

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

January 31, 2020

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: February 5, 2020, “Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps”

The Committee on Financial Services will hold a hearing entitled, “Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps.” on February 5, 2020, at 10:00 a.m. in Room 2128 Rayburn House Office Building. This single-panel hearing will have the following witnesses:

- **The Honorable Monique Limón**, Chair, Banking & Finance Committee, California State Assembly
- **Graciela Aponte-Diaz**, Director of Federal Campaigns, Center for Responsible Lending
- **Creola Johnson**, Professor, The Ohio State University Moritz College of Law
- **Lauren Saunders**, Associate Director, National Consumer Law Center
- **Brian Knight**, Director and Senior Research Fellow, Program on Innovation and Governance, Mercatus Center at George Mason University.

Overview

Bank partnerships with non-banks are a rising occurrence in lending.¹ When a loan is originated under such partnership, the bank originates the loan but under the guidelines of the non-bank lender. This loan is then quickly sold to the non-bank lender. The consumer receives the loan from the bank. Under current federal law, national banks and Federal Deposit Insurance Corporation (FDIC)-insured state banks may maintain the maximum interest rates of the states where they are headquartered, meaning they can charge those rates even when lending to borrowers in other states with stricter usury laws.² Legal questions have been discussed over the years as to whether the above applies to non-banks that purchase loans from banks in these and other types of partnerships. Some have argued that banks can effectively assign the interest rate exportation power when they sell loans to non-banks, which otherwise do not have such a power as a non-bank. They argue this is permitted through a purported “valid when made” doctrine, which stipulates that a loan that is compliant with the law’s usury caps when originated cannot become noncompliant at a later time.³ Others have disagreed with this interpretation of the “valid when made”

¹ For example, see U.S. Department of the Treasury, “[Opportunities and Challenges in Online Marketplace Lending](#),” May 10, 2016; and U.S. Department of the Treasury, “[A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation](#),” July 31, 2018.

² *Marquette Nat’l Bank of Minneapolis v. First Omaha Servs. Corp.*, 439 U.S. 299, 303 (1978); 12 U.S.C. §§ 85, 1831d(a). See generally, Congressional Research Service (CRS) Report, “[Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress](#),” May 17, 2019.

³ See Office of the Comptroller of the Currency (OCC) Proposed Rule, [Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred](#), 84 Fed. Reg. 64,229, 64,231 (November 2019).

doctrine.⁴ They have argued that Congress provided banks with the exportation power within the context of a comprehensive regulatory regime, and that banks do not have an inherent power to assign that regime's benefits to entities that are not subject to its restrictions.⁵ The National Consumer Law Center points to the "true lender" doctrine that states that if the non-banks have the primary economic interest, then the non-bank is the true lender and they must comply with the state interest rate laws.⁶

Furthermore, consumer advocates and experts have warned of the dangers of "rent-a-bank" partnerships where the sole purpose is for non-banks to use these partnerships to export high cost loans, such as small dollar "payday" loans into states with lower interest rate caps.⁷ Short-term, small-dollar loans are consumer loans with relatively low initial principal amounts, and with relatively short repayment periods, generally for a small number of weeks or months. A payday loan is a form of small-dollar loan, typically due on the borrower's next payday. Payday loans are sometimes called cash advance or check advance loans. A car-title loan is another form of a small dollar loan where the borrower's vehicle serves as collateral for the loan. Small-dollar loans are provided by nonbank lenders, such as payday lenders and automobile title lenders. Banks and credit unions offer other forms of small-dollar loans through financial products such as credit cards, credit card cash advances, and checking account overdraft protection programs.⁸

Research has shown that borrowers who take out payday and car-title loans may fall into a harmful debt-trap cycle with deceptively high interest rates. Some states have responded by imposing various interest rate caps and other limitations on these harmful forms of small dollar loans. At the Federal level, there is a 36 percent interest rate cap for many consumer loans provided to active-duty servicemembers and their dependents. In addition, Federal regulators, like the Consumer Financial Protection Bureau (Consumer Bureau or CFPB), have previously sought to further protect consumers through guidance and rulemaking, though recent proposals reverse some of these protections.⁹ Consumer advocates warn that rent-a-bank partnerships will allow high cost predatory loans to return to the states where either the voter or the legislature opted to ban them with lower rate caps. This hearing will provide the Committee an opportunity to review these market and policy developments, and to consider legislative options that may better protect consumers.

Consumer Impact of Payday and other Small-Dollar Loans

Small-dollar loans are often used to cover a consumer's cash needs due to unexpected expenses or periods of inadequate income.¹⁰ However, research has shown many payday and car-title loans can be harmful to consumers. According to one estimate, payday and car-title loans carry an annual percentage rate (APR) of 391 percent on average.¹¹ Many borrowers who take out payday loans roll them over when they come due and take out up to 10 such loans a year, and car-title borrowers generally refinance their

⁴ See [Testimony](#) of Adam J. Levitin, Professor of Law, Georgetown University Law Center, before the Committee at a hearing entitled, "Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace," on January 30, 2018. Also see National Consumer Law Center (NCLC), [Consumer and Civil Rights Groups Urge Federal Banking Regulator to Stop Rent-a-Bank Payday Loan Schemes](#) (Jan. 22, 2020).

⁵ See Motion for Leave to File Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, Rent-Rite Super Kegs West, Ltd. v. World Bus. Lenders, LLC at 31, No. 1:19-cv-01552-REB (Bankr. D. Colo. Sept. 19, 2019).

⁶ National Consumer Law Center, [FDIC/OCC Proposal would Encourage Rent-a-Bank Predatory Lending](#) (Dec. 2019).

⁷ *Id.*

⁸ See CRS Report, "[Short-Term, Small-Dollar Lending: Policy Issues and Implications](#)," (June 14, 2017).

⁹ See Full Committee hearing, "[Ending Debt Traps in the Payday and Small Dollar Credit Industry](#)," (Apr. 30, 2019).

¹⁰ According to the Federal Reserve, "[Four in 10 adults in 2017 would either borrow, sell something, or not be able pay if faced with a \\$400 emergency expense](#)."

¹¹ CRL, "The Debt Trap of Triple-Digit Interest Rate Loans: Payday, Car-Title, and High-Cost Installment Loans" (Mar. 20, 2019), <https://www.responsiblelending.org/research-publication/debt-trap-triple-digit-interest-rate-loans-payday-car-title-and-high-cost>.

loan up to eight times. One out of five car-title borrowers lose their car in repossession. Experts have noted that payday loans often target communities of color, military servicemembers, and seniors,¹² charging billions of dollars a year in unaffordable loans to borrowers with an average annual income of \$25,000 to \$30,000.¹³

Many payday and car-title loans not only undermine wealth-building opportunities for vulnerable communities, but also force people that are already struggling financially and underbanked into worse circumstances, including losing their bank accounts, vehicles, or even bankruptcy. According to the Center for Responsible Lending (CRL), payday loans cost over \$4.1 billion in fees a year for those persons in states that allow triple-digit interest rate payday loans. Car title loans cost consumers over \$3.8 billion in fees annually. Together, these loans cost consumers nearly \$8 billion in fees every year.¹⁴ CRL also estimates that in states that cap annual interest for these loans at 36 percent or less, consumers save over \$5 billion in fees every year—\$2.3 billion from payday lending, plus another \$2.8 billion from car-title lending.¹⁵

State Regulation of Payday Loans

According to the CFPB, as of January 2020, 32 states permit payday loans, and 18 states and the District of Columbia either ban payday loans or have regulations that do not allow payday lenders to sustain their business models.¹⁶ Of the states that permit payday loans, 11 states have binding laws regulating payday loans, which generally limit either payday loan size or rollovers, and may set caps in fees and interest rates. Some cities and counties also have local ordinances relating to payday lending.¹⁷

Caselaw and Federal Policy regarding Rent-A-Banks

There are certain legal precedents set by the Supreme Court and by other federal courts that create some legal framework to rent-a-bank issues. In 1978, the Supreme Court ruled in the case of *Marquette National Bank v. First of Omaha Corp.* that the permissible interest rate national banks can charge is governed by the state usury law of where the bank is headquartered, not where the borrower resides.¹⁸ The 1996 Supreme Court Case, *Barnett Bank of Marion County, N.A. v. Nelson* establishes that federal law can preempt both “inconsistent state laws and state laws that interfere with federal objectives.”¹⁹ These federal principles are applied by the Office of the Comptroller of the Currency (OCC) to national banks via the caselaw and via the National Bank Act (NBA), and by the FDIC to FDIC-insured state banks via caselaw and the Federal Deposit Insurance Act (FDI Act).²⁰

Advocates argue that these cases do not actually address or legally extend to bank and non-bank partnerships.²¹ In the early 2000s, the federal regulators pushed back at the emergence of payday loan focused rent-a-bank partnerships. In fact, then-OCC Comptroller Hawke referred to these rent-a-bank

¹² <https://www.opploans.com/payday-news/who-do-payday-loans-target-and-why/>

¹³ 82 Fed. Reg. 54581.

¹⁴ Diane Standaert and Delvin Davis, “[Payday and Car Title Lenders Drain \\$8 Billion in Fees Every Year](#)” (Jan. 2017).

¹⁵ *Id.*

¹⁶ According to the CFPB’s proposed rule from February 2019, as of the date of the rule, p.32: CFPB, “[Payday, Vehicle Title, and Certain High-Cost Installment Loans](#),” 84 Federal Register 4252, Feb. 14, 2019.

¹⁷ The National Conference of State Legislatures (NCSL) has compiled a list of payday lending laws by state. The list is current as of January 23, 2018 and can be found at: <http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx>.

¹⁸ *Marquette Nat’l Bank v. First of Omaha Corp.*, 439 U.S. 299 (1978).

¹⁹ *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 33 (1996).

²⁰ CRS, “[Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress](#),” May 17, 2019.

²¹ National Consumer Law Center, *supra* note 6.

plans as “an abuse of the national Charter.”²² Comptroller Hawke further cautioned, “In the case of the payday lending industry...the OCC has opposed arrangements in which third parties effectively ‘rent out’ the preemption privileges of a national bank for the sole purpose of evading state law.”²³

A critical case that addresses these topics is *Madden v. Midland Funding, LLC*, which was decided by the Second Circuit court in 2015.²⁴ The Second Circuit court in this case declined to apply the “valid when made” doctrine, and held that a non-bank debt collector could *not* benefit from the exportation power of a national bank from which it had purchased credit-card debt.²⁵ In *Madden*, a New York borrower sued a debt collector for violating New York usury law because the interest rate on her debt exceeded New York’s limit of 25 percent per year.²⁶ In response, the debt collector argued that the NBA preempted the borrower’s New York usury claim because the debt had been originated by a Delaware-based national bank and was not usurious under Delaware law.²⁷ The Second Circuit sided with the borrower, reasoning that New York usury law would not “significantly interfere” with the national bank’s powers because the debt collector was a separate entity and was not acting on the bank’s behalf.²⁸

In November and December of 2019, respectively, the OCC and FDIC proposed rules that would override the *Madden* decision and adopt the “valid when made” principle for bank-originated loans.²⁹ The OCC’s proposed rule would amend its regulations governing national banks to provide that “[i]nterest on a loan that is permissible under [Section 85 of the NBA] shall not be affected by the sale, assignment, or other transfer of the loan.”³⁰ In its Notice of Proposed Rulemaking (NPRM), the OCC explained that it was issuing the proposal in response to regulatory uncertainty created by the *Madden* decision, and that “various provisions of Federal banking law” support its interpretation of the exportation power.³¹ Specifically, the agency argued that its view of the exportation power derives support from (1) the “valid when made” doctrine, (2) banks’ power to sell and assign loans, and (3) the purpose of Section 85 of the NBA “to facilitate banks’ ability to operate across state lines by eliminating the burden of complying with each state’s interest laws.”³² While the OCC argued that a contrary rule would “unduly curtail” national banks’ power to sell and assign loans, the agency did not explicitly invoke either *Barnett Bank* or its “significant interference” test.³³

The FDIC’s proposed rule would adopt a similar regulation for FDIC-insured state banks. The proposed regulation would provide that “[w]hether interest on a loan is permissible under [Section 27 of the FDI Act] is determined as of the date the loan was made,” and that such a determination “shall not be affected by any subsequent events,” including the “sale, assignment, or other transfer of the loan.”³⁴ Like the OCC, the FDIC identified regulatory uncertainty created by *Madden* to justify its NPRM.³⁵ The agency

²² Office of the Comptroller of the Currency, “Comptroller Calls Preemption a Major Advantage of National Bank Charter” (2002), available at <https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html>.

²³ *Id.*

²⁴ *Madden v. Midland Funding, LLC*, 786 F.3d 246, 249-53 (2d Cir. 2015).

²⁵ 786 F.3d 246, 249-53 (2d Cir. 2015).

²⁶ *Id.* at 248.

²⁷ *Id.* at 248-49.

²⁸ *Id.* at 251-53.

²⁹ See OCC Proposed Rule, *supra* note 3; [FDIC Proposed Rule, Federal Interest Rate Authority](#), 84 Fed. Reg. 66,845, 66,848 (December 2019).

³⁰ OCC Proposed Rule, *supra* note 3, at 64,232. The OCC’s proposed rule also includes a similar provision that would amend its regulations governing federal savings associations, *id.*, which possess the same exportation power as national banks, 12 U.S.C. § 1463(g).

³¹ OCC Proposed Rule, *supra* note 3, at 64,230.

³² *Id.* at 64,230-231.

³³ *Id.* at 64,231.

³⁴ FDIC Proposed Rule, *supra* note 28, at 66,853.

³⁵ *Id.* at 66,845, 66,848-849.

also appealed to banks' power to sell and assign loans and the purpose of Section 27 of the FDI Act as the legal authority supporting its interpretation of the exportation power.³⁶ While the FDIC noted that its NPRM was "consistent" with the "valid when made" principle, it maintained that the proposal was not "based on" that doctrine.³⁷ The OCC accepted comments on its proposed rule until January 21, 2020,³⁸ while the FDIC will accept comments until February 4, 2020.³⁹

Consumer law advocates and experts have expressed their deep concerns about the proposed rules and possible corresponding guidance. The National Consumer Law Center notes that the proposals are both silent on the "true lender" doctrine and fail to provide evidence that the *Madden* decision has had a negative impact on the market or on consumer access to credit.⁴⁰ Other consumer organizations point to the dangers of allowing rent-a-bank partnerships to force the return of triple-digit interest loan products to the states and territories that pushed them out to protect their residents.⁴¹ In 2017, State Attorneys General from 20 states wrote to Congress opposing provisions essentially overturning *Madden* in the Financial CHOICE Act (H.R. 10). The letter noted that the bill "would restrict states' abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps."⁴² More recently, stakeholders have warned that states with newly established state rate caps like California risk seeing a federally legal return of these products through rent-a-bank partnership.⁴³

Legislation

- **H.R. 5050, The Veterans and Consumers Fair Credit Act (Garcia-Grothman)**. This bipartisan legislation sponsored by Representatives Jesus "Chuy" Garcia (D-IL) and Glenn Grothman (R-WI) would impose a federal 36 percent usury APR cap for certain consumer loans, including payday loans and car-title loans. Specifically, the bill extends the current 36 percent interest rate cap protections for certain consumer loans established under Military Lending Act (MLA) to all consumers, including veterans and their families. The proposal would not preempt stricter state laws, and it would create specific penalties for violations of the cap and allows for enforcement through civil courts and by state Attorneys General. This proposal has been endorsed by a wide coalition of military and veteran advocacy organizations, along with consumer and civil rights groups and faith-based organizations.⁴⁴

³⁶ *Id.* at 66,848.

³⁷ *Id.*

³⁸ OCC Proposed Rule, *supra* note 3, at 64,229.

³⁹ FDIC Proposed Rule, *supra* note 28, at 66,845.

⁴⁰ National Consumer Law Center, *supra* note 6. Also see FDIC Proposed Rule, *supra* note 28, at 66,850 ("The FDIC 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.")

⁴¹ Center for Responsible Lending, Americans for Financial Reform, and National Consumer Law Center, FDIC/OCC Proposal Would Encourage Rent-a-Bank High-Cost Predatory Lending (2019), available at <https://www.responsiblelending.org/media/fdic-occ-proposal-would-encourage-rent-a-bank-high-cost-predatory-lending>.

⁴² State of New York Office of the Attorney General letter to Congress opposing the Financial CHOICE Act (June 2017), available at https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf.

⁴³ National Consumer Law Center, Issue Brief: Payday Lenders Plan to Evade California's New Interest Rate Cap Law Through Rent-A-Bank Schemes (2019), available at <https://www.nclc.org/issues/ib-rent-a-bank.html>.

⁴⁴ See Press Release, "[Reps. García, Grothman Introduce Bipartisan Veterans and Consumers Fair Credit Act](#)," Nov. 12, 2019; Military and Veteran Organization [Support Letter](#); Consumer Federation of America, "[Landmark Bipartisan Bill Will Protect Consumers and Veterans from Predatory Lending](#)," Nov. 12, 2019.