participation interest shifts almost all of the credit risk to the Elevate SPVs. The banks play no meaningful role in the design of the products, in their marketing, in the underwriting of borrowers, or in the servicing of the loans. Instead, the only purpose of the banks in the products appears to be evasion of state usury laws. This is particularly clear with the Rise product, because Elevate offers the product directly in states where it can do so without running afoul of the state's usury laws. There is no obvious efficiency from adding in FinWise bank to the mix. To the contrary, adding in the bank partner only adds transaction costs and operational inefficiencies.

Elevate is clearly aware of the issue. In both the contracts and its annual report, Elevate takes pain to insist that that its bank partners maintain control over the entire product, even though it provides the marketing, the website, the technology platform, and the underwriting, funding, and servicing of the loans.[191] For example, Elevate states in its annual report:

> Under the terms of our agreement with Republic Bank, we provide them with marketing services related to the Elastic program and license them our website, technology platform and proprietary credit and fraud scoring models to originate and service Elastic customers. However, as originator of the Elastic lines of credit, Republic Bank reviews and approves all marketing materials and campaigns and determines the underwriting strategies and score cutoffs used in processing applications. In addition, Republic Bank defines all

[191] *See, e.g.*, Elastic Participation Agreement, § 19(e) ("RB and ESPV each acknowledge and agree that it is the intention of the Parties that RB is the sole lender with respect to the Accounts and the Receivables, and ESPV shall not assert that it is the lender of the Accounts and the Receivables in connection with any litigation, regulatory purpose or any other purpose."); Elevate Credit, Inc., 2019 10-K at 43. ("We do not originate and do not ultimately control the pricing or functionality of Elastic lines of credit originated by Republic Bank, Rise loans originated by FinWise Bank ('FinWise') and the Today Card originated by Capital Community Bank ('CCB') (collectively the 'Bank-Originated Products' and the 'Bank Partners' or the 'Banks')").

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> program parameters and provides full compliance oversight over all aspects of the program. [192]

This claim is hard to square with the automated nature of the underwriting and the black box nature of the underwriting software. Elevate brags that:

> Credit and fraud determinations are made in seconds and approximately 94% of loan applications for all products are fully automated with no manual review required, based on our proprietary credit and fraud scoring models and affordability assessments. Once approved, the customer is provided the loan amount and relevant terms of credit being offered. Of the approximately 6% of loan applications requiring manual review, in the US the majority require further documentation, which can be provided via scanning, fax, email or mail, others may have failed a fraud rule in the applicable underwriting methodology, and are managed based on the rule failed, and others are reviewed to address "know your customer" and/or [Office of Foreign Asset Control] requirements.[193]

This means that for 94% of loans, the bank has no real involvement in the underwriting decision. As we have seen, the underwriting criteria are proposed by Elevate (subject to the bank's approval), and the actual underwriting done automatically in almost all cases by the software licensed by Elevate to the bank. While that software should reflect the agreed-upon criteria, the software is contractually a black box to the bank.[194] As for the other 6% of cases, the underwriting is still automated through the black box software, but with manual document collection and data input. In other words, for all intents and purposes, the underwriting is all done by Elevate, even if it is the bank that presses the "go" button.

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[192] Elevate Credit, Inc., Form 10-K (2019) at 16 (Elastic, but also with parallel language regarding FinWise Bank and Rise).

[193] Elevate Credit, Inc., Form 10-K (2019) at 19. "As a result of our proprietary technology and risk analytics, approximately 94% of loan applications are automatically decisioned in seconds with no manual review required." *Id.* at 8.

[194] Amended and Restated License and Support Agreement, dated July 1, 205, by and between Republic Bank & Trust Company and Elevate Decision Sciences, LLC, § 4, https://content.edgar-online.com/ExternalLink/EDGAR/0001193125-15-371673.html?hash=949bb7318f6e6488cfa47b9c53666278efec432bfad757d790662bd149ebeb48&dest=D83122DEX106_HTM#D83122DEX106_HTM ("Licensee shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part…"); Technology and Support Agreement, § 4 ("FB shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part….") (p.708 of 10-K).

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Likewise, the structuring of the transactions as sales of participation interests seems designed to give Elevate a stronger basis for claiming that the banks are in fact the lender—after all, the loans remain on the banks' books the entire time. Indeed, from a consumer perspective, this arrangement seems potentially deceptive, as the consumer might reasonably believe that the bank was the real party in interest on the loans (and therefore that the applicable usury law was the one applicable to the bank, not to Elevate entities). There is no obvious reason why Elevate would in fact choose to use a participation purchase structure rather than an outright sale other than to strengthen its claim to shelter in the banks' regulatory status. A purchase of a participation interest in inherently a riskier investment than a purchase of a loan outright in part because the holder of the participation interest lacks the ability to control the loan completely. Elevate largely sides steps these risks via contract, but that is the point—the only reason to go to so much trouble creating an ersatz loan purchase is because an actual loan purchase would reduce Elevate's claim that the bank is the actual lender. Whether Elevate's state-of-the-art rent-a-bank structure holds up remains to be seen; Elevate has been sued by the District of Columbia for violation of the District's usury laws.[195]

There are two key take-aways here. First, this case study underscores the sophistication and deliberate design of rent-a-bank structures that have been undertaken with an eye to insulating the structures from legal challenges. And second, but for Elevate being a public reporting company, the details of its rent-a-bank arrangements, and even their very existence, could not be known from the outside. The use of a sale of participation interests, rather than a sale of the loans outright makes Elevate's involvement in the loans all but invisible. We will return to the significance of this point in the conclusion of the Article.

## IV. THREE COMPETING DOCTRINAL APPROACHES

Rent-a-bank transactions are all premised on the idea that the nonbank can shelter in the bank's exemption from state usury laws by virtue of being the bank's transferee by assignment or participation. Whether the nonbank of a loan from a bank can in fact step into the shoes of the bank for usury law purposes is a sharply disputed doctrinal question. It is a question that affects rent-a-bank transactions, but also potentially other transactions, particularly securitization, where loans are sold by bank sponsors to non-

[195] Complaint, District of Columbia v. Elevate Credit, Inc., 2020-CA-002697 (D.C. Superior Court, June 5, 2020).

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bank SPVs, and sales of defaulted debt from bank originators to nonbanks debt buyers.

This Part reviews the three different doctrinal approaches courts have taken to these transactions: (1) the valid-when-made rule, which holds that if a loan was not usurious in the hands of its originator, it cannot become usurious in the hands of a transferee; (2) the *Madden* rule, which holds that a nonbank transferee may not shelter in the bank's exemption from state usury laws; and (3) "true lender" doctrine, which applies the usury law to the party deemed the true lender in the circumstances of the transaction.

### *A. The "Valid-When-Made" Doctrine*

The legal viability of rent-a-bank schemes are premised on a doctrine called "valid-when-made." This doctrine holds that if a loan was not subject to a state usury law when it was made, it can never subsequently become so upon transfer. Thus, if a loan is made by a bank that is exempt from state usury laws by virtue of the National Bank Act of 1864 (NBA) or Federal Deposit Insurance Act (FDIA), the loan will remain exempt from state usury laws in the hands of a nonbank transferee that is not itself exempt from state usury laws.

Proponents of "valid-when-made" argue that it is a "well-established" common law doctrine that it is a "cardinal rule" of banking law and essential for the functioning of banking markets.[196] Specifically, they argue that the doctrine is necessary to protect bank liquidity[197] and to vindicate banks' powers to both charge interest and to sell loans.[198] Without the doctrine, its proponents argue, there is uncertainty about whether higher rate loans sellable, and the uncertainty can lead to inefficient pricing in secondary markets.[199]

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[196] Petition for Panel Rehearing and Rehearing *en Banc* by Defendant-Appellees, *Madden v. Midland Funding, LLC,* No. 14-12131-cv (2nd Cir. 2015) at 7-9; Brief of the Clearing House Association, L.L.C., Financial Services Roundtable, Consumer Bankers Association, and Loan Syndication and Trading Association, as *Amici Curiae* in Support of Rehearing and Rehearing *en Banc*, *Madden v. Midland Funding, LLC,* No. 14-12131-cv (2nd Cir. 2015) at 5-6; Brief of the Structure Finance Industry Group, Inc. and the Securities Industry and Financial Markets Association as *Amici Curiae* in Support of Defendants-Appellees' Petition for Rehearing and Suggestion for Rehearing *en Banc*, *Madden v. Midland Funding, LLC,* No. 14-12131-cv (2nd Cir. 2015) at 8-9.

[197] *See, e.g.*, 85 Fed. Reg. 33530, 33532-33 (Jun 2, 2020); 85 Fed. Reg. 44146, 44149, 44151 (July 22, 2020).

[198] Reply in Support of Motion to Dismiss by Defendants Chase Card Funding LLC, Chase Issuance Trust, and Wilmington Trust Company, Petersen v. Chase Card Funding, LLC, No. 19-cv-00741 (W.D.N.Y. Oct. 8, 2019) at 8.

[199] *See, e.g.*, Marvin, *supra* note at 43 at 1839-40.

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Valid-when-made proponents further argue that the doctrine was incorporated into section 85 the NBA,[200] the interest rate exportation provision for national banks, because it was part of the common law background against which that statute was written.[201] They further claim that it is incorporated into section 1831d of the FDIA,[202] which preempts state usury laws for state-chartered banks, because FDIA section 1831d is patterned on section 85 the NBA and is read *in pari materia* with the NBA.[203] Section 1831d of the FDIA was enacted in 1980 as part of the Depository Institutions Deregulation and Monetary Control Act of 1980.[204]

Proponents of valid-when-made also argue that the doctrine follows from the common law of contracts because the assignee of a contract takes all the contractual rights of an assignor, so that a nonbank transferee merely steps into the shoes of a bank from which it acquires a loan and accedes to all the bank's rights and privileges, including exemption from state usury laws.[205]

The "valid-when-made" doctrine was endorsed by the Solicitor General's office and the Office of Comptroller of the Currency (OCC), the regulator of national banks, in a brief opposing granting a writ of *certiorari* litigation.[206] The doctrine was subsequently endorsed by OCC and FDIC in another amicus brief.[207] In 2020, the OCC and FDIC codified the doctrine in a pair of non-uniform rulemakings.[208]

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[200] 12 U.S.C. § 85.

[201] *See* 85 Fed. Reg. 33530, 33532 (June 2, 2020); Structured Finance Association and Bank Policy Institute, Comment Letter to FDIC on Proposed Rule on Federal Interest Rate Authority, RIN 3064-AF21, Feb. 4, 2020, *at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-043.pdf* at 4. *See also* Astoria Fed. Sav. & Loan Ass'n v. Solimino, 501 U.S. 104, 108 (1991) (noting a presumption that Congress legislates in light of the common law); SCA Hygiene Prods. Aktiebolag v. First Quality Baby Prods., LLC, 137 S. Ct. 954, 966 (2017) (discussing the "presumption that Congress legislates against the background of general common-law principles").

[202] 12 U.S.C. § 1831d.

[203] *See* Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 827 (1st Cir. 1992); Brief Amicus Curiae of the FDIC and the OCC, *In re Rent-Rite Superkegs West Ltd. v. World Business Lenders, LLC,* 2019 WL 4569774 (D. Colo. Sept. 10, 2019) at 5-6 (hereinafter "FDIC/OCC Amicus Brief").

[204] P.L. 96-221, § 521.

[205] FDIC/OCC Amicus Brief at 14-16.

[206] The Solicitor General opposed a grant of certiorari on the grounds that the case was not a good vehicle, but still held that it was wrongly decided. Brief for the United States as Amicus Curiae, *Midland Funding, LLC v. Madden*, 2016 WL 2997343 (S. Ct. 2016) (jointly filed by the Solicitor General and the Office of the Comptroller of the Currency)

[207] FDIC/OCC Amicus Brief.

[208] 85 Fed. Reg. 33530 (June 2, 2020) (OCC final rule on Permissible Interest on Loans

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The OCC rule provides that "interest on a loan that is permissible under [the National Bank Act] shall not be affected by the sale, assignment, or other transfer of the loan."[209] In other words, for national banks, the OCC rule provides that section 85 of the National Bank Act applies to a loan even if it has been transferred to a non-bank. The FDIC rule in contrast, purports to clarify the timing for evaluating an interest rate for purposes of the FDIA by providing that whether interest on a loan is permissible under the FDIA "is determined as of the date the loan was made" and is not affected by "the sale, assignment or other transfer of the loan, in whole or in part."[210] Both the OCC and FDIC rules have been challenged by state attorneys general.[211]

### *B. The Madden Rule*

An alternative approach to the application of state usury laws to a nonbank assignees of a bank emerged in 2015 in the Second Circuit's decision in *Madden v. Midland Funding.*[212] *Madden* involved a putative class action brought against a nonbank debt buyer, Midland Funding, for violation of New York's usury law.[213] Midland had purchased the defaulted credit card debt of named plaintiff Saliha Madden from FIA Card Services, N.A., a national bank subsidiary of Bank of American, N.A., another national bank.[214] Madden was a New York resident.[215] The debt had an annual interest rate of 27% and purported to be governed by Delaware law.[216] Delaware allows credit card debt to have whatever interest rate is agreed upon contractually,[217] whereas New York has a 16% usury cap.[218] After Midland attempted to collect the debt of approximately $5,000 from Madden, she brought suit for violation of New York's usury law and the federal Fair Debt Collection Practices Act.[219]

That Are Sold, Assigned, or Otherwise Transferred); 85 Fed. Reg. 44146 (July 22, 2020) (FDIC final rule on Federal Interest Rate Authority).

[209] 12 C.F.R. § 7.4001(e). *See also* 12 C.F.R. § 160.110(d) (identical regulation for federal savings associations).

[210] 12 C.F.R. § 331.4(e).

[211] Complaint, California *ex rel.* Becerra v. FDIC, No. 20-5860 (N.D. Cal. Aug. 20, 2020); Complaint, California *ex rel.* Becerra v. OCC, No. 20-5200 (N.D. Cal. July 29, 2020).

[212] 786 F.3d 246 (2d Cir. 2015).

[213] *Id.* at 247.

[214] *Id.* at 248.

[215] *Id.* at 247.

[216] *Id.* at 248.

[217] 5 DEL. CODE § 943.

[218] The Second Circuit cites New York's 25% annual rate for criminal usury. *Id.* (citing N.Y. PENAL L. § 190.40). The civil usury rate applicable to a bank in New York is 16% annually. N.Y. GEN. OBLIG. L. 5-501; N.Y. BANKING L. 14-A.

[219] 786 F.3d at 248.

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The District Court held that the National Bank Act would preempt any usury claim against Midland, the nonbank debt buyer,[220] but on appeal, the Second Circuit reversed,[221]

> [b]ecause neither defendant is a national bank nor a subsidiary or agent of a national bank, or is otherwise acting on behalf of a national bank, and because application of the state law on which Madden's claim relies would not significantly interfere with any national bank's ability to exercise its powers under the NBA….[222]

For NBA preemption to apply to a non-national bank the Second Circuit held, the application of state law must "significantly interfere with a national bank's ability to exercise its power under the NBA."[223] This "significantly interfere" standard comes from the Supreme Court's decision in *Barnett Bank of Marion County, N.A. v. Nelson*,[224] which was subsequently codified by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[225] While "it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states" the Second Circuit held that such an effect was not a significant interference with national bank powers.[226]

### *C. Anti-Evasion and "True Lender" Doctrine*

The valid-when-made rule and the *Madden* rule are both bright line rules. Whereas valid-when-made looks solely at the originator of the loan, *Madden* looks instead to the identity of the party holding the loan. Many courts, however, have eschewed such bright line rules and instead adopted a standard known as "true lender" doctrine that determines the application of usury law based on which party has the real economic interest in the loan.

True lender doctrine has its roots in a long-standing anti-evasion principle in usury law. Historically, courts would look through the form of a transaction to its substance to determine if the form is but a mere contrivance to evade usury laws.[227] As the Supreme Court noted in 1835:

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[220] *Id.* at 247.

[221] *Id.*

[222] *Id.* at 247.

[223] *Id.* at 249, 250.

[224] 517 U.S. 25 (1996).

[225] Pub. L. 111-203, § 1045, 124 Stat. 1376 (July 21, 2010), *codified at* 12 U.S.C. § 25b(b)(1)(B).

[226] 786 F.3d at 251.

[227] *See, e.g.,* Whitworth & Yancey v. Adams, 26 Va. 333, 337-338 (Va. 1827) ("the only question in all [usury] cases like the present is, what is the real substance of the transaction, not what is the colour and form."); Scott v. Lloyd, 34 U.S. 418, 419 (1835); Andrews v. Pond,

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> The ingenuity of lenders has devised many contrivances by which, under forms sanctioned by law, the statute may be evaded….Yet it is apparent that if giving this form to the contract will afford a cover which conceals it from judicial investigation, the statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction. If that be in fact a loan, no shift or device will protect it.[228]

Likewise, the Georgia Supreme Court noted in 1887:

> No disguise of language can avail for covering up usury, or glossing over an usurious contract. The theory that a contract will be usurious or not according to the kind of paper bag it is put up in, or according to the more or less ingenious phrases made use of in negotiating it, is altogether erroneous. The law intends that a search for usury shall penetrate to the substance.[229]

38 U.S. 65, 76 (1839) ("But although the transaction, as exhibited in the account, appears on the face of it to have been free from the taint of usury, yet if the ten per cent. charged as exchange, or any part of it, was intended as a cover for usurious interest, the form in which it was done, and the name under which it was taken, will not protect the bill from the consequences of usurious agreements…"); Wetmore v. Brien & Bradley, 40 Tenn. 723, 727 (Tenn. 1859) (" But if the note were made for the purpose of being sold, to raise money, or as an artifice to evade the usury laws, under the color of a sale and purchase of the paper, this will not avail; and the purchaser, under such circumstances, with knowledge of the facts, either actual, or inferable from the facts of the case, will be held guilty of usury, if the discount shall have been greater than the legal rate of interest."); Missouri, Kansas & Texas Trust Co. v. Krumseig, 172 U.S. 351, 355-356 (1899) ("[T]he question always is whether it was or was not a subterfuge to evade the laws against usury."); Seeman v. Phila. Warehouse Co., 274 U.S. 403, 408 (1927) ("the form of the transaction must not 'disguise its real character.'"); Sachs v. Ginsberg, 87 F.2d 28, 30 (D.C. Cir. 1936) ("It was the duty of the trial court to look beyond the form of the contract and to determine the exact nature of the transaction, and, if found to be a loan and usurious, to bring it within the terms of the statute, no matter how righteous the cloak of formality which was used to conceal its real character.").

[228] Scott v. Lloyd, 34 U.S. 418, 419 (1835).

[229] Pope v. Marshall, 78 Ga. 635, 640 (Ga. 1887). *See also* Crim v. Post, 41 W.Va. 397 (W.V. 1895) (syllabus by the Court) ("The usury statute contemplates that a search for usury shall not stop at the mere form of the bargains and contracts relative to such loan, but that all shifts and devices intended to cover a usurious loan or forbearance shall be pushed aside, and the transaction shall be dealt with as usurious if it be such in fact."); First Nat'l Bank v. Phares, 174 P. 519, 521 (Okla. 1918) ("In deciding whether any given transaction is usurious or not, the courts will disregard the form which it may take, and look only to the substance of the transaction in order to determine whether all the requisites of usury are present…. If all these requisites are found to be present, the transaction will be condemned as usurious, whatever form it may assume and despite any disguise it may wear."); Bank of Lumpkin v. Farmers' State Bank, 161 Ga. 801, 807 (Ga. 1926) (syllabus by the Court) ("The ingenuity of man has not devised a contrivance by which usury can be legalized . . . . [F]or the name by which the

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As the *Ruling Case Law* treatise summed up:

> The cupidity of lenders, and the willingness of borrowers to concede whatever may be demanded or to promise whatever may be exacted in order to obtain temporary relief from financial embarrassment, as would naturally be expected, have resulted in a great variety of devices to evade the usury laws; and to frustrate such evasions the courts have been compelled to look beyond the form of transaction to its substance, and they have laid it down as an inflexible that mere form is immaterial, but that it is the substance which must be considered.[230]

Numerous state supreme courts have adopted similar statements.[231]

This anti-evasion principle has been reanimated in a string of modern cases dealing with rent-a-bank or rent-a-tribe situations under the name of "true lender" doctrine, in that these cases attempt to determine which entity was the "true lender" for the purposes of determining which usury laws apply.[232]

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transaction is denominated is altogether immaterial if it appears that a loan of money was the foundation and basis of agreement which is under consideration."); Anderson v. Hershey, 127 F.2d 884, 886 (6th Cir. 1942) (finding district court correctly determined that bank's requirement that plaintiff "purchase the non-interest-bearing certificate of deposit was a device on the part of the bank to collect usury …. The courts of Kentucky in usury cases look behind the form of the transaction to its substance (*Hurt v. Crystal Ice & Cold Storage Co.*, 215 Ky. 739, 286 S.W. 1055)"); Jackson v. Comm. Credit Corp., 90 Ga. App. 352, 355 (Ga. Ct. App. 1954); Daniel v. First Nat'l Bank of Birmingham, 227 F.2d 353, 355, 357 (5th Cir. 1956) ("Usurious contracts are condemned by public policy both state and national Code of Alabama …. That public policy cannot be defeated by the simple expedient of a written contract, but the real substance of the transaction must be searched out.").

[230] 27 RULING CASE LAW 211 (1920).

[231] *See, e.g.*, Barry v. Paranto, 97 Minn. 265, 267 (Minn. 1906) ("It is elementary that no device or scheme intended for the purpose of evading the laws against usury will prevent the courts from giving force to the statute and declaring contracts made in violation thereof null and void."); Fidelity Sec. Corp. v. Brugman, 137 Ore. 38, 50 (Ore. 1931) ("The courts do not permit any shift or subterfuge to evade the law against usury. The form into which parties place their transaction is unimportant. Disguises are brushed aside and the law peers behind the innocent appearing cloaks in quest for the truth.") Beacham v. Carr, 122 Fla. 736, 742-743 (Fla. 1936) (quoting 27 R.C.L. 211) Milana v. Credit Discount Co., 27 Cal. 2d 335, 340 (Cal. 1945) ("The courts have been alert to pierce the veil of any plan designed to evade the usury law and in doing so to disregard the form and consider the substance."); Austin v. Ala. Check Cashers Ass'n, 936 So. 2d 1014, 1031 (Ala. 2005) (quoting *Hurt v. Crystal Ice & Cold Storage Co.*, 215 Ky. 739, 286 S.W. 1055, 1056-57 (Ky. Ct. App. 1926), which in turn cited 27 R.C.L. 211).

[232] Goleta Nat'l Bank v. O'Donnell, 239 F. Supp. 2d 745 (S.D. Ohio 2002); Goleta Nat'l Bank v. Lingerfelt, 211 F. Supp. 2d 711 (E.D.N.C. 2002).

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The anti-evasion principle was codified in the 2004 Georgia Payday Lending Act, which, responding to rent-a-bank payday lending[233] included a provision that prohibited:

> Any arrangement by which a de facto lender purports to act as the agent for an exempt entity. A purported agent shall be considered a de facto lender if the entire circumstances of the transaction show that the purported agent holds, acquires, or maintains a predominant economic interest in the revenues generated by the loan.[234]

The Georgia Court of Appeals subsequently held that a payday lender could be liable for violating the usury laws through a rent-a-bank transaction.[235] Subsequently, numerous courts have adopted a similar position, whether in the context of a complete preemption analysis for removal purposes or substantive preemption in a merits ruling.[236] Thus, when determining whether New York law applied to a payday lender in a rent-a-bank arrangement, the New York Supreme Court's Appellate Division noted that:

> we must look to the reality of the arrangement and not the written characterization that the parties seek to give it, much like Frank Lloyd Wright's aphorism that "form follows function." Thus, an examination of the totality of the circumstances surrounding this type of business association must be used to determine who is the "true lender," with the key factor being "who had the predominant economic interest" in the transactions.[237]

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[233] OCGA § 16-17-1(c) (noting "The General Assembly has determined that various payday lenders have created certain schemes and methods in order to attempt to disguise these transactions or to cause these transactions to appear to be "loans" made by a national or state bank chartered in another state in which this type of lending is unregulated, even though the majority of the revenues in this lending method are paid to the payday lender.").

[234] OCGA § 16-17-2(b)(4), *upheld by BankWest, Inc. v. Baker*, 411 F.3d 1289, 1293 (11th Cir. 2005), *vacated and appeal dismissed as moot*, 446 F.3d 1358 (11th Cir. 2006) (per curiam). Some have claimed that the true lender doctrine originates with the Georgia statute, John D. Skees, *Comment: The Resurrection of Historic Usury Principles for Consumption Loans in a Federal Banking System*, 55 CATH. U.L. REV. 1131, 1154 (2006); John Hannon, *Note: The True Lender Doctrine: Function over Form as a Reasonable Constraint on the Exportation of Interest Rates*, 67 DUKE L.J. 1261, 1280 (2018), the existence of a pair of true lender cases from two years prior to the statute, *see supra* note 207, plus Georgia's well developed jurisprudence on disguised usury, *see supra* note 204, suggests that the statute was reflective of an established doctrine, rather than the origin of the doctrine. Indeed, the Georgia court of appeals applied the doctrine to a transaction that took place before the enactment of the statute, implying a common law "true lender" doctrine that had merely been codified. Ga. Cash Am. v. Greene, 318 Ga. App. 355, 361-362 (Ga. Ct. App. 2012).

[235] Ga. Cash Am. v. Greene, 318 Ga. App. 355, 361-362 (Ga. Ct. App. 2012).

[236] *See supra* note 22 (listing cases).

[237] *Matter of People of State of New York v. County Bank of Rehoboth Beach, Del.*, 45 A.D.3d 1136, 1138 (N.Y. App. Div. 3d Dept. 2007).

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While "true lender" is often defined with reference to predominant economic interest, it is ultimately a totality-of-the-circumstances inquiry about which party is the serving as the lender, and no court has attempted to articulate an exclusive list of factors or their weights, much less whether any particular factor is determinative. Notably, only a few courts have outright rejected true lender doctrine,[238] and even some of the cases that are cited in favor of "valid-when-made" indicate that the analysis would be different if a true lender allegation had been made,[239] while another key case cited as support for "valid-when-made" actually engages in something akin to a true lender analysis.[240]

Under valid-when-made, usury laws do not apply to nonbanks in rent-a-bank transactions. In contrast, under the *Madden* rule, the nonbank would be subject to state usury laws only if it purchased the loans outright, while under true lender doctrine irrespective of how the transaction were structured.

## V. THE SPURIOUS PEDIGREE OF "VALID-WHEN-MADE"

### A. *The Purported Historicity of Valid-When-Made*

The legal viability of rent-a-bank transactions stands on the valid-when-made doctrine. A central claim made by proponents of the "valid-when-made" doctrine is that it is a "well-established and widely accepted" common law doctrine that is a "cardinal rule" of banking law endorsed by multiple Supreme Court decisions.[241] By virtue of being part of the common law, the doctrine was supposedly incorporated into section 85 of the National Bank Act of 1864 and thus again into section 1831d of the Federal Deposit

[238] Beechum v. Navient Solutions, Inc., 2016 U.S. Dist. LEXIS 129782, at *18 (C.D. Cal. Dec. 20, 2016); Sawyer v. Bill Me Later, Inc., 23 F. Supp. 3d 1359 (D.Utah 2014); Hudson v. ACE Cash Express, Inc., 2002 U.S. Dist. LEXIS 11226 (S.D. Ind. 2002).

[239] *See* Nichols v. Fearson, 32 U.S. 103, 106 (1833); Federal Deposit Ins. Corp. v. Lattimore Land Corp., 656 F.2d 139, 148 n.15 (5th Cir. 1981).

[240] Krispin v. May Dep't Stores Co., 218 F.3d 919, 924 (8th Cir. 2000).

[241] *See, e.g.*, FDIC/OCC Amicus Brief at 10. It is also worth noting that the "valid when made" doctrine is a federal common law. This would seem to create a problem for the doctrine. The Supreme Court made clear in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), federal courts lack a judicial power to create general federal common law regarding state law claims when sitting in diversity jurisdiction. Usury claims are state law claims, so to the extent that jurisdiction exists based on diversity, there is no basis for federal courts extending a common law rule. Jurisdiction might be federal question jurisdiction based on section 85 the National Bank Act of 1864 (NBA), 12 U.S.C. § 85, and section 1831d the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), 12 U.S.C. § 1831d, but neither statute can support as broad of a doctrine as "valid-when-made". Instead, any federal common law under either statute would have to be confined to the scope of the statute.

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Insurance Act, which was enacted in 1980, because that provision is patterned on the National Bank Act.

The valid-when-made doctrine's supposed historicity is critical for the claim that the doctrine is essential to the smooth functioning of credit markets and bank liquidity, as well as claims of justified reliance on the doctrine in secondary market pricing. The doctrine's deep historical roots have been claimed by the Solicitor General's Office,[242] the OCC and FDIC,[243] as well as various white-shoe law firms representing major financial institutions,[244] and trade associations,[245] and have been endorsed sua sponte by a federal bankruptcy court, as well as accepted by much of the scholarly literature.[246]

This Part probes the doctrine's purported historicity through a close examination of the historical cases on which the doctrine supposedly rests. These cases considered are those cited by the OCC and FDIC in their rulemakings and an amicus brief in a bankruptcy appeal, and cited by trade associations, the OCC, and Solicitor General in the *Madden* litigation. They include a bevy of 19th century cases, a handful of 20th century cases, and a series of 21st century cases. An examination of these cases and other sources shows that the valid-when-made doctrine is utterly lacking in historical roots. The doctrine was unknown to American law until the 21st century. The historical sources that supposedly support the doctrine are in fact dealing with an entirely different transactional issue that is unfamiliar to most contemporary lawyers, who have relied on decontextualized quotations from historical cases to claim a historical pedigree for a doctrine that fits their policy preferences.

### *B. Impossibility of Valid-When-Made Before 1864*

As an initial matter, the claim that valid-when-made was part of the common law background of the National Bank Act runs into the problem that the doctrine could not possibly have existed prior to the enactment of the NBA in 1864 because there was no situation in which it could have arisen.

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[242] *See supra* note 181.

[243] *See* FDIC/OCC Amicus Brief.

[244] *See, e.g.*, Sullivan & Cromwell LLP, *supra* note 52; Davis Polk, *supra* note 52;

[245] *See, e.g.*, Marketplace Lenders Association, Comment Letter to OCC on "Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred," Docket ID No. OCC-2019-0027; RIN 1557-AE73 at 2 (undated), *at https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-042.pdf;* Structured Finance Association and Bank Policy Institute, Comment Letter to FDIC on "Federal Interest Rate Authority," RIN 3064-AF21, Feb. 4, 2020, https://www.fdic.gov/regulations/laws/federal/2019/2019-federal-interest-rate-authority-3064-af21-c-043.pdf, at 3 (noting "centuries-old fundamental market expectations").

[246] *See supra* note 43.

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Prior to the NBA, state usury laws applied to all entities equally, with choice of law rules limited by an anti-evasion principle.[247] Therefore, it was not possible prior to 1864 for a loan to be non-usurious in the hands of a bank, yet be usurious in the hands of a nonbank assignee merely by virtue of an assignment. This alone should indicate that all of the *antebellum* cases on which the doctrine supposedly rests (considered in more detail in the next section) in fact have nothing to do with the issue and that the "valid-when-made" doctrine could not be background law against which the NBA was enacted.

### *C. Pre-1979 "Valid-When-Made" Cases*

Turning to the cases themselves, the valid-when-made doctrine is not mentioned as such in any case until 2019.[248] The first case actually consistent with the doctrine only appears in 1979,[249] but it qualifies itself with an anti-evasion principle. Cases clearly consistent with a valid-when-made doctrine can only begin to be observed in the 2000s. In other words, cases clearly consistent with the doctrine do not emerge until twenty years after the enactment of the FDIA's interest rate exportation provision.

So what are the historical cases claimed to support the doctrine actually about? The historical cases are actually dealing with three different problems in the law of usury that relate to the question of how to calculate the interest rate on a loan, not the question of what usury law applies to the loan. These cases are dragooned into support for "valid-when-made" and the associate deregulatory policy agenda through selective, decontextualized quotations, but when seen in context, none of the historical cases support the claimed doctrine.

The historical (pre-1979) cases address three issue patterns:

(1) The "payment option" pattern, dealing with the effect of the exercise of a payment option by the borrower on the calculation of the interest rate on a loan. These cases do not even necessarily involve an assignment of the loan, underscoring that they are not about a valid-when-made issue whatsoever;

(2) The "discounted assignment" pattern, dealing with the effect of a discounted assignment on the calculation of the interest rate on a loan. The question in these cases is whether the discounted price paid by the assignee may be treated as imputed interest on the loan

[247] Miller v. Tiffany, 68 U.S. 298, 308 (1864).

[248] Rent-Rite SuperKegs W., Ltd. v. World Bus. Lenders, LLC (*In re* Rent-Rite SuperKegs W., Ltd.), 603 B.R. 41, 66 (Bankr. D. Colo. 2019).

[249] Strike v. Trans-West Discount Corp., 92 Cal.App.3d 735, 745 (Cal. Ct. App. 4th Dist. 1979).

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and thus added to the loan's stated interest rate when determining if the loan is usurious; or

(3) The "cleansing assignment" pattern, dealing with the effect of a valid assignment on a usurious loan. This pattern is the reverse transaction of what is at stake with valid-when-made.

Each of these patterns is reviewed in turn.

*1. Effect of Debtor's Payment Option*

Many of the cases that are cited in support of "valid-when-made" fit the "option" pattern regarding the effect of the debtor's exercise of an option on the calculation of the interest rate being charged on the loan. The idea in all of these cases is that there is a stated interest rate on the loan, but the effective interest rate charged—the charges as a percentage of principal balance—changes upon the exercise of an option. The issue in these cases is whether the exercise of the option should be considered in determining if the loan is usurious.

The type of option involved in these cases varies. Sometimes the option in these cases is for prepayment, sometimes it is for late payment, and sometimes it is an option regarding the form of payment. Significantly, these cases generally do not even involve assignments of the loan, and when they do, the fact of the assignment is irrelevant to the holding. None of the option pattern cases deal with the question of whether an assignee may shelter in an assignor's statutory exemption from state usury laws.

Thus, in *Tate* v. *Wellings*, one of the oldest cases cited in support of the "valid-when-made" doctrine, an English decision from the King's Bench, the court opined on the effect on the usury calculation of a loan of stock that was repayable in stock or cash at the borrower's option.[250] Similarly, in *Unity Plan Finance Co. v. Green*, the Louisiana Supreme Court was addressing the effect on the calculation of the interest from the acceleration of a debt that the debtor had failed to repay on time.[251]

Late payment is in effect an option to default.[252] Whether late payment penalties are to be included in the calculation of interest is an issue that has arisen in multiple cases, with courts consistently holding that late fees are not

[250] 100 Eng. Rep. 716, 721 (K.B. 1790) (Buller, J. seriatim).

[251] 155 So. 900, 905 (La. 1934).

[252] *See* O.W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) ("The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, — and nothing else."). Damages are merely the "strike price" for exercising the default option.

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part of the interest rate calculation if the debtor controlled the timing of payment.[253]

Other types of payment options have been treated similarly. For example, in *Zang v. Schumann*, the Wisconsin Supreme Court held that a borrower's exercise of an option to pay an extra premium to be relieved from a lease was not to be considered in the calculation of the interest rate.[254] The payment option pattern also includes cases dealing with whether the value of a non-optional discounted stock sale accompanying the loan should be included in the interest for the loan,[255] whether an optional prepayment should effect the calculation of the interest rate.[256] What should be clear is that none of these cases have anything to do with "valid-when-made" in the sense of whether a nonbank assignee may shelter in a bank assignor's exemption from state usury laws.

*2. Effect of Usury in Transaction #2 on Transaction #1*

The second common fact pattern in the cases relied upon for support of "valid-when-made" involves two separate transactions. The question in these cases is whether usury in transaction #2 could be imputed to transaction #1. As with the option cases, the issue here has nothing to do with the question of what jurisdiction's usury law applies to the note, but merely about whether rate on the note exceeds the usury cap.

Several of the two-transaction cases relate to the discounting of notes and bills of exchange. To understand these cases, it is important to understand how a discounting transaction works. While such transactions are rare today, they were the centerpiece of the 18th and early 19th century commercial system, which was based on a robust secondary market in bills (payment orders) and notes (payment promises). In this secondary market, bills and notes were frequently sold at a discount from their face amount, but with the seller guarantying the note through indorsement.[257]

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[253] *FDIC v. Tito Castro Constr.*, 548 F. Supp. 1224, 1227 (D.P.R. 1982) ("it was only as a consequence of defendant's election to delay in repaying the principal amount of those [demand] notes that an effective rate of interest in excess of the Puerto Rico statutory ceiling may have resulted."); *Rangen, Inc. v. Valley Trout Farms, Inc.*, 658 P.2d 955, 959 (Id. 1983) (effect on usury calculation of a fee for late payment option); *Southwest Concrete Products. v. Gosh Construction Corp.*, 51 Cal.3d 701, 708 (Cal. 1990) ("a transaction that was not usurious at its inception cannot become usurious by virtue the debtor's voluntary default.").

[254] 262 Wis. 570, 577-579 (Wisc. 1952).

[255] *First Nat'l Bank v. Danek*, 556 P.2d 31, 34 (N.M. 1976).

[256] *Saul v. Midlantic Nat'l Bank*, 572 A.2d 650, 658 (N.J. App. Div. 1990); *Hoffman v. Key Federal Sav. and Loan Ass'n*, 416 A.2d 1265, 1269 (Md. 1979) ("[t]he virtually universal rule is that a contract legal at its inception will not be rendered usurious by voluntary prepayment.").

[257] Indeed, the National Bank Act does not itself expressly authorize banks to sell loans,

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At first blush, a discounting transaction may appear to be little more than the sale of the note with a discount reflecting the possibility of nonpayment by the obligor or indorser. As a practical, matter, however, a discounting transaction is actually more akin to a loan from the buyer to the seller, collateralized by the possibility of enforcing the note against its original maker.

For example, suppose that the seller Sally holds a $120 note, due in one year, from obligor Owen. Sally discounts the note to buyer Billy for $100, meaning that she sells Billy the note, which she has indorsed. While Billy has only paid $100 for the note, he has a right in one year to collect the full $120 face amount of the note from either Owen, the obligor, or Sally, the indorser.

Let's suppose that it is Sally who pays on the note.[258] If so, she has paid $120 in exchange for having had use of $100 for one year. That is equivalent to Billy having loaned Sally $100 dollars for one year at a 20% interest rate. To be sure, if Sally pays on the note, she can turn around and try to collect the $120 she paid from Owen, who might be insolvent, but that's her problem, not Billy's.[259]

Because discounting can effectively be a loan, it can also be usurious. Indeed, reflecting this concern, section 85 of the National Bank Act covers not just usurious loans, but usurious discounting as well.[260] Although this sort of discounting transaction has largely disappeared from commercial use,[261] the idea of a discount being treated as imputed interest is still regularly applied today in the tax and bankruptcy law, where "original issue discount" on bonds is treated as imputed interest.[262]

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only to discount them, which historically meant guarantying their payment. 12 U.S.C. § 24(Seventh).

[258] If Billy collects from Owen, then Sally's indorser liability is discharged. She will have had use of $100 for 30 days with no charge.

[259] This sort of discounting transaction was common in the 18th and 19th centuries before the introduction of national paper currency. Transactions in coin were impractical, so private payment obligations and orders were used as a circulating medium by means of indorsement. This explains why Billy would seek to collect from Sally, rather than from Owen, the original obligor on the note. Billy likely has no idea who Owen is. In the discounting transaction, Owen's identity, much less solvency, is of scant consequence to Billy, because he has given Sally the $100 on the basis of *her* credit quality, not Owen's. The ability to pursue Owen gilds the lily.

[260] 12 U.S.C. § 85 . *See also* Dillard v. First Nat'l Bank of Birmingham, 227 F.2d 353, 355-356 (5th Cir. 1955), *reh'g denied with* opinion, 228 F.2d 803 (5th Cir. 1956) (addressing whether a discount was usurious).

[261] The discounted sale as a financing is a kissing cousin of the repo (sale and repurchase agreement) that is the financing mechanism of choice in wholesale financial markets.

[262] *See, e.g.*, Treas. Reg. § 1.61-7(c); *In re Chateaugay Corp.*, 961 F.2d 378 (2d Cir. 1992);

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Notice that in the example above that there were two separate loans: (1) a loan someone made to Owen, evidenced by his note, and (2) the loan from Billy to Sally through the discounting transaction, for which Owen's note was merely the collateral. Does the interest rate on Billy's loan to Sally affect the interest rate on the separate loan to Owen? Owen, after all, remain remains liable on the note, so that Billy can seek to collect from him or Sally.

There are two ways to look at the transaction. From Owen's perspective, the fact of the subsequent discounting transaction changes nothing. He still owes the principal and interest he originally agreed to pay and nothing more. Suppose that Owen's note has a stated 10% annual interest rate and that the usury cap was 15%. From Owen's perspective, all he is liable for is the $120 principal of the note plus one year of 10% interest, or $132 total. The interest rate of 10% is nonusurious.

From Billy's perspective, however, it is as if Owen is liable for $100 principal plus the imputed (usurious) interest from the $20 discount plus the $12 in interest from the face of the note. Instead of there being merely $12 in interest, there is $32, from Billy's perspective, rending the real interest rate on the note 32%, well above the usury cap.

The issue that the second transaction pattern deals with is whether the fact of the discounting being usurious affects the interest rate on Owen's note. It would only be so if it is seen from Billy's perspective, not Owen's. This situation has nothing to do with the question of what usury law applies. Instead, it is a question of calculation of the interest rate.

That is exactly the issue in a trio of early state court cases, *Munn v. Comm'n Co.*,[263] *Knights v. Putnam*,[264] and *Tuttle v. Clark*,[265] cited by valid-when-made

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*Matter of Pengo Indus. Inc.*, 962 F.2d 543 (5th Cir. 1992). Under tax and bankruptcy law, secondary market discounts are not treated as imputed interest, however, only discounts at issuance.

[263] 15 Johns. 44, 55 (N.Y. Sup. Ct. 1818) ("The principle is too well settled to be questioned, that a bill, free from usury, in its concoction, may be sold at a discount, by allowing the purchaser to pay less for it than it would amount to at the legal rate of interest, for the time the bill has to run. The reason is obvious: as the bill was free from usury, between the immediate parties to it, no after transaction with another person can, as respects those parties, invalidate it."). [Cited in SFA and BPI Comment Letter to OCC at 4, n.4.]

[264] 20 Mass. 184, 185 (Mass. 1825) ("a note, valid in its inception, may be recovered against the maker, by an indorsee, although discounted by him at a rate exceeding legal interest. It is a well established principle, that if a note or security is valid when made, no usurious transaction afterwards between the parties or privies will affect its validity."). [Cited in SFA and BPI Comment Letter to OCC at 4, n.4.].

[265] 4 Conn. 153, 157 (1822) (the note "not being usurious in its original concoction, did not become so, by the subsequent [discounted] sale to the plaintiffs"). [Cited in FDIC/OCC Amicus Brief and in SFA and BPI Comment Letter to OCC at 4, n.4.]

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proponents as supposed support for the doctrine.[266] The first two cases deal with the effect of a usurious discounting on the validity of the original note, which *Tuttle* involved whether a discounted sale of a note would be treated as a loan (giving rise to the imputed interest problem) or a sale (avoiding the imputed interest problem).[267] These cases' holdings that the usurious discount did not affect whether the original note was usurious have nothing to do with the question of whether a nonbank may piggyback on the unique exemption of banks from state usury laws. The cases are wholly inapposite for the proposition for which valid-when-made proponents claim they support.

Similarly, *Gaither v. Farmers' & Mechanics' Bank of Georgetown* involved a non-usurious note that was pledged by the payee as collateral for an unrelated, usurious loan.[268] The Supreme Court observed that:

> [T]he rule cannot be doubted, that if the note free from usury, in its origin, no *subsequent usurious transactions respecting it*, can affect it with the taint of usury.[269]

The point here is that usury in transaction #2 does not impute usury to unconnected transaction #1. The use of a non-usurious note as collateral for a usurious loan does not render the collateral note usurious. *Gaither* had nothing to do with the supposed "valid-when-made" doctrine that a "promissory note originated by a state bank with a non-usurious interest rate" by virtue of a federal banking statute cannot "be transformed into a usurious promissory note by virtue of assignment to a nonbank entity".[270] Again, as in *Tuttle,* the interest charged on transaction #1 continued to be charged at a rate that would have been legal had the assignee made the loan directly, whereas the valid-when-made situation involves a loan that would have been illegal for the assignee to make directly.

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[266] Other early cases not cited by valid-when-made advocates make the same point, but are more clearly about discounting, which might be why they are not cited. *See, e.g.*, Cram v. Hendricks, 7 Wend. 569, 572 (N.Y. Ct. for the Correction of Errors 1831) ("The principle is too well settled to be questioned, that a bill free from usury in its concoction may be sold at a discount; because, as it was free from usury between the original parties to it, no subsequent transaction with another person can, as it respects those parties, invalidate it."); Taylor v. Bruce, 21 Va. 42, 90 (Va. 1820) ("it is settled, that a bill or note which is free from usury, in its concoction, may be sold at an usurious discount, for that as it was free from usury between the original parties, no after transaction can, as to these parties, invalidate it").

[267] 4 Conn. 153 at 156 (reporter's description).

[268] 26 U.S. (1 Pet.) 37, 41 (1828).

[269] *Id.* at 43 (emphasis added).

[270] Rent-Rite SuperKegs W., Ltd. v. World Bus. Lenders, LLC (*In re* Rent-Rite SuperKegs W., Ltd.), 603 B.R. 41, 66 (Bankr. D. Colo. 2019). Note that the note would always have been usurious under state law, but federal law requires a different choice of law when the bank is holding the note.

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Likewise, *Nichols v. Fearson*, perhaps the key case cited in support of the doctrine, involved a discounted sale of a note indorsed by the defendant.[271] When the defendant indorsed the note, the defendant became jointly liable for the full face amount of the note, just as if it were the maker of the note.[272] The Supreme Court held that the usurious discounting did not void the original note,[273] observing that among the:

> cardinal rules of the doctrine of usury …[is] that a contract which in its inception is unaffected by usury can never be invalidated by any *subsequent usurious transaction*.[274]

Again, the point is that usury in transaction #2 does not affect transaction #1. Note the underlined word "usurious" in the quotation. The Court did not say that the nonusurious nature of a contract transaction cannot be affected by any subsequent transaction generally, but that it is not affected by a subsequent *usurious* transaction. As we will see, the inclusion of the word "usurious" is key for the meaning of *Nichols*. *Nichols* was only dealing with a question of usury and thus would have had no business addressing the effect of subsequent transactions generically. Yet the word "usurious" has been read out of the case by valid-when-made proponents in an attempt to press it into service of a deregulatory policy agenda. *Nichols* has nothing to do with the question of whether a bank can transfer its statutory preemption privilege to an assignee to allow the assignee to purchase and enforce a loan that the assignee could not legally make itself. [275]

*3. Effect of a Subsequent Valid Transaction on Prior Usury*

The third common fact pattern in the cases relied upon for support of "valid-when-made" is the about the effect of a later valid transaction on a loan that is usurious *ab initio*. For example, in *Highway Equip. & Supply Co. v. Jones*, the issue before the court was whether usury in the initial transaction was purged by an assignment.[276] Similarly, in *Coral Gables First Nat. Bank v. Constructors of Fla., Inc.*, the issue was the effect of renewal of a usurious loan

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[271] 32 U.S. (7 Pet.) 103 (1833).

[272] *See* UCC § 3-415(a) (modern statutory analog).

[273] 32 U.S. at 110, 112.

[274] *Id.*, at 109 (emphasis added). *See also id.*, at 106 ("the rule of law is everywhere acknowledged that a contract free from usury in its inception shall not be invalidated by any *subsequent usurious transactions upon it*.") (emphasis added).

[275] The same pattern appears in a more recent case, *Concord Realty v. Cont'l Funding*, which addressed whether the interest rate should be calculated based on the contract rate or on the imputed rate of interest from a foreclosure sale bid. 776 P.2d 1114, 1120 (Colo. 1989) (noting that "the usurious nature of a transaction must be determined from its inception" in reference to the timing of the calculation of the interest rate, not the question of what law applies).

[276] 153 N.W.2d 859, 863 (Neb. 1967).

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on non-usurious terms,[277] and in *Waggener v. Holt Chew Motor Co.*, the issue was whether the lender's acquisition of a required license after making loan at rate above that allowed for unlicensed lenders cured the usury violation.[278] These "*invalid*-when-made" cases are all dealing with the reverse of the valid-when-made situation, and as such tell us nothing about the existence of a valid-when-made doctrine.

### *D. The Absence of "Valid-When-Made" in Historical Treatises*

If the "valid-when-made" doctrine were a "cardinal rule" of banking law, founded on Supreme Court opinions, one would expect it to regularly appear in 19th and 20th century usury and banking law treatises. Yet the doctrine is entirely unknown to historical treatise writers. Nothing even approaching the "valid-when-made" doctrine in which the assignment of a loan from an originator to an assignee subject to a different state usury law appears in any 19th or 20th century usury treatise. No prior reference to "valid-when-made" can be found in *any* banking or usury treatise.

Instead, what is found in treatises are restatements of the second pattern of cases. For example, an 1821 treatise on bills and notes observes:

> In general, a *subsequent* illegal contract or consideration of any description, taking place in a second indorsement or transfer of a bill, and not in its inception, nor in a transfer through which the holder must make title, will not invalidate the same, in the hands of a bona fide holder.[279]

To be sure, proponents of the doctrine cite to language from 1838 edition of Blackstone's *Commentaries on the Laws of England* for support: "'[t]he

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[277] 119 So. 2d 741, 746 (Fla. Dist. Ct. App. 1960).

[278] 274 P.2d 968, 971 (Colo. 1954). Also in this pattern is *Watkins v. Taylor*, 16 Va. 424, 436 (Va. 1811), which dealt with the effect of payment by surety on surety's subrogation claim on usurious contract. The language sometimes cited in support of "valid-when-made" comes from the dissent, however, not the majority opinion. Given that the subrogated surety was ultimately subject to the usury defense, *Watkins* tells us nothing about the existence of a "valid-when-made" doctrine.

[279] JOSEPH CHITTY, *A PRACTICAL TREATISE ON BILLS OF EXCHANGE, CHECKS, ON BANKERS, PROMISSORY NOTES, BANKERS' CASH NOTES, AND BANK NOTES* * 106 (5th Ed. 1821) (emphasis original). *See also* SIR ROBERT BUCKLEY COMYN, *A TREATISE ON THE LAW OF USURY* 187 (1817) ("As a security or contract which is usurious in its inception must always retain its unsoundness; so on the other hand, where the security or contract has been originally valid, no subsequent taking of, or contract to take, illegal interest will invalidate it; although by such taking the party absolute incur the penalty of the statute."); JAMES AVERY WEBB, *A TREATISE ON THE LAW OF USURY, AND INCIDENTALLY, OF INTEREST* 344 (1899) ("A contract, free from usury at its execution, cannot be rendered invalid by any subsequent usurious agreement between the same or other persons. A subsequent agreement may be usurious in itself and thereby become either wholly or partly nugatory; but its fate cannot be visited upon the original valid contract.").

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usury must be part of the contract in its inception' for a contract to be deemed usurious."[280] But the quoted language does not appear in Blackstone's original treatise. Instead, it is from a later annotator's footnote. Nor does it actually provide much support the "valid-when-made" doctrine. The footnote cites two English cases. The first, *Lowes v. Mazzaredo*,[281] dealt with usurious discounting of a non-usurious bill of exchange, which was held not to affect the validity of the bill of exchange. *Mazzaredo* is squarely within the discounted assignment pattern (pattern 2). The second case, *Lowe v. Waller*,[282] dealt with whether a good faith assignee of a usurious bill of exchange is subject to the defense of usury (pattern 3). This case fits neatly in the cleansing assignment pattern. Both cases are uninformative about the "valid-when-made" doctrine. There is nothing else even remotely related to the doctrine to be found in any 19th or early 20th century American usury or banking treatise.

### *E. Modern "Valid-When-Made" Decisions*

The first case to fit within the "valid-when-made" doctrine is a 1979 California appellate decision, *Strike v. Trans-West Discount Corp.*[283] *Strike* involved an assignment of a loan from a bank (exempt from California usury law by the California constitution, not the National Bank Act or DIDMCA) to a nonbank that was normally subject to California usury law. The California Court of Appeals held that the transfer of the loan did not change its status vis-à-vis the usury laws, but suggested that the outcome would be different if the loan had been intended for assignment *ab initio*.[284] This is a sensible articulation on an anti-evasion position that ensures the liquidity of bank loans, but also prevents abuse of federal preemption through rent-a-bank arrangements and the like. Notably, *Strike*, does not mention any "valid-when-made" doctrine; the doctrine was unknown to the California court of appeals.

There are several post-1980 cases that are consistent with the "valid-when-made" doctrine as described by its proponents. These post-1980 cases, however, are in a line founded on a misinterpretation of a decontextualized

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[280] FDIC/OCC Amici Brief at 10 (citing BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND).

[281] 1 Stark 385 (Assizes at Nisi Prius 1816).

[282] 2 Dougl. 736 (King's Bench 1781).

[283] 92 Cal.App.3d 735, 745 (Cal. Ct. App. 4th Dist. 1979).

[284] *Id.* (citing *Calimpco, Inc. v. Warden*, 100 Cal. App. 2d 429, 446-447 (Cal. Ct. App. 1st Dist. 1950) ("If [an assignee cannot be held liable for accepting usurious interest], the statutes on usury might as well be abolished. All a lender would have to do would be to obtain a contract from a borrower providing for usurious interests…and then assign his contract and the contract would no longer be usurious.")). *See also Miller v. Tiffany*, 68 U.S. at 308 (contractual choice of law provisions for usury are enforceable, but when done with intent to evade the law, law of the contract location applies).

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quotation from the Supreme Court's 1833 decision in *Nichols v. Fearson*.[285] Thus, *Munoz v. Pipestone Financial, LLC*[286] contains no original analysis, but instead, relies on a citation to *Phipps v. FDIC*.[287] *Phipps* too has no original analysis, but relies on a citation to *Krispin v. May Department Stores Co.*[288] *Krispin* is actually a true lender case,[289] but it supports its determination with a citation to *FDIC v. Lattimore Land Corporation*, a 1981 case.[290]

*Lattimore Land Corporation* dealt with a loan made by a nonbank in Georgia and then partially assigned to a national bank in Tennessee that ended up in FDIC receivership.[291] The case turned on whether Georgia or Tennessee law applied to the loan in the hands of the bank: if Georgia law, the loan was nonusurious; if Tennessee law, it was usurious.[292] The Fifth Circuit held that even though section 85 of the National Bank Act subjects a bank to the usury cap of the state its home state, section 85 applies only when the bank makes the loan or discounts the note.[293] Because section 85 did not apply, the Fifth Circuit held that under normal choice of law rules, the Georgia statute applied and was not affected by the assignment of the loan.[294]

While valid-when-made proponents have taken *Lattimore* as supporting their position, the case is actually more complicated and ultimately shows the error that gave rise to the idea of valid-when-made. As an initial matter, *Lattimore* is dealing with an assignment of a loan *to* a bank, not from one. In other words, it is dealing with the opposite of the "valid-when-made" situation. In any event, *Lattimore* was not decided under the National Bank

[285] 32 U.S. (7 Pet.) 103 (1833).

[286] 513 F.Supp.2d 1076 (D. Minn. 2007).

[287] 417 F.3d 1006 (8th Cir. 2005).

[288] 218 F.3d 919 (8th Cir. 2000).

[289] *Id.* at 924 ("the store's purchase of the bank's receivables does not diminish the fact that it is now the bank, and not the store, that issues credit, processes and services customer accounts, and sets such terms as interest and late fees. Thus, although we recognize that the NBA governs only national banks…in these circumstances we agree with the district court that it makes sense to look to the originating entity (the bank), and not the ongoing assignee (the store), in determining whether the NBA applies.…Accordingly, for purposes of deciding the legality of the late fees charged to appellants' credit accounts, we find that the real party in interest is the bank, not the store.").

[290] 656 F.2d 139 (5th Cir. 1981).

[291] *Id.* at 140-41.

[292] *Id.* at 146.

[293] *Id.* at 147. This reading is suspect. Section 85 provides that "Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located…" 12 U.S.C. § 85. The Fifth Circuit focused on the "any loan or discount made" language, which it took to limit the scope of the provision to loans or discounts made by the bank. But the following clause "or upon any notes…or other evidences of debt" is not limited to obligations originated by the bank.

[294] *Id.* at 148-49.

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Act, but just under regular choice of law principles. Moreover, *Lattimore* was decided after the enactment of FDIA's interest rate exportation provision, so it could not be part of the common law background of that statute, much less the 1864 National Bank Act. As such, it is not actually support for the valid-when-made position. Indeed, the court also made clear that if there had been a true lender claim, the analysis would have been different.[295]

The reason *Lattimore* is cited as support for valid-when-made is because of a single sentence, "The non-usurious character of a note should not change when the note changes hands."[296] This proposition is given without any analysis, but is supported by a footnote that is worth examining in detail. The footnote that reads:

> This Court long ago observed that: "If, in its inception, the contract which that instrument purported to evidence was unaffected by usury, it was not invalidated by a subsequent transaction." *Huntsman v. Longwell*, 4 F.2d 105, 106 (5th Cir. 1925). This proposition was articulated by the Supreme Court as one of the "cardinal rules in the doctrine of usury." *Nichols v. Fearson*, 32 U.S. 103, 109-11 (1833).[297]

We have already seen that *Nichols v. Fearson* had nothing to do with valid-when-made. The same is true of *Huntsman v. Longwell*. *Huntsman* is just another case that like *Nichols* fits into the second pattern of cases in which the interest from a second transaction is not imputed to an original transaction for purposes of calculating whether the first transaction violated the usury statute. In *Huntsman,* he borrower raised a usury defense to a loan that on its face was in compliance with the usury cap based on a claim that the day after the loan agreement was made, he had agreed in a separate contract to assume certain debts of the lender as part of the consideration of the loan, the effect of which was to make the real interest rate on the loan usurious.[298]

*Huntsman* itself cites to *Nichols*, correctly relying on it as support for the idea that imputed interest from transaction #2 cannot be bundled with interest from transaction #1 to result in a combined interest rate that violates the usury cap.[299] But *Huntsman* provides no support for the Fifth Circuit's

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[295] *Id.* at 148, n. 15 ("The present case differs from *Daniels* in that here the obligors assumed that the allegedly usurious instrument called for non-usurious interest when held by the initial obligee and the obligors have never claimed that Hamilton National Bank was the lender in fact.").

[296] *Id.* at 148-49.

[297] *Id.* at 149, n.17.

[298] 4 F.2d 105, 106 (5th Cir. 1925). The issue before the court in *Huntsman* related to the admissibility of evidence regarding the second contract. *Id.*

[299] *Id.* at 106.

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position in *Lattimore*. Indeed, tellingly, *Huntsman*, unlike *Lattimore*, was not an assignment case.

What is most interesting, however, about *Huntsman* is that it paraphrases *Nichols* in a way that omits a key word. *Huntsman* cites *Nichols* for the proposition that:

> If, in its inception, the contract which that instrument purported to evidence was unaffected by usury, it was not invalidated by a subsequent transaction.[300]

*Nichols*, however, actually made a more limited claim:

> a contract which in its inception is unaffected by usury can never be invalidated by any subsequent <u>usurious</u> transaction.[301]

*Huntsman*'s paraphrase of *Nichols* omits the critical penultimate word (underlined in the quotation). In *Huntsman* itself, that omission was of no consequence because it followed the same fact pattern as *Nichols*, but it was in *Lattimore* and in all the subsequent cases 21st century valid-when-made cases that rely on *Lattimore* as their foundational authority, but apply it to a totally different fact pattern. By ignoring the word "usurious," the courts that embraced valid-when-made have misread *Nichols* as standing for a broader proposition than it does. All *Nichols* stands for is the idea that the interest rate in transaction #2 does not affect the calculation of interest in transaction #1. Hence in *Nichols* the Supreme Court referred to "any subsequent *usurious* transaction," not merely "any subsequent transaction." *Nichols* is a holding about the effect of a usurious discounting, nothing more.

The only major modern "valid-when-made" case that does not stand on this misreading of *Nichols* is the 7th Circuit's decision in *Olvera v. Blitt & Gaines, P.C.*[302] *Olvera*, however, does not actually embrace valid-when-made, but instead arrives at a similar result through a common law of assignment theory, namely that because the assign of a contract takes all of the assignor's rights under that contract, a nonbank assignee accedes to the bank assignor's usury exception for a loan.

This argument, echoed by other valid-when-made proponents,[303] reflects a fundamental misunderstanding of the common law of assignments. The common law of assignments relates solely to the assignment of rights under a contract or property rights. An assignee takes all of the rights of the assignor

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[300] *Id.* at 106.
[301] 32 U.S. at 109 (emphasis added)
[302] 431 F.3d 285 (7th Cir. 2005).
[303] FDIC/OCC Amici Brief at 14-16; 84 Fed. Reg. 66848 (Dec. 6, 2019).

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*under the contract.*[304] An assignee does not, however, assume the assignor's other rights extraneous to the contract, such as rights under licenses or from status. For example, if I sell my car, the buyer gets whatever rights are appurtenant to the car, but does not also get my driver's license or the benefits of my American Automobile Association membership, much less my parental or spousal rights. Similarly, if a credit union sells a loan, the buyer does not assume the credit union's statutory tax-exempt status. The assignee "steps into the shoes" of the assignor. It does not step into the assignor's "feet". Thus, the common law of assignment has no bearing on regarding a transfer of federal statutory status or privileges, as those are neither contract nor property rights.

Banks' exemptions from state usury laws, whether under the National Bank Act or FDIA are statutory rights; they are not contractual terms in a loan agreement. These exemptions are not alienable property rights. Neither are they characteristics of the loan that travels with the note; they are nowhere to be found in the loan documents. Instead, NBA and FDIA preemption is a personal and non-transferrable privilege that are part of a legal scheme that applies only to banks. Indeed, NBA and FDIA preemption does not void state usury laws—state usury laws remains valid and in effect for nonbanks, and in the case of FDIA, states even retain the right to opt-out of the provision. [305] Instead, NBA and FDIA "preemption" are not true preemption. They merely allow banks to export the usury cap of their home state into other states.

Because the exemption from state usury laws is essence a personal privilege, not a property right, it is no more assignable than a medical license or a tax-exempt status or FDIC insurance or Federal Reserve System discount window access. Indeed, if these privileges were freely assignable, there would be no point in having a bank licensing regime because regulators would not exercise control over who ultimately gained the privileges attached to the license. Accordingly, the common law of assignments has nothing whatsoever to do with the assignability of exemptions from usury laws.

### *F. Is "Valid-When-Made" Necessary for Bank Liquidity?*

The preceding sections have shown that "valid-when-made" is not a historical doctrine. It is a modern invention read back into the record through selective, decontextualized quotations of historical cases. The doctrine's lack of historicity is important because it undercuts the major policy claim made

[304] *See* Restatement (2d) of the Law, Contracts, § 317(2) ("A *contractual* right can be assigned....") (emphasis added); 29 WILLISTON ON CONTRACTS § 74:10 (4th ed.) ("Generally, all *contract* rights may be assigned….) (emphasis added).

[305] 12 U.S.C. 1831d note (DIDMCA § 525, not codified).

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in support of doctrine, namely that it is necessary for the smooth functioning of bank credit markets.

In particular, proponents of the doctrine claim that the doctrine is economically necessary because without it banks could not sell loans in the secondary market.[306] Without the doctrine, they claim, banks could find themselves illiquid, and there would be uncertainty over the validity of sale transactions that would result in reduced sale prices for banks and confusion in secondary markets.[307] Thus, Judge Posner, when confronted with the issue, noted that the only effect of applying usury law to "assignees would be to make the credit market operate less efficiently."[308]

Yet it is hard to see how the doctrine is essential to the banking system given that the system has operated successfully for centuries without it. "Valid-when-made" would imbue nonbank transferees with a liquidity-enhancing status like holder-in-due-course doctrine for negotiable instruments. But even holders-in-due-course of negotiable instruments are still subject to a defense of usury on the underlying note if the usury would invalidate the note.[309] Moreover, a careful look at the banking system shows that valid-when-made would actually do little work to protect bank liquidity.

First, when banks are truly pressed for liquidity, they do not rely on loan sales. Instead, they turn to the Federal Reserve's discount window, where they are able to obtain liquidity by borrowing against illiquid assets like loans.

Second, the principal secondary market in loans is the market for mortgages. State usury laws are specifically preempted for most mortgages, regardless of the entity that holds them.[310] Indeed, the broad express preemption for mortgages suggests that Congress did not intend such broad preemption for other types of loans.

Third, there are over 5,000 FDIC insured banks, all of which benefit from National Bank Act or FDIA preemption.[311] Banks can and do sell loans to each other. Even without a "valid-when-made" doctrine, there is a sizeable potential secondary market for non-mortgage loans that is unaffected by state usury laws.

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[306] FDIC/OCC Amici Brief at 17 (any other position would be "uneconomic" and "disastrous in terms of bank operations"); Rent-Rite SuperKegs W., Ltd. v. World Bus. Lenders, LLC (In re Rent-Rite SuperKegs W., Ltd.), 603 B.R. 41, 66 (Bankr. D. Colo. 2019) ("Any contrary legal standard would interfere with the proper functioning of state banks.").

[307] *See, e.g.*, Marvin, *supra* note at 43 at 1839-40.

[308] Olvera v. Blitt & Gaines, P.C., 431 F.3d 285, 288 (7th Cir. 2005).

[309] UCC § 3-305(a).

[310] 12 U.S.C. §§ 1735f-7, 1735f-7a.

[311] FDIC, *Statistics at a Glance*, Sept. 30, 2020.

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Fourth, most bank loans are made at non-usurious rates. "Valid-when-made" is not necessary for a secondary market in non-usurious loans, and indeed, nonbanks regularly sell their non-usurious loans without incident even in jurisdiction that have rejected valid-when-made. This holds true of the securitization market. State usury caps do not apply to the mortgages, which are the primary loan type sold in the securitization market, and only a very small minority of securitized non-mortgage loans are likely to exceed state usury caps.

The same is true of bank sales of defaulted loans, such as in the *Madden* case. Only a few states have usury laws sufficiently low that they are likely to cause conflicts with any loans originated by banks for their own books, as opposed to rent-a-bank arrangements. What's more, defaulted consumer loans already sell at such a substantial discount (often in the range of 2¢-3¢ on the dollar[312]), that the risk of a usury challenge is unlikely to materially affect the discount banks must accept upon sale.

At most, "valid-when-made" affects the price at which bank could sell ***usurious*** loans. The National Bank Act and FDIA, however, are not a price guaranty for banks' sale of usurious loans, any more than they guaranty a sale price for any bank loan. Some loans will always be inherently harder to sell than others. As the Second Circuit observed in *Madden*, application of state usury laws to the assignee of a national bank might "decrease the amount a national bank could charge for its consumer debt in certain states," but that possible outcome would not "significantly interfere with the exercise of a national bank power."[313]

Perhaps the best proof of the irrelevance of valid-when-made to banks' actual operations is the lack of evidence of *Madden* affecting bank operations in the Second Circuit. A pair of empirical studies have indicated that *Madden* did result in a contraction of marketplace lending in the Second Circuit,[314] but marketplace lending is a relatively small market that is, by definition, only a rent-a-bank or non-bank market. There is no suggestion, however, much less evidence, that *Madden* has materially affected any major consumer credit market or that it has materially affected banks other than in the rent-a-bank context. Indeed, the OCC and FDIC were unable to adduce any actual evidence in their valid-when-made rulemakings of *Madden* creating problems for banks other than in the rent-a-bank context,[315] and the FDIC even

[312] Adam J. Levitin, *Bankruptcy Markets: Making Sense of Claims Trading*, 4 BROOK. J. CORP. FIN. & COMM. L. 67, 82 (2009).

[313] 786 F.3d at 251.

[314] *See supra* note 44.

[315] *See, e.g.*, 85 Fed. Reg. 33530, 33534 (June 2, 2020) (OCC) (claiming that post-*Madden* suits challenging the legality of interest collected by credit card securitization trusts is evidence

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admitted that it is "not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision."[316]

What we see then, is that not only does the valid-when-made doctrine not stand on solid historical grounds, but the claim that it is essential for protecting bank liquidity is dubious. Instead, valid-when-made is effectively a collateral attack on state usury laws in the guise of a historical claim. As the following Part explains, it is also an affirmatively bad policy position because it produces a regulatory vacuum.

## VI. AVOIDING REGULATORY VACUUMS

### A. "Valid-When-Made" Produces a Regulatory Vacuum

The danger the valid-when-made doctrine poses is the creation of a regulatory vacuum. NBA and FDIA preemption is part of a bundle of regulatory benefits and burdens specific to banks; allowing it to be assigned to a nonbank would result in a regulatory vacuum in which the nonbank would be exempt from state law, but also not subject to federal regulation.[317] That is precisely the effect of valid-when-made. It enables nonbanks to evade compliance with state usury laws as well as state licensure and supervision requirements without substituting any, much less an equivalent, federal regulatory regime. For this reason, valid-when-made should be rejected as a policy position. It is a poor way of addressing concerns over the restrictiveness of some states' usury laws or over the continuance of a state-based regulatory system that has proven more resilient against regulatory capture than federal banking regulators.[318]

### B. Benefits of the Madden Rule

Valid-when-made proponents are correct on one point, however. Uncertainty is not desirable in commercial markets because it impedes efficient business planning. Yet uncertainty can be resolved equally well by either the valid-when-made rule or the *Madden* rule. The *Madden* Rule is a better approach than the valid-when-made rule because it creates transactional certainty, but does not produce regulatory vacuums. The *Madden* rule respects that clear statutory boundaries of federal banking law while effectuating state usury laws. Banking law is predicated upon there being a fundamental difference between banks and nonbanks. This is why

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of uncertainty, without showing that there has been any change in market practice, as opposed to merely litigation being filed); 85 Fed. Reg. 44146, 44151-52 (July 22, 2020).

[316] 85 Fed. Reg. 44146, 44156 (July 22, 2020).

[317] *See* Levitin, *Hydraulic Regulation*, *supra* note 40, at 188-89.

[318] *Id.* at 199-205 (noting that complete capture of all state attorneys general is much less likely that capture of federal regulators).

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banking law restricts entry into banking through the limited granting of charters, as opposed to state law free chartering of corporations. It is also why banks are subject to an extensive and detailed regime of regulation and why they have certain privileges that accompany that regulatory regime.

The *Madden* Rule captures this regulatory distinction between banks and nonbanks. It grants banks the full measure of their regulatory privilege, including interest rate exportation, but confines that privilege to the banks—the entities that are also subject to the concomitant regulatory burden. In other words, the *Madden* rule takes seriously the conceit that bank safety-and-soundness regulation is actually an adequate substitute for usury laws. Limiting banks' privileges to banks is the only way an entity-based regulatory system can in fact function. If banks can freely transfer their regulatory privileges to nonbanks, there would be no purpose to a banking charter. Rent-a-bank arrangements threaten the very concept of banks as special entities.

The *Madden* Rule also preserves state usury laws. The unspoken heart of the valid-when-made doctrine is a distaste for state usury laws. The financial services industry has never attacked state usury laws head-on, but instead has always chipped around the edges, carving out certain types of institutions and loans. Yet behind this approach rests a belief that state usury laws are outmoded restrictions on contract that unnecessarily restrain the financial services industry.[319] Valid-when-made is not an attack on the level of state usury caps, but on their very existence. Whatever one thinks of the merits of state usury laws, they are still the laws on the books and should be given effect as such. If they are misguided, they should be repealed, rather that evaded through regulatory arbitrage. The *Madden* Rule avoids a collateral attack on state usury laws.

Finally, and it is no small matter, the *Madden* Rule also has the benefit of easy administrability and certainty. It is simple to apply because it merely inquires whether the entity holding the receivable on which interest is accrued (and not the "account" which is meaningless in a usury context) is a bank or not. If an entity is a bank, the applicable usury law is that of the bank's home state per section 85 of the NBA and section 1831d of the FDIA. If an entity is not a bank, then whatever state's usury law would normally apply to the contract (generally the law of the borrower's state) applies.

In contrast with the fact-specific inquiry required for "true lender" doctrine, the *Madden* rule preserves state usury laws in a sensible and administrable fashion because it tracks institutional boundaries by looking at who actually owns the loan. No further inquiry about the transaction's details

[319] *See, e.g.*, Marvin, *supra* note at 43 at 1844.

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must be undertaken under the *Madden* rule, so it creates more transactional certainty than true lender doctrine.

### *C. Disclosure Requirements to Prevent Evasion*

While the *Madden* Rule represents the single best of the three doctrinal approaches to the application of usury laws to nonbank assignees of banks, it is incomplete. The *Madden* Rule's very administrability benefit also renders it susceptible to evasion because it is an entity-based rule, and entity boundaries can be blurred by contract.

For example, consider both World Business Lenders loan purchases arrangements and Elevate Credit's participation purchase arrangements. Under the *Madden* Rule, the World Business Lenders, would be the lender because it purchased the loans themselves from the bank partner, but Elevate Credit would not be the lender because it had not purchased the loans from the bank partner, only a derivative interest in them. The *Madden* Rule invites evasion through contracts such as participation sales and credit derivatives.

Thus, the *Madden* Rule needs to be buttressed by the anti-evasion principle from historical usury doctrine. Courts have recognized that "[t]he ingenuity of lenders has devised many contrivances by which, under forms sanctioned by law, the [usury] statute may be evaded."[320] Thus, the Supreme Court noted that:

> if giving [credence to the] form to the contract will afford a cover which conceals it from judicial investigation, the [usury] statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction.[321]

An anti-evasion principle effectively incorporates "true lender" doctrine, as it looks to the true economic nature of the relationship: which party has the economic risk and control regarding the loans?

An anti-evasion principle alone, however, is not enough to be effective. Instead, an anti-evasion principle needs to be coupled with a disclosure requirement. Banks seeking to enforce debt contracts should be required to disclose whether they transferred an economic interest in the contract to a nonbank. Without such a disclosure obligation, neither consumers nor regulators would be able to tell if the bank in fact remained the true party in interest on a loan or if the bank had merely rented out its charter to a nonbank.

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[320] Scott v. Lloyd, 34 U.S. 418, 419 (1835).
[321] *Id.*

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The case of Elevate Credit, Inc., is again instructive in this regard. The only reason we know of Elevate's participation purchases this is because Elevate is a public reporting company.[322] If Elevate were not a reporting company, its involvement in the Elastic and Rise credit products would be invisible to borrowers. As far as borrowers would be able to tell, the lender would be Elevate's bank partners. As a result, borrowers would not be able to vindicate their rights under state usury laws by bringing a true lender challenge to the relationship.

Banking regulators would, in theory, be able to learn of the participations, but it would take quite a bit of sleuthing for bank examiners to piece together the relationship of the various Elevate entities with one of its bank partners, not least because the contracts are all with different Elevate entities whose names do not always indicate an affiliation.

To address the possibility of evasion through derivative contracts, including participations, the CFPB should create such a requirement for consumer loans under its power to prohibit unfair, deceptive, and abusive acts and practices.[323] If a bank discloses that it has parted with an economic interest in a loan, then the consumer debtor should be able to seek discovery regarding the terms of such transfer so that they can potentially bring a usury suit.

### *D. The OCC and FDIC Rulemakings*

In 2020, the OCC and FDIC both issued valid-when-made rulemakings,[324] and the OCC also issue a true lender rulemaking.[325] The finalized rules were promptly challenged by a number of state attorneys general as failing to comply with the Administrative Procedures Act and, in the case of the OCC, with the procedural requirements of the National Bank Act. These challenges remain pending as of the date of this Article, but even

[322] The only reason we know the details of Think Finance's earlier rent-a-bank and rent-a-tribe dealings are because of litigation brought by the Commonwealth of Pennsylvania that took five years to get to summary judgment, and even then, the unsealing of documents had to be litigated.

[323] 12 U.S.C. §§ 5531, 5536 (2018). Such a requirement should also exist for business loans, but the ability to enact a parallel requirement for business loans, including small business loans, is more complicated, because federal banking regulators lack a general power to prohibit unfair and deceptive acts and practices. Interagency Guidance Regarding Unfair and Deceptive Credit Practices, FIL-44-2014, Aug. 22, 2014 (noting that the Dodd-Frank Act resulted in the repeal of federal banking regulators' authority to issue unfair and deceptive practices regulations).

[324] 85 Fed. Reg. 33530, 33532 (June 2, 2020), *codified at* 12 C.F.R. §§ 7.4001, 160.110 (OCC); 85 Fed. Reg. 44146 (July 22, 2020), *codified at* 12 C.F.R. § 331.4(e) (FDIC).

[325] 85 Fed. Reg. 68742 (Oct. 30, 2020), *codified at* 12 U.S.C. § 7.1031.

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if the rules are upheld, they fail to actually resolve the uncertainty about the viability of bank partnership arrangements.[326]

First, the OCC and FDIC rules purport to address only interest rates, which has been the major focus of legal challenges to rent-a-bank arrangements. But that is not the only basis on which rent-a-bank arrangements can be challenged. In particular, rent-a-bank arrangements can be challenged on the basis of state licensing requirements for nonbank lenders, and potentially on state regulations dealing with contract terms other than interest rates. While the OCC's true lender rule deems a national bank that is the lender of record or funds a loan to be the true lender for purposes of interest rates, nothing prevents states from arguing that when a nonbank is the "true lender" that it must comply with state licensure and other requirements.

Second, even for usury laws, all that the rules do is shift the issue of the legitimacy of the rent-a-bank arrangements from the courts to the regulatory agencies. The OCC and FDIC have previously taken actions against the banks involved in rent-a-bank arrangements,[327] and could readily do so again with their existing authorities. The rulemakings immunizes the nonbank partners from state and private litigation regarding usury laws, but the banks and potentially the nonbanks[328] remain vulnerable to federal supervisory action. Even if the motivation for these supervisory actions is addressing the high interest rates in rent-a-bank arrangements, the supervisory actions are often couched in terms of safety-and-soundness, including reputational risk. These supervisory actions usually result in negotiated consent orders that often contain limited facts about the details of the arrangement at issue and thus provide little guidance about regulators' expectations.

Shifting the action from courts to federal regulators means is that the legality of rent-a-bank arrangements is likely to see-saw with changes of political control of the federal banking regulators. It also means that there will be more intense pressure from consumer advocates for the federal

[326] The FDIC has not proposed a true lender rule, as it does not believe it has statutory authority to do so. Alan S. Kaplinsky, *FDIC questions its authority to issue "true lender" rule*, CONSUMER FINANCE MONITOR, Dec. 9, 2020, https://www.consumerfinancemonitor.com/2020/12/09/fdic-questions-its-authority-to-issue-true-lender-rule/. Accordingly, for state-chartered banks, true lender doctrine remains a possible basis for challenging rent-a-bank arrangements, even if the OCC True Lender rule is upheld.

[327] *See supra* notes 87, 90, 103.

[328] *See* 12 U.S.C. §§ 1464(d)(7), 1867(c)(1) (providing that providers of services to banks and thrifts shall be subject to regulation and examination by federal banking regulators the same as if the service were performed by the bank or thrift).

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banking regulators to take supervisory actions against rent-a-bank arrangements.

Ultimately, this is the worst of all possible outcomes. Instead of allowing the judicial process to create certainty about what is and what is not legal in terms of bank partnership arrangements, the OCC and FDIC rulemakings have removed the issue from the judicial sphere and made regulation dependent upon informal regulatory whim that is likely to shift with election cycles. The OCC and FDIC rulemaking claim to be based on providing greater certainty for banks,[329] but the regulations fail to actually provide that, as the rulemakings do not bind the regulators to the extent that they couch their objections to rent-a-bank arrangements in terms of safety-and-soundness, not violation of state usury laws. The rulemakings provide certainty regarding the courts, not regarding regulatory actions. They actually increase regulatory uncertainty. Put another way, even if the OCC and FDIC rulemakings are upheld, they are not the final word on rent-a-banking.

## CONCLUSION

The policy debate regarding regulation of bank partnership arrangements is a function of an entity-based bank regulatory system having failed to adapt to a fundamental market change, namely the disaggregation of consumer lending. Disaggregation has resulted in transactions that involve a mosaic of entities—bank and nonbank—playing various roles in the lending process.

The entity-based regulatory system, however, insists of categorizing such transactions overall in a binary fashion. This binary treatment has left the system open to the kind of regulatory arbitrage that is the hallmark of "shadow banking"—the provision of banking-type services by nonbanks without bank regulation.[330] While shadow banking is mainly seen as a systemic risk concern, its regulatory arbitrage also threatens to undermine a long-standing set of state-law consumer protections. Consumer protections are best served by limiting the privileges of banks to the ambit of bank regulation, and not allowing them to be "rented" out by nonbanks that seek to operate in a regulatory vacuum.

[329] 85 Fed. Reg. 33530 (June 2, 2020) (OCC); 85 Fed. Reg. 44146, 44155 (July 22, 2020) (FDIC).

[330] Normally the regulatory arbitrage of shadow banking has been to offer bank-type services without bank-type regulation. Here the arbitrage has been to offer bank-type lending services by nonbanks without compliance with the regulatory regime that applies to nonbanks themselves.

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**APPENDIX B**

Order on Bankruptcy Court's Determination

*In re: Rent-Rite Superkegs West Ltd.,* No. 19-cv-01552 (D. Colo. Aug. 12, 2020)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Judge R. Brooke Jackson

Civil Action No. 19-cv-01552-RBJ
(Appeal from Bankruptcy Adversary Proceeding NO. 18-1099-TBM)

In Re: RENT-RITE SUPERKEGS WEST LTD,

Debtor.

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RENT-RITE SUPERKEGS WEST LTD,

Appellant,

v.

WORLD BUSINESS LENDERS, LLC,

Appellee,

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**ORDER ON BANKRUPTCY COURT'S DETERMINATION**

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This matter is before the Court on Rent-Rite SuperKegs West Ltd. ("Rent-Rite")'s appeal, ECF No. 7, of the judgment of the U.S. Bankruptcy Court for the District of Colorado ("Bankruptcy Court") on May 20, 2019, ECF No. 1-2. Judgment was entered for Appellee World Business Lenders, LLC ("WBL") and against Rent-Rite. This Court exercises jurisdiction over the appeal pursuant to 28 U.S.C. § 1334(a) and 28 U.S.C. § 158(a)(1). The Court has reviewed the record and the briefs of the parties, and it held a hearing on July 31, 2020. For the reasons set forth below, the Bankruptcy Court's judgment is REVERSED in part and REMANDED.

## I. BACKGROUND

Bank of Lake Mills is a Wisconsin state-chartered bank. ECF No. 1-2 at 4. On April 19,

2016 it loaned $550,000 to CMS Facilities Maintenance ("CMS"), a Colorado-based corporation. *Id.* CMS executed a promissory note promising to repay the balance within one year at "a remarkably high interest rate" of "0.331123287671% per day until paid in full," or 120.86% per year. *Id*. at 5. The promissory note dictates that federal law and Wisconsin law govern. *Id.* It also states that it "is accepted by [Bank of Lake Mills] in Wisconsin," and that payment shall be received in Wisconsin. *Id.* at 4–5.

For reasons unknown, a third party, Yosemite Management LLC ("Yosemite"), executed a deed of trust pledging its Colorado real property ("the property") as security on CMS's promissory note a few days later on April 21, 2016. *Id*. at 5. The deed of trust dictates that federal law and "the law of the jurisdiction in which the Property is located," i.e. Colorado law, govern. *Id*. at 6–7. The deed of trust also incorporates by reference the terms of the promissory note, including expressly identifying the high interest rate. *Id*. at 6.

On June 13, 2016 Bank of Lake assigned its rights under the promissory note and the deed of trust to WBL. *Id*. at 7. WBL is a non-bank entity registered as an LLC in New York with a principal place of business in New Jersey. *Id*. CMS defaulted on the promissory note by February 15, 2017. *Id*. at 8. On December 3, 2017 Yosemite sold its encumbered real property to Rent-Rite. *Id*. at 7. Rent-Rite knew about the default and received a purchase price discount based on the amount of debt secured by the property. *Id*. at 7–8. Yosemite and Rent-Rite have common management. *Id*. at 8.

Rent-Rite filed for Chapter 11 bankruptcy on December 11, 2017. *Id*. at 3. WBL filed a proof of claim in the bankruptcy proceedings, claiming an owed amount of $658,652.95 plus interest at the rate of 120.86% per year. *Id*. at 8–9. WBL asserted that the proof of claim was secured by the property. *Id*. at 9. The Bankruptcy Court noted that because Rent-Rite is not the

obligor on the promissory note, WBL's proof of claim sounded in rem in relation to the property. *Id*.

A few months later, Rent-Rite commenced adversary proceedings against WBL. *Id*. at 3. Rent-Rite asserted three causes of action: (1) declaratory judgment under Fed. R. Bankr. P. 7001(9); (2) claim disallowance under § 502 of the Bankruptcy Code; and (3) equitable subordination under § 510 of the Bankruptcy Code. *Id*. at 9. All three of Rent-Rite claims were premised on the theory that the interest rate in the promissory note is governed by Colorado law, and a 120.86% per year interest rate is usurious under Colorado law. ECF No. 7 at 4. WBL's answer asserted the following three affirmative defenses: (1) the parties to the promissory note agreed that Wisconsin law governed the interest rate; (2) Rent-Rite lacked standing to challenge the interest rate; and (3) Rent-Rite failed to join indispensable parties. ECF No. 6-1 at 14.

The parties agreed that the facts of the case were largely uncontested, and that the dispute was purely legal. Therefore, the parties filed a Joint Motion to Vacate Trial stating as such and requesting "a determination by the [Bankruptcy] Court on the legal principles at issue . . . without the need for trial." ECF No. 1-2 at 3. The parties proposed that they be permitted to submit stipulated facts, stipulated exhibits, and written closing arguments in lieu of trial. *Id*. The Bankruptcy Court granted the motion and received the parties' stipulations and written closing arguments. *Id*. at 3–4.

In its closing arguments, Rent-Rite asserted that the Bankruptcy Court must utilize Colorado conflict of law analysis, which applies Restatement § 187, under which the Wisconsin choice of law provision is unenforceable. *Id*. at 10. Alternatively, Rent-Rite argued that for choice-of-law purposes the Court should focus not on the promissory note but on the deed of trust, which is governed by Colorado law. *Id*. WBL responded that the Bankruptcy Court

should enforce the Wisconsin choice-of-law provision provided in the promissory note. Alternatively, if Colorado conflict of law analysis comes into play, WBL argued that it nevertheless also leads to Wisconsin substantive law. *Id*.

After reviewing the closing arguments the Bankruptcy Court "concluded that additional legal briefing was necessary." *Id*. at 11. The Bankruptcy Court raised issues that the parties had not themselves identified. ECF No. 7 at 7. Those issues included (1) whether the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1831d ("DIDA § 1831d") governs the interest rate and (2) if DIDA § 1831d applies, whether it federally preempts any of Rent-Rite's claims. *Id.*

In the requested supplemental briefing, Rent-Rite stuck with its original arguments: Colorado conflict of law analysis utilizes Restatement § 187, which leads to Colorado substantive law, under which the interest rate is invalid; and alternatively, the analysis should focus on the deed of trust. ECF No. 1-2 at 11. However, WBL modified its arguments in its supplemental brief. It argued that DIDA § 1831d does apply, and DIDA § 1831d dictates application of Wisconsin substantive law. *Id*. Further, even if DIDA § 1831d does not apply and Colorado choice of law is considered, the proper Colorado choice of law framework is Colorado's Uniform Commercial Code ("UCC"), which leads to Wisconsin substantive law. Alternatively, WBL proffers its original arguments that (1) the parties agreed to Wisconsin substantive law and (2) even if Restatement § 187 applies, it still leads to Wisconsin substantive law. *Id*.

On May 20, 2019 the Bankruptcy Court denied all of Rent-Rite's claims in favor of WBL. *Id.* at 45. The court found that DIDA § 1831d does apply; DIDA § 1831d dictates the application of Wisconsin law; and the interest rate is valid under Wisconsin law. The court

further found that even if DIDA § 1831d did not apply, federal choice-of-law principles also dictate application of Wisconsin law. For the sake of finality the court also conducted choice-of-law analyses pursuant to both Colorado statutory law under the Colorado UCC and Colorado common law under Restatement § 187. It found that both analyses also dictated application of Wisconsin law. Thus, no matter what choice-of-law analysis was correct, the Bankruptcy Court found that all roads led to Wisconsin substantive law.

Rent-Rite makes four arguments in the instant appeal. First, it argues that DIDA § 1831d cannot apply because the note was assigned to WBL, a non-bank. ECF No. 7 at 10. Second, it argues that WBL waived federal preemption as an argument by failing to plead it as an affirmative defense. *Id.* at 10–11. Third, it argues that the Bankruptcy Court should have focused its choice-of-law analysis on the deed of trust, not on the promissory note. *Id.* at 10. Fourth, it argues that the Bankruptcy Court improperly weighed the factors in the Colorado common law choice-of-law analysis. *Id.*

Two amici briefs were filed. The Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency filed an amicus brief in support of WBL. ECF No. 11. Professor Adam J. Levitin of Georgetown University Law Center filed an amicus brief in support of Rent-Rite. ECF No. 16. Both amici consider only whether DIDA § 1831d applies to non-banks upon assignment.

## II. STANDARD OF REVIEW

This Court reviews the Bankruptcy Court's legal determinations de novo. *See In re Baldwin*, 593 F.3d 1155, 1159 (10th Cir. 2010). The Court also reviews de novo mixed questions of law and fact that primarily involve legal issues. *See In re Wes Dor Inc.*, 996 F.2d 237 (10th Cir. 1993). The Bankruptcy Court's factual findings are

reviewed for clear error. *See In re Johnson*, 477 B.R. 156, 168 (10th Cir. BAP 2012). If a "lower court's factual findings are premised on improper legal standards or on proper ones improperly applied, they are not entitled to the protection of the clearly erroneous standard but are subject to de novo review." *Id.*

## III. ANALYSIS

### A. Whether DIDA § 1831d Applies

DIDA § 1831d provides that state banks may charge interest "at the rate allowed by the laws of the State . . . where the bank is located." The parties do not dispute that the promissory note's interest rate was valid when made under DIDA § 1831d. Bank of Lake Mills was located in Wisconsin, and the parties agree that the interest rate is valid under Wisconsin substantive law. However, the parties dispute whether the promissory note's interest rate remained valid upon assignment to WBL, a non-bank entity. There exists no precedent directly addressing whether DIDA § 1831d extends to loans that have been assigned from state banks to non-bank entities. The parties' argument centers on two cases—*Meade v. Avant of Colorado, LLC*, 307 F. Supp. 3d 1134 (D. Colo. 2018), and *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015)—and on two common law rules—the valid-when-made rule and the stand-in-the-shoes rule.

Briefly, in *Meade* a District of Colorado court considered whether DIDA § 1831d completely preempted a state usury claim against a non-bank. *See* 307 F. Supp. 3d at 1142. It found in the negative, stating that "the cause of action provided by § 1831d(b) does not on its face apply to actions against non-banks." *Id.* at 1145. Although this language facially sounds compelling, *Meade* expressly notes that "[w]hether or not [§ 1831d] gives rise to a *defense* of preemption on the merits of Plaintiff's claims, it does not establish complete preemption or

permit *removal*," and it left that question to the state court on remand. *Id*. (emphasis in original). Indeed, the Tenth Circuit has distinguished complete preemption and defensive preemption. *See Schmeling v. NORDAM*, 97 F.3d 1336, 1339 (10th Cir. 1996) (describing complete preemption "not as a crude measure of the breadth of the preemption (in the ordinary sense) . . . , but rather as a description of the specific situation in which a federal law . . . substitutes a federal cause of action for the state cause of action, thereby manifesting Congress's intent to permit removal"). Thus, *Meade* is inconclusive for our purposes.

In *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), the Second Circuit considered whether § 85 of the National Bank Act ("NBA") defensively preempted state usury law when the collecting entity was a non-bank. The NBA is the mirror image of DIDA as applicable to federal banks, and federal courts routinely interpret and apply DIDA § 1831d in accordance with NBA §§ 85, 86. *See Mamot Feed Lot*, 539 F.3d at 902-03; *Discover Bank v. Vaden*, 489 F.3d 594, 604–06 (4th Cir. 2007) (noting that DIDA § 1831d "is to state-chartered banks" as the NBA "is to national banks"), *rev'd on other grounds* 129 S. Ct. 1262 (2009); *Stoorman*, 908 P.2d at 135 (giving the "same interpretation" to DIDA § 1831d and NBA § 85). Thus, the NBA "expressly permits national banks to 'charge on any loan . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located.'" *Madden*, 786 F.3d at 250 (quoting 12 U.S.C. § 85). The Second Circuit held that NBA § 85 did not apply to defensively preempt New York state usury law when the collecting entity was a non-bank. *See id.* at 249. It found that extending the NBA to non-bank entities "would create an end-run around usury laws." *Id.* at 251–52.

However, the Bankruptcy Court, WBL, and the FDIC variously assert that *Madden* was both incorrectly decided and irrelevant to the case at hand. First, the FDIC argues that *Madden*

incorrectly determined that no conflict existed between the state usury law and the NBA. ECF No. 11 at 23. The state usury law prohibited non-bank assignees from enforcing interest rates exceeding 25% per year. *See Madden*, 786 F.3d at 248. *Madden* found that the state usury law did not conflict with, and therefore could not be preempted by, the NBA because "applying state usury laws to the third-party debt buyers would [not] significantly interfere with [a] national bank's ability to exercise its powers under the NBA." *Id.* at 251. Rather, the ruling "'limit[s] . . . only activities of the third party which are otherwise subject to state control,' and which are not protected by federal banking law or subject to [Office of the Comptroller of the Currency] oversight." *Id.* (quoting *SPGGC, LLC v. Blumenthal,* 505 F.3d 183, 191 (2d Cir. 2007)). Yet the FDIC argues that prohibiting assignees from enforcing otherwise-usurious interest rates is in practice a prohibition on banks from assigning those interest rates, which ultimately conflicts with the NBA's provision that federal banks can charge interest rates as allowed by their respective home states.

Second, the FDIC explains that *Madden* is irrelevant anyway because the Second Circuit did not analyze the deciding factors in the instant case: the common law valid-when-made rule and the common law stand-in-the-shoes rule, both of which are applied by both Colorado and Wisconsin. Indeed, the Bankruptcy Court premised its decision that DIDA § 1831d extends to non-bank entities upon the valid-when-made rule. The Bankruptcy Court defined the valid-when-made rule as holding that if the interest rate in the original loan agreement was non-usurious, the loan cannot become usurious upon assignment. ECF No. 1-2 at 21. The Bankruptcy Court described the valid-when-made rule as "long-established," citing to several old Supreme Court cases and a handful of more recent Court of Appeals cases. *Id*. at 21–22. So long-standing, the Bankruptcy Court asserted, that it was inherently incorporated into both the

NBA and, later, the DIDA. *Id.* at 21. The FDIC further elaborates on this argument in its amicus brief. ECF No. 11 at 10–13.

Professor Levitin makes a compelling counterargument to the valid-when-made rule in his own amicus brief. He explains that the valid-when-made rule is a modern invention that could not have been incorporated into either the NBA or the DIDA. ECF No. 16 at 15–18. Alternatively, Professor Levitin requests that if I do apply the valid-when-made rule, I carve out an exception for loans intended for assignment from their inception. He cites to *Strike v. Trans-West Discount Corp*., 92 Cal. App. 3d 735, 745 (Cal. Ct. App. 1979), which he describes as the only pre-DIDA case that has "anything remotely" to do with the valid-when-made rule as conceived by the Bankruptcy Court. In that case, a California state appellate court ruled that the California Constitution's exemption for banks from usury extended to assignees. *See id*. However, the court carved out an exception for loans intended for assignment from inception. *See id.*

Although I am convinced by Professor Levitin's academic analysis and by the Second Circuit's discussion, the Office of the Comptroller of the Currency ("OCC") in the U.S. Department of Treasury recently finalized a rule that upholds the valid-when-made rule in the instant context. *See Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred*, 85 Fed. Reg. 33,530, 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pt. 7, 160). The rule clarifies that "when a bank transfers a loan, the interest permissible before the transfer continues to be permissible after the transfer." *Id*. The rule is expressly reactionary to "the legal uncertainty created by the *Madden* decision." *Id*. at 33,531. It was issued after the briefing and the decision by the Bankruptcy Court in this case.

The OCC cites the NBA as authority for this rule. *See Permissible Interest on Loans*, 85 Fed. Reg. at 33,531. As noted, the NBA and the DIDA are mirror images and are generally interpreted in accordance. *See Mamot Feed Lot*, 539 F.3d at 902-03. The rule explains that the NBA "clearly establishes that a national bank may (1) lend money, pursuant to a loan contract, with an interest term that is consistent with the laws of the state in which the bank is located and (2) subsequently transfer that loan and assign the loan contract." *Permissible Interest on Loans*, 85 Fed. Reg. at 33,531. Further, "[w]hen Congress enacted the NBA, it understood that loan transfers were a fundamental aspect of the business of banking and . . . the national banking system." *Id.*

The rule addresses commentator concerns that the valid-when-made rule "would facilitate predatory lending by promoting rent-a-charter relationships that allow nonbanks to evade state law." *Id.* at 33,534. It emphasizes the OCC's "strong position" against predatory lending and points to its guidance on how to manage risk related to third-party relationships. *See id.* The rule also refutes the argument that it "would undermine state interest caps" by noting that the valid-when-made rule affects only which state law applies; not whether state law applies. *See id.* However, the rule states that it "does not address which entity is the true lender" for predatory lending purposes. *Id.* at 33,535.

In accordance with this new OCC rule, I find that a promissory note with an interest rate that was valid when made under DIDA § 1831d remains valid upon assignment to a non-bank. But, as noted below, the new OCC rule introduces another issue that is relevant in this case: was the nonbank the "true lender" in this instance.

**B. <u>Whether Preemption is an Affirmative Defense</u>**

Rent-Rite argues that even if DIDA § 1831d does apply to loans assigned to non-banks, the Bankruptcy Court erred in even considering DIDA § 1831d because WBL failed to plead federal preemption as an affirmative defense. Here, the parties had agreed that the facts of the case were largely uncontested, agreed to forgo trial, and requested that the Bankruptcy Court rule on the remaining legal dispute. After receiving the parties' final briefs, the Bankruptcy Court decided that additional legal disputes required briefing—including whether DIDA § 1831d applied. Rent-Rite argues that it was error for the Bankruptcy Court to sua sponte raise federal preemption. ECF No. 7 at 15.

The Bankruptcy Court addressed this concern in its order, explaining that whether federal preemption constitutes an affirmative defense that must be pled is not settled within the Tenth Circuit. I tend to disagree with that conclusion. The Tenth Circuit held in *Cook v. Rockwell Int'l Corp.*, 790 F.3d 1088, 1092 (10th Cir. 2015), that "potential preemption defenses, like most other affirmative defenses, are forfeited if not made." Although the Bankruptcy Court is correct that *Cook* relies on the inapposite case of *Mauldin v. Worldcom, Inc.*, 263 F.3d 1205, 1211 (10th Cir. 2001) (finding that an argument had not been preserved for appeal because neither party had ever brought it up), that does not change *Cook*'s binding holding. In *Devon Energy Prod. Co., L.P. v. Mosaic Potash Carlsbad, Inc.*, 693 F.3d 1195, 1203 n.4 (10th Cir. 2012), the Tenth Circuit noted that "[o]rdinary preemption may be invoked in both state and federal court as an affirmative defense to the allegations in a plaintiff's complaint."

In this case, however, the parties asked the Bankruptcy Court to make a ruling on the law. The court reasonably concluded that it needed to have the DIDA issue briefed before rendering a decision. The purpose of requiring affirmative defenses to be pled is to "give the opposing party fair notice of the defense and the grounds upon which it rests." *Hayne v. Green Ford Sales, Inc.*,

263 F.R.D. 647, 649 (D. Kan. 2009). By requesting supplemental briefing on a new legal question, the Bankruptcy Court provided Rent-Rite notice and opportunity to address it. Holding otherwise would prevent courts from requesting additional briefing as necessary to resolve a case.

That being said, the Bankruptcy Court's request for supplemental briefing on DIDA § 1831d unknowingly (because the OCC rule had not yet issued) raised a new and material factual dispute: whether WBL was the "true lender" on the loan. If the true lender is a non-bank assignee, then DIDA § 1831d cannot attach. *See Fed. Deposit Ins. Corp. v. Lattimore Land Corp.*, 656 F.2d 139, 147 (5th Cir. 1981) (citing *Daniel v. First National Bank*, 227 F.2d 353 (5th Cir. 1955)) (noting an exception to NBA § 85 where "what was nominally a discount was either in fact a disguised loan by the bank or a usurious loan originally which the bank by its close association to the original transaction knew was flawed"). The OCC's new valid-when-made rule incorporates this principle, noting that it "does not address which entity is the true lender." *Permissible Interest on Loans*, 85 Fed. Reg. at 33,535.

The addition of a new factual dispute is relevant here because the parties agreed to forgo discovery and trial expressly based on their understanding that there were no relevant factual disputes. They agreed that only legal disputes remained, specifically: whether the choice-of-law provision in the promissory note governed; whether and how to apply Colorado conflict of law analysis; and whether the promissory note or the deed of trust was the governing instrument for choice-of-law purposes. Thus, the fact that Rent-Rite had notice of the federal preemption argument at the supplemental briefing stage is insufficient here because it did not give Rent-Rite opportunity to conduct discovery on the factual question of whether WBL was the true lender. Indeed, at oral argument Rent-Rite alleged that evidence exists in this case indicating that WBL

was the true lender who engaged in a rent-a-bank scheme with Bank of Lake Mills. For example, Rent-Rite noted the fact that a small Colorado lender obtained a subprime, high-interest loan from a Wisconsin community bank and the existence of alleged evidence that WBL was involved in negotiations over the original loan with CMS indicate that WBL may be the true lender.

**C. Conclusion**

I find that, per rule-based guidance from the OCC, a promissory note with an interest rate that was valid when made under DIDA § 1831d remains valid even upon assignment to a non-bank. However, DIDA § 1831d cannot apply to a promissory note with a nonbank true lender. Here, the parties did not have the opportunity to conduct discovery on the factual question of whether WBL was the true lender. As such, I reverse and remand to the Bankruptcy Court so that the parties can conduct discovery on whether WBL was the true lender, and the Bankruptcy Court can then make an appropriate finding on the issue.

**ORDER**

For the reasons described above, the May 20, 2019 Order of the Bankruptcy Court is REVERSED in part and REMANDED.

DATED this 12th day of August, 2020.

BY THE COURT:

R. Brooke Jackson
United States District Judge

## APPENDIX C

Comment of the Structured Finance Association and Bank Policy Institute (Jan. 21, 2020)

STRUCTURED
FINANCE
ASSOCIATION

bpi
BANK POLICY INSTITUTE

January 21, 2020

Office of the Comptroller of the Currency
Chief Counsel's Office
Attention: Comment Processing Office
400 7th Street, SW, Suite 3E-218
Washington, DC 20219

**Docket ID OCC-2019-0027, RIN 1557-AE73**

Re: Permissible Interest on Loans that are Sold, Assigned or Otherwise Transferred (84 Fed. Reg. 64229 - November 21, 2019)

Dear Ladies and Gentlemen:

**Executive Summary**

The Structured Finance Association ("SFA")[1] and the Bank Policy Institute ("BPI")[2] appreciate the opportunity to comment on the notice of proposed rulemaking ("Proposed Rule") by the Office of the Comptroller of the Currency ("OCC") concerning Section 85 of the National Bank Act ("Section 85") and Section 4(g)(1) of the Home Owners' Loan Act ("HOLA"), 12 U.S.C. § 1463(g)(1) ("Section 1463"). The Proposed Rule amends 12 C.F.R. § 7.4001 and 12 C.F.R. § 160.110 in a manner that would directly rectify the ruling by the U.S. Court of Appeals for the Second Circuit in *Madden* v. *Midland Funding*, LLC, 786 F.3d 246 (2nd Cir. 2015), which erroneously held that a loan that is validly originated by a national bank under Section 85 may, at a subsequent time, become usurious if that national bank sells or assigns the loan to any person or entity that is not a bank.

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[1] SFA is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFA provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFA represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.structuredfinance.org.

[2] BPI is a nonpartisan public policy, research, and advocacy group, representing the nation's leading banks. BPI's members include universal banks, regional banks, and major foreign banks doing business in the United States. Collectively, BPI members employ nearly two million Americans, make 72% of all loans, including nearly half of the nation's small business loans, and serve as an engine for financial innovation and economic growth.

SFA, BPI, and their members have a substantial interest in the Proposed Rule. BPI's primary goal is to help its member banks function in a safe and sound manner, which includes ensuring that they are able to originate and sell or assign loans or participation interests in loans in an efficient and timely manner and serve their customers and communities. As of September 2019, insured depository institutions held over $10 trillion in outstanding loans. *See* FDIC, Statistics at a Glance (September 30, 2019).[3] SFA's core mission is to support a robust and liquid securitization market, recognizing that securitization is an essential source of core funding for the real economy. As of the end of 2018, securitization transactions were the source of more than $11.3 trillion in funding for the U.S. economy.[4] This amount represented more than 50% of aggregate outstanding U.S. household debt—including 69% of residential mortgage debt, 17% of automobile debt, 12% of student loan debt, and 14% of credit card debt.

Without the Proposed Rule, *Madden*, and the more recent complaints filed in the federal district courts in the Eastern and Western Districts of New York[5] against the credit card securitization programs of two of the largest national banks, threaten to disrupt substantially the multi-trillion dollar U.S. origination, securitization, and secondary markets for loans.[6] These recent cases do not target payday or similar short-term high interest loans but rather credit cards, the most prevalent form of U.S consumer credit. Specifically, these cases throw into doubt the enforceability of the interest rate terms of loan agreements following a national bank's assignment of a loan to a non-bank and have overturned long-established legal principles. Government officials, Congress and industry groups have recognized the threat presented by *Madden* and have asked the OCC and the Federal Deposit Insurance Corporation ("FDIC") to help address this issue.[7] Accordingly, SFA and BPI strongly support the Proposed Rule.

*First*, the Proposed Rule would fix the plainly erroneous ruling in *Madden* by correctly articulating the function of Section 85 and Section 1463, which allow national banks and federal savings associations not only to make loans, but, as an essential part of making loans, to sell, assign, or securitize those loans or participation interests in those loans without interference from state law. This is especially true because, as explained below, Sections 85 and 1463 were enacted in the context of the already long-established, "cardinal rule" that a loan "valid-when-

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[3] https://www.fdic.gov/bank/statistical/stats/2019sep/industry.pdf

[4] *See* Sec. Indus. & Fin. Mkts. Ass'n, *US ABS Issuance and Outstanding* (July 1, 2019), https://www.sifma.org/resources/research/us-abs-issuance-and-outstanding/; Sec. Indus. & Fin. Mkts. Ass'n, *US Mortgage-Related Issuance and Outstanding* (July 1, 2019), https://www.sifma.org/resources/research/us-mortgage-related-issuance-and-outstanding/.

[5] *See Petersen, et al.* v. *Chase Card Funding, LLC*, et al., No. 1:19-cv-00741-LJV (W.D.N.Y. June 6, 2019); *Cohen, et al.* v. *Capital One Funding, LLC et al*., No. 19-03479 (E.D.N.Y. June 12, 2019).

[6] *See* Claire Boston, "Usury Lawsuits Put Future of a $563 Billion Bond Market at Risk" (Bloomberg Sept. 17, 2019) (pair of lawsuits could threaten the future of the $563 billion market for debt backed by consumer obligations).

[7] For example, the Secretary of the U.S. Department of the Treasury recommended, in a July 2018 report to the President, that the Federal banking regulators should "use their available authorities to address challenges posed by Madden." *See* "A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation," July 31, 2018, at p. 93; *see also* Letter to Joseph Otting, Comptroller of the Currency from Members of Congress dated September 19, 2019 (requesting that the OCC take action to mitigate the consequences of the Madden decision).

made" cannot subsequently become usurious simply because the loan is sold or assigned to another party.

*Second*, by restoring centuries-old fundamental market expectations, the Proposed Rule would enable national banks and federal savings associations to support their customers and communities by extending credit to consumers and small businesses, without fear that the lenders will not be able to sell, assign, or securitize the loans or participation interests in those loans due to the concern that potential purchasers or assignees of the loans will have about the application of state interest rate restrictions to the loans post-purchase. The clarity of authority will be of particular benefit for loans to borrowers with lower credit because a bank will be more reluctant to make loans with higher credit risk if they must be held to maturity or are less salable. Allowing national banks and federal savings associations to sell, assign, or securitize loans or participation interests in loans will also provide them with the additional capital they need to continue lending into the market.

*Third*, the Proposed Rule would increase the safety and soundness of the financial system by allowing national banks and federal savings associations the flexibility to easily liquidate loans in times of stress. For national banks and federal savings associations, the uncertainty regarding the enforceability of interest rate terms hinders and frustrates risk management activities such as securitization, loan sales, and sales of participation interests in loans, which are crucial to the safety and soundness of these institutions' operations for several reasons. Securitization, loan sales, and the sale of participation interests in loans enable banks to increase liquidity in an economic downturn, to meet unusually high deposit withdrawal demands, or to pay unexpected liabilities. Securitization, loan sales, and the sale of participation interests in loans also enable banks to increase liquidity and meet increasing credit demand from borrowers. Banks may also need to sell loans to avoid excessive concentrations in particular asset classes. Additionally, banks may need to seek to sell non-performing loans in circumstances to improve overall asset quality or where it would be unduly costly to pursue collection strategies. Without the ability to sell, assign, or securitize loans or participation interests in loans, a bank's or federal savings association's lending would be constrained by the size of its balance sheet.

*Finally*, SFA and BPI have some comments to help strengthen the Proposed Rule.

## I. The Proposed Rule would reestablish the correct legal interpretation—well understood for over 150 years—that a loan validly originated does not become usurious if the originator subsequently sells, assigns, or securitizes the loan.

In enacting the National Bank Act ("NBA") in 1864, "Congress intended to facilitate . . . a 'national banking system.'" *Marquette Nat'l Bank of Minneapolis* v. *First of Omaha Serv. Corp.*, 439 U.S. 299, 314–15 (1978) (quoting Cong. Globe, 38th Cong., 1st Sess. 1451 (1864) (statement of Rep. Hooper)). To achieve this purpose, the NBA sought to insulate national banks from "the hazard of unfriendly legislation by the States." *Tiffany* v. *Nat'l Bank of Mo.*, 85 U.S. 409, 413 (1873). Section 85 and 12 U.S.C. §86 ("Section 86") are two ways that Congress protected national banks from state usury claims.

Under Section 85, national banks are permitted to "charge on any loan . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located," rather than complying with local law in every jurisdiction in which the borrower may be located. Section

86 then provides the exclusive remedy for a bank's charging of interest at a rate greater than permitted by Section 85. Courts have long recognized that together these two sections completely preempt the application of state usury laws to loans originated by a national bank. *See, e.g., Beneficial Nat'l Bank* v. *Anderson*, 539 U.S. 1, 11 (2003) ("[T]here is . . . no such thing as a state-law claim of usury against a national bank."); *Marquette*, 439 U.S. at 318 & n.31 ("To the extent the enumerated federal rates of interest are greater than permissible state rates, state usury laws must, of course, give way to the federal statute.").

Section 1463 permits federal savings associations to charge interest at the highest rate allowed to competing lenders by the state where the association is located and to export this rate to borrowers in other states, regardless of any other state law purporting to limit the interest permitted on bank loans. Exportation of interest rates under Sections 85 and 1463 allows national banks and federal savings associations to operate uniform nationwide lending programs without regard to multiple and variable state limits on interest rates. Investors and secondary market purchasers of bank loans also need to know that the terms of the loans, including the interest rate, will remain permissible after the sale, assignment or transfer of the loan by the national bank or federal saving institution.[8] The Proposed Rule is consistent with the underlying purposes of the NBA and HOLA and reduces uncertainty in the marketplace by providing that interest on a loan that is permissible under Sections 85 and 1463, respectively, is unaffected by the sale, assignment, or other transfer of the loan by the institution.[9]

Under the NBA and HOLA, the authority of national banks and federal savings associations to sell, assign, and securitize those validly originated loans is clear for several reasons.

*First*, the rule established by Sections 85 and 1463 is not a departure from, but rather is consistent with and codifies, common law. Well before the enactment of the NBA or HOLA, the U.S. Supreme Court recognized the longstanding common law principle that a loan that is valid-when-made at origination cannot become usurious because it is sold or assigned to another party.[10] Indeed, the Supreme Court called this principle the "cardinal rule[ ] in the doctrine of usury."[11] Numerous state courts—some pre-dating the Supreme Court's decision—had also recognized the valid-when-made doctrine when considering whether a loan is usurious.[12] This

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[8] In this context, the term "investor" refers to investors in a securitization or similar investment vehicle, rather than an entity coming into a loan or credit facility at the time of origination or in the secondary market.

[9] Under the NBA and HOLA, the OCC has the authority to prescribe regulations with respect to national banks and federal savings associations and has previously exercised this interpretive authority with respect to Sections 85 and 1463. *See* 12 U.S.C. § 93a. (OCC "authorized to prescribe rules and regulations to carry out the responsibilities of the office."); 12 U.S.C. § 1463(a)(2) (OCC authorized to "prescribe regulations with respect to savings associations, as the Comptroller determines to be appropriate. . . .".

[10] *Nichols v. Fearson*, 32 U.S. (7 Pet. 103, 109 (1833).

[11] *Id.*

[12] *See, e.g., Munn v. Comm'n Co*., 15 Johns. 44, 55 (N.Y. Sup. Ct. 1818) ("[A]s the bill was free from usury, between the immediate parties to it, no after transaction with another person can, as respects those parties, invalidate it."); *Tuttle v. Clark*, 4 Conn. 153, 157 (1822) (holding that "this note, free from the taint of usury, in its origin," did not become usurious by a subsequent sale); *Knights v. Putnam*, 20 Mass. (3 Pick.) 184, 185 (1825) ("It is a well established principle, that if a note or security is valid when made, no usurious transaction afterwards between the parties or privies will affect its validity.").

longstanding doctrine certainly applies to loans made by a national bank or federal savings association.[13] Congress is presumed to have understood this long-standing doctrine and incorporated it into the NBA and HOLA.[14] Accordingly, a loan by a national bank or federal savings association made in compliance with Section 85 or 1463 is not rendered usurious in the hands of the subsequent holder of the loan.

*Second*, apart from the valid-when-made doctrine, the Proposed Rule aligns with the original purpose of the National Banking Act of 1864. In passing that Act, "Congress intended to facilitate . . . a 'national banking system,'" *Marquette*, 439 U.S. at 314–15 (quoting Cong. Globe, 38th Cong., 1st Sess. 1451 (1864) (statement of Rep. Hooper)), and insulate national banks from "the hazard of unfriendly legislation by the States," *Tiffany*, 85 U.S. at 413. Furthermore, the Proposed Rule is supported by the inherent power of a national bank or federal savings association to originate, sell, or assign contracts. Clearly, a state statute that would require the bank to restructure a loan before it could be resold is a direct infringement of the bank's right to sell the loans made. As the Second Circuit conceded, under the *Madden* rule "it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states."[15] Rather, the application of Madden constitutes a direct infringement of the rights of a national bank under the NBA to set interest rates as the national bank deems appropriate, subject only to the law of the bank's home state. Moreover, national banks and federal savings associations have the authority to make loans and assign their loan contracts to third parties.[16] Because the assignee steps into the bank's or federal savings association's shoes upon assignment, the third party receives the benefit of and may enforce the permissible interest term under the loan agreement. Again, the loan does not become usurious after the assignment simply because a third party is enforcing the contractually agreed upon interest term. *Madden* upsets the expectations of both parties to the loan contact. The consumer agreed to the rate of interest when the loan was made by the national bank or federal savings association and the disclosed terms (including rate of interest) and the other rights provided to the borrower should remain constant. If the interest rate on the loan was changed each time the loan was sold, transferred or assigned, it would create a significant amount of confusion for consumers and secondary market participants.

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[13] SFA and BPI understand that some commentators have erroneously contended that valid-when-made only applies to situations in which the originator of the loan sells the loan at a discount such that the new owner of the loan is effectively receiving a much higher rate of interest on the loan than the originator. Not only do such contentions fly in the face of the clear language and logic of the valid when made doctrine, but we are unaware of those commentators identifying a single case prior to *Madden* where a loan became usurious simply because it was sold or assigned.

[14] *See Astoria Fed. Sav. & Loan Ass'n* v. *Solimino*, 501 U.S. 104, 108 (1991) ("[W]here a common-law principle is well established, * * * the courts may take it as given that Congress has legislated with an expectation that the principle will apply 'except when a statutory purpose to the contrary is evident.'" (quoting *Isbrandtsen Co.* v. *Johnson*, 343 U.S. 779, 783 (1952)) (internal quotation marks and citations omitted)); see also *Lozano* v. *Montoya Alvarez*, 134 S. Ct. 1224, 1232 (2014) (citing *Astoria*, 501 U.S. at 108).

[15] *Madden*, 786 F.3d at 251.

[16] *See* 12 U.S.C. 24(Seventh) (expressly authorizing national banks to carry on the business of banking by "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt"); 12 C.F.R. § 7.4008 (national bank may make, sell, purchase, participate in, or otherwise deal in loans subject to terms, conditions, and limitations prescribed by the OCC and any applicable federal law); 12 C.F.R. § 160.30 (authority for federal savings associations to make, sell, invest in and participate in or otherwise deal in loans).

*Third*, in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which was enacted before the Second Circuit issued *Madden*, Congress indicated its clear desire to maintain the *status quo* ability of national banks and federal savings associations to originate loans and to sell or assign those loans without the risk that that they would become usurious under state law as a result of the sale or assignment to an entity that is not a bank. Specifically, although Congress enacted provisions for when "state consumer financial laws" are preempted, including through the application of the U.S. Supreme Court's preemption test in *Barnett Bank of Marion Cnty., N.A.* v. *Nelson*, 517 U.S. 25, 33 (1996), *see* 12 U.S.C. § 25b(b), Congress specifically stated that no provision of Dodd-Frank "shall be construed as altering or otherwise affecting the authority conferred by section 85 of this title for the charging of interest by a national bank at the rate allowed by the laws of the State, territory, or district where the bank is located, including with respect to the meaning of 'interest' under such provision." 12 U.S.C. § 25b(f). If Congress had desired to do anything but reaffirm the centuries-old *status quo* that a validly originated loan may be sold or assigned without making the loan usurious, Congress would have spoken at that time.

*Fourth*, even if a court were to apply the U.S. Supreme Court's decision in *Barnett Bank*—under which a state law is preempted if it would "prevent or significantly interfere with the national bank's exercise of [those] powers"—also supports the OCC's proposed rule.[17] "[T]he level of 'interference' that gives rise to preemption under the NBA is not very high." *Monroe Retail, Inc.* v. *RBS Citizens, N.A.*, 589 F.3d 274, 283 (6th Cir. 2009). If state usury limits applied to sold, assigned, or securitized loans, national banks and federal savings associations could be forced to (i) forgo loan sales, sales of participation interests or securitizations in order to maintain the benefits of preemption under Sections 85 and 1463; (ii) originate loans in compliance with each individual state's interest rate restrictions, in order to preserve the option of sale, assignment, or securitization; or (iii) reduce the interest rates on the loans prior to sale or assignment. Any of these alternatives would substantially interfere with a national bank's or federal savings association's operations in violation of 12 U.S.C. § 25b(b)(1)(B) or 12 U.S.C. § 1465.

As to the first and third points, it is clear that effectively compelling national banks and federal savings association to forgo sales of loans or participation interests in loans or securitizations would, as explained above, significantly and improperly intrude on their statutorily granted powers. For example, when one state passed a law that expanded the scope of liability for assignees of certain mortgage loans, the OCC opined that the state law was inconsistent with "the exercise of national banks' real estate lending powers, *including the power . . . to securitize these loans*," and that the state law was therefore preempted. Preemption Determination and Order, 68 Fed. Reg. 46,264-02, 46,278–79 (Aug. 5, 2003) (emphasis added).[18]

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[17] Congress has codified the *Barnett Bank* standard. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1044(f ), 124 Stat. 2017 (codified at 12 U.S.C. 25b(f)); 12 U.S.C. § 1465 (covering federal savings associations).

[18] Courts have reached similar conclusions. *See, e.g.*, *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285, 288–89 (7th Cir. 2005) (Posner, J.) (bank would be improperly "deprived" of power to transfer interest in loan if original interest rate could not be charged post-transfer); *Strike v. Trans-West Discount Corp.*, 155 Cal. Rptr. 132, 139 (Cal. Ct. App. 1979) (restriction of bank's ability to access secondary loan market "would be disastrous in terms of bank operations and not conformable to the public policy" of exempting banks from usury laws).

As to the second point, subjecting national banks and federal savings associations to a patchwork of dozens of state-law interest rate limits would impose an extraordinary burden. For every loan that a national bank or federal savings association might want to, or needed to, sell or securitize at some point, it would have to forgo its rights under Sections 85 and 1463 and comply with the interest rate restrictions in each individual jurisdiction. Instead of employing standardized loan products and nationwide underwriting programs, national banks and federal savings associations would be forced to establish different lending programs for each state. Further, the question of state interest rate caps is not limited to a simple analysis of a stated percentage rate (or, often, rates);[19] it also entails a detailed and complex analysis of what is deemed to constitute interest (*e.g.*, fees) for this purpose. Employing state-specific lending programs therefore would significantly increase the costs and administrative burden of loan origination for the many national banks and federal savings associations that make loans to borrowers in multiple states, and such increased cost would most certainly be passed on to borrowers in the form of higher interest rates. Thus, applying state interest rate limits to securitized loans would significantly interfere with the lending powers of national banks and federal savings associations, regardless of whether they seek to comply with those limits in order to continue securitization or forgo securitization to retain their rights under Sections 85 and 1463. As explained below, there is already evidence that, by threatening the ability of national banks and federal savings associations to validly exercise these powers, *Madden* is causing interference in the lending and securitization markets.

## II. The Proposed Rule will help avoid disruption to the lending and securitization markets.

*Madden*, if not fixed, will continue to negatively impact U.S. credit markets. Non-bank purchasers of loans will hesitate to purchase loans originated by national banks for fear that the act of selling the loan will trigger a change in the rate of interest that can be charged on the loan. National banks and federal savings associations will hesitate to sell loans because of an increased risk of liability to the purchasers if the loans are later held to be usurious (particularly where they will not be able to make standard representations and warranties regarding the validity of the loan). To the extent that non-bank purchasers do purchase loans from national banks or federal savings associations, those purchasers will need to engage in due diligence to understand the potentially relevant new rates, and then potentially discount the purchase price to reflect the different rates and time and money spent on the due diligence.

If banks are unable to sell or securitize loans, or are restricted in those transactions, they will be forced to reduce the amount of credit they extend and to increase the costs for the reduced amount of credit they do extend. This will reduce the overall liquidity to the financial markets. The reduction in bank lending would adversely impact the economy in several ways. First, it would result in higher borrowing costs for those receiving credit. This would mean higher interest rates for consumers and small businesses obtaining credit. Second, fewer borrowers would be able to obtain credit from banks, resulting in less credit for consumers and small businesses, especially those with lower credit scores or thin credit files. As scholars have long

[19] Many states establish multiple permissible rate levels for loans subject to the laws of the state depending, among other things, on the type of borrower, type or purpose of the loan, and/or the size of the loan.

pointed out with respect to these types of loans, "restrictions in credit markets hurt highest-risk borrowers the most."[20]

Although *Madden's* long-term effects on the credit markets are still being studied and analyzed, there already are indications of its adverse impact on certain types of loans and consumers located in Connecticut, New York and Vermont.[21] Likewise, some financial institutions are reported to have imposed restrictions on credit facilities used to finance consumer lending, prohibiting loans to borrowers in the Second Circuit if those loans bear interest at rates higher than the state-permitted rates.

These adverse effects inevitably will grow if *Madden* is not corrected, and this is especially so if *Madden* is followed in other circumstances and by courts in other Circuits. In the current low interest rate environment, many loans are made at rates that would not be deemed usurious under many states' laws. But, as interest rates rise, more loans will necessarily be made at rates that may exceed those permitted in the numerous states that have fixed interest rates.[22] In turn, banks and other lenders—as a result of *Madden*—will likely have to impose tighter restrictions on lending to ensure that the loans they make will not be subject to state interest rate limits if sold.

If adopted in its current form, the Proposed Rule would (i) alleviate these concerns, (ii) provide borrowers with greater access to credit, (iii) provide investors, banks engaged in securitizations and secondary market purchasers of bank loans and participation interests greater certainty around the enforceability of these loans, (iv) as discussed below, enhance safety and soundness,[23] and (v) alleviate concerns that courts outside the Second Circuit will adopt *Madden*'s flawed reasoning.[24]

## III. The Proposed Rule will help the safety and soundness of the financial system.

National banks and federal savings associations depend on the ability to sell, assign, or securitize the loans they originate to provide liquidity to support their lending operations and to foster their safety and soundness. If these loans could not be sold or securitized, or the ability to do so was

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[20] William F. Baxter, Section 85 of the Nat'l Bank Act and Consumer Welfare, 1995 Utah L. Rev. 1009, 1023 (1995). Small businesses likely will be similarly affected because they lack access to the broader capital markets, and are more dependent on bank financing than large corporations. *See* Karen Gordon Mills & Brayden McCarthy, The State of Small Business Lending: Credit Access during the Recovery and How Tech. May Change the Game (Harvard Bus. Sch. Working Paper No. 15-004, 2014).

[21] *See* Colleen Honigsberg, Robert Jackson and Richard Squire, "How Does Legal Enforceability Affect Consumer lending? Evidence from a Natural Experiment," Journal of Law and Economics, vol. 60 (November 2017); and Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy" (July 5, 2018).

[22] For example, the standard maximum permissible interest rate is 12% in Virginia, *see* Va. Code Ann. 6.2-303(A), and 17% in Arkansas, see Ark. Const. Amend. 89 § 3.

[23] The Dodd-Frank Act explicitly stated that Section 85 would not be impacted by the new preemption standards of Title X. *See* 12 U.S.C. §25b(f). Furthermore, the OCC received deference in *Smiley* in interpreting Section 85. *See Smiley v. Citibank (South Dakota)*, 517 U.S. 735, 739 (1996).

[24] While beyond the scope of this comment letter, SFA believes that the OCC's interpretation of Sections 85 and 1463 as set forth in a final rule would be entitled to deference.

severely restricted, national banks and federal savings association would be required to reduce vastly the amount of credit they extend to avoid carrying potentially too many illiquid loans and to increase the costs for the reduced amount of credit they do extend.

Indeed, the *Madden* decision greatly complicates all loan sales by forcing market participants to consider the following factors in originating, purchasing or securitizing loans that they did not have to consider before:

- How readily will the original lender, or a subsequent purchaser, be able to sell, or resell, the rights to the loan to another party?
- What state law will govern the rate (and definition) of interest collectible on the loan?
- Will the purchaser be able to collect based on the original loan terms?
- Will the assignee be subject to suit in the Second Circuit, or only a court that applies the traditional valid-when-made rule?

The multiple uncertainties will constrict the availability of liquidity in the credit markets, because secondary market participants will likely be less willing, indeed sometimes unwilling, to purchase loans, participation interests in loans or interests in securitizations of loans that may be subject to state law interest rate limits that are lower than the stated rate of the loan. This is especially true given that some purchasers may even be subject to criminal sanctions in a number of states.[25] And, to the extent market participants do purchase loans or participation interests in loans, they are likely to discount the value to reflect the risk they take of receiving lower rates of interest than allowed on the face of the loan, or even the voiding of the loan.

In addition, sales of loans or participation interests in loans usually include representations and warranties that the loan is collectible in accordance with its terms and that the sale does not violate any law. However, in light of *Madden*, sellers in the Second Circuit may now be unable to make those representations and warranties, which could further depress the price of any loans sold by national banks or federal savings associations or, at worst, render such sales infeasible. To the extent sellers make such representations and warranties and *Madden* is not fixed, the sellers could be subject to liability in private lawsuits. Moreover, the impact of Madden is not limited to future loan sales. Any entity that has purchased or sold loans in the past now faces the possibility that those prior transactions—entered into in reliance upon on the valid-when-made doctrine—may now become subject to disputes with, and potential liability to, purchasers for collecting interest as permitted in loan agreements valid at origination and claims by purchasers against loan sellers seeking to recover for the loss in value of the loans they purchased.

[25] *See, e.g.*, Mich. Comp. Laws Ann. 438.41 (interest in excess of 25% is punishable by up to five years imprisonment and/or $10,000 fine); N.Y. Penal Law 190.40 (interest in excess of 25% is a felony punishable by up to four years imprisonment and/or $5,000 fine).

By threatening to reduce the value and liquidity of the multi-trillion-dollar portfolio of loans that banks currently hold or have securitized, the decision could reduce the capital of banks, and ultimately have implications for the safety and soundness of the banking system.

## IV. Suggestions for clarifying the text of the Proposed Rule.

As noted, SFA and BPI are highly supportive of the OCC's efforts to address the adverse effects of the *Madden* decision on the origination, secondary, and securitization markets via the Proposed Rule and would ask the OCC to finalize the proposal as soon as possible to address the uncertainty in the market.

Although the Proposed Rule is not a joint rulemaking, we encourage the OCC to work with the FDIC to harmonize the text of the Proposed Rule with the proposed rule issued by the FDIC based on its comparable authority under 12 U.S.C. § 1831d ("Section1831d") with respect to FDIC-insured state depository institutions. Recognizing the value of uniformity in applicable interest laws amongst the various types of depository institutions, Congress extended the longstanding principles of Section 85 to federal savings associations and state-chartered insured depository institutions when it enacted the Depository Institutions Deregulation and Monetary Control Act of 1980.[26]

The FDIC historically has interpreted this interest rate authority provision in Section 1831d in a consistent manner with Section 85 and OCC precedent.[27] From the perspective of investors, secondary market purchasers of loans and participation interest in loans and depository institution lenders, it is important that there remains interest rate authority parity amongst depository institutions regardless of whether they may be a national bank, federally-licensed branch, federal savings association, or state-chartered insured depository institution. Harmonizing the Proposed Rule with the FDIC's proposed rule will also help ensure that this parity amongst depository institutions continues and the effect on interest after a loan is sold, transferred or assigned will not vary depending upon whether the lender is a national bank, federal savings association or state-chartered insured depository institution.[28]

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[26] *See* 12 U.S.C. § 1831d; 12 U.S.C. § 1463(g).

[27] *See Greenwood Trust Co. v. Mass.,* 971 F.2d 818, 827 (1st Cir. 1992) (Section 1831d borrows from Section 85 to achieve parity between national banks and their state-chartered counterparts.). For this reason, courts have held that Section 85 and Section 1831d should be interpreted the same way. *Id*.

[28] For example, we believe the FDIC's definition of interest in its proposed rule is comprehensive and helpful and follows the language in the OCC's current definition in 12 C.F.R. § 7.4001. 84 Fed. Reg. 66,853 (Dec. 6, 2019).

## V. Conclusion

SFA and BPI appreciate the opportunity to provide the foregoing comments on the Proposed Rule. Should you wish to discuss any matters addressed in this comment letter further, please contact Kristi Leo of SFA at (202) 847-4556 or at kristi.leo@structuredfinance.org, or Naeha Prakash of BPI at (202) 589-2429 or at Naeha.Prakash@BPI.com.

Respectfully submitted,

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**APPENDIX D**

Comment of Professor Adam J. Levitin (Jan. 5, 2020)

GEORGETOWN LAW

**Adam J. Levitin**
*Agnes N. Williams Research Professor*
*& Professor of Law*

January 5, 2020

Office of Comptroller of the Currency
Chief Counsel's Office,
Attention: Comment Processing
400 7th Street, SW., suite 3E-218
Washington, DC 20219
*regs.comments@occ.treas.gov*.

RE: Docket No. OCC-2019-0027 (RIN 1557-AE73)

Dear Sir/Madam:

I write to strongly object to the Notice of Proposed Rulemaking (the "Proposed Rule") issued by the Office of Comptroller of the Currency (OCC) regarding "Permissible interest on loans that are sold, assigned, or otherwise transferred," Docket No. OCC-2019-0027.[1] Without claiming any statutory ambiguity, the Proposed Rule seeks to overturn the decision of the Second Circuit Court of Appeals in *Madden v. Midland Funding*,[2] to allow non-bank assignees of national banking associations to charge interest at the rates permitted to national banks pursuant to section 85 of the National Bank Act,[3] without regard to the usury laws of the borrower's state. In other words, the Proposed Rule would effectively preempt state usury laws in order to allow non-bank assignees to purchase loans with interest rates that exceed the rates allowed if the non-bank assigned had made the loans themselves. The Proposed Rule allows non-banks to do indirectly what they are forbidden to do directly, and in so doing endangers the safety-and-soundness of national banks and undermines consumer protections. As I detail below, the Proposed Rule is both illegal and bad policy. The OCC should retract the Proposed Rule.

[1] 84 Fed. Reg. 64229 (Nov. 21, 2019).
[2] 786 F.3d 246 (2nd Cir. 2015).
[3] 12 U.S.C. § 85.

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## I. Qualifications

By way of background, I am the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center, where I teach courses in Consumer Finance, Financial Regulation, Contracts, Commercial Law, Structured Finance, and Bankruptcy. I have also previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School and as faculty for the Federal Trade Commission's Division of Financial Practices training program, and am elected member of the American Law Institute, which awarded me its Young Scholars Medal in 2013. I have also previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board and as an expert witness for the Federal Deposit Insurance Corporation in four related rent-a-bank litigations.[4]

Among my publications is the first law school textbook on consumer finance, ADAM J. LEVITIN, *CONSUMER FINANCE: MARKETS AND REGULATION* (Wolters Kluwer 2018), which includes a chapter devoted to usury laws, as well as materials on rent-a-bank lending and securitization. I have also written several journalistic articles about the so-called "valid-when-made" doctrine, as well as submitted amicus briefs about the doctrine in four cases, including one, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo.), in which the OCC has also appeared as an amicus. The OCC was served electronically (at its consent) with my amicus brief in that case. I have attached a copy of the brief, which details the spurious nature of the valid-when-made doctrine and the fallacious claim of the applicability of the common law of assignments to the question of what interest a non-bank may charge as an appendix.

## II. The Proposed Rule Is Illegal

The Proposed Rule is patently illegal for three reasons. First, the OCC is lacks delegated authority to undertake the rulemaking. The OCC has no authority to regulate interest charges by entities other than national banks, so it has no authority to undertake a rulemaking with such effect. Even if it had such authority, however, the OCC is bound by the *Madden* decision under the Supreme Court's *Brand X* jurisprudence because section 85 of the National Bank Act is unambiguous.

Second, the Proposed Rule fails to comply with the statutory requirements of the National Bank Act. All OCC rulemakings that have the effect of preempting state consumer financial laws are subject to the procedural requirements of section 25b(b) of the National Bank Act. The statute provides no exceptions. The OCC has not complied with the procedural requirements of section 25b(b), nor can the Proposed Rule meet the preemption standard of "significant interference" provided by section 25b.

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[4] FDIC v. Columbus Bank & Trust, Columbus, Georgia, FDIC-08-139b, FDIC-08-140k (2008); FDIC v. First Bank of Delaware, Wilmington Delaware, FDIC-07-256b, FDIC-07-257k (2007); FDIC v. First Bank & Trust, Brookings, South Dakota, FDIC-07-228b, FDIC-07-260k (2007); FDIC v. CompuCredit Corp., FDIC-08-033b, FDIC-08-034k (2008).

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Third, the Proposed Rule is arbitrary and capricious and therefore in violation of the Administrative Procedures Act.[5] The Proposed Rule is arbitrary and capricious for three reasons: it lacks an evidentiary basis; it ignores key evidence; it patently misapplies common law; and its solution does not actually address key aspects of the supposed problem. This section elaborates on the legal problems with the Proposed Rule.

### *A. The Proposed Rule Fails to Comply with the Administrative Procedures Act Because It Goes Beyond the Scope of Congressional Delegation to the OCC*

#### *1. The Proposed Rule Goes Beyond the Scope of the OCC's Statutory Authority Because the OCC Has No Authority to Regulate Interest Charges by Non-banks*

The Proposed Rule is illegal because it does not comply with the Administrative Procedures Act because it exceeds the scope of the OCC's statutory authority.[6]

The question this rulemaking addresses is whether the interest allowed to national banks under section 85 is affected by "sale, assignment, or other transfer," that is, whether the interest allowed under section 85 is permitted to a non-bank assignee. Congress has not delegated to the OCC the power to preempt state usury laws with respect to non-banks except as through the section 25b procedures. A rulemaking with this effect goes beyond the delegation to the OCC in section 93a to "carry out the responsibilities of the office"[7] because the OCC's responsibilities do not extend to non-banks. the OCC has no authority to interfere with state regulation of non-banks, except to the extent that such regulation "prevents or significantly interferes" with the exercise of a national bank's powers.[8]

The limited scope of the section 85 delegation is patent from the express language of section 85 of the National Bank Act, which refers only to the rate of interest charged by a national banking "association." The reference in section 85 to a national banking "association" inherently excludes all other entities, including all non-banks, from the scope of the provision. There is no ambiguity about what "association" means, and the OCC has not claimed any ambiguity regarding the text of section 85.[9] The scope of the OCC's interpretive authority under section 85 is limited to interest *for banks*.

Indeed, the limited authority in section 85 is clear from comparison with other statutory provisions in title 12. Congress has itself acted to preempt state usury laws with respect to non-banks in a specific context, namely in regard to first lien mortgage loans.[10] Moreover, that same provision expressly preempts state law even in the event of an

[5] 5 U.S.C. § 706(2)(A).

[6] 5 U.S.C. § 706(2)(C).

[7] 12 U.S.C. § 93a.

[8] 12 U.S.C. § 25b(b).

[9] Nor is there any ambiguity about the term "interest" at issue in the Proposed Rule. This is not a situation like that in addressed by the Supreme Court in *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996), regarding what sort of charges are included in the term "interest."

[10] 12 U.S.C. § 1735f-7a.

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assignment.[11] That Congress has acted to preempt state usury laws for assignees other than national banks in another context implies a lack of authority for the OCC to act more broadly under section 85.

### 2. *The OCC Is Bound by Madden v. Midland Funding, LLC and Has No Authority to Undertake the Proposed Rulemaking*

The Proposed Rule seeks to overturn the result of the Second Circuit's ruling in *Madden v. Midland Funding, LLC*.[12] The OCC does not appear to realize that it is in fact bound by the Second Circuit's interpretation of the National Bank Act in *Madden* absent any contrary judicial authority. It does not matter that the OCC was not a party to Madden; the question is not one of issue preclusion, but one of *Chevron* jurisprudence. The OCC has authority to interpret the National Bank Act, but only to the extent that the statute is ambiguous. If the statute is unambiguous and the OCC must defer to prior judicial authority, irrespective of whether it was party to such prior case.[13] Thus in *United States v. Home Concrete & Supply, LLC*, the Supreme Court held that a Treasury regulation did not supplant a prior judicial interpretation of the statute because the statute was unambiguous.[14] Likewise, in *National Cable & Telecommunications Association v. Brand X Internet Services*, the Supreme Court held that "A court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[15]

Although the Supreme Court held that the statute in at issue in *Brand X* was ambiguous, the Circuit Court decision it reversed had applied a prior precedent against the challenged rulemaking even though the agency that promulgated the rule had not been a

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[11] 12 U.S.C. § 1735f-7a(a)(1)(C)(v). I note that Congress enacted this provision at the very same time that it enacted 12 U.S.C. § 1831d, the equivalent provision to section 85 for state insured banks. That Congress chose to address assignees in one provision and not in the other provision (that mirrors section 85) strongly indicates that Congress did not intend section 1831d (or section 85 by implication) to apply to assignees.

[12] 786 F.3d 246 (2nd Cir. 2015).

[13] The idea that the OCC should get any *Chevron* deference is further undermined by the fact that the OCC filed a brief with the Supreme Court opposing certiorari in *Madden*. While that brief did note that the OCC disagreed with *Madden*'s holding, it argued that the case was an inappropriate vehicle to address the case. In other words, the OCC had an opportunity to litigate the *Madden* case and declined to do so. The OCC cannot oppose certiorari because it believes that a case it an inappropriate vehicle for the courts to address a case and then decide that *it* is the appropriate entity to address an unambiguous statute. This sort of gamesmanship is beyond anything allowed by administrative law.

[14] 566 U.S. 478, 486-487 (2012).

[15] 545 U.S. 967, 982 (2005). I noted, however, that under section 25b of the National Bank Act, the OCC's rulemaking would not be entitled to *Chevron* deference. 12 U.S.C. § 25b.

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party to that prior litigation.[16] Subsequent Circuit Court opinions have made clear that when a statute is unambiguous, agencies are bound by prior judicial interpretation and that it is not necessary for the court to have expressly stated that the statute was unambiguous for the agency to be bound.[17]

In this instance, the Second Circuit ruled in *Madden* to interpret the unambiguous text of section 85 of the National Bank Act. This means that the OCC is bound under *Madden* regarding the interpretation of section 85 of the National Bank Act; the OCC's policy preferences are irrelevant in this regard. Accordingly, the Proposed Rule goes beyond the scope of the Congressional delegation to the OCC and is in violation of the Administrative Procedures Act.[18]

### *B. The Proposed Rule Fails to Comply with the Procedural Requirements of the National Bank Act and Is Therefore Illegal under Both the National Bank Act and the Administrative Procedures Act*

The Proposed Rule is illegal because it fails to comply with the procedural requirements of section 25b of the National Bank Act.[19] Section 25b is a new section of the National Bank Act, added as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 25b is a sharp Congressional rebuke of the OCC's aggressive campaign of preemption of state consumer financial laws during the 1990s and 2000s, which contributed directly to the financial crisis. Indeed, there is no provision in the entire Dodd-Frank Act that is a more direct reproach of a federal agency's pre-financial crisis actions other than the outright elimination of the Office of Thrift Supervision.

Section 25b(b) provides that:

> State consumer financial laws are preempted only if…in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in *Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner, et al.*, 517 U.S. 25 (1996), the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers; and any preemption determination under this subparagraph may be made by a court, or by regulation or order of the Comptroller of the Currency on a case-by-case basis, in accordance with applicable law.[20]

The OCC has not made any determination regarding preemption in the Proposed Rule on a case-by-case basis as defined in section 25b(b)(3). Nor is the Proposed Rule supported by *any* evidence, much less the "substantial evidence, made on the record of the proceeding," required by section 25b(c). Accordingly, the Proposed Rule is illegal because it does not

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[16] 545 U.S. 967 (2005).

[17] *See, e.g.*, Texas v. Alabama-Coushatta Tribe of Texas 918 F.3d 440 (5th Cir. 2019); Patel v. Napolitano, 706 F.3d 370 (4th Cir. 2013).

[18] 5 U.S.C. § 706(2)(C).

[19] 12 U.S.C. § 25b.

[20] 12 U.S.C. § 25b(b)(1)(B).

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comply with the procedural requirements of the National Bank Act for preemption of state consumer financial laws, much less the evidentiary burden.

The OCC has previously failed to comply with section 25b's requirements when enacting the current preemption regulations in 12 C.F.R. Part 7, Subpart D. As a result, the entirety of these existing preemption regulations are illegal.[21] The OCC's continued unwillingness to abide by section 25b's procedures suggest that the OCC has not properly internalized the Congressional censure in that provision and is simply defying a clear statutory directive.

Alternatively, it is possible that the OCC's failure to adhere to the requirements of section 25b for the instant Proposed Rule is because the OCC believes that section 25b is inapplicable to a rule made under section 85. If so, the OCC is incorrect. *All* OCC rulemakings that preempt state consumer financial laws must comply with section 25b's procedural and evidentiary requirements. Section 85 is not excepted from section 25b's requirements.[22]

The procedural requirements for preemption of state consumer financial laws are found in section 25b(b), while the evidentiary standards necessary to support a rulemaking with a preemptive effect are found in both sections 25b(b) and 25b(c). Section 25b(b) is absolute in its statement that of the preemption standard: "State consumer financial laws are preempted only if…[there is a finding through the requisite procedures of significant interference or prevention of the exercise of a national bank's powers]." No exception is stated to this rule.

To the extent that the OCC is relying on section 25b(f) as creating an exception for rules promulgated under section 85, it is incorrect. Section 25b(f) is not an exception to section 25b(b). Section 25b(f), entitled "Preservation of Powers Related to Charging Interest" states that:

> No provision of title 62 of the Revised Statutes shall be construed as altering or otherwise affecting the authority conferred by section 85 of this title for the charging of interest by a national bank at the rate allowed by the laws of the State territory, or district where the bank is located…[23]

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[21] *See* Lusnak v. Bank of America, N.A., 883 F.3d 1185 (9th Cir. 2018).

[22] Even if section 85 were itself exempt from section 25b's procedural and evidentiary requirements, the Proposed Rule would still be subject to these requirements because it is not undertaken solely to facilitate national banks' most favored lender power. It is also undertaken to facilitate national bank's power to assign loans as evidenced by the OCC's discussion about the importance of loan assignments for bank risk management and liquidity. The power to assign loans arises under section 24(Seventh) of the National Bank Act, and preemption of state consumer financial laws under that section is, without question subject to the procedural and evidentiary requirements of section 25b. Either way, the Proposed Rule must comply with the procedural and evidentiary requirements of section 25b. It does not.

[23] 12 U.S.C. § 25b(f).

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Even assuming that section 25b(f)'s reference to a "provision of title 62 of the Revised Statutes" is actually meant to include the Dodd-Frank Act itself, section 25b(f) is still not a general exception to section 25b(b), much less for any entities other than national banks themselves.

First, if section 25b(f) were meant to be an exception to 25b(b), it would be drafted as "notwithstanding subsection (b) of this section," or the like. It is not drafted as such. Congress knows how to draft legislative exceptions to rules, and section 25b(f) does not read as one.

Second, the meaning of section 25b(f) is difficult to determine,[24] but it must be read *in pari materia* with sections 25b(e) and 25b(h). Section 25b(e) provides that notwithstanding any provision of title 62 of the Revised Statutes (including, under this reading, the Dodd-Frank Act and thus section 25b(f)), state consumer financial law shall apply the same to a subsidiary or affiliate of a national bank (other than those that are themselves national banks) as to any other non-bank entity.[25] Section 25b(h) provides that "No provision of title 62 of the Revised Statutes [including, again, under this reading, the Dodd-Frank Act and thus section 25b(f)]…shall be construed as preempting, annulling, or affecting the applicability of State law to any subsidiary, affiliate, or agent of a national bank…"[26]

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[24] Arguably, section 25b(f) is meant to clarify that section 25b is not changing the law *as it existed in 2010 when the Dodd-Frank Act was enacted.* Put another way, section 25b(f) is saying that section 25b(b) does not change the existing application of section 85, meaning that it preserves judicial glosses like *Marquette National Bank v. First of Omaha Service Corporation*, 439 U.S. 299 (1978). and *Smiley v. Citibank (South Dakota) N.A.*, 517 U.S. 735 (1996). Section 25b(f), however, says nothing about new interpretative extensions of section 85. Such new interpretative extensions of section 85 are subject to the procedural and evidentiary requirements of sections 25b(b) and 25b(c).

The OCC's Proposed Rule is not simply a restatement of the law as of 2010. Instead, it is a new, expansive interpretation of section 85 beyond the state of the law in 2010. As of 2010 there were virtually no judicial decisions about whether non-bank assignees of national banks were able to shelter in section 85. The only pre-Dodd-Frank decisions touching on the issue, *Krispin v. May Department Stores,* 218 F.3d 919 (8th Cir. 2000), and *Phipps v. FDIC*, 417 F.3d 1006 (8th Cir. 2005). were decided in the procedural context of removal for federal question jurisdiction, rather than on the merits. Moreover, these decisions were both explicitly tied to the unique factual circumstances of the case, rather than absolute statements of blanket rules like the one proposed by the OCC. Indeed, the unique circumstances were why the Second Circuit readily differentiated these cases in *Madden*, 786 F.3d 246 (2nd Cir. 2015). Most critically, *Krispin* was effectively overturned by section 25b(e) because *Krispin* involved the question of whether section 85 extended to an assignee that is an affiliate of a national bank. *Phipps* simply follows *Krispin*, so the overturning of *Krispin* puts it into question.

[25] 12 U.S.C. § 25b(e).

[26] 12 U.S.C. § 25b(h).

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Whereas section 25b(f) refers to a "national bank," sections 25b(e) and 25b(h) refer to national banks' subsidiaries, affiliates, and agents that are not themselves national banks. Thus, whatever section 25b(f) and section 85 are doing, it does not extend to the subsidiaries, affiliates, or agents of national banks, and, by implication, to any non-banks.[27]

It would be absurd to prohibit subsidiaries, affiliates, and agents of national banks from sheltering in section 85, while permitting other non-bank entities to do so. Subsidiaries, affiliates, and agents are all subject to federal regulatory oversight, but other non-bank assignees, are either state-regulated or even unregulated foreign entities. For less regulated entities to gain a regulatory privilege denied to more regulated entities is absurd. If the benefits of section 85 are denied to affiliates, subsidiaries, and agents, *a fortiori* they are denied to unconnected entities. Accordingly, section 25b(f) cannot be read as an exception to section 25b(b).

Because there is no exception to section 25b(b), its procedural requirements apply to any OCC rulemaking that preempts state consumer financial law, including this one, and that means that the Proposed Rule is illegal because it fails to comply with the section 25b(b) requirements. Therefore, it is illegal not just under the National Bank Act, but also under the Administrative Procedures Act because it is "without observance of procedure required by law."[28]

### *C. The Proposed Rule Fails to Comply with the Administrative Procedures Act Because It Is Arbitrary and Capricious*

#### *1. The Proposed Rule Is Arbitrary and Capricious Because It Lacks Any Evidentiary Basis*

On top of the OCC's lack of authority for the rulemaking, the Proposed Rule fails to comply with the Administrative Procedures Act because it is arbitrary and capricious because it lacks an evidentiary basis.[29] The Proposed Rule claims that it is necessary to protect national banks' ability to sell loans without any evidentiary basis of this in fact being a problem post-*Madden*. Specifically, the OCC claims that "banks of all sizes continue to routinely rely on loan assignments and securitization to access alternative funding sources, manage concentrations, improve financial performance ratios, and more efficiently meet customer needs."[30] The OCC has adduced zero data to support this claim, which is in fact misleading. While banks of all sizes engage in residential *mortgage* securitization, most mortgage loans are already exempt from state usury laws.[31] Only a handful of the very largest banks engage in securitization of any other asset class. Other than securitization, banks rarely assign loans

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[27] The Proposed Rule does not distinguish between assignees based on whether they are subsidiaries, affiliates, or agents of national banks or not. Accordingly, even if section 25b's procedures do not apply to the Proposed Rule, the scope of the Proposed Rule is broader than that allowed under section 25b(f) and 25b(h).

[28] 5 U.S.C.§ 706(2)(D).

[29] 5 U.S.C. § 706(2)(A).

[30] 84 Fed. Reg. 64231 (Nov. 21, 2019).

[31] 12 U.S.C. §§ 1735f-7, 1735f-7a.

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to non-banks other than selling charged-off debts (for pennies on the dollar) or as part of rent-a-bank partnerships in which banks originate loans according to a non-bank's specifications for sale to a non-bank.

The truth is that the OCC has no idea how many, if any, national banks are materially engaged in making loans with interest rates exceeding state usury caps, just as it has no idea how frequently national banks assign such loans, or even assign loans in general. More generally, the OCC has presented no evidence that the sale of debt obligations with interest rates that exceed state usury caps is a material source of liquidity for any bank, much less for banks in general. Indeed, banks obtain liquidity primarily through the incurrence of liabilities—accepting deposits—and through borrowing via repurchase agreements (repos), correspondent bank lines, Federal Home Loan Bank advances, and the Federal Reserve's discount window. Banks do not generally rely on the sale of non-mortgage assets as a key liquidity source.

It is worth noting that the FDIC, in its parallel rulemaking concedes that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, immediate widespread effects on credit availability would not be expected."[32] Similarly, the FDIC concedes in its parallel rulemaking that it does not have information regarding the number of small entities that have been directly affected by ambiguity resulting from *Madden*.[33] Just as the FDIC lacks this information on small banks, so too does it lack it on banks generally because the FDIC does not collect the relevant information from any banks. The same is true regarding the OCC and national banks. The Proposed Rule cannot stand on naked assertions about the importance of asset sales to bank liquidity generally and on the further implicit assumption that banks rely on sales of loans with interest rates exceeding state usury caps as an important source of liquidity. There is no evidentiary basis whatsoever for either assertion. Accordingly, the rule is arbitrary and capricious.

2. *The Proposed Rule Is Arbitrary and Capricious Because It Ignores Key Contrary Evidence*

Not only does the Proposed Rule lack an evidentiary basis, but it entirely ignores some of the most obvious and contrary evidence. Accordingly, it is arbitrary and capricious and

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[32] 84 Fed. Reg. 66850 (Dec. 6, 2019). *See also id.* at 66852 ("The FDIC is not aware of any broad effects on credit availability having occurred as a result of *Madden*.…the FDIC believes the number of institutions materially engaged in making loans [with interest rates exceeding state usury caps] to be small.").

[33] 84 Fed. Reg. 66851 (Dec. 6, 2019). FDIC likewise concedes that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision. Thus, to the extent the proposed rule contributes to a return to the pre-*Madden* status quo regarding market participants' understanding of the applicability of State usury laws, immediate widespread effects on credit availability would not be expected." *Id.*

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therefore in violation of the Administrative Procedures Act.[34] While the Proposed Rule contends that it is necessary to protect bank liquidity, the idea that state usury laws actually constrain bank liquidity is preposterous. Banks may always sell loans to other banks. There are over 5,200 federally insured depositories, so there is a robust market for national bank loans simply from national banks and insured state banks, none of which are subject to state usury laws. Nowhere in the Proposed Rule is this enormous market for bank loans ever mentioned.

Additionally, the Proposed Rule ignores that state usury laws do not actually prevent the sale of bank loans to non-banks, even if the loans have interest rates that exceed state usury caps. The loan purchaser may always choose to forgo collecting interest that exceeds the state usury cap. If the purchaser does so, it is likely to discount what it will pay on the purchase price. As the Second Circuit noted in *Madden*, while the sale price of the loans may be lower than otherwise, the National Bank Act is not a retail price maintenance statute. There is a world of difference between ensuring that there is a market for bank loans and insisting that banks get the best possible price for their loans.

Because the Proposed rule ignores obvious contrary evidence—failing to give it any consideration whatsoever—it is arbitrary and capricious.

*3. The Proposed Rule Is Arbitrary and Capricious Because It Is Based on a Patent Misapplication of the Common Law*

The OCC claims that Proposed Rule is based on the principles found in the common law of assignments and the so-called "valid-when-made" doctrine.[35] This is incorrect on both counts. Neither the common law of assignments or the actual valid-when-made doctrine supports the Proposed Rule. A rule that is founded on a patent misrepresentation of the law is arbitrary and capricious and "otherwise not in accordance with law" and therefore violates the Administrative Procedures Act.[36]

i. The Proposed Rule Misapplies the Common Law of Contracts

The OCC contends that the Proposed Rule is consistent with the common law of contract assignment, which generally allows an assignee to accede to all of the rights of the assignor under the contract. While this is an accurate characterization of the law of contracts, it is a misapplication of the common law of contracts to the question of whether a national bank's most favored lender status under section 85 of the National Bank Act is assignable.

The common law of assignments relates solely to the assignment of rights under a contract or property rights. It has no bearing on whether federal statutory status or privileges may be assigned. A national bank's most favored lender status is a function of statute, not contract. Most favored lender status cannot arise from contract because contract cannot displace state usury statutes and other state regulations. Because essence a personal privilege, not a property right it is no more assignable than a medical license or a tax-exempt status or a national bank's trust powers or discount window access. If these privileges were freely

[34] 5 U.S.C. § 706(2)(A).

[35] 84 Fed. Reg. 64231 (Nov. 21, 2019).

[36] 5 U.S.C. § 706(2)(A).

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assignable there would be no point in having a licensing regime like national bank chartering because regulators would not exercise control over who ultimately gained the privileges attached to the license. Accordingly, the common law of assignments has nothing whatsoever to do with the assignability of most favored lender status.[37]

ii. The Proposed Rule Misapplies the So-Called "Valid-When-Made" Doctrine

The OCC also claims that the Proposed Rule is supported by the so-called "valid-when-made" doctrine. The OCC claims that this doctrine means that if a loan was valid when it was made for purposes of state usury law, it cannot thereafter cease to be valid by virtue of an assignment. The OCC's claim is founded on a blatant misreading of historical cases. There has never been a valid-when-made doctrine such as the one the OCC claims. Instead, to the extent that any sort of valid-when made doctrine exists, it is about the *calculation* of the interest rate on a loan, not about what law determines the applicable usury rate.

In support of the Proposed Rule, the OCC cites a pair of 19th century Supreme Court decisions, *Nichols v. Fearson*[38] and *Gaither v. Farmers & Mechs. Bank of Georgetown*,[39] as standing for a "cardinal rule[] in the doctrine of usury," namely that "if a loan is non-usurious at origination, the loan does not subsequently become usurious when assigned."[40] That is a blatant mischaracterization of these decisions. The Supreme Court held in both cases that the interest imputed from a discounted sale of a loan would not be added to the stated interest rate on the loan for the purpose of calculating whether *the assignor* violated state usury law. The cases had absolutely nothing to do with what interest rate the *assignee* could charge.

I have written at length previously about the ahistoricity of the valid-when-made doctrine as claimed by the OCC. In particular, I refer the OCC to an amicus brief I filed in a federal district court cased captioned *Rent-Rite Super Kegs West Ltd. v. World Business Lenders,* LLC, 1:19-cv-01552- REB (D.Colo.). OCC also appeared as an amicus in this on-going litigation, and my brief was served on the OCC electronically per the OCC's consent. I have attached the brief as an appendix to these comments. It shows that the historical cases relied up for a "valid-when-made" doctrine have absolutely nothing to do with the ability of a non-bank assignees of a bank to shelter in the bank's ability to export interest rates under section 85. Instead, to the extent that such a doctrine has ever existed, it deals with three distinct issues related to the calculation of the interest rate, not the question of what law applied. I note here that in its amicus brief in the *Rent-Rite* litigation the OCC engaged in

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[37] The Seventh Circuit simply erred in this regard in *Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285 (7th Cir. 2005). In any event, the Seventh Circuit was sitting in diversity jurisdiction and its pronouncements on state common law of contracts law are not controlling.

[38] 32 U.S. (7 Pet.) 103, 109 (1833).

[39] 26 U.S. (1 Pet.) 37, 43 (1828).

[40] 84 Fed. Reg. 64231 (Nov. 21, 2019).

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more extensive selective and even misleading quotation from other cases, not one of which actually supports its position in the Proposed Rule.

*4. The Proposed Rule Is Arbitrary and Capricious Because Its Solution Fails to Address an Important Aspect of the Supposed Problem*

Finally, the Proposed Rule is arbitrary and capricious and therefore violates the Administrative Procedures Act because its solution entirely fails to address an important aspect of the problem of market uncertainty regarding interest rate assignment—the "true lender" doctrine.[41] The OCC notes the problem of uncertainty after the *Madden* decision, but the truth is that the uncertainty about what interest rate a non-bank assignee of a national bank may charge did not begin with *Madden* in 2015. Instead, it began in 2004 with the inclusion of a "true lender" provision in the Georgia Payday Loan Act,[42] and subsequent litigation.[43] Since 2004, several courts have adopted a similar "true lender" doctrine as a matter of state common law,[44] and such a provision is also consistent with 19th and early 20th century federal common law to disregard sham transactions for usury purposes.[45]

True lender doctrine and the question of whether a non-bank assignee may shelter in section 85 are inextricably intertwined. The Proposed Rule explicitly states that it does not

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[41] 5 U.S.C. § 706(2)(A). *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co., 463 U.S. 29, 43 (1983) (noting that an agency rule is "arbitrary and capricious" if the rule "entirely failed to consider an important aspect of the problem"); *see also* Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971) (holding that, in assessing whether a rule is arbitrary and capricious, "the ultimate standard of review is a narrow one").

[42] OCGA § 16-17-1(c).

[43] Ga. Cash Am. v. Greene, 318 Ga. App. 355, 361-362 (Ga. Ct. App. 2012).

[44] Easter v. Am. West Fin., 381 F.3d 948, 957-959 (9th Cir. 2004) (applying true lender doctrine under Washington State law); Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012) (noting that, "where a plaintiff has alleged that a national bank is the lender in name only, courts have generally looked to the real nature of the loan to determine whether a non-bank entity is the de facto lender"); CashCall, Inc. v. Morrisey, 2014 W. Va. LEXIS 587, at* 43 2014 WL 2404300, at *14 (W.Va. May 30, 2014) (looking to form, not substance under West Virginia law); Pennsylvania v. Think Fin., Inc., 2016 U.S. Dist. LEXIS 4649, *30-33, 2016 WL 161597 (E.D. Pa. Jan. 14, 2016, upholding complaint based on true lender doctrine under Pennsylvania law); Consumer Fin. Prot. Bureau v. CashCall, Inc., 2016 U.S. Dist. LEXIS 130584, *15-16 (C.D. Cal. 2016) (form, not substance determines who is the true lender); Meade v. Avant of Colorado, LLC, 307 F. Supp. 3d 1134, 1150-1151 (D. Colo. 2018) (declining to dismiss a complaint predicated on true lender doctrine under Colorado law); Meade v. Marlette Funding LLC, 2018 U.S. Dist. LEXIS 46814, *8-9, 2018 WL 1417706 (D. Colo. Mar. 21, 2018) (same); CashCall, Inc. v. Md. Comm'r of Fin. Regulation, 448 Md. 412, 436, 139 A.3d 990, 1005, 2016 Md. LEXIS 371, *36 (Md. Ct. App. 2016) (holding a party that was the de facto lender was a "credit services business" subject to Maryland usury law).

[45] Miller v. Tiffany, 68 U.S. 298, 310 (1864); Seeman v. Phila. Warehouse Co., 274 U.S. 403 (1927).

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take a position on true lender issues.[46] Without addressing true lender doctrine, the rule fails to materially reduce any uncertainty about what interest rate is permissible on a loan assigned by a national bank. As such, the proposed rule is arbitrary and capricious and therefore illegal under the Administrative Procedures Act because its solution does not address a key aspect of the problem it identifies.

## III. The Proposed Rule Is Bad Policy

The Proposed Rule is non-mandatory and it should be retracted because it is bad policy. The Proposed Rule is contrary to the OCC's duties to ensure the safety and soundness of national banks and consumer protection from predatory lending.

### *A. The Proposed Rule Does Not Actually Enhance National Banks' Liquidity*

The OCC claims that the Proposed Rule helps protect and enhance national banks' liquidity and risk management and that "[t]his risk management tool would be significantly weakened if the permissible interest on assigned loans were uncertain or if assignment of the permissible interest were limited only to third parties that would be subject to the same or higher usury caps."[47] This is incorrect. The Proposed Rule does not materially enhance national banks' liquidity or risk management capabilities, and the OCC has adduced no evidence that it does. This is because a national bank can already always sell loans—no matter the interest rate—to any of the more than 5,200 other FDIC-insured banks in the United States. A potential market of over 5,200 buyers "subject to the same or higher usury caps" is not a constrained market, nor does the OCC present any evidence that it is. The claim that limiting the market for usurious loans to over 5,200 banks "significantly weaken[s]" bank risk management is unsupported and frankly preposterous.

Moreover, national banks can already always sell loans—no matter the interest rate—to any non-bank. *Madden* did not change this situation by one iota. The only catch is that because under *Madden* the non-bank cannot collect the usurious interest, it will discount the purchase price, but there is a difference between preserving liquidity and maintaining resale prices. The Second Circuit found in *Madden* that this would not be a "significant interference" with a national bank power, and the OCC has not claimed otherwise in the Proposed Rule.

Additionally, as noted above, the Proposed Rule presents no evidence that most banks in fact rely on the loan sale market to non-banks for liquidity. Only the very largest banks engage in securitization of any assets other than residential mortgage loans. While banks will sell charged off loans to non-bank debt buyers, this is not a material source of liquidity for banks, and only one OCC-regulated institution currently engages in rent-a-bank transactions. Instead, banks' primary sources of liquidity are deposits and wholesale funding markets, as well as Federal Home Loan Bank advances, and the GSE cash windows, with the

[46] 84 Fed. Reg. 64232 (Nov. 21, 2019).

[47] 84 Fed. Reg. 64231 (Nov. 21, 2019).

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Federal Reserve's discount window as a backup. To suggest that *Madden* has materially threatened bank liquidity is preposterous and unsupported by any evidence.

Moreover, if uncertainty about what usury cap applies to a non-bank assignee is the problem, the OCC's Proposed Rule presents no solution, as discussed above, because it does not remove the uncertainty that comes from true lender doctrine.

### *B. The Proposed Rule Facilitates Rent-a-Bank Arrangements That Pose Pipeline and Reputational Risk for National Banks*

Rather than provide a material enhancement of bank liquidity, the Proposed Rule merely facilitates rent-a-bank lending arrangements, by which I mean arrangements where a bank agrees in advance to make loans according to a non-bank's specifications and to transfer a substantial economic interest in those loans to the non-bank (or its affiliate). Rent-a-bank arrangements are an inherent threat to the safety-and-soundness of national banks because of the pipeline and reputational risks involved. If the non-bank fails to honor its commitment to purchase the economic interest in the loans, the national bank will be stuck with the risk of a bunch of loans that by definition it would never have made for its own account. Moreover, because the sole reason for non-banks to engage in rent-a-bank lending is the evasion of state usury laws, there is reputational risk for national banks because they will be associated with predatory lending, which may hurt their other lines of business.

### *C. The Proposed Rule Facilitates Predatory Lending and Is Contrary to the OCC's Consumer Protection Mandate*

Because the Proposed Rule facilitates rent-a-bank lending arrangements, it undermines state consumer protection laws. Rent-a-bank lending enables non-banks to make loans indirectly that they are forbidden to make directly. Whatever the OCC may think of the wisdom of state usury laws and state laws restricting various types of loan fees, these laws are on the books and apply to non-banks, and it is not the OCC's place to second-guess them or attempt to undermine them. The CFPB has brought enforcement actions for unfair and deceptive and abusive acts and practices for rent-a-tribe lending relationships. The OCC, which enforces the same statute, should similarly discourage, rather than facilitate analogous rent-a-bank relationships. Indeed, historically the OCC has done precisely that; I am aware of only one OCC regulated institution, Axos Bank, a federal savings association, that currently engages in rent-a-bank arrangements through its partnership with World Business Lenders, LLC, a subprime small business lender.

### *D. The Proposed Rule Would Create a Regulatory Vacuum and Undermine the Value of a National Bank Charter*

National banks are allowed the privilege of interest rate exportation under section 85, as interpreted by *Marquette National Bank v. First of Omaha Service Corporation*.[48] That privilege, however, comes with being subject to a comprehensive federal regulatory regime, including regular federal examination by the OCC or CFPB for compliance with consumer financial laws. Non-bank assignees of national banks are not subject to such a regulatory

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[48] 439 U.S. 299 (1978).

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regime. Unless they fall into certain enumerated types of institutions,[49] they are not subject to any sort of federal supervisory authority for compliance with consumer financial laws. Indeed, non-bank assignees of national banks may not even be subject to *state* supervision, as they need not be state-licensed. For example, a national bank might assign loans to an off-shore special purpose entity, such as a Cayman Islands trust, which would be entirely outside the scope of any US regulatory authority.[50]

Congress has allowed national banks the privilege of interest rate exportation because it is confident that the OCC's careful regulatory stewardship of national banks will be an adequate substitute for any particular state's usury laws. Allowing unregulated non-banks to take advantage of banks' interest rate exportation undermines that trade-off and creates a regulatory vacuum in which there is no meaningful consumer protection.[51]

Indeed, the Proposed Rule would also undermine the value of a national bank charter. If a non-bank can simply acquire the privileges of a national bank by paying a national bank a fee for those privileges it desires a la carte, the value of a national banking charter would be reduced. While this might be the OCC's ultimate goal—to co-opt so-called "fintechs" into bank partnerships in lieu of its controversial "fintech charter" proposal that is subject to on-going litigation, it is ultimately bad for the prestige and value of the national banking charter. The national banking charter was originally promulgated based on the belief that regulation by the OCC signaled the financial strength and operational quality of a bank, such that consumers would purchase that bank's national bank notes. If national banks simply rent out their charters, the charter will lose its value.

### *E. The Proposed Rule Fails to Exclude Assignments Undertaken to Evade State Usury Laws*

There are some loan sale transactions, such as securitizations, that do not raise inherent consumer protection consumers, even if they do not currently comply with state usury laws. But the Proposed Rule fails to differentiate between benign transactions and malignant ones. In particular, it fails to exclude transactions undertaken to evade state usury laws, even though the anti-evasion principle is core to usury jurisprudence and were part of the immediate legal background of the National Bank Act.[52]

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[49] 12 U.S.C. §§ 1867, 5514.

[50] Elevate Financial, a fintech that has rent-a-bank relationships with two insured state banks, uses a Cayman Islands special purpose vehicle to purchase loan participations from those banks. *See* Kadhim Shubber, *Why this subprime lender funds loans through the Cayman Islands*, FIN. TIMES, Jan. 29, 2016, https://ftalphaville.ft.com/2016/01/19/2150488/why-this-texas-subprime-lender-routes-loans-through-the-cayman-islands/.

[51] Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. REG. 143, 176 (2009).

[52] *See* Miller v. Tiffany, 68 U.S. 298, 310 (1864); Seeman v. Phila. Warehouse Co., 274 U.S. 403 (1927).

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I strongly urge the OCC, if it persists in this ill-advised rulemaking, to include a provision that clearly excludes rent-a-bank arrangements and other assignments undertaken for the primary purpose of evading state usury laws. Doing so would not only be consistent with the OCC's consumer protection mandate—for Congress has not yet generally preempted state usury laws, even for national banks, only allowed rate exportation—but also because it is the only position that is consistent with well-established Supreme Court precedent.

**Conclusion**

The Proposed Rule is illegal and misguided. I urge the OCC to abandon the Proposed Rule and get back to its job of ensuring consumers protection and the safety-and-soundness of national banks. The OCC should not mistake the protection of profits at the handful of bad actor banks that engage in rent-a-bank arrangements with its job of husbanding the national banking industry for the benefit of American consumers.[53] The OCC should retract the Proposed Rule.

Sincerely,

Adam J. Levitin

Attachments:

(1) Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, *Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019).
(2) Adam J. Levitin, *'Madden fix' bills are a recipe for predatory lending*, Am. Banker, Aug. 28, 2017, https://www.americanbanker.com/opinion/madden-fix-bills-are-a-recipe-for-predatory-lending.

[53] As Sir Thomas More notes in Richard Bolt's *A Man for All Seasons*, "For Wales? Why Richard, it profit a man nothing to give his soul for the whole world. . . but for Wales!" So too, the OCC is giving its soul for a handful of bad actor rent-a-banks.

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ATTACHMENT 1

Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant,

*Rent-Rite Super Kegs West, Ltd., v. World Business Lenders, LLC,*

No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019).

<table>
<tr><td>IN THE UNITED STATES DISTRICT COURT<br>DISTRICT OF COLORADO<br><br>RENT-RITE SUPER KEGS WEST, LTD.,<br>Appellant,<br><br>v.<br><br>WORLD BUSINESS LENDERS, LLC<br>Appellee.</td><td>▲ COURT USE ONLY ▲</td></tr>
<tr><td>Adam J. Levitin<br>Agnes N. Williams Research Professor &<br>Professor of Law<br>Georgetown University Law Center<br>600 New Jersey Ave., NW<br>Hotung 6022<br>Washington, DC 20001<br>(202) 662-9234<br>adam.levitin@law.georgetown.edu</td><td>Case No. 1:19-cv-01552-REB<br><br>(Appeal from Bankruptcy Adversary Proceeding No. 18-1099-TBM)</td></tr>
<tr><td colspan="2">MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT</td></tr>
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DATED: September 19, 2019

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Professor Adam J. Levitin, *pro se*, respectfully requests leave to submit the attached, conditionally filed, *amicus curiae* brief in support of the Appellant, Rent-Rite Super Kegs West, Ltd., and as grounds therefore states the following:

**INTRODUCTION**

On its face, the instant litigation is an unremarkable adversary proceeding in a small business bankruptcy, the ultimate outcome of which has no particular public policy significance. Yet this is no ordinary *business* bankruptcy appeal. This case involves the single most critical *consumer* credit regulation issue in the courts today—the vitality of a so-called "valid-when-made" doctrine, which purports to hold that a non-bank lender may ignore state usury laws for loans it purchases from a bank that is exempt from those laws.

If courts recognize a "valid-when-made" doctrine, high-cost non-bank lenders, such as payday lenders and predatory small business lenders, will be able to evade long-standing state interest rate limits[1] through "rent-a-bank" lending

[1] States have set interest rate limits since the founding of our nation. *See* AMERICANS FOR FAIRNESS IN LENDING, THE HISTORY OF USURY (citing *James M.*

schemes, in which a non-bank lender uses a complicit bank to originate loans, which are promptly sold to the non-bank lender. Payday lenders have long attempted to use rent-a-bank schemes, which regulators have historically shut down,[2] but these attempts are making a comeback. Colorado, in particular, has been active in attempting to prevent a new wave of rent-a-bank lending, and two high-profile cases bought by the Colorado Attorney General are pending. *See Meade, Uniform Consumer Credit Code Administrator v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); *Meade, Uniform Consumer Credit Code Administrator v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).[3]

The unusual involvement of the Federal Deposit Insurance Corporation ("FDIC") and Office of the Comptroller of the Currency ("OCC") as *amici* in the appeal of an otherwise unexceptional small business bankruptcy adversary

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*Ackerman, Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61 (1981)), https://bit.ly/2lSASjl.

[2] *See* NATIONAL CONSUMER LAW CENTER, CONSUMER CREDIT REGULATION § 9.6.1 (2D ED. 2015), *updated at* www.nclc.org/library; *see also ID.* §§ 3.4.3.3, 3.4.3a.

[3] Professor Levitin has previously submitted amicus briefs on the valid-when-made doctrine in both of these cases.

proceeding underscores the importance of the consumer credit policy issue implicated in this case. The FDIC and OCC allege that a purported "valid-when-made doctrine" is a longstanding, "cardinal rule" of banking law and incorporated into the federal statutes preempting state usury laws for bank. Yet the doctrine appears only in a handful of recent cases. With one exception, it cannot be found in caselaw predating the relevant statute, much less in treatises, or scholarly articles, and the Second Circuit rejected the doctrine in 2015 in *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

After the defendant in the *Madden* case unsuccessfully sought *certiorari* from the Supreme Court of the United States, 136 S. Ct. 2505 (2016), the financial services industry attempted to advance "*Madden*-fix" legislation in Congress. *See* H.R. 3299 (115th Cong.); S. 1642 (115th Cong.). Numerous state attorneys generals, led by the Colorado Attorney General,[4] and over 200 consumer, civil rights, faith

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[4] *See* Letter from Cynthia H. Coffman, Attorney General of Colorado, *et al.* to Hon. Mitch McConnell *et al.,* opposing H.R. 3299 and S. 1642 (June 27, 2018), https://bit.ly/2kCyjlp.

and other groups[5] voiced their opposition to the legislation, and Congress did not act to overturn the decision.

The OCC and FDIC are now intervening as *amici* in an obscure small business bankruptcy dispute to seek a favorable appellate decision on the valid-when-made doctrine that could ultimately produce a circuit split. Such a circuit split might entice the Supreme Court to grant *certiorari* and possibly overturn the Second Circuit's *Madden* decision. Simply put, this is a critical case for consumer credit policy.

In this amicus brief, Professor Levitin draws on his expertise in the history of negotiable instruments and usury regulation to address the spurious pedigree of the valid-when-made doctrine, which is a recent invention, rather than a fundamental part of American banking and negotiable instrument law.

**INTEREST OF AMICUS CURIAE**

*Amicus curiae* Adam Levitin is the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center in Washington, D.C. Professor Levitin's scholarship and teaching focuses on consumer finance regulation

[5] See letter from 202 state and national groups opposing H.R. 3299 (McHenry) and S. 1642 (Warner) (Nov. 29, 2017), https://bit.ly/2kNossK.

and commercial law, including the law of usury and the law of negotiable instruments. He has previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board, as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP).

Professor Levitin has previously written about the origins of the "valid-when-made" doctrine and the effects of preemption of state consumer protection laws in rent-a-bank transactions. *See* Adam J. Levitin, *"Madden Fix" Bills Are a Recipe for Predatory Lending*, AMERICAN BANKER, Aug. 28, 2017 (valid-when-made doctrine); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. REG. 145 (2009) (rent-a-bank transactions). He has also previously testified before Congress thirty times, including at a hearing specifically addressing the valid-when-made doctrine. Hearing Before the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, Jan. 30, 2018 (testimony of Professor Adam J. Levitin). Professor Levitin has also previously filed amicus briefs on the valid-when-made doctrine in Colorado state court litigation brought by the Colorado Uniform Consumer Credit

Code Administrator against non-banks engaged in rent-a-bank transactions. Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade, Uniform Consumer Credit Code Administrator v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade, Uniform Consumer Credit Code Administrator v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).

Professor Levitin believes that his expertise regarding the history of usury regulation in the United States will be helpful to the court, particularly in light of the claims of Appellee and its amici that the "valid-when-made" doctrine is a longstanding, fundamental rule of US banking law.

## DESIRABILITY OF AMICUS CURIAE BRIEF

As explained above, this case has potentially momentous implications for states' ability to regulate consumer lending by non-banks. Given the importance of the alleged historicity of the valid-when-made doctrine for its applicability through incorporation in the Depository Institutions Deregulation and Monetary Control Act of 1980, an informed understanding of its supposed caselaw roots is critical for the Court's evaluation. This is where Professor Levitin seeks to assist the Court.

The $18^{th}$ century English and early $19^{th}$ century American commercial law cases on which the "valid-when-made" doctrine claims to rest are extraordinarily difficult for modern readers to parse. These cases involve a set of financial instruments, transactions, doctrinal problems, procedural stances, and even terminology that have largely disappeared from commerce. Further obfuscating the meaning of these cases is the style of judicial writing. These are cases that only a commercial law professor with antiquarian inclinations could love. Professor Levitin believes that his familiarity with these cases, with historical negotiable instrument law, and as well as with the larger (and now obscure) doctrinal context of usury law in the $19^{th}$ century would assist the court in evaluating the claims about the historicity of the "valid-when-made" doctrine and whether it is in fact part of the background to the Depository Institutions Deregulation and Monetary Control Act of 1980.

## POSITION OF THE PARTIES

Professor Levitin has obtained the consent of the Appellant to the filing of an amicus brief. Professor Levitin has not received any response from Appellee in regard to his request for consent to file.

## TIMELINESS OF THE AMICUS BRIEF

Professor Levitin recognizes that he is seeking to file the amicus brief after the ordinary deadline provided by Federal Rule of Bankruptcy Procedure 8017(a)(6). Rule 8017(a)(6) provides the district court with discretion to grant leave for later filing. *See also Wildearth Guardians v. Lane*, 2012 WL 10028647 (D.N.M. 2012) (noting federal courts' broad discretion to allow participation of an amicus and the lack of 10th Circuit precedent).

Professor Levitin requests leave for a late-filing of the amicus brief on the grounds that he was not aware of the litigation until the Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency filed their amicus brief in support of the Appellee on September 10, 2019.

As noted above, this case is of potentially significant importance for consumer credit regulation because of its implication for the "valid-when-made" doctrine. Yet because the doctrinal question arose in a small business bankruptcy case, it received no notice within the community of consumer credit scholars or consumer advocates, who had no reason to be aware of this particular case among the thousands being litigated in the federal courts. It is also unusual for the FDIC or OCC to file an amicus brief before a district court. The unusual context of the case is the reason that Professor Levitin was unaware of the case and thus unable to file a timely amicus

brief. Upon learning of the case, Professor Levitin promptly prepared the conditionally filed brief and submitted this motion.

Additionally, upon learning of the case, Professor Levitin spoke with leadership at a number of national consumer advocacy groups, as well as with the offices of certain state banking regulators and attorneys general. All confirmed that this case had escaped the notice of all of them—including the Colorado Attorney General's office—because it arose in the context of an unexceptional small business bankruptcy. All were concerned at the possibility of a district court upholding a "valid-when-made" theory, but none believed that they would be able to respond quickly enough with their own late-filed amicus briefs, in part because of their own internal institutional processes for approving amicus filings.

Given the importance of the case to consumer credit regulatory policy and the absence of institutional amici to offset the presence of the FDIC and OCC, Professor Levitin believes that the assistance of an academic amicus in support of the Appellant, even in a late-filed brief, is important to ensure a fully briefed consideration of by the Court of the historicity of the "valid-when-made" doctrine.

WHEREFORE, Professor Levitin respectfully requests leave to file the brief submitted with this motion.

Respectfully submitted this 19th day of September 2018.

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## CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT was served by email upon the following this 19th day of September, 2019:

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*Attorneys for Appellant*

I further certify that a true and correct copy of the foregoing MOTION FOR LEAVE TO FILE AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT was served by Federal Express delivery upon the following, this 19th day of September, 2019:

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Professor Adam J. Levitin

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<tr><td>IN THE UNITED STATES DISTRICT COURT<br>DISTRICT OF COLORADO<br><br>RENT-RITE SUPER KEGS WEST, LTD.,<br>Appellant,<br><br>v.<br><br>WORLD BUSINESS LENDERS, LLC<br>Appellee.</td><td>▲ COURT USE ONLY ▲</td></tr>
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<tr><td colspan="2">AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN<br>IN SUPPORT OF APPELLANT</td></tr>
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## INTRODUCTION

On its face, the instant litigation is an unremarkable adversary proceeding in a small business's bankruptcy, the ultimate outcome of which has no particular public policy significance. Yet this is no ordinary bankruptcy appeal. Although this is a *business* bankruptcy case, it involves the most critical *consumer* credit regulation issue in the courts today—the vitality of a so-called "valid-when-made" doctrine. That doctrine purports to hold that a non-bank lender may ignore state usury laws for loans it purchases from a bank that is exempt from those laws.

The vitality of a "valid-when-made" doctrine is a question of whether federal preemption of state usury laws for banks under the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA") or under the National Bank Act of 1864 ("NBA") is assignable to non-bank lenders that are not covered by those statutes. That is, is federal preemption a feature of a loan that travels with it like a warranty, or is it a non-transferrable privilege, personal to the federally-regulated bank? Thus, when a bank that is not subject to a state's usury law by virtue of federal preemption assigns a loan to a non-bank, may the non-bank also shelter in federal preemption despite not being subject to the federal bank regulation regime?

The stakes are significant for consumer credit regulation. Since colonial times, states have had usury laws to protect their citizens. While a wave of deregulation

starting in 1978 exempted banks from state usury laws, states retain authority over non-bank lenders. If courts recognize a "valid-when-made" doctrine, high-cost non-bank lenders, such as payday lenders and predatory small business lenders, will be able to evade state usury laws through "rent-a-bank" lending schemes, in which a non-bank lender uses a complicit bank to originate loans, which are promptly sold to the non-bank lender. As a court recently observed:

> If [the statute] indeed gave [assignees] a preemption defense for any loan that originated with a federal savings bank, then homeowners would be deprived of state law protections based solely on their original lender and [assignees] would be allowed to engag[e] in the otherwise illegal conduct.

*McShannock v. JP Morgan Chase Bank, N.A.,* 354 F.Supp.3d 1063, 1077 (N.D. Cal. 2018) (internal quotations omitted) (holding that preemption under the Home Owners Loan Act of 1933 was not assignable). Payday lenders have long attempted to use rent-a-bank schemes, which regulators have historically shut down,[1] but these attempts are making a comeback.

In this case, the record is not developed, but there are indicia of rent-a-bank lending as a Colorado small business obtained a 120% interest rate loan from a tiny

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[1] *See* NAT'L CONSUMER L. CTR., CONSUMER CREDIT REGULATION § 9.6.1 (2d ed. 2015), *updated at* www.nclc.org/library; *see also* *ID*. §§ 3.4.3.3, 3.4.3a.

Wisconsin community bank that then transferred the loan to Appellee, World Business Lenders, LLC ("Appellee"), a subprime small business lending specialist firm based in New Jersey. *See* Zeke Faux, *Wall Street Finds New Subprime With 125% Business Loans*, BLOOMBERG.COM, May 22, 2014, *at* http://www.bloomberg.com/news/2014-05-22/wall-street-finds-new-subprime-with-125-business-loans.html (discussing Appellee's predatory business practices) (included as Appendix A).

## INTEREST OF AMICUS

*Amicus curiae* Adam Levitin is the Agnes N. Williams Research Professor and Professor of Law at Georgetown University Law Center. Professor Levitin's scholarship focuses on consumer finance regulation and commercial law, including the law of usury and the law of negotiable instruments. He has previously served on the Consumer Financial Protection Bureau's Consumer Advisory Board and as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School.

Professor Levitin has previously written about the origins of the "valid-when-made" doctrine and the effects of preemption of state consumer protection laws in rent-a-bank transactions. *See* Adam J. Levitin, *"Madden Fix" Bills Are a Recipe for Predatory Lending*, AMERICAN BANKER, Aug. 28, 2017 (valid-when-made doctrine); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets*

*Upstream*, 26 YALE J. ON REG. 145 (2009) (rent-a-bank transactions). He has also testified before Congress regarding the "valid-when-made" doctrine. Hearing Before the House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, Jan. 30, 2018. Professor Levitin has also filed amicus briefs on the "valid-when-made" doctrine in litigation brought by the Colorado Attorney General against non-banks engaged in rent-a-bank transactions. Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade v. Marlette Funding, LLC*, No. 17-30376 (Colo. Dist. Ct.); Amicus Brief of Professor Adam J. Levitin in Support of Plaintiff, *Meade v. Avant of Colorado LLC*, No. 17-cv-30377 (Colo. Dist. Ct.).

Professor Levitin's interest in this litigation is in ensuring a proper understanding of usury laws and their relationship to the so-called "valid-when-made" doctrine. Professor Levitin takes no position on other issues in this litigation.

Professor Levitin has authored and funded this brief entirely himself. He has no financial stake in the litigation.

**ARGUMENT**

The Bankruptcy Court held that "the long-established 'valid-when-made' rule answers the question" of:

> whether a promissory note originated by a state bank with a non-usurious interest rate under DIDA section 1831 somehow can be transformed into a usurious promissory note by virtue of assignment to a non-bank entity.

Op. at 21. Likewise, Appellee and its *Amici*, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency (together "*Amici*"), point to this "longstanding" doctrine as a basis for affirming the bankruptcy court. Appellee's Br. at 1-2; Amici Br. at 3. *Amici* refer to the "valid-when-made" doctrine as a "well-established and widely-accepted rule," Amici Br. at 10, and claim that the Supreme Court described it as a "'cardinal rule' of American law." *Id.* Moreover, according to the Bankruptcy Court, the valid-when-made doctrine's "long-accepted principles were inherently incorporated into the NBA and, later, the DIDA." Op. at 21.

Yet if the law were in fact so "well-settled" on this point, as *Amici* claim, it begs the question why two federal bank regulators would bother filing a joint amicus brief in the district court in a small business bankruptcy appeal to which no regulated bank is a party? The presence of the *Amici* underscores that the law is hardly well-settled—and indeed, the Second Circuit has rejected the valid-when-made argument, *Madden v. Midland Funding, LLC*, 786 F.3d 246, 250-53 (2d Cir. 2015) (holding that National Bank Act preemption does not apply to a debt buyer from a national bank)—but that they would like it to be.

Appellee and *Amici* present three arguments in support of the valid-when-made principle. First, they argue that DIDA preemption is assignable under the common law of contracts. Second, they claim that "valid-when-made" is a "longstanding" doctrine and "well-settled" law that was part of the common law background to the NBA and DIDA (which is modeled on the NBA) and thus incorporated in those statutes. Therefore, Appellee and *Amici* argue, a non-bank purchaser of a loan originated by a bank also purchases DIDA preemption of state usury laws. Third, they argue that irrespective of the historical roots of valid-when-made, the principle is inherent within DIDA section 1831d, 12 U.S.C. § 1831d.

All three of these arguments are wrong. DIDA preemption is not a contract right that can be freely assigned. It is not alienable property, but is a privilege personal to a bank that comes as part of a bundle of a detailed regulatory scheme.

Likewise, the supposed historical roots of "valid-when-made" are spurious. With one exception, nothing approaching the claimed "valid-when-made" doctrine is to be found in cases, treatises, or scholarly articles that pre-date DIDA's 1980 preemption provision, much less the 1864 NBA, such that this supposedly longstanding doctrine is not even mentioned by name prior to 2015, when it suddenly appeared as part of unsuccessful *amicus curiae* briefing by financial institution trade associations in support of the defendant debt buyer in the *Madden* litigation.

No pre-1864 case deals with a "valid-when-made" situation, and only a single pre-1980 case cited by *Amici* deals with a transactional situation even remotely similar to the "valid-when-made" issue. *Amici* rely entirely and improperly on out-of-context and even misleadingly edited quotations from older cases to support the doctrine's claimed antiquity. At best the doctrine is "valid-when-made-up," and even the handful of post-1980 cases consistent with the doctrine are readily distinguishable from the instant litigation and some also include an exception for loans intended for assignment *ab initio*.

Similarly, there is nothing in DIDA section 1831d that compels "valid-when-made." The power of banks to assign their loans does not inherently include the power to assign federal preemption to non-bank entities. Contrary to *Amici*'s hyperbolic claims, declining to create a "valid-when-made" doctrine (with a falsified historical pedigree) will not prevent banks from selling loans in the secondary market. Instead, as the Second Circuit rightly recognized in *Madden v. Midland Funding, LLC*, 786 F.3d at 251, applying state usury laws to non-bank assignees will merely reduce the price at which banks are able to sell a subset of usurious loans.

Whether a "valid-when-made" doctrine *should* exist is a policy question properly reserved for the legislature, not the courts, and bills seeking to enact have failed to advance in Congress.

### A. The Common Law of Assignments Is Irrelevant Because DIDA Preemption Is Not an Assignable Right Under a Contract

*Amici* argue that under the common law of contracts, the assignee takes all of the rights of the assignor. Amici Br. at 14-16. That is true, subject to an important limitation: an assignee takes all of the rights of the assignor *under the contract. See* Restatement (2d) of the Law, Contracts, § 317(2) ("A *contractual* right can be assigned….") (emphasis added). It is self-evident that an assignee does not assume the assignor's other rights extraneous to the contract, such as rights under licenses or from status. For example, if I sell my car, the buyer gets whatever rights are appurtenant to the car, but does not also get my driver's license or the benefits of my American Automobile Association membership , much less my parental or spousal rights.

This limitation underscores *Amici's* misconceptualization of what DIDA preemption is. Preemption is not a right *under the contract* that can be assigned. It is not an alienable property right or a characteristic of the loan that travels with the note. Instead, DIDA preemption is a personal and non-transferrable privilege that is part of a legal scheme that applies only to banks. Indeed, DIDA preemption does not void state usury laws—state usury laws remains valid and in effect for non-

depositories. Instead, DIDA preemption merely allows an insured depository to export the usury cap of its home state into other states. DIDA preemption is part of a bundle of regulatory benefits and burdens specific to banks; allowing it to be assigned to a non-bank would result in a regulatory vacuum in which the non-bank would be exempt from state law, but also not subject to federal regulation. *See Levitin, Hydraulic Regulation*, *supra* at 188-89.

## B. "Valid-When-Made" Is Not Incorporated in the NBA or DIDA Because It Is a Modern Invention Lacking Historical Roots

### *1. "Valid-When-Made" Responds to a Problem That Could Not Exist Prior to the NBA*

*Amici* argue that "valid-when-made" is incorporate in DIDA because it was part of the common law background to section 85 of the NBA, 12 U.S.C. § 85, on which DIDA section 1831d is patterned. *See* Amici Br. at 5-6. Collectively, the Bankruptcy Court, the Appellee, and especially *Amici* cite to numerous cases that pre-date DIDA's enactment in 1980 and also to five cases that pre-date the NBA's enactment in 1864. Significantly, neither the Bankruptcy Court opinion, nor the briefing by the Appellee or *Amici* actually discusses the context or substance of a single pre-DIDA opinion. Instead, in every instance, they rely on selective snippets of decontextualized and even edited language that supposedly establishes "valid-

when-made" as a "cardinal rule" of banking law. When one examines the actual cases, however, it becomes apparent that nothing remotely approaching a "valid-when-made" doctrine existed prior to DIDA, much less the NBA.

As an initial matter, the doctrine could not possibly have existed prior to the enactment of the NBA in 1864 because there was no situation in which it could have arisen. Prior to the NBA, state usury laws applied to all entities equally, with choice of law rules limited by an anti-evasion principle. *Miller v. Tiffany*, 68 U.S. 298, 308 (1864). Therefore, it was not possible prior to 1864 for a loan to be non-usurious in the hands of a bank, yet be usurious in the hands of a non-bank assignee merely by virtue of an assignment. This means that all of the *ante-bellum* cases on which the Appellee and *Amici* rely have nothing to do with the issue in this case. Accordingly, the "valid-when-made" doctrine could not be background law against which the NBA was enacted, and thus it could not have been incorporated into DIDA.

***2. The Bankruptcy Court, Appellee, and Amici Rely on Decontextualized Language from Pre-DIDA Cases that Have No Connection to "Valid-When-Made"***

An examination of the pre-DIDA cases cited by the Bankruptcy Court, Appellee, and *Amici* shows that with one exception, *Strike v. Trans-West Discount Corp.*, 92 Cal.App.3d 735, 745 (Cal. Ct. App. 4th Dist. 1979), none of them are

dealing with anything remotely related to "valid-when-made" in the sense of assignment of a loan from a bank to a non-bank having no impact on the application of usury laws. *Strike* was decided as a matter of the California Constitution and expressly carves out an exception for loans intended to be assigned *ab initio*, as may well be the case in this litigation. *Id.* (citing *Calimpco, Inc. v. Warden*, 100 Cal. App. 2d 429, 446-447 (Cal. Ct. App. 1st Dist. 1950) ("If [an assignee cannot be held liable for accepting usurious interest], the statutes on usury might as well be abolished. All a lender would have to do would be to obtain a contract from a borrower providing for usurious interests…and then assign his contract and the contract would no longer be usurious.")). *See also Miller v. Tiffany*, 68 U.S. at 308 (contractual choice of law provisions for usury are enforceable, but when done with intent to evade the law, law of the contract location applies).

It is hardly support for "valid-when-made" being part of the pre-DIDA, much less pre-NBA, common law.

Other than *Strike*, the pre-DIDA cases address three issue patterns:

**(1)** the effect of the exercise of a payment option by the borrower on the usurious status of a loan (*i.e.*, where there is no assignment of the loan involved);

**(2)** the effect of a discounted assignment, where the question is whether the discount in the assignment may be treated as imputed interest on the note; or

**(3)** the effect of a valid assignment on a usurious loan (*i.e.*, the inverse transaction from that at issue).

Thus, the evidence Appellee and *Amici* adduce of the historical roots of the doctrine is limited to a set of selective, decontextualized, and even misleading quotations from cases that have nothing to do with the doctrine as they describe it. The doctrine's historical pedigree is thus entirely invented by shoehorning selective and decontextualized quotations from older cases to serve a modern deregulatory policy agenda. Indeed, even the handful of post-DIDA cases that are consistent with the doctrine are almost all pyramided on a single decision's selective and out-of-context language from a 19th century Supreme Court case.

***a. Cases Regarding Effect of Debtor's Payment Option***

Many of the cases cited in support of "valid-when-made" fit the "option" pattern.[2] Sometimes the option in these cases is prepayment, sometimes it is late

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[2] *See Tate* v. *Wellings*, 100 Eng. Rep. 716, 721 (K.B. 1790) (Buller, J.), (effect on usury calculation of loan of stock that was repayable in stock or cash at the borrower's option); *Unity Plan Finance Co. v. Green*, 155 So. 900, 905 (La. 1934) (effect on the calculation of the interest rate on the acceleration of the debt upon the debtor's failure to timely pay); *State v. J. C. Penney Co.*, 179 N.W.2d 641, 645 (Wis.

payment, and sometimes it is the form of payment. These cases generally do not even involve assignments of the loan. In all these cases, the idea that the calculation of the interest rate on a loan for usury purposes should not be determined based on the debtor's exercise of an option has nothing to do with "valid-when-made" in the sense of whether an assignment of the loan affects what state's usury law applies to the creditor.

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1970) (language cited by *Amici* is actually from a block quotation from *Zang v. Schumann*, 262 Wis. 570, 577-579 (Wisc. 1952) (effect of borrower exercising option to pay extra premium to be relieved from a lease)); *First Nat'l Bank v. Danek*, 556 P.2d 31, 34 (N.M. 1976) (whether value of a non-optional discounted stock sale accompanying the loan should be included in the interest for the loan); *FDIC v. Tito Castro Constr.*, 548 F. Supp. 1224, 1227 (D.P.R. 1982) ("it was only as a consequence of defendant's election to delay in repaying the principal amount of those [demand] notes that an effective rate of interest in excess of the Puerto Rico statutory ceiling may have resulted."); *Rangen, Inc. v. Valley Trout Farms, Inc.*, 658 P.2d 955, 959 (Id. 1983) (effect on usury calculation of a fee for late payment option); *Saul v. Midlantic Nat'l Bank*, 572 A.2d 650, 658 (N.J. App. Div. 1990) (effect on usury calculation borrower's optional prepayments).

Unfortunately, in an attempt to pressgang inapposite precedent for support from option cases, *Amici* engage in misleading edits of quotations. For example, *Amici* represent *Hoffman v. Key Federal Sav. and Loan Ass'n*, 416 A.2d 1265, 1269 (Md. 1979) as standing for:

> "[t]he virtually universal rule is that a contract legal at its inception will not be rendered usurious" by subsequent acts.

Amici Br.at 12-13. But what *Hoffman* actually says is that:

> "[t]he virtually universal rule is that a contract legal at its inception will not be rendered usurious ***by voluntary prepayment***."

416 A.2d 1265, 1269 (emphasis added).

Similarly, *Amici* cite *Southwest Concrete Products. v. Gosh Construction Corp.*, 51 Cal.3d 701, 708 (1990) for the proposition that:

> "a transaction that was not usurious at its inception cannot become usurious by virtue of" a later act.

Amici Br.at 13, n.9. The full quotation from *Southwest Concrete Products,* however is that:

> "a transaction that was not usurious at its inception cannot become usurious by virtue of **the debtor's voluntary default.**"

*Southwest Concrete Prods. v. Gosh Construction Corp.*, 51 Cal.3d 701, 708 (Cal. 1990) (emphasis added). Rather than expressing support for the idea that an assignment of a loan has no effect on what state's usury law applies, *Hoffman* and

*Southwest Concrete Products* merely state that the debtor's exercise of a payment option does not affect the rate on the loan for usury calculations. *Amici*'s editing and paraphrasing of the quotations, however, misleadingly portrays these cases as supporting "valid-when-made."

#### ***b. Cases Regarding the Effect of Usury in a Second, Subsequent Transaction on the First Transaction***

The second common fact pattern in the cases relied upon for support of "valid-when-made" is the question of whether when there were two transactions, usury in transaction #2 could be imputed to transaction #1. As with the option cases, the issue here has nothing to do with the question of what jurisdiction's usury law applies to the note, but merely about whether rate on the note exceeds the usury cap.

Several of the cases cited in support of "valid-when-made" deal with the two-transaction scenario, particularly the impact of discounting of notes and bills. To understand these cases, it is important to recognize that in the 19th century a robust secondary market in bill and notes, which were frequently sold at a discount from their face amount The discount from face can be conceived as interest because the obligor on the note would owe the face amount irrespective of the discount to the purchaser. For example, if a $120 note were purchased for $100, the purchaser would have a right to collect the full face amount of $120. Economically, however, the

transaction is equivalent to the purchaser having made a $100 loan and received $20 in interest. Indeed, this concept is still regularly applied today in the tax and bankruptcy law, where "original issue discount" on bonds is treated as imputed interest. *See, e.g.*, Treas. Reg. § 1.61-7(c); *In re Chateaugay Corp.*, 961 F.2d 378 (2d Cir. 1992); *Matter of Pengo Indus. Inc.*, 962 F.2d 543 (5th Cir. 1992).

Critically, the discounted sale issue does not give rise to the evasion of state usury laws like the "valid-when-made" doctrine. When a note is sold with a discounted sale, the borrower continues to pay interest to the purchaser at the contract rate, which would have been legal had the purchaser made the loan itself. The usury question only arises from the imputed interest in the discount. "Valid-when-made" deals with a situation in which the loan would have been illegal had the assignee made it directly. The "valid-when-made" would allow non-bank lenders to do indirectly what they cannot do directly.

Thus, *Amici* cite *Tuttle v. Clark*, 4 Conn. 153 (1822), which involved whether a discounted sale of a note would be treated as a sale or a loan. 4 Conn. at 156 (reporter's description). *Tuttle*'s holding—that the note "not being usurious in its original concoction, did not become so, by the subsequent [discounted] sale to the plaintiffs", 4 Conn. at 157—has nothing to do with the question of whether a non-

bank may piggyback on the unique exemption of banks from state usury laws. The case is wholly inapposite for the proposition for which *Amici* cite it.

Similarly, *Gaither v. Farmers' & Mechanics' Bank of Georgetown*, 26 U.S. (1 Pet.) 37 (1828) involved a non-usurious note that was pledged by the payee as collateral for an unrelated, usurious loan. 26 U.S. (1 Pet.) at 41. The Supreme Court observed that:

> [T]he rule cannot be doubted, that if the note free from usury, in its origin, no *subsequent usurious transactions respecting it*, can affect it with the taint of usury.

*Id.* at 43 (emphasis added). The point here is that usury in transaction #2 does not impute usury to unconnected transaction #1. *Gaither* had nothing to do with the supposed "valid-when-made" doctrine that a "promissory note originated by a state bank with a non-usurious interest rate under DIDA section 1831" cannot "be transformed into a usurious promissory note by virtue of assignment to a non-bank entity". Op. at 21. Again, as in *Tuttle,* the interest charged on transaction #1 continued to be charged at a rate that would have been legal had the assignee made the loan directly, whereas the current case involves a loan that would have been illegal for the assignee to make directly.

Likewise, *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103 (1833), involved a discounted sale of a note indorsed by the defendant. 32 U.S. at 103. When the

defendant indorsed the note, the defendant became jointly liable for the full face amount of the note, just as if it were the maker of the note. *See* UCC § 3-415(a). The Supreme Court held that the usurious discounting did not void the original note, *id.* at 110, 112, observing that among the:

> cardinal rules of the doctrine of usury …[is] that a contract which in its inception is unaffected by usury can never be invalidated by any *subsequent <u>usurious</u> transaction*.

*Id.* at 109 (emphasis added). *See also id.* at 106 ("the rule of law is everywhere acknowledged that a contract free from usury in its inception shall not be invalidated by any *subsequent <u>usurious</u> transactions upon it*.") (emphasis added). Again, the point is that usury in transaction #2 does not affect transaction #1. *Nichols* has nothing to do with the present question of whether a bank can transfer its statutory preemption privilege to an assignee to allow the assignee to purchase and enforce a loan that the assignee could not legally make itself.

The same pattern appears in a more recent case, *Concord Realty v. Cont'l Funding*, 776 P.2d 1114, 1120 (Colo. 1989), which addressed whether the interest rate should be calculated based on the contract rate or on the imputed rate of interest from a foreclosure sale bid. The language quote by the *Amici,* "the usurious nature of a transaction must be determined from its inception" merely refers to the timing

of the calculation of the interest rate, not the question of what law applies, which is the issue in this case.

#### *c. Cases Regarding the Effect of a Subsequent Valid Transaction on Prior Usury*

The third common fact pattern in the cases relied upon for support of "valid-when-made" is the about the effect of a later valid transaction on a loan that is usurious *ab initio. See Highway Equip. & Supply Co. v. Jones*, 153 N.W.2d 859, 863 (Neb. 1967) (issue of whether initial usury was purged by assignment); *Coral Gables First Nat. Bank v. Constructors of Fla., Inc.*, 119 So. 2d 741, 746 (Fla. Dist. Ct. App. 1960) (effect of renewal of a usurious loan on non-usurious terms); *Waggener v. Holt Chew Motor Co.*, 274 P.2d 968, 971 (Colo. 1954) (lender's acquisition of required license after making loan at rate above that allowed for unlicensed lenders does not cure violation).

Also in this pattern is *Watkins v. Taylor*, 16 Va. 424, 436 (Va. 1811) (effect of payment by surety on surety's subrogation claim on usurious contract). Shockingly, *Amici* fail to note that the language they quote from *Watkins* is from the *dissent*, not the majority opinion. Given that the subrogated surety was ultimately subject to the usury defense, *Watkins* tells us nothing about the existence of a "valid-

when-made" doctrine, but again shows *Amici* playing fast-and-loose in their presentation of the law.

### *2. The "Valid-When-Made" Doctrine Is Entirely Absent from Historical Usury and Banking Law Treatises*

If the "valid-when-made" doctrine were a "cardinal rule" of banking law, founded on Supreme Court opinions, one would expect it to regularly appear in 19th and 20th century usury and banking law treatises. Yet the doctrine is entirely unknown to historical treatise writers. Nothing even approaching the "valid-when-made" doctrine in which the assignment of a loan from an originator to an assignee subject to a different state usury law appears in any 19th or 20th century usury treatise. No prior reference to "valid-when-made" can be found in *any* banking or usury treatise.

*Amici* cite to language from 1838 edition of Blackstone's Commentaries on the Laws of England for support: "'[t]he usury must be part of the contract in its inception' for a contract to be deemed usurious." Amici Br. at 10. The quoted language is not from Blackstone himself, but from an annotator's footnote. It too, however, does not support the "valid-when-made" doctrine. The footnote cites two English cases, *Lowes v. Mazzaredo*, 1 Stark 385 (Assizes at Nisi Prius 1816) (usurious discounting of a non-usurious bill of exchange—pattern #2), and *Lowe v.*

*Waller*, 2 Dougl. 736 (King's Bench 1781) (good faith assignee of a usurious bill of exchange is subject to the defense of usury—pattern #3 of loan usurious *ab initio*), both of which are uninformative about the "valid-when-made" doctrine.

Similarly, *Amici* cite the 2018 edition of the *American Jurisprudence (2d)* treatise on Interest and Usury. Amici Br. at 10 (citing 44B Am. Jur. 2d Interest and Usury § 65 (2018)). That treatise too also never refers to "valid-when-made" and note one of the cases it cites in support of the language quoted by *Amici*—that the "usurious nature of a transaction is [determined] at the inception of the transaction" and that "usury therefore must exist at the inception of the contract"—deals with the question of whether an assignment affects the usurious status of a loan. The cases cited by *American Jurisprudence (2d)* are all in either payment option cases (the first pattern) or usury in separate, subsequent transactions (the second pattern).

***3. Only a Single Pre-DIDA Case That Supports "Valid-When-Made"***

There is only one pre-DIDA decision that is consistent with a "valid-when-made" doctrine. *Strike v. Trans-West Discount Corp.*, 92 Cal.App.3d at 745 (Cal. Ct. App. 4th Dist. 1979). The presence of a single pre-DIDA decision embracing valid-when-made suggests that it is unlikely that the doctrine is incorporated in DIDA.

*Strike,* notably, does not mention any such doctrine, even though *Strike* dealt with a situation similar to the instant case—a loan was assigned from a bank (exempt from California usury law by the California constitution) to a non-bank that was normally subject to California usury law. The California Court of Appeals held that the transfer of the loan did not change its status vis-à-vis the usury laws, but suggested that the outcome would be different if the loan had been intended for assignment *ab initio*. *Id.* This is a sensible position that ensures the liquidity of bank loans, but also prevents abuse of federal preemption through rent-a-bank arrangements and the like. *Strike* is the only pre-DIDA case that fits with "valid-when-made," and there is no evidence that Congress intended to incorporate its rule into DIDA, but if *Strike* was incorporated, that incorporation would also include the exception for loans intended for assignment *ab initio*.

### *4. Post-DIDA Cases All Stand on a Misreading of* ***Nichols v. Fearson***

A handful of post-1980 cases arguably support the doctrine, although they were obviously not incorporated into DIDA because they post-date the statute. These post-1980 cases are in a line founded on a misinterpretation of the same decontextualized quotation from *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103 (1833), upon which the Bankruptcy Court opinion, Appellee, and *Amici* rely. Thus, *Munoz v. Pipestone Financial, LLC*, 513 F.Supp.2d 1076 (D. Minn. 2007) cites to *Phipps*

*v. FDIC*, 417 F.3d 1006 (8th Cir. 2005), which in turn relies with no original analysis on *Krispin v. May Dep't Stores Co*., 218 F.3d 919 (8th Cir. 2000), which in turn relies on *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148-49, n.17 (5th Cir. 1981). An examination of *Lattimore Land Corp.* and *Krispin* show that neither is applicable to the instant case.

The holding in *Lattimore Land Corp.* was supported by two citations with no original analysis. One citation was to *Nichols v. Fearson* and the other to *Huntsman v. Longwell*, 4 F.2d 105 (5th Cir. 1925). *Huntsman*, unlike *Lattimore*, was not an assignment case, and properly relied *Nichols* as support for the idea that imputed interest from transaction #2 cannot be bundled with interest from transaction #1 to result in a combined interest rate that violates the usury cap. 4.F.2d at 106.

*Lattimore*, however, misread *Hunstman* and *Nichols* (as did subsequent courts, including the Bankruptcy Court in this case). These courts take the Jovian language from *Nichols* that among the "cardinal rules" of usury is that:

> a contract which in its inception is unaffected by usury can never be invalidated by any subsequent usurious transaction

32 U.S. at 109, and omit the penultimate word, so that it reads:

> a contract which in its inception is unaffected by usury can never be invalidated by any subsequent … transaction.

Indeed, *Huntsman* itself, in paraphrasing *Nichols* omitted the penultimate word. 4 F.2d at 106. By ignoring the word "usurious," courts have misread *Nichols* as standing for a broader proposition than it does. *Nichols* is a holding about the effect of a usurious discounting, nothing more. Hence the Supreme Court referred to "any subsequent ***usurious*** transaction," not merely "any subsequent transaction." The entire line of modern "valid-when-made" cases all stands on this misreading of *Nichols*.[3]

There is only one pre-DIDA decision, *Strike,* 92 Cal.App.3d. at 745 (Cal. Ct. App. 4th Dist. 1979), that is consistent with a "valid-when-made" doctrine. The presence of a single pre-DIDA decision embracing "valid-when-made" makes it unlikely that the doctrine is incorporated in DIDA, but if *Strike* was incorporated,

[3] *Krispin v. May Dep't Stores* can also be distinguished from the instant case because it involved a transfer between a bank and its parent corporation (a department store), not a transfer between two unaffiliated parties. The continued affiliation between the bank and the debt buyer and the bank's continued involvement in the loan was the key factor in *Krispin.* 218 F.3d at 924. No such corporate nexus exists in this case.

that incorporation would also include its exception for loans intended for assignment *ab initio*.

Because the "valid-when-made" doctrine did not exist at the time of DIDA's enactment, it could not have been incorporated in DIDA, and the doctrine's current vitality is far from a "well-settled" matter, as it was rejected by the Second Circuit in 2015. *Madden*, 786 F.3d at 250-53.

### C. "Valid When Made" Is Not an Inherent Implication of DIDA section 1831d

*Amici* further argue that irrespective of historical roots, "valid-when-made" is an inherent implication of section 1831d of DIDA. Amici Br. at 16-20. No one questions the power of banks to assign their loans. But it does not follow that the authority to assign loans also means the authority to assign federal preemption to non-bank entities that are not subject to the same extensive regulatory scheme as banks with the effect of also immunizing the non-banks from state laws. It is absurd to suggest that an inherent implication of section 1831d—part of a *federal bank* regulation law—is that *non-banks* should be exempt from *state* regulation.

*Amici* contend, however, that absent "valid-when-made" it would be "uneconomic" and "disastrous in terms of bank operations" because banks could not sell loans in the secondary market. Amici Br. at 17. Similarly, the Bankruptcy Court

claimed that "[a]ny contrary legal standard would interfere with the proper functioning of state banks". Op. at 22.

There is no evidence in the record to support the Bankruptcy Court's conclusion, which is a matter of supposition about financial markets that goes beyond the proper scope of any judicial notice. In any event, this hyperbolic conjecture is demonstrably wrong; the ability of banks to sell loans in the secondary market does not depend on the vitality of "valid-when-made." Nothing in the *Madden* position prevents banks from selling loans.

First, the principal secondary market in the United States is the market for mortgages. State usury laws are preempted for most mortgages, regardless of the entity that holds them. 12 U.S.C. §§ 1735f-7, 1735f-7a. Indeed, the broad express preemption for mortgages suggests that Congress did not intend such broad preemption for other types of loans.

Second, there are over 5,300 FDIC insured banks, all of which benefit from DIDA preemption. FDIC Statistics on Depository Institutions, 2d Quarter 2019. Even without a "valid-when-made" doctrine, there is a sizeable potential secondary market for non-mortgage loans that is unaffected by state usury laws.

Third, most bank loans are made at non-usurious rates—nothing like the 120.86% rate in this case. "Valid-when-made" is not necessary for a secondary

market in non-usurious loans, and indeed, non-banks regularly sell their non-usurious loans without incident.

Fourth, even usurious loans can still be sold absent "valid-when-made" because usury laws are not self-executing and are unlikely to be invoked absent a default on the loan. A robust "grey" market exists in "stale" debts, which are unenforceable because they are beyond the statute of limitations. *See, e.g.*, Andrew Martin, *Old Debts That Won't Die,* N.Y. TIMES, July 30, 2010, at B1. There is no reason to believe that a "grey" market would not also persist in usurious debts without "valid-when-made."

The only consequence of rejecting the spurious "valid-when-made" doctrine would be to decrease the price at which bank could sell *usurious* loans. DIDA, however, is not a price guaranty for banks' sale of usurious loans. As the Second Circuit observed in *Madden*, application of state usury laws to the assignee of a national bank might "decrease the amount a national bank could charge for its consumer debt in certain states," but that possible outcome would not "significantly interfere with the exercise of a national bank power." 786 F.3d at 251. So too, a lower price for usurious loans would not be a significant impairment of banks' powers, much less a conflict with section 1831d of DIDA, particularly in light of presumption against preemption in areas of traditional state regulation, such as

consumer protection law. *Vien-Phuong Thi Ho v. Recontrust Co., NA*, 840 F.3d 618, 625 (9th Cir. 2016).

**D. The Court Should Clearly State that It Is Not Addressing Whether Appellee Was the "True Lender" or Whether the *Ab Initio* Exception to "Valid-When-Made" Is Applicable**

There are three doctrinal paths by which Appellee could be subject to Colorado's usury law. First, Appellee could be liable if the Court follows *Madden* and holds that DIDA preemption does not immunize non-bank assignees of banks. Second, the Appellee could be liable if it is found to be the "true lender" on the loan, meaning that the involvement of Lake Mills Bank in the loan was so *de minimis* that it should be disregarded. And third, Appellee could be liable if the Court holds that it falls under the exception to "valid-when-made" for loans intended for assignment *ab initio. See Strike,* 92 Cal.App.3d at 745; *Lattimore*, 656 F.2d at 148 n.15.

Only the first of these three paths has been briefed in this appeal and has a factual record sufficient for judgment. It is important that the Court not rule more broadly than necessary in this case. Irrespective of the outcome, the Court should make clear that it is not addressing the two paths to liability that are not before it. In particular, the Court should make clear that it is not addressing whether Appellee was the "true lender;" that issue has not been raised. If Appellee is the "true lender,"

then the Wisconsin choice-of-law provision would be void because it was selected for purposes of evading the Colorado usury laws. *Miller v. Tiffany*, 68 U.S. 298, 308 (1864).

Likewise, if the Court does embrace "valid-when-made," it should clearly enunciate the *ab initio* exception and remand the case for fact-finding about the circumstances of the assignment of the loan from Lake Mills Bank to World Business Lenders. It is not clear if the loan was always intended for assignment, but the known facts suggest that the loan might have been originated for assignment as part of a rent-a-bank transaction: a Colorado entity obtained a small business loan at 120.86% interest from a tiny Wisconsin community bank, which assigned the loan to World Business Lenders, a subprime small business lender whose website states that its loans are currently offered through a bank.

## CONCLUSION

There was no "valid-when-made" doctrine prior to either the NBA or DIDA. The doctrine is a modern invention based on a misreading of *Nichols v. Fearson.* The doctrine is not implicit in the common law of assignments or in DIDA section 1831d. The doctrine is not valid, but made up. Whether such a doctrine should exist is properly the province of Congress, not the courts, and Congress has thus far declined to advance bills that would enact a "valid-when-made" doctrine.

Respectfully submitted this 19th day of September, 2019.

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## CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing AMICUS CURIAE BRIEF OF PROFESSOR ADAM J. LEVITIN IN SUPPORT OF APPELLANT was served by email upon the following, this 19th day of September, 2019:

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## CERTIFICATE OF COMPLIANCE

I certify that this amicus curiae brief complies with the type-volume limitation of Federal Rule of Bankruptcy Procedure 8017(a)(5) (and 8015(a)(7)(B)) because it contains 6,496 words, excluding the parts of the brief exempted by Federal Rule of Bankruptcy Procedure 8015(g).

Dated this 19th day of September, 2019.

Professor Adam J. Levitin

# APPENDIX A

http://www.bloomberg.com/news/2014-05-22/wall-street-finds-new-subprime-with-125-business-loans.html

Bloomberg

# Wall Street Finds New Subprime With 125% Business Loans

Zeke Faux

May 22, 2014, 12:00 AM EDT

Doug Naidus made his fortune selling a mortgage company to Deutsche Bank AG months before the U.S. housing market collapsed. Now he's found a way to profit from loans to business owners with bad credit.

From an office near New York's Times Square, people trained by a veteran of Jordan Belfort's boiler room call truckers, contractors and florists across the country pitching loans with annual interest rates as high as 125 percent, according to more than two dozen former employees and clients. When borrowers can't pay, Naidus's World Business Lenders LLC seizes their vehicles and assets, sometimes sending them into bankruptcy.

Naidus isn't the only one turning to subprime business lending. Mortgage brokers and former stock salesmen looking for new ways to make fast profits are pushing the loans, which aren't covered by federal consumer safeguards. Goldman Sachs Group Inc. (GS) and Google Inc. are among those financing his competitors, which charge similar rates.
"This is the new predatory lending," said Mark Pinsky, president of Opportunity Finance Network, a group of lenders that help the poor. "And the predators, just as they did in the mortgage market, have gotten increasingly aggressive."

Subprime business lending -- the industry prefers to be called "alternative" -- has swelled to more than $3 billion a year, estimates Marc Glazer, who has researched his competitors as head of Business Financial Services Inc., a lender in Coral Springs, Florida. That's twice the volume of small loans guaranteed by the Small Business Administration.
`Main Street'

Naidus, 48, chief executive officer of World Business Lenders, declined to be interviewed. Marcia Horowitz, a spokeswoman at public relations firm Rubenstein Associates Inc., said the company explains loan terms in plain English and takes steps to ensure that borrowers understand.

"World Business Lenders' sales and marketing techniques, as well as the interest rates it charges and the default rates it experiences, are generally consistent with those throughout the industry," Andy Occhino, general counsel for the company, wrote in a May 21 letter. "In serving the underserved small-business community along Main Street USA, World Business Lenders complies with all applicable laws and endeavors to ensure a positive experience for its customers."

Hurricane Damage

Maher and Tamer Kasem, a father and son who sell cigarettes and cosmetics to corner stores in Brooklyn and Philadelphia, are typical customers. They borrowed from World Business Lenders in December to keep their company afloat after being rejected by a bank and turned down for a hurricane-recovery loan.
A saleswoman initially talked about an unsecured $45,000 loan, they said. They had fallen further behind on bills by the time they received the final terms to borrow $12,500. The money, plus almost $1,000 in fees, was to be repaid over six months with $144.73 deducted from their bank account each business day, according to a contract they provided. That worked out to a total of $18,236 or an annualized rate, inclusive of fees, of about 110 percent.

Tamer and his mother Lamis said they signed personal guarantees that they would repay the money even if the business went bust, and the family put up a vacant lot as collateral.

"I was just wanting to get money to survive my business any way," Maher Kasem, 57, said in an interview at his office in the Bensonhurst section of Brooklyn, where he keeps boxes of fruit-flavored cigars and makeup ruined in Hurricane Sandy stacked on the crumbling tile floor. "They're slick."
World Business Lenders sued the Kasems and obtained a judgment for $22,828, which included a $3,879 prepayment fee. The firm hasn't yet foreclosed on the property, Kasem said.

## Packaging Loans

Horowitz, the spokeswoman for World Business Lenders, said the company works with borrowers to avoid defaults.

"If the default cannot be cured, World Business Lenders enforces its rights under the loan documents, including the recovery of the pledged collateral," she said.

Wall Street banks are helping the industry expand by lending originators money. They're starting to package the loans into securities that can be sold to investors, just as they did for subprime-mortgage lenders.

OnDeck Capital Inc., a lender with funding from Google's venture-capital arm and PayPal Inc. co-founder Peter Thiel, sold $175 million of notes backed by business debt last month in a deal put together by Deutsche Bank. Interest rates on the loans ranged from 29 percent to 134 percent, according to a report from credit rater DBRS Ltd., which labeled most of the deal investment grade.

Representatives for Thiel, Google Ventures and Goldman Sachs, which lends money to OnDeck, declined to comment.

## 'Your Choice'

"While I am not real thrilled about some of the prices being charged, in some cases businesses need to get something done in a hurry and it makes sense," said William Dennis, who directs the research foundation at the National Federation of Independent Business. "It may not be the world's best choice, but at least it's your choice."

Brokers are popping up around the country to originate loans on behalf of lenders including OnDeck and World Business Lenders. The companies pay fees to the brokers of about $6,000 for finding people willing to take a $50,000 loan, according to current and former brokers, most of whom asked not to be identified to preserve their job prospects.

Some stock brokers have jumped to business loans after getting kicked out of the securities industry by regulators.

## 'Absolutely Crazy'

“Our industry is absolutely crazy,” said Steven Delgado, who left World Business Lenders last year to become an independent loan broker. “There’s lots of people who’ve been banned from brokerage. There’s no license you need to file for. It’s pretty much unregulated.”

David Glass, 39, was still on probation for insider trading when he co-founded Yellowstone Capital LLC, a New York-based brokerage and lender that originated $200 million in loans last year, including for OnDeck.
He said he learned to sell in the 1990s at Sterling Foster & Co., a Long Island firm where he got his friend a job interview that inspired “Boiler Room,” a movie that portrayed a college dropout’s foray into high-pressure stock sales. Glass said he coached actor Vin Diesel on cold-calling for the film. “A natural,” Glass said.
Glass said it’s a lot easier to persuade someone to take money than to spend it buying stock.

“The guys I worked with then were incredible sales guys,” Glass said. “I don’t really feel like we’re selling now because everyone we’re calling is an inbound phone call or they’ve filled out a form on the Internet.”

Breeding Money

Jonathan Cutler, a spokesman for New York-based OnDeck, said Yellowstone and World Business Lenders have originated less than 1 percent of the company’s loans this year. OnDeck drops brokers who charge upfront fees or send a lot of deals that go bad, he said. OnDeck also doesn’t require collateral.

“OnDeck customers are experienced, savvy people,” said Andrea Gellert, senior vice president of marketing for the company. “Since entering the market, OnDeck has brought down pricing significantly.”

Since Aristotle condemned the “breeding of money” as the worst way to make it around 350 B.C., societies have both enacted laws against usury and devised ways to work around them. New York State instituted a 25 percent interest-rate cap after a 1965 investigation found the Genovese crime family backing a Fifth Avenue business lender that charged 5 percent a week.
Usury Laws

Some loan companies avoid state usury laws by partnering with banks based in Utah, which doesn't cap rates. Others say "cash advances," repaid by collecting a share of businesses' credit-card sales, aren't loans. World Business Lenders lends in only about half of U.S. states and won't make loans in New York, according to its website. The loan to the Kasems was made in Pennsylvania, where they also do business.
"It's kind of the Wild West right now," said Nick Bourke, who studies small loans for the Pew Charitable Trusts, a research and policy group. "Online lending is raising lots of legal questions about which state law governs."
Naidus, described by colleagues as the best salesman they'd ever met, turned the brokerage he founded after graduating from Syracuse University in 1987 into one of the biggest mortgage originators in the nation. He took MortgageIT Holdings Inc. public and then arranged to sell it to Deutsche Bank in 2007 for $429 million. During the sale process, Naidus made at least $12 million selling his shares and options, and the bank agreed to hire him for $17 million in pay and guaranteed bonuses over two years, according to public filings.
MortgageIT Settlements

Even as MortgageIT's loans went bad during the financial crisis, Naidus earned the trust of top Deutsche Bank executives. He became global head of mortgages and helped start a home-loan joint venture in Saudi Arabia.

Like other banks that bought mortgage originators, Deutsche Bank ended up bearing the cost of allegedly fraudulent loans that helped fuel the housing bubble. The Frankfurt-based lender paid $202 million in 2012 and admitted MortgageIT arranged for government insurance on ineligible loans that soured.

Deutsche Bank also paid $12 million to settle U.S. allegations that the originator imposed higher fees and interest rates on black and Hispanic applicants. It denied those claims. Naidus wasn't a defendant in any of the cases.

Naidus made colleagues at Deutsche Bank aware of his wealth, one former co-worker said. He invited his bosses to play golf at the Bridge, a country club near his summer house in the Hamptons. The club cost $750,000 to join, the Wall Street Journal reported in 2007. He also owned a duplex on the Upper East Side of Manhattan that he bought for $6.2 million in 2005, real estate records show.

## Sharia Lending

Naidus founded World Business Lenders in April 2011, according to a regulatory filing. He rented the 29th floor of an office tower on West 45th Street and began reassembling his lieutenants from the mortgage company. Naidus left Deutsche Bank the following year, said Renee Calabro, a spokeswoman for the bank in New York.
The business plan sounded promising, ex-employees said. Naidus said they'd build the largest small-business lender in the country and share the wealth when he took it public. He also created a company called Palm National Partners that would make loans to Muslims structured to avoid the sharia ban on charging interest.

"We are already helping so many entrepreneurs to realize their dreams," Naidus said in an undated video that was posted on World Business Lenders' website. "I can relate to every one of our customers because I am the prototype of our customer."

## 'Who Cares?'

World Business Lenders put up job listings seeking former brokers, and they came. A February orientation schedule provided by a former employee shows that training is run by Bryan Herman, who got his start under Stratton Oakmont Inc.'s Belfort, the con man portrayed in "The Wolf of Wall Street." Herman later ran his own boiler room in the 1990s and avoided jail by informing on other brokers when he was charged with fraud in 1998, court records show. Another salesman was released from prison in 2010 after serving about a year for penny-stock fraud.

Herman has paid for his crimes, according to his lawyer, Marty Kaplan.

"It's really like saying Bill Clinton smoked dope in college," Kaplan said. "Who cares?"

Cold-callers said they typically got paid a draw of $1,300 a month against commission. Four former employees said Naidus impressed them during job interviews with his success and intensity. He'd meet them in his office, which he decorated with a photo of himself striking a martial-arts pose with a sword, shirtless. One ex-colleague said Naidus liked to discuss his street-fighting skills. He looked like action star Jean-Claude Van Damme, another said.

## 'Money Factors'

Salespeople said they were told to refer to “short-term capital” instead of loans and “money factors” instead of interest rates. Eight of them said they talked business owners into applying by saying they’d offer a good rate after reviewing bank statements.

World Business Lenders charged most people 125 percent annualized interest rates on six-month loans regardless of their situation, five former employees said. The borrowers often put up cars, houses or even livestock worth at least twice as much as the loan. About one in five were going bust as of last year, two people with knowledge of the matter said. One said that 9 percent of the loans made this year have already defaulted.

“The sweet spot is someone who can limp along well enough for six months but probably isn’t going to be around much longer,” Opportunity Finance Network’s Pinsky said. “They’re in the business of helping these businesses fail.”

## Sushi Lunches

Naidus took the top three salespeople at World Business Lenders to lunch each month, often choosing sushi, former colleagues said. The successful ones were given the preferred leads, people who had called in about loans. Those who didn’t close deals survived on $1 pizza slices for a month or two until they were fired.

Former employees said finding qualified borrowers willing to pay their rates proved more difficult than Naidus made it sound. Six said they questioned whether their business was legal. Two others said they wondered why the company seized cars that weren’t worth enough to cover the repo man’s fee.

“You know payday loans?” said Aleena Skinner, who worked for World Business Lenders for a few months in 2012 and is now a saleswoman for a copy-machine company. “I don’t really feel like high-interest loans are in anybody’s best interest.”

World Business Lenders makes $1 million to $3 million a month in loans and was running at a loss as of last year because so many borrowers weren’t paying, one former executive said. Naidus once joked that the business would be better off if it paid salesmen in repossessed Pontiacs, the person said.

## Pizza Oven

Naidus's investors include Fahad Abdullah Al Rajhi, the son of one of the billionaire founders of Saudi Arabia's Al Rajhi Bank. Al Rajhi invested in Palm, the sharia-compliant part of the business, and brought in the Muslim scholar who blessed its practices, according to former employees.

Instead of lending, Palm buys an asset, such as a refrigerator or a pizza oven, and then leases it to the business owner. Other than that, the terms were the same. Finding Muslims to take the loans was hard, the ex-employees said. Messages left for Al Rajhi with his family's bank weren't returned.

Palm and World Business Lenders are legally separate entities and operate at arm's length, Horowitz said. Palm complies with all laws and isn't associated with the Al Rajhi family's bank, she said.

Tow Truck

Nick Frederick, 38, a tow-truck driver in Sykesville, Maryland, said the Islamic lender solicited him by e-mail and phone last year when he needed $15,000 to buy a trailer. The six-month "asset sale and lease" cost the equivalent of an annualized 96 percent interest rate, according to Frederick's contract. Frederick said a saleswoman assured him she would lower the rate in a few months and hire him to tow other people's cars.
"They were real friendly at first," he said. "I should have known better because it sounded too good to be true."

Frederick said he struggled to make the daily $166.98 payments when one of his trucks broke down, so he borrowed from his grandmother to pay off the contract early. Palm wouldn't accept his money, he said. Then without warning, he said, the company took his truck, along with a license-plate scanner and a laptop.

"I'm real close to going out of business because they're jerking me around," Frederick said. "Alls I want out of the deal is I want my property out of it, and I want my damn truck back."

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ATTACHMENT 2

Adam J. Levitin, *'Madden fix' bills are a recipe for predatory lending*,

AM. BANKER, Aug. 28, 2017,

https://www.americanbanker.com/opinion/madden-fix-bills-are-a- recipe-for-predatory-lending.

# BankThink 'Madden fix' bills are a recipe for predatory lending

By Adam J. Levitin
Published August 28 2017, 10:24am EDT

More in Midland Funding v Madden, Policymaking, Payday lending, Online banking

*Editor's note: This is an altered version of a post that originally appeared on the Credit Slips blog.*

Currently pending in both houses of Congress are versions of the Protecting Consumers Access to Credit Act of 2017 — bills that would "fix" the 2015 appellate court decision in Madden v. Midland Funding LLC. Unfortunately, these so-called legislative solutions are based on a faulty reading of case law.

The Madden case held that National Bank Act preemption of state usury laws applies only to a national bank, and not to a debt collector assignee of the national bank. The decision has potentially broad implications for all secondary markets in consumer credit in which loan assignments by national banks occur: securitizations, sales of defaulted debt and rent-a-BIN lending.

Unfortunately, the "Madden fix" bills are overly broad and unnecessary and will facilitate predatory lending. Specifically, the Madden fix bills claim to be restoring the so-called "valid-when-made" doctrine, which, according to proponents of the legislation, means that the usurious or nonusurious nature of a loan is fixed at the time when the loan is made. The problem is that this particular doctrine is wholly concocted. There is a "valid-when-made" doctrine in commercial law, but it means something entirely different than the Madden fix proponents claim.

Bills to address concerns about the effects of the Madden court decision would facilitate predatory lending through schemes that have no purpose other than evading state usury laws.
**Adobe Stock**

The actual "valid-when-made" doctrine provides that the maker of a note cannot invoke a usury defense based on an unconnected usurious transaction. The basic situation in all of the 19th-century cases establishing the doctrine involves *X* making a nonusurious note to *Y*, who then sells the note to *Z* for a discount. The discounted sale of the note can be seen as a separate and potentially usurious loan from *Y* to *Z*, rather than a sale. The valid-when-made doctrine provides that *X* cannot shelter in *Y*'s usury defense based on the discounting of the note. Even if the discounting is usurious, it does not affect the validity of *X*'s obligation on the note. In other words, the validity of the note is a free-standing obligation, not colored by extraneous transactions.

"Valid-when-made" was a sensible and indeed critical rule for 19th-century commercial law. In the 19th century, negotiable instruments such as notes passed as currency, and their liquidity depended on them being "travelers without baggage," such that parties could accept them without undertaking diligence beyond the four corners of the note itself. The

rule is not only practical, but also just — why should *X* get a windfall because of *Y*'s separate dealings with *Z*?

But notice that the actual valid-when-made doctrine has absolutely nothing to do with the Madden situation. The consumer in the court case did not attempt to invoke the rights of the national bank against the debt collector. Instead, the consumer's argument was that the interest rate on the debt was usurious — and clear — under state law from the get-go. The state usury law's application is preempted by the National Bank Act as applied to national banks, but only as to national banks; the National Bank Act does not void the state usury law, only stay its application. Once the note leaves the hands of a national bank, the state usury law applies as it always would. This too is a sensible outcome. National banks are not subject to certain state laws because they are subject to an alternative federal regulatory regime. An assignee of a national bank is not subject to that regulatory regime, however, so it should not get that regime's benefits lest there be a regulatory vacuum. And because consumer debts are not used as currency, there is no policy reason to enhance their liquidity by excusing debt purchasers from basic diligence.

The point is that Madden did not reverse long-standing case law; the National Bank Act was not held to preempt state usury laws in any circumstances until 1978. Instead, Madden reversed some relatively recent assumptions of the financial services industry about the scope of National Bank Act preemption in secondary markets, the foundations of which I questioned in a 2009 article. The Madden fix bills are not restoring long-standing doctrine, but creating it out of whole cloth to meet the financial services industry's desires about what the law should be, not what it is.

The flawed legal foundations of the Madden fix bills also present another problem: They fail to incorporate an important corollary doctrine. The courts have consistently distinguished between a situation in which there is a legitimate loan and an unconnected usurious transaction, and situations in which the assignee is the true lender and the assignment is a sham. Thus, the sale of defaulted loans to a debt collector who has had no input in the loan's underwriting is entirely different under this doctrine than a rent-a-BIN operation, in which the assignee is substantially involved in marketing and underwriting the loans.

The Madden fix bills fail to distinguish between these situations. Instead of merely protecting relatively benign financial transactions, like credit card securitization or even facilitating a secondary market in defaulted loans, the Madden fix bills are actually facilitating predatory lending through rent-a-BIN and rent-a-tribe schemes that have no purpose other than the evasion of state usury laws and other consumer protections.

In any event, it's not clear that the Madden court decision poses any problem that needs fixing. The bills cite a single, unpublished academic study that shows that some marketplace lenders responded to Madden by limiting credit to borrowers with low FICO scores. The study does not indicate the total dollar amount of that credit contraction, much less if it was offset by increased lending from other sources, or its effect on consumer welfare. We simply don't know the net effect of Madden on credit markets.

Even if there were a net reduction in credit as a result of Madden, that access to credit must be balanced against sensible borrower protections. If access to credit were everything, we should be eliminating limitations on debt collection and allowing consumers to pledge their children and organs as collateral.

Usury laws are the oldest form of borrower protection known. They are blunt tools, but that is also their virtue, insofar as they are easy to administer. Congress should be hesitant to do a quickie, backdoor repeal of laws that have been on the books since colonial times, especially as state legislatures are free to repeal their usury laws directly.

It's reasonable to rethink the role of state usury laws in national credit markets, but any erosion of consumer protections on the state level must be matched by a strengthening of those protections on the federal level, such as with a federal usury floor or an ability-to-repay requirement. Sadly, the Madden fix bills don't do this, and instead gut state usury laws in the name of restoring an imaginary legal doctrine that never existed.

**Adam J. Levitin**

**BankThink submission guidelines**

**APPENDIX E**

Comment of the Center for Responsible Lending *et al*. (Jan. 21, 2020)

January 21, 2020

The Honorable Joseph M. Otting
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219
***Submitted electronically via regulations.gov***

Re: Comments on OCC Notice of Proposed Rulemaking, Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 12 CFR Part 7 and Part 160, Docket ID OCC-2019-0027, RIN 1557-AE73

Dear Comptroller Otting:

## I. Introduction and Overview

The **Center for Responsible Lending**,[1] **National Consumer Law Center** (on behalf of its low income clients),[2] **Americans for Financial Reform Education Fund**,[3] **Consumer Federation of America**,[4]

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[1] The **Center for Responsible Lending** (**CRL**) is a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions. Over 37 years, Self-Help has provided over $7 billion in financing through 146,000 loans to homebuyers, small businesses, and nonprofits. It serves more than 145,000 mostly low-income members through 45 retail credit union locations in North Carolina, California, Florida, Greater Chicago, and Milwaukee.

[2] Since 1969, the nonprofit **National Consumer Law Center®** (**NCLC®**) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

[3] **Americans for Financial Reform Education Fund** (**AFREF**) works in concert with a coalition of more than 200 consumer, investor, labor, civil rights, business, faith-based, and community groups to lay the foundation for a strong, stable, and ethical financial system. Through policy analysis, public education, and outreach, AFREF works for stronger consumer financial protections and against predatory practices.

[4] **The Consumer Federation of America** is a nonprofit association of more than 250 national, state and local consumer groups that was founded in 1968 to advance the consumer interest through research, advocacy, and education. For over 50 years CFA has been at the forefront of consumer protection with a broad portfolio of issues including product safety, banking, telecommunications, investor protection, energy, housing, insurance, privacy and saving. CFA's non-profit members range from large organizations such as Consumer Reports and AARP, to small state and local advocacy groups and include unions, co-ops, and public power companies.

**Leadership Conference on Civil and Human Rights**,[5] **NAACP**,[6] **National Association for Latino Community Asset Builders (NALCAB)**,[7] **Public Citizen**,[8] and the **United States Public Interest Research Group (U.S. PIRG)**,[9] strongly oppose the Office of the Comptroller of the Currency (OCC)'s proposed rule on Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred (proposal or proposed rule).[10] The proposed rule would allow predatory non-bank lenders to launder their loans through banks to evade state interest rate caps. The proposal is outside the OCC's statutory authority; it is not justified by any evidence of problematic impact on legitimate bank operations; and the OCC has failed to consider the strong likelihood that the proposal will unleash a torrent of predatory lending. The proposal will take away powers that states have had since the time of the American Revolution to protect their residents.

Our concerns are not speculative. The OCC has directly supported the claim that a predatory non-bank lender, World Business Lenders, can charge 120% APR on a $550,000 loan despite Colorado law to the contrary. In that context, the OCC used the same Chicken Little claims and revisionist history it uses to justify this proposal. The OCC has failed to restrain Axos Bank, a federal savings bank, from fronting for WBL on horrific loans—often personal loans disguised as business loans—including a 138% APR $90,000 mortgage, a 92% APR $175,000 mortgage, and a 73% APR $28,000 mortgage. In the consumer space,

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[5] The **Leadership Conference on Civil and Human Rights** is a coalition charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States. Through advocacy and outreach to targeted constituencies, The Leadership Conference works toward the goal of a more open and just society - an America as good as its ideals. The Leadership Conference is a 501(c)(4) organization that engages in legislative advocacy. It was founded in 1950 and has coordinated national lobbying efforts on behalf of every major civil rights law since 1957.

[6] Founded in 1909, the **National Association for the Advancement of Colored People** (hereinafter **NAACP**) is our nation's oldest, largest and most widely known grassroots civil rights organization. The principal objectives of NAACP are to ensure the political, educational, social and economic equality of all citizens; to achieve equality of rights and eliminate racial prejudice among the citizens of the United States; to remove all barriers of racial discrimination through democratic processes; to seek enactment and enforcement of federal, state and local laws securing civil rights; to inform the public of the adverse effects of racial discrimination and to seek its elimination; to educate persons as to their constitutional rights and to take all lawful action to secure the exercise thereof.

[7] **National Association for Latino Community Asset Builders** (**NALCAB**) represents and serves a geographically and ethnically diverse group of more than 120 non-profit community development and asset-building organizations that are anchor institutions in our nation's Latino communities. Members of the NALCAB Network are real estate developers, business lenders, economic development corporations, credit unions, and consumer counseling agencies, operating in 40 states and DC.

[8] **Public Citizen, Inc.**, is a consumer-advocacy organization founded in 1971, with members in all 50 states. Public Citizen advocates before Congress, administrative agencies, and the courts for the enactment and enforcement of laws protecting consumers, workers, and the general public. Of particular relevance here, Public Citizen advocates for strong consumer-protection laws to bring fairness to consumer finance and accountability to the financial sector. Public Citizen actively supported establishment of the CFPB to serve as the first federal agency devoted to protecting the financial interests of consumers.

[9] **The United States Public Interest Research Group, Inc**. (**U.S. PIRG**) is an independent, non-partisan organization that works on behalf of consumers and the public interest. Through research, public education, outreach, and litigation, it serves as a counterweight to the influence of powerful special interests that threaten the public's health, safety, or well-being.

[10] 84 Fed. Reg. 64229 (Nov. 21, 2019).

predatory rent-a-bank lending is happening through FDIC-regulated banks. More OCC-supervised banks are likely to follow if this proposal is finalized.

Some online lenders are responsible market participants, complying with applicable law, not evading state interest rate limits, and succeeding through efficiencies in operations, customer acquisition, and underwriting. But others seek competitive advantage by avoiding state usury laws. Some flood the market with loans at interest rates and fees of 60% to 180% APR or higher that most states ban. State-regulated lenders are increasingly looking to federal bank regulators to help them avoid state laws against high-cost loans and predatory lending.

This proposal follows in the heels of the OCC's earlier attempt, which has failed to date, to allow non-bank lenders to evade state rate caps through a special purpose charter under the National Bank Act (NBA).[11] The OCC is now offering lenders another approach to avoiding state law, namely the so-called "bank partnership model," which this proposal threatens to endorse by broadly validating a wide array of arrangements by which a nonbank might assert a bank's exemption from state usury law.

The loans this proposal would encourage by facilitating rent-a-bank schemes are among the most exorbitantly priced, irresponsible, ugly loans on the market. These include the loans currently being peddled through these schemes: high-cost installment loans and lines of credit, typically directly accessing the borrower's checking account on payday; car title installment loans; subprime business loans; and mortgages masquerading as business loans. In addition, the proposal could bring back the rent-a-bank balloon-payment payday and car title loans that have not used rent-a-bank schemes since the mid-2000s but that used the same legal arguments and similar arrangements to justify their schemes.

**Our comment makes the following points in turn:**

- The OCC lacks authority under Section 85 to establish permissible rates for non-banks.

- The OCC wholly fails to meet the procedural requirements of Section 25b or to show that its proposal is necessary to avoid significant interference with a bank power.

- The proposal usurps the States' historical and constitutional role in our federalist system.

- The OCC fails to consider the risks the proposal poses to consumers and small businesses:

    - Bad actors are already engaged in predatory rent-a-bank schemes, which the OCC and FDIC are not restraining.

    - The OCC is supporting and has failed to address predatory rent-a-bank lending by an OCC-supervised bank in the small business area.

    - Payday lenders in California have explicitly stated plans to broadly expand rent-a-bank schemes; the proposal would embolden these and other new schemes.

[11] *See Lacewell v. Office of the Comptroller of the Currency* (No. 18-cv-8377) (ruling in favor of the NY Dept. of Financial Services in striking down the OCC's special purpose charter for "fintechs"). The OCC is appealing the decision.

- The proposal would embolden additional auto title lending through rent-a-bank schemes.

- The proposal's statement that it does not address "true lender" is cold comfort, as the proposal effectively encourages, rather than guards against, evasion of state law through rent-a-bank schemes.

- The proposal could encourage short-term payday lenders to return to rent-a-bank lending.

- The proposal fails to consider that high-cost lenders that are or will be engaged in rent-a-bank lending make loans that severely harm financially vulnerable consumers.

- The proposal is inconsistent with the agency's obligations under the Community Reinvestment Act.

➢ The OCC fails to consider the risks the proposal poses to the safety and soundness of national banks.

➢ The OCC fails to consider the proposal's impact on market participants that comply with state law.

## II. The OCC lacks authority under Section 85 to establish permissible rates for non-banks.

### A. Section 85 of the NBA and similar authority in HOLA do not provide the OCC the authority to establish permissible rates for non-banks.

The interest rate exportation provision of the National Bank Act, 12 U.S.C. § 85, the primary authority upon which the proposal attempts to rely, does not provide the OCC the authority to establish permissible interest rates for non-banks. The same is true of the rate exportation provision of the Home Owners' Loan Act, 12 U.S.C. § 1463(g), which governs federal savings associations. Since the authority is the same under both statutes, we will focus our discussion on Section 85 of the NBA.

Section 85 unambiguously provides the agency the authority to regulate interest rates only for a "[national bank] association."[12] It says nothing whatsoever about rates that any non-bank entity may charge or that the assignees of a bank may charge. The interest rate that a national bank may charge is not at issue in the proposal. Thus, Section 85 provides no authority here. As *Madden v. Midland Funding* observed, Section 85 is limited to national banks and does not govern the rated charged by non-bank

[12] 12 U.S.C. § 85. *See also* 12 U.S.C. § 1463(g) (preempting state usury laws regarding the interest "a savings association may charge").

assignees,[13] and the alternative "would create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank."[14]

Contrary to the OCC's assertion, Section 85's authority for national banks to charge home state rates, even when read in conjunction with bank powers to lend money and to make contracts, does not create the power to authorize non-bank assignees to charge interest at rates not permitted under state law.[15] Rather, loan assignment is a power discrete from Section 85. The NBA delineates the power to assign loans as "an additional power" of national banks in Section 24(Seventh) of the NBA.[16] Thus, to the extent that the OCC has the authority to preempt state laws that may impact the power of assignment, that authority is found outside of Section 85.

The Third Circuit[17] and numerous other courts have observed that section 85 (or the rate exportation provision of the FDIA) is limited to banks themselves in the context of rejecting arguments that the NBA either completely preempts[18] or provides a substantive defense[19] to usury claims against non-bank

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[13] *Madden v. Midland Funding, L.L.C.*, 786 F.3d 246, 250 (2d Cir. 2015). The *Madden* court cited *SPGGC, LLC v. Blumenthal*, 505 F.3d 183, 191 (2d Cir. 2007), which held that state limits on gift card fees charged by a nonbank, not by the national bank that issued the cards, were not preempted by the National Bank Act or federal bank regulations that authorize banks to charge such fees. *See also Citibank v. Martin*, 807 N.Y.S.2d 284 (N.Y. Civ. Ct. 2005).

[14] 786 F.3d at 252. *See also Eul v. Transworld Systems*, No. 15C7755, 2017 WL 1178537 (N.D. Ill. Mar. 30, 2017); *In re Cmty. Bank of N. Va.*, 418 F.3d 277 (3d Cir. 2005) (finding no complete preemption of claim against assignee because "Sections 85 and 86 of the NBA and Section 521 of the DIDA apply only to national and state chartered banks, not to non-bank purchasers of second mortgage loans such as RFC"); *Community State Bank v. Knox*, 523 Fed. Appx. 925 (4th Cir. 2013) (no complete preemption where consumer asserts claims against parties other than the bank, here payday lenders who claimed to be agents of an out-of-state bank).

[15] *See* OCC Proposal, 84 Fed. Reg. at 64230-31.

[16]Section 24(Seventh) of the NBA authorizes national banks "to carry on the business of banking" by "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt"; see also C.F.R. § 7.4008(a) ("A national bank may make, sell, purchase, participate in, or otherwise deal in loans . . .").

[17] *In re Cmty. Bank*, 418 F.3d 277, 296 (3d Cir. 2005) ("Sections 85 and 86 of the NBA and Section 521 of the DIDA apply only to national and state chartered banks, not to non-bank purchasers of second mortgage loans such as RFC.").

[18] *Colorado ex rel. Salazar v. ACE Cash Express, Inc.*, 188 F.Supp.2d 1281 (D. Colo. 2002) ("the NBA 'regulates national banks and only national banks . . . '" (quoting *Weiner v. Bank of King of Prussia*, 358 F.Supp.684, 687 (E.D. Pa. 1973)); *Flowers v. EZPawn Okla., Inc.,* 307 F. Supp. 2d 1191 (N.D. Okla. 2004) ("The question of whether plaintiff's state law claims would be preempted by DIDA if brought against County Bank, however, is not the issue before the Court . . . . The state action claims are asserted against EZPawn and EZCorp, neither of which is a state-chartered, federally insured (or national) bank.").

[19] *See Eul v. Transworld Sys.,* 2017 WL 1178537 (N.D. Ill. Mar. 30, 2017) ("it is not so clear that NBA preemption applies to assignees of loans originated by national banks…. The Court is not persuaded that NBA preemption applies here as a matter of law."); *Goleta National Bank v. Lingerfelt,* 211 F. Supp. 2d 711 (E.D.N.C. 2002) ("the NBA patently does not apply to non-national banks"). Even where courts find preemption, it is because the facts show that the bank is the real party in interest. *See Krispin v. May Department Store,* 218 F.3d 919 (8th Cir. 2000); *Discover Bank v. Vaden*, 489 F.3d 594, 601 (4th Cir. 2007) (finding bank is real party in interest, but if it is not, "the FDIA does not apply because [the named defendant] is not a bank"), *rev'd and remanded*, 556 U.S. 49 (2009).

assignees. Yet that is exactly what the OCC is trying to achieve here: preemption of state usury claims against non-bank assignees.

HOLA[20]and similar rate exportation language under the FDIA[21] are similarly limited in scope to the interest charged by banks themselves.

That Section 85 does not extend to non-banks is reinforced by other statutory provisions. In Section 25b, after federal preemption played major role in creating the financial crisis of 2008, Congress made clear that Section 85 does not extend to bank affiliates, subsidiaries, or agents; it defies logic that Congress would have intended it to extend to unaffiliated non-banks (see section III below).[22] While Section 25b does not alter or affect the authority of a "national bank" to make loans under Section 85, the section makes no reference to any authority of non-bank assignees to charge interest.[23] Indeed, courts that have found preemption of state usury laws in situations involving assignees generally did so in a context where the assignee was related to the bank *and* before Congress overturned preemption for subsidiaries, affiliates and agents.[24]

Further, in earlier legislation extending rate exportation to the out-of-state branches of state-chartered banks, Congress explicitly preempted state law for non-banks in the context of first lien mortgages, including when non-banks are assignees of national bank loans.[25] Congress's specific action in this context indicates a lack of authority for the OCC to act more broadly under Section 85. It also suggests that, had Congress subsequently or otherwise intended to preempt state law for non-banks in other contexts, it would have. The NBA and HOLA have no such provision and there is no evidence that the purported valid-when-made theory, discussed below in section B, was incorporated into interest rate provisions that are strictly about banks.

The statutory intent of Section 85 also underscores the point. Since our country's founding, States have protected their citizens from financial abuses, setting standards for lenders with respect to terms of credit, as well as the allowable methods of collecting debts. Congress enacted the NBA during the Civil

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[20] See 12 U.S.C. § 1463(g) (preempting state usury laws regarding the interest "a savings association may charge"); *Cf.* McShannock v. JP Morgan  Chase Bank, N.A., 354 F. Supp. 3d 1063 (N.D. Cal. 2018) ("even if Congress and OTS, subsequent to HOLA's enactment, contemplated federal savings associations' selling of mortgage loans in the secondary market, there is no indication in the subsequent legislative history that Congress intended HOLA preemption to continue to apply to loans sold to non-HOLA entities").

[21] *BankWest, Inc. v. Baker*, 411 F.3d 1289 (11th Cir. 2005), *reh'g granted, op. vacated,* 433 F.3d 1344 (11th Cir. 2005), *op. vacated due to mootness, 446 F.3d 1358* (11th Cir. 2006); *Community State Bank v. Knox*, 523 Fed. Appx. 925 (4th Cir. 2013) (no complete preemption where consumer asserts claims against parties other than the bank, here payday lenders who claimed to be agents of an out-of-state bank); *Commonwealth v. Think Fin., Inc*., 2016 WL 183289 (E.D. Pa. Jan. 14, 2016); *CashCall, Inc. v. Morrisey*, 2014 WL 2404300 (W. Va. May 30, 2014);

[22] 12 U.S.C. § 25b(b)(2), (3), and (h)(2).

[23] 12 U.S.C. § 25b(f).

[24] *See, e.g., Krispin v. May Department Stores*, 218 F.3d 919 (8th Cir. 2000)..

[25] 12 U.S.C. § 1735f-7a(a)(1)(C)(v). *See also* S. REP. 96-368, 1980 U.S.C.C.A.N. 236, 254-55 (1980) ("It is the committee's intent that loans originated under this usury exemption will not be subject to claims of usury even if they are later sold to an investor who is not exempt under this section.").

War in order to create a single national currency to finance the federal government's war effort.[26] In that context, as the OCC's proposal notes, Congress deemed it necessary to protect national banks from discrimination by States, and in particular state laws that might proscribe stricter interest rate limits for national banks than for state banks.[27] Accordingly, Congress enacted section 85 of the NBA to prohibit states from imposing upon national banks stricter interest rate caps than those that were otherwise lawful in states where the banks were located.[28] A century later, the Supreme Court extended the reach of section 85 to exempt national banks from interest rate caps in effect in any state except the state where the bank is *headquartered*. Additionally, common law principles of conflict preemption (now clarified and codified in section 25b of the NBA) protect national banks from interference by state laws that "prevent or significantly interfere" with national bank powers.[29]

Still, as the Supreme Court made plain soon after the NBA's enactment, and reiterated many times since, banks are "governed in their daily course of business far more by the laws of the States than of the nation."[30] Moreover, after the OCC exceeded its authority with a series of improperly over-reaching preemptive rules, Congress in 2010 added section 25b to the NBA to make clear the limits on the OCC's preemptive authority.

Section 85 has nothing to do with non-banks. Further, federal preemption is part and parcel with the obligation to submit to federal supervision. Once a loan is assigned, there is no federal bank supervision of the assignee. The legislative drafters certainly did not contemplate non-banks as beneficiaries of national interest rate preemption.

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[26] 12 U.S.C. § 38 ("The Act entitled 'An Act to provide a national currency secured by a pledge of United States bonds, and to provide for the circulation and redemption thereof,' approved June 3, 1864, shall be known as 'The National Bank Act.'").

[27] 84 Fed. Reg. 64230.

[28] 12 U.S.C. § 85.

[29] *Barnett Bank v. Nelson*, 517 U.S. 25, 33 (1996).

[30] *National Bank v. Commonwealth*, 9 Wall. 353, 362 (1870) ("National banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional."); *see also Davis v. Elmira Savings Bank*, 161 U.S. 275, 290 (1896) ("Nothing, of course, in this opinion is intended to deny the operation of general and undiscriminating state laws on the contracts of national banks, so long as such laws do not conflict with the letter or the general objects and purposes of Congressional legislation"); *First Nat. Bank in St. Louis v. Missouri*, 263 U.S. 640, 656 (1924) (national banks "are subject to the laws of a State in respect of their affairs unless such laws interfere with the purposes of their creation, tend to impair or destroy their efficiency as federal agencies or conflict with the paramount law of the United States"); *Atherton v. F.D.I.C.*, 519 U.S. 213, 223, 117 S. Ct. 666, 672, 136 L. Ed. 2d 656 (1997); *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1, 11 (2007) ("Federally chartered banks are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or the general purposes of the NBA."); *Epps v. JP Morgan Chase Bank, N.A.,* 675 F.3d 315, 320 (4th Cir. 2012).

### B. Neither the common law of assignment nor the purported valid-when-made theory gives the OCC authority to preempt state usury laws as to non-banks.

The proposal essentially asserts that, since common law generally allows assignment of contract rights, common law provides national banks the right to assign their *status* derived from the most favored lender doctrine. This is not so. This status is not an assignable contract right. It is a privilege national banks enjoy, provided by Section 85, because they are national banks. (The same is true for federal savings associations under HOLA.) As former Comptroller Hawke stated:

> "The benefit that national banks enjoy by reason of [preemption] cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank. Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself."[31]

Indeed, the OCC acknowledges three exceptions to this "normal" rule of assignability, one of which is where the contract involves "obligations of a personal nature."[32] Though the bank's preemptive status is a right of the bank and not an obligation, the notion is informative. It is a right "personal" to the national bank derived exclusively from its status as a national bank, and it may not be assigned.

Just because something is legal under a contract for one party does not mean that it is legal for an assignee. Banks may accept deposits, but they could not assign a deposit agreement to a non-bank and thereby give it the legal right to accept deposits and receive deposit insurance. Someone who is ineligible for or has failed to follow the requirements for a license to run a food service business cannot get into that business by purchasing a restaurant contract with a mall and arguing that the contract gives them the right to run the restaurant. States give certain licensed lenders the authority to charge interest rates above the rates charged by older usury states, but that does not mean that all states will allow state-regulated entities to avoid licensing laws and state supervision by taking assignment of loans originated by licensed lenders but then quickly sold to unlicensed entities.

And just because a contract has a term, and contracts are generally enforceable, doesn't mean that every contractual term is enforceable. Usury laws exist to protect borrowers from lenders' overreaching regardless of the rate at which the parties could otherwise contract.[33]

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[31] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance at 10 (Feb. 12, 2002), https://www.occ.treas.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

[32] Proposal, 84 Fed. Reg. at 64239 (citing Williston on Contracts § 74:10 (4th ed.). The other two exceptions noted are where the assignment would materially change the duty of the obligor or materially increase the obligor's burden or risk under the contract. *Id.*

[33]Indeed, longstanding common law and usury jurisprudence holds that, in any event, contracts designed to evade state interest rate limits are unenforceable. *Miller v. Tiffany*, 68 U.S. 298, 307–10, 17 L. Ed. 540 (1863) (holding that while contractual choice of law provisions for usury are enforceable, when done with intent to evade the law, the law of the contract location applies). *See also Seeman v. Philadelphia Warehouse Co*., 274 U.S. 403, 408, 47 S. Ct. 626, 628, 71 L. Ed. 1123 (1927) (echoing holding in *Miller v. Tiffany* that "the parties must act in good faith, and that the form of the transaction must not 'disguise its real character'"); *Stoddard v. Thomas*, 60 Pa. Super. 177, 181 (1915) (noting that in deciding choice of law provisions, "[a] person may contract to pay at the rate of interest of the place of the contract or the place of performance unless the place is fixed to escape the usury laws").

The purported "valid when made" principle gives the OCC no authority to preempt state usury laws as to non-bank entities. The OCC makes a dramatic leap from the authority of Section 85 and 1463(g) to ancient caselaw interpreting state usury laws in contexts very different from the instant one. The OCC offers no support for the idea that the purported valid-when-made doctrine—which it has misinterpreted—has anything whatsoever to say about the agency's authority under the NBA and HOLA.

First, and most important, the cases that the OCC cites in support of valid-when-made are interpreting state usury law, which the OCC lacks the authority to interpret—not federal banking law. At best, those cases and other common law doctrines could be relevant to an assessment of whether state usury laws significantly interfere with the power of banks (but, as discussed below, the OCC has failed to show any significant interference). But there is not the slightest bit of evidence that Congress incorporated those principles into the rate exportation provisions of NBA and HOLA, which, as discussed above, are strictly limited to the rates that banks can charge. Indeed, the complete preemption and true lender caselaw mentioned above says the opposite: that the NBA and HOLA are limited to the interest rates that banks can charge, not their assignees.

Second, the purported valid-when-made cases the agency cites as support do not even stand for the principle that the OCC claims. The OCC relies in particular on two 19th Century Supreme Court cases interpreting state usury laws.[34] Those cases merely hold that the interest rate on a loan will not be *recalculated*—potentially resulting in a higher, usurious rate—based on subsequent transactions. This means, for example, that a loan at a legal rate will not become usurious later if it is sold at a discount (so that the effective rate of return for the purchaser is higher than for the original lender) or if a note is pledged as security for a second, usurious transaction.[35] Neither of those cases addresses the situation where the assignee is subject to a different set of laws, much less whether a state-regulated lender governed under state usury law may be assigned a loan at the rate permitted only to the entity exempt from state interest rate limits. Indeed, this situation could not have even existed prior to the enactment of the NBA and, in practice, not until the 1978 *Marquette* decision since, until then, banks were subject to state interest rate laws in the states where they made loans.[36]

The other case the OCC cites,[37] which does involve an assignee, is an interpretation of one particular state law, not an interpretation of the NBA or HOLA, and does not support the OCC's assertion of authority to propose the instant rule.

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[34] *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833) and *Gaither v. Farmers & Mechs. Bank of Georgetown,* 26 U.S. (1 Pet.) 37, 43 (1828). In these cases, the Supreme Court held that imputed interest on the discount on the later sale of a loan could not be added to the stated interest on the original loan—addressing whether the assignor had violated usury, not the assignee.

[35] For a longer discussion, see Amicus Curiae Brief of Professor Adam J. Levitin In Support Of Appellant, *Rent-Rite Super Kegs West., Ltd*., No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019).

[36] While national banks can charge the higher of the rate of the state where they are located or a federal rate, that federal rate has been so low that banks generally charge the state law rate.

[37] *Olvera v. Blitt & Gaines, P.C*., 431 F.3d 285, 286, 289 (7th Cir. 2005) (interpreting Illinois law). In *Rent-Rite Superkegs West. Ltd*., 603 B.R. 31 (Bankr. D. Colo. 2019), the court, like the OCC, relied on cases interpreting state laws; misinterpreted the older usury cases that do not address whether an assignee is subject to a different set of laws; cited pre-Dodd-Frank cases dealing with subsidiaries; and relied on other inapposite cases. In *Phipps v. F.D.I.C.*, 417 F.3d 1006 (8th Cir. 2005), the bank itself, and not the nonbank, was the entity that charged the

Indeed, despite the claim that *Madden* overturned a cardinal rule of usury, the Second Circuit in *Madden* did not even address what state usury law permits or whether New York usury applied (as opposed to Delaware law, which does not limit interest rates, as specified in the contract).[38] The Second Circuit in Madden appropriately conducted the three step analysis that the OCC has blithely ignored:

- First, does the NBA address the interest rates that non-bank assignees may charge? The answer is clearly no.
- Second, would applying state usury laws to the non-bank assignees in Madden (debt buyers) significantly interfere with the powers of a national bank? As discussed below, the answer is clearly no.
- Third, what does state usury law and state choice-of-law law permit? Those are state law issues outside the OCC's authority.

The purported valid-when-made theory is just a creative interpretation of state law usury cases in a different context that have nothing to do with the OCC's authority under Section 85 and 1463(g).

## III. The OCC wholly fails to meet the procedural requirements of Section 25b or to show that its proposal is necessary to avoid significant interference with a bank power.

### A. The OCC fails to meet the procedural requirements of Section 25b.

In 2010, Congress rebuked broad federal preemption, "which it believed planted the seeds 'for long-term trouble in the national banking system.'[39] "[T]he simple failure of federal regulators to stop abusive lending" [40] had been "a major cause" of "a financial crisis that nearly crippled the U.S. economy."[41] In the years leading up to the crisis, the OCC continued to staunchly defend preemption while ignoring the writing on the wall, clear to so many others: that foreclosures on predatory, unaffordable mortgage loans would bring the economy to its knees.[42] States had been preempted from regulating *any* mortgage

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interest. *FDIC v. Lattimore Land Corp.,* 656 F.2d 139 (5th Cir. 1981), held that state usury laws are not preempted when the bank is an assignee, not originator.

[38] In *Madden*, after finding that the NBA did not preempt state usury laws as applied to debt buyers, the Second Circuit remanded to the district court to address the usury law issue of whether the account's choice of law provision (Delaware law) determined the relevant state usury cap or whether New York's criminal usury statute applied. 786 F.3d at 254. Similarly, the Seventh Circuit allowed a debt buyer to charge the rates allowed for its assignor, but did so as a matter of Illinois law, not rate exportation. *See Olvera v. Blitt & Gaines, P.C.*, 431 F.3d 285 (7th Cir. 2005);

[39] *Lusnak v. Bank of America*, 883 F.ed 1185, 1189 (9th Cir. 2018) (quoting S. Rep. No. 111-176, at 2 (2010)).

[40] *Lusnak*, 883 F.ed 1189 (9th Cir. 2018) (quoting The Creation of a Consumer Financial Protection Agency to Be the Cornerstone of America's New Economic Foundation: Hearing Before S. Comm. On Banking, Hous., and Urban Affairs, 111th Cong. 82 (2009) (Statement of Travis Plunkett, Legislative Director, Consumer Federation of America)).

[41] *Lusnak*, 883 F.ed 1189 (9th Cir. 2018) (quoting S. Rep. No. 111-176, at 2 (2010)). *See also* Testimony of Eric Stein, Center for Responsible Lending, Before the Senate Committee on Banking, Housing and Urban Affairs Hearing (2008),

[42] Testimony of Martin Eakes, Center for Responsible Lending, Before the Senate Committee on Banking, Housing and Urban Affairs Hearing On The Office of the Comptroller of the Currency's Rules on National Bank Preemption

lender (bank or non-bank) on the very terms that made many mortgages dangerous: balloon payments, negative amortization, variable rates, and other nontraditional terms.[43] In 2006, national banks, federal thrifts, and their subsidiaries made 32% of subprime loans, 40% of Alt A loans, and 51% of interest-only and option ARM loans.[44] A total of over $700 billion in risky loans were made by entities that states could not touch. By enacting Section 25b, Congress aimed to "address an environment where abusive mortgage lending could flourish without State controls."[45]

Section 25b could not be clearer: "State consumer financial laws are preempted *only if*…in accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in [*Barnett Bank v. Nelson*], the State consumer financial law prevents or significantly interferes with the exercise by the national bank of its powers."[46] Moreover, "any preemption determination under this subparagraph may be made…by regulation or order of the Comptroller of the Currency *on a case-by-case* basis."[47] Such case-by-case determination must be made in consultation with the Consumer Financial Protection Bureau (CFPB), taking the views of the CFPB into account.[48]

In particularly stark terms, Congress directed that "No regulation or order of the Comptroller of the Currency … shall be interpreted or applied so as to invalidate, or otherwise declare inapplicable to a national bank, the provision of the State consumer financial law, unless *substantial evidence, made on the record of the proceeding*, supports the specific finding"" [49] that a particular state law "prevents or significantly interferes with" [50] the exercise of a national bank power. In evaluating the legitimacy of any preemption rule, a reviewing court must consider "the thoroughness evident in the consideration of the agency, the validity of the reasoning of the agency," among other factors.[51] While section 85 exempts *banks* from state usury limits without such showing, any effort to expand such exemption to cover entities entity *other than a bank*—which impacts only the bank's power to sell loans, not to charge interest—requires the thorough consideration of substantial evidence demonstrating substantial interference with a power necessary to the business of banking.

Putting the matter beyond any conceivable doubt, Congress enshrined into statute, no fewer than three separate times, the principle that state laws, including state consumer laws governing the cost of credit, apply to bank affiliates and subsidiaries—except for those that are themselves chartered as banks—to

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and Visitorial Powers (2004), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/20040407_testimony_eakes_preemption.pdf.

[43] *See* The Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report, pgs. xxiii, 111-113, 126.

[44] *See* Lauren Saunders, National Consumer Law Center, "Restore The States' Traditional Role As 'First Responder'" (Sept. 2009), available at http://www.nclc.org/images/pdf/preemption/restore-the-role-of- states-2009.pdf.

[45] *Lusnak,* 833 F.ed at 1189 (quoting S. Rep. No. 111-176, at 17).

[46] 12 U.S.C. sec. 25b(b)(1)(B) (emphasis added); *see also Lusnak*, 833 F.ed at 1191-92 (Dodd-Frank made clear that Barnett is the legal standard for preemption).

[47] 12 U.S.C. sec. 25b(b)(1)(B) (emphasis added); *see also Lusnak*, 833 F.ed at 1191-92.

[48] 12 U.S.C. sec. 25b(b)(3); *see also Lusnak*, 833 F.ed at 1191-92.

[49] 12 U.S.C. § 25b(c) (emphasis added).

[50] 12 U.S.C. § 25b(b)(1).

[51] 12 U.S.C. § 25b(b)(5)(A).

the same extent they apply to any other non-bank entity. Congress made clear that this is true "notwithstanding" section 85. For example, section 25b(e) states:

> Notwithstanding any provision of [Title 62 of the Revised Statutes (which includes section 85)]…a State consumer financial law shall apply to a subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank) to the same extent that the State consumer financial law applies to any person, corporation or other entity subject to such State law.

Section 25b(b)(2) is to similar effect:

> [Title 62]…[does] not preempt, annul, or affect the applicability of any State law to any subsidiary or affiliate of a national bank (other than a subsidiary or affiliate that is chartered as a national bank).

Section 25b(h) extends this same clarification to "agents" of national banks:

> Clarification of law applicable to nondepository institution subsidiaries and affiliates of national banks…
>
> No provision of [title 62]…shall be construed as preempting, annulling, or affecting the applicability of State law to any subsidiary, affiliate, or agent of a national bank (other than a subsidiary, affiliate, or agent that is chartered as a national bank).[52]

Three times Congress declared this rule, and three times it articulated its sole exception (for subsidiaries or affiliates chartered as national banks). Had Congress intended to add an exception for assignees, it would have done so. The clear language of section 25b forecloses the OCC's attempt to write into the statute an additional exception for assignees. This would produce the nonsensical result of privileging mere contractual counter-parties over subsidiaries, affiliates and agents of national banks—even those that are wholly owned by a national bank. There is no reasonable reading of the NBA that would support this outcome.

Finally, as to many rent-a-bank schemes, the explicit non-application of section 85 to agents is dispositive. As discussed in section B below, the non-bank assignees that service loans and charge interest typically do so under the fiction that they are only agents of the bank that is the nominal originator of the loan.[53]

Accordingly, the OCC has no power to preempt the application of state usury laws as to non-bank assignees unless it follows the Dodd-Frank procedural and substantive requirements. That requires a careful delineation, supported by substantial evidence on the record of a proceeding, that particular state laws significantly interfere with bank powers. The OCC does not even attempt such a showing.

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[52] 12 U.S.C. § 25b(h)(2).

[53] *Bank Partnership and the Valid-When-Made Doctrine: an Update on Madden v. Midland*, Catherine M. Brennan, Meghan Musselman and Joseph Vitale, Hudson Cook, Thirteenth Annual Consumer Financial Services Conference (April 2016), available at https://catherinembrennan.files.wordpress.com/2016/04/madden-panel.pdf.

**B. The OCC does not show that state usury laws as applied to non-banks significantly interfere with bank powers for purposes of bank liquidity or any other legitimate banking purpose.**

Under Dodd-Frank, the OCC can only preempt particular state laws on a case-by-case basis. In the usury context, since usury laws are clearly not preempted as a class, the OCC needs to consider the particular contexts in which those laws significantly interfere with banks.[54] The OCC fails to do this.

The OCC's proposal generally states that "banks of all sizes continue to routinely rely on loan assignments and securitization to access alternative funding sources, manage concentrations, improve financial performance ratios, and more efficiently meet customer needs."[55] The proposal then leaps to a single sentence conclusion—with no evidence at all—that this "risk management tool would be significantly weakened if the permissible interest on assigned loans were uncertain or if assignment of the permissible interest were limited only to third parties that would be subject to the same or higher usury caps."[56]

Yet despite the OCC's criticism of the *Madden* decision and the nearly five years since that decision, the proposal does not even allege the *Madden* decision has had any impact whatsoever on debt-buyers' relationships with national banks or on any other market.[57]

The proposal is extraordinarily broad. Without limitation as to the parties involved, the means by which the party came to possess the debt, the purposes and circumstances surrounding the party's acquisition of the debt, the outrageousness of the interest rate, or the impact on the bank, the proposal would exempt any holder of a bank-originated debt from otherwise applicable state law. An analysis of the potential impact on different markets, which the OCC failed to conduct, shows that state usury laws as to non-banks do not create significant interference with a bank power. This analysis also underscores that the OCC has failed to meet the procedural requirement of evidence on the record of a proceeding and that the proposal is overbroad.

**1. Sales to Debt-buyers**

The Second Circuit directly addressed the impact on national banks of applying state usury laws to debt buyers. The court specifically found that "state usury laws would not prevent consumer debt sales by national banks to third parties," and although "it is possible that usury laws might decrease the amount

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[54] "Under the "case-by-case basis" requirement, the OCC must individually evaluate state consumer laws." *Lusnak*, 883 F.3d at 1194.

[55] OCC Proposal, 84 Fed. Reg. at 64231.

[56] *Id.*

[57] Some critics of the *Madden* decision point to a study that showed a drop in marketplace lending for subprime borrowers by three lenders in the Second Circuit after the decision, especially for those borrowers with FICO scores below 644. Colleen Honigsberg et al., *The Effects of Usury Laws on Higher-Risk Borrowers*, Columbia Business School Research Paper No. 16-38 (Dec. 2 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780215. However, the study showed that these lenders offered only miniscule amounts of credit in the low FICO range even before the *Madden* decision. Id. at 44 (Before Madden and After Madden charts). More relevant to this proposal, the study shows no significant impact on banks.

a national bank could charge for its consumer debt in certain states (i.e., those with firm usury limits like New York), such an effect would not 'significantly interfere' with the exercise of a national bank power."[58]

The OCC makes no attempt to dispute this conclusion. There is no evidence that the OCC's proposal is necessary to sustain banks' business with debt buyers. It is not even clear that the *Madden* ruling has meaningfully altered the price at which banks sell their defaulted debts, or even the price at which they can do so. Debt buyers already purchase at a steep discount, often not more than 10 cents on the dollar, based on a wide range of factors, most far more significant than the additional interest added to a principal that will never be collected in full. Indeed, the only impact of adding additional interest at high rates on top of already unaffordable debt is to bury struggling consumers under a load they may never escape. Thus, the OCC's decision to overturn the Second Circuit's decision as to debt buyers lacks any support.

**2. Securitization of bank loans**

The OCC references the ability of banks to securitize loans on the secondary market in order to access funding sources. Securitization of loans and revolving credit agreements can be a tool that banks use in the furtherance of their own legitimate bank lending programs that are not fronting for a third party. But securitization can also be an aspect of an operation that is designed to evade state usury law.

The questions that the OCC has left unanswered are whether the *Madden* decision is having any impact on legitimate, non-evasive bank securitization markets, and whether exercise of the power to securitize loans requires a complete exemption from state usury laws for every securitization vehicle and every assigned loan, in every conceivable circumstance.

The FDIC candidly stated in its proposed rule that it "is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred to this point as a result of the *Madden* decision."[59] The OCC offers no evidence to the contrary.

The analysis required by Section 25b—had the OCC followed its statutory requirements—would likely have revealed that the *Madden* ruling has had, and will likely have, limited if any impact, and that the proposed rule is not necessary for bank liquidity.[60] The largest securitization market by far is the mortgage market. State usury laws are already preempted for all first mortgages. And there is no evidence of any impact on the market for second mortgages by banks. (Yet, as discussed in section 5 below, the proposed rule could legitimize predatory rent-a-bank second mortgages currently being made by non-bank World Business Lenders through OCC-supervised Axos Bank at rates of 79% to 139% APR.)

The second largest securitization market is the auto loan market. Most auto loans are originated by dealers, not banks, and thus are subject to state usury laws. Auto loans originated by depositories

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[58] 786 F.3d at 251.

[59] FDIC Proposal, "Federal Interest Rate Authority," 84 Fed. Reg. 66845, 66850 (Dec. 6, 2019).

[60] We are aware of no evidence that *Madden* has negatively impacted any bank's stock price, for example.

generally are not securitized. To the extent they are or are otherwise sold on the secondary market, there is no evidence that *Madden* has impacted the health of any aspect of the auto loan market.

Some private student loans are securitized, but those loans are typically at low rates that do not exceed state usury caps. There is no evidence of any impact on the student loan market.

There are questions about the impact of *Madden* on the credit card securitization market in light of the recent suits filed alleging that the *Madden* decision requires the interest on credit cards to follow state law if the receivables are sold to a non-bank securitization trust. However, the OCC does not even mention the credit card market in its proposal. Mere allegations early in a lawsuit with an uncertain impact are not sufficient to justify an overbroad rule that will have tremendous far reaching impacts and harms to consumers.[61] There is no evidence of any broader impact to date on the credit card markets.

Even if the *Madden* decision requires restructuring some securitization vehicles, that may not have a significant enough impact on banks to justify preemption of state usury laws.

The proposal fails to consider that a significant option for national banks seeking liquidity and diversification of risk for high-cost loans is to securitize and sell them to other depository institutions that likewise benefit from their own interest rate-exportation privilege. The OCC has adduced no evidence that this option is insufficient to avoid significant interference with national bank lending powers.

Nor has the OCC undertaken the statutorily mandated detailed analysis of the potential market and borrower impacts of a blanket exemption for usurious loans sold into the secondary market. With respect to consumer impacts, this omission is striking given the enactment of 25b in the immediate aftermath of the financial crisis. The foreclosure crisis that gave rise to the broader financial collapse demonstrated that when banks hold loans on their balance sheets, they are less likely to put borrowers into loans the borrowers ultimately will be unable to repay. Higher cost loans are more likely to produce this outcome because borrowers who struggle to repay loans at lower interest rates generally find it even more difficult to cover higher costs. Originators tend to better assess borrower ability to repay when they plan to hold onto the loans themselves, than when they plan to off-load the loans to investors.

Of course, it is possible that the OCC could make the showing required by section 25b to support a rejection of *Madden* in a narrow context to the extent necessary to facilitate bank liquidity in particular, legitimate markets for bank products. While there can be no justification for flooding the secondary

[61] The court in these cases may find that the banks that issue the credit cards are the true lender and that they are covered by the NBA rate exportation provisions, or that the bank is the lender for purposes of state usury law. In a far cry from the high-cost rent-a-bank market or even the marketplace loan market, the banks in the credit card cases appear to market, offer, take applications for, underwrite, approve, issue and set the terms of the credit and have a continuing interest in the credit by owning and servicing the accounts (and, likely, having a significant interest in the interest paid). No one of these factors is determinative; in some high-cost rent-a-bank schemes, as well, the bank may claim to "own" the account and "charge" the interest through its agent. But the credit card securitization trusts, unlike rent-a-bank lenders, are not independent lenders and do not appear to have a significant role or economic interest in the lending programs other than in securitizing the receivables. The banks that offer the credit cards already have the right to charge the rate permitted by their home state and have no need to create vehicles to evade usury laws.

market with triple-digit interest rate loans, or loans of tens of thousands of dollars at high double-digit interest rates, should evidence of problems impacting bank products arise, it is possible that in a proper rulemaking, the OCC could marshal substantial evidence in support of a more appropriately tailored rule. That is exactly why Congress told the OCC how to conduct a preemption analysis. It did not do so.

#### 3. Assignment to online lenders otherwise subject to state law

A third context that the proposed rule will apply to is lending programs in which a non-bank company that would otherwise be subject to state law has a significant role in the loan program but uses a bank to originate its loans. Typically the non-bank is involved both on the front end—designing the loan program, marketing the loans to consumers or small businesses, taking and processing applications—and on the back end, servicing and collecting the loans and owning or benefiting from the assigned loans or receivables. The bank nominally makes underwriting decisions, but often using criteria, software, or analysis primarily designed or provided by the non-bank company. In more recent incarnations, the bank may claim to retain ownership of the "loan" or "account" and only to sell receivables. The bank may retain a share of the receivables, but the non-bank company typically has the larger share of the economic interest in the program.

Sanitized as a "bank partnership model," these arrangements can be used by companies that charge rates that, while below 36%, are still high and may, for some loans, exceed what states allow, especially for larger loans. Or these models can be used by predatory lenders charging extraordinary rates.

Some of these models operate with brazen openness about the centrality of evasion of state usury laws. Publicly available documents, like a presentation by a prominent fintech law firm, eliminate doubt as to how the "bank partnership" model works: The bank originates the loan; the loan acquires the bank's right to ignore usury laws in all states but the bank's home state; and the non-bank handles the marketing, consumer interactions, servicing and/or other tasks associated with the loan.[62]

One slide from the presentation provides:[63]

*How Do Bank Partnerships Work?*

- Nonbank entity partners with a state FDIC-insured chartered bank or a federally chartered bank to help the bank originate the loan;
- Federal law gives the bank the ability to charge the interest rate permitted to it by its home state to people in every state ("rate exportation");
- Nonbank partner provides marketing and loan processing assistance up front, as well as purchasing, servicing, and collections activities on the back end.

Another states:[64]

*How Do Bank Partnerships Work?*

1) A non-bank partner enters into a contractual relationship with a Bank.

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[62] *Bank Partnership and the Valid-When-Made Doctrine: an Update on Madden v. Midland*, Catherine M. Brennan, Meghan Musselman and Joseph Vitale, Hudson Cook, Thirteenth Annual Consumer Financial Services Conference (April 2016), available at https://catherinembrennan.files.wordpress.com/2016/04/madden-panel.pdf.

[63] *Id.*

[64] *Id.*

2) Under the terms of the relationship, the Bank originates the loans, applying its own credit underwriting guidelines.
3) The non-bank partner, through its employees, may act as an agent for the bank in the states where the borrowers are located.
4) The non-bank partner may receive the borrower's loan application and forward it, usually by electronic means, to the Bank.
5) The Bank approves or rejects the application. If approved, the Bank funds the loan from its location.
6) After the Bank makes the loan, the non-bank partner who acted as the bank's agent for purposes of loan origination may purchase it. The purchase usually takes place within seconds of the loan being made and the entire transaction is usually handled electronically.
7) By agreement with the non-bank partner, the Bank often retains a small (perhaps 5%) participation interest in the loan or sells the whole loan.
8) By agreement, the non-bank lender often guarantees or indemnifies the bank for the risk it assumes in originating the loans.

Whatever the merits of the lending programs, these are programs predominantly run by non-bank companies that are and should be subject to state law. While the bank purportedly applies its own credit underwriting guidelines and approves lending decisions, in practice key decisions are led by the non-bank.[65] Facilitating evasion of state law is not a legitimate bank power protected by the Supremacy Clause. These bank-partnership programs are not designed primarily to help banks with their liquidity or their own businesses. To date, only one federal savings association that we are currently aware of, Axos Bank, has built a business off of this model. While other national banks and federal savings associations might want to monetize their rate exportation privileges, it does not significantly interfere with a legitimate power of those banks to apply state interest rates to the assignees of "bank partnership" loans. No other bank concerns compel protecting the non-bank lender's ability to assert the preemption rights of a bank whose role in the lending program is minor compared to that of the non-bank entity.

The OCC not only wholly fails to justify its proposal. It also fails to consider the vast implications of its proposal—the impact on state laws, the consequences for consumers and small businesses, national banks, and nonbanks that operate incompliance with state law. We address these in turn in the following sections.

### IV. The proposal usurps the States' historical and constitutional role in our federalist system.

States have a long-standing, well-recognized interest in determining the policies best suited to prevailing conditions and priorities within state borders. As compared with the federal government, States are more familiar, accessible and accountable to their constituencies and can more nimbly develop policies

[65] As but one indication of the lender's control over the business, note Elevate's discussion of its control over their products' APRs: "We aim to manage our business to achieve a long-term operating margin of 20%, and do not expect our operating margin to increase beyond that level, as we intend to pass on any improvements over our targeted margins to our customers in the form of lower APRs. We believe this is a critical component of our responsible lending platform and over time will also help us continue to attract new customers and retain existing customers." Press Release: 10Q, Elevate Credit, Inc. (Aug.10, 2018).

to address the problems they face.[66] With good reason, the Constitution preserves the rights and role of States within our federalist republic.

The proposal fails to recognize States' historical and primary role in regulating and enforcing usury and the way that the proposal would undermine that role. The OCC's authority is over national banks and federal savings associations, not over non-bank lenders. In our federalist system, states have always been the primary regulator of non-bank lenders. Yet the proposed rule threatens to deprive states of their historic power by allowing non-bank lenders to use banks as a fig leaf to avoid state consumer protection laws.

Interest rate limits are the simplest and most effective protection against predatory lending.[67] Since the time of the American Revolution, states have set interest rate caps to protect their residents from predatory lending.[68] In more recent years, a handful of states eliminated their rate caps, others carved out limited exceptions for short-term payday loans (some since reversed), and a combination of federal and state laws exempt most banks from interest rate limits.[69] But the vast majority of states retain interest rate caps for non-bank installment loans and lines of credit.[70]

At least 43 states and the District of Columbia (DC) impose interest rate caps on some consumer loans. Among those that cap rates, the median annual rate including all fees is 36.5% for a $500, six-month loan, 31% for a $2000, two-year loan, and 25% for a $10,000, five-year loan.[71] While payday lenders are pushing hard at the state level to make high-cost long-term payday loans legal in more states, the large majority of state legislatures have rejected these efforts. In addition, sixteen states plus DC have interest rate caps that prevent short-term payday loans, a number that has grown by several over the last decade.

Notably, state laws often provide a comprehensive risk-based licensing and rate regime under which non-banks operate. For example, almost all states have a low usury limit at which even unlicensed, unsupervised lenders may lend, but permit a higher usury rate for licensed lenders. Essentially, in exchange for being allowed to charge a higher rate, the lender subjects itself to supervision and examination. As another example, as reflected in the prior paragraph, many states set lower rate limits on larger loans than they do on smaller loans, in light of the higher overall costs involved.

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[66] *See Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991) (stating that federalism "assures a decentralized government that will be more sensitive to the diverse needs of a heterogenous society" and "allows for more innovation and experimentation in government").

[67] See NCLC, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016), https://www.nclc.org/issues/misaligned-incentives.html.

[68] James M. Ackerman, Interest Rates and the Law: A History of Usury, 1981 Ariz. St. L.J. 61 (1981).

[69] See generally NCLC, Consumer Credit Regulation (2d ed. 2015), updated at www.nclc.org/library.

[70] *Id.*

[71] See Carolyn Carter et al., NCLC, Predatory Installment Lending in 2017: States Battle to Restrain High-Cost Loans (Aug. 2017), http://bit.ly/2vRZkEf; Carolyn Carter et al., NCLC, A Larger and Longer Debt Trap? Analysis Of States' APR Caps For A $10,000 5-year Installment Loan (Oct. 2018), overview http://bit.ly/2QOp6AG and full report, http://bit.ly/instloan18; *see also* NCLC, State Annual Percentage Rate (APR) Caps for $500, $2,000, and $10,000 Installment Loans (2019), https://www.nclc.org/images/pdf/high_cost_small_loans/fact-sheet-apr-caps-for-installment-loans.pdf.

States are typically successful in enforcing their interest rates against the products to which interest rate caps apply.[72] But the OCC's proposal risks undermining these regulatory landscapes and severely hamstringing states' ability to enforce rate caps.

High-cost lenders are notoriously relentless in their efforts to evade state usury laws (and any other law intended to rein them in) .[73] In the late 1990s and early 2000s, lenders attempted to evade the usury laws applying to balloon-payment payday loans through rent-a-bank schemes (see section V.E below). In 2000, the OCC and the Office of Thrift Supervision (OTS) issued guidance that by 2003 stopped national banks and federal thrifts from participating in these schemes (see section VI below).[74] Other federal regulators ultimately shut down these schemes for payday loans as well.[75]

With that option foreclosed, payday and other high-cost lenders turned to a similar sham whereby they claimed that a Native American tribe, which they argued was not subject to state law, was the true lender.[76] Notably, one such lender was Think Finance and its CEO Ken Rees, who were sued by the State of Pennsylvania in 2014 for violating the state's usury law by peddling 448% APR loans through a sham partnership with a Native American tribe. In 2019, Think Finance settled that lawsuit by agreeing to pay 80,000 Pennsylvanians $130 million.[77] CFPB also sued Think Finance for pursuing payments and collecting on loans that violated state usury laws and were thus void under state law.[78]

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[72] *See* Diane Standaert and Brandon Coleman, *Ending the Cycle of Evasion: Effective State and Federal Payday Lending Enforcement* (2015), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/crl_payday_enforcement_brief_nov2015.pdf.

[73] For example, they evaded the 2006 federal Military Lending Act until its more comprehensive regulations in 2015, and they schemed to evade the CFPB's payday lending rule as it was being developed. For a fuller discussion of the myriad ways payday lenders have engaged in evasion, see Comments of CRL, NCLC, and other consumer and civil rights groups to CFPB on its Proposed Rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans, Oct. 7, 2016, at pp. 35-40, https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_comment_oct2016.pdf.

[74] *See* OCC Advisory Letter No. AL 2000-10 (Nov. 27, 2000), https://occ.gov/news-issuances/advisory-letters/2000/advisory-letter-2000-10.pdf. *See also* Office of Thrift Supervision, Letter P-2000-4 (Feb. 3, 2000) (OTS will conduct examinations of the thrift's partner in payday lending to the same extent as it will of the thrift).

[75] *See, e.g.*, Robert Schoenberger, Republic to Get Out of Payday Loans; FDIC Urged Bank to Exit Business, The Courier-Journal, Mar. 3, 2006; Republic Bancorp Inc., SEC Form 8-K (Feb. 24, 2006), *available at* www.sec.gov; *In the Matter of* First Bank of Delaware, and CompuCredit Corporation, Notice of Charges for an Order to Cease and Desist and For Restitution, Federal Deposit Insurance Corporation, FDIC-07-256b, FDIC-07-257k, *available at* www.fdic.gov.

[76] *See Consumer Financial Protection Bureau v. CashCall, Inc*., 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016).

[77] *Pa. Attorney General Announces Payday Loan Relief Settlement*, KDKA 2CBS Pittsburgh, July 24, 2019, https://pittsburgh.cbslocal.com/2019/07/24/think-finance-payday-loan-settlement/.

[78] CFPB, *CFPB Sues Think Finance For Collecting On Debts That Consumers Did Not Legally Owe*, Nov. 15, 2017, https://www.consumerfinance.gov/about-us/newsroom/cfpb-sues-think-finance-collecting-debts-consumers-did-not-legally-owe/.

Back in 2014, Think Finance spun off its loan portfolio to a new company, Elevate[79]—which, undeterred by the exposure of one ruse, quickly and brazenly entered into a rent-a-bank scheme with Republic Bank for its Elastic product, and later entered into a scheme for its Rise product as well, with FinWise Bank. The OCC's proposal plays right into the hands of high-cost lenders and their unceasing efforts to evade interest rate and other consumer protection laws.

Maxine's story, which she shares in the documentary film *Let My People Go*, illustrates the relevance of state usury law in the lives of individuals and families:

> *I was like, "Collateral? Isn't my paychecks enough?" They said, "Sometimes, if you lose your job, we'll lose our money. So, we need something more." So, that's whenever my husband said, "Well, we have our vehicle." He was working, so my check paid for the loan and then we kind of lived off of his. So, I was a day late, 243.60, and I paid it anyways. I thought everything was okay, came up to Rapid to the celebration for Black Hills Powwow. My son . . . and his cousin were outside, and they said, "Mom, there's some men by the Suburban." And I said, "For what?" "I don't know. They want to see you and dad." . . . . So, we went out there and, here it was, a tow truck, and they came and they said, "Your car is being repossessed." I said, "For what? I paid down." And the man said, "Apparently [] you didn't pay them." And I said, "But all of our things are here. My whole family, I brought my whole family," and he said, "That's not our problem. You people should pay your bills."*
>
> *Maxine's family witnessed around 30 vehicle repossessions at the powwow*.[80]

Maxine lives in South Dakota, which in 2016 voted to cap rates at 36%, and car title lenders left the state. The OCC's proposal would embolden their return. The OCC fails to consider the proposal's impact on millions of consumers like Maxine, residing not only in South Dakota, but in all states with interest rate caps aimed at high-cost lending, and in all states who might like to enact those caps in the future.

## V. The proposal fails to consider the risk it poses to cause consumers and small businesses.

The OCC's proposal fails to consider the devastating impact it could have on consumers and small businesses, even as the risk is clear. Indeed, predatory lenders have long hoped for the banking regulators to issue this very proposal. After the proposal was released, one investment advisor wrote in its investment notes:

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[79] *Think Finance Announces Business Restructuring and Spinoff of New Company, Elevate*, BusinessWire, May 1, 2014, https://www.businesswire.com/news/home/20140501006196/en/Finance-Announces-Business-Restructuring-Spinoff-New-Company.

[80] *Source: Let My People Go,* a 30-minute documentary from the Center for Responsible Lending and South Dakotans for Responsible Lending, illuminating the harms that payday and vehicle title borrowers experienced in South Dakota and the 2016 ballot initiative that led to these lenders' exit from the state. A full transcript of the documentary was submitted to the docket to the CFPB's proposed repeal of the ability-to-repay provisions of its Payday, Vehicle Title, and Certain High-Cost Installment Loans rule, ID CFPB-2019-0006-51897, https://www.regulations.gov/document?D=CFPB-2019-0006-51897; the documentary may be viewed here: https://www.captheratesd.com/let-my-people-go/.

"Enova received a strong endorsement from banking regulators in support of its bank partnership model, which is a key aspect of its California growth strategy moving forward (Elevate Credit [ELVT, MP] is also a beneficiary of these developments)."[81]

Similarly, when the FDIC issued its Request for Information on small dollar lending in late 2018, an attorney who represents payday lenders wrote:

"[P]erhaps *most significantly*, this RFI could serve as a vehicle for the FDIC to confirm that, in a properly structured loan program between a bank and a non-bank marketing and servicing agent, the Federal Deposit Insurance Act authorizes state-chartered banks to charge the interest allowed by the law of the state where they are located, without regard to the law of any other state, despite "true lender" and *Madden* arguments to the contrary."[82]

High-cost products currently using rent-a-bank schemes are longer-term installment payday loans, lines of credit, vehicle title installment loans, subprime business loans, and mortgages masquerading as business loans. The proposal would also clearly embolden a return of short-term balloon-payment payday loans and balloon-payment vehicle title loans.

### A. The proposal fails to consider that bad actors are already engaged in predatory rent-a-bank schemes, which the OCC and FDIC are not restraining.

The proposal fails to consider that rent-a-bank schemes are already underway, including a small business loan scheme involving an OCC-supervised savings association, **Axos Bank**. In these comments, we focus on the most egregious examples of lenders making loans far in excess of 36%. But even 36% is a very high rate, and most states limit large loans well below that level. For example, the median rate cap in the states on a $10,000, 5-year loan is 25% APR, and New York limits loans over $25,000 to 16% APR. The limits on mortgage rates are often lower than that. Efforts to evade state usury caps are inappropriate even if the rates do not reach the triple digits.

With respect to consumer loans, two FDIC-regulated banks, **Republic Bank & Trust** (chartered in Kentucky) and **FinWise Bank** (chartered in Utah) are helping three high-cost lenders, **OppLoans, Elevate, and Enova**, make installment loans or lines of credit in excess of 100% APR in a total of at least 30 states and the District of Columbia (DC) that do not allow such high rates.[83]

OppLoans offers $500 to $4,000 installment loans through FinWise Bank at 160% APR in 24 states and the District of Columbia (DC) that do not allow that rate. [84] FinWise sells the receivables back to

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[81] On file with National Consumer Law Center.

**[82]** Jeremy T. Rosenblum, *FDIC seeks comment on small-dollar lending*, Ballard Spahr's Consumer Finance Monitor, Nov. 15, 2018, https://www.consumerfinancemonitor.com/2018/11/15/fdic-seeks-comments-on-small-dollar-lending/ (emphasis added).

[83] For details on rent-a-bank lending, see NCLC, Fact Sheet: Stop Payday Lenders' Rent-a Bank Schemes! (Dec. 2019), http://bit.ly/StopRent-a-BankSchemes ("Rent-a-Bank Fact Sheet"), also attached as Appendix A, and NCLC, Issue Brief: FDIC/OCC Proposal Would Encourage Rent-a-Bank Predatory Lending (Dec. 2019) ("Rent-a-Bank Issue Brief"), http://bit.ly/FDICrent-a-bankproposal (providing links to lenders' websites).

[84] *See* https://www.opploans.com/rates-and-terms/.

OppLoans or a related entity. OppLoans makes loans directly through a state license in states that allow high rates.

Elevate Credit uses FinWise Bank to originate Rise installment loans at 99% to 149% APR in 16 states and DC that do not allow those rates and in other states through a state license.[85] FinWise sells a 95% interest in the loans to an entity controlled by Elevate for which Elevate is the primary beneficiary.[86]

Elevate also offers a line of credit called Elastic that carries an effective APR of up to 109% in 14 states and DC that do not allow that rate on a line of credit.[87] Elevate uses Republic Bank & Trust of Kentucky to originate the Elastic product. Republic sells a 90% interest in the loans to an entity controlled by Elevate for which Elevate is the primary beneficiary.[88]

**Enova's NetCredit** brand recently began using Republic to fund $1,000 to $10,000 installment loans with APRs up to 99.99% in 22 states and DC that do not allow that rate.[89] Enova or a related entity likely purchases the loans or receivables shortly after origination.

**FDIC-supervised Capital Community Bank (of Utah)** is helping car title lender **LoanMart** evade state law in a number of states. LoanMart's loans range from 60-222% interest; a typical loan is $2,500, 18-month loan at 90%, totaling $2,136 in interest.[90]

In the small business area, two other banks—FDIC-regulated **Bank of Lake Mills** in Wisconsin and **OCC-regulated Axos Bank**—have helped **World Business Lenders** (WBL) originate loans. For example, WBL used Bank of Lake Mills to originate a 120% APR $550,000 loan[91] and a 74% APR mortgage,[92] and WBL uses Axos Bank to originate a mortgage that exceeded 138% APR.[93] The loans appear to be resold to a WBL-related entity.

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[85] *See* https://www.risecredit.com/how-online-loans-work#WhatItCosts (select each state); Rent-a-Bank Issue Brief, *supra.*

[86] *See* Elevate Credit, Inc., Form 10-Q for the period ending Sept. 30, 2019, S.E.C. file no. 001-37680 at 22, 43, https://www.sec.gov/Archives/edgar/data/1651094/000165109419000048/elevate10-qxq22019.htm ("Elevate 10-Q").

[87] Elevate 10-Q at 46; Rent-a-Bank Issue Brief, *supra.*

[88] Elevate 10-Q at 21.

[89] *See* https://www.netcredit.com/ (bottom of page); https://www.netcredit.com/rates-and-terms.

[90] *See* https://www.800loanmart.com/ (accessed Jan. 20, 2020).

[91] *See Rent-Rite Super Kegs West, Ltd., v. World Business Lenders*, LLC, 603 B.R. 41 (Bk. Ct. D. Colo. 2019).

[92] *See* Complaint, Deramo et al. v. World Business Lenders, LLC, et. al, No. 8:17-cv-01435-RAL-MAP (Cir. Ct. of 12th Jud'l Cir., Sarasota Co., FL June 16, 2017).

[93] *See Adoni, Harbor Park Realty, LLC v. World Business Lenders, LLC, Axos Bank f/k/a B-of-I Federal Bank*, filed Oct. 17, 2019 in Supreme Court of the State of N.Y., County of Suffolk, removed to E.D.N.Y on Dec. 12, 2019 as No. 2:2019cv06971-JMA-GRB.

In summary, loans currently being made through rent-a-bank schemes include:

- 160% APR, $400 to $5,000 loans (OppLoans's product)
- 99% to 149% APR, $500 to $5,000 loans (Elevate's Rise product)
- Up to 109% effective APR, $500 to $4,500 lines of credit (Elevate's Elastic product)
- Up to 99.99% APR, $2,500 to $10,000 loans (Enova's NetCredit product)[94]
- Up to 222% APR, $2,500 loans (LoanMart's car title loan)
- 75% to 139% APR and higher small business loans, including disguised personal mortgages at rates up to 139% that are resulting in foreclosure.

A review of the CFPB Consumer Complaints data on those predatory lenders currently using rent-a-bank scams find several recurring themes:

- consumers puzzled and distraught that their large bi-weekly or monthly payments are not reducing principal due to the loan's high interest rates;
- frequent inability to sustain the high payments;
- queries about how such loans can possibly be legal;
- distress caused by wage garnishment; and
- stress caused by relentless collection calls to a borrower's home or workplace.[95]

Having reviewed complaints about payday and other payday installment loans, these comment authors can attest that complaints about these loans are of the very same nature, replete with financial and emotional anguish at the hands of unaffordable high-cost loans. Dozens of examples of complaints about loans made by these lenders are provided in section G below, which discusses the harms of high-cost lending.

### B. The OCC is supporting and has failed to address predatory rent-a-bank lending by an OCC-supervised bank in the small business area.

The rent-a-bank lending currently going on in the consumer area, as far as we know, is entirely with FDIC-supervised banks. While one payday lender has apparently been in talks with OCC-supervised MetaBank for a possible rent-a-bank arrangement to evade California's new law (see section C below), so far we have not seen it. Theoretically, OCC enforcement of its 2000 guidance addressing relationships with payday lenders,[96] as well as its 2013 third-party service provider guidance,[97] could be used to prevent the spread of rent-a-bank schemes to OCC-supervised banks. But the agency's will to use these guidances to prevent rent-a-bank schemes in recent years is uncertain at best. The evidence from the

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[94] *See* https://www.netcredit.com/rates-and-terms/california.

[95] Complaints related to Elevate, OppLoans, Enova (NetCredit), Curo (SpeedyCash), and LoanMart, 2015 to present; downloaded from CFPB's complaint database and on file with CRL.

[96] OCC Advisory Letter No. AL 2000-10 (Nov. 27, 2000), https://occ.gov/news-issuances/advisory-letters/2000/advisory-letter-2000-10.pdf.

[97] OCC Bulletin 2013-29 (Oct. 30, 2013), Third-Party Relationships: Risk Management Guidance (flagging compliance risk "when a third party implements or manages a product or service in a manner that is unfair, deceptive, or abusive to the recipient of the product or service"), https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html.

small business area shows that the OCC is actively supporting predatory rent-a-bank schemes. The OCC has also failed to police or stop predatory rent-a-bank lending happening at Axos Bank, an OCC-supervised bank, despite a truly shocking fact pattern.

In July 2019, the OCC filed an amicus brief supporting World Business Lenders (WBL) in a district court bankruptcy case, *Rent-Rite Super Kegs v. World Business Lenders.*[98] The OCC is defending WBL's ability to charge 120% APR on a $550,000 loan despite Colorado's lower (but still hefty) 45% business interest rate cap because the loan was originated through a bank (FDIC-supervised Bank of Lake Mills).

Not one word of the OCC's brief expresses any concern about the ridiculously predatory interest rate. The OCC chose to side with a predatory lender in a case that is not at the appellate level, when the bank is not involved in the case, and where there is no argument that the bank would be impacted if WBL were limited to collecting 45% APR instead of 120% APR.

In the *Rent-Rite* case, the OCC made the same arguments in support of the non-bank WBL's right to charge 120% APR as it raises to justify this rulemaking. The OCC did not raise the possibility that the bank might not be the true lender or qualify its support for WBL or the application of the valid-when-made doctrine to WBL in any way..

The OCC's decision to support WBL in the *Rent-Rite* case is shocking enough, and dispels any hopes that the OCC has concerns about the valid-when-made theory being misused. But what is even more telling is that WBL's current rent-a-bank partner is OCC-supervised Axos Bank, formerly known as Bank Of Internet (BOFI), a federal savings association.[99]

Several cases filed in court against WBL reveal that the *Rent-Rite* case is not an aberration. This is a company with a predatory business model of approaching struggling businesses and charging exorbitant rates, using a bank as a front to escape interest rate limits. The loans are secured by personal residences, making the high rates truly shocking, and in some cases the business aspect of the transaction appears to be trumped up to disguise that these are loans for personal purposes and are covered by consumer laws. The bank has little if anything to do with the loans, and **in more than one case, WBL appears to have use of a power of attorney for the bank.**

The facts described below are taken from the complaints as alleged. There is a striking similarity to them.

In *Kaur et al. v. World Business Lenders et al*., filed in Massachusetts in April 2019, a married couple was threatened with foreclosure after borrowing $175,000 at 92% APR from World Business Lenders for their business, New England Distributors, secured by a mortgage on their house.[100] The loan paperwork listed BOFI/Axos Bank as the lender, but the loan was presented by WBL, all the forms were WBL forms,

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[98] *See Amicus Brief of the [FDIC] and the [OCC] in Support of Affirmance and Appellee, In Re: Rent-Rite Super Kegs West Ltd.*, https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2019/09/Amicus_Brief.pdf (Sept. 10, 2019); *see also* Letter to the OCC and FDIC from NCLC, CRL, and additional groups opposing the agencies' support of a predatory small business lender using a rent-a-bank scheme (Oct. 24, 2019), https://www.nclc.org/issues/ltr-opp-rent-a-bank.html.

[99] *See* https://www.wbl.com/.

[100] Complaint, *Kaur et al v. World Business Lenders et al.* (removed to D. Mass. June. 19, 2019 as 1:19-cv-11364).

and the application discussed WBL's role including ordering a valuation of the collateral. The mortgage was assigned from BOFI to WBL and that assignment by BOFI "was signed by World Business Lenders, LLC, as attorney-in-fact for BOFI Federal Bank."[101]

In *Adoni et al. v. World Business Lenders, LLC, Axos Bank and Circadian Funding,* filed in New York in October 2019, Jacob Adoni has been threatened with threats to foreclose on his home after receiving a $90,000 loan at 138% APR secured by his personal residence.[102] Adoni was contacted by Circadian Funding with an offer of a personal loan that would be funded by WBL and Axos Bank. He was told that the loan documents would be provided to him at 12:00 pm and he must execute them by 6:00 pm or the offer would no longer be valid. Adoni was told by Circadian that the loan was meant to be a personal loan to him but it was necessary for the loan documents to make reference to his business. The defendants "have inundated Mr. Adoni with multiple threats to foreclose on his home and on the mortgage."[103]

In *Speer v. Danjon Capital et al.,* filed in Connecticut in late 2019, Elissa Speer is facing a civil action in Nevada and a foreclosure of a residential property in Connecticut after taking out a $30,000 loan alleged to be at 400% and a second loan of $20,000, alleged to be at 121% APR.[104] The loans were offered by Danjon Capital in collusion with World Business Lenders, but were purportedly on funds lent by Bank of Lake Mills. After executing the first note and mortgage, Danjon refused the release the funds unless Speer executive a lease agreement for "restaurant equipment" despite the fact that Speer was never in the restaurant business and the equipment referenced, including two backpack leaf blowers, have no practical restaurant use. The complaint alleges that the defendants disguised residential mortgage loans made to consumers primarily for personal, family, or household uses, as commercial loans in order to avoid Connecticut's licensure and other laws.

In *B&S Medical Supply et al v. World Business Lenders et al*., filed in New York in 2017, WBL solicited Boris Simon, the owner of B&S Medical Supply, for a $28,000 business loan at 73% APR, provided by Liberty Bank, that was secured by Simon's home. The business loan application contained both the business logo and contact information of WBL and Liberty. The loan was immediately assigned from Liberty to WBL. WLB corresponded with Simon, referring to itself as the "Lender" and saying that it would service the loan and have the right collect payments.

In another case, *Michael Gangi Plumbing et al v. BOFI Federal Bank and World Business Lenders*, filed in New York in April 2019, the complaint is not available but the plaintiff alleged usury, fraud and misrepresentation by the defendants in connection with commercial and residential loans.[105]

The OCC's supervision of Axos Bank is clearly not stopping the bank from letting itself be used—up to the point of handing over a power of attorney—by a predatory lender in order to evade state interest

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[101] *Id.* at 21.

[102] Complaint, Adoni et al. v. World Business Lenders, LLC et al (removed to E.D.N.Y. Dec. 12, 2019 as No. 2:19-cv-06971).

[103] *Id.* at 5.

[104] Complaint, Speer v. Danjon Capital et al., No. 3:19-cv-01778 (D. Conn. filed Nov. 12, 2019).

[105] *See* Notice of Removal, *Michael Gangi Plumbing et al v. BOFI Federal Bank n/ka/a Axos Bank and World Business Lenders*, No. 19-cv-3409 (E.D.N.Y filed June 7, 2019).

rate limits. The bank itself has been named in these lawsuits, so the bank's supervisors should surely know about them. These practices have been going on for some time. A 2014 article describes how WBL employs some of the worst actors and practices from the foreclosure crisis for its predatory lending practices towards small businesses.[106]

The OCC's direct support for World Business Lenders on the same grounds used to justify the proposed rule shows exactly what should be expected to happen if the rule is finalized: predatory lending, which not only may leave people in financial ruin but jeopardizes their homes and businesses.

### C. The proposal fails to consider payday lenders' explicit plans in California to broadly expand rent-a-bank schemes, as well as other potential schemes that the proposal would embolden.

The proposal also fails to consider the entirely foreseeable growth of rent-a-bank schemes expected to occur, including possibly with OCC-supervised **MetaBank.**

On October 10, 2019, California Governor Gavin Newsom signed into law AB 539, effective January 1, 2020, which targets long-term payday loans, limiting the interest rates on loans of $2,500 to $10,000 to 36% plus the federal funds rate. Before now, there has been no rate cap in California on loans over $2,500.

Three large high-cost lenders, which were charging from 135% to 199% APR on high-cost installment loans—rates illegal under the new law—indicated their plans to start or expand rent-a-bank arrangements into California, with the clear intent to evade the new interest rate cap. These lenders discussed with investors their plans even before it was enacted. These brazen declarations of their intentions make patently clear that the involved lenders would be forming these partnerships for the purpose of evading the law, and that the involved banks would be renting out their charters to these lenders. These lenders have been met with resistance,[107] and to our knowledge have not yet begun new schemes in California. But at least two of these lenders appear to be already making high-cost rent-a-bank loans elsewhere, and the OCC's proposal would embolden these schemes—a fact the proposal fails to consider.

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[106] Zeke Faux, Wall Street Finds New Subprime With 125% Business Loans, Bloomberg (May 22, 2014), https://www.bloomberg.com/news/articles/2014-05-22/wall-street-finds-new-subprime-with-125-business-loans.

[107] *See* Press Release, *Advocates Urge FDIC, OCC, Federal Reserve to Stop Banks from Helping Payday Lenders Evade State Interest Rate Limits* (Nov. 7, 2019) (discussing letters to the agencies from a coalition of 61 consumer, civil rights, and community groups, flagging the lenders' statements of intent to evade California law and urging the regulators to prevent rent-a-bank schemes in California and elsewhere), https://www.responsiblelending.org/media/advocates-urge-fdic-occ-federal-reserve-stop-banks-helping-payday-lenders-evade-state-interest. Those letters attached another letter from Californians for Economic Justice to the California Department t of Business Oversight, the Attorney General, and the Governor, flagging the same concerns. *See also* Letter from Rep. Katie Porter of California to FDIC, Dec. 20, 2019 and Tweet: "High-cost lenders announced during their earnings calls that they planned to target CA borrowers with abusive loan terms banned in our state. Today, I'm forwarding transcripts of those calls to federal watchdogs. I won't stand by while bad actors try to skirt our laws." https://twitter.com/RepKatiePorter/status/1208039708095238145?s=20.

**CURO Group Holdings Corp.** currently offers both short-term and long-term payday loans through its **SpeedyCash** brand. Its website gives an example of a $2,600 installment loan at 134% APR and a $5,000 loan at 131% APR.[108]

The following is an example of a SpeedyCash loan made in California before the new rate cap: $2,600 loan at 135% APR, repayable over 3.5 years with payments of $138 every two weeks, or approximately $276 monthly, totaling **$12,560** in total payments.[109]

| ANNUAL PERCENTAGE RATE<br>The cost of your credit as a yearly rate | FINANCE CHARGE<br>The dollar amount the credit will cost you | Amount Financed<br>The amount of credit provided to you or on your behalf | Total of Payments<br>The amount you will have paid after you have made all payments as scheduled |
|---|---|---|---|
| 135.211% | $9,960.35 | $2,600.00 | $12,560.35 |

**Your Payment Schedule will be:**

| Number of Payments | Amount of Payment | When Payment is Due |
|---|---|---|
| 90 | $138.09 | Every 14 days , beginning 28 Feb 2014 |

CURO discussed plans to evade the California law, noting discussions with the national bank **MetaBank**, while praising the economics of the bank partnerships:

> "In terms of regulation at the state level in California, we expect a new law . . . [to make] our current installment products no longer viable . . . . "**[W]e continue to talk to Meta[Bank] and we continue to talk to other banks about partnership opportunities**" . . . . "I think we feel very good about being able to find products and partnerships that will serve our, the customer base in California that wants this longer, longer term, larger installment loan or possibly as a line of credit product . . . . And I think from a margin standpoint [] the bank partnerships are great. You have to sacrifice a little bit of the economics there because you have a, you have a bank partner there that's going to need a good rev share . . . . And I think . . . with bank partnership opportunities [] we feel . . . we've got a good, a really good opportunity to do that."[110]

We note that in April 2018, CURO announced plans to offer a line of credit product "through a relationship with MetaBank" which would not contribute to its financial results until 2020,[111] and that in its November 2019 10Q, it announced that it had discontinued that agreement in September 2019.[112]

Notably, MetaBank has a history of working with payday lenders and helping third parties offer predatory products and evade the law. MetaBank issues prepaid cards sold by ACE Cash Express and

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[108] https://db4nnybic3xty.cloudfront.net/pdf/SRC/2018/california/store/california.pdf (See "Installment Bank Line Loan Price Disclosure" at the bottom).

[109] Loan document on file with CRL.

[110] CURO Group Holdings Corp., Earnings Call, pp. 3, 7-8 (July 30, 2019) at SeekingAlpha.com.

[111] CURO 2018 10K at 46.

[112] CURO 10Q, Nov. 2019, at 44, https://fintel.io/doc/sec-curo-10q-curo-group-holdings-2019-november-04-18209.

other payday lenders, and those payday lender prepaid cards were the only major prepaid cards with overdraft fees until new rules from the Consumer Financial Protection Bureau went into effect.[113] And MetaBank now issues the "ACE Flare Account by MetaBank"—effectively a prepaid card sold by ACE and other payday lenders—which purports to be a bank account in order to evade the new prepaid rules and continue charging overdraft fees.[114] MetaBank was also sanctioned in 2010, when under the supervision of the OTS, in connection with another prepaid card offered by a third party, iAdvance. The OTS shut down the line of credit offered on that prepaid card, finding that bank had engaged in unfair and deceptive practices in connection with it.[115]

Two other high-cost lenders also noted plans to evade the California law through rent-a-bank schemes. Though not naming OCC-supervised banks, they could pursue such schemes with national banks as they look to evade the new law.

**Elevate Credit, Inc.** was offering high-cost installment loans in California through its **Rise** brand at rates of 60% to 225% APR for a $2,600 to $5,000 loan.[116] In other states, where that product would not be permitted by non-banks, Elevate currently uses FDIC-supervised **FinWise Bank** to originate its Rise loans at rates of 99-149% APR.

Elevate also uses FDIC-supervised **Republic Bank** to originate **Elastic**, an open-end line of credit with an effective APR of approximately 109%[117] in about 33 states, including in states that do not permit that rate by non-banks.[118]

In its July earnings call, Elevate discussed its plans to expand its Rise arrangement through a bank partner to evade the new California rate cap:

> "[Q:] So what does [the new California law] mean for Elevate? . . . [A:] [W]e expect to be able to continue to serve California consumers via bank sponsors that are not subject to the same proposed state level rate limitations. . . . [W]e are confident that we can make that transition . . . . And the effective yield that we are looking at on the product would be very similar to what we have on the market today. So we think the impact would be minimal and this transition would be pretty seamless."[119]

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[113] *See* NCLC, Payday Lender Prepaid Cards: Overdraft and Junk Fees Hit Cash-Strapped Families Coming and Going (2015), https://www.nclc.org/issues/payday-lender-prepaid-cards.html.

[114] *See* Press Release, National Consumer Law Center, "No Fooling! New Prepaid, Payroll, and Government Benefit Card Protections Take Effect April 1" (March 28, 2019), https://www.nclc.org/uncategorized/no-fooling-new-prepaid-payroll-and-government-benefit-card-protections-take-effect-april-1.html.

[115] Form 8-K filed by Meta Financial Group, Inc. with the Securities and Exchange Commission, October 6, 2010, *available at* http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319_18k.htm.

[116] https://www.risecredit.com/how-online-loans-work#WhatItCosts (select California).

[117] Elevate Sept. 2019 10-Q at 46.

[118] *See* NCLC, Rent-a-Bank Fact Sheet, *supra.*

[119] Elevate Credit Inc., Earnings Call, pp. 5-6 (July 29, 2019) at SeekingAlpha.com.

> "**Realistically, we will probably use a new bank to originate as we transition into California for Rise.** It will be [] probably different than FinWise. So that will add to the diversification."[120]

**Enova International, Inc.**, was offering two long-term high-cost loan products over $2,500 in California that are now outlawed by the new law, NetCredit (up to 155% APR) and CashNetUSA (up to 191% APR). Last summer, Enova discussed plans to evade the California law, while touting how relatively little lenders must give up in margin to purchase the bank's preemption rights:

> "[W]e will likely convert our near-prime product [NetCredit] to a bank-partner program, which will allow us to continue to operate in California at similar rates to what we charge today"[121] . . . ."There's no reason why we wouldn't be able to replace our California business with a bank program."[122]

When asked the following on the call: "Do you have a bank partner in place already? Just remind me, that will allow you to make higher rate loans that is, kind of, pass the product through their regulator?," the Enova spokesperson responded:

> "We do have a bank program. We do have a bank partner that does higher interest rate loans, and kind of, we'll have to do a couple of quick changes to our program with them to offer that in California, but we don't see any reason why we couldn't do that . . . . In terms of the conversion to a bank program, we give up a couple about percentages — a couple percent of margin to the bank partner, but other than that it's largely like-for-like."[123]

So far, Enova has not yet rolled out rent-a-bank products in California. But as discussed above, NetCredit uses a rent-a-bank operation in other states. The proposed rule would only give Enova more confidence to move into California and other states.

**LoanMart** has just recently added California to the list of states where it uses a bank to originate loans. In December 2019, prior to the effective date of California's new law, California was not included among those states on LoanMart's website; today, it is.[124]

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[120] *Id.* at 6.

[121] Enova International Inc., Earnings Call, p. 3 (July 25, 2019) at SeekingAlpha.com.

[122] *Id.* at 9.

[123] *Id.* at 9, 10.

[124] "Loans **for certain California residents**, and residents of Delaware, District of Columbia, Florida, Illinois, Indiana, Kansas, Kentucky, Michigan, Mississippi, Oklahoma, Ohio, Oregon, South Dakota, Tennessee, Texas, and Washington residents are made by Capital Community Bank, a Utah chartered bank located in Provo, UT, Member FDIC. Loans made by Capital Community Bank will be governed by Utah law and serviced by LoanMart." https://www.800loanmart.com/ (accessed Jan. 20, 2020) (emphasis added). The authors accessed LoanMart's website on December 19, 2019, and California was not listed at that time; the other states were already listed.

In addition, **OppLoans**, which makes 160% APR long-term payday loans, was previously originating some loans in California through FDIC-supervised FinWise Bank and other loans directly through a California state license, and now appears to be lending entirely through FinWise Bank., [125]

These publicly disclosed rent-a-bank operations and expansions are most likely in addition to others that have not yet been revealed. Other state-regulated payday lenders that are not publicly traded may well be in talks to begin rent-a-bank schemes to evade the will of California's legislature.

The immediately pending threat of brazen expansion of rent-a-bank schemes in California—and the risk to other states that already had strong rate caps—should have been considered by the OCC. Notably, FDIC Chairman McWilliams testified at a December 2019 Congressional hearing, following the issuance of both agencies' proposals, that she was unaware of these developments,[126] despite letters having been sent to her intended to alert her to these developments.[127]

### D. The proposal fails to consider the impact of auto title lending through rent-a-bank schemes.

As noted above, one of the markets where rent-a-bank lending has started to happen is the auto title loan market. Yet the proposed rule fails to consider the impact of legitimizing a rent-a-bank model for this market plagued not only by unaffordable high-cost loans but also by the risk of losing the vehicle.

**LoanMart**, which lends under a state license in states that permit its high rates, is using FDIC-supervised **Capital Community Bank (of Utah)** to evade state law in a number of states. LoanMart's website now says at the bottom:

> Loans for certain California residents, and residents of Delaware, District of Columbia, Florida, Illinois, Indiana, Kansas, Kentucky, Michigan, Mississippi, Oklahoma, Ohio, Oregon, South Dakota, Tennessee, Texas, and Washington residents are made by Capital Community Bank, a Utah chartered bank located in Provo, UT, Member FDIC. Loans made by Capital Community Bank will be governed by Utah law and serviced by LoanMart.[128]

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[125] *See* https://www.opploans.com/rates-and-terms/#california.

[126] House Financial Services Committee hearing on Oversight of Prudential Regulators, Dec. 5, 2019:
Rep. Porter: "[A[re you aware of statements made on earnings calls by lenders in California in the wake of California's new lending law, several payday lenders announced on their earnings calls that they plan to use rent-a-bank schemes to evade California's new law that outlaws 100 to 200 percent installment loans."
Chairman McWilliams: "I'm not and I frankly don't listen to payday lender' investor calls. I just don't have the time."

[127] At the time of the hearing, and prior to the FDIC's proposed rule on "federal interest rate authority," two letters, both publicized through press releases, had been sent to Chairman McWilliams, with copies to her staff, notifying the agency of lenders' stated intentions to evade the new California law through rent-a-bank schemes: an Oct. 24 letter opposing the agencies' support of WBL in the Rent-Rite case (https://www.nclc.org/issues/ltr-opp-rent-a-bank.html), and a Nov.7 letter addressing the California statements in detail (https://www.responsiblelending.org/media/advocates-urge-fdic-occ-federal-reserve-stop-banks-helping-payday-lenders-evade-state-interest).

[128] https://www.800loanmart.com/ (last accessed Jan. 20, 2020).

LoanMart's website directs borrowers from these states to a page for "ChoiceCa$h serviced by LoanMart," where the fine print indicates the loans are made Capital Community Bank.[129] That webpage indicates that loans are installment loans up to three years, and "The Annual Percentage Rate (APR) is 170% with a repayment period of 36 months. A loan example: a 3-year $3,000 loan with an APR of 170% has 36 scheduled monthly payments of $428.64," for a total cost of $15,431.04.[130]

The language indicating that for "certain California residents" loans are made through a bank appeared for the first time in January 2020. That is when California's interest rate caps on loans up to $10,000 went into effect (see section D below for further discussion). It is not clear which California residents receive loans originated by LoanMart; those may be loans of $300 or less, for which rates are not capped.

Most of the other states where LoanMart uses a bank to originate the loans are also ones that impose interest rate caps far lower than 170% APR on auto title loans or have other restrictions on auto title loans.[131] For example, in Florida, interest rates on auto title loans are capped at 30% per year on the first $2,000, 24% per year on the principal amount exceeding $2,000, and 18% per year on the remainder.[132] In Kentucky, interest rates on auto title loans are capped at 36% per year on amounts less than $3,000 and 24% per year on loan amounts greater than $3,000.[133] Some other jurisdictions, such as the District of Columbia and Washington State, do not have specific statutes governing auto title lending but generally cap interest rates at 36% or less.[134]

The dangers of allowing auto title lenders to charge otherwise usurious rates on loans originated by banks are especially great given the serious repercussions of losing one's car. For further discussion of the harm caused by auto title loans, see section G below.

### E. The proposal's statement that it does not address "true lender" is cold comfort as the proposal effectively encourages, rather than guards against, evasion of state law through rent-a-bank schemes.

The OCC's discussion of its proposed rule notes that the agency is not addressing the question whether the bank is the real party in interest or the "true lender" on a loan.[135] While the proposal would be even farther outside the OCC's authority if it purported to limit interest rates when the true lender that originates the loan is not a bank, this statement does little to mitigate the dangers of the proposed rule. This is particularly true when considered in the context of other recent and immediately relevant OCC

[129] https://www.800loanmart.com/choicecash/.

[130] *Id.* The website also indicates that the interest rate and monthly payment will drop each month if certain conditions are met.

[131] *See generally* National Consumer Law Center, Consumer Credit Regulation, Chapter 12 (2d ed. 2015), updated at www.nclc.org/library.

[132] Fla. Stat. § 537.011.

[133] Ky. Rev. Stat. Ann. § 286.4-530(1) (West).

[134] *See generally* National Consumer Law Center, Consumer Credit Regulation, Chapter 12 & Appx. D (2d ed. 2015), updated at www.nclc.org/library.

[135] OCC Proposal, 84 Fed. Reg. at 64232.

and FDIC statements and actions. In fact, the agency's proposal has the effect of inviting, rather than guarding against, evasion of state law through rent-a-bank schemes.

First, the proposed rule would eliminate the clean line established by the *Madden* case that is simple to enforce (in addition to being consistent with the OCC's limited authority): The rate exportation provisions of federal banking law only preempt state usury laws as applied to interest that the bank charges, not interest charged by a non-bank assignee. It is simple for state regulators, enforcement officials, and consumers to see what interest rate a non-bank is charging. The true lender doctrine, on the other hand, requires review of the totality of the circumstances and can require years of litigation and facts that are not immediately publicly available—such as what relative share of the economic interest the non-bank has or whether the non-bank is immunizing the bank for the risk. Forced arbitration clauses will block consumers from bringing true lender cases on a classwide basis. And consumers cannot count on states to bring these cases, as enforcement and regulator resources are limited and in some parts of the country the state officials do not have a strong track record on consumer protection. Indeed, in a number of states today, consumers are being harmed by ongoing rent-a-bank schemes. Thus, the true lender doctrine alone cannot be expected to provide adequate defense against evasion of state law through rent-a-bank schemes.

Second, the OCC's unfavorable view of some rent-a-bank schemes appears to be toothless. The OCC stated in 2018 that it "views unfavorably an entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s)."[136] This language—in contrast to the agency's historically very strong anti-rent-a-bank position (see section VI below)—is clearly so narrow as to invite abuse. By limiting itself to cases were evasion is the "sole" purpose, it risks green-lighting schemes where evasion is one of the purposes—perhaps even the dominant purpose. Lenders can always concoct additional rationales for their arrangements with banks. Moreover, the FDIC made the same statement in the proposal it issued accompanying the OCC's present proposal,[137] but has shown no indication that it "views unfavorably" the several rent-a-bank schemes ongoing under its nose, including the Republic Bank/Elevate scheme that has been going on for years.

Third, the OCC has already directly demonstrated how the proposed rule should be expected to work: to support predatory rent-a-bank lenders like World Business Lenders. As noted above, the OCC filed an amicus brief promoting the purported "valid-when made" theory this proposal promotes *to defend the validity of a predatory loan made through a rent-a-bank scheme*, without even suggesting that the bank might not be the true lender. Similarly, though the extraordinarily predatory *Rent-Rite* loan is clearly part of a business model, the OCC has done nothing to shut down predatory lending by WBL through OCC-supervised Axos Bank, as discussed above.

The proposal was made in the context of ongoing rent-a-bank schemes, including one the agency explicitly supported, with no indication that the agency will crack down on future schemes beyond one toothless sentence. The proposal can only be read to invite these schemes.

Predatory lenders will use the proposed rule to justify their arrangements and hope they are not challenged or that they can use forced arbitration clauses or other means to defeat challenges. As the rent-a-bank schemes become increasingly complex, courts, for their part, may find it easier to reject true

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[136] OCC Bulletin 2018-14, Installment Lending, May 23, 2018.

[137] FDIC Proposal, 84 Fed. Reg. at 66846.

lender challenges and instead simply enforce a rule that the assignee may charge whatever interest the bank can charge.

### F. The proposal fails to consider that it could encourage short-term payday lenders to return to rent-a-bank lending.

Some of the lenders that offer or are threatening to offer high-cost rent-a-bank installment loans also offer short-term payday loans. Enova's CashNetUSA offers both balloon-payment payday loans and long-term payday loans. CURO's SpeedyCash also offers short-term payday loans.

Currently, to our knowledge, rent-a-bank schemes are not being used to offer short-term loans, as they were 20 years ago. This is little consolation, as larger, longer high-cost loans are often an even bigger, deeper, more intractable debt trap than short-term loans.

Moreover, it is important to note that the arrangements between payday lenders and banks 20 years ago, and the arguments they made, were not that different from today's rent-a-bank lending. If the proposed rule is finalized, there is little other than the self-restraint of banks that would prevent short-term rent-a-bank lending from returning.

In 2000, the OCC itself described the older payday loan rent-a-bank arrangements in terms that are strikingly similar:

> [S]ome national banks have entered into arrangements with third parties in which the national bank funds payday loans originated through the third party. In these arrangements, national banks often rely on the third party to provide services that the bank would normally provide itself. These arrangements may also involve the sale to the third party of the loans or the servicing rights to the loans.[138]

In the older payday loan rent-a-bank schemes as in the newer ones, lenders argued that they were only the agent, service provider or assignee of the bank.[139] For example, as described in one case, Advance America was identified as "the fiscal agent and loan marketer/servicer." Advance America "procures the borrower and submits a loan application to BankWest. BankWest then approves (or denies) the application and advances all funds." The bank "used a separate third-party "loan processing agent" (an

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[138] OCC Advisory Letter No. AL 2000-10 (Nov. 27, 2000), https://occ.gov/news-issuances/advisory-letters/2000/advisory-letter-2000-10.pdf.

[139] *BankWest, Inc. v. Baker*, 411 F.3d 1289, 1295 (11th Cir. 2005) ("To avoid this direct prohibition, however, payday stores have entered into agency agreements whereby the stores procure such payday loans for out-of-state banks …"), *reh'g granted, op. vacated*, 433 F.3d 1344 (11th Cir. 2005), *op. vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006); *Flowers v. EZPawn Oklahoma, Inc*., 307 F.Supp.2d 1191, 1196, 1205 (2004) ("Defendants assert that they acted as servicers for the loan made by County Bank… Defendants submit that County Bank developed the loan product at issue, approved and made the extension of the loan to the Plaintiff and all others similarly situated, funded the loan …"); *Colorado ex rel. Salazar v. Ace Cash Express*, 188 F.Supp.2d 1282 (D. Colo. 2002) ("Defendant admits that it is a 'loan arranger/agent.'"); *Commonwealth v. Think Finance, Inc.,* 2016 WL 183289 (E.D. Pa. Jan. 14, 2016).

automated-consumer-information database that the payday lender itself used in other states) to electronically approve applications. [140]

As described by the OCC in 2000, decades ago the payday lenders not only performed services as an agent of the bank but also were assignees of loans that banks chose to sell to the secondary market: "BankWest 'owns' all the loans initially, but retains the right to sell a loan to any third party; Advance America, as the payday store has a right of first refusal on any loan the BankWest chooses to sell."[141] For example, one lender made arguments reminiscent of the OCC's that it stepped into the bank's shoes: "preemption applies to any challenge of interest or fees on a bank-issued loan … [and] preemption rights do not disappear when a loan is assigned or transferred from the bank."[142]

The OCC has failed to consider the abuse of payday loan rent-a-bank arrangements of the past and the reputation risk to banks that eventually drove the bank regulators to shut them down. Yet the core of the OCC's argument—that a bank has a right to sell loans, and that when it does the assignee steps into the bank's shoes—can be applied no matter what the interest rate or term of the loan.

Moreover, the OCC's repeal of its guidance against bank payday loans (aka "deposit advance products") leaves banks with no guidance against these pernicious short-term loans. Although the OCC's excuse for repealing that guidance was that the CFPB had finalized a rule governing payday loans, the CFPB has proposed to repeal that rule and it is currently stayed by a court.

Thus, the twin signals of repealing guidance that stopped banks from offering balloon-payment payday loans, coupled with a rule that says those loans may be assigned to and collected by anyone, may be all that is needed for this same "abuse of the national charter," as Comptroller Hawke called rent-a-bank schemes in 2002,[143] to return.

For discussion of the harm consumers experience at the hands of short-term payday loans, see section G below.

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[140] *BankWest, Inc. v. Baker*, 411 F.3d 1289 (11th Cir. 2005) ("To avoid this direct prohibition, however, payday stores have entered into agency agreements whereby the stores procure such payday loans for out-of-state banks …"), *reh'g granted, op. vacated*, 433 F.3d 1344 (11th Cir. 2005), *op. vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006).

[141] *BankWest*, 411 F.3d at 1295 n.6; *see* also People ex rel. Spitzer v. Cty. Bank of Rehoboth Beach, Del., 45 A.D.3d 1136, 1137, 846 N.Y.S.2d 436, 438 (2007) ("County Bank and TC [Telecash] entered into an agreement wherein County Bank agreed to make and TC agreed to market and service such payday loans….TC and CRA purchased a 95% participation interest in each and every loan made."); *Hudson v. ACE Cash Express,* 2002 WL 1205060, 2002 U.S.Dist. LEXIS 11226 (S.D.Ind. 2002) ("The Master Agreement provides that Goleta will sell an undivided participation interest in certain 'Bank Loans' to ACE [Cash Express]…. At the time of Goleta's loan to Hudson, ACE was required to purchase an undivided 95% participation interest in these loans.").

[142] *Think Finance*, 2016 WL 183289 at *13.

[143] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance at 10 (Feb. 12, 2002), https://www.occ.treas.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf; see further discussion in section VI below.

### G. The proposal fails to consider that high-cost lenders that are or will be engaged in rent-a-bank lending make loans that severely harm financially vulnerable consumers.

#### 1. Harm in general.

In recent years, the harms of high-cost lending have been more comprehensively and thoroughly documented than ever before.[144] High-cost lending is a debt trap by design, exploiting the financially distressed and leaving them worse off, leading to a host of financial consequences that include greater delinquency on other bills,[145] high checking account fees and closed accounts,[146] and bankruptcy. [147]

Across the board, borrowers of high-cost loans are already struggling to manage existing credit obligations. The credit scores of Elevate's borrowers typically range from 511 to 626.[148] Elevate's Elastic borrowers have a median income of $39,500.[149] Its Rise customers also have modest, if somewhat higher, incomes averaging $53,600,[150] but they are clearly struggling, as the stories described below attest. The profile of short-term payday loan and auto-title borrowers is even more dire: their median credit scores are deep subprime or subprime, averaging 525-530, with about 85% of borrowers with scores below 600.[151] They typically earn $25,000-$30,000 per year.[152]

A fundamental, perverse reality drives the high-cost loan market: Borrowers meeting this profile are not likely to have the ability to repay the loans high-cost lenders make to them; lenders know this and depend on it, as the interest rates are so high that they make money anyway. For short-term loans, borrowers cannot afford the large balloon payment without borrowing another loan to repay the first,

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[144] *See* CFPB, Rule Addressing Payday, Vehicle Title, and Certain High-Cost Installment Loans, Final Rule, 82 Fed. Reg. 54472 (Nov. 17, 2017) (CFPB Payday Rule) and Docket No. CFPB-2016-0025 associated with that rule; *see* CRL and NCLC's comments to that docket, filed with additional consumer and civil rights groups, here: https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_comment_oct2016.pdf (CRL, NCLC, et al., Comments on CFPB Payday Rule); *see id.* at §2, pp. 17-40 (discussing harm to consumers).

[145] *See, e.g.*, B. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, (2011), Oxford University Press, *available at* http://bit.ly/10M01tZ; Agarwal, S., Skiba, P. M., & Tobacman, J., *Payday loans and credit cards: New liquidity and credit scoring puzzles?* NBER Working Paper (2009), *available at* http://bit.ly/RtDsXx.

[146] CFPB Payday Rule, 82 Fed. Reg. 54564, 73; *see also* Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,* Harvard Business School, 12/3/08, *available at* www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf.

[147] Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?,* Vanderbilt University and the University of Pennsylvania, 10/10/08, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215.

[148] Elevate 10K, 2018, at 9.

[149] *Id.*

[150] *Id.*

[151] *See* CFPB Payday Rule, 82 Fed. Reg. at 54556-58.

[152] *Id.*

and the long-term cycle of debt drives the business model for lenders. For longer-term loans, borrowers often cannot afford the still-large payments on payday, or, even if they make some payments, they cannot *sustain* those payments for the life of the loan and ultimately pay it off. NCLC has shown how high interest rates on longer-term loans create misaligned incentives that lead lenders to want—and to profit off of—borrowers who will struggle and default at high rates.[153]

The dangers of high-cost, longer-term loans have become apparent, as payday lenders have increasingly shifted to these loans, or offered them alongside short-term balloon-payment payday loans. These loans include so-called "fintech" loans that attempt to portray themselves as better alternatives to payday loans, but which, in most significant respects, are not distinguishable from loans by traditional, "non-fintech" payday lenders. All of these longer-term loans typically still carry extremely high interest rates, are still tied to repayment on payday, and are still made with little regard for the borrower's ability to repay the loan while meeting other expenses.[154] These loans have the potential to inflict as much or more harm—creating a deeper, longer debt trap—for borrowers than two-week payday loans.[155]

Just like short-term payday loans that have very high rates of refinancing and default, the performance of longer-term high-cost loans reflects distress. The CFPB found that for online payday installment loans, (the channel for most new "fintech" loans) refinance rates were very high,[156] and a full 55% of loan sequences ended in default.[157]

Publicly available information about one high-cost lender already engaging in rent-a-bank schemes demonstrates this high-cost, high-default model. Elevate's entire book of business carries an average APR of 129%.[158] Elevate's nationwide charge-off rates as a percentage of outstanding loan volume in 2014 was over 50%.[159] Elevate's net charge-offs as a percentage of revenues is 52%,[160] a metric that Elevates states it does not intend to drive down.[161] Essentially, Elevate's is a high-rate, high-default model that profits while making unaffordable loans.

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[153] Lauren Saunders et al., NCLC, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016), https://www.nclc.org/issues/misaligned-incentives.html.

[154] CRL, NCLC, et al., Comments on CFPB Payday Rule at § 2.5 (pp. 31-34) and § 10.1-10.3 (pp. 165-172). *See also* CFPB Proposed Rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans, discussion of longer-term high-cost loans, 81 Fed. Reg. 47864, 47885-92 (July 11, 2016).

[155] *Id.*

[156] CFPB Supplemental Findings on payday, payday installment, and vehicle title loans (June 2, 2016) at 15 (35% for storefront, 22% for online).

[157] *Id.* at 22 (55% for online; 34% for storefront). On a per-loan basis, the default rate is 24%.

[158] Elevate Form 10K, 2018, at 78.

[159] As calculated by the CFPB, CFPB Proposed Payday Rule, 8c1 Fed Reg. 47886, n.246. CFPB's calculation is consistent with rates calculated by NCLC using California data. Lauren Saunders et al., NCLC, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016), https://www.nclc.org/issues/misaligned-incentives.html.

[160] Elevate Form 10K, 2018, at 78.

[161] *Id.* at 86.

Research CRL released recently documents the experience of focus group participants in Colorado, where high-cost longer-term payday loans averaging 129% APR often triggered significant additional financial hardships for borrowers.[162]

Auto title loans can be particularly devastating. In addition to inflicting the same harms caused by payday and other high-cost installment loans, auto title loans put borrowers at substantial risk of losing their car. Research has found that an astounding one in five auto title borrowers have their car repossessed.[163] The consequences of losing one's vehicle are dire—both the loss of a valuable asset and the serious disruption of a borrower's ability to get to work, earn income, and manage their lives.[164] More than a third of auto title borrowers have reported pledging the only working car in their household as security for their auto title loan.[165]

Mere statistics on the loan performance of high-cost loans, staggering as they are, do not do justice to the brutal financial, emotional, and physical turmoil these toxic products inflict. The distress can pervade every facet of a person's life, often extending to the borrower's family members as well. Growing research documents the links between high-cost loans and negative health impacts.[166]

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[162] Center for Responsible Lending, *Sinking Feeling: Colorado Borrowers Describe Their Experiences With Payday Loans* (July 2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf.

[163] CFPB Single-Payment Vehicle Title Lending at 4 (2016). CRL estimates that approximately 340,000 auto title borrowers annually have their car repossessed, well exceeding the population of St. Louis. For calculation, *see* CRL, Public Citizen, NCLC et. al comments on CFPB's proposed repeal of the ability-to-repay provisions of the payday rule at 26, n.90 (May 15, 2019), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/comment-cfpb-proposed-repeal-payday-rule-may2019.pdf.

[164] *See* CFPB Payday Rule, 82 Fed. Reg. at 54573, 93.

[165] CFPB Payday Rule, 82 Fed. Reg. at 54573 & n. 592 (internal citations omitted).

[166] One finds that access to payday loans substantially increased suicide risk—including by over 16% for those ages 25-44. Jaeyoon Lee, *Credit Access and Household Welfare: Evidence From Payday Lending* (SSRN Working Paper, 2017. Another finds that short-term loans, including payday loans, are associated with a range of negative health outcomes, even when controlling for potential confounders. Elizabeth Sweet et al., *Short-term lending: Payday loans as risk factors for anxiety, inflammation and poor health,* 5 SSM—Population Health, 114–121 (2018), *https://doi.org/10.1016/j.ssmph.2018.05.009.* These outcomes include symptoms of physical health, sexual health, and anxiety, as well as higher levels of C-reactive protein, which is an indicator of many long-term diseases, including cardiovascular disease, and an indicator of psychological stress. *Id.* Another study finds that restrictions on payday lending reduced liquor sales. Harold E. Cuffe & Christopher G. Gibbs, *The Effect of Payday Lending Restrictions on Liquor Sales,* 85(1) J. Banking & Fin. 132–45 (2017). In one study of qualitative data, respondents revealed symptoms of "allostatic load," a health psychology term that describes how compounding stress can lead to wear and tear on the body. Elizabeth Sweet et al., *Embodied Neoliberalism: Epidemiology and the Lived Experience of Consumer Debt*, 48(3) International Journal of Health Services (2018). The authors describe the respondents as having "embodied" their debt through idioms like "drowning in debt" and "keeping [their] head above water," which illustrated that the participants "experienced debt as a bodily sensation, not only a socioeconomic position or emotional stressor." *Id.* One payday borrower has reported that after being a "a pretty healthy young person," she "became physically sick, broke out in hives . . . [and] had to go to urgent care" as a result of her high-cost loan. Health Impact Partners and Missouri Faith Voices, *When Poverty Makes You Sick: The intersection of health and predatory lending in Missouri* (Feb. 2019), https://humanimpact.org/wp-

Below are narratives from the CFPB complaints database describing borrowers' experiences with high-cost installment loans by lenders currently engaging in rent-a-bank schemes (Elevate, OppLoans, Enova (NetCredit brand), and LoanMart), or who have stated that they intend to (CURO (SpeedyCash brand)). While many of these complaints so far do not involve rent-a-bank loans, they are illustrative of the type of loans these lenders make that they will bring to states that do not allow high-cost loans.

In addition, in light of the risk that the OCC's proposal would promote growth of both short- and longer-term payday and car title loans through rent-a-bank schemes, attached at Appendix B are over 150 borrower experiences with short- and longer-term payday and car title loans from a variety of lenders.

<u>Elevate:</u>

- I am a single mother who is living . . . below the poverty level. I have had my share of credit problems and have owed more than I make for quite some time. I was misled by Rise Credit to believe that they were unlike other predatory loan companies. By the time I understood what I had [signed], I had paid them thousands of dollars in interest. I have recently become temporarily unemployed and called them to ask for help during my time of financial hardship. They refused any solution and my account is headed to collections now . . . . [T]he total paid is far over the amount I initially borrowed from Rise . . . . This is robbery and all of the necessities I have for myself and my children are suffering because of it . . . . How is it that they can do this? I am asking for help for not only my family, but for all of the families targeted by these predatory loans meant to target those living in poverty and struggling to live paycheck to paycheck.[167]

- [T]hey are charging me over $6000.00 interest on a simple loan for only $2600.00 . . . . i did not forsee such an impact on my monthly income for so long ... that $500.00 is supposed to be the monies I have left over after bills and survive/live on after all my other bills. They have access to my bank account and automatically take it out . . . . I do not know how to stop this madness. How can they charge me over $8000.00 for a $2600.00 loan? Is this legal?[168]

- My [] mother was solicited by a predatory lender, RISE for a personal loan. She agreed to $1300.00 loan but was told the California law stated the minimum loan amount was $2600.00. Her interest rate is 125 %, how is this legal? She is on a fixed income and RISE has set up an auto pay with her checking account with a monthly payment of $470.00 . . . . This is elder abuse! Please shut this company down.[169]

- To date I have paid well over $6900.00, almost three times the principle. I still owe close to $3000.00. Prior to accepting the loan I did read the " fine print '' but it was not easy to understand. It was not explicit[ly] stated that the monthly payments would be going to the interest and not to paying down the principle, making the loan impossible to pay off quickly. I called . . . and asked specifically for an amnesty on the remaining balance because I am having a

content/uploads/2019/02/HIP-MFV_PayDayLending_2019.02fin1.pdf. Another expressed feeling, "[i]f I died, my debt would die with me. At least I could give my family that." *Id.*

[167] #1487339 (California borrower)

[168] #1361463 (California borrower)

[169] #1584177 (California borrower)

hard time paying on this exorbitantly high interest loan for over 12 months. I also explained to her that to date I had paid almost three times the principle . . . . in the end, the total paid before it is satisfied will be over $9500.00! Paying $7500.00 in interest for a $2500.00 loan is outrageous and should be illegal.[170]

- I took a loan with rise credit . . . and I was unable to make timely payments. I expected to pay it once I received my tax return. However, it went to collections and then a lawyer and they added so many penalties and fees. Now I owe XXXX for a XXXX loan. Now, they are garnishing 25 percent of my paycheck and I 'm already struggling as it is.[171]

- I am a visually impaired person, with a monthly income of less than $900. I can surely say that I had no idea that the monthly installment would not be applied to the principal loan amount. After my aid read to me just a few days ago that I was not paying off the loan all of the money was going to interest and only {$19.00} was applies to the principal. But I do not have that kind of money. I am requesting that you cease deducting {$520.00} from my bank account . . . . I have struggled for the last five moths giving RISE most of my income, and I can not make the rent, utilities, or food.[172]

- I have a high interest installment loan through Rise. I pay $220.00 every 2 weeks with $16.00 of that going to the principal. I had a medical procedure done that kept me out of work for just a little more than a month. I did not receive a paycheck during that time. This has put me a few payments behind on my loan as they come due every 2 weeks. I am trying to get this all worked out so I can catch up with them over time as I just started back to work today. My issue is when I came back today I was told by my coworkers that this number called ( XXXX ) so many times a day that they turned off the phone in our office. . . . . I am willing to work something out with them but calling my work to harass me and doing multiple attempt debits to my bank account that has no money in it racking up a ton of fees. This is not helping their cause as I have to pay my bank now instead of putting that money towards catching up on my loan. They tried withdrawing twice within a few minutes during XXXX attempt which racked up an instant $70.00 more to my bank account fees like the money was going to instantly appear in there after the first attempt a few minutes earlier.[173]

- We originally signed up for a $3,000 [loan] with an interest rate of 208%. I have been paying $520.00 every month and paid a total of $5500.00 . . . . This has been a burden for me and my family. As an [redacted] military member, i have reached out to my chain of command regarding this issue. I have been advised by financial counselors that in accordance with Military Lending Act says that you can't be charged an interest rate higher than 36 % on most types of consumer loans and provides other significant rights. I am currently working with my local Judge Advocate General 's Office to get some help with legal issues.[174]

[170] #1962588 (California borrower)

[171] #2181870 (California borrower)

[172] #2202311 (California borrower)

[173] #2303749 (Missouri borrower)

[174] #2442651 (U.S. Armed Forces - Pacific borrower)

- I received a mail out stating that I was pre-approved for credit and to go online and apply. I did so and entered into a line of credit agreement in the amount of $2500 . . . . The payments are bi-weekly and the second one jumped to $240.00. My gross income is XXXX per month. I have XXXX child and simply can not afford this high of a payment. My father called . . . and tried to get the company to lower the payment. They said that they could do whatever they wanted to and refused to address my concerns. The APR on this loan was 199 %. I feel this company is operating on an unfair and deceitful basis.[175]

- Why are my payments not reducing my principal balance? My statement for month 1 states that my balance is $3800.00. It said I owed $430.00. I paid it. The next month my bill was $540.00 and I paid it. After that payment was applied (? ) my total balance owed wasn$3800.00. So I asked them why my balance was only reduced by $3.00 even though I had paid them almost $1000.00 . . . . please help me. This can not be right.[176]

- I have fallen on hard times . . . . I borrowed $1200.00 and have paid back $1100.00, however due to the interest rate being so high [I owe a] balance of over $1000.00 still. I was told when I took this loan that after a period of time I would be able to refinance the loan and lower my payments. This was not true, I have attempted to refinance and the APR is the same 291 %. I would like to cancel my account and come to an agreement that works for both of us. I am a single mother and paying $160.00 every time I get paid equaling to $260.00 per month is unbearable. I have also [made] large payments over the past few months hoping this would decrease the balance and it has not.[177]

- On XX/XX/17 I needed to pay for a major repair on my vehicle and had to refinance an existing loan I had with Rise credit to an amount of $2500.00. Since that date I have been making regular payments twice a month of $230.00 and it has all been interest. I have made 21 payments, so over $4000.00 in interest and my principal balance has not gone down at all. I am at a loss of what to do, because I was in a tight spot but had I known id be living this nightmare I never would have taken out this loan.[178]

- I would have rejected/not accepted the loan if I had realized it was a 238.36% interest rate. They set up ACH installment payments of $410.00 a month which I can not afford . . . . I am on Social Security XXXX (Fixed income ) with limited resources . . . . I can't believe that this is legal-this is more like loan sharking and preying on people who are not able to defend themselves. I am more than willing to pay the $2000.00 back at a reasonable interest rate and reasonable monthly payments of $200.00 a month ( ie ... a credit card rate for people with limited resources perhaps 25-28 %?)[.] [N]ot 238.36 %[. H]ow can this even be legal?[179]

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[175] #2764858 (Kansas borrower)

[176] #2816269 (Tennessee borrower)

[177] #2858004 (Wisconsin borrower)

[178] #2942998 (North Dakota borrower)

[179] #3141291 (Wisconsin borrower)

OppLoans:

- I am being contacted everyday, with the exception of Sunday, for a month. The[y] want the loan paid but, I am unemployed and a [] veteran. I have tried to explain this to the company. However, they continue to contact me. It's the same thing everyday.[180]

- I have been paying this loan for more than a year and the principal has not changed. I borrowed $2000.00 and have paid $4600.00 into this loan to date….[181]

- I contacted this firm opp loans several times . . . regarding the high interest[] rates being charged on my loan. I informed them that [we are] military spouses and famil[ies] . . . that we are protected against high interest rates. They informed me that they needed proof to review my interest rate. They then informed me that spouse loans are not covered under the military lending act and was notified by their legal department. My current interest rate is 159 % on short term installment loan. Please assist[182]

- This company calls me 6 times or more a day. I informed them . . . that I had lost my job and I would call them back when I start work again and get my finances back on track. They dont care they have been calling non stop. They have made it harder for my recovery.[183]

- I had a loan with this company for about $2000.00[,] now i went on short term [leave or disability] with my job and didn't get paid [and] called the company [and] explained why I couldn’t make payment . . . . I really dont know what to do but i have arrangements with other companies after they knowingly understood my dilemma. Im upset that i have to pay all the fees and loan with no arrangement and still be a single mom and live. Now they are emailing and calling me saying they will garnish my bank account for 20 years and my check and so on. Im very afraid and dont want to be homeless or behind over 4500 dollars.[184]

- I work as an [] for my [daughter], who was in the Intensive care unit . . . . When my daughter is hospitalized I do not get paid. After being in the hospital for a month I signed an Opp loan for $2600.00 . . . . I have paid them over $3600.. Today they tell me that I owe them $2800.00 . . . . [185]

- I . . . took out the loan[.] I am not disputing the loan[.] I had a downfall in life and defaulted . . . . I . . . received a " Notice of Intent to Assign Wages[.]'' I spoke to [a representative] who refused to assist. [H]er only option was for me to pay $560.00 now and make the original monthly payments. I stated to her I do not have that money[.] I really do not[.] I need help[.] [S]he refused to offer me any solution. I currently have $100.00 in my checking account. I asked to

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[180] #2812101 (Tennessee borrower) (appears to be a rent-a-bank loan)

[181] #3106431 (Maryland borrower)

[182] #3354050 (Michigan borrower) (appears to be a rent-a-bank loan)

[183] #3371847 (Arizona borrower) (appears to be a rent-a-bank loan)

[184] #3015405 (Illinois borrower)

[185] #3028087 (California borrower) (appears to be a rent-a-bank loan)

speak to a supervisor and she refused to allow me to speak to a supervisor . . . . I think this company has no intentions to help anyone who is struggling.[186]

- I took a payday installment loan for the sake of building my credits . . . . I then told them I am not doing it through debit card anymore . . . . as per contract, it doesn't say I have to use my debit card as a routing number was a condition for approval. This week . . . they contacted my employer and decided to garnish my wage. This is unfair to me as I wasn't informed and it is not my fault, I never refused to pay or change my account. They didn't do their responsibility to deduct money while I gave my account information (confirmed today they still have ). This is unfair garnishment and punishment to me because of their fault ( or their systems ) . . . . I urge your help to assist me to remove this unfair garnishment on me and let the company comply with their promises. I also ask you to judge this and make Opploans repair my damaged credits that were caused by this unfair transaction. I am not delinquent to this transaction.[187]

- I emailed company . . . and then I also called and rescinded the wage assignment. I sent an email to the CEO office and also spoke to several representatives to try to reach a settlement for the principle amount of the loan. The amount when I asked for the settlement was XXXX. This would have had the company write off about 200 in interest only. There was a los[s] of income in my household. So to prevent a long term impact to my credit and finances, I asked to settle the account. I was informed that I had to be at least 61 days behind and that if I made a minimum payment of XXXX that I would stay in a positive balance. This did not make sense as this would also keep the account in a current status. This would also cause more interest to accrue over time. I wanted to settle the account, close the account and avoid negative impact on my credit, and more fees. The company refused to work with stating the contract was enforceable. This would benefit the company to continue to accrue more interest and fees over a period of time and impact the consumer in a negative light.[188]

<u>Enova (NetCredit brand)</u>

- On XX/XX/2016 I was approved for a personal loan with NetCredit. I was unaware of the future circumstances and took out a very high interest loan, 99 % interest on a $2000.00 [loan]. I have become a XXXX veteran and unemployed at the moment due to my condition. The total amount that I will be paying back on a $2000.00 loan is $7800.00. I have been paying on this loan since that date. [The complaint was filed on May 2, 2019.][189]

- Netcredit is a company that [is] not interest[ed] in listening to any complaint or trying to work with [] me to help because I can't pay the high amount of interest[,] and the very little amount going towards the principle [--] that is unfair and wrong for anybody to have to do. I am not trying to not pay them but I have a problem with them trying to lock me in a five year loan which they seek to collect three time the loan amount they gave me. I am a XXXX Veteran that

[186] #3027480 (Illinois borrower)

[187] #3190625 (Illinois borrower)

[188] #3407914 (Illinois borrower)

[189] 3229883 (South Carolina borrower)

gets a monthly check that all I have to live on[.] [F]or Netcredit to do this is shameful and disgraceful. PLEASE HELP!![190]

- At the time, I had been struggling financially because . . . I lost the father of my [] children. I lost more than half of our income and could not keep up on my salary alone. I became in over my head with debt to many people . . . . I took out the loan through NetCredit for the amount of $3700.00 . . . I was steadily making payments every two weeks on this loan for $230.00 . . . I am a XXXX employee who was out of work and without pay for the duration of the XXXX . . . NetCredit deferred my payments without question or hesitation giving me the peace of mind that everything was going to be okay . . . . [M]y intent was to pay the balance in full. What NetCredit failed to tell me was that the payments I had made toward the loan did not go to the principle whatsoever . . . . By the time the XXXX was over, they had tacked on over $1000.00 in interest to the loan. Despite almost paying the loan off, they still reported I owed $3700.00 plus accrued interest at that time. They told me that since I had been in non-pay status for so long . . . that if I didn't make a payment immediately they would send me to collections . . . . They have yet to close the account and are continuing to rack up interest and report the balance of the loan increasing every month. They are reporting that I owe 6600.00 . . . . I am a single mother of [] children who are not even old enough to be in school yet. I can not afford what they are putting on me and they are making it so I can not provide for my family by destroying my credit.[191]

- I got a loan in the amount of $2100.00. [D]ecided to login into my account to see how much principal was left on the loan and its $2100.00. Only $57.00 paid to principal in the last year. Ive made all my payments on time, $58.00 every 2 weeks. Something can not be right with this loan. I feel as though Ive been getting robbed for the past year. I do not understand. My [fiancé] has a loan with NetCredit as well within the same timeframe . . . Loan amount $3000.00 . . . principal is only down to $2900.00. Her payments are $78.00 every 2 weeks, never missed a payment. Please help![192]

- I was contacted by netcredit advising that I was pre approved for an installment loan. As I am a single mother of XXXX and have been . . . behind on HOA fees and other bills and decided to take out the loan . . . . I checked an account that I used and realized that they were taking out the XXXX every 2 weeks . . . . I told them I could not afford the XXXX coming out every 2 weeks as this is not what I [anticipated]. This has brought my checking account seriously negative and my bank is giving me a hard time as well . . . . I feel this is very deceptive, [an] installment loan is supposed to be a monthly payment[,] a payday loan is a bi weekly payment. I really need help with this. I can [make] [monthly] payments[,] I can not make bi weekly payments of XXXX[,] that is too much and it is really creating a hardship for my family.[193]

- I took out a loan in 2014 with NetCredit for $2600.00. I paid on the loan for 40 payments . . . . I ran into an inability to pay and wanted to work with Net Credit to settle the loan. I even hired a

[190] #3251851 (Georgia borrower)

[191] #3370736 (California borrower)

[192] #3393212 (Virginia borrower)

[193] #3053313 (Utah borrower)

firm to assist. Net Credit was not willing to work with the firm nor myself and an agreement was never reached. My fear is that they are holding back wanting to work with me while late fees and interest continue to accrue at an alarming rate.[194]

- I am disputing this loan based on that it is impossible to pay it off at 98.8 % . . . I will pay over $7000.00 for a $3900.00 loan at 98.8 % . . . . I have called and spoke with them about 10 times within the last 3 1/2 weeks. NETCREDIT WILL NOT WORK WITH ME OR DISCUSS ANY OPTIONS WITH ME. All I am asking for is to take the interest away from this loan and allow me to make monthly payments that I am able to handle. I understand my responsibility of the balance of the loan but they do not work with their consumers, instead make a profit with predatory lending practices.[195]

- I offered NetCredit a reasonable settlement amount which they dismissed and demand full payment which is completely insane. I had no idea after I paid $3000.00 on $3400.00 loan that I would have to pay an additional $4000.00 to pay it off or continue making the payment and by the time it was paid off I would have paid many thousands of dollars.[196]

- I took a loan from NetCredit in the amount of $1200.00. To date I have made 11 payments at the payment amount of $100.00 each for a total paid of $2000.00 plus a check payment of $100.00 which has not been cashed or applied to my account. NetCredit states I still have fourteen more payments of $100.00 each to make. For a $1200.00 loan, I will end up paying $3600.00, more than THREE TIMES the loan amount!![197]

- [I] [b]orrowed $1400.00 . . . Paid [x]payments of $110.00 = $1100.00 . . . balance is currently $1400.0 . . . Was unable to keep up with payments due to XXXX income (was unemployed for 10 months- catching up on past debts and medical bills ). Several attempts were made to set up payment agreements with NETCREDIT . . . but Net Credit didn't agree . . . . I was NOT aware the interest on $1400.00 would be $1200.00 (almost the amount of the loan). I would have NEVER agreed to this loan. I am a veteran and XXXX civilian on a tight budget. This interest charged on the loan is hideous. I could have borrowed that amount from a local bank/lender and not have that much in interest. This is a horrible way to take advantage of those that are in need![198]

- NetCredit is a company that take advantage of people ... they approve your loan on line then hit you with 98 % interest . . . . I took a loan out for $6000.00 ... once I found out the loan was to be taken out of my checking account 2x a month [] I called and asked them to adjust to 1x a month ... they said they couldn't do ... this was the biggest mistake I have ever made to take a loan out [] with them ... I was unable to pay and got in touch to work something out ... they sent gave me minimal options and then sent a letter saying that I can pay off the balance which now is $7800.00 . . . . I had been paying the monthly for a year at least??? and now I owe XXXX

[194] #2418022 (California borrower)

[195] #2183667 (Virginia borrower)

[196] #3270880 (California borrower)

[197] #3324359 (South Carolina borrower)

[198] #2144831 (Virginia borrower)

more??? This is a company that the government should look into … they are sharks!!!! I would recommend that people stay away from this company!!![199]

LoanMart

- I have this loan and ... being a senior citizen the payment[s] are [too] high[.] I am [p]aying $420.00 each month[,] have not paid for this month[,] and they can take my car at anytime[.] I am trying to work with them[,] my health is now becoming poor as I can not sleep . . . . I want to pay them and I will but I need the payment to be [up to] $320.00 per month[,] which would be a hardship but I could do that . . . . had I known I would not have take[n] this loan out and would have just gone homeless . . . .at least I would have had a car to sleep in and live not . . . on the street with no car or a place to live[.][200]

- I have been paying monthly, often times after . . . my due date, but I get the payment in monthly. On two occasions I was given extensions, but I have paid way more than the $1500.00 loan amount and expected to be paid off . . . . I was told because I was late many times, my loan has been extended for approx 20 more months, unless I can come up with the $1500.00 original loan amount plus $680.00 in late fees. Had I paid on time by the 11th if every month I would be paid off. When I told them that was ridiculous that it was still paid in the same month they told me too bad . . . . so now I have to pay another $4000.00 plus dollars ( {$210.00} x 20 ) on time . . . or it may take longer . . . . I [will] never get my title back or get this loan paid off … . I will be paying over $8000.00 on a $1500.00 loan.[201]

- My Loan charged off . . . . after i turned [in] the vehicle . . . . They auctioned off the vehicle and sent me a final charge off amount of $2600.00 . . . I received a payment settlement request in XXXX of XXXX for $1500.00 . . . As of today, they are reporting that i owe $7700.00 as the interest is still being charged on a loan they have been " charged off ''. They are . . . inflating the amount owed to well over 300 % of what the original loan was . . . . They already have my car, now they want to ruin my credit. They are predatory [and] overly punitive with high interest after the charge off.[202]

- I was in need of a loan to move and the television and radio were [inundated] with advertisements from "1-800- Loan-Mart XXXX[.]'' I called and they offered me a " title loan '' for $10000.00 specific to my . . . Toyota Camry. The payment was and remains a staggering $850.00 per month. Also, my ex-husband bounced a check to me . . . which prevented making a payment so I called for an extension [but] they repossessed my car . . . and charged me almost $2500.00 to get the car back . . . . I have been paying the $850.00 monthly for over two years and the principle balance or payoff remains just a [little] less than the original loan. What guidelines

[199] #1998233 (California borrower)

[200] #2894498 (California borrower)

[201] #3126449 (Wisconsin borrower)

[202] #1792457 (California borrower)

regulate the loan industry and why are they permitted to be rude, abusive and lend money like . . . loan sharks?[203]

- 1 800 Loan Mart has repeatedly called me 30 times a day for the last 7 months[,] also have incorrectly reported negative things on my credit report, also called and threatened me with imprisonment lawsuit . . . [A]fter I paid them $4000.00 and they took my vehicle[,] now they're saying I still owe them $5000.00[.] [T]he original amount of loan was $2500.00.[204]

- I needed money to pay for my moving expenses. I took a title max car loan. I 've tried to keep up with the payments but fall short so my payments are late and include a hefty penalty payment in addition to interest . . . . My plan is to pay the entire bill with large lump sum payments. The problem is the amount that is added to the principal balance makes it difficult to pay the loan off. My car was reposed this morning. In order to get my car back, I must pay them $900.00 which includes towing, paying for personal property left in the car and making a trip to the police department to obtain a [repossession] receipt. This is robbery.[205]

- I took out a loan in . . . 2014 for $5700.00. I've made payments of $450.00 since then [totaling] about $8000.00. I just recently got a payment history to see my balance due and almost none of my payments have applied to principal balance, almost all of it has gone towards interest! I spoke with a customer service rep today and they still want $7000.00 to close [the] account. I told them I no longer have a steady job or income and have been going through health/medical issues and have been in and out of the hospital. I just want to settle amount of another $1000.00 to close account. I 've already paid back the $5700.00 and interest of more than $2000.00 and still going to give $1000.00 to settle. I 'm trying to be honest with them and get a settlement and close my account.[206] (This complaint was submitted on August 12, 2016).

<u>CURO (SpeedyCash brand)</u>

- Speedy Cash took money from my . . . debit card without my authorization. I receive my social security SSI payments in the amount of $730.00 on this card . . . my card was debited by Speedy Cash for the amount of $520.00. When I called them they stated that my account was past due . . . and that it had gone into collections . . . . They also said that there was nothing they could do because the third party collector was involved . . . When I called [the third party], the representative told me that they were not involved in collecting on this account any longer because Speedy Cash had taken the loan back. I am confused by the back and forth. Now, I am in a horrible position. My account was basically drained which leaves me with no money for the entire month. No money for rent, utilities, doctor visit, or prescriptions. I . . . have no idea what I am going to do.[207]

[203] #1867122 (California borrower)

[204] #2356677 (California borrower)

[205] #2157776 (Nevada borrower)

[206] #2958482 (California borrower)

[207] #2657445 (Missouri borrower)

- I have paid $1600.00 on the account and all payments have gone towards the interest and late fees. I have given seven payments at $220.00 each month since the loan and I owe at this time $2800.00 at this rate the loan will cost more than I borrowed. I need help because this is a car title loan and I can't afford losing my car over this. I have called the corporate office and . . . they all say the same thing (--) there is nothing that can be done except keep making the payments . . . It's like I borrowed the monies from [someone] in a street alley.[208]

- I borrowed $750.00 . . . .First month repayment . . . $240.00 . . . . Remaining balance over $1000.00. Next installment $240.00 . . . remaining balance over $1000.00. Payments increase as does amounts owed. Decline in principal is offset by increase in fees or 'interest.' . . . . Never ending cycle.[209]

- [I] borrowed $1300.00 from speedy cash and the first payment was ok ($77.00) and after that they were $140.00 every other week and [I] am now unable to make these ridiculous payments [because] my hours have been cut at [work]. I notified them . . . I am in default and [I] have sent emails . . . . [T]hey say to contact them if [you can't] make a payment and they will work with you. All they do is extend it 4-5 days out and [that don't] help either! I am desperate[, I] have called about filing bankruptcy and [I] may have to and [I don't know what else to do.[210]

- Speedy Cash stopped the payday loans and changed to the installment loans . . . . If your payment is due on a certain day they could move it up by 4 days but it [doesn't] help if that 4th day is not a payday. I have paid so many overdraft and bank fees until I feel ashame[d] and stupid. I needed the money but once you get it [it's] hard to get rid of it. I [don't] understand [what's] hard about reasonable payment arrangements. Your 4 day extension is not realistic to customers.[211]

- I currently have an installment loan in the amount of $2600.00 from Speedy Cash . . . . At the same time, I also have [x] $300.00 payday loans from [x] different storefronts in my neighborhood, including Speedy Cash. So basically, I have both a $300.00 payday loan from Speedy Cash and a $2600.00 installment loan. Is that legal? I am drowning in debt and I can't handle it anymore. I need some relief. This is very stressful and expensive for me, and I don't know what to do . . . . . I 've been paying about $140.00 every two weeks on the Speedy Cash installment loan, and I 've already paid $2200.00 . . . but my total balance is still $2600.00! How is this even possible? Are all my payments going toward interest only? I can't keep paying on all these loans. I need to prioritize my rent ($1100.00), car payment ($320.00), insurance ($180.00) and my other basic needs like food and utilities. After taxes, I only bring home about $1800.00 a month. So this is really hurting me and I 've reached my breaking point . . . . I don't want to default on the loan, but at this point I'm not seeing another alternative. I recently received XXXX

[208] #2792493 (California borrower)

[209] #2772146 (Utah borrower)

[210] #3046440 (Tennessee borrower)

[211] #2718087 (Mississippi borrower)

utility disconnection notices from my gas, water and light companies[.] To make matters worse, I'm also facing being laid off from work in the next few months. I need help.[212]

- I could not get Speedy Cash to stop taking payments out of by bank account using my debit card. I called them, I wrote them. I tried to set up payments. I told my bank to not authorize any more payments. Didn't help. Finally I had to shut down all my accounts at my bank and go to another bank. I could not believe it when I when, at my new bank, Speedy Cash withdrew $100.00, the next day $60.00. I have no idea what that amount is for. I'm disputing the charges Can you help me?[213]

### 2. Particular harm to communities of color.

High-cost lending disproportionately harms communities of color, exploiting and perpetuating the racial wealth gap. A legacy of racial discrimination in housing, lending, banking, policing, employment, and otherwise, has produced dramatically inequitable outcomes that persist today. Communities of color, often largely segregated due to the history of redlining and other racially exclusionary housing policies, experience higher rates of poverty, lower wages, and higher cost burdens to pay for basic living expenses. Payday lenders peddling unaffordable loans cause particular harm to these communities,[214] which several of the undersigned groups represent.

Storefront lenders, which often offer both short-term and longer-term loans, target borrowers of color, in part by concentrating their locations in communities of color.[215] Indeed, the communities most affected by redlining are the same who are saturated by payday lenders today. Multiple studies have found that payday lenders are more likely to locate in more affluent communities of color than in less affluent white communities.[216] In light of this targeting, it is unsurprising that a disproportionate share of

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[212] #1377341 (California borrower)

[213] #2158561 (Kansas borrower)

[214] *See* CFPB Payday Rule, 82 Fed. Reg. at 54556-57.

[215] *See*, *e.g.*, Delvin Davis, *et al.*, *Race Matters: The Concentration of Payday Lenders in African-American Communities in North Carolina*, Center for Responsible Lending (2005), http://www.responsiblelending.org/north-carolina/nc-payday/research-analysis/racematters/rr006-Race_Matters_Payday_in_NC-0305.pdf (finding that, even when controlling for a variety of other factors, African-American neighborhoods had three times as many payday lending stores per capita as white neighborhoods in North Carolina in 2005); Assaf Oron, *Easy Prey: Evidence for Race and Military Related Targeting in the Distribution of Payday Loan Branches in Washington State*, Department of Statistics, University of Washington (2006) (concluding based on a study of Washington State payday lenders that "payday businesses do intentionally target localities with a high percentage of African Americans.").

[216] Li, *et al.*, *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California,* Center for Responsible Lending (2009), http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf; Brandon Coleman and Delvin Davis, *Perfect Storm: Payday Lenders Harm Florida Consumers Despite State Law*, Center for Responsible Lending at 7, Chart 2 (March 2016); Delvin Davis and Lisa Stifler, *Power Steering: Payday Lenders Targeting Vulnerable Michigan Communities*, Center for Responsible Lending (Aug. 2018), https://www.responsiblelending.org/research-publication/power-steering-payday-lenders-targeting-vulnerable-michigan-communities; Delvin Davis, *Mile High Money: Payday Stores Target Colorado Communities of Color*, Center for Responsible Lending (Aug. 2017; amended Feb. 2018),

payday borrowers come from communities of color, even after controlling for income.[217] The disparity in payday loans is especially significant given that African Americans and Latinos are much less likely to have checking accounts, typically a requirement for a payday loan, than whites.[218]

Online high-cost lenders may focus more on subprime credit score than geography. But the historical discrimination against communities of color is also reflected in credit scores.[219] Lenders that focus on subprime borrowers inevitably will disproportionately target borrowers of color. The algorithms and big data that "fintech" lenders use may also result in disparate impacts on these communities.[220]

Communities of color have historically been disproportionately left out of the traditional banking system, a disparity that persists today. About 17 percent of African American and 14 percent of Latino households are unbanked, compared to 3 percent of white households.[221] High-cost loans, with their high association with lost bank accounts,[222] drive borrowers out of the banking system and exacerbate this disparity. By sustaining and exacerbating an existing precarious financial situation, high-cost lending reinforces and magnifies existing income and wealth gaps—legacies of continuing discrimination—and perpetuates discrimination today.[223]

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https://www.responsiblelending.org/research-publication/mile-high-money-payday-stores-target-colorado-communities-color.

[217] CFPB Payday Rule, 82 Fed. Reg. at 54556. African-Americans are payday borrowers at three times the rate, and Hispanics at twice the rate, of non-Hispanic whites. 82 Fed. Reg. at 54556-57 (citing 2015 FDIC National Survey of Unbanked and Underbanked Households (calculations using custom data tool)). Vehicle title borrowers are also disproportionately African-American and Hispanic. *Id.*

[218] 2017 FDIC National Survey of Unbanked and Underbanked Households, at 3, *available at* https://www.economicinclusion.gov/downloads/2017_FDIC_Unbanked_HH_Survey_Report.pdf.

[219] *See* Chi Chi Wu, *Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination*, National Consumer Law Center (May 2016), https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

[220] *See* Testimony of Chi Chi Wu, National Consumer Law Center, Before the U.S. House Committee on Financial Services Task Force on Financial Technology Regarding "Examining the Use of Alternative Data in Underwriting and Credit Scoring to Expand Access to Credit" (July 25, 2019); Carol A. Evans, *Keeping Fintech Fair: Thinking about Fair Lending and UDAP* Risks, Consumer Compliance Outlook (2017), https://consumercomplianceoutlook.org/2017/second-issue/keeping-fintech-fair-thinking-about-fair-lending-and-udap-risks/.

[221] 2017 FDIC National Survey of Unbanked and Underbanked Households, at 3, *available at* https://www.economicinclusion.gov/downloads/2017_FDIC_Unbanked_HH_Survey_Report.pdf.

[222] CFPB found that about half of borrowers with online payday loans paid a nonsufficient funds (NSF) or overdraft fee. These borrowers paid an average of $185 in such fees, while 10% paid at least $432. It further found that 36% of borrowers with a bounced payday payment later had their checking accounts closed involuntarily by the bank. CFPB Online Payday Loan Payments at 3-4, 22 (April 2016).

[223] For further on the undersigned groups' concerns about the harm payday and vehicle title loans cause communities of color, and the efforts we have long made to stop that harm, see the sampling of references cited here: http://stopthedebttrap.org/wp-content/uploads/2014/11/PayDay-loans.7-2016.pdf; http://stopthedebttrap.org/wp-content/uploads/2015/08/lcchr_resolution_payday_deposit_advance_lending_12dec2015.pdf; http://stopthedebttrap.org/wp-content/uploads/2015/08/naacp_letter_obama_payday_15december2014.pdf; http://ourfinancialsecurity.org/2011/04/hilary-shelton-cfpb-testimony/;

### H. The proposal is inconsistent with the agency's obligations under the Community Reinvestment Act.

The objective of the Community Reinvestment Act, which the OCC implements as to national banks, is to ensure that financial institutions meet the banking needs of the communities they are chartered to serve, including low- and moderate-income neighborhoods and individuals.[224] This legal obligation is considered a *quid pro quo* for the valuable public benefits financial institutions receive, including federal deposit insurance and access to favorably priced borrowing through the Federal Reserve's discount window.[225]

In contradiction to this obligation, the OCC now puts forth a proposal that would encourage banks to facilitate predatory lending. CRA requires that banks serve communities' credit needs.[226] But the data show that high-cost, unaffordable loans to financial distressed consumers do the opposite, leading to high-cost cycles of indebtedness that not only leave borrowers' needs unmet but leave them affirmatively worse off than before the lending began.

Through rent-a-bank schemes, banks rent out their privileges to entities that spread predatory lending to other communities far and wide. Indeed, through these schemes, banks are involved in scurrilous online lending that they would not do through their own channels or in their own communities. From what we can tell, Axos Bank, FinWise Bank, Republic Bank & Trust, and Capital Community Bank are not offering the loans that we have described in these comments through their limited number of branches or on their own websites. Yet through rent-a-bank lending, banks can profit through the operations of third parties that do not have CRA responsibilities. The proposed rule would only exacerbate this irresponsible lending that is at the core of what the CRA is designed to prevent.

While the OCC has proposed to revise the CRA regulations, the CRA proposal would not prevent this kind of predatory bank lending.

## VI. The OCC fails to consider the risks the proposal poses to the safety and soundness of national banks, despite having long acknowledged those risks.

The OCC has historically taken very seriously the risks that rent-a-bank schemes pose for national banks. This proposal and other recent agency actions will increase the risks to national banks, yet the proposal does not even so much as mention risks to banks.

In the late 1990s and early 2000s, banks, including national banks and federal savings associations, entered into agreements with payday lenders to help the payday lenders evade state interest rate caps.

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http://www.responsiblelending.org/payday-lending/policy-legislation/states/Letter-JBond_Rendell-012306.pdf; https://nalcab.org/nalcab-new-pay-day-rule-step-forward-latino-consumers-businesses/.

[224] 12 U.S.C. 2901 *et seq*.

[225] Federal Reserve Board Chairman Ben S. Bernanke, "The Community Reinvestment Act: Its Evolution and New Challenges," Speech at the Community Affairs Research Conference, Washington, D.C. (March 30, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm#f2.

[226] 12 U.S.C. 2901.

In 2000, the OCC (with the OTS) issued guidance on payday lending, flagging a number of risks to banks from these arrangements with payday lenders.[227] These included credit risk, should the non-bank not meet its terms of the contract;[228] transaction risk, should the non-bank misrepresent information;[229] and reputation risk associated with facilitating loans with terms that a non-bank could not make directly.[230] The guidance also expressed substantive concerns with the payday loan product, including flagging that "renewals without a reduction in the principal balance . . . are an indication that a loan has been made without a reasonable expectation of repayment at maturity."[231] And it cited the agency's general guidance on abusive lending, which identifies "loan flipping, i.e., frequent and multiple refinancings" as a characteristic of abusive lending.[232]

In 2002, the agency strongly condemned rent-a-bank schemes. As noted earlier, Comptroller John D. Hawke called the schemes "an abuse of the national charter,"[233] noting that "[t]he preemption privileges of national banks derive from the Constitution and are not a commodity that can be transferred for a fee to non-bank lenders."[234] He criticized the payday lending industry, which "has expressly promoted such a 'national bank strategy' as a way of evading state and local laws. Typically, these arrangements are originated by the payday lender, which attempts to clothe itself with the status of an 'agent' of the national bank. Yet the predominant economic interest in the typical arrangement belongs to the payday lender, not the bank."[235]

Hawke highlighted the safety and soundness risks these schemes posed: "[They are] *highly conducive to the creation of safety and soundness problems* at the bank, which may not have the capacity to manage effectively a multistate loan origination operation that is in reality the business of the payday lender."[236] He noted a recent enforcement action against a "small national bank that dramatically demonstrated its

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[227] OCC Advisory Letter No. AL 2000-10 (Nov. 27, 2000), https://occ.gov/news-issuances/advisory-letters/2000/advisory-letter-2000-10.pdf.

[228] *Id.* ("Contractual agreements with third parties that originate, purchase, or service payday loans may increase the bank's credit risk due to the third party's inability or unwillingness to meet the terms of the contract . . .").

[229] *Id.* ("Because payday loans may be underwritten off-site, there is the risk that agents or employees may misrepresent information about the loans or increase credit risk by failing to adhere to established underwriting guidelines.")

[230] *Id.* ("Banks face increased reputation risk when they enter into arrangements with third parties to offer payday loans with fees, interest rates, or other terms that could not be offered by the third party directly.")

[231] *Id.*

[232] *Id.* (citing OCC AL 2000-7 on Abusive Lending Practices). *See also* OCC AL 2002-3 on Predatory and Abusive Lending Practices.

[233] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance at 10 (Feb. 12, 2002), https://www.occ.treas.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

[234] https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html.

[235] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance at 10 (Washington, D.C. Feb. 12, 2002), https://www.occ.treas.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

[236] *Id.*

inability to manage such a relationship in a safe and sound manner."[237]

The OCC's 2003 annual report cites enforcement actions against three national banks that were partnering with storefront payday lenders, terminating those partnerships in each case.[238] In one enforcement action, the Comptroller noted that the OCC is "particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws."[239]

The risks highlighted by the OCC in the early 2000s remain today. In fact, the reputation risk by bank involvement in high-cost lending is likely only higher than it was in the early 2000s. Since the early 2000s, as noted in section V above, the harms of high-cost lending, both short-term loans and longer-term loans, have become more fully documented and known. Several states have had statewide ballot initiatives that capped interest rates at 36% APR or less. And direct bank involvement in payday lending by a handful of banks, until 2013 guidance that generally led to its end,[240] was met with sweeping public condemnation from virtually every sphere—the military community,[241] community organizations,[242] civil

[237] Remarks by John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance at 10 (Washington, D.C. Feb. 12, 2002), https://www.occ.treas.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

[238] OCC, Annual Report, Fiscal Year 2003, p. 17. *See also*, Jean Ann Fox, "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," Consumer Federation of America, March 30, 2004 at 17

[239] https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-3.html. The Office of Thrift Supervision also issued an advisory, noting "Associations should not 'lease' their charter out to nonthrift entities through an agreement that allows the nonthrift entity to circumvent state and local law." OTS Bulletin 82, Aug. 18, 2003, at 8.

[240] The OCC rescinded that guidance in 2017.

[241] *See*, *e.g.*, Testimony of Steve Abbot, former President of the Navy-Marine Corps Relief Society, Before the U.S. Committee on Banking, Housing and Urban Affairs (Nov. 3, 2011) (noting bank payday loans among the "most egregious trends"); Comments of Michael Archer, Director of Military Legal Assistance, Marine Corps Installations East, to CFPB (April 4, 2012): "Most ominously, a few large banks have gotten into the business of payday loans through the artifice of calling the loans open ended credit," http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0009-0056.

[242] Hundreds of groups urged the prudential regulators to stop banks from trapping borrowers in payday loans. Letters from approximately 250 groups to FDIC, OCC, FRB and CFPB, March 13, 2013 (http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2013/03/Bank-Payday-Sign-On-Letter-3-13-13-Final.pdf) and February 22, 2012 (http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Dear-Regulators.pdf). Thousands of individuals and many community groups filed comments with the OCC urging that Wells Fargo's Community Reinvestment Act rating be negatively impacted because it makes payday loans, including CRL and NCLC (http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/cra-comment_wells-nov-29-2012_final.pdf).

rights leaders,[243] faith leaders,[244] socially responsible investors,[245] state legislators,[246] and members of Congress.[247] Moreover, the rise of online and social media make it faster and easier to garner outrage at a bank that is facilitating predatory lending.

In addition, credit risk may be even greater today, as banks may retain some ongoing interest in the loans (though nowhere near the predominant one) as lenders try out more sophisticated schemes to skirt regulators or courts.

The OCC has not updated its rent-a-bank guidances to focus on the installment, line-of-credit and second mortgage rent-a-bank lending happening today. While OCC banks, to our knowledge, have so far stayed out of predatory consumer rent-a-bank lending, the OCC has directly supported a predatory small business rent-a-bank lender and the OCC has been unable or unwilling to stop Axos Bank from facilitating predatory loans. The signals the OCC is sending, and the direct aid of the proposed rule, will

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[243] *See*, *e.g.*, Letter from Benjamin Todd Jealous, President and Chief Executive Officer, NAACP, to FDIC, OCC, FRB, and CFPB opposing bank payday lending (Feb. 21, 2013), http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/NAACP-redatory-Pay-Day-Loans-to-regulators-BTJ.pdf.

[244] *See*, *e.g.*, Elaina Ramsey, Faith Groups Take On Payday Lenders, Sojourners, https://sojo.net/magazine/stub/faith-groups-take-payday-lenders (discussing a National Day of Action among faith leaders in early 2013 to address payday lending). In connection with this National Day of Action, Rev. DeForest B. Soaries, jointly with other nationally prominent African American ministers, called for "an end to enslavement to both payday lenders and the banks now offering equally dangerous products" in *An Emancipation Proclamation from Payday Lending.* Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns*, CRL Issue Brief, March 7, 2013, http://www.responsiblelending.org/payday-lending/tools-resources/BPD-media-coverage-3-7-13.pdf

[245] For proxy year 2013, investors filed shareholder resolutions with the four largest banks making payday loans expressing concern about the product and requesting data, which none of the banks agreed to provide. Wells Fargo (https://trilliuminvest.com/shareholder-proposal/payday-lending-wells-fargo-2013/); Fifth Third Bank (http://www.trilliuminvest.com/resolutions/payday-lending-fifth-third-bancorp-2013/); U.S. Bank; (https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/dominisocial012513-14a8.pdf); and Regions (https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2013/congregationsisters011413-14a8.pdf).

[246] *See*, *e.g.*, "Legislative Black Caucus slams Regions Bank over payday-style loans," Raleigh News and Observer "Under the Dome," Oct. 11, 2012, http://www.cashcowadvances.com/paydayblog/legislative-black-caucus-slams-regions-bank-over-payday-style-loans.html (quoting letter from N.C. Senator Floyd McKissick, Jr., chairman of the N.C. Legislative Black Caucus, to Regions Bank, which stated: "We are deeply concerned about recent reports of Regions Bank offering its 'Ready Advance' payday loans in North Carolina . . . . High-cost, short-term balloon loans like these sharply increase the financial distress of families under economic strain"); Letter from Arizona Democratic Caucus to the prudential banking regulators, February 2012 (noting that Arizona "has spent countless state resources to study and understand the effects of [payday lending], and ultimately outlaw payday lending entirely" and calling on federal regulators to "take immediate action so that meaningful reforms taking place in Arizona and throughout the country in the name of consumer protection will not be undermined.").

[247] In January 2013, several Senators wrote the FRB, OCC, and FDIC urging action to address bank payday lending (http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-regulators-to-act-to-stop-abusive-bank-payday-lending). In April 2013, House members did the same. For further documentation of opposition to bank payday lending, *see* Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns* at 10, CRL Issue Brief, March 7, 2013, http://www.responsiblelending.org/payday-lending/tools-resources/BPD-media-coverage-3-7-13.pdf.

pose safety risks to OCC-supervised banks and thrifts that the OCC has not acknowledged or considered.

## VII. The OCC fails to consider the proposal's impact on market participants that comply with state law.

The OCC also has failed to analyze the proposed rule's impact on other market participants. Such analysis might reveal anti-competitive impacts on other non-bank lenders—those lenders that obtain state licenses and comply with state interest rate limits. Such lenders might face greater difficulty in raising capital if forced to compete for investors with growing numbers of non-bank lenders who can offer outsized returns by exceeding state interest rate limits. The OCC has not analyzed the extent to which eliminating rent-a-bank lending would result in a more level playing field on which state-law compliant lenders could compete for investors to fund their loans, thereby increasing access to credit at non-usurious rates. This would better reflect the Congressional purpose in enacting Section 85 in the first place, namely to prevent the use of interest rate limits to disadvantage national banks over state-licensed lenders. Today, Section 85's "mission creep" threatens the reverse.

## VIII. Conclusion

For all of the reasons discussed above, the undersigned groups urge the OCC to withdraw its proposal. The OCC lacks the authority to issue the proposal, the proposal is unreasoned, and it is likely to open the floodgates to predatory lending, resulting in severe harm to consumers across the country. Thank you for your consideration.

Yours truly,

Center for Responsible Lending
National Consumer Law Center (on behalf of its low income clients)
Americans for Financial Reform Education Fund
Consumer Federation of America
The Leadership Conference on Civil and Human Rights
NAACP
National Association for Latino Community Asset Builders
Public Citizen
United States Public Interest Group (U.S. PIRG)

**Attachments: Appendix A: NCLC Fact Sheet: Stop Payday Lenders' Rent-a-Bank Schemes**

**Appendix B: Individual Borrower Experiences with Payday and Car Title Loans (Short- and Longer-Term Loans)**

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# Appendix A

## Fact Sheet: *Stop Payday Lenders' Rent-a-Bank Schemes*
## National Consumer Law Center

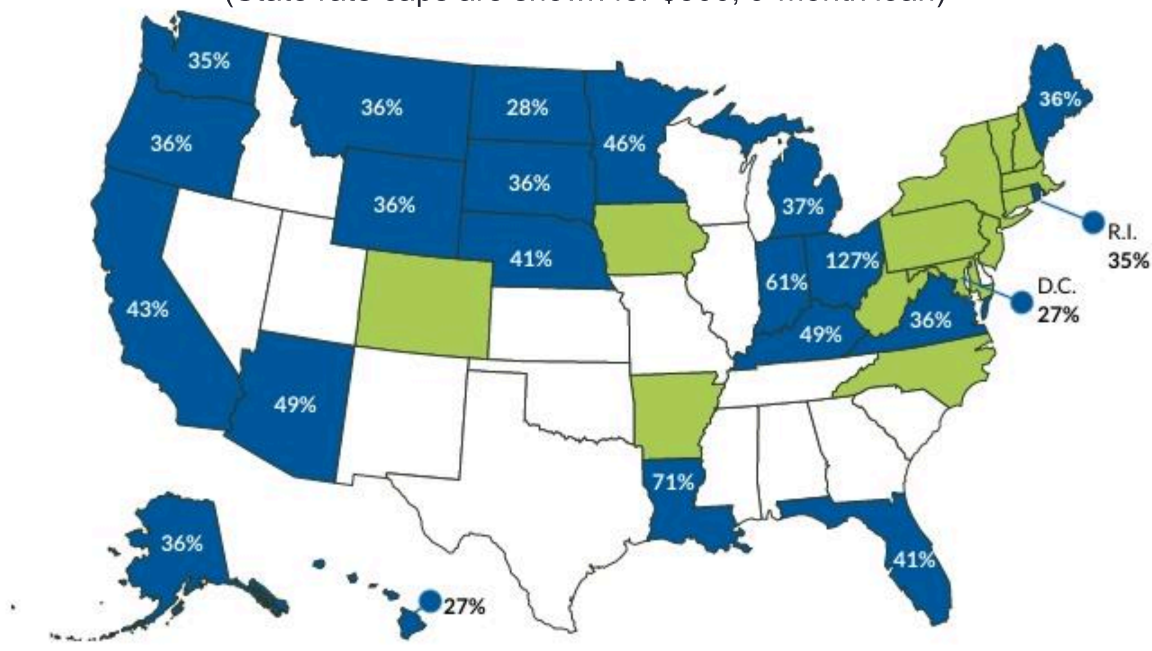
NCLC
National Consumer Law Center

# STOP PAYDAY LENDERS' RENT-A-BANK SCHEMES!

Payday lenders are starting to make **usurious loans up to 160% in states where those rates are illegal** by using banks, which are not subject to state rate caps, as a fig leaf**.** Banks have little to do with the loans, which they immediately sell. Bank regulators shut down these schemes in the early 2000s, but two state-chartered banks, FinWise Bank and Republic Bank and Trust, both regulated by the FDIC, are again helping payday lenders evade the law in 28 states & DC.

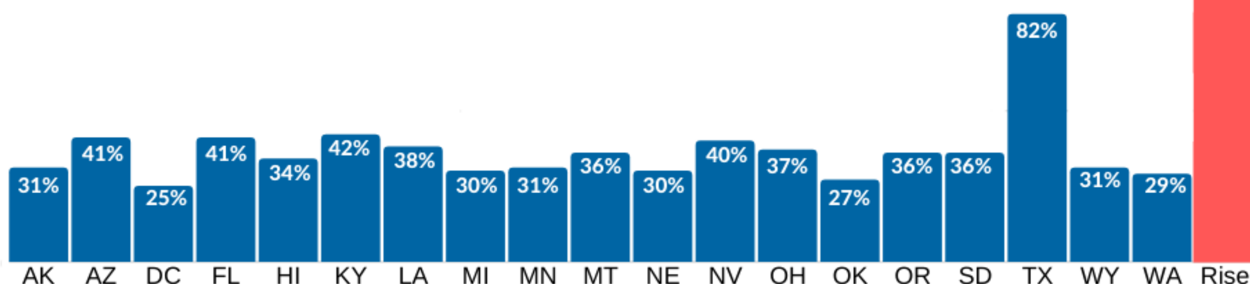
## OppLoans + FinWise Bank = 160% APR

OppLoans ignores the interest rate cap laws of 24 states & DC
(State rate caps are shown for $500, 9-month loan)




## Rise (Elevate) + FinWise Bank = 99%-149% APR

Rise ignores state interest rate caps in 18 states & DC
(State rate caps shown are for $2,000, 2-year loan)



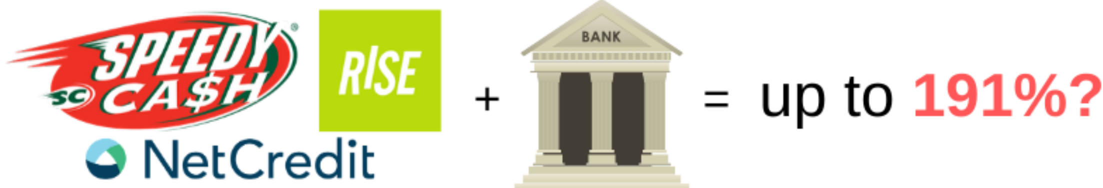
## Elastic (Elevate) + Republic Bank & Trust = 109%

Elastic uses a rent-a-bank scheme to offer lines of credit at rates above those allowed in many states. Elastic does not disclose an APR to consumers, but its SEC filing gives an example of a $2,500 advance with an effective **APR of 109%.** Actual APRs vary depending on the amount advanced and repayment schedule. The Elastic line of credit is offered in 14 states and DC where rate caps are far lower for lines of credit.

| Maximum APR (with fees) for $2,000 advance repaid over 2 years | | | |
|---|---|---|---|
| Alaska | 31% | Minnesota | 36% |
| Arizona | 41% | Montana | 36% |
| Arkansas | 17% | Nebraska | 30% |
| D.C. | 25% | Nevada | 42% |
| Florida | 34% | Oregon | 36% |
| Kentucky | 35% | South Dakota | 31% |
| Louisiana | 39% | Texas | 28% |
| Maryland | 33% | | |

## Coming soon to California

Speedy Cash (Curo), NetCredit (Enova), and Rise (Elevate) have announced plans to their investors to **use rent-a-bank schemes to evade a new California law** going into effect on January 1, 2020 that will ban their current loans above $2,500 that go up to 135%-191% APR.




**Federal and state legislators, regulators of both banks and payday lenders, and enforcement agencies must all do their part to stop payday lenders from evading state interest rate caps through rent-a-bank schemes.**

**November 2019**

# Appendix B
# Individual Borrower Experiences with Payday and Car Title Loans
# (Short- and Longer-Term Loans)

## Introduction

Consumers across the country are devastated by the impacts of payday, car title, and other high-cost loans. The stories below highlight real customers' experiences with predatory lending and illustrate the harms associated with these loans. Stories were collected from a variety of sources. The Center for Responsible Lending has an established relationship with some of the victims who recounted their stories. Other stories were obtained by Freedom of Information Requests for complaints and original loan contracts that were sent to the consumer protection agencies of certain states. Borrowers' experiences were also derived from news articles and other media sources.

## Coding

Following each story, one or more code is applied, indicating the following:

***Type of harm experienced:***

"**1**" Borrower endures long loan sequences, including frequent loan renewals, loan flipping, or long cycles of taking out one loan to pay another.

"**2**" Borrower experiences delinquency and/or default, including lender and bank fees triggered by the loan itself, aggressive debt collection, and loss of a vehicle.

"**3**" Borrower suffers collateral harms from making unaffordable payments, including defaulting on other major financial obligations or basic living expenses.

***Other loan features:***

"**LT**" Long-term loan

"**CT**" Car title loan

"**SL**" Small loan with principal of $200 or less.

***Asterisks*** following an annual percentage rate (APR) indicate approximate APR as calculated by CRL staff, based on the information provided by the borrower.

## Borrower Experiences

1. Arthur, a 69-year-old warehouse worker and grandfather of seven, started with a loan of $200 from Advance America. The loan eventually increased to $300. Every payday, rather than defaulting or coming up short on bill money, Arthur went into the Advance America store and paid a fee of $52.50 so Advance America would not deposit his check for the full loan amount. Advance America flipped the loan over a hundred times, until his total interest paid was an

estimated $5,000. The clerks knew him by name and often had his paperwork ready for him when he came in. Payday lenders have a name for consumers they see every payday: "26ers"—because they pay up every two weeks, 26 times a year. In Arthur's case, they saw him once a month rather than every two weeks, but only because his repayment came from his monthly Social Security check.
Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(1, 3, SL)

2. Mary is a single mother who has owned her one-story brick house in New Castle, Delaware for nearly a decade. After falling behind on the mortgage payments, she applied for and received a 135% APR payday installment loan from California-based, LoanMe. Mary, who works part-time as a dietary aid and receives disability payments, immediately put the money toward the mortgage and repaid the loan in the first month to avoid paying high interest, she said. It still wasn't enough to make her current on the mortgage, so she applied for a second loan in the spring. This time, she was approved for $3,100 with an APR of 135%. She has up to 47 months to repay the loan – meaning that she will pay approximately $16,500 in principal, fees and interest if it takes her the entire time. "I make monthly payments to make sure they are not coming after me, but with interest that won't do much," she said. "Now I'm left with this bill, plus my mortgage. I'm in worse shape now."
Source: [http://www.delawareonline.com/story/news/local/2016/08/26/lawmakers-eye-caps-changing-payday-lending-industry/87632062/](http://www.delawareonline.com/story/news/local/2016/08/26/lawmakers-eye-caps-changing-payday-lending-industry/87632062/)
(1, 2, 3, LT)

3. In September 2011, Pauline, a 96-year old widow living on Social Security income and a small pension each month, received a $450 payday loan from Allied Cash Advance with an APR of 360%. To circumvent the Virginia's payday lending law, the company framed its product as an open-end credit agreement rather than a payday loan. Although she made payments to Allied totaling $597, her balance remained at $776.20. Company representatives threatened Pauline numerous times, telling her they would deal "harshly" with her for failure to pay and falsely asserting that failure to pay the loan constituted fraud and could result in jail time. Pauline believed the criminal threats were real and suffered significant distress and anxiety as a result.
Source: *Pauline Honey v. Allied Title Lending LLC*, 12-00045, Filed 9/14/12, United States District Court for the Western District of Virginia
(2, 3, LT, OE)

4. Virginia regulations for payday and car title loans. To avoid these regulations, payday lenders encouraged consumers to enter into open-end credit agreements. Allied Title Lending offers car title loans and open-end credit agreements at the same locations where the company (previously called Allied Cash) had operated as a payday lender. James and his wife, who live solely on their Social Security income, fell on difficult times financially and entered into a "Motor Vehicle Equity Line of Credit Agreement" with Allied Title Lending to assist with their struggles. James agreed to borrow $2,160 at an annual interest rate of 182.5%. Although James has never made a late payment in the five years that Allied Title Lending has continued to collect on the contract, the company has threatened James the entire time that if his payments were late, his vehicle would be repossessed. The company repeatedly tricked James into collecting much more than what was actually due under the contract by telling him he could pay off the loan more quickly if he paid more than the minimum payment each month. Allied Title Lending categorized

the loan as an open-end line of credit, but no money in excess of the original loan amount was ever made available to James, and he has paid back more than $16,000 on his $2,160 loan. Source: *James F. Lam v. Allied Title Lending, LLC*, United States District Court for the Eastern District of Virginia
(1, 2, LT, OE)

5. Christopher received a $500 payday loan from CashNetUSA, with a total repayment of $625. He had to roll the loan over to the next month five subsequent times, meaning that he paid a $125 fee each time with none of the fee going toward paying off the principal. As a result, he paid $1250 total on his $625 loan. A few months later, CashNetUSA told Christopher they had increased his credit line to $1,500. He obtained the $1,500 loan with a total repayment of $1,875. When payment was due, Christopher did not have the money to repay the loan and contacted CashNetUSA prior to the due date to arrange a payment plan. The company debited a $375 rollover fee from his checking account and then took the entire $1,500 loan amount from his account anyway. Christopher did not have enough money in his account to pay the loan, so he accrued $934.82 in NSF fees from his bank and was unable to pay any of his other bills, including child support and rent. In order to prevent eviction, he took out another payday loan from CashNetUSA for $1,500 to pay his rent, further perpetuating the cycle of debt.
   Source: Florida Attorney General's Office, 2007
   (1, 2, 3)

6. Sandra, a successful professional, worked diligently to keep up with her bills. In a tough time, she turned to payday lending. After several rollovers, Sandra's first loan was due in full. She couldn't pay it off, so she took a loan from a second lender. Frantically trying to manage her bills, she eventually found herself with loans from six payday lenders including Advance America, Check Into Cash, Check 'n Go, Urgent Money Express and two on-line lenders. She paid over $600 per month in fees, none going to pay down her debt. After writing checks to payday lenders totaling $9,200, she was evicted and her car was repossessed. "At the time it seems like the way out, but this is not a quick fix. It's like a ton of bricks," said Sandra.
   Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
   (2, 3)

7. Edith, an Asheville, North Carolina single mother, cut down on her family's groceries, stopped driving her car, and kept her lights off to save electricity as she scrambled to pay the fees on her payday loans. She took out her first $300 payday loan, and then a second and third, trying to repay the first. Edith borrowed a total of $900, received $765 in cash and paid $135 in interest ($45 x 3) at the time she borrowed. She continued to pay $270 in interest every month ($135 twice a month) for well over a year because she could not afford to repay the $900 principal owed. Though she only received cash advances totaling $765, during the next year, she paid over $3,500 in fees alone, and still owed the original $900.
   Source: CRL website: *The Victims of Payday Lending*.
   http://www.responsiblelending.org/issues/victims-payday.
   (2, 3)

8. Vanessa obtained a $1,455 payday installment loan from The Cash Store. She was to make twelve payments over six months of $357 each, paying a total of $2,832 in finance charges, reflecting an APR of 581%. Although she certified that the payment on principal and interest did

not exceed 25% of her income, Vanessa could not keep up with her loan in addition to her ongoing monthly expenses. She paid $2,100 over four months for the loan but still owed $1,600—more than the original principal amount. She was forced to close her bank account after incurring too many overdraft fees, and she has worse credit than when she obtained the loan. She is still facing a legal debt collection action. Vanessa has testified before the Texas Legislature to tell her story, saying, "The short of it: I, like so many Texans who got payday loans, was sunk."
Source: Loan contract on file with CRL
(1, 2, 3, LT)

9. Sherry was a struggling, working single mother who made 15 monthly payments totaling approximately $3,000 on the $1,000 payday installment loan she obtained from Western Sky. The loan required an automatic draft of 24 monthly payments of $198, which carried an APR of 233%. Sherry could not afford the payments, but continued to make them despite falling further behind on her mortgage and other bills and incurring overdraft fees from her bank. When she was offered a trial loan modification to resolve her mortgage delinquency, she attempted to stop the automatic electronic payments being made to Western Sky but was initially unsuccessful. As a result, her first trial payment on her mortgage modification was returned for insufficient funds and the mortgage company cancelled the modification. Although she initially took out the loan to improve her financial situation, it deepened her financial distress and even caused her to lose her initial chance to save her home from foreclosure.
   Source: Loan contract on file with CRL
   (1, 2, 3, LT)

10. Oscar Wellito took out a $100 loan American Cash Loans, LLC after he went bankrupt. He was supporting school-aged children while trying to service debt obligations with two other small loan companies. He earned about $9 an hour at a Safeway grocery store, which was not enough money to make ends meet, yet too much money to qualify for public assistance. "That's why," he testified, "I had no choice of getting these loans, to feed my kids, to live from one paycheck to another paycheck." He needed money for groceries, gas, laundry soap, and "whatever we need to survive from one payday to another payday." His loan carried a 1,147.14% APR and required repayment in twenty-six biweekly installments of $40.16 with a final payment of $55.34. Thus, the $100 loan carried a total finance charge of $999.71.
    Source: *State ex rel. King v. B & B Investment Group, Inc.*, 2014-NMSC-024, 329 P.3d 658
    (2, LT, SL)

11. Delores, a 78-year-old retiree, borrowed $730 at an APR of 300% from Wisconsin Auto Title Loans when she needed new tires for her 1992 Buick Park Avenue. The company required her to turn over the spare key and title to her vehicle. A month later on the due date, her loan had grown to $1,027 and she couldn't afford to pay it. The amount due was more than her entire Social Security check. Because she couldn't imagine giving up her vehicle, she began to borrow money from other sources just to pay the interest on the car title loan, never making a dent in the principal. She eventually sold her car for $1,000 to help pay the debt.
    Source: Yeoman, Barry. "Sudden Debt." AARP Magazine September & October 2006: 108-113, 128. Print.
    (2, 3, CT)

12. Jane, a 79-year-old woman, obtained a $380 payday loan from SpeedyCash with a 259% APR to help pay for her daughter's cancer medication. She earned $922 in social security benefits and paid a rent of $430, the lender did not ask her about her ability to repay the loan and simply required proof of income. Despite making 16 monthly payments of between $65 and $95, Jane still owes $500 on the loan. She has never made a late payment although she owes other bills because that would allow the lender to take the funds straight from her account. She reasons, "I would rather not pay my light bill than for the [payday loan company] to take all the money I need to pay my rent."
    Source: Video on file with Texas Appleseed.
    (3)

13. Lauren received a car title loan from TitleMax for $817.19, with an initial APR of 66.02%. She was charged monthly for automobile insurance coverage, which the company claimed was voluntary. However, TitleMax required certain stipulations if customers wanted to use their own auto insurance, including paying the policy through the maturity date of the transaction in advance, listing the company as a lien holder on the insurance policy, and carrying a deductible of no more than $500. Lauren could not afford to pay her insurance premium in advance, and as a result had to pay TitleMax monthly for auto insurance in addition to the loan principal and interest. As she could not afford to pay off her loan in full each month, Lauren was forced to refinance the loan 13 times. Each renewal resulted in an increase in the monthly auto insurance premium she was charged by TitleMax. She eventually surrendered her 2004 Chevy van to the company because she could not afford to repair it. At the time of surrender, her balance on the loan had ballooned to $3,883.35 and she had been charged $4,128.55 in fees and other charges over the course of the loan.
    Source: Florida Office of Financial Regulation, 2014
    (1, 2, 3, CT)

14. Fearing she and her family would soon lose their home, Jessica obtained a $1,900 car title loan from Instaloan in October of 2013. It was marketed as a no-credit-check collateral loan, but she did not understand what that meant. When she asked the company representative, he told her that it was a car title loan but he wasn't allowed to tell customers that. Jessica was told that she was required to purchase their auto insurance even though the contract terms indicated the insurance was voluntary. Over the next 13 months, she paid more than $4,000 for her $1,900 loan, and none of her payments have been applied toward the principal of her loan. Recently, she moved from Florida to Arizona. She called Instaloan to ask for their address so she could send her payment via mail and was told she could not mail a payment because the company needed to receive the payment and a signature on the loan renewal on the same day. Instaloan told her the only option was to contact another title loan company and have them buy out the loan at the payoff amount. The company representative recommended that she contact TitleMax, which she realized was the same company as Instaloan. No one from TitleMax has returned Jessica's phone calls, and she is worried that her vehicle will be taken.
    Source: Florida Office of Financial Regulation, 2014
    (1, 2, CT)

15. Shirley, an elderly woman on a fixed income, received a car title loan from TitleMax for $2,453.29. She did not understand that the loan had to be repaid in one lump sum or it would be flipped each month and she would accrue new finance charges. Because she was unable to pay the full amount of the loan at once, TitleMax flipped the loan six times. Despite the fact that

Shirley paid over twice the principal amount of the loan to the company, including $1326.01 for the company's auto insurance, TitleMax still repossessed her vehicle when she was unable to make a monthly payment.
Source: Florida Office of Financial Regulation, 2014
(1, 2, 3, CT)

16. James, a 67-year-old on a fixed income, obtained a $500 car title loan from TitleMax in May 2013. He had hoped to be able to pay the loan off in three months; however, he has paid $957 over the past year and still owes $603.98 – over $100 more than the original loan principal. His loan has been flipped 14 times, and he does not understand why he is also charged a monthly auto insurance premium. After paying almost twice the original principal amount, James is now in danger of losing his vehicle as TitleMax claims he is 15 days late in making a payment.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

17. Deborah received a $2,000 car title loan from TitleMax in July 2014. Her loan has been flipped ten times and despite paying over $4,000 to the company, she still owes $1,785.73 – almost as much as the original amount of her loan. Over the course of the year that she's been paying on her loan, the APR has ranged from 43.33% to 46.48% and she has been forced to pay for costly auto insurance that she does not want and did not understand she would have to pay at the time she signed the contract. Representatives from the company have called her place of employment several times a day, putting her job at risk. When she was late on her payment to TitleMax, they sent a tow truck to her place of employment to repossess her vehicle.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

18. Sam received a $604.31 car title loan from TitleMax in July 2013, which carried an APR of 78.7%. His loan was flipped three times and he was forced to pay for auto insurance that he did not need or want. Although the loan contract indicated that the company's auto insurance was voluntary, he was told that his existing car insurance did not meet the company's requirements. The loan contract stated that the policy through TitleMax does not insure the customer against liability for bodily injury or property damage caused to others and does not suffice under Florida's law requiring all resident motorists to have auto insurance for personal injury protection and property damage. As a result, Sam paid $246.17 over four months for TitleMax's car insurance, in addition to the coverage he paid for under his existing insurance policy. Due to the high interest rate and unwanted insurance products, over four months Sam paid a total of $1,186.00 for a $604 loan.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

19. Betty was 78 years old and drove very infrequently when she decided to pursue a car title loan for $2,217.29 from TitleMax. The company required her to buy their auto insurance unless her current policy met their criteria. After realizing that she had paid $348.48 over three months for their additional auto insurance that she did not want or need, she decided to decline TitleMax's insurance and use her current coverage with Geico instead. She believed her insurance met TitleMax's requirements, but she received a call from the company telling her that she had to list them as the payee within fifteen minutes or be forced to pay $175.00 per month for their

policy. She believed she was being taken advantage of by TitleMax because she was elderly and did not understand what she was signing.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

20. Derek received a car title loan from TitleMax for $1,541.06 in May 2014. After paying on his loan for three months, his fourth payment was late. As a result, the company required that he take out an auto insurance policy even though he already had full insurance coverage through another provider and had listed TitleMax as the payee on that policy. He gave them documented proof of his current insurance policy but was told that he must purchase TitleMax's additional insurance although the form he was required to sign stated that the insurance was voluntary. When he attempted to make his payment of $98.00, Derek was told that he owed an additional $141.82 for the additional insurance. Derek could not afford the increased monthly payment and TitleMax is now threatening to repossess his car.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

21. Diego received a car title loan from TitleMax for $654.77 with an APR of 76.4% in September 2013. Over the next year, his loan was flipped eleven times. During this time, he was charged $334.30 extra for auto insurance financed through the company. Although he had a current auto insurance policy, TitleMax required that his policy be current through and including the next payment date. However, Diego found that the company would not accept his insurance policy because he paid his insurance premium each month on the day after his loan payment was due and therefore could not provide proof of insurance until the next business day after he had already renewed the loan.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

22. Phyllis received a car title loan from TitleMax for $643.73 that carried an APR as high as 115.6%. She has paid $2,190 on the loan over 18 months and still owes $261.64. Despite paying over three times the principal amount of the loan, the company has repossessed her vehicle twice, forcing her to pay an additional $400 each time to receive access to her vehicle.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

23. Jane received a car title loan from TitleMax in November 2013 for $4,335.86. Despite having paid $3,245 over the past eight months, the company says she still owes $3,686.73. She has paid $272.50 for auto insurance through TitleMax even though she already possesses a current auto insurance policy.
Source: Florida Office of Financial Regulation, 2014
(2, CT)

24. After her husband passed away, Rachel was short on cash and decided to obtain a car title loan from TitleMax in August 2014 for $3,000. After paying on the loan for a year, including over $2,000 in auto insurance she did not need or want, she had to return to her previous residence in Wisconsin to handle an issue with her husband's estate. When she called TitleMax to let them know she'd be sending her payment by money order, she was told that she had to make all payments in person because she was also required to renew the loan at the time of payment. A

company representative even told her that TitleMax sends an employee to the hospital to obtain payment and a signature on the loan renewal if a customer is hospitalized during the time a payment is due. She called several times after that to again see if she could make a payment over the phone or have a relative make a payment in person, but the company refused. Because she could not return to Florida to make a payment, TitleMax is in the process of repossessing Rachel's vehicle.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

25. Dan received a car title loan from TitleMax in October 2014 for $1,500, with an APR ranging from 47.2% to 51.9%. Over the past year, he has paid a total of $2,371.54, yet he still owes $1,415.53—almost the entire original loan amount. Although Dan informed the company that he had AAA Plus coverage and did not want to purchase any additional towing services, he was told he must pay $12.50 per month for a "tow package." In addition, he has paid a total of $1,357.80 in car insurance to the company.
Source: Florida Office of Financial Regulation, 2014
(1, 2, CT)

26. Shortly after a heart attack forced her to retire, Sandra was short on cash. Her ex-husband had fallen behind on his alimony payments, and she didn't receive enough income from her monthly disability checks to cover all her bills. She received a payday loan for $150 from First Southern Cash Advance to pay her overdue telephone bill. The next month, her husband still had not paid the alimony, so she was unable to repay the loan. As a result, she borrowed money from another payday lender, then from a third and fourth just to attempt to pay off one loan and the interest. By the time she sought help from a legal aid attorney, Sandra was forced to give up her apartment and move into a trailer in her brother's backyard.
Source: Yeoman, Barry. "Sudden Debt." AARP Magazine September & October 2006: 108-113, 128. Print.
(2, 3, SL)

27. Amy Keaton of Spring Hill, MO said during a public comment session that desperation led her to take out a $200 payday loan a year ago. "You get into that mindset when you are struggling that tomorrow will take care of tomorrow," Keaton said. "So I took out the loan, even though I knew that it wasn't a very good idea." Keaton said the lenders expected a payment of $297, and in return she would receive $250 for her bills. The amount she actually ended up paying escalated. "I was paying almost $100 a month just to take my own paycheck home," she said. Keaton will have her debt paid off this September with the help of Catholic Charities.
Source: http://www.kansascity.com/news/business/article81380962.html
(1, 2, SL)

28. Terrence Wise, who supports tighter regulation of the industry**,** said a $150 payday loan ended up costing him $400. "They were calling my job and harassing me at work," Wise said. "My employer told me I could be disciplined if they didn't stop harassing me. I had papers brought to my home serving me to court. And all of these things, they make you feel degraded."
Source: http://kcur.org/post/hundreds-rally-downtown-public-hearing-proposed-payday-loan-rules#stream/0
(2, SL)

29. Maryann Olson's monthly Social Security check wasn't enough to cover the cost of orthopedic shoes that she desperately needed so she turned to a payday lender. However, her $150 loan quickly turned into $1,900 in debt.
    Source:http://www.oregonlive.com/opinion/index.ssf/2015/03/congress_must_crack_down_on_pa.html
    (2, SL)

30. "We got a payday loan of about $200," Lara said. By the time payday came around the lender wanted $300. They were able to pay back the $300, but they came up short on their next payment. "So we took out another loan," Lara explained. And just like that, the trap door slammed down. "It's just so easy to get. So easy! You just bring a paystub down and you tell them how much you need," Lara said. "I kid you not, we did that dance for close to six months," Lara said. "It was horrible. Just unbelievably horrible." Finally, Lara had to beg her parents to help get them out of the cycle for good.
    Source: http://www.tcdailyplanet.net/new-guidelines-nonprofits-help-curtail-predatory-payday-loans-in-minnesota/
    (1, 2, SL)

31. Diana, a 71-year-old who lived on her Social Security income of $1,100 per month, took out a car title installment loan from Cash America for $1,533. The loan carried an APR of 98%, and she was required to make 13 payments of $195 each. $551 of the loan went to pay off an old lien. Diana subsequently obtained a Cash Plus 0% APR single-payment payday loan for $225 while her car title loan was outstanding. Cash Plus pursued criminal charges for "theft by check", which is essentially Texas's bad check law. There is now a warrant outstanding for Diana's arrest.
    Source: Loan contracts on file with CRL
    (2, 3, CT, LT)

32. John lived paycheck to paycheck. In December 2013, he took out a car title installment loan with Loan Max for $1,715, requiring 12 monthly payments of $391 each, totaling $2,969 (243% APR). John struggled to make the first two payments and was struggling to make the third. Two months later, in February 2014, he took out a $700 payday installment loan from Check N Go to stay current on his car title loan. The payday loan required 11 biweekly payments of $110 each (247% APR). Of the first payment of $110, only $14 went toward the loan principal. John defaulted on that loan after one payment and was incurring substantial overdraft fees as the bank threatened to close his account. He has no hope of keeping up with his loan payments, much less escaping the debt trap. The extreme stress prevents him from sleeping, and he likely will be forced into bankruptcy.
    Source: Loan Max and Check N Go loan contracts on file with CRL
    (1, 2, LT, CT)

33. In 2009, Pamela received a payday loan from Cash Transfer Centers for $960 on a two-week period, plus a finance charge of $259.20. The loan required payments of $160 in order to be paid off. Once Pamela saw that her monthly payments stayed the same while the interest on the loan continued to grow, she knew there was something wrong.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2)

34. In 2010, Anne received a $1,000 payday loan, which required repayment every two weeks. However, her payments were doing very little to decrease the size of the loan, and eventually, she had paid $1,689 but still had an outstanding balance of $1,082. Moreover, because the bi-weekly payments were being drawn directly from her bank account, she began to incur overdraft fees from her bank and was forced to close her bank account to stop the overdraft fees.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (1, 2)

35. Mary received a $300 payday loan from Fast Cash Advance in late 2009. She repaid the $300 loan and upon learning that Kentucky had made internet payday lenders illegal in January of 2010, Mary closed her bank account in order to stop Fast Cash Advance from continuing to withdraw funds from her bank account. Fast Cash Advance sold her remaining debt to another company who then turned the account over to a collection agency.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2)

36. Christine obtained a payday loan from US Fast Cash for $350 in May 2007. The contract stated that she would owe a total of $455, which reflects an APR of 496.73%. When Christine discovered that payday loans were illegal in Kentucky, she repeatedly contacted US Fast Cash to inform the company that she would instead pay a total of $411.61, the maximum amount allowed under State law for a $350 loan. However, US Fast Cash insisted that she owed $560 in payments and sent her a threatening and intimidating email accusing Christine of "unreasonable demands" and trying to "set the terms" of the loan and stating that no one "twisted [her] arm" to obtain the loan.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2007
    (2)

37. 500FastCash solicited Beverly via email to obtain a payday loan for $300, and she accepted. She had an agreement with 500FastCash to debit her bank account on Fridays as she is paid on those days. Instead, the company debited her account on Thursdays before she was paid, which resulted in extensive bank overdraft fees. Beverly's bank closed her checking account, and she has hired a bankruptcy attorney. Moreover, 500FastCash has put her employment in jeopardy. The company has harassed her at work, calling her office despite her numerous emails to the company stating that she is not allowed to receive personal calls during work hours.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2, 3)

38. Kenneth obtained a $250 payday loan and paid a total of $389 on the loan. Shortly thereafter, he took out another $250 loan with an APR of 547.5%. He paid $75 toward the new loan, but combined with the overdraft fees he had already been charged on the first loan, he had paid a total of $500. Kenneth asked the company to mark his account paid in full as he had repaid the $500 total principal amount of the two loans, but the company refused and continued to call him even though he requested that all correspondence be in writing.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (1, 2)

39. Doris received a $350 payday loan from Ameriloan. She was disabled and living on Social Security, and made an arrangement with the company to debit her checking account four times on the days she received her payments. Instead, Ameriloan twice debited her account the day before she received her Social Security check and she incurred overdraft fees. Moreover, after taking out the four payments she and the company had agreed upon, Ameriloan told her she still owed $455.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2, 3)

40. Carole received several payday loans in 2007 from different companies, including Ace Cash Express, Quik Cash, and Check 'N Go. She was on a fixed income consisting only of her disability payments, and she knew she could not afford to pay the balance of the loans. The companies never verified how many outstanding loans she had or whether she could actually pay the loans back. She notified each company that she wanted to pay the balance on her loans but could only pay $10 a month because she needed to have enough money to purchase her medication. Carole's son received a call from a person claiming to be a lawyer who told him that his mother was engaging in check fraud due to the outstanding payday loan. The caller instructed him to tell his mother to buy a prepaid card with $120 on it and to send her the routing number. She was collecting for a payday loan through Ace Express, which Carole could not to pay on, and the total loan price had ballooned up to $839.93. Carole could not afford to buy the prepaid card and was concerned that she would be sued by the company.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2, 3)

41. Joseph received a $500 payday loan from Eastside Lenders with a $150 recurring payment every two weeks. After the company deducted $150 from his account three times for a total of $450, Joseph was told that he still owed $650. He sent Eastside Lenders an email to let them know that he was revoking his ACH agreement under the Federal Electronic Funds Transfer Act, but they continued to debit his account.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2)

42. Dennis received a $300 payday loan, and was under the impression that he would owe a total of $390 on the loan. Every payday, $90 was debited from his bank account. The company continued to withdraw money, and by the time he was forced to close his bank account, he had paid a total of $990 on a $300 loan. After his account was closed, the payday lender began calling his place of employment despite Dennis's requests that all correspondence be in writing, and the company has threatened to sue him and garnish his wages.
    Source: Office of the Attorney General, Commonwealth of Kentucky, 2010
    (2)

43. In a 2012 court case initiated by the New Mexico Attorney General, Endow testified about her borrowing experience with FastBucks. She stated, "I didn't buy no TV. I didn't buy no jewelry. I didn't go on trips. It wasn't any joyous ride to go to the casino…It was basically to care of my family and put a roof over our head." She earned a mere $18,000-$19,000 a year, yet managers at FastBucks only asked for her pay stubs and bank statements rather than her expenses or other outstanding loans. Endow testified that eventually she had several outstanding loans and would use the proceeds of one to pay off the others. "I was starting to get stressed and

overwhelmed," she said, becoming tearful again on the witness stand. "What am I going to do? How am I going to make it? Is it ever possible to get out of this?" Nevertheless, Endow managed to pay back her loans without going into default until her last loan.
Source: *New Mexico Attorney General v. FastBucks*, 2012
(1, 2)

44. After Joe received a payday loan, he became unemployed. He owed CashNet one more payment of $332.22, so he explained the situation to a representative of the company. They said that they understood. He then received a call at his parents' home, stating that a collection agency needed to speak to him concerning check fraud. CashNet had sold his account to a third party without telling him, and the collection agency attempted to charge a bank account that had been closed. Although he had previously told CashNet he closed that bank account and would need to pay with a new debit card, the collections agency accused him of committing check fraud. The accusation of check fraud has caused unnecessary tension and stress between Joe and his parents.
Source: Alabama Attorney General's Office, 2011
(2, 3)

45. After receiving a $250 payday loan from EZ Money, Terri was contacted by the company at her place of employment. Despite the fact that she informed EZ Money she could not receive personal correspondence at work, the company sent a letter to her job informing her that she had an outstanding balance on her loan. The letter even included the name of Terri's supervisor, which Terri interpreted as a threat to contact her employer.
Source: Alabama Office of the Attorney General, Consumer Affairs Section, 2010
(2, 3)

46. Robyn received a payday loan from National Credit Consultants three years ago. After making three sizeable payments to the company, Robyn asked to have her due date pushed back just one day. The company refused, threatened to have her arrested, and insinuated that they would contact her place of employment. Robyn has been brought to tears several times and feels sick from the stress of the 4-5 calls she receives from National Credit Consultants each time a payment is due.
Source: Florida Attorney General's Office, 2011
(2, 3)

47. Justin received a payday loan for $450 from CashNet USA. Shortly thereafter, he noticed there was an additional $250 deposit in his bank account. He discovered that the credit was for a loan that he never applied for. He called the company and was told that CashNetUSA created a new loan on top of the one he already had because he had "shown interest." The company told him he should have declined the loan within three days if he did not want it, which he was unable to do because he had been out of town with no access to internet to check his bank account. Justin's bank account has been debited repeatedly for payments for the two loans; as a result, he has accrued $450 in bank overdraft fees and his bank has restricted the use of his debit card.
Source: Florida Attorney General's Office, 2008
(2)

48. A San Antonio family requested assistance from their church in developing a household budget and becoming financially independent. In the course of developing a budget, the church deacon

discovered that the family would be able to live within their means except for one item of debt that was dragging them down: a $700 payday loan they had taken out roughly four months earlier to help with a rent payment on their home. The terms of the loan: $200 every two weeks was automatically deducted from the husband's bank account and timed with the deposit of his paycheck. This $200 did not reduce the original amount of the loan. It merely allowed for the $700 principal to roll-over until the next pay-period. In the course of the four months the family had maintained this loan, they had rolled the principal over nine times—at a cost of $1,800. Now, as they approached the church again for help, they needed help to pay their rent or face eviction.
Source: [http://www.christianitytoday.com/local-church/2016/july/texas-pastor-payday-loan-reform-isnt-distraction-its-christ.html](http://www.christianitytoday.com/local-church/2016/july/texas-pastor-payday-loan-reform-isnt-distraction-its-christ.html)
(1, 2, 3)

49. Dodie received a $500 payday loan from National Payday. The company now says that she owes over $1,200 on the loan but will not explain the extra fees. National Payday has called her employer, her family, and her husband's employer and has threatened to file criminal charges against Dodie. Her mother had a heart attack after one of the company's harassing phone calls. Dodie informed National Payday that she has filed bankruptcy, but the calls continue.
Source: Florida Attorney General's Office, 2006
(2, 3)

50. Over a 17-month time period, Lisa, a single mom living in North Carolina, received 35 payday loans from Urgent Money Service – roughly one loan every two weeks. She spent over $1200 in fees for a $255 cash loan that kept rolling over because she could never repay the loan within the two-week period. Each time, she would write a check for $300 and receive $255 back in cash. Urgent Money Service never took into account Lisa's income and expenses. Each of her biweekly paychecks amounted to only $600, so she was left with only $300 for her other bills and expenses until her next paycheck. The debt trap cycle continued as she couldn't afford to pay back the loan and couldn't stretch her remaining $300 to cover all her bills without obtaining yet another loan. The only way she could stop the withdrawals from her bank account was to close her account. It took her two years to finally pay off the $255 loan.
Source: Commerce Committee meeting testimony, North Carolina General Assembly, 6/17/2003
(1, 2)

51. Lenny, who made about $600 a week, went to Advance America thinking a payday loan would help him catch up on an overdue bill. Over a year later, he had renewed his Advance America loan every two weeks, fallen deeper into debt, and taken a second payday loan to stay afloat. Lenny lost his apartment and ended up in a homeless shelter. While he lived there, Advance America continued to flip his loan, charging $20 per $100 every two weeks, 521% APR.
Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(1, 2, 3)

52. Mr. & Mrs. Anderson were unable to cure the default on their home loan because of their payday loans. A construction worker, Mr. Anderson had taken out payday loans from Advance America to help them through a bout of bad weather that slowed his work. They paid $200 every two weeks in fees to Advance America, for loans in both his and her names. This debt disqualified the couple for their loan modification.

Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(3)

53. Jason, a military service member who worked on a nuclear submarine in Kings Bay, Georgia, borrowed $300 from Advance America to make ends meet after being in a car accident. He soon found himself taking out loans from other payday lenders as he fell further and further behind. "In five months, I spent about $7,000 in interest, and didn't even pay on the principal $1,900. I was having marital problems because of money and didn't know what to do for Christmas for my kid," Jason told an AP reporter. The base emergency relief office finally helped Jason by paying off his triple-digit payday loans, some as high as 780% APR, and letting him repay the charity's interest-free loan over 18 months.
Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(1, 3)

54. Clarissa and her 15-year-old son put in more sweat equity hours than required on their Habitat for Humanity house, in joyful anticipation of living in their own home. Clarissa worked full time, but received no child support and struggled to manage her expenses, sometimes taking on a second job. When the company she worked for shut down, Clarissa borrowed from Advance America and Nationwide. Eventually, when she couldn't repay one of her loans, the payday company deposited the check they were holding as collateral. The check bounced and both her bank and the payday lender charged her additional fees for insufficient funds.
Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(2, 3)

55. Anita went to an Advance America store in hopes of finding a solution to a common problem -- how to delight her grandkids on Christmas. Unable to repay the loan, she had to renew her loan with Advance America every payday, paying $45 to keep the same $300 loan outstanding. She went to a second payday lender, Check 'n Go, to help repay Advance America. Anita could not afford the $820 it would take to pay off the two loans in full and get out of the trap. After just four months, she had paid almost $1,000 in fees, and still owed the $820. "I got a promotion and a raise, but I never saw any of that money," said Anita. She finally went to her church to get help paying the rent, and to a consumer credit counseling agency to get help negotiating a repayment plan. It took her nine more months to complete these payments.
Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(1, 2, 3)

56. Danny, a forklift operator from Kannapolis, was making $9.00 per hour. He got behind on his bills after being hospitalized from a heart attack and stroke. He went to his first payday lender in March 2000 and borrowed $300 for a 7-day term. This was about the same as his weekly pay, so he could not afford to pay back the loan, and got caught in the debt trap. Over the course of two years, Danny used eight different lenders including Advance America, Advance Internet, Check into Cash, and First Southern Cash Advance. He paid more than $5,000 in fees over the next two years, with over 170 check stubs for payments to these payday lenders.

Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(1, 2)

57. Stephanie paid her first payday loan back the first time when it was due on payday, but a few days later came up short again, so she took out another loan. "I was paying the fees, but still coming up short on bills. So I got a loan from another lender just to pay the fees on my other loans. I ended up with several loans from different payday lenders, struggling to pay the interest every two weeks so I wouldn't default, because if I did they would have passed my check to the bank." Stephanie had loans with Advance America, Check Into Cash, Check 'n Go and several others. Eventually she was paying $800 every month just in interest fees, without paying down any principal. "The payday lenders were not willing to work with me, even after I talked to them about my situation following the advice of my credit counselor," she said. One payday lender threatened to send her check to the magistrate's office, and to take her to court for writing a bad check.
Source: *Caught in the Trap: The real story from payday lending borrowers* – CRL Issue Brief, June 2010
(2)

58. Betty, a senior in Durham, took out a small $100 payday loan. She had no other debt at the time. When this loan came due a month later, she borrowed from a second payday lender to repay the first. And, then she did this four more times. Each time, it was slightly less expensive to flip a loan than to pay the bounced check fees if she defaulted. With six loans, she was paying over half of her $564 monthly Social Security income in payday fees, never paying down a penny of principal on these loans. She lost her phone and got one-time emergency help from social services to avoid eviction. We suspect Betty was later evicted when we could no longer reach her at her apartment.
Source: CRL Issue Brief: *Why We Must Keep Payday Lenders Out of NC: North Carolinians Caught in the Debt Trap*, April 2016
(2, 3, SL)

59. With retirement and disability income, Mary, a 62-year-old African American mother and grandmother, brought in about $1,000 per month. She took out her first payday loan because she needed "a little extra" money to go out of town. Like many borrowers, she had to take out a second loan to pay off the first. She ended up with loans from four payday lenders. "When I get a little extra money, I'm going to pay them off and I'm through with them," said Mary. "It's a rip off. There's nothing cute about it. I'm supposed to get some money, but I lose money." The fees Mary paid to keep from defaulting on her payday loans added up to over 40 percent of her monthly income.
Source: CRL Issue Brief: *Why We Must Keep Payday Lenders Out of NC: North Carolinians Caught in the Debt Trap*, April 2016
(2)

60. After her husband was laid off, Pamela borrowed $500 from a payday lender. But the Phoenix, Arizona, woman found that she, like many other borrowers, could not manage to repay the $588 she owed ($500 plus $88 in fees) when it was due in two weeks. She went to a second lender to pay the first, and a third to pay the second, getting in deeper until she had five loans of $500. She was paying $880 every month in payday fees, never paying down the principal owed.

By June of 2004, she had paid $10,560 in interest on these five loans. She was afraid of going to jail if she stopped paying the fees, and had no idea how to get out of the trap.
Source: CRL website: *The Victims of Payday Lending*.
http://www.responsiblelending.org/issues/victims-payday.
(1, 2)

61. Kym, a single mother working as a temp in the Triangle area, took out a payday loan when a friend told her about how she could borrow money until her next payday. She quickly fell into the debt trap, and had to pay a high fee every payday to renew the loan and avoid default. When she had trouble keeping up this cycle, she took out a second loan to pay fees on the first. She paid on both loans for about a year, finally convincing one of the lenders to let her pay off the loan in increments. It took Kym another eight months to shake free from the debt trap.
Source: CRL website: *The Victims of Payday Lending*.
http://www.responsiblelending.org/issues/victims-payday.
(1, 2)

62. As a grad student in North Carolina's Triangle area, Allen found it very difficult to pay off the four payday loans he had accumulated. When he did manage to pay off one or two of the loans, he soon found himself strapped for cash and forced to renew the loan. Allen finally sought help from a credit counselor. He sent letters to the payday lenders asking for a payment plan he could afford. But instead of helping him work out payments, one of the lenders deposited his check upon receiving his letter, and it bounced twice before he could cancel the check. Two other lenders were internet-based companies who automatically drafted his checking account. He had to close his account to stop them. When one of these lenders received Allen's payment plan letter, they called and threatened to send a sheriff to his house and serve him court papers. Allen now realizes he has technically repaid the debt several times over in rollover fees.
Source: CRL website: *The Victims of Payday Lending*.
http://www.responsiblelending.org/issues/victims-payday.
(2)

63. Rhonda and her two daughters experienced a financial crisis last summer that sent Rhonda looking for help from payday lenders. She found not the help she needed, but disaster. Rhonda fell into the payday lending debt trap - the terms of the loans she took out required her to either pay them off in less than two weeks or have $90 fees automatically debited from her bank account repeatedly. Those loans, at triple-digit APR, have cost her much more than the exorbitant fees. Her family's finances are in ruins and she is planning to file bankruptcy.
Source: CRL website: *The Victims of Payday Lending*.
http://www.responsiblelending.org/issues/victims-payday.
(1, 2, 3)

64. Like many borrowers, Janis went to one payday lender to get help paying the fees of another. She ended up borrowing from three different lenders. Since she could not pay the loans in installments, she paid the repeat fees until she got her tax returns. When she couldn't keep up with the fees one lender demanded, they called and left her a message saying that they would take her to court if her account was short. It was several months before Janis found her way out of the trap, and she needed help from social services during this time, once to pay her rent and twice to pay her light bill.

Source: CRL website: *The Victims of Payday Lending*.
http://www.responsiblelending.org/issues/victims-payday.
(1, 2, 3)

65. Sandy's first payday loan was for $100, with an $18 fee. She worked down the street from the payday shop, and since she was short on cash, she called to see what she needed to get a loan. All she needed was a source of income and a banking account, so she walked into the shop, and walked out 15 minutes later with the loan. Sandy got caught up in the payday lending debt trap, taking out multiple loans to pay the fees on each one as they became due. At one point, she was paying $300 every two weeks for four different loans. Over a six-month period, this added up to $3,600, but she was in the trap much longer, paying off one loan, then another, until she lost her job and could no longer keep up with the fees. She filed bankruptcy.
Source: CRL website: *The Victims of Payday Lending*.
http://www.responsiblelending.org/issues/victims-payday.
(1, 2, 3, SL)

66. Betty, a senior citizen in Durham, North Carolina, paid over half of her $564 monthly Social Security income in payday fees, never paying down her loans. She lost her phone and needed emergency help from social services to avoid eviction.
Source: CRL website: The Victims of Payday Lending.
http://www.responsiblelending.org/issues/victims-payday.
(2, 3)

67. Mr. R utilized payday loans for temporary help when he struggled to pay his bills. He ended up taking out at least 24 loans over the course of four years, becoming trapped in the payday debt cycle. His final loan was from a tribal payday lender who took $250 out of his bank account every two weeks. Only $50 of the payment applied to the principal of the loan, with the remaining $200 going towards fees. Eventually Mr. R was forced to close his credit union account, and even though he had repaid the principal several times over, he was harassed with round-the-clock phone calls from the payday lender.
Source: Brief of *Amici Curae* Nine Advocacy Organizations in Support of Defendants-Appellees Urging Confirmance, *The Otoe-Missouria Tribe of Indians v. New York State Department of Financial Services*, No. 13-3769 (2nd Cir. Nov. 13, 2013).
(1, 2)

68. Patricia paid half of her income every pay period to internet payday lenders. She obtained five internet payday loans, including one from a tribal lender, with a total of $2,000 to help pay her bills after incurring unanticipated medical expenses. The APRs on the loans ranged from 620% to 990%. The lenders took close to $600—half of her income—from her bank account every two weeks. After she had repaid more than the principal amounts of the loans, she closed her bank account to stop the lenders' debits.
Source: Brief of *Amici Curae* Nine Advocacy Organizations in Support of Defendants-Appellees Urging Confirmance, *The Otoe-Missouria Tribe of Indians v. New York State Department of Financial Services*, No. 13-3769 (2nd Cir. Nov. 13, 2013).
(1, 2)

69. Ms. B is a 71-year-old whose only income is her Social Security benefits and her pension. In November 2012, she received payday loans from three different lenders to help pay her bills.

Immediately, she struggled with the payments, which caused her to fall further behind on her rent and other bills. As a result, she took out another payday loan in January 2013. Fortunately, she was able to stop the lenders' withdrawals by closing her bank account, but they continue to harass her by phone and email, even threatening to sue her on the illegal loans.
Source: Brief of *Amici Curae* Nine Advocacy Organizations in Support of Defendants-Appellees Urging Confirmance, *The Otoe-Missouria Tribe of Indians v. New York State Department of Financial Services*, No. 13-3769 (2nd Cir. Nov. 13, 2013).
(2, 3)

70. Ivy, a retail worker from Brooklyn, took out six internet payday loans carrying APRs as high as 782%, to help pay her bills. The payday lenders continuously drained her bank account, often triggering overdraft fees. In a two-month period, the lenders tried to debit her account 55 times, and she was charged $1,500 in overdraft fees as a result. Because she was unable to pay the overdraft fees, her bank closed her account and reported her to ChexSystems, a consumer reporting agency, to prevent her from opening accounts at other banks.
Source: Brief of *Amici Curae* Nine Advocacy Organizations in Support of Defendants-Appellees Urging Confirmance, *The Otoe-Missouria Tribe of Indians v. New York State Department of Financial Services*, No. 13-3769 (2nd Cir. Nov. 13, 2013).
(1, 2, 3)

71. Subrina's exempt child support funds were seized by her bank after she took out three internet payday loans to help pay her bills. The lenders withdrew as much as $168 in fees from her bank account biweekly, while her bank charged her $800 in overdraft fees as a result of the repeated debits. Further, the bank illegally seized more than $600 in child support funds to cover the fees. The payday lenders refused to stop debiting her account. The bank eventually closed the account, but repeatedly called her to pay the overdraft fees and reported her to ChexSystems, a consumer reporting agency, to prevent her from opening accounts at other banks.
Source: Brief of *Amici Curae* Nine Advocacy Organizations in Support of Defendants-Appellees Urging Confirmance, *The Otoe-Missouria Tribe of Indians v. New York State Department of Financial Services*, No. 13-3769 (2nd Cir. Nov. 13, 2013).
(2, 3)

72. Cynthia, a New York City employee and single mother, borrowed eight payday loans over the course of several months when she fell behind on her rent. Soon, her entire paycheck was swallowed by the lenders. One company that debited money from her account never even made her a loan, but simply obtained personal and financial information from another lender and began electronically debiting her account. Cynthia's bank charged her $1,390 in overdraft fees, seized $721 in child support funds, closed her account, and reported her to ChexSystems so that she could not open an account at another bank. Two years later, debt collectors continue to harass Cynthia to repay the illegal loans.
Source: Brief of *Amici Curae* Nine Advocacy Organizations in Support of Defendants-Appellees Urging Confirmance, *The Otoe-Missouria Tribe of Indians v. New York State Department of Financial Services*, No. 13-3769 (2nd Cir. Nov. 13, 2013).
(2, 3)

73. Yesenia's mother was diagnosed with breast cancer and could no longer work, so Yesenia borrowed $510 (two loans of $255 each) to help pay the rent. She was trapped in a cycle of debt for 5 months, where she paid $90 every two weeks in fees alone. When she became late on a

payment to the payday lenders, they debited her bank account for the full amount of the loan, wiping out all of her funds and causing her to incur overdraft fees. A non-profit charity called Season of Sharing helped her pay one month's rent and she was finally able to pay back the loans. She paid $900 in fees to borrow $510.
Source: http://www.responsiblelending.org/issues/payday-loans-california-video
(2, 3)

74. George, an elderly man living in California, borrowed $1,020 (4 payday loans of $255 each). He was stuck in a debt trap for three years and paid $180 in fees every two weeks. Dolores Street Community Services helped him find his way out of the debt trap. He paid $12,960 in fees to borrow $1,020.
Source: http://www.responsiblelending.org/issues/payday-loans-california-video
(1, 2)

75. Michael borrowed approximately $1,530 (six payday loans of about $255). He has been stuck in the debt trap for more than two years and pays $270 per month in fees alone. Michael's monthly fees take a quarter of his Social Security benefits. He is working with a non-profit organization called Community Housing Works to help him get out of the debt trap. So far, he has paid more than $6,000 in fees to borrow $1,530.
Source: http://www.responsiblelending.org/issues/payday-loans-california-video
(1, 2)

76. Kimberly borrowed $1,550 from three different payday loan companies: one store front, one online, and one bank payday loan. She was stuck in a cycle of debt for nearly six months. She stopped paying her electric bill, went without power, and stopped buying groceries until she was able to pay back all her loans. She paid more than $2,800 to borrow $1,550.
Source: http://www.responsiblelending.org/issues/payday-loans-california-video
(1, 2, 3)

77. In June 2014, Dina took out a $4,570 installment loan from NetCredit. She was behind on her mortgage payments and other household bills and thought the loan could help her get back on track. The interest rate was advertised as 5% but in fact the loan carried an APR of 64%. The loan contract requires her to pay $135 every two weeks for three years, which means she will have paid more than $10,530 to borrow $4,560. Because she is paying $270 per month, she is having a hard time making her mortgage payments. Since obtaining the loan, Dina has been late on her mortgage every month and her credit score has dropped to 590. Instead of helping her get out of financial distress, the loan has put her in an even worse situation.
Source: CFPB complaint, NetCredit loan contract
(1, 2, 3, LT)

78. In May 2013, National Financial, LLC loaned $200 to Gloria James, a resident of Wilmington, Delaware. James worked in the housekeeping department at a hotel, earning $11.83 per hour. As a part-time employee, her hours varied. On average, after taxes, James took home approximately $1,100 per month. National described the loan product as a "Flex Pay Loan." In substance, it was a one-year, non-amortizing, unsecured cash advance. The terms of the loan called for James to make twenty-six, bi-weekly, interest-only payments of $60, followed by a twenty-seventh payment comprising both interest of $60 and the original principal of $200. The total repayments added up to $1,820, including $1,620 in fees. According to the loan document

that National provided to James, the APR for the loan was 838.45%. Before this loan, James had obtained five prior loans from National. For her first loan from National, James borrowed $100 on September 1, 2011. She repaid a total of $205 by making five payments over the course of two months. For her second loan, James borrowed $100 on August 22, 2012. She again repaid a total of $205, this time by making four payments over the course of two months. For her third loan, James borrowed $150 on October 31, 2012, less than two weeks after repaying her second loan. She repaid a total of $252 by making three payments over the course of two months. For her fourth loan, James borrowed $100 on December 20, 2012, one week after repaying her third loan. She repaid it the next day by making a single payment of $102. The prompt repayment suggests that James refinanced her loan through another provider. For her fifth loan, James borrowed $200 on December 27, 2012, less than one week after repaying her fourth loan. James failed to make the second payment, failed to make the fourth payment, and finally repaid the loan two months later. Her repayments totaled $393. Despite James' difficulty in repaying her fifth loan, National sent her text messages soliciting her interest in another loan. A text message on March 29, 2013, stated, "Loan Til [sic] Payday welcomes you with open arms. If you ever need a loan again we want to be your source! :)" A text message on April 5, 2013, stated, "Loan Til [sic] Payday misses you! Call NOW and receive $20 off your first payment."
Source: *James v. National Financial, LLC*, 132 A.3d 799, 805 (Del. Ch. 2016)
(1, 2, LT, SL)

79. Realizing that her next payday was two weeks away, Leticia Ortega worried about how she was going to get enough cash to pay overdue telephone and electric bills. Then Ortega, a cashier in San Antonio, Texas, spotted an advertisement by National Money Service in a local weekly newspaper. National Money Service charged her a $90 interest fee for a $300 loan, due by her next payday. This fee amounts to an APR of 780%. When the loan's due date arrived, Ortega did not have sufficient cash to repay the entire loan. Consequently, for almost a year, National Money Service debited Ortega's bank account every two weeks in the amount of $90 as interest to "roll over" the loan. Because none of the $90 interest payments counted as principal, Ortega still owed National Money Service $300 even though she had paid $1,800 in interest charges.
    Source: Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 Minn. L. Rev. 1, 2–3 (2002)
    (1, 2)

80. When her job sorting jeans at a garment factory didn't pay the bills, 47-year-old Patricia Turner went to E-Z Check Cashing of Cookeville, Tennessee. E-Z loaned her $300 for 30 days, and Turner secured the loan by writing a check for $405, $105 of which was for interest and "Other Charges." The APR on this loan was over 400%. At the end of the 30-day period, Turner was unable to repay the loan. She did not have enough money in the bank to cover the check or enough cash to pay the debt outright. She could have defaulted, but instead she chose to extend the loan by paying a cash extension fee of $105. After she extended the loan eight times, paying $840 over an eight-month period without reducing the principal of the loan, she was unable to pay either the balance of the loan or an additional extension fee. With full knowledge that there were insufficient funds in her account to cover it, E-Z then deposited Turner's eight-month-old check into its account. When the check bounced, Turner was forced to declare bankruptcy.
    Source: Charles A. Bruch, *Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. Cin. L. Rev. 1257 (2001)
    (1, 2, 3)

81. On a monthly basis from March 2005 through November 2007, Wilma A. Ruby entered into a total of 33 payday-loan agreements with Cashnet, Inc., d/b/a Cash Advance Centers. The amount of each loan increased over time, starting at $200 and reaching $500. Typically, Wilma would pay $575.00 in cash to Cashnet and would immediately enter into another payday loan agreement with Cashnet for $500. Wilma was to repay the $500.00 plus a 15% finance charge of $75.00 (for a total of $575.00) to Cashnet one month later. On the due date, Wilma would again pay $575.00 in cash to Cashnet and immediately enter into another loan with the company. This cycle continued until November 2, 2007, when Ruby entered into her final payday-loan agreement with Cashnet for $500. She could not repay this loan. With a fixed income of only $624.00 per month, Ruby could not afford to repay in full her loan with Cashnet and meet her monthly expenses. Thus, each time she repaid in full one loan, she immediately had to obtain another, usually for the same or a greater amount.
    Source: *Ruby v. Cashnet, Inc.*, 281 Va. 604, 607, 708 S.E.2d 871 (2011)
    (1, 2, SL)

82. On December 14, 2010, Timothy Williams obtained a short-term personal loan from Valued Services. The loan was for $550, and was due to be repaid approximately one month later. The APR was listed at 385.28%, with a total finance charge of $156.75. On January 10, 2011, the day the December loan was due, Williams obtained another loan from Valued Services to repay the December loan. The January loan was for $706, with APR of 246.51%, and a total finance charge of $1,241.40. It required Williams to repay the loan in 12 monthly payments, beginning February 9, 2011. Valued Services made high-interest loans to Williams despite the fact that Valued Services' files showed Williams' sole source of income was a monthly social security payment of $1,147. It also showed that in November 2010, Williams had an ending checking account balance of $8.32.
    Source: Williams v. Valued Servs. of Wisconsin LLC, No. 2012AP2115, 2013 WL 4016941 (Wis. Ct. App. Aug. 8, 2013)
    (1, 2, LT)

83. In March 2012, Rodella Smith obtained a loan for $5,000 from Western Sky Financial. The loan was subject to an APR of 116.73%, and the repayment term was set for a period of about seven years, resulting in a total payment of $41,172.61. She made payments of $480 for over two years, paying Western Sky approximately $13,000 in total—more than double the original loan amount. She then refused to make any more payments, and that's when the company began calling Smith's work and home phone numbers and emailing her, demanding ongoing payments and threatening to report Smith to credit reporting companies. The company has also called Smith's granddaughter four times accusing her of owing a debt and requesting Smith's contact information. Smith has suffered emotional and mental pain and anguish and damage to her credit as the result of reporting a debt that she does not owe.
    Source: Civil Action Complaint, *Smith v. Western Sky Financial, LLC*, 168 F. Supp. 3d 778 (E.D. Pa. 2016), *appeal dismissed* (Apr. 19, 2016)
    (1, 2, 3, LT)

84. In June 2008, Dominginho Powell obtained a car title loan from The Payday Loan Store of Illinois (PLS) using his 1972 Oldsmobile as collateral. He had been having financial difficulties and needed a loan to make ends meet. The loan was for $2,265 with an APR of 300% and called for two installments: one payment of $558.49 in July and a balloon payment of $2,842 in August.

The finance charge was listed as $1,135.60. PLS knew that Dominginho would not be able to make the balloon payment at the time of the loan but entered into the transaction anyway. When he went in to make the first payment in July, he was told that he had to refinance the loan. He went back to PLS in August to make his second payment, and PLS took a payment for the old loan and told Dominginho that he was required to refinance the remaining balance of $2,263, which was not yet due. PLS flipped his loan seven more times, each with terms more unfavorable than the last. Dominginho was told this is the "way loans work." When he was told he had to refinance for the seventh time, Dominginho realized that he had paid almost $5,000 in finance charges for a loan that was supposed to cost $1,135. He still owes $2,235—almost the original principal amount of the loan.
Source: Complaint, *Powell v. The Payday Loan Store of Illinois, Inc.*, No. 09 C 4146, 2010 WL 3893894, (N.D. Ill. Sept. 28, 2010)
(1, 2, CT)

85. Peter Alfeche entered into 23 payday loans with CashNet over a 10-month period, paying the company approximately $2,000 in fees. Being short on money an unable to meet all of his monthly expenses, Peter first obtained a loan from Cash America in November 2006. He agreed to borrow $250 for nine days for a fee of $62.50, representing an APR of 1,013.89%. Many of his subsequent 22 loans were obtained to pay off previous loans, as he often lacked enough money on the due date to pay off the loan and still pay his recurring expenses. Once Peter had established a personal account with CashNet, he also received email invitations to take out more payday loans from other internet payday lenders. Over the 10-month period in which Peter received the 23 loans from CashNet, he also obtained additional payday loans from some of these other lenders. In addition to paying $2,000 in fees to the payday lenders, he incurred hundreds of dollars per month in overdraft charges from his bank.
Source: Class Action Complaint, *Alfeche v. Cash America International, Inc.*, No. CIV.A. 09-0953, 2011 WL 3565078 (E.D. Pa. Aug. 12, 2011)
(1, 2)

86. Cynthia Williams and her husband were facing financial difficulties, so she decided to apply for and received a payday loan of $500 with an APR of 430% from Advance America. Over the next year, she was trapped in a cycle of debt with the company. Although the payday loans consumed over half of her monthly income, Advance America never considered Cynthia's ability to repay. As a result, she fell behind in her mortgage payments. Cynthia and her husband were only able to save their home with the help of a nonprofit foreclosure prevention group by taking on second jobs and increasing their workload by 70 hours per week.
Source: Plaintiffs' Second Amended Complaint*, Williams v. Advance Am., Cash Advance Centers of Missouri, Inc.*, No. 07-04187-CV-C-NKL, 2007 WL 3326899 (W.D. Mo. Nov. 6, 2007)
(1, 2, 3)

87. In order to evade the Arizona's voter mandate sunset of payday loans, the Ohio-based payday lender CheckSmart started making an open-end line of credit linked to a prepaid card in the months preceding the sunset's effect (and after CheckSmart unsuccessfully tried to push legislation in 2010 to repeal the voter's mandate). While this product is no longer on the market, because it was shut down via regulatory action as an evasion of consumer protections, here is what happened to one Arizona borrower: A 71 year old gentlemen was given one of these open-end line of credit loans by CheckSmart one month before the payday loan sunset in 2010. He was told by CheckSmart that it was his only option. His only income was a monthly

Social Security check of $2,350. The line of credit was for approximately half of this amount: $1,402. The fees then were structured as the following – 36% annual percent interest rate, but a "convenience transfer fee" that were far in excess of the actual interest. Because it was an open-end line of credit, the contract only states a 36% APR, despite all of the additional fees that would add up to an effective triple-digit APR.
Source: Contract on file with CRL
(1, LT, OE)

88. Check Into Cash, a Tennessee-based payday lender, makes open-end lines of credit to borrowers in Virginia. According to a legal services attorney in Virginia, here is one client's story: One woman, now aged 63 and whose source of income is comprised of disability plus a small pension, took out an open-end line of credit from Check into Cash in 2011. She is still paying it off today. She has paid over $3,000 in fees and interest alone on what has been less than $1,000 of credit over that time. This same borrower has another open-end line of credit from California-based payday lender– Allied Cash Advance. With this loan she has paid over $1,100 in fees after being stuck for more than a year in a $360 loan. As further evidence of payday lenders' disregard for the affordability of these loans, this same borrower is stuck also payday and car title loan as well. Because the monthly fees consume such a large amount of her monthly income, she forgoes purchases of the food and medicine she needs.
(1, 3, CT, LT, OE)

89. Single mother Malia Andrews lives in Tennessee, and obtained an open-end line of credit with a 279% APR. When she was short on cash, she took out one of these loans. Although it was touted as a better alternative to payday loans, it was not any better for Andrews. "I just about had a complete meltdown in the car," Andrews recalled, describing the moment she realized it would take years to pay off her flex loan. While approximately $300 of her monthly payment went to interest and fees, only about $20 actually paid down the principal of the loan. If she'd known how much the loan would end up costing her, she never would have taken it out.
Source: http://www.newschannel5.com/news/newschannel-5-investigates/consumer-alert/critics-call-279-loan-a-debt-trap-for-poor
(1, LT, OE)

90. Military veteran Joshua Hause had two existing loans for $925 that he said more than doubled after they were converted to a flex loan, an open-end line of credit carrying a 279% APR. Suddenly, his loan payment was over $2,000 when his original loan principal was less than half that amount. Due to the exorbitant interest and fees, Hause keeps getting farther behind. "If they're going to continue to get higher payments each month, I'll never get out of that hole," he lamented.
Source: http://www.newschannel5.com/news/newschannel-5-investigates/consumer-alert/critics-call-279-loan-a-debt-trap-for-poor
(1, LT, OE)

91. Jennifer Williams of Clarksdale, MS, teaches at a high school but remains in a debt trap due to payday lenders. She at one point owed thousands to nine different payday lenders in three separate towns. What started as a $100 loan when she had just began teaching in 2006 and needed a small amount of money due to her credit cards defaulting in college, had accrued to $4,000 in debt by 2009. She says, "It takes a toll on you, mentally. Those places are the devil. Once you get wrapped into it, it's hard to get out". After her son was born in 2011, she decided

to enroll in a 5-week financial boot camp, which was sponsored by the community bank, Southern Bancorp. As a result of completing the boot camp, she qualified for a savings account, as well as an affordable loan, with which she could refinance her debt. Credit counselor Charlestien Harris from Southern Bancorp states that Jennifer's situation is not uncommon.
Source: http://www.csmonitor.com/Business/2016/0903/Payday-loans-a-scourge-but-still-a-need
(2, SL)

92. Don Miller of HopeLink, a center that assists low-income families and people in Nevada, says that most seniors who he works with are living on $700-900 per month for utilities and rent. Some may take out $150 in payday loans to afford food in a crisis, not realizing that it will take them at least a year or two to pay off. Miller states that many of the seniors go into debt, with at least half of them having taken out payday loans. He also states that they often default on their loans and receive an influx of phone calls from the lenders, who usually threaten to send a lawyer to their homes.
Source: http://www.reviewjournal.com/view/seniors-often-pay-hefty-price-relying-payday-loan
(2, SL)

93. A man confided in pastor Wes Helm about his financial hardship with payday loans. Helm looked through the man's budget and discovered one major monthly expense: a payday loan fee three times more than the loan itself. When the church conducted a further investigation, they found that dozens other families at the church had been victimized by payday lenders as well, sometimes even losing their vehicles and homes.
Source: http://www.npr.org/2016/06/16/481558398/with-payday-loans-burying-borrowers-community-tries-alternatives
(2, 3)

94. Candice Byrd was a payday loan borrower in 2011, when she took out a $500 loan for a car payment. She was working in sales at the time. It was due in six weeks; however, three weeks after she took out the loan, she was advised to take out a new loan. She was told, "You're a good customer. This would be helpful for you." That second loan spurred a two-year cycle of paying off her debt. She eventually lost her car and apartment. She now only pays in cash. She said, "These places want you to keep borrowing. They don't want you to climb out of the hole."
Source: http://www.nytimes.com/2016/06/02/business/dealbook/payday-borrowings-debt-spiral-to-be-curtailed.html?
(2, 3, LT)

95. J.F. from Fresno, California, stated, "About two years ago I used a payday loan to assist with monthly expenses. I thought it would be easy to pay off but then I noticed I could not afford to pay the loan without securing another! The lenders provide little to no other option to pay back the loan which lets you know they aren't concerned with helping you get through the hard spot they are more concerned with keeping you in the endless cycle to pad their pockets! Payday loans are BAD business!!!"
Source: Collected by the California Reinvestment Coalition and quote reprinted verbatim from https://calreinvest.wordpress.com/2016/06/01/california-payday-loan-consumers-share-their-experiences/
(1)

96. S.F. from Oakland, California, shared, “In 2006 I was working full-time but when my boyfriend moved out I had to pay the entire rent myself and had trouble making ends meet. I started to use the payday loans and soon found myself in an endless cycle of debt, having to pay off two or more in cash every two weeks in order to get two more to cover my bills. The loan rates were outrageous and some of these franchises require you pay in cash instead of depositing your personal check. It took me a couple of years to get out of this cycle of debt and it kills me to think of all the money I lost on fees over those years. I will never use those services again. These companies are absolutely predatory and should be fully regulated and restricted since they profit from the people who can least spare the financial fleecing. Thank you."
Source: Collected by the California Reinvestment Coalition and quote reprinted verbatim from https://calreinvest.wordpress.com/2016/06/01/california-payday-loan-consumers-share-their-experiences/
(1, 2)

97. J.J. from Lamont, California, stated that he had "[n]o work, needed money to keep afloat and the lender made it too easy to get loan, a car title loan and it has been a nightmare, do yourself a big favor don’t ever get a title loan!"
Source: Collected by the California Reinvestment Coalition and quote reprinted verbatim from https://calreinvest.wordpress.com/2016/06/01/california-payday-loan-consumers-share-their-experiences/
(CT)

98. M. from San Diego, California, lamented, “I have been caught up in payday loan for over a year now it’s taking all of my money and I don’t know how to get out help."
Source: Collected by the California Reinvestment Coalition and quote reprinted verbatim from https://calreinvest.wordpress.com/2016/06/01/california-payday-loan-consumers-share-their-experiences/
(1)

99. D. D. from Los Angeles shared his story, explaining, “I was in a difficult financial time in my business and needed a $2,500 loan to cover my rent that was due. I had exhausted all my other options and wasn’t expecting any checks for a few weeks. I own my car and decided to go to Loanmart to get a loan. I called them up, told them what I needed and what kind of car they had. They approved me for $3,000, even though I asked them for only $2,500. Considering I was desperate for money, I went ahead with it, not knowing about the interest cap over $2,500. Which I am sure they were well aware of and is why they urged me to get a higher loan. So, after 2 years of paying, I have now given them over $4,500, that’s $1,500 more than the original loan. They say I still owe them $3,000. For a total of $7,500 due on a $3000 loan. It’s highway robbery. These people are awful, they harass me all the time, lie to me about payment due dates and even on one occasion sent me to collections on a missed payment even though I had already paid it for that month from their 3rd party payment site (moneygram). I went and checked and the payment never went through. Which is very suspicious. Now they are threatening to repo my vehicle. I don’t know what to do, this whole experience has been horrible. I am self-employed and struggle enough getting by. I hope someone can sue them for these shady business practices. I will be more than happy to testify against them.”
Source: Collected by the California Reinvestment Coalition and quote reprinted verbatim from https://calreinvest.wordpress.com/2016/06/01/california-payday-loan-consumers-share-their-experiences/

(2, CT)

100. An anonymous borrower reported the following story to the Pew Charitable Trusts, who shared the story with the LA Wave: “I had to come up with money [when] my husband was out of work, and I actually was up to $900 [in storefront payday loan debt]. … My entire check was gone the next two weeks, so that’s when I went to the online ones. … And then after I did the online ones, and got in that loop, and got stuck in there, I went back to the store again, and, yeah, it got bad. And my [checking] account ended up pretty negative. I had to close it out totally.”
Source: http://wavenewspapers.com/payday-lenders-may-face-new-regulations/
(1, 3)

101. Raymond Chaney, now 66, is a veteran who became homeless after he took out a payday loan and spiraled into the debt trap. He needed $400 to repair his broken-down car. Soon enough, he owed mounds of money on several loans to many different lenders. He also owed overdraft fees to banks while paying rent. The payday lenders had full access to his account and eventually took all of his Social Security money. Chaney lost his apartment as a result. The $400 loan led to $3,000 in additional loans, which later accumulated to $12,000 of debt. “I’m not dumb, but I did a dumb thing,” he said. He now lives in a rescue mission located in Boise, and is working with the Idaho Consumer Finance Bureau to pay off his debt. His advice to anyone considering taking out a payday loan is as follows: “I had a friend who had back surgery, and it was so painful...If the choice is between back surgery and dying, consider dying. Well, I give people the same advice about payday loans. If the alternative to a payday loan is dying, think long and hard about dying.”
Source: http://www.nbcnews.com/feature/in-plain-sight/drug-payday-loan-users-hooked-quick-cash-cycle-v18088751
(2, 3)

102. Ann Baddour, Director of Fair Financial Services Project, spoke on behalf of an anonymous borrower at the United Way Leadership Breakfast. She said that the senior citizen, who was living on Social Security, had taken an auto title loan at a value of $2,000 three years prior. She still owed the lender $1,900 after paying off $9,200 on the $2,000 loan.
Source: http://www.tdtnews.com/news/article_fa7d0ea0-7f8f-11e6-9006-afc9a2e7f963.html
(2, CT)

103. As reported by the American Forces Press Service, one military borrower took out a $300 loan when he was desperate for money to help him afford expenses necessary for his three children. He got trapped into the cycle of jumping from lender to lender in order to afford the original loan. The $300 loan soon cost him $15,000.
Source: http://www.military.com/money/personal-finance/credit-debt-management/pay-day-loans-big-business-for-them-headache-for-you.html
(2)

104. Joylynn M. Jossel from Columbus, OH, took out a loan of a couple hundred dollars. She could not pay off the first loan, so she took out a new loan from another payday lender, eventually owing money to four different lenders. Soon she was paying $1,800 each month on payday loans alone. At one point, she had to let a $600 loan she had taken out bounce to avoid dire circumstances. “It was either that or not pay my rent that month,” she says. “It was horrifying. They tell you any and everything to get you to come in and pay for the check that didn't clear.

They'll tell you, 'You're a criminal, you wrote a bad check. That's against the law, it's a felony, you're going to jail.' They call all of your references and your job. It's horrifying. I felt so suffocated. It felt as if I was in this black hole that I just couldn't get out of." Soon enough, the other three loans bounced as well, as she had to afford basic living expenses as well. She faced embarrassment at work when the lender called her at work and the receptionist would say who the caller was in front of the office before turning the call over to Joylynn. "Every time the phone rang, I'd jump like I was the next one in a horror movie to be taken out. I'd fear they'd come to my house because I'd known them to go to people's houses before. I felt guilty just putting gas in my tank. I felt guilty buying food. I felt as though any money I got should be going to the payday lenders and collection agencies to get them off my back." Eventually, she was able to repay her loans after winning a civil lawsuit not affiliated with her payday loans.
Source: http://www.aol.com/article/2010/11/02/payday-loans-how-one-woman-got-caught-in-a-vicious-cycle/19674757/
(2, 3)

105. Donald Garrett got behind on his bills, so he took out a $100 loan from Advance Till Payday and repaid them $200. "And I said, 'I appreciate you loaning me the $100. I'm sorry that I was in this bind but you helped me and I appreciate it and you won't see me anymore.' And I thought that was the end of it." Later on, he was receiving a dialysis treatment when he received another phone call from the company. "And he told me that I had a balance of $260 outstanding because of the $80 a month membership fee. Where did that come from? Nobody mentioned that when they gave me the $100."
Source: http://wvtf.org/post/federal-lawsuit-reveals-dark-underworld-payday-loans-virginia#stream/0
(2, SL)

106. Roger Tillman, 64, took out a $500 payday loan from The Money Center when he was tight on cash and needed to pay his bills. He was earning $9.00 an hour working as a late-night security guard. The Money Center's website states that they charge an APR of 650%, amounting to about $150 in interest and fees on a 2-week loan. He could not pay the loan back before the first two weeks, and renewed it as the costs accrued. He took a loan out from another payday store, falling into a debt trap. He soon lost his job. He tried to contact The Money Store two days later, and got no response. The manager finally reached out to Tillman. He recalls of the manager, "His statement was that 'I hope you don't get stopped by the police, because I'm filing a theft by check charge against you.' I didn't say anything. I was floored, because I was expecting to work out a payment plan." The Money Center filed a criminal complaint against him in November of 2009. The district attorney told Tillman that he must pay Marpast of Texas, the company through which The Money Center operates, $1,020 within 10 days, in addition to lawyers' fees of $140 and $90 in merchant fees. Otherwise, he would face 2 to 20 years in jail and would be fined as much as $10,000. This shocked him, leaving him scared - too scared to even attend his daughter's graduation from Lackland Air Force Base in San Antonio, fearing that there could be a warrant out to arrest him. "I'm innocent here," he said, "other than losing my job and an inability to pay. I tried to get on a payment plan. If my intention was to duck and dodge, why would I even call them?" He continued to avoid his jail by writing letters to the DA, the state Office of the Consumer Credit Commissioner, and Marpast. He mentioned that the Texas Office of Credit Commissioner submitted his debt to the DA for "collection purposes".
Source: https://www.texasobserver.org/cash-fast-how-taking-out-a-payday-loan-could-land-you-in-jail/

(2, 3)

107. Christina McHam took out a $200 loan from Cash Biz, near Houston, but was unable to repay it. She was arrested in November 2012 and charged an additional $305 for court costs and other fines. She "paid off" her debt with one night in jail.
Source: https://www.texasobserver.org/cash-fast-how-taking-out-a-payday-loan-could-land-you-in-jail/
(2, 3, SL)

108. An anonymous man, a veteran who had served in the military for 23 years, was being charged by the Potter County Attorney for a payday loan he could not repay. His wife wrote to the state Office of Consumer Credit Commissioner, “My husband is a good man! He has never done anything wrong, he fought for this country for 23 years … and now the Potty [sic] County Attorney wants to prosecute him for a payday loan.”
Source: https://www.texasobserver.org/cash-fast-how-taking-out-a-payday-loan-could-land-you-in-jail/
(2, 3)

109. An anonymous borrower repaid $800 on his $400 payday loan after 70 days. However, he was still in dire need of money, and took out another $500 loan the following day. Again, the next day he took out a $1,000 loan, as he was still struggling to afford his basic living expenses. He paid $2,051 back on that loan 70 days later. He took out another $1,000 loan, and a $600 loan from another store. By this time, he had paid $3,000 interest on these loans, in addition to the $2,500 principal amount.
Source: http://www.standard.net/Guest-Commentary/2016/08/07/paydaylenders-Ponzischeme-fraud-loans-column-Winward
(1, 2)

110. “Perry Green, 30, took out a $300 payday loan that soon cost him $1,000 in interest and other fees. By taking out this one loan, he fell into a three-year debt trap. He took out multiple loans after the initial $300 loan. Originally, he needed the loan to afford his rent, thinking a payday loan was the only option.”
Source: http://www.miunited.org/payday-loans-target-those-with-no-cash/
(1, 2)

111. Leonard Abbot, a 53-year-old security officer at the Department of Public Safety at the Texas State Capitol, had been warned of the dangers of payday loans. But after he owed some unexpected medical bills, he felt his only choice was to take out a $500 loan from a payday store. He says, “One thing that I didn’t realize is, it doesn’t matter how many payday loans you have, you still qualify for more.” He adds, “I’ve always been against those things, the payday loans. I knew about them ahead of time and I knew it’s easy to get caught up in their trap, but again, at the time I just felt like I didn’t have any other alternative options.” By May 2016, he had taken out four different payday loans totaling $2,500 and costing him $450 per month. He eventually converted his loans through the Predatory Loan Conversion Program, led by the Society of St. Vincent de Paul in Austin. “My favorite part about working at the Capitol is seeing the representatives coming in, and also just to see Texas law working at its best,” he said. “I am hoping and will be praying that they will look at legislation to regulate this.”

Source: https://www.texastribune.org/2016/06/18/federal-rules-could-tame-wild-west-texas-payday-le/
(2)

112. An anonymous veteran reported, “I took out a loan for thirty-four hundred bucks. I was gonna pay it back as soon as I got my paycheck. But when I realized I’d have to take out another loan to pay my living expenses, I let it ride. Even though I was paying more than $700 a month on the loan, with the high interest rate, it took forever to pay it off, and I ended up having to pay nearly double what I had borrowed.” He got caught in a debt trap for several years, taking out new loans to pay off previous loans.
Source: http://www.vietnow.com/veteran-buyout-plans-and-other-bad-ideas/
(1, 2)

113. Jon Gomez of Hialeah, FL, received a $400 payday loan at a Money Superstore location, due in 14 days and a $41 service charge. "I paid back the $441, but the next day, I took out another $400 payday loan because I needed the money," Gomez told VICE. "I was in this vicious cycle for three months." Eventually, he didn't have enough money to cover one of his payday loan checks, and it bounced.
Source: http://www.vice.com/read/inside-the-battle-over-floridas-racially-charged-payday-loan-racket
(1, 2)

114. “In 2014, hunger drove Michelle Warne, a retiree in Green Bay, Wisconsin, to take out a loan from a local Check ‘n Go. ‘I had no food in the house at all,’ she said. ‘I just couldn’t take any more.’ It took her two years to pay off that loan. Then she took out a second loan, which she has not paid off completely. Caught in a debt trap, she borrowed another $401, plus $338 to pay off the outstanding balance. According to her truth-in-lending statement, paying off this $740 will cost Warne $983 in interest and fees over 18 months. Warne’s APR on her so-called installment loan was 143%. ‘We need better laws,’ said Warne, 73. ‘Because when they have something like this, they will take advantage of anybody who is poor.’ Warne never applied for a standard personal loan from a bank or credit union, which offer loans at a fraction of the interest rate she paid. She was positive a bank would not lend to her, she said, because her only income is her Social Security retirement. For now, Warne said she has no way to pay off her loan. She has made one payment of $101, but does not know how she will pay off the remainder of her debt, which with principal, interest, and fees will cost her $1,723. Warne’s only income is a monthly $763 Social Security check. Warne said she would “never” borrow from a payday lender again, adding, “I wish I would have read the fine print.”
Source: http://wisconsinwatch.org/2016/06/no-relief-from-wisconsins-565-percent-payday-loan-interest-under-new-rules/
(2, LT)

115. Ronnette Souza-Kaawa, 46, lives in Waianae, HI and works in administrative services at an elementary school. Her family faced financial difficulty when her teenage daughter had a baby, so she simply went down the road to Easy Cash Solutions to take out a payday loan. Souza-Kaawa says she has taken out roughly a dozen payday loans in the past two years, ranging from $150 to $400. She says she’d always strive to pay them off before her next paycheck, but wasn’t always able to do so. “If I borrowed a high (amount), I’d pay some off and re-borrow only a little,” she says. Today, Souza-Kaawa owes roughly $1,470 from two recent loans. She is learning

budgeting and financial management strategies from a nonprofit called Hawaiian Community Assets. Today, Souza-Kaawa views payday lenders as a last-ditch option for many families. “It’s there when you need it,” she says, adding that thanks to financial counseling, she’s become savvy to what she now describes as their “hideous” interest rates. “If don’t need it, don’t take out a loan,” she says. “Don’t go borrowing $500, just because you can."
Source: http://www.hawaiibusiness.com/payday-lenders/
(1, 2, SL)

116. Toniette Brown from Alabama needed her first payday loan to afford prescription medicine for her daughter. Working as a part-time librarian, she did not have health insurance coverage to cover her family, or even herself. The payday lender gave her a $275 loan without any credit check. When she couldn't repay her loan by the next payday two weeks later, she took out another. This accrued to 12 loans across 4 different lenders, both in Alabama and online. She frequently had 3 to 5 loans at once. She was eventually in $4,288.96 worth of debt. "I couldn't pay them because I was already living on an income that was paycheck to paycheck," she said. When the interest and fees began to grow several times the amount of the original loan, she sought help from Gateway Financial Freedom and landed a full-time job. She has since almost fully paid back her loans, interest and fees, and says that she will never make the same mistake again
Source: http://www.al.com/news/index.ssf/2015/03/lifeline_or_financial_anchor_u.html
(1, 2)

117. Yolanda Roth, of Robbinsdale, Minnesota, took out a payday loan when she lost her job. She had to accept a lower-paying job and needed some extra money to afford her rent. “My check wasn’t quite enough to pay it off and still live, and I ended up racking up a lot of debt because of fees and so on,” Roth said. “I eventually paid it off, but it took a very long time.” Her original loan was for a couple hundred dollars, but ended up costing her a total of $1,500 over the next six months. She describes this experience as "very unpleasant" and "extraordinarily stressful." However, she understands that there is risk associated with taking out these types of loans. “I felt like I understood what was expected and I could definitely do it,” she said. “I was just in a desperate situation, or what I thought was a desperate situation.”
Source: http://post.mnsun.com/2015/10/12/faith-leaders-protest-payday-loan-practices-in-robbinsdale/
(1, 2)

118. Reverend Stevie Wakes, a Baptist minister in Kansas City, Kansas, received a payday loan of $500 that he thought he could pay back in two weeks. "We thought it was short-term," he said. He thought he would get a higher-paying job soon enough, but wasn't able to. He kept returning to the store to take out more loans every two weeks, and four months later had accumulated $1,250 in debt. He says that he renewed his loans about ten times, with an APR of about 450%. As soon as he realized how quickly his debt he was racking up, he managed to save the money to pay off his debt. “I’d like to see them cap the rate so that no one has to experience that kind of robbery, which is why I support the campaign [for a 36% interest rate cap] 100 percent," he says of payday lenders. "It's a debt trap."
Source: http://www.kansascity.com/news/local/article300576/Alternative-arises-as-payday-loan-industry-comes-under-scrutiny.html
(1, 2)

119. "Michael" of Verona, WI, had taken out payday loans from a dozen stores. He began taking out payday loans after a company mailed him an offer to take out a loan for no charge, directly after he had repaid his car title loan. Soon enough, his debt grew as he continued to take out loans to repay previous ones. He says he felt like a "gerbil on a treadmill". The payday lenders began aggressively calling his personal references, which he provided when he applied for the loans, causing him even deeper feelings of shame and desperation. "It got to be where I felt like my hair was on fire," he says. He eventually declared bankruptcy, halting the fees on the loans.
Source: http://host.madison.com/ct/news/local/govt_and_politics/wisconsin-is-one-of-few-states-with-no-ceiling-on/article_4e3585bc-cda8-5be9-8bf0-7d6b6a02dfdf.html
(1, 2, 3, CT)

120. Janet is a part-time security officer. She took out a $300 payday loan to afford diabetes medicine, as well as her rent. She found herself in a debt cycle. She recalls, "I called and tried to set up a repayment plan with them. I was not aware that I could do that and when I found out that I could, I did talk with them. And the amount that they said I owe is $425, and they said that I could repay in 2 payments which was over $200. I asked them if they could stretch it out 2 more payments; something that would be a lot smaller. The lady told me that they could only stretch it out 4 for 4 payments, which a little over $100 per payment, which is a payment I still cannot afford to pay at this time." She was still in debt 6 weeks later. "It's very frustrating because it's like I'm more on interest than the actual loan itself... it's like I'm actually paying double."
Source: Texas Fair Lending Alliance, https://www.youtube.com/watch?v=HCOwaudHr3g
(1, 2)

121. Trudy Robideau from California received an $800 loan from a payday loan store. She wasn't able to repay her loan right away, and renewed it for a fee. "Ka-ching," Robideau said. "You're hooked. You can feel the hook right in your mouth. And you don't know it at the time, but it gets deeper and deeper." She soon turned to other payday lenders, racking up fees totaling thousands of dollars. "I was having to get one to pay another," she said. "It's a real nightmare."
Source: http://www.npr.org/2015/03/26/395421117/payday-loans-and-endless-cycles-of-debt-targeted-by-federal-watchdog
(1, 2)

122. Elise Robillard, a teacher and single mother, said she fell into a cycle several years ago of taking short-term, high-interest loans that ultimately played a role in her decision to file for bankruptcy. "I spent the better part of 15 years stuck in a cycle of debt because of the initial payday loan that I took out," Robillard said.
Source: http://www.koat.com/news/nm-supreme-court-exorbitant-payday-loans-violate-state-law/26688316
(2, 3)

123. In 2008, Joy Young and her newly immigrated husband were making only $30,000, in Woonsocket, RI. She and her husband stretched their income to cover their living expenses and their monthly payments on a home equity loan that paid for house repairs and a used vehicle. She received $450 from Advance America, which had to be paid back in two weeks, plus a fee of $45. Two weeks later, she paid her $495 debt, but was forced to borrow again to meet her

monthly expenses. She was now caught in the debt trap, borrowing a third and fourth loan. Every two weeks, Young spent two hours on a Friday afternoon waiting in line to pay off her loans and borrow again. Advance America pocketed $360 in fees each month from her alone. "Every time I got another loan, I thought it would help me in the short term," Young says. "But there was no way out. I felt like I was in prison. Any time I would talk about my story I would start to cry. It has been a horrible, horrible last few years." She was weeks away from foreclosure when she received a loan from Capital Good Fund, a microfinance institution that began extending small loans at 30% interest for a twelve-month term. She was able to pay off three of her payday loans with their help and is slowly paying off the fourth.
Source: http://www.rimonthly.com/Rhode-Island-Monthly/October-2014/Reporter-Breaking-the-Payday-Loan-Cycle/
(1, 2, 3)

124. Christina Sarno in Warren, OH borrowed just $200 from a payday lender, but she quickly realized she could not pay back the principal or the interest. "After receiving constant calls and having the store manager show up at my house to try to collect the money I owed, I gave up. At this point I had developed a lot of interest on the loan and owed more than I could possibly pay back on my income," she said during a meeting at the Warren YWCA. She lost her car, but the Beatitude House of Warren helped her with housing and education to avoid falling into the payday lending trap again.
Source: Reprinted verbatim from http://www.vindy.com/news/2016/jun/28/women-tell-of-troubles-with-payday-lendi/
(2, 3, SL)

125. Tiffany Richardson, a resident of Houston, Texas, received a $5,000 car title loan, using the title to the 2005 Nissan Altima she bought for her mother as collateral. She fell behind on repaying the loan. She took out another car title loan for $2,400 using her 1999 Toyota 4Runner as collateral this time. The amount she owed skyrocketed to several times the original principal amount. "You're like a hamster on a wheel," Ms. Richardson, 43, said of repaying her ballooning debt, adding that she was "looking out the window every night" to make sure her cars had not been repossessed. One night, however, Ms. Richardson woke to see both cars being towed away.
Source: http://www.nytimes.com/2014/08/24/us/thousands-in-texas-lose-cars-amid-calls-for-loan-restrictions.html?_r=0
(1, 2, 3, CT)

126. Maranda Brooks, a records coordinator at a Cleveland college in OH, took out a $500 loan to help pay an electricity bill. Two weeks later, the full amount of the loan plus a $50 fee were deducted from her usual $800 paycheck. To cover expenses for herself and her four children, she took out another loan, falling into a debt trap that lasted almost a year. "It was a nightmare of going around and around," said Brooks.
Source: http://www.chicagotribune.com/chi-payday-loans-rules-20150202-story.html
(1, 2)

127. According to her social worker, Sandra, is an illiterate 33-year old single mother in Missouri with a third-grade education. Sandra received a payday loans from King of Kash. Her only income was her Social Security disability check. Sandra took out a loan for $300 at an APR of 342%, which cost her $1,080 to pay off.

Source: https://www.youtube.com/watch?v=2enmyz-7CQo
(2, LT)

128. After his daughter returned from serving in Iraq and asked for financial help to relocate her family, Preston White, 63, took out a title loan on his pickup truck from a store in Killeen, Texas. The 30-day, $4,000 loan carried a 375% APR. White had already spent his life savings on paying for treatment for his wife's pancreatic cancer and soon realized that his fixed income left him only enough money to cover the fees, not the principal. He recognized the cycle of debt: "In four months, I could have paid more than what I went to the store for in the first place, and still owe the original loan amount," he said. "Never in my wildest imagination did I think that such a loan product could even exist. You assume the system will have usury laws and protect you from such things…Everybody's got to make a profit but there should be no place for usury in the 21st century." He was ultimately able to retire the debt by taking out a loan at 16% APR through a credit union.
Source: Gogoi, P. (2010). "Costly cash: How a retiree wound up with a 375% loan." *Daily Finance.* Available at http://aol.it/16TVtof (viewed 5/24/13).
(1, 2, CT)

129. Alicia and Clinton Lummus of Conyers, Georgia, took out a $525 car title loan after injuries forced them both to stop working. Over eight months, they made payments totaling $1,056—more than twice the amount borrowed—but ultimately fell behind on payments. The lender repossessed the vehicle, worth $14,000—and was able to keep any excess money from the sale of the vehicle, since Georgia law allows the lender to do so.
Source: Kirchhoff, S. (2006). "Some consumers run into big problems with auto title lending." *USA Today*. Available at http://usat.ly/124EbDR (viewed 5/25/13).
(2, CT)

130. Shanell White of Elk Grove, California, needed money to pay for rent after her expenses increased when she began to care for her neice. She took out a $3,900 installment title loan using her car—worth $12,000—as collateral. After having paid nearly $10,500 over three years, she was told she still owed the full principal that she had borrowed. The lender repossessed and sold the car yet still sent her a bill for the loan after. "To me, it's just modern-day loan sharking. People are being taken advantage of," she concluded.
Source: Said, Carolyn. (2013). "'Car-title loans' a road to deep debt: Legislators weight capping high-interest 'car-title loans.''' *San Francisco Chronicle*. Available at http://bit.ly/ZgEx6D (viewed 5/30/13).
(1, 2, CT)

131. Sean received a $1,500 car title loan, which he renewed over 40 times—paying over $11,500 in interest—before receiving help from family to pay off the principal. He said, "I was too embarrassed to ask my parents for the initial loan money, [but] ended up borrowing money from them to make some of the payments and ultimately had to ask them to pay off the whole loan, after losing tons of money along the way."
Source: Martin, N. & Adams, O. (2012). "Grand theft auto: Repossession and demographic realities in title lending." *Missouri Law Review*. Available at http://bit.ly/Z12wSX.
(1, 2, CT)

132. Caroline O'Connor, a 30-year-old hospital lab technician, was in need of $1,000 to cover her rent and electricity bills. When she saw a television commercial advertising how to get cash from your car in the form of a short-term loan, she believed she had found relief. The loan carried a 171% APR. Two years of being stuck in the debt cycle, the lender seized her car. ""These companies put people in a hole that they can't get out of," Ms. O'Connor said.
Source: http://dealbook.nytimes.com/2014/12/25/dipping-into-auto-equity-devastates-many-borrowers/
(2, CT)

133. Ken Chicosky, a 39-year-old Army veteran, received a $4,000 car title loan from Cash America, a in his Austin, Texas, neighborhood. The loan came with an APR of 98.3%. He says he knew the loan was a bad decision when he received his first bill detailing that he would have to pay a total of $9,346 on the $4,000 loan over 24 months. Even though the City of Austin limits loan terms to three months, according to the New York Times investigation, Cash America made the 24-month loan term by having Mr. Chicosky filled out the paper work and pick up his loan check from a store in a nearby town. Chicosky, a college student, said the loan has sunk his credit score and he uses some of his financial aid money to pay his title-loan bill.
Source: http://dealbook.nytimes.com/2014/12/25/dipping-into-auto-equity-devastates-many-borrowers/
(2, CT)

134. Derek Drewery was caught in the debt trap beginning in 1996, when he was stationed at Wright-Patterson Air Force Base in Ohio. He received a payday loan of a few hundred dollars at a payday lender near the base. When he returned to the store to repay the loan, he realized that with interest and fees, he owed a lot more than he had borrowed. "I had to borrow again to pay that back, and had to borrow again to pay that back," Drewery says of getting trapped in the debt cycle. "I got into the real churning situation to borrow this week to pay for last week." To help pay off the loan, Drewery cut back on food, even sharing his last box of Cheerios with his Jack Russell terrier until his father found out and sent him grocery store gift cards. He now works as an electrician and is the pastor of a church which has joined a coalition of Christians to oppose predatory lending.
Source: http://www.nytimes.com/2016/06/11/us/full-faith-and-credit-christian-groups-unite-against-predatory-lending.html
(1, 2, 3)

135. Mr. Sanchez, a veteran who served in Iraq as an infantryman in 2004, returned home to his wife and two daughters but suffers from Post-Traumatic Stress Disorder. When he needed a bit more cash to make ends meet, he took out a car title loan to pay for his family's monthly bills. He had already taken out a $2,500 car title loan earlier in the year, paying $350 per month on the loan. After 10 months of paying a total of $3,500 in fees, he could no longer afford the loan and sold his family's second vehicle in order to continue paying on the original title loan. Unfortunately, a few months later the Sanchez family was in a similar situation, unable to make the regular monthly payment of $350 in interest-only payments while still owing the original $2,500 principal. He couldn't lose his second car to the predatory lenders as it was the only way his wife could get to her job. Desperate for a solution, Mr. Sanchez turned to Helping Hands Ministry, a Texas social service organization that provides opportunities for financial empowerment to veterans and working class families. The organization was able to help the Sanchez family pay off their debt.

Source: https://medium.com/@stoppaydaypreds/payday-lenders-target-veterans-fcfe91b92c86#.wl764nkqu
(1, 2, CT)

136. Susan Fronczak, a 60-year-old woman from Florence, Arizona, secured a $2,000 car title loan using her 2007 Nissan as collateral. Fronczak had six months to pay off the loan, at an APR of 182%. Her loan contract provided for 11 interest-only payments followed by a balloon payment of $2,100, for a total repayment amount of $3,860. By month five, she had paid pack $1,920 and the lender said she still owed the full $2,000. When Fronczak could no longer afford the monthly interest-only payments, her car was repossessed. Getting it back cost her $1, 100. Fronczak continued to struggle after refinancing the loan, and it is estimated that she had paid close to $5,000 on the $2,000 loan by the time she got help. Not only had she paid over double the original loan amount, but she was still facing threats of repossession from the lender. The company returned Fronczak's car title and released her from the debt only after she filed a complaint with the Consumer Financial Protection Bureau.
Source: http://www.azcentral.com/story/news/local/mesa/2014/06/20/auto-title-lenders-give-additional-high-risk-option/11061451/
(2, 3, CT, LT)

137. Elaine is 74 years old and lives independently in a small, one-bedroom apartment. She receives social security and a small monthly pension totaling $1,278. She was struggling with her bills. Elaine came to one of the Catholic Charities of Northeastern Kansas' Emergency Assistance Center (EAC) for help with an electric bill. During her meeting she shared that she had payday loans totaling $1,725. She had these payday loans for years and, unfortunately, her low income just would not cover the loans to be paid off while still trying to take care of her daily living expenses and housing. Because of the high rate, Elaine was paying $275 per month just in interest on all of her payday loans. Elaine shared that she had not told her grown children because she was ashamed to let them know she had gotten into this situation in the first place. Catholic Charities was able to assist Elaine through its Kansas Loan Pool Project (KLPP). By converting her high-interest payday loan into a new, low-interest fixed loan, Elaine now has a manageable payment with an actual payoff date. Elaine participates in monthly financial coaching through the KLPP program. Her bills are now up to date and she has set some realistic financial goals. Elaine has newfound hope through the help of Catholic Charities and the KLPP program. "It's a relief to know that I now have enough money to pay my bills AND go to the grocery store." Elaine shared.
Source: Catholic Charities of Northeastern Kansas
(1)

138. Tiemeyer White, a 33-year-old Navy veteran from Texas, full-time electrical engineering college student, and father, took out a car title loan more than a year ago. When the federal government shut down due to a budget impasse in October 2013, White didn't get his Post-9/11 benefits or work-study pay for his Department of Veterans Affairs job for almost two months. As a result, he fell behind on his bills, and the car title lender began calling him several times a day both at work and at home, demanding loan payments. "I tell them, I understand you're doing your job, but I also understand that your job – you make your living off of making my life worse," White says. "That's how I felt that moment." Two weeks later, his 2003 Dodge pickup truck was repossessed from his school's parking lot.

Source: https://www.nerdwallet.com/blog/banking/banking-news/car-title-payday-loans-trap-unwary-veterans/
(2, CT, LT)

139. Homeless veteran Mel Hair hitchhiked to Sioux Falls, South Dakota, from Minnesota a few years ago. He stayed at a shelter to get back on his feet. When Hair and his girlfriend were able to get their own apartment, he received a car title loan for $200. One title loan turned into three loans amounting to more than $2,000. He has been making monthly payments of $430 per month for the past two years.
Source: http://www.keloland.com/news/article/featured-stories/the-high-price-for-small-loans-
(1, 2, CT, SL)

140. Kim Brust of South Dakota started taking out payday loans three years ago. At the time, her social security and disability checks were not enough to cover her monthly expenses for the children and other family members who had moved in with her. She fell into a cycle of debt, taking out a total of eight loans from four different lenders in Sioux Falls. The interest rates range from 247 percent to as much as 608 percent over the course of a year. "I fell into that same trap and I know better. I'm not stupid, but I was stressing about money. I was wondering sometimes where the next meal was coming from," Brust said. "It just sneaks up on you and one day I just laid out all the papers and I go, 'Oh, my Lord what have I done.'"
Source: http://www.keloland.com/news/article/featured-stories/the-high-price-for-small-loans-
(1, 2)

141. Eddie Dorman of Duval County, Florida, has been caught in a vicious debt trap for years. He uses one payday loan to pay for another, and is currently fighting with a car title loan company in Gainesville that is trying to repossess his truck. "I would never do it again, if I ever get out from under this one." Dorman said. "Everyone has problems. I got behind on a payment, the next thing you know there is a wrecker in the front yard at 3 in the morning." With his truck title loan, the company made him take out a $700 insurance policy to cover the company. "It covers them and yet it does not cover you," Dorman explained.
Source: http://www.news4jax.com/news/borrower-beware-title-payday-lenders-are-back
(1, 2, CT)

142. Lara was a young mother who stayed home to raise three children while her military husband worked full time. She worked jobs when she could, but the family still found themselves strapped for cash. They reluctantly took out a payday loan of $200 to manage the bills until their next paycheck. When payday arrived, the lender wanted $300. They paid the $300 but came up short on their next payment, so they took out another loan and quickly found themselves caught in the debt trap. "I kid you not, we did that dance for close to six months," Lara said. "It was horrible. Just unbelievably horrible." Ultimately, Lara had to beg her parents to help get them out of the cycle, but she knows not everyone has a safety net to fall back on.
Source: http://www.tcdailyplanet.net/new-guidelines-nonprofits-help-curtail-predatory-payday-loans-in-minnesota/
(2, SL)

143. Gordon Martinez: "About 8 years ago, I was struggling financially. I had a family and was starting out a new job in sales, transitioning from being a band director. I used my most prized possession, a tuba valued at $8,000, as a security against a $500 pawn loan to help make ends

meet. I made payments faithfully every 2 weeks, fighting Friday rush hour traffic, trying to stay afloat. I could only ever cover interest fees, none of my payments hit the principal. In the midst of making those payments, I took out another loan from another payday storefront, and even went online to several payday loan [stores] trying to cover my bills. Avoiding pending eviction and keeping my family's finances afloat, I felt hopeless, and that I was failing to uphold my responsibilities. I was trying to do what was best for my family, only to be taken deeper and deeper into a financial mess created by products that were advertised to help. Ultimately, all of the loans and fees took too much of my paycheck and I couldn't keep up. I defaulted on the loans. We lost our residence, I lost my prized tuba, and the strain led to the loss of my marriage, destroying our family. I found myself answering an online ad to rent a couch in a one room studio apartment with all of my worldly possessions housed in two plastic storage tubs. I have never felt so low in my life. I felt isolated, ashamed and lonely. I did what I had to do to survive, but I never imagined I would hit such a low. Thankfully, in the midst of this, I found my church and they helped me get back on my feet. I started sharing my story and exposing what I feel are predatory lending practices that run counter to our faith. I felt powerless while I was trapped in payday loans, but now I work with Faith in Texas to help organize other borrowers to help them so that what happened to me, doesn't happen to them. And to advocate for an end to the debt trap I found myself in. My experience is not uncommon. In a recent Faith for Just Lending survey with Clergy and Congregations, 86% said payday loan products were more harmful than helpful. Common themes raised in interviews with Congregations included a cycle of debt, and loss of a major asset such as a home, family, stress and shame. All of which I lived."
Source: https://vimeo.com/167331364
(1, 2, 3)

144. Diana LaCroix, a 63-year-old widow living off of her husband's Social Security survivor's benefits, received a $300 payday loan. It took her three or four months to pay off the small $300 loan. Then, she found herself caught in the debt trap, borrowing $50, $75, or $100 at a time. She is still borrowing money to make up for the loan payments that are eating into her fixed monthly budget, explaining, "I'll probably have to borrow a little more next month to get caught up on bills."
Source: http://www.omaha.com/money/days-of-the-payday-loan-could-be-numbered-with-new/article_0565b988-8356-5fb5-acf9-d3a076e250a0.html
(2)

145. John Miller, an attorney in Missouri, tells the story of his friend who had been struggling financially and turned to a payday loan store as a last resort before taking his own life.
Source: https://www.youtube.com/watch?v=t2-Ullrs95A
(3)

146. Richard Kitterman, a retired Master Sergeant and former Chief of Consumer Affairs Office, tells the story of a solider: "I remember one particular story, I'll never forget it. She was a young soldier, and she was a good solider. She was a single mother, she was doing her best to meet her obligations to the Army, and to raise her child. But she was facing in some cases, some nearly insurmountable obstacles: she had to have daycare, she had to have babysitting for her kids when she worked late. And she found herself getting her first payday loan and then another, and then another... and it got down to where on payday, her entire check disappeared. It was gone to pay back payday loans. And so her payday was spent standing in line at several different payday

loan offices to get new loans or to renew existing loans. And each time paying healthy loan fees to get that money. And she eventually…and she was a responsible solider. Most of the soldiers that get involved in this are really good, decent soldiers, good people who want to pay their bills, understand their obligations, but they just have more month left at the end of a paycheck. So they just see this as a quick fix; something they only have to do once, and that was the case with this young lady. She just got in over her head. And I remember after she got straightened out and things were going good and she continued to work to pay off those loans, even though she could have walked away and there wasn't really much the payday lender could have done, but that's not the kind of person she was. And I remember her telling me, 'Sergeant Kitterman, I felt like I was in a black hole. Every morning I woke up, every night I went to sleep, I was sick to my stomach over what am I going to do? How am I going to work this out?'"
Source: https://vimeo.com/143323466
(1, 2)

147. Paula, who lives in Texas with her husband and 3 children, took out some payday loans through lenders on the Internet after her husband lost his job. After he started working again, they were never able to get out of the debt trap due to excessive rollover fees. At one point, $800 a month of the family's money was going towards payday loans.
Source: Fact Sheet: *The Victims of Payday Lending*,
http://www.responsiblelending.org/issues/victims-payday
(2)

148. Tennessee resident Natalie has paid over $4,000 in fees for $800 worth of loans. Each time that she thinks she is has paid down the principal, the lender informs her of more fees that have been piled onto her already steep debt. Additional fees are added every time that she pays late.
Source: Fact Sheet: *The Victims of Payday Lending*,
http://www.responsiblelending.org/issues/victims-payday
(1, 2)

149. Maria took out one payday loan three years ago. Now, she is struggling to handle five payday loans and is over $3,000 in debt. Most of her budget goes to paying fees to rollover her loans, leaving little money for her to live on the rest of the month. She cannot afford to pay them off.
Source: Fact Sheet: *The Victims of Payday Lending*,
http://www.responsiblelending.org/issues/victims-payday
(1, 2)

150. According to a 2013 *New York Times* investigation, "Johanna Pimentel said she and both of her brothers had taken out multiple title loans. They are everywhere, like liquor stores," she said. Ms. Pimentel, 32, had moved her family out of Ferguson, Mo., to a higher-priced suburb of St. Louis that promised better schools. But after a divorce, her former husband moved out, and she had trouble paying her rent. Ms. Pimentel took out a $3,461 title loan using her 2002 Suburban as collateral. After falling behind, she woke up one morning last March to find that the car had been repossessed. Without it, she could not continue to run her day care business."
Source: http://dealbook.nytimes.com/2014/12/25/dipping-into-auto-equity-devastates-many-borrowers/

(2, CT)

151. Knoye Jackson of Goodyear, Arizona received a $700 car title loan, which then ballooned to $7,000 in three years due to the high interest rate and additional fees. The $80 Jackson was paying each week was only paying the interest she was accruing—none of it went toward paying down the principal. Ultimately, Jackson's car was repossessed and she filed for bankruptcy. She wishes she had just called the utility company she owed money to and arranged a payment plan directly with them rather than taking out a loan. Of her experiences, Ms. Jackson says, "I think they trap you because they make it seem like, come and get this good money so you can get caught up on your bills, but you never get caught up. They're getting richer by charging you all of this money. We're getting poorer." Those loans don't bring you out of debt, they put you in debt.
    Source: http://www.abc15.com/news/state/woman-caught-in-flex-loan-cycle-speaks-out
    (1, 2, 3, LT)

152. A single mother in Georgia took out a $450 loan from Atlanta Title Loans to help make her utility payments. After making four monthly interest-only payments of $112.50, she was unable to keep up with the payments and found the firm had repossessed her car in the middle of the night. Without access to her vehicle, she could no longer get to work.
    Source: http://usa.streetsblog.org/2010/11/10/driven-to-the-poorhouse-how-car-title-lenders-prey-on-americans/
    (2, 3, CT)

153. Jamela Lott, a single mother of five, was falling behind on her rent and borrowed $900 from Loan Max in Akron, Ohio. She used her 2001 Oldsmobile as collateral for the loan. After paying $938 on the original $900 loan, she was unable to keep up. Lott was told she still owed more than $1,600 or had to face repossession of her car. Shortly thereafter, she and her children became homeless and entered the program of Family Promise of Summit County, which provides temporary shelter to homeless families and offers assistance. Harry McKeen, a local attorney, accepted Lott's case via Legal Aid, and settled with LoanMax to write off Lott's debt. Meanwhile, readers donated more than $1,160 to help Lott get into a rental house in West Akron.
    Source: http://www.ohio.com/business/taking-action/akron-woman-works-through-financial-situation-involving-lender-1.470027
    (2, 3, CT)

154. Norma Poalson, 68, of Akron, Ohio, took out a $600 car title loan from LoanMax for a now-deceased friend who needed money for a chair lift. When she fell behind on her payments, the company rolled over her loan for the same amount. Poalson says she has paid about $2,200 on the loan and still owes another $1,690 or faces repossession.
    Source: http://www.ohio.com/business/taking-action/akron-woman-works-through-financial-situation-involving-lender-1.470027

155. Rasheeda Jackson of Akron, Ohio, took out a $600 car title loan. She fell behind on the payments, and her car was repossessed a few months later. To get her car back, Jackson had to pay $890, including $600 to a repossession company. The company charged her storage fees and tried to ask for money to get things out of her car if she didn't pay the full fees.
    Source: http://www.ohio.com/business/taking-action/akron-woman-works-through-financial-situation-involving-lender-1.470027

156. Tony Williams of South Carolina was strapped for cash and took out a $715 car title loan. He says it was easy and he was desperate. “They just ask what your income is, and whatever you tell them is what they go by,” said Tony. However, there is a catch. The annual percentage rate on his loan is 360%. So, of the $715 dollars he and his wife borrowed, they'll end up paying back nearly four times that amount, unless they’re able to pay it off sooner. If they don't, their car gets repossessed. “It’s like you're caught in a revolving door and you can't get out,” said Tony. At Max Cash Title Loan in Spartanburg, the max APR was listed as up to 396%. At North American Title Loans, it was 372%.
Source: http://wspa.com/2014/05/01/driven-to-debt/
(2, CT)

157. Roger Irby of North Akron, Ohio, faced financial difficulty when he broke a bone in his neck which hindered his ability to work full time. He turned to Loan Max for a $500 car title loan, using his 13-year-old truck as collateral. Loan Max required him to pay the loan back in 30 days, along with $200 in interest. A month later, the only way he could pay the loan off in time and have enough money to pay his family’s bills was to take out another loan—this time, for $1,000. The loan is due in 30 days, plus $295 in interest. Irby has paid almost $500 to borrow $1,500 for two months. “They are modern day loan sharks,” Irby said. “Me and my wife are trying to pay this bill off and we don’t ever want to mess with them again. Ever.”
Source: http://www.ohio.com/news/local/need-emergency-cash-cuyahoga-falls-group-considering-an-alternative-to-payday-lenders-1.505993
(2, CT)

158. In July 2010, Army Staff Sergeant Jason Cox of Columbus, Georgia, faced a family emergency. He obtained a $3,000 loan with his car title as collateral from Alabama Title Loans in Phenix City, Alabama. The loan carried an APR of 146% and was required to be paid off in 30 days, or Cox would have to pay the interest portion and renew the loan to set the due date back another 30 days. Unable to pay what eventually grew to approximately $4,500, Cox paid between $330 and $417 each month. After nearly a year of monthly payments, Cox could no longer afford to pay the monthly fee, none of which went to pay down the principal of the loan. He stopped making payments and his vehicle was repossessed at his home on the Fort Benning military base. That’s when Cox felt something was amiss, and visited Columbus attorney Kyle Fischer of the law firm Day Crowley. As a former JAG lieutenant in the Army, Fischer knew many of the laws pertaining to military active duty personnel and soon realized that it appeared Cox’s loan was in violation of the 2007 Military Lending Act, implemented by Congress to protect active duty personnel from predatory lending. Barnes and Bevis agreed with Fischer, and in November, they filed a class-action lawsuit against Community Loans of America and Alabama Title Loans. “I definitely feel like I was taken advantage of,” said Cox, who has served three tours in Iraq during his 11 years of service and earned the Purple Heart for a foot injury he received during enemy gunfire. “I had no clue this law was in place, and nothing was explained to me.”
Source:
http://www.barneslawgroup.com/Portals/0/Veteran%20challenges%20title%20loan%20company%20in%20courtmdj.pdf
(2, 3, CT)

159. In 2012, Tammy in Colorado received a payday loan from Speedy Cash, after seeing a commercial and facing trouble paying rent. She now says, "I would be better off if I never had

one."  She had a job and thought she could pay the loan back with no problem.  She was approved for the loan in less than 10 minutes and given $500 based on her income. The fee did not seem too bad added on top of the $500 loan, and the payback terms seemed okay, until it was time to make her first installment payment.  She was going to be $50 short.  She called Speedy Cash to tell them to not send her check to the bank because the total amount was not in her account.  She made the request for them not to send the check for another 7 days, but the check was sent anyway.  She was charged an NSF Fee from Speedy Cash and a Retun Check Charge from the bank, and her bank account went into the negative. Tammy recounts, "This became my downward spiral. I then went to another payday lending company to obtain another loan and was granted."  With the second payday loan, she paid the $125 installment plus $35 NSF from the first payday loan.  She said, "However, the next payday from my job came around and I was still in the same position again.  I was short now on both payday loans and I could not figure out how to settle it, then I got my third payday loan from another payday store.  These loans happened all in a timeframe of less than 90 days. Then the awful phone calls began and I stated to dodge all the calls.  Letters began and I did not try to address them because I knew that I am now unable to pay any of them due to the all the fees applied from all the payday lending sources. The end result to my story was that since I met payday lenders my life resulted in filing Chapter 7 bankruptcy.  I lost my home, car and became homeless and also my credit was damaged.  Even today through my email I am now getting threats to garnish my income, and now that I am disabled I cannot afford them to be able to do this to me.  This is all because the first payday lender would not honor my request to hold off for a week so I could get the 50.00 and not have to seek other lenders to rob peter to pay Paul. Even today this is a nightmare!"
Source: Story on file with CRL
(2, 3)

# APPENDIX F

Comment of Senator Sherrod Brown *et al*. (Nov. 21, 2019)

SHERROD BROWN
OHIO

COMMITTEES:
AGRICULTURE, NUTRITION, AND FORESTRY
BANKING, HOUSING, AND URBAN AFFAIRS
FINANCE
VETERANS' AFFAIRS

# United States Senate

WASHINGTON, DC 20510 - 3505

November 21, 2019

The Honorable Joseph M. Otting
Comptroller
Office of the Comptroller of the Currency
400 7th St., SW
Washington, D.C. 20219

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, D.C. 20429

Dear Comptroller Otting and Chairman McWilliams:

We write to express our strong opposition to rules proposed by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) that could eviscerate state laws that limit the interest rates on loans and allow **unregulated** predatory lending across the nation.[1]

The proposed rules could allow payday and other non-bank lenders to launder their loans through banks so that they can charge whatever interest rate federally-regulated banks may charge, threatening federalism's careful balance and overturning more than two centuries of state regulation of lending activity. Since our nation's founding, states have enacted laws to provide for limits and regulation over the amount of interest that lenders can charge.[2] In the early 20th century, 34 states capped interest rates between 36 and 42 percent.[3] Currently, a supermajority of states and the District of Columbia limit the amount of interest that lenders can charge on many loans. For example, 43 states and the District of Columbia have capped the interest rate for loans of up to $500, six-month loans, and 42 states and the District of Columbia have capped the interest rate for $2,000, two-year loans.[4] The clear trend in the states is toward more protections for consumers and small business borrowers, with new bipartisan laws capping interest rates on payday and other personal loans in Montana in 2010, South Dakota in 2017, Ohio in 2019, and going into effect in California in 2020.[5]

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[1] https://www.occ.gov/news-issuances/news-releases/2019/nr-occ-2019-132.html; https://www.fdic.gov/news/news/press/2019/pr19107.html.
[2] James M. Ackerman, Interest Rates and the Law: A History of Usury, 1981, Arizona St. L.J.61 (1981).
[3] Elisabeth Anderson, Experts, Ideas, and Policy Change: The Russell Sage Foundation and Small Loan Reform, 1910–1940, at 2 (Mar. 8, 2006), *available at* http://www.yale.edu/scr/andersen.doc.
[4] National Consumer Law Center, State Annual Percentage Rate (APR) Caps for $500, $2,000 and $10,000 Installment Loans, *available at* https://www.nclc.org/images/pdf/high_cost_small_loans/fact-sheet-apr-caps-for-installment-loans.pdf .
[5] *See* https://www.ksfy.com/content/news/South-Dakota-voters-approve-interest-rate-cap-on-payday-loans-400489561.html; https://www.cincinnati.com/story/money/2019/04/26/ohio-payday-loan-law-what-it-means-what-changes/3585952002/; https://www.cnbc.com/2019/09/13/california-passes-new-rules-that-cap-payday-loan-interest-at-36percent.html.

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The proposed rules would gut state laws by encouraging payday and other non-bank lenders to try to evade state interest limits by funneling payday and other loans through federally-regulated banks, which are not subject to these state laws.[6] In these "rent-a-bank" arrangements, the bank plays a nominal role as the formal lender of the loan.[7] The non-bank lender, by contrast, does all the work and bears all or nearly all of the economic risk: it markets and advertises the loan, conducts the underwriting (or licenses its underwriting software to the bank), collects payments from consumers, services the loan, and is either the assignee of or purchases a derivative interest in the loan.[8] Consumers have no relationship with the bank; they apply to and deal with the non-bank lender, which arranges and collects payments on the loan.[9]

During President George W. Bush's administration, the OCC and FDIC cracked down on these rent-a-bank schemes. In 2001, the OCC issued guidance making clear that it may be an "abuse of the national bank charter" for banks to enable non-bank lenders to make loans that violate state law.[10] In 2003, then OCC Comptroller John D. Hawkes, Jr. explained:

> We have been greatly concerned with arrangements in which national banks essentially **rent out their charters** to third parties who want to evade state and local consumer protection laws. The preemption privileges of national banks derive from the Constitution and are not a commodity that can be transferred for a fee to nonbank lenders.[11]

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[6] National banks are subject to state usury limits. But under the "exportation doctrine," the Supreme Court held that nationally-chartered banks can "export" the interest rate of the state in which they are located to other states. *Marquette Nat'l Bank of Minneapolis v. First of Oma Serv. Corp.*, 439 U.S. 299 (1978).

[7] *See CFPB v. CashCall, Inc.*, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016) (payday lender indemnified bank and had a contractual obligation to purchase the loans funded by the bank that were underwritten based on the payday lender's guidelines).

[8] *See, e.g.*, Elevate, Inc. 2018 10-K at 17, (Mar. 8, 2019) (non-bank lender conducts marketing and licenses its website, technology platform, proprietary credit and fraud scoring models to bank to originate loans), *available at* http://www.snl.com/Cache/c397055303.html.

[9] For example, FinWise Bank, one of the banks that rents its charter to non-bank lenders, does not offer small dollar loans directly to consumers. Instead, the bank's website includes links to non-bank lenders' websites, like Opploans, where consumers can "learn more" about these "[p]artner offers." *See* https://www.finwisebank.com/lending/.

[10] OCC Bulletin 2001-47, available at https://ithandbook.ffiec.gov/media/resources/3557/occ-bul_2001_47_third_party_relationships.pdf.

[11] https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-6.html (emphasis added); *see also* Remarks by Comptroller John D. Hawke, Jr., Before the Women in Housing and Finance, (Feb. 12, 2012) (same), *available at* https://www.occ.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf.

In the following years, the OCC brought several enforcement actions to end these arrangements.[12] The FDIC issued guidelines in 2005[13] and brought enforcement actions to end payday lenders' rent-a-bank arrangements with banks.[14]

Despite the troubling history of misuse of these rent-a-bank schemes, and prior clear steps from the OCC and FDIC to shut down these arrangements, we have seen a recent comeback. Opploans, for example, is an online non-bank lender that makes loans with a 160 percent annual percentage rate (APR), which are illegal in 22 states and the District of Columbia, through a rent-a-bank arrangement with FinWise Bank, regulated by the FDIC.[15] Elevate Credit, Inc. (Elevate), another online non-bank lender, makes loans (branded as Rise loans) with a 99 to 149 percent APR that are illegal in at least 15 states, also through a rent-a-bank arrangement with FinWise Bank.[16] Elevate also offers another loan product (branded as Elastic lines of credit) in 40 states at rates that can reach 109 percent APR through a rent-a-bank arrangement with Republic Bank, also regulated by the FDIC.[17]

The Trump administration's well-known support of payday lenders has only emboldened payday and other unscrupulous lenders to pursue rent-a-bank arrangements. Some of these non-bank lenders are openly discussing their efforts to evade the California state interest rate caps that are set to go into effect on January 1, 2020. The CEO of Elevate, Inc., for example, stated during a July 29, 2019 earnings call with investors:

> As you know, in California a piece of legislation . . . would limit the amount of interest that can be charged loans from $2,500 to $10,000. So what does this mean for Elevate? As you know, . . . similar to our recent experience in Ohio, we expect

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[12] *See, e.g.*, *In re Eagle National Bank*, No. 2001-104 (Dec. 18, 2001), available at https://www.occ.gov/static/enforcement-actions/ea2001-104.pdf; *In the Matter of Peoples National Bank*, No. 2003-02, *available at* https://www.occ.gov/static/enforcement-actions/ea2003-2.pdf.
[13] FDIC Guidelines for Payday Lending (Nov. 2015), available at https://www.fdic.gov/news/news/financial/2005/fil1405a.html.
[14] *In re CompuCredit Corp.*, Case Nos. FDIC-08-139b, FDIC-08-140k, FDIC-07-256b, FDIC-07-257k, FDIC-07-228b, FDIC-07-260k (Dec. 19, 2018), *available at* https://www.fdic.gov/news/news/press/2008/pr08142a.pdf.
[15] *See* https://www.opploans.com/licenses/ (listing Alaska, Arizona, California, District of Columbia, Florida, Hawaii, Indiana, Kansas, Kentucky, Louisiana, Maine, Michigan, Minnesota, Montana, Nebraska, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Tennessee, Virginia, Washington, and Wyoming). *See* National Consumer Law Center, Issue Brief: Stop Payday Lenders' Rent-a-Bank Schemes (Nov. 2019), *available at* https://www.nclc.org/issues/issue-brief-stop-payday-lenders-rent-a-bank-schemes-november-2019.html. The 160 percent APR on loans exceeds the interest rate caps in these states. *Id.*
[16] Elevate 2018 10-K at 15-16. Elevate also appears to be evading interest rate caps in Ohio and Texas by "brokering" the loan as a credit service organization (CSO). *Id.* at 7, 15-16. Under this scheme, a third-party lender finances the loan at the legal interest rate, but has no relationship with the borrower. Elevate, as the CSO, charges fees to arrange, collect, and guarantee the loan, which result in an effective APR of 60 percent to 299 percent. *Id.* at 15 *See also* CRL Issue Brief, "Payday Lenders Pose as Brokers to Evade Interest Rate Caps," (Jul. 2010), *available at* https://www.responsiblelending.org/payday-lending/policy-legislation/states/CRL-CSO-Issue-Brief-FINAL.pdf.
[17] Elevate Form 10-Q at 46 (for period ending June 20, 2019).

> to be able to continue to serve California consumers **via bank sponsors** that are **not subject to the same proposed state level rate limitations.**[18]

Several other online payday lenders have also informed investors that they would be pursuing a rent-a-bank strategy to evade the new California law.[19]

Given the OCC's and FDIC's prior efforts to eradicate rent-a-bank arrangements, it is disturbing to see the agencies now reverse course and propose rules that could actively enable these predatory lending schemes. The OCC and FDIC's stated justification for enabling the return of rent-a-bank arrangements is to "clarify" the applicability of the "valid-when-made" doctrine. This doctrine purports to hold that a non-bank lender can ignore state usury laws for loans it purchases from a bank that is exempt from those laws.

But, like rent-a-banks arrangements, the valid-when-made doctrine is a legal fiction. As Professor Adam Levitin of Georgetown University Law Center explained: "With one exception, it cannot be found in case law predating the relevant statute, much less in treatises, or scholarly articles, and the Second Circuit rejected the doctrine in 2015 in *Madden v. Midland Funding, LLC* . . . ."[20] The OCC and FDIC are also wrong that the banks' preemption can be treated like property and assigned to a non-bank lender. Preemption is instead "a privilege personal to a bank that comes as part of a bundle of a detailed regulatory regime,"[21] which non-bank lenders are not subject to. Finally, the OCC and FDIC are wrong to seek to overturn the Second Circuit's *Madden* decision through a rulemaking. As evidenced by legislation introduced in the House and Senate, it is the role of Congress, not the executive branch, to address any disagreements with the Second Circuit's *Madden* decision.

The OCC's and FDIC's proposed rulemakings represent a disturbing return to their pre-financial crisis role in broadly applying federal preemption to undermine state consumer protection laws. For over two centuries, states have taken the lead in addressing interest rates within their borders. Now is not the time to overturn this system. We urge you to reverse course on this path, which

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[18] *See* https://seekingalpha.com/article/4278838-elevate-credit-inc-elvt-ceo-ken-rees-q2-2019-results-earnings-call-transcript (emphasis added).

[19] *See* National Consumer Law Center, Issue Brief: Payday Lenders Plan to Evade California's New Interest Rate Cap through Rent-a-Bank Partnership, (Oct. 2019) (providing transcripts of earnings calls in which the CEOs of Curo Holdings Corp. (d/b/a Speedy Cash), Elevate Credit Inc., and Enova (d/b/a NetCredit, CashNetUSA) discuss plans to evade California's state law interest rate caps through rent-a-bank arrangements), *available at* https://www.nclc.org/issues/ib-rent-a-bank.html.

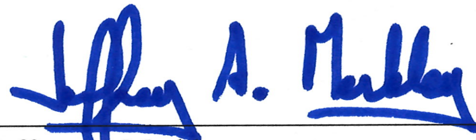
[20] *Rent-Rite Super Kegs West, Ltd. v. World Business Lenders, LLC*, Case No. 1:19-cv-01552 (D. Col.), Mot. for Leave to File *Amicus Curiae* Brief of Professor Adam J. Levitin in Support of Appellant, at 4, and Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, 10-12, *available at* https://www.creditslips.org/files/levitin-amicus-brief-rent-rite-super-kegs-west-ltd-v-world-business-lenders-llc.pdf.

[21] Levitin Amicus Brief at 12.

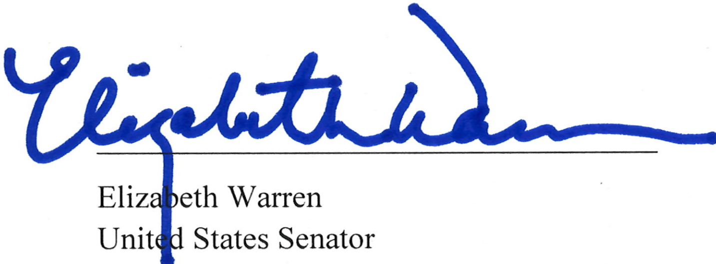
enabled predatory lending practices and led to the financial crisis from which the country is still emerging.

Sincerely,

Sherrod Brown
United States Senator



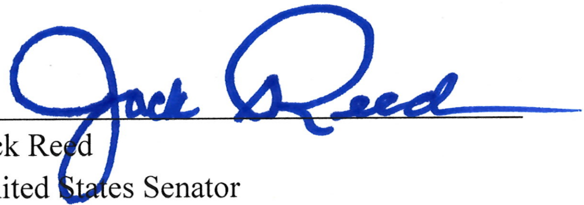
Jeffrey A. Merkley
United States Senator



Elizabeth Warren
United States Senator

Chris Van Hollen
United States Senator

Brian Schatz
United States Senator



Jack Reed
United States Senator

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**APPENDIX G**

Comment of AARP (Jan. 21, 2020)

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January 21, 2020

Jonathan Gould
Senior Deputy Comptroller and Chief Counsel
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

**RE: Permissible Interest on Loans that are Sold, Assigned, or Otherwise Transferred Docket ID OCC-2019-0027, RIN 1557-AE73**

Dear Mr. Gould:

AARP, on behalf of our 38 million members and all older Americans nationwide, thank you for the opportunity to comment on the Office of the Comptroller of the Currency's (OCC) proposed rule governing permissible interest on loans that are sold, assigned, or otherwise transferred.

The OCC's guidance notes that "banks continue to increase the number and complexity of relationships with both foreign and domestic third parties."[1] There are certainly many reasons for banks to enter into partnerships with third parties in order to provide new products and services. However, AARP has concerns the proposed rule is overly broad with respect to bank-nonbank partnerships and, as a result, lacks sufficient guardrails to prevent consumer harm to older adults. More specifically, the proposed rule is likely to permit the growth of high-cost lending practices, such as payday loans, auto title loans, and installment loans, in states where they are presently restricted. As a result, the proposed rule would undermine efforts by states – and in some cases by their individual citizens at the ballot box – to address harmful and deeply unpopular lending practices within their communities.

Older adults face increasing financial challenges and often have less capacity to recover from financial shortfalls. At the median spending level, nearly 80 percent of dollars spent by those age 65 and older simply fill their basic needs of housing, healthcare, food, clothing, and

[1] OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance," October 30, 2013, available at https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html.

transportation.[2] Meanwhile, fixed, regular payments such as Social Security and pension income make older adults attractive targets for lenders. In Florida, for instance, the fastest-growing demographic of payday loan borrowers between 2005 and 2015 was age 65 and older—and in California, payday loan usage tripled among those age 62 and older from 2015 to 2016 alone.[3] In addition to payday loans, the high-cost lending market has diversified to include installment loans that contain similar pitfalls for borrowers, albeit with a longer repayment period.[4] AARP is concerned that older borrowers who fall into a cycle of debt from high-cost lending have even fewer options to return to a solid financial footing, such as returning to work or taking on more hours.

The proposed rule, which codifies an extension of banks' interest rate authority to nonbanks, opens the door more widely for high-interest nonbank lenders to operate in ways that contravene state protections for borrowers. For example, the vast majority of states place a rate cap on a $2,000 installment loan, with 33 states and the District of Columbia limiting the annual percentage rate to an already exorbitant 36 percent or less, inclusive of all fees.[5] However, nonbank lenders have already expressed interest in using out-of-state bank partnerships to evade rate caps, as we have seen in efforts to evade California's new interest rate cap on installment loans between $2,500 and $10,000 that went into effect this year.[6]

If the proposed rule officially sanctions these types of partnerships and extends banks' interest rate authority to nonbanks, it will additionally subvert the will of voters in states where rate caps limiting high-cost lending resulted from broadly supported ballot initiatives. This includes 72 percent of Montana voters selecting to cap rates on payday loans in 2010, more than 76 percent of South Dakota voters approving an interest rate cap in 2016, and more than 75 percent of Colorado voters approving a rate cap in 2018.[7] Even when voters needed to navigate competing ballot provisions, they overwhelmingly chose to restrict high-cost lending practices.

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[2] Steven A. Sass, "Will the Financial Fragility of Retirees Increase?" Center for Retirement Research at Boston College, February 2018, available at https://crr.bc.edu/briefs/will-the-financial-fragility-of-retirees-increase/.

[3] Alessandra Malito, "Lax payday loan regulations could hit older Americans especially hard," *MarketWatch*, February 9, 2019, available at https://www.marketwatch.com/story/lax-payday-loan-regulations-could-hit-older-americans-especially-hard-2019-02-08.

[4] Diane Standaert and Peter Smith, "Payday and Car Title Lenders' Migration to Unsafe Installment Loans," Center for Responsible Lending, October 2015, available at https://www.responsiblelending.org/other-consumer-loans/car-title-loans/research-analysis/crl_brief_cartitle_lenders_migrate_to_installmentloans.pdf.

[5] Carolyn Carter, Lauren Saunders, and Margot Saunders, "Predatory Installment Lending in 2017: States Battle to Restrain High-Cost Loans," National Consumer Law Center, August 2017, available at https://www.nclc.org/images/pdf/pr-reports/installment-loans/report-installment-loans.pdf

[6] Kevin Wack, "High-cost lenders already seeking ways around crackdown in California," *American Banker*, October 15, 2019, available at https://www.americanbanker.com/news/high-cost-lenders-already-seeking-ways-around-crackdown-in-california.

[7] Erin Madison, "Debate over I-164 rages as high-rate lenders prepare to close," *Great Falls Tribune*, November 7, 2010; Dana Ferguson, "Payday lenders flee South Dakota after rate cap," *Argus Leader*, January 6, 2017, available at https://www.argusleader.com/story/news/politics/2017/01/06/payday-lenders-flee-sd-after-rate-cap/96103624/; Joe Robino, "Colorado Proposition 111: Payday loan interest limit wins big," *The Denver Post*, November 6, 2018, available at https://www.denverpost.com/2018/11/06/colorado-proposition-111-payday-wins/.

The proposed rule is also inconsistent with prior actions of the OCC to limit risky bank-nonbank relationships. Nearly two decades ago, the OCC sternly warned banks about third-party activities in potential violation of state law: "National banks should be especially mindful of any third party seeking to avail itself of the benefits of a national bank charter, particularly with respect to the application of state and local law. In some instances, nonbank vendors may target national banks to act as delivery vehicles for certain products and services, or to act as the nominal deliverer of products or services actually provided by the third party, in order to avoid state law standards that would otherwise apply to their activities. … National banks should be extremely cautious before entering into any third-party relationship in which the third party offers products or services through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly. Such arrangements may constitute an abuse of the national bank charter."[8] Similarly, while the OCC's 2013 guidance was less explicit on this matter, it nevertheless noted that "risk may also increase when the third party relies on the bank's regulated entity status and offers services or products through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly."[9] We see no reason for the OCC to propose a rule that fails to take this well-known and historic risk into account with regard to high-cost lending.

AARP submits that the OCC should reconsider its proposed rule in light of the potential for consumer harm to older adults and reduced confidence in the oversight of abusive practices. Millions of Americans strongly oppose high-cost lending and the cycle of debt it can foster. They expect their federal and state governments to work together to provide robust oversight of lending practices to protect vulnerable consumers.

Once again, AARP appreciates the opportunity to address our concerns with the OCC's proposed rule regarding Permissible Interest on Loans that are Sold, Assigned, or Otherwise Transferred. If you have any questions, please feel free to contact Tom Nicholls of our Government Affairs staff at 202-434-3765 or by email at TNicholls@aarp.org.

Sincerely,

David Certner
Legislative Counsel and Legislative Policy Director
Government Affairs

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[8] OCC Bulletin 2001-47, "Third-Party Relationships," available at https://ithandbook.ffiec.gov/media/resources/3557/occ-bul_2001_47_third_party_relationships.pdf.
[9] See footnote 3 of OCC Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance."