RENT-A-BANK SCHEMES AND NEW DEBT TRAPS: ASSESSING EFFORTS TO EVADE STATE CONSUMER PROTECTIONS AND INTEREST RATE CAPS

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WEDNESDAY, FEBRUARY 5, 2020

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RENT-A-BANK SCHEMES AND NEW DEBT TRAPS: ASSESSING EFFORTS TO EVADE STATE CONSUMER PROTECTIONS AND INTEREST RATE CAPS

Wednesday, February 5, 2020

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:10 a.m., in room 2128, Rayburn House Office Building, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Sherman, Meeks, Scott, Green, Perlmutter, Himes, Heck, Vargas, Gottheimer, Lawson, Tlaib, Porter, Axne, Pressley, McAdams, Wexton, Adams, Dean, Garcia of Illinois, Garcia of Texas, Phillips; McHenry, Wagner, Lucas, Posey, Luetkemeyer, Huizenga, Barr, Tipton, Williams, Hill, Zeldin, Loudermilk, Mooney, Davidson, Budd, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, Gooden, Riggleman, Timmons, and Taylor.

Chairwoman WATERS. The Committee on Financial Services will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps."

I will now recognize myself for 4 minutes for an opening statement.

In November of last year, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) issued a proposed rule that would provide legal cover for predatory rent-a-bank schemes, where payday lenders partner with banks to peddle harmful short-term, triple-digit interest rate loans in States that have reasonable and often voter-approved interest rate caps to protect consumers. Even if a State, like my home State of California, has passed a law setting a usury rate cap, this rule would allow lenders to ignore the law and to import high-rate, high-risk, and otherwise illegal loans back into the State. Low-income consumers, who are already struggling, will pay the price.

American consumers used to be able to look to their regulators to protect them from these kinds of predatory schemes. Not so under the Trump Administration, where consumer protection takes a back seat to consumer predation. And Trump's regulators are working overtime to make sure the bad actors have a clear path to trap millions of Americans in unending debt.

This anti-consumer rule is just the latest to benefit predatory payday lenders. When Trump's acting Chief of Staff, Mick Mulvaney, was running the Consumer Financial Protection Bureau (CFPB), he did everything he could for predatory payday lenders, including withdrawing a lawsuit against a group of deceptive payday lenders who were allegedly ripping off consumers with loans with interest rates as high as 950 percent a year.

It is no wonder that a CEO of a notorious payday lender thought nothing of submitting her resume to be considered as the next CFPB Director, but the job instead went to Kathy Kraninger, who is no doubt making that CEO proud. Director Kraninger has both delayed and proposed to undermine key provisions of the CFPB's important payday, small-dollar, and car title rules, which would have curbed abusive payday loans. And 101 House Democrats wrote to Director Kraninger to call on her to reconsider her efforts, but she has not relented.

Today, we will examine the implications of regulators' actions to open the payday loan floodgates and the impact this will have on States with sensible interest rate caps. We will also discuss H.R. 5050, the Veterans and Consumers Fair Credit Act, Congressman Garcia's bipartisan bill to place a Federal 36 percent annual percentage rate usury cap on payday loans and car title loans, and extend the protections that active-duty servicemembers have under the Military Lending Act to all consumers across the country. It is long overdue for Congress to take action to ensure that all Americans are protected from harmful payday products with sky-high interest rates.

So, I look forward to hearing from our witness panel of advocates and experts.

I now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 4 minutes.

Mr. MCHENRY. Madam Chairwoman, thank you for holding this hearing. I think it is important and essential that Congress understand how the banking industry is evolving in response to technological innovation. It also is essential to help Congress understand its role to ensure all consumers benefit from advances in technology. So, I think it is a meaningful conversation that we can have today.

Technological innovation over the past few decades has enabled faster, more accurate credit underwriting for a much broader population of borrowers. Much of this innovation has been driven by industry newcomers that have developed a new idea or business model, faster in time than it takes to get a bank charter. So, these newcomers often partner with banks.

Bank/non-bank partnerships can make sense for several reasons. First, economic: Because of their deposit-based funding, banks tend to have the cheapest possible cost of capital among all capital allocators.

Second, capacity: Banks have relatively large balance sheets, enabling them to absorb new loans rapidly.

Third, expertise, and expertise still matters. Banks are expert lenders. In other words, they are proficient in such tasks as underwriting, compliance, and securitizing or selling loans into the secondary market.

One other major reason that fintech partners with banks is that special legal status banks have had for well over a century—actually, a century and a half. Since the passage of the National Bank Act, Congress has given special privileges to banks, and that includes regulatory certainty about what interest rates banks are permitted to charge on a loan. When conducted properly, the benefits from this arrangement can be cost savings for fintechs and banks, better competition among banks, and better, faster, and cheaper banking products for all consumers.

The best way to make sure that these partnerships live up to their promise is to provide a clear regulatory framework under which they can operate. To that end, I want to commend the recent efforts of the OCC and the FDIC for their proposed rulemaking that helps restore clarity to a segment of the market. Their proposed rules would clarify what we all thought we knew before 2015: that when a bank sells, assigns, or otherwise transfers a loan that was valid when it was made, that loan does not become invalid because of the transfer. This is a common-sense rule of contracting that has existed for over 100 years, until 2015, when the Second Circuit Court's *Madden* decision decided that, no, banks cannot be sure that their loans hold any value when sold.

The *Madden* decision has been roundly criticized on its legal reasoning, but more importantly, economists have now measured the negative impact to consumers in the three States governed by this bad *Madden* decision. The uncertainty caused by the result has driven lenders away from those States. Borrowers with FICO scores below 625 have seen a 52 percent reduction in credit availability. Furthermore, personal bankruptcy filings rose by 8 percent more in those States, relative to States outside the Second Circuit. We can clearly see the harm that results when lenders are faced with regulatory uncertainty.

I am pleased that we are hearing from experts today about the need for clear rules of the road. Technology is the key for greater financial inclusion, and while we must provide oversight and certainty, we cannot fear innovation because we don't understand it.

I yield back.

Chairwoman WATERS. I now recognize the Chair of our Subcommittee on Consumer Protection and Financial Institutions, Mr. Meeks, for one minute.

Mr. MEEKS. Thank you, Chairwoman Waters. Despite a decade of economic growth, over 40 percent of American families don't have savings for a $400 emergency. This problem is compounded by the dramatic rate at which bank branches are closing nationwide and the rapid disappearance of small community banks and minority banks which serve marginalized communities at a far greater rate than megabanks, creating banking deserts and depriving these communities of access to credit and financial services.

As a result, check-cashing stores, pawn brokers, auto title lenders, and payday lenders often fill the gap. Payday lenders are especially harmful, trapping borrowers in unsustainable debt traps. We need to regulate payday lenders and address the terrible harm they cause across the country. But in doing so, we must ensure that something viable fills the gap. This committee has long advocated for bringing more people into the regulated banking space, ensuring that consumer protection, anti-discrimination, and fair banking practice laws are all applicable and enforceable.

This is a very real and urgent priority for me, and I thank the witnesses and look forward to their testimony.

Chairwoman WATERS. I now recognize the subcommittee's ranking member, Mr. Luetkemeyer, for one minute.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. Thanks in large part to the Dodd-Frank Wall Street Reform and Consumer Protection Act, financial institutions have largely exited the small-dollar lending space. However, some financial institutions have managed to continue providing these products through partnerships with fintech firms that help with underwriting, marketing, and lending. Now, it seems my colleagues on the other side of the aisle are going after these partnerships to push banks out of small-dollar lending altogether.

If that wasn't enough, the Majority is considering legislation to enact an APR rate cap on all loans. Using an APR, in my opinion, is a misleading measurement of any loan under a year in length, and only serves to hide the true cost of a small-dollar loan from consumers. Where is the transparency in that?

On one hand, my colleagues are attempting to eliminate bank involvement in small-dollar lending, pushing consumers into less-regulated spaces, and on the other hand, they want to eliminate the ability for non-bank entities to offer small-dollar loans. If they succeed, you have to ask the question, where will the unbanked and underbanked go to access credit? I don't think any of us will appreciate and like the answer to that question.

With that, Madam Chairwoman, I yield back.

Mr. MEEKS. [presiding]. I would now like to introduce our witnesses and welcome you to this committee: Ms. Graciela Aponte-Diaz, who is the director of Federal campaigns for the Center for Responsible Lending; Ms. Lauren Saunders, who is the associate director at the National Consumer Law Center; Professor Creola Johnson, who is the President's Club Professor of Law at the Moritz College of Law at the Ohio State University; Assemblymember Monique Limon, from the California State Assembly, who is serving as Chair of the Banking and Finance Committee; and Brian Knight, director and senior research fellow for the Program on Innovation and Governance at the Mercatus Center at George Mason University.

Each of you will have 5 minutes to summarize your testimony, and when you have one minute remaining, a yellow light will appear. At that time, I would ask you to wrap up your testimony so that we can be respectful of both the witnesses' and the committee members' time. And without objection, all of the witnesses' written statements will be made a part of the record.

Ms. Diaz, you are now recognized for 5 minutes to present your oral testimony.

STATEMENT OF GRACIELA APONTE-DIAZ, DIRECTOR OF FEDERAL CAMPAIGNS, CENTER FOR RESPONSIBLE LENDING

Ms. APONTE-DIAZ. Good morning, Chairwoman Waters, Ranking Member McHenry, and members of the committee. My name is Graciela Aponte-Diaz, and I am the Director of Federal Campaigns for the Center for Responsible Lending (CRL). CRL is a nonprofit research and advocacy organization dedicated to protecting home ownership and family wealth by fighting predatory lending practices. For nearly 20 years, I have dedicated my career to fighting for low-income families and communities of color. I, myself, grew up low-income, with a single mom who was trying to make ends meet. Luckily, she was never a target of abusive payday or high-cost installment loans because she lives in Maryland, a State that bans these products.

In fact, 16 States, plus the District of Columbia, do not allow payday loans, and the vast majority of States have interest rate caps on installment loans. Active-duty servicemembers are also protected from predatory loans through the bipartisan Military Lending Act (MLA). Unfortunately, some lenders have found a way to continue to target vulnerable consumers, despite State laws, through rent-a-bank schemes.

Here is how a rent-a-bank scheme works. A predatory, nonbank lender decides that they want to lend at higher rates than what is allowed by State law, frequently, loans of 100 percent APR or more, even in States that have a 36 percent interest rate cap or less. They find a bank that is willing to originate the loans, because federally-insured banks are exempted from State interest rate laws.

After the loan is processed, the bank sells the loan or receivables back to the nonbank. The nonbank handles marketing, consumer interactions, and servicing. The nonbank lender is the public face of the loan, and neither the customers nor the general public are aware of the motions behind the scenes to legitimize a loan that would otherwise be illegal.

Nonbank lenders, such as Elevate, OppLoans, Enova, LoanMart, and World Business Lenders currently lend at outrageous rates in States where those rates are illegal under State law. Through the use of rent-a-bank schemes with banks regulated by the FDIC and the OCC, neither regulator appears to have done anything to shut down these abuses.

I would like to share three examples of high-cost loan documents that I have seen firsthand from borrowers with whom I have worked.

A disabled Marine veteran was targeted with a $5,000 loan at an APR of 115 percent, and a ridiculously long term of 84 months. As stated in her loan documents, that resulted in a cost of $42,000 to borrow just $5,000 over 7 years. Not surprisingly, she was unable to keep up with these unaffordable payments and ended up in bankruptcy.

In another example, a single mother was targeted for a $2,500 loan with an APR of more than 100 percent. After 5 years, she paid back $14,000, but was unable to save for her daughter's college tuition.

And finally, a Spanish-speaking man was lured into a store that said, "Se habla espanol," which means, "We speak Spanish." However, no one spoke Spanish, and all of the loan documents were in English. He walked out with a $2,700 loan at 123 percent APR. Worse, it was secured by the title of his truck. He had to pay back $10,000 over a 5-year term or risk his only mode of transportation to work.

These are just some examples of a now-too-common loan that is being offered online or through storefronts that are disproportionately located in communities of color. This is not access to credit. This is not access to innovation. This is access to debt.

Fortunately, there are ways to stop these abusive lending practices. First, we need the FDIC and the OCC to take enforcement actions against these predatory lenders that are using rent-a-bank schemes and offering illegal loans in States with rate caps. Second, the FDIC and the OCC should rescind their proposal that does nothing to address this abuse, and, in fact, emboldens predatory lenders to engage in rent-a-bank schemes. Third, Congress should swiftly pass H.R. 5050, a 36 percent interest rate cap bill for veterans and all consumers.

And finally, the FDIC should preserve its 2005 payday loan guidelines, its 2007 guidelines advising of a rate cap of 36 percent, and its 2013 guidelines, advising of ability to repay for all bank payday loans.

Let me thank the committee again for the opportunity to address these scams and real-life situations. I look forward to your questions.

[The prepared statement of Ms. Aponte-Diaz can be found on page 50 of the appendix.]

Mr. MEEKS. I now recognize Assemblymember Limon for 5 minutes.

STATEMENT OF THE HONORABLE MONIQUE LIMON, CHAIR, BANKING & FINANCE COMMITTEE, CALIFORNIA STATE ASSEMBLY

Ms. LIMON. Thank you. Thank you for holding this hearing and inviting me to testify on how rent-a-bank schemes undermine State consumer protection efforts. My name is Monique Limon. I serve in the California State Legislature as an Assemblymember and as Chair of the Committee on Banking and Finance.

High-cost consumer loans have created havoc for California families over the last decade. Driven by the desire to avoid the forthcoming CFPB rule, the payday lending industry began to aggressively market larger, longer-term loans to vulnerable consumers who were trying to pick up the pieces caused by the Great Recession.

The average size of these loans is about $3,000, with an annual interest rate of 100 to more than 200 percent. While these high-interest rates are unconscionable, I am more concerned by how often consumers default on these loans. As we dug through the data, we found that more than one-third of borrowers could not repay their loans, representing more than 100,000 Californians each year. Failing to repay a loan exposes consumers to serious negative consequences like aggressive debt collection, ruined credit scores, vehicle repossessions, and even bankruptcy.

While consumers try to find a way out of this turmoil, high-cost lenders are able to stay profitable because of the extremely high rates and fees that they charge. Over the past several years, the California Legislature attempted to address this problem by establishing a ceiling on interest rates, similar to policies adopted by dozens of red and blue States across this country. It took us 3 years and 5 different bills before we found the right balance to keep responsible lenders in the market while also protecting consumers from high fees and defaults.

Last year, I introduced a bill that caps rates on loans in the $2,500 to $10,000 range at 36 percent plus the Federal funds rate. This bill received strong bipartisan support from a broad coalition of lenders, consumer groups, faith leaders, veterans organizations, and community groups across the State. On the strength of this coalition, the bill passed with broad support and was signed into law by our governor.

In summary, the effort was thoughtful, and was deliberate. The Legislature considered multiple options until we found the right balance. But now that the new law is in place, high-cost lenders are looking to exploit gaps and ambiguities in the administration of Federal banking laws that would allow these lenders to evade State laws and continue with business as usual. When left unchecked, these rent-a-bank schemes perpetuate the system of misaligned incentives that allows lenders to profit, even when many of their customers fall into default.

Both the FDIC and the OCC have stated that they do not support bank partnerships designed to evade State laws. But those agencies need to back up their words with actions. Until they act, there will continue to be a small number of banks and lenders who try to dodge State laws.

Before I conclude, I want to be clear that I do not believe that all bank partnerships are bad. Bank partnerships that create products where the interested borrowers and lenders are aligned can be a healthy part of the financial system. However, at the very least, bank partnerships must be limited to banks that follow the FDIC's 2007 guidance on offering affordable, small-dollar loans which encourage banks to offer small-dollar credit with APRs that do not exceed 36 percent.

The Federal Government has the ability to fix the problem of the rent-a-bank schemes with solutions that protect State sovereignty, protect consumers, and create a fair and competitive credit market with all lenders playing by the same rules.

Thank you for bringing attention to this issue. I am hopeful that Congress can work with the FDIC to ensure that a handful of supervised banks are not being used to undermine State consumer protection laws across this country.

[The prepared statement of Ms. Limon can be found on page 80 of the appendix.]

Mr. MEEKS. Thank you for your testimony. I now recognize Professor Johnson for 5 minutes.

STATEMENT OF CREOLA JOHNSON, PROFESSOR, THE OHIO STATE UNIVERSITY MORITZ COLLEGE OF LAW

Ms. JOHNSON. Good morning. I am Professor Creola Johnson at the Ohio State University College of Law. I was the first academic to write a law review article about payday lending. It was based on my research, which was funded by the university, where we actually took out payday loans. And what I discovered through this research of payday lenders surveyed in Franklin County, Ohio, is that they had two primary goals: first, to get the consumer to sign up for a loan without understanding the consequences of what they were signing up for; and second, to get the consumer on the hook to pay as long as possible at triple-digit interest rates.

As has been mentioned, the rent-a-bank schemes are part of keeping consumers in the dark. The consumer goes to a physical store, interacts with a lender that is a nonbank entity, and has no interactions at all with the bank that is in the background. As I put in my remarks, this is part of the overall mission of keeping people in the dark, keeping the consumer in the dark.

As a result of my research, I concluded that rent-a-bank schemes allow nonbank lenders to get away with charging triple-digit or quadruple-digit interest rates, and not only so but to keep consumers on the hook, and I describe these practices in three main areas. I call them "debt entrapment practices," and by that, I mean practices that seek to get a consumer on the hook, and by that, I mean they are approved for credit in a minimal amount of time.

Someone mentioned a few minutes ago that we are able to do this quickly. You are able to do it quickly because you are not actually focusing on the ability of the consumer to pay back the loan. Debt entrapment practices also include issuing large amounts, at triple-digit interest rates, and short maturity dates. In other words, paying back the loan in a short period of time where the majority of customers cannot pay back that debt and keep up with their ongoing expenses.

The second category of illegal practices are what I call, "treadmill practices." These practices are designed to keep a continuing stream of payments coming in from the borrower. They include multiple rollovers—extending the loan date multiple times—back-to-back loan transactions, rapacious electronic debits to the consumer's bank accounts, and illegal garnishment of consumer wages.

Third, criminalization practices. These practices include making the consumer feel that they need to fear imminent arrest unless they comply with the nonbank lender's demands. These include threatening to prosecute consumers for crimes, filing police reports against them for criminal charges, and misusing civil contempt proceedings to obtain arrest warrants against consumers.

These three practices—debt entrapment, debt treadmill, and debt criminalization practices—are what nonbank lenders want to do, and they want to be able to hide behind the banks to perpetrate these practices. Let us keep in mind that these nonbanks are not subject to regulatory oversight by the FDIC or the OCC, so they should not be able to get away with these practices by hiding behind a preemption doctrine.

This is important for us to focus on, not just new technology but focus on protecting the State sovereignty, to protect consumers from usurious interest rates in these practices that I just spoke about, and to protect consumers based on all of these consumer protection laws in all 50 States, and U.S. Territories. And yes, we want to balance that with allowing for reasonably priced credit products for consumers. But they have to be balanced against the State sovereignty and State consumer protection laws.

Thank you for allowing me to speak, and I look forward to your questions.

[The prepared statement of Ms. Johnson can be found on page 68 of the appendix.]

Mr. MEEKS. Thank you for your testimony. Ms. Saunders, you are now recognized for 5 minutes.

STATEMENT OF LAUREN SAUNDERS, ASSOCIATE DIRECTOR, NATIONAL CONSUMER LAW CENTER

Ms. SAUNDERS. Thank you. Chairwoman Waters, Chairman Meeks, Ranking Member McHenry, and members of the committee, thank you for inviting me to testify today on behalf of the low-income clients of the National Consumer Law Center (NCLC).

Today, we are facing the biggest threat in decades to States' historic power to protect Americans from predatory lending, rent-a-bank lending. Interest rate limits are the simplest and most effective protection against predatory lending, and are strongly supported by American voters of all stripes.

At the time of the American Revolution, every State had interest rate caps, and the vast majority still do today. For example, on a $500, 6-month loan, 45 States and the District of Columbia limit the rate at a median of 37.5 percent. At the end of the 20th Century, however, most banks were exempted from State rate caps, and rent-a-bank lending began as the latest in a long line of attempts to evade State usury laws.

Short-term payday lenders first tried using rent-a-bank schemes 20 years ago, but the bank regulators shut them down. Yet in today's environment, high-cost lenders across the country are again using a small number of rogue banks to offer loans at astonishing rates that they cannot offer directly, and that banks would not offer in their own branches.

My fellow witnesses have described some of the loans being offered to consumers. I would like to focus on the rent-a-bank lender that the OCC and the FDIC are actively supporting: World Business Lenders. The FDIC and the OCC filed an amicus brief supporting World Business Lenders and its right to charge a Colorado business 120 percent on a $550,000 loan, because the loan was originated by the Bank of Lake Mills and assigned back to World Business Lenders, the same bank, by the way, that the FDIC had sanctioned for targeting our servicemembers.

We have discovered several cases involving similar facts. A World Business Lenders agent approaches a small business and offers a loan. The paperwork shows that the loan comes from an FDIC-supervised bank, Bank of Lake Mills or Liberty Bank, or OCC-supervised Axos Bank. The bank quickly assigns the loan back to World Business Lenders. These loans, ranging from $20,000 to $400,000, are secured by a mortgage on the home of the small-business owner at astonishing rates: 72 percent for a general contractor in Florida; 73 percent for a New York owner of a medical supply company; 92 percent for a couple in Massachusetts. Many of these small business owners are facing foreclosure, like a REALTOR in New York who was buried by a $90,000 mortgage at 138 percent APR.

Many States prohibit these rates on second mortgages by nonbank lenders, but World Business Lenders argues that as the bank's assignee, it can charge outrageous rates.

This is the lender that the OCC and the FDIC are supporting, with the same arguments that they are using to justify their proposed new interest rate rules. These proposed rules are in no way necessary to address legitimate secondary markets. We see no problem in those markets. What we do see is an explosion of predatory rent-a-bank lending undermining power that States have had for nearly 250 years. The FDIC's and the OCC's support for World Business Lenders tells us exactly who is eager to step into the bank's shoes: predatory lenders.

So, what can Congress do? First and foremost, pass H.R. 5050, the Veterans and Consumers Fair Credit Act, to cover all lenders, banks and nonbanks, with a 36 percent interest rate cap. That is still a high rate, and the bill will not stop all evasions of State usury laws. But an upper limit of 36 percent will cut off the most egregious abuses of the bank charter that facilitate predatory lending.

Second, stop the FDIC and the OCC from facilitating rent-a-bank lending, and support States' historic power to limit interest rates.

Third, pass H.R. 1423, the Forced Arbitration Injustice Repeal Act, which will restore consumers' and small businesses' access to the courts when predatory lenders violate the law.

Thank you for inviting me to testify today. I look forward to your questions.

[The prepared statement of Ms. Saunders can be found on page 91 of the appendix.]

Mr. MEEKS. Thank you for your testimony. Mr. Knight, you are recognized for 5 minutes.

STATEMENT OF BRIAN KNIGHT, DIRECTOR AND SENIOR RESEARCH FELLOW, PROGRAM ON INNOVATION AND GOVERNANCE, MERCATUS CENTER AT GEORGE MASON UNIVERSITY

Mr. KNIGHT. Thank you. Good morning, Chairwoman Waters, Subcommittee Chair Meeks, Ranking Member McHenry, and members of the committee. Thank you for inviting me to testify today.

My name is Brian Knight, and I am the director of the Program on Innovation and Governance, and a senior research fellow at the Mercatus Center at George Mason University. Much of my research focuses on the role of technological innovation in the provision of financial services.

The key point I want to leave you with is that innovation and competition in lending, of which the bank partnership model is a key part, is helping to improve access to credit, especially for borrowers poorly served by the traditional market. We are witnessing an important evolution in the credit markets, powered by innovative firms partnering with banks, frequently smaller banks. Fintech firms, many partnering with banks, now account for 38 percent of unsecured personal loan balances, up from only 5 percent, 5 years ago. There is evidence that these partnerships allow some borrowers to access credit on better terms than they would receive from a traditional lender. There is also evidence that these partnerships allow for greater access to credit for borrowers in parts of the country that are underserved by traditional lenders, and that innovative lending can be less racially discriminatory than traditional lending.

These partnerships are mutually beneficial for both the fintech firm and the bank. The bank receives access to technology beyond what it could develop on its own; access to customers outside of its immediate geographic area, helping it to diversity its business; better management of its balance sheet; and enhanced servicing capacity. Fintech firms receive assistance with regulatory compliance and the ability to do business nationwide, under a consistent regulatory regime in conjunction with their bank partner.

It is important to keep in mind that these relationships are highly regulated. Fintech firms that partner with banks are frequently regulated under the Bank Service Company Act and are subject to examination by the bank's Federal regulator for the services the fintech firm provides to the bank.

Additionally, the fintech partner is frequently subject to examination by a State bank regulator if the partner bank is State-chartered, and is covered by consumer protection laws enforced by the Consumer Financial Protection Bureau (CFPB) and the Federal Trade Commission (FTC). Likewise, the bank is accountable for the actions of its fintech partner, taken in furtherance of that partnership. Bank regulators have shown themselves to be willing and able to police bank partnerships and hold both banks and their partners accountable for bad acts.

While these partnerships between banks and innovative technology companies have displayed significant promise, they have been threatened by recent litigation that has disrupted long-settled expectations. In the case of *Madden* v. *Midland Funding*, the United States Court of Appeals for the Second Circuit held that New York law governed a loan that was originally issued validly by a bank under Delaware law, and therefore, the loan was usurious, when it was sold to a debt collector after default. In effect, the court held that the legality of a validly-made loan could change, depending on who held it after it was made, even if the terms of the loan itself did not change.

This holding has been criticized as an incorrect interpretation of the law by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Obama Administraton's solicitor general.

While this case does not directly deal with the type of bank partnerships at the heart of innovative lending, it appears to have had a significant and negative impact on credit markets because it calls into question the ability of banks to sell their loans to fintech partners. One study found that, in the wake of the *Madden* decision, funding for marketplace loans aimed at borrowers with FICO scores under 700 decreased significantly in New York and Connecticut compared to outside the Second Circuit, because of concerns that any loan made to those borrowers may become invalid if sold to a nonbank marketplace lender.

A subsequent study found a reduction in marketplace lending credit available to New York and Connecticut residents, especially low-income residents, as well as an increase in personal bankruptcies, a phenomenon that the authors of the study linked to the inability of low-income borrowers to access credit in order to refinance debt or address exigent circumstances like medical bills.

These unfortunate results highlight the potential harm of impeding increased innovation and competition in credit markets. Consumer protection is essential, but denying consumers access to credit does not necessarily protect them, because it does not remove the underlying issues motivating the need for credit. Rather, allowing more innovation and competition in credit markets, especially to those insufficiently served by traditional products, presents a better path to what we all want: a credit market that allows consumers to make informed choices that best serve their needs.

Thank you again for the opportunity to testify, and I look forward to your questions.

[The prepared statement of Mr. Knight can be found on page 77 of the appendix.]

Mr. MEEKS. Thank you, and I thank all of the witnesses for their testimony. I now recognize myself for 5 minutes for questions.

Your testimony today has been very good, and I am sitting here listening and trying to dig through where and what will be the best way to go. One of the things that I have been trying to do, especially on the subcommittee, is try to make sure that there is access to credit in low- and moderate-income communities, and we have found, to a large degree, that that came from minority depository institutions (MDIs).

There are only 20 MDIs left today, and during that hearing that we had, it was 20 that are left. And I agree with what most of you said, when you look at payday lending and the title and pawn shops, especially when it comes to small-dollar loans, that is where folks in my community go when they try to borrow some money. And generally, the MDIs have more accessibility in working with them. When they testified here, they said it may be better for them to have partnerships, especially when dealing with technology.

So my first question will go to Ms. Johnson. I don't know whether your research had shown what effect this would have on minority depository institutions in regards to, if there was a rate cap at 36 percent, what effect would that have on their viability, remaining in the community, and/or what other incentives can be utilized so that they can feel it is okay to do business with a small-dollar loan with a lower interest rate?

Ms. JOHNSON. If I understand your question correctly, you are asking what impact would an interest rate cap have in minority communities?

Mr. MEEKS. Minority depository institutions, minority banks.

Ms. JOHNSON. Right. My research does not deal specifically with those types of organizations. I don't know if any of my colleagues could speak to that.

Mr. MEEKS. Ms. Aponte-Diaz, do you—

Ms. APONTE-DIAZ. Yes. Hello. I can speak to our credit unions or our partners' Self-Help Federal Credit Union offers loans capped at 18 percent, and they are able to do that for—we did a special program for DACA recipients at 18 percent at the top, depending on their credit, and we are able to do that and provide lower interest rate loans for—

Mr. MEEKS. And is that for small-dollar loans?

Ms. APONTE-DIAZ. Small-dollar loans. Yes, a DACA loan is about $600.

Mr. MEEKS. Let me ask another question, because one of the things that I had hoped, back when we had the financial crisis and we created the CFPB, was that we would have someone that would be fighting for consumers. Unfortunately, I think that we have moved back from, say, some of the rules that were being put down by Director Cordray. Under Director Cordray's CFPB, particularly for the payday rule, it was anchored by two pillars: ability to repay, which is tremendously important, and that is what got us in trouble before with these no-doc loans; and capping at three the number of loans that lenders could make in quick succession. He was indicating that this would get at the heart of the payday industry's debt trap business model.

Assemblymember Limon, what would you say about what the CFPB was saying under Director Cordray's leadership?

Ms. LIMON. Thank you. I do want to comment on your previous point. I can tell you that with the State law in California that was passed at 36 percent plus Federal rate, we still have a $2 billion industry for just California alone. I can't tell you how many of those are minority-owned banks but the space is still there for lending. So, I want to be clear that there are still some options.

And as far as Director Cordray's direction, the ability-to-repay underwriting is absolutely important to this space and to this market, and certainly capping the number of loans that people take out at one time is another way to address this. These are elements that we have explored in the State of California and elements of which we are supportive. They are not written into the law that was passed, but there are different elements that can further address the security of ensuring payback.

Mr. MEEKS. So if he was still here, are the rules that he was putting in place—do you believe it would been a failure or a success in the rule as he had outlined it?

Ms. LIMON. Success.

Mr. MEEKS. Thank you. I am out of time, and so I now recognize the gentleman from California, excuse me, the ranking member from North Carolina—

Mr. MCHENRY. Very different. We are getting some California jobs though.

Mr. MEEKS. —Mr. McHenry.

Mr. MCHENRY. We are getting some California jobs, and I am so grateful for that.

Anyway, Mr. Knight, in your written testimony you speak of the spread of the bank/fintech partnership model as having a number of benefits, including better credit terms for consumers, improved access, and some of the technological advantages that we see in other areas outside of consumer lending, right? So, there are a lot of benefits afforded to this model.

But looking at this, in 2015, the Second Circuit had a ruling in *Madden* v. *Midland* that a loan to a New York resident was valid when it was made by a bank, but became invalid once it was sold by the bank to a nonbank third party, right? This came as a surprise to many. Why?

Mr. KNIGHT. Because it upset a well-settled expectation that, one, banks can sell loans, that that is the power of a bank and that they can sell the loan and the loan remains valid, and that is an important criteria.

Mr. MCHENRY. Why can they sell a loan?

Mr. KNIGHT. Well, they need to sell loans for a host of reasons—balance sheet management, risk management. In the case of *Madden,* this loan had gone into default, so they wanted to move it off of their balance sheet so they could shed the risk. There is a profitability argument there, particular for smaller banks which don't necessarily have the deposit base to sit on a whole bunch of loans. So, it has long been recognized that selling a loan is part and parcel of being a bank, that is the ability to sell the loan as a bank prong.

The second prong, which the Second Circuit really didn't deal with, is the common law of valid-when-made doctrine, which generally says that a loan, if it is valid when it is made, does not become usurious because of a downstream transaction.

Mr. MCHENRY. Okay. So is that a payday issue, a payday lending issue of valid-when-made? Is that all this is about?

Mr. KNIGHT. No. This applies to—

Mr. MCHENRY. To every loan.

Mr. KNIGHT. —every loan.

Mr. MCHENRY. Okay. And a loan is an asset on a bank's balance sheet.

Mr. KNIGHT. Correct.

Mr. MCHENRY. Right. So the issue of valid-when-made is how old? How longstanding is this practice?

Mr. KNIGHT. The early 19th Century court cases refer to it as this longstanding maxim, but I don't know how far back it goes.

Mr. MCHENRY. So how does this affect the banking system if it becomes the national norm?

Mr. KNIGHT. It could severely limit the ability of a bank to sell a loan, because under the logic of the *Madden* decision, the bank could only sell the loan and have it remain valid if the recipient could have made that loan themselves. So in that case, you basically have banks selling to other banks, and not just any bank. It would have to be a bank that, under that bank's home State law, could have made that loan. Which means, one, you can't move that risk outside the banking system. You are just trading it among banks. And two, that significantly diminishes the ability of a bank to sell a loan at what should be its appropriate market value.

Mr. MCHENRY. Okay. But this issue gets conflated with a number of issues that are hotly litigated across States. Is that not the case?

Mr. KNIGHT. Right. It has been validly made it has been conflated with the ability of a bank to sell a loan statutorily, and it has been conflated with the True Lender doctrine, and they are all related but they are also all distinct.

Mr. MCHENRY. What is True Lender?

Mr. KNIGHT. The True Lender—so, valid-when-made is about what happens to the loan after it is sold, because if the loan isn't valid in the first place, valid-when-made doesn't apply. True Lender is an emerging doctrine that even if the bank technically makes a loan, it is not considered the true lender under certain circumstances by some courts. And the emerging doctrine is a predominant economic interest test, so if the bank does not have the predominant economic interest test in the loan when the loan is made, or shortly thereafter, some courts will say, "Well then, bank, you weren't the true lender. The party that has the predominant economic interest was, in fact, the true lender, and so we will look to see if that party could have made the loan."

Mr. MCHENRY. Okay. So resolving this issue of valid-when-made is distinct from True Lender?

Mr. KNIGHT. Yes, it is.

Mr. MCHENRY. And to this end, what we have seen in the Second Circuit jurisdictions of New York, Connecticut, and Vermont is that the availability of credit has gone down, that rates have gone up, and it has had a negative effect on consumers. And that is according to the Stanford-Columbia-Fordham study of this. Is that correct?

Mr. KNIGHT. Both that study and a subsequent study.

Mr. MCHENRY. Thank you. I yield back.

Mr. MEEKS. The gentleman's time has expired. I now recognize the gentleman from California, Mr. Sherman, who is also the Chair of our Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, for 5 minutes.

Mr. SHERMAN. Thank you. It is interesting to see the argument made that if fewer payday loans are made, consumers are hurt. That jumps to a conclusion. But the fact is that wages are too low, and people often are knowledgeable but poor. What are you going to do? Sell your truck? Rely on overdraft protection? Fall behind on your rent? Or go to one of these payday loans or similar loans?

I don't think APR is the best way to evaluate the cost of short-term loans. I think the minority made that point. For example, I pay a $2 fee to use a particular ATM. If I spent 15 minutes extra time, I could go to my own bank's ATM. So I am borrowing the money, $200, for 15 minutes, and paying $2 to do that. That is, what, about 100,000 percent interest. It is not because—the bank is getting a fair fee. The owner of the machine is getting a fair fee. They have to have the machine there. They are entitled to what I think is a fair fee to save me from having to wait for my money for another 15 minutes.

The position of the OCC seems outrageous when they say that they can adopt any regulation to facilitate banks' ability to operate across State lines. I will throw out one example. Are we going to have a position where if a bank makes a loan on a piece of real estate, that State and local law can't change the zoning of that real estate, because that would hurt the bank? And if a bank ever were to make a loan, then forever, that property would be exempt from down-zoning.

The OCC is taking an outrageous position on this, but they want us to listen to them on LIBOR and other issues. The OCC's position is, well, if you are a bank, you are not going to be subject to State and local regulations to protect consumers, and we are going to make sure that there is no Federal protection for consumers. And if you engage in a business practice to roll over the loan 26 times a year, year after year, well, that is just fine as long as a bank is involved that is making some money, and we are facilitating banks and making banks more profitable.

Let me ask my own California Assemblymember. We have taken some real actions in California. What do people do when they need money to pay to keep the lights on?

Ms. LIMON. People still have access to credit. As I mentioned, there is still a $2 billion credit space in California under the rate cap.

Mr. SHERMAN. Is that $2 billion of all consumer loans, or how do you define it?

Ms. LIMON. For small-dollar lending.

Mr. SHERMAN. Small-dollar lending, not credit cards.

Ms. LIMON. Small-dollar lending.

Mr. SHERMAN. And when you say "small," you mean under $5,000? Under $2,000? Under what?

Ms. LIMON. Under $10,000.

Mr. SHERMAN. Under $10,000. Is there space there for people who need to borrow $500, because I would hate to borrow $5,000 if I need $500.

Ms. LIMON. Under $10,000 includes the $500.

Mr. SHERMAN. Yes, but is there a vibrant industry in California where I can get a $500 loan, if I don't need a $10,000 loan?

Ms. LIMON. There is an industry, and regrettably the industry, at this moment, for $300 and under, and above, if it is under the 36 percent, is a very healthy one. We haven't done anything about addressing payday proper. The bill that we have passed in California is about the $2,500 to $10,000 space, which is the highest-used product, the highest-growing product in the State of California.

Mr. SHERMAN. I would point out to my colleagues that it looks like OCC wants to push this regulation through, but a provision on an appropriations bill preventing them from doing that would be the best way to make sure that we don't have a situation, as we do today, where there is no Federal regulation, and an agency dedicated to making a lot more money for banks is going to allow them to evade California law and other law.

It would be one thing if the OCC was applying this after we, in Congress, consider the Garcia bill and others, and have reasonable Federal rules. Then, the OCC would be saying, "Well, you are a bank. That means nationally." But to have a zero consumer protection rule for everything shows that the OCC needs to be reined in, hopefully by a provision in the appropriations bill.

I yield back.

Mr. MEEKS. The gentleman's time has expired. I now recognize the gentlewoman from Missouri, Mrs. Wagner, for 5 minutes.

Mrs. WAGNER. I thank the Chair. According to a 2017 survey by the FDIC, 25 percent of U.S. households, or 32 million Americans—

and I will say again, 32 million Americans—are either unbanked or underbanked. These households might have a checking or a savings account but they also obtain financial products and services outside of the formal banking system. A minority of these households do not even have a bank account with an insured institution.

Lack of access to banking continues to worsen as branches close across our country. Access to safe and affordable financial services is absolutely critical, especially among families with limited wealth, whether they are looking to invest in education or simply manage the ups and downs of life.

Mr. Knight, in your testimony you stated that the bank partnership model allows for greater access to credit for borrowers in parts of the country that are underserved by traditional lenders. Could you please elaborate more on how these partnerships help those without access to mainstream banking services?

Mr. KNIGHT. Absolutely. Thank you for that question, ma'am. Based upon the research I have seen, where the partnerships bear fruit is that a relatively modest-sized bank that could never make the sort of financial commitment to build out their technology on their own is able to partner with a technology firm that is able to put forward an internet platform that can penetrate just about anywhere, particularly with the increasing penetration of the internet and smart devices, and that enables borrowers who are in areas where maybe banks have retrenched or are otherwise underserved to access relatively high-quality credit over the internet, who couldn't necessarily do that via a traditional bank branch model.

And so, that allows your modest-sized bank, which is good at banking but not so great at technology and scope, to partner with a fintech company that is great at technology and scope and is not a bank, and it is two great tastes that often taste great together.

Mrs. WAGNER. You have given us kind of the outline of how the pieces are put together in terms of this bank partnership. How does the actual constituent benefit? How does this model work for them, those who are, in fact, underserved in so many of these communities?

Mr. KNIGHT. First, it gives them more options and more potential lenders competing for their business. Competition has been shown to frequently drive down prices and credit, just—

Mrs. WAGNER. Drive down prices and credit.

Mr. KNIGHT. Yes. You will also see, and there is evidence, that many of these firms are using innovative underwriting to better serve groups that are not necessarily well-served by your traditional FICO-based underwriting model. So for those groups, they will see better underwriting that is both more accurate and also frequently cheaper.

Then, they have ease of access and convenience, and it can often be relatively quick to access these loans.

Mrs. WAGNER. So they can get that money when they need it, expeditiously, for the, as I call it, ups and downs of life.

Mr. KNIGHT. That is correct, and an example from the small-business space is that one of the things that these small-business loans, and to be completely clear, on the small-business side, these loans are often more expensive than a small-business bank loan.

But a lot of these businesses could not get a small-business loan because they need less money, and the bank would take much, much longer to approve the loan, so they are paying for convenience and a right-sized loan.

Mrs. WAGNER. In my limited time, is it possible for banks to evade State law if they have bank preemption?

Mr. KNIGHT. No. They are operating on the basis of Federal law, and Congress has made a choice to grant both State and Federal banks certain authorities.

Mrs. WAGNER. And you have already talked about what will happen to access to affordable credit if bank partnerships are prohibited by Congress. It will go away. Is that correct?

Mr. KNIGHT. It would certainly be crimped.

Mrs. WAGNER. And who would step in to fill that void?

Mr. KNIGHT. Probably an alternative provider or an illegal provider, or—

Mrs. WAGNER. An illegal provider. Thank you. My time has expired.

Mr. MEEKS. The gentlelady's time has expired. The gentleman from Georgia, Mr. Scott, is now recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. I want to follow up on a point of questioning that I agree on with Chairman Meeks, and also my colleagues, Mr. Sherman and Mrs. Wagner. We have been working in this committee for many years against predatory lending, but what we have found out is that we need to do a rifle approach to solving this problem and not a scatter gun that could bring innocent bystanders in who are actually out here doing a remarkable job, providing credit access and lending to the very people that we are concerned about protecting from the predatory lenders.

Let me start with you, Ms. Limon. When it comes to the creation of new financial products, are there not other pro-consumer features to products that policymakers should focus on beyond the APR, things like fee transparency, limitation on debt rollovers? Are those not also important aspects for us to explore as we look to incent innovation and expand services to the unbanked and underserved?

Ms. LIMON. Yes. Those are also important elements to consider.

Mr. SCOTT. And now, let me get to the heart of the matter here. In your written testimony, you describe feedback from some lenders in your State, stating that they preferred an interest rate cap to underwriting guardrails.

Our concern on this committee is around access to credit. And I have heard from lenders, I have heard from online lenders, and I have heard from banks, and as my chairman, Mr. Meeks, mentioned, we have had our African-American bankers here—and we have not had a new African-American bank in a quarter of a century—who are very concerned about this rate cap and their ability to provide access to credit for the very people that we want to provide with credit. They feel that they may be unable to fulfill demand for credit under such circumstances, particularly for the low-income consumers who are already having many challenges.

I call your attention to a 2018 study by the World Bank that found that binding interest rate caps below market values can reduce overall credit supply. I am sure you may be familiar with that. A separate study, looking at the experience in Chile, found that the impact was felt most profoundly by the youngest, least educated, and poorest families, the very families that you and I both are concerned about.

And also let me add this. Because the underwriting costs are strained by the rate cap, the lender must make larger loans in order to make the loan profitable. This means that consumers may take out a larger loan than they need, which can place our consumers in a financially precarious position. And the rate cap extends broadly to most types of credit and is not narrowly targeted—that is our concern—to the payday lenders, and rate caps cause a loss of credit availability, particularly for non-prime, subprime consumers who pose a greater risk of default. And this is because the lender cannot afford to offset the underwriting costs due to the rate cap.

All I am saying is that we can't dismiss these concerns; we have to deal with them. So what I want to kind of hear from you, Ms. Limon, is what information did you have prior to passing your law that led you to believe the rate cap would not restrict access to credit?

Ms. LIMON. The very principle of our law is that high interest rates cause higher defaults for the very same families that we are trying to serve. And so, that is a concern. We saw over 20,000 Californians have a car repossessed and over 100,000 Californians go into default because of these loans.

Mr. SCOTT. And do you—

Mr. MEEKS. The gentleman's time has expired.

Mr. SCOTT. Thank you, sir.

Mr. MEEKS. The gentleman from Florida, Mr. Posey, is recognized for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman. Our topic today illustrates one of the great paradoxes of regulations. On the one hand, our government has sought to regulate prices to protect consumers, only to find out that doing that restricts the supply of the good or service and actually hurts those whom they seek to protect. And, in an everyday perspective, a lot of consumers would jump for joy if Congress passed a law that said you couldn't charge over $1 a gallon for gasoline. A lot of people would be really excited and say, "You really did the right thing."

But we know what would happen, don't we? You would have zero gasoline. And so, is it better to pay more than $1 for a gallon of gasoline or not have any gasoline?

In that regard, I ask unanimous consent to enter into the record a 1970 Newsweek article by the late Milton Friedman, entitled "Defense of Usury."

Mr. MEEKS. Without objection, it is so ordered.

Mr. POSEY. Thank you, Mr. Chairman. There are two more items I would like to put in the record. The first is Rolf Nugent's classic paper that appeared in the Harvard Business Review in 1930, that showed how half-percentage reductions in maximum interest rates across three States was correlated with funding for small loan needs of low-income people and the unfortunate growth in bootleg lenders.

And finally, a 1975 paper from the Florida State University Law Review that details the history of small-loan regulation in Florida. This paper details the ways that market innovators got around rate ceilings. The articles will help remind us that regulating small-dollar loans has a wide range of unintended consequences, including denying many low-income people the loans that they need.

Mr. MEEKS. Without objection, it is so ordered.

Mr. POSEY. Thank you, Mr. Chairman. These papers also underscore another important aspect of our hearing, and that is regulatory arbitrage. Interest rate caps in one or more States make incentives for market lenders to innovate to make loans to residents of those States who need them. They have done this in partnership with banks in other States.

Mr. Knight, what role do small-dollar lenders or loans play in our economy? Do they provide essential financial services?

Mr. KNIGHT. Small-dollar credit can provide essential financial services for borrowers. There is definitely evidence. I should say that for small-dollar credit, particularly, say, storefront payday, the economic evidence is mixed as to whether access is a good thing or a bad thing, but it is pretty clear that for at least some borrowers, it can be absolutely essential.

Mr. POSEY. Okay. I believe that the regulation of interest rates, as I mentioned, is a real paradox, and some States seek to protect consumers and they make money unavailable to them, unfortunately. This two-edged sword is difficult to balance sometimes. Which aspect do you believe is more important, protecting from high interest rates or protecting from credit scarcity?

Mr. KNIGHT. I believe that protecting from credit scarcity is frequently more important. I believe that in a functioning, competitive, and well-regulated market, there is definitely a role for regulation to play, consumers should be able to access credit and that they will be able to address their credit needs, because frequently they are accessing credit to avoid a greater harm. There is always the option to not take a loan, but if you are taking a loan to avoid a greater harm, that loan should be available to you.

Mr. POSEY. The CFPB has delayed the ability-to-repay mandatory underwriting provisions until November. CFPB originally proposed to rescind the entire rule. Can you evaluate the underwriting provisions in terms of benefits, costs, and impact on consumer credit availability?

Mr. KNIGHT. Sir, I am afraid I cannot do that. I have not done a sufficient study of that to have an informed opinion.

Mr. POSEY. Okay. In fairness, Ms. Limon, would you care to respond?

Ms. LIMON. I'm sorry. Can you repeat the question that you would like me to respond to?

Mr. POSEY. Yes. It was talking about the delay of the CFPB rule, that they had the ability to pay rule.

Ms. LIMON. We would like to see that in California, and that has actually been a challenge to us, and part—not full, but part of the reason we also stepped up to pass our own rate cap law.

Mr. POSEY. Okay. Thank you very much. Mr. Chairman, I see my time has expired.

Mr. MEEKS. The gentleman yields back. The gentlewoman from North Carolina, Ms. Adams, is recognized for 5 minutes.

Ms. ADAMS. Thank you, Mr. Chairman, and I want to thank all of the participants today for sharing with us your ideas.

Let me, first of all, ask Ms. Limon, in addition to your work on predatory lending, you have also been leading a conversation in California about strengthening the oversight authority of the State financial regulator, particularly in light of the Trump Administration's efforts to weaken consumer financial protection and the CFPB's role in enforcement. Can you talk briefly about why California feels the need to act, and what you hope to accomplish by strengthening the State's role in protecting consumers in the financial marketplace?

Ms. LIMON. Thank you. Last year, I introduced a bill that would have developed a California version of the CFPB. In light of the Administration taking action on some of the work that we expected to be coming down, California has really seen a need to step up. With almost 40 million people in the State of California, we know that we are a big portion of the market share for a lot of this lending space, and so we feel that it is very important to protect consumers, and as a State, we have had to step up in the absence of Federal oversight and regulation.

Ms. ADAMS. Okay. So it is my understanding that California had been trying for a number of years to get a rate cap in place. What do you think were the key components of your efforts last year to get the bill over the finish line, and was there bipartisan support for the new California law?

Ms. LIMON. Thank you. There was strong bipartisan support for this bill, and we built a coalition that I think was very strong. Over 2 decades of having this conversation, with multiple bills introduced in the last 3 years, we put together a coalition that included, among others, veterans' groups, and the Urban League. We had many groups at the table, including responsible lenders, who told us time and time again that they could work within the interest cap rate and provided options for consumers in California.

Ms. ADAMS. Okay. Well, great. I served in the North Carolina House for about 20 years so I understand how important it is to bring stakeholders to the table. Otherwise, they say you are on the menu. But thank you for that.

Ms. Saunders, NCLC has previously highlighted some high-cost mortgage loans, as high as 138 percent APR made to small business owners through a rent-a-bank scheme. Would you please tell us more about these loans, the terms, and the circumstances in which they were made?

Ms. SAUNDERS. Sure. First mortgage loans are deregulated and there is no rate cap, but many States do limit the rates for second mortgages. And yet, there is a nonbank lender, World Business Lenders, that is using a couple of banks, OCC-supervised Axos Bank, and in the past, FDIC-supervised the Bank of Lake Mills in Wisconsin, to entrap small business owners with really horrendous loans.

For example, Jacob Adoni in New York, was looking for a personal loan, but he was forced to reference his business in the loan documents. He ended up with a $90,000 loan at 138 percent, and he is facing foreclosure. And that is an illegal loan in New York, but the claim is that because the loan was—the paperwork showed it came from a bank and then it was assigned back to the lender, that makes it legal.

Elissa Speer is facing foreclosure in Connecticut because of a $20,000 loan at 121 percent, supposedly for her restaurant, which she didn't own a restaurant, but they trumped up these loan documents claiming that a leaf blower was equipment for a restaurant.

These are the kinds of things that we are seeing predatory lenders do, using banks as a fig leaf.

Ms. ADAMS. Thanks very much. Ms. Saunders, where are we now with the ability-to-repay standard in the 2017 rule? Is it important for us to fight for this, and what other features are necessary?

Ms. SAUNDERS. It is absolutely necessary for us to fight for it. In the absence of a rate cap, the CFPB's ability-to-repay rule, a very modest rule that simply caps the number of loans and has a common-sense rule, that the lender should consider a person's ability to repay, should go into effect. It has been saved by the court. The CFPB has threatened to repeal it, and we need to put it into effect.

Ms. ADAMS. Thank you. Ms. Aponte-Diaz, CFPB Director Kraninger will be appearing before our committee tomorrow. What questions would you recommend we ask her about these issues? You have 20 seconds.

Ms. APONTE-DIAZ. For Ms. Kraninger?

Ms. ADAMS. Yes.

Ms. APONTE-DIAZ. She was on the board that approved the FDIC proposed rule, so we would ask her to rescind that rule and also to move forward with the ability-to-repay payday rule.

Ms. ADAMS. Great. Thank you very much. Mr. Chairman, I yield back.

Mr. MEEKS. The gentlelady's time has expired. I now recognize the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. Ms. Limon, you made a statement a minute ago when you were talking about your bill from California. My understanding is that the bill was signed October 11, 2019. Is that correct?

Ms. LIMON. Yes.

Mr. LUETKEMEYER. And it only regulates loans between $2,500 and $10,000. Is that correct?

Ms. LIMON. That is correct.

Mr. LUETKEMEYER. Okay. Mr. Sherman from California asked you about $300 loans a while ago, and I didn't really hear you give him a good answer to that. You don't regulate the $300 loans, though. Is that correct?

Ms. LIMON. We have not done anything around payday loans.

Mr. LUETKEMEYER. Okay. That was not the impression we got from your testimony and your earlier comments. Also, you said that you have a $2 billion industry. Have you studied—and I doubt that you have, since the most you could have studied would be 4 months here, since the law was signed—what kind of effect it has had on small-dollar lending yet?

Ms. LIMON. The $2 billion that I referenced is the lenders that are lending within the rate cap, so just to be clear, the industry is bigger—

Mr. LUETKEMEYER. Okay. But have you seen an effect on this? I would imagine you haven't, at this point.

Ms. LIMON. The data will not come out for another year.

Mr. LUETKEMEYER. Okay. So we really can't say whether it has or has not helped it, at this point.

Ms. LIMON. What I can say is what the existing market is under the rate cap, and that is $2 billion.

Mr. LUETKEMEYER. Very good. My concern is—and I think you have found the sweet spot there, because a George Washington University study says that the break-even point for a 36 percent APR is $2,600. So, you are where the break-even point is, so it is interesting that you have that.

Also, there is a UK study that my good friend from Georgia, I think, is referencing here. The UK put into effect, in 2015, a 100 percent rate cap, and then the Financial Conduct Authority did an assessment on it and found that the value and number of short-term dollar loans fell 50 percent in 6 months. I am guessing you are going to see a significant decline in loans in this $2,500 to $10,000 area as well.

And one of the things that concerns me is the misrepresentation of the cost of the loan. APR, in my judgment, if you are talking about a loan that is less than one year, is irrelevant, and I will give you an example. If you have a leaky faucet in your house, you call the plumber up. He comes out, turns a tap, and 10 minutes later, he walks out the door and hands you a bill for $50. Now, was that a surcharge, Ms. Saunders, or did he charge you $300 an hour for that service?

Ms. SAUNDERS. I think that the rent-a-bank loans that we are talking about—

Mr. LUETKEMEYER. I am asking you a question. Is it a service charge for him coming to your home with his truck, his equipment, his knowledge, and his tools, fixing your faucet, or did he charge you $300 an hour?

Ms. SAUNDERS. Well, he hasn't offered you a loan, so no, it is not an interest rate.

Mr. LUETKEMEYER. That is not the question I asked. I asked whether he is charging you by the hour or whether he is charging you a service charge.

Ms. SAUNDERS. People charge in various ways. You can charge by the hour or you can charge a surcharge, and—

Mr. LUETKEMEYER. Okay. You don't want to answer the question. The answer is, it is a service charge, which is exactly what any kind of a loan less than a year should be. It should be disclosed as a service charge. I would argue that you are hiding the true cost of the loan, hiding behind an APR, because that customer doesn't know what the true cost of it is. If it is $5 per 100, $10 per 100, $20 per 100, whatever it is, if you don't disclose that in a way they can understand, they will never know. Who knows what a 200 percent—let me give you an example.

You have a $400 loan, which is the average that most people can't afford to cover anymore. And if you charge them $20, do you know off the top of your head what kind of interest rate that would be?

Ms. SAUNDERS. It depends on how long it has been—

Mr. LUETKEMEYER. Over 14 days, 2 weeks. That is the normal rate.

Ms. SAUNDERS. Twenty dollars for a $400 loan?

Mr. LUETKEMEYER. Yes, 14 days.

Ms. SAUNDERS. You know, under pressure, I can't do the math. I can tell you that 15 for 100 is—

Mr. LUETKEMEYER. Okay. It is 120 percent.

Ms. SAUNDERS. Okay.

Mr. LUETKEMEYER. A while ago, we just established that the average is going to cost you $35. So, here we have a loan that is below the cost. Do you think they are going to make that loan if it is below the cost?

Ms. SAUNDERS. What they would probably do is make a better loan, that is a longer-term loan, that gives you time to pay it back.

Mr. LUETKEMEYER. No. The customer doesn't want—you see, that is the problem that you are getting into here. You are trying to drag them into something different. The customer just walks in and wants a 14-day loan until he gets to payday, and I will show you here in just a minute that there is a reason for this. And if you only use that amount of money, that is all you want, why should you drag the customer into something they don't want? That is my concern.

Ms. SAUNDERS. APRs give people the ability to compare the same amount of money—

Mr. LUETKEMEYER. APRs hide the true cost of the loan. I will argue that until—

Ms. SAUNDERS. And I would argue the other way around because it is usually—

Mr. LUETKEMEYER. Professor Johnson, I have a comment for you, before I end my testimony here. You are talking about having gone out and surveyed some different payday loan institutions. I would recommend to you, for reading, "The Unbanking of America," by Lisa Servon. She went out and did 4 months in 2 separate locations of check cashers and payday lenders. She had the same sort of preconditioned, pre-thought process that you have displayed today with regard to your testimony, and she came up with a completely different view of what happened. I suggest that you read that.

Mr. MEEKS. The gentleman's time has expired.

Mr. LUETKEMEYER. Thank you very much, Mr. Chairman.

Mr. MEEKS. The gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Thank you. Professor Johnson, who funded your research?

Ms. JOHNSON. The Ohio State University.

Ms. TLAIB. The university academics. I really pay attention to who is funding various research and books and things of that nature.

I want to focus on the truth today. We are calling this the rent-a-bank method, correct?

Ms. JOHNSON. Yes.

Ms. TLAIB. When someone is intentionally committing an act that is clearly illegal and uses someone else to do it, isn't that still a crime?

Ms. JOHNSON. Yes.

Ms. TLAIB. So, the truth is that the rent-a-bank is actually a criminal scheme, correct? Do you not agree, Mr. Knight?

Mr. KNIGHT. It depends on the nature of the action.

Ms. TLAIB. Got it.

Mr. KNIGHT. I don't want to give you a misleading answer.

Ms. TLAIB. That is okay. I will make sure to tell my son that hiding behind someone else when he is part of the crime—that he is still part of a criminal scheme if he does that. So you can all continue to say it depends, but the truth is you have State law that is being circumvented by these banks that are really targeting the most vulnerable communities, people that we represent. We are not here representing the banks and big corporations. We are elected by the people, not by them.

On December 5th and 6th, FDIC Chairwoman McWilliams had testified before various committees and was asked several questions about FDIC-supervised banks that are helping high-cost lenders evade State interest, abusing in these terminologies, really, to commit crimes, to basically sit back and watch them do it, whether or not their proposal that they submitted encourages those criminal schemes.

I specifically asked Chair McWilliams about these criminal schemes happening in my State, in Michigan, where we have really strong interest caps, and it is really important. We have a huge amount of working-class, middle-class families who are being targeted. Chair McWilliams said the agency, "frowns upon arrangements between banks and nonbank lenders for the sole purpose of evading state law." Great. Let's see that in action, right?

Ms. Aponte-Diaz, does this satisfy your concerns about the so-called rent-a-bank criminal scheme, is what I am going to be calling it, because that is the truth?

Ms. APONTE-DIAZ. Absolutely not. It has been lip service to date. There have been no enforcement actions on these rent-a-bank schemes from the FDIC, and the proposed rule actually is going to embolden predatory lenders to enter into more rent-a-bank schemes.

And if you don't mind, I just wanted to add to the many questions around access to credit. We recently did a study in South Dakota where voters, through a ballot initiative, voted 77 percent that they wanted a 36 percent rate cap. We came back 3 years later to ask folks how they felt about that, and 82 percent of the folks in the poll said that they are very happy with the 36 percent and they wouldn't change it. We saw, still, an increase in lending—not just stable but an increase in lending, in South Dakota. And so, I just wanted to add that as well.

Ms. TLAIB. And I think, Ms. Aponte-Diaz, we can do a lot of polling and surveys. That seems not to matter here. And it is the truth. It seems to me that there is a lack of a sense of urgency in trying to help middle-class families not become targets of these criminal schemes. And it may be corporations, it may be folks. But I will tell you, my residents get labeled these kinds of really awful names and so forth, and kind of get brushed off. But boy, if it is a corporation, a CEO, a bank, a predatory lender, it seems like we kind of give them a pass. And I feel very strongly about this.

Do you think FDIC's McWilliams is being straight with Congress about the criminal rent-a-bank scheme when, I believe the quote was, 'It is up to states to decide what rate caps are appropriate, if any, or whether or not the states want to opt out of that ability of the interest rates to be preserved when an out-of-state entity purchases the loan product." There is a lot of stuff here. But it is because of this that a Utah bank can simply claim that the loan was made in Utah because that is where the charges are imposed, and payments sent, but it is really in the fine print of the contract. It literally is on paper that they are circumventing the law. It is blatantly, in your face, a criminal scheme.

What more can we do, because it is very obvious that is exactly what is happening?

Ms. APONTE-DIAZ. Chairwoman McWilliams mentioned this opt-out, but States should not have to opt out. California spent 3 years going through the democratic process, and Colorado and South Dakota, through the ballot initiative. We should not have to go through these extra steps.

Ms. TLAIB. No. It undermines—

Mr. MEEKS. The gentlelady's time has expired.

Ms. TLAIB. Thank you, Mr. Chairman.

Mr. MEEKS. The gentleman from Kentucky, Mr. Barr, is now recognized for 5 minutes.

Mr. BARR. Thank you. I am stunned. I have never heard interest rate preemption that is specifically authorized under Federal law, the National Banking Act and the Federal Deposit Insurance Act, ever described as a criminal scheme. But nevertheless, I learn something new every day here.

Mr. Knight, many of the other witnesses here today have offered this narrative that banks in these partnerships are merely passive participants who allow bad actors to use their charters to prey on consumers. The title of this hearing, in fact, suggests that banks play no significant role in these partnerships. But in reality, the relationships we are discussing today are genuinely innovative partnerships that allow banks to provide access to credit to portions of the population previously underserved by financial institutions, or stuck with predatory payday lenders, check-cashing businesses, or pawn shops. In many cases, banks provide significant value to both their partners and the consumers, including by developing underwriting standards, retaining a portion of the risk on their books, and maintaining high standards of customer service.

Would you please discuss how banks play an important, active role in these bank fintech partnerships that we are discussing today, and discuss how banks have skin in the game?

Mr. KNIGHT. Yes. Thank you very much. Yes, I think that there is a concern that these partnerships are basically a bank handing a nonbank lender a stack of stationery and saying, "Go for it." And if that is the case, that is against the law, and the regulators already have tools to police it.

In reality, many of these partnerships are a collaborative effort between a bank and what amounts to sort of a vendor who can help them, from a technology perspective, from an underwriting perspective, with the utilization of technology, from a marketing perspective, and then from a balance sheet management perspective, which are things that banks contract to third parties all the time.

Mr. BARR. And then, banks have additional capital and they have underwriting expertise.

Mr. KNIGHT. They have capital. They have underwriting expertise. They have regulatory expertise.

Mr. BARR. Yes.

Mr. KNIGHT. The have the ability to help the fintech firm manage the efforts.

Mr. BARR. Well, let's just follow the logic of the critics that this is truly only passive conduct on the part of the bank. And I think by passivity they mean the loans are not kept in portfolio. But banks are passive in a number of other asset classes, and I don't hear our witnesses leveling charges of rent-a-bank for these activities. Consider a mortgage. Fannie Mae and Freddie Mac have very specific rules for what kinds of paper they will buy. Are they involved in a rent-a-bank when they insist on specific loan terms for mortgages, and then purchase them a few days after the loans are extended? Should we shut down that system and insist that Fannie and Freddie enter the direct lending market?

Mr. KNIGHT. No.

Mr. BARR. Okay. Let me ask you, Mr. Knight, in your testimony you note that the *Madden* decision resulted in the reduction of credit availability to residents in States within the Second Circuit, and that the rate of personal bankruptcy filings increased due to a lack of available funding options for borrowers. Would the FDIC and the OCC's proposed rules to clarify valid-when-made help reverse these credit availability issues?

Mr. KNIGHT. They would help.

Mr. BARR. And tell me, what would happen to the credit markets, particularly in terms of liquidity, when originators and purchasers of loans are not certain about the permissible interest rate for those loans?

Mr. KNIGHT. I think what we are seeing is that it dries up, and particularly for the riskier loans, the loans that would have to be priced at a somewhat higher interest rate, because there are concerns about their validity. People are not going to invest money in a loan that they are not certain will remain valid.

Mr. BARR. So the vibrancy of a secondary market is directly contingent upon the valid-when-made doctrine?

Mr. KNIGHT. Well, some combination of the valid-when-made doctrine and the ability of a bank to sell a loan and have it remain valid, which is a statutory power.

And, sir, if I may note, one more important thing in that partnership.

Mr. BARR. Sure.

Mr. KNIGHT. The bank has to own the credit model. The bank has to be the ultimate decision-making party. They own that regulatorily. They are responsible for the loans that are made. And if it isn't that way, that is against the law, and they are in trouble, and there are tools available to police that already, and the FDIC and the OCC have shown a willingness to do so.

Mr. BARR. Mr. Knight, final question. I represent a relatively rural district. I have some urban and suburban parts in my district as well, but I do think about my rural constituents a lot, in the context of access to financial services. A recent Federal Reserve study shows that 51 percent of the counties in the U.S. saw net declines in the number of bank branches between 2012 and 2017, and these declines in bank branches disproportionately hit rural communities. Another report by researchers from the Fed found that online fintech lending has penetrated areas that could benefit from additional credit supply, including those areas that have lost bank branches.

As banks are closing and consolidating, how are fintech/bank partnerships able to fill the void and service rural customers?

Mr. MEEKS. The gentleman's time has expired. The gentlewoman from Massachusetts, Ms. Pressley, is now recognized for 5 minutes.

Ms. PRESSLEY. Thank you, Mr. Chairman, and thank you to our witnesses for being here today.

It seems there is no lack of creativity when it comes to the financial industry's desire to exploit those facing hardship. To be clear, unless you believe that poverty is a character flaw, there is absolutely no justification for triple-digit interest rate installment loans. The unfortunate reality is that if 40 percent of Americans cannot afford a $400 emergency, then there are larger structural issues at play. People are not being paid enough for their work to be able to live, let alone save. In times of struggle, the options shouldn't be a debt trap interest rate or nothing at all.

This is particularly frustrating when States like my own, the Commonwealth of Massachusetts, go to great lengths to protect consumers from predatory lenders. Massachusetts maintains criminal usury laws, capping small loans at 23 percent interest while making it a crime to assist in providing a predatory loan, implicating the lender and the bank.

Ms. Johnson, how does this compare to protections in other States you have looked at?

Ms. JOHNSON. In response, I wanted to say that, yes, this isn't something new. The Pennsylvania attorney general sued Think Finance, who had rent-a-bank partnership with First Bank of Delaware, and rent-a-tribe partnerships, in other words, partnering with Native American tribes in order to charge triple-digit interest rates. The lawsuit is going forward against Think Finance as a criminal enterprise with this partnership with the Native American tribes. So, that is not something foreign. We have criminal usury statutes.

And in response to your question, we have some States suing civilly. We have some States suing criminally. But either way it goes, consumers need to be protected through these statutes to protect consumers from triple-digit interest rates.

Ms. PRESSLEY. Absolutely, and I still hear from folks in my district, Massachusetts 7th, and across the State, about the continued availability and marketing of these predatory loans.

There is also a question of what happens when the debt from these loans is sold. So Ms. Saunders, how might a debt collector's pursuit of the purchased loan differ from that of a lender illegally operating in the State?

Ms. SAUNDERS. Debt buyers who buy charged-off debt are obviously going after people who are struggling the most and who often have been the target of predatory lending. And we have heard a lot of talk about the *Madden* case. Well, debt buyers are buying charged-off credit card debt for pennies on the dollar. They do not need to charge outrageous interest rates on top of that, and certainly the *Madden* court was correct that it doesn't hurt banks not to let debt buyers continue to pile on to people who have been the target of predatory lending.

Ms. PRESSLEY. I think we eliminated debtors' prisons in something like 1833. But last December, ProPublica published their report entitled, "The New Debtors' Prisons," highlighting University of Utah law professor Christopher Peterson's work on the skyrocketing abuse of the States' small claims courts.

And I ask for unanimous consent to submit this article for the record, Mr. Chairman.

Mr. MEEKS. Without objection, it is so ordered.

Ms. PRESSLEY. Mr. Peterson's research is just one more case study into our continued criminalization of poverty and the weaponization of the legal system against those who are already living on the margins.

Ms. Saunders, do you believe that what we are seeing in Utah can spill over into States with stronger consumer protection?

Ms. SAUNDERS. Yes. Unfortunately, we are seeing that Utah is the center of a lot of this predatory rent-a-bank lending. We have FinWise Bank there and others that are enabling debts of thousands of dollars, tens of thousands of dollars, over years, at 160 percent APR or higher. There is a $4,500 loan that will cost $13,000 to repay. APRs matter.

And if the lack of oversight and rate caps in Utah can spread across the country, then every State, including your own, will be the subject of predatory lending.

Ms. PRESSLEY. Back in 2017, Massachusetts Attorney General Maura Healey settled with the State's then-largest debt collector for $1 million for egregious abuse of the State's small claims courts to collect from folks whose incomes were exempt.

Ms. Saunders, what does it mean to have exempt income, and what are the unique risks of these aggressive collection practices to vulnerable communities?

Ms. SAUNDERS. Exempt income is income that you need for basic necessities—food, medicine, rent—and income that, like Social Security, other forms of pension, public benefits, and certain amounts of wages, are exempt from collectors, because we don't believe that people should have to starve because they are in debt.

Ms. PRESSLEY. That is right. It seems that this is less access to credit or really just access to debt.

Mr. MEEKS. The gentlelady's time has expired.

Ms. PRESSLEY. Thank you.

Mr. MEEKS. The gentleman from Texas, Mr. Williams, is now recognized for 5 minutes.

Mr. WILLIAMS. Thank you, Mr. Chairman. Interest rates are the price of obtaining credit. I am a small-business owner in Main Street America. I have been in business for 50 years and have never had one day in my business life that I have been out of debt.

In any line of business, price is determined by calculating many different factors. A business must cover the cost of hiring employees, keeping inventory, and paying taxes, just to name a few.

Tom Miller, of Mississippi State University, stated, "Although a 36 percent interest rate might sound high and profitable, personal installment loans are profitable at that rate only if the loan exceeds a certain size threshold. If we set a national rate cap at 36 percent, many of those innovative products that are filling a need for many people in our economy, would no longer be profitable and would cease to exist.

"Rather than increase government intervention with a national rate cap, we should allow capitalism and the free market to determine the price of obtaining credit. This is called competition."

Before I continue with my questions, Mr. Knight, are you a proponent of capitalism or are you a socialist?

Mr. KNIGHT. I am a proponent of capitalism.

Mr. WILLIAMS. Thank you very much. That is a great answer. We are doing good this year.

This issue is about personal and financial freedom. If we, in Congress, set an arbitrary rate cap on what we think is too high an APR, we are limiting customer choice and saying that the government knows your financial situation better than you do. Unfortunately, some of my colleagues seem to believe that if we legislate high APR loans out of the marketplace, the demand for these products will simply go away.

However, statistics show that millions of Americans lack the ability to pay for a $400 emergency expense. We should be spending our time on legislation that allows people to save more of their hard-earned money and build personal wealth, rather than limiting the options available to them when they are most in need of assistance.

Mr. Knight, can you elaborate on what population would be most hurt by enacting a national interest cap, and what would happen to their availability of credit?

Mr. KNIGHT. Yes. In terms of access to credit, the population that would be most likely to suffer would be the more marginal borrowers, your relatively less affluent, your relatively young. Underrepresented groups would likely see a reduction in access to credit.

Mr. WILLIAMS. A Bloomberg analysis showed that 5 years ago, 22 percent of Wells Fargo's consumer loans were made to customers with credit scores below 680. Today, this number has shrunk to 11 percent. Traditional financial institutions are having to avoid riskier lending after greater pressure from regulators following the financial crisis, and more government involvement. Unfortunately, these changes have made obtaining credit much harder for a person of that population.

So Mr. Knight, can you explain how greater bank partnerships can help solve this issue, and the benefit to consumers that it would create?

Mr. KNIGHT. Yes. There is a benefit in two ways, potentially: one, better access to assessment underwriting on the front end; and two, better balance sheet management and servicing on the back end. So a bank is able to leverage a partnership to access customers, underwrite them, service them, and move the credit off of their balance sheet into either a loan sale or a securitization, which is very similar to what we do with any number of other things like credit cards, car loans, et cetera, and then have that loan serviced. And this allows, particularly smaller banks, to access these markets, which allows for greater competition in the credit markets.

Mr. WILLIAMS. And most people deal with smaller banks. Mr. Knight, in your testimony you talk about innovation and the benefits of bank partnerships with fintech companies. There is a misconception that these partnerships operate outside the bounds of any laws. So, could you talk briefly about some of the third-party guidance that currently exists, and how it helps protect consumers?

Mr. KNIGHT. Sure. Both the OCC and the FDIC have strong third-party guidance that both places a strong burden on the bank to manage its partner and the conduct with its partner, and holds the bank accountable for the auctions of its partner as if the bank did it themselves.

Also, under the Bank Service Company Act, to the extent that the partner is providing services for a bank, be it marketing, underwriting, or servicing, or something like that, that partner is also subject to examination by the bank regulator. And if you talk to some of these firms, you will see that they have bank regulators coming in to visit them.

Mr. WILLIAMS. I yield back. Thank you for being a capitalist.

Mr. MEEKS. The gentleman yields back. The gentleman from Illinois, Mr. Garcia, is now recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Mr. Chairman. I live a half-block from Main Street in a Chicago neighborhood, and I have seen how predatory payday loans and sky-high interest rates are trapping too many consumers into debt traps. Consumers might take out a small-dollar loan to meet a short-term need, only to find that they can't keep up with the triple-digit interest rate on that loan. Soon, they are forced to take out another loan to meet the need, stacking debt on top of debt, and trapping them in a vicious cycle.

Ms. Saunders, can you tell us very briefly two instances of what happens when people get caught up in a debt trap, and what are the hardships and health consequences that consumers face?

Ms. SAUNDERS. Sure. When they get into a debt trap, they have trouble meeting other expenses. Especially when they have very aggressive payday lenders or debt collectors after them, they may have trouble buying medicine or buying food or paying for their rent. In addition, these predatory lenders often require access to their bank account, and they take out money before they have paid for expenses, and they are going to incur overdraft fees and NSF fees.

Mr. GARCIA OF ILLINOIS. Thank you. One major reason why I think it is so important for this committee to pass my bill, the Veterans and Consumers Fair Credit Act, is that the protections in the Military Lending Act have been shown to work. Veterans and military groups support my bill because they are familiar with the research showing that the Military Lending Act protects active duty servicemembers from predatory loans and so pushes them towards healthier forms of credit.

Assemblywoman Limon and Ms. Aponte-Diaz, what alternatives to payday loans exist out there that comply with the 36 percent rate cap but make sure that people get the credit that they need without falling into a debt trap, and how have consumers fared in States with strong interest rate caps in place?

Ms. LIMON. Thank you, and I want to point out that California has the California Pilot Program for Affordable Small Dollar Credit, and we have had that in place for a number of years, and that caps loans under $2,500 to 36 percent. So, that exists. It is a market that has been increasing over the last few years, and what we have also seen is that businesses are looking for regulatory stability to keep investing in this space.

Mr. GARCIA OF ILLINOIS. Thank you.

Ms. APONTE-DIAZ. And I will just add, I am from a State, Maryland, which has never had payday loans or high-cost installment loans, and there are multiple other ways to access credit. There are credit cards. There are also credit unions, and to your point, minority depository institutions, and credit unions are not charging more than 36 percent.

There is also just the targeting—the marketing done by these high-cost lenders is why it is concentrated in communities of color. It is on your phone. It is on our radio stations. It is everywhere. So this is sort of what our community thinks, this is what is available. But there is a lot more. There are emergency programs for utility companies. There are nonprofits, churches, and a lot of other things. But we are bombarded with the marketing from these high-cost lenders.

Mr. GARCIA OF ILLINOIS. Thank you. A little bit of history on this issue for a moment. In 1978, Robert Bork, a well-known jurist in our country, argued and won a Supreme Court case that allowed banks to exploit high-interest rates.

Here is how Binyamin Applebaum described what happened next in his book, “The Economists’ Hour”: “Citicorp’s vice chairman compiled a list of five states that had lenient laws or might be willing to write new laws. One of the five names on the list was South Dakota, which was already moving to get rid of its interest rate caps. The bill sailed through the legislature and was signed into law.

“But that wasn’t enough. Under Federal law, banks needed an invitation to enter a new state. Citicorp executives flew to South Dakota and promised to bring 400 jobs.—you may have heard that earlier—The company gave the text of the desired invitation to South Dakota’s Governor, Bill Janklow. The necessary legislation was introduced on the last day of the legislative session in 1980, passed by both houses, and the same day signed into law by Janklow before the sun went down. He also declared that the need for jobs was an emergency, so the law took effect immediately.”

Four hundred jobs saved the State of South Dakota. Ever since then, South Dakota has exported high interest rates to consumers all over the country. So, that is why we are advancing this bill. We need to learn from history and not repeat those mistakes.

Mr. MEEKS. The gentleman’s time has expired. The gentleman from Tennessee, Mr. Kustoff, is recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman, and I do want to thank the witnesses for appearing this morning.

Mr. Knight, if I could, I would like to plow over some ground that I know that we have talked about this morning, and make a couple of observations. One, and again, we have talked about this, I think every Member of Congress has constituents who lack the ability to pay a $400 emergency expense. They are my constituents, and everybody else represents these hard-working people as well, who literally do work paycheck to paycheck.

The second observation is, as we have talked about, we have a number of people in our communities, for all the reasons we have discussed, who are becoming unbanked or underbanked. So again, if we look at capping interest rates at, say, 36 percent, a couple of questions. One is, what happens to access to credit for those who are unbanked or underbanked, in my district or any other district, maybe whose credit score is around 600, give or take? If you could address that question first.

Mr. KNIGHT. We would expect to see a rationing effect of credit, so some loans would not get made because they could not be made profitably. We would also expect to see a distortion in the model of credit, because APR is just one factor in a loan. And so if you have to squeeze the balloon, you would see either larger loans being made or longer timelines being made, or some combination thereof.

There is also evidence that you would see a shift from independent loans to loans secured by something, or loans made by, say, a seller. There is a CFPB working paper that shows that in the presence of a binding usury cap, you don't see subprime independent auto loans. You see the dealer, the subprime car dealer, be the only lender, because they can raise the cost of the car. So it is a smaller interest rate but applied to a bigger principal, which becomes a problem if you want to prepay the loan or default on the loan, and you end up buying less car for more money.

Ms. APONTE-DIAZ. Can I just add that payday lending actually leads to being unbanked.

Mr. KUSTOFF. Thank you. Mr. Knight, if we could look from the historical perspective and maybe look 5, 6, 7 years ago at Chile, they instituted a cap rate of 36 percent on small loans, unsecured loans. Are you familiar with what happened in that country?

Mr. KNIGHT. There was, as expected, a rationing of credit. There was a reduction in access, and the reduction in access fell disproportionately on the relatively poor and the relatively young.

Mr. KUSTOFF. And what further result occurred when they capped the rate at 36 percent?

Mr. KNIGHT. My recollection is that, yes, there was that rationing of credit. You saw fewer loans being made, and people had to then compensate in some other way. And there is other evidence and other scholarship that indicates that in the presence of credit rationing, particularly something like subprime credit rationing, people move to other alternative forms of credit. They don't go with a credit card. They go to another alternative form or something like overdraft.

Mr. KUSTOFF. Thank you. So as far as usury laws are concerned, they essentially set a cap on the price that a lender can recoup from making a loan, unless, of course, the lender gets into fees and other charges. Can you talk about how those laws affect the incentives to lend in a given market?

Mr. KNIGHT. Yes. As I mentioned, a usury cap is going to disincentivize loans made to relatively risky borrowers, because they cannot be made profitably over the portfolio of loans. They are also going to incentivize either shifting to more fee income rather than interest rate income if the law allows for that, or shifting the structure of the loan to be generally high principal and longer term, so that while the APR is lower, it is actually acting on a higher principal for a longer period of time.

A useful exercise is if you compare a 30-year mortgage at 4 percent APR to a payday loan of 2 weeks at 500 percent APR, taken to their natural term, as interest is a percentage of principal, it is actually higher with the mortgage, because even though it is a lower APR, it is a longer loan.

Mr. KUSTOFF. Thank you. My time has expired, and I yield back.

Mr. MEEKS. The gentleman yields back. I now recognize the gentleman from Texas, Mr. Green, who is also the Chair of our Subcommittee on Oversight and Investigations, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witnesses for appearing as well.

Mr. Knight, persons who are caught in this debt trap, who received loans that they could not afford—what do you propose we do for the countless number of people who are caught in these debt traps? Do we just write them off as persons who should not have engaged in this process? They should have been better educated? Maybe they should have made more money. Perhaps, they shouldn't have been poor. But what do we do? We have people who are being harmed when we know that things shouldn't be occurring as they are. The Supreme Court has ruled, since the 19th Century, that you cannot engage in a scheme to create loans that are usurious. So, what do we do?

Mr. KNIGHT. Thank you very much for your question, sir, and it is a very valid concern about the plight of people who are trapped in suboptimal situations. I don't mean to make light of it. It is a very real concern. And I would say that I think we are looking at sort of a two-pronged issue. One is the underlying macroeconomic situation.

Mr. GREEN. I understand that, but let's not use my time explaining the micro or the macro either, of economics. Tell me, what do we do with the people, for the people?

Mr. KNIGHT. I would say that our best bet is to provide people with better options, because the risk we run is that you can legislate away the supply of credit, but you cannot legislate away the demand for credit. So, the solution is to provide better options for credit for people who are poorly served. I don't think anyone thinks that a payday loan is the pinnacle of credit, and I hope we move to something that is better and more broadly available.

Mr. GREEN. We are talking about people now who are entrapped into this cycle of borrowing. We know that it is unlawful to develop a scheme such that a bank and a nonbank entity can enter into it for the purpose of having an interest rate that they could not ordinarily have in a given State. That is unlawful. So, what do we do? What do we do for the people who are caught in this trap?

Ms. APONTE-DIAZ. Can I add that this is a bigger problem than just access to loans. This is low wages, historically, in our country.

When the gentleman speaks about Chile, if we are following what is recently going on in Chile, there is a huge inequality issue in Chile, and they are still struggling because of wage issues.

So we need to not try to solve this problem by giving people loans of 150 percent APR. Even at 36 percent, a $10,000 loan costs $10,000. So APRs do matter, and this is not the solution that we should be talking about, "Oh, we should let the free market charge whatever, 100 percent." Thirty-six percent is generous. It is a very generous number to say that you can charge someone that amount.

Mr. GREEN. Thank you. Mr. Knight, back to you. What do we do when we have persons who are in this position? We have at least one recommendation, but the other side doesn't offer any alternative. They don't come with a plan to help extricate people from the enigmatic circumstance. Their plan is leave things as they are. This is the way things are and they should continue to be. I am asking you for a plan. What do we do? There is a plan on the table. What do we do?

Ms. Johnson, are you attempting to weigh in?

Ms. JOHNSON. I was not, but I was just thinking in my head that we need to pass—if we don't want an interest rate cap, then we need to say that banks in partnership with nonbanks should not be able to do multiple rollovers, should not be able to extend the maturity date multiple times, should not be able to electronically debit people's credit cards or bank accounts over and over again, and should not engage in illegal garnishments in order to collect on the debts. In other words, we need to—if we are not going to have an interest rate—

Mr. GREEN. With my time that I have left, pardon me for interrupting, I am going to challenge my colleagues on the other side to give us a solution as opposed to an objection. I yield back.

Mr. MEEKS. The gentleman's time has expired. I now recognize the gentleman from Tennessee, Mr. Rose, for 5 minutes.

Mr. ROSE. Thank you, Mr. Chairman, and I thank Chairwoman Waters and Ranking Member McHenry for organizing this hearing today.

Mr. Knight, I think as has already been discussed here today, the valid-when-made issue is often confused or used interchangeably with the True Lender issue. When Chair McWilliams testified in a Financial Services Committee hearing here in December, she tried to clarify that the FDIC's proposed rule did not touch the True Lender doctrine. Do you agree with Chair McWilliams' assertion that the True Lender question is outside the scope of this rulemaking?

Mr. KNIGHT. I do.

Mr. ROSE. Thank you. When done properly, bank partnerships with nonbank lenders are good for consumers, good for competition, and good for innovation. These partnerships and a healthy secondary market for loans also help extend credit to consumers who might not otherwise be able to access it. This includes many of my own constituents in the Sixth District of Tennessee.

Mr. Knight, in your comment letter supporting the OCC's rulemaking, you noted that these bank partnerships are a critical aspect of the business of banking. You go on to also say that having these loans remain valid is critical the modern economy. Why is the ability to sell a loan important for banks?

Mr. KNIGHT. It is important for banks because it is an important function of safety and soundness concerns, the ability to shift risk off their platform in a meaningful way, and a potential source of revenue, particularly for smaller banks who don't necessarily have the deposit base to hold a whole bunch of loans on their balance sheet, given the regulatory requirements that they face.

And so, if we want, particularly smaller community and other banks to be more competitive going forward, they need options to manage that, and these bank partnerships provide such an option when done well.

Mr. ROSE. Earlier, Ms. Tlaib cut you off when asking about the illegality of these arrangements. Would you like to take a moment and complete your response there?

Mr. KNIGHT. Sure. The point I was going to make is it is not that—I think we need to distinguish between a rent-a-bank scheme and a bank partnership, because they are two separate things. A rent-a-bank scheme is where the bank is a passive party that basically just allows whomever, the nonbank lender, to impersonate it and just sign off on everything that is done.

In these bank partnerships, the bank actually exercises ownership, discretion, and control. They are ultimately responsible and they ultimately have the final say, and they have a relationship with these partners akin to that of a vendor.

Mr. ROSE. I think you made an important point in your comment letter that I would like to highlight here today, and you just reiterated a few moments ago, which is that diminishing access to credit does not diminish the need for credit. I see this in my district, and I want to make reference to Mr. Luetkemeyer's comments earlier about what happens when we restrict the ability of individuals to get those small-dollar loans that they may need, on terms that they want, which is to borrow for a very short period of time. I see this in my community all the time and I just want to stress the importance that we may think, when we impose statutes that limit those types of transactions, that they somehow go away.

But I can assure the listeners, and our experts testifying, and my colleagues, that they don't go away, that people find ways to get the credit they need, whether that be by extending terms in some way or whether it be by seeking that credit through nontraditional sources, and that is what I often see in my community, where I guess so-called bootleg lenders are available, loan sharks, if you will, that unfortunately, we force borrowers to seek out when we restrict their ability to access the credit that they want and that they need through traditional terms.

I want to conclude by just stressing that it is important to note that in the 115th Congress, this committee passed legislation, on a bipartisan basis, that would have codified the valid-when-made doctrine. And when that legislation, H.R. 3299, came to the House Floor, it again passed with bipartisan support. And so I think we would be well-advised to keep that bipartisan mindset in mind. I yield back.

Mr. MEEKS. The gentleman yields back. I now recognize the gentleman from Florida, Mr. Lawson, for 5 minutes.

Mr. LAWSON. Thank you, Mr. Chairman. I would like to welcome you all to the committee. And I will start out with you, Ms. Saunders. Can you please explain the True Lender doctrine?

Ms. SAUNDERS. The True Lender doctrine is just a variant of centuries-old rules that usury law should not be evaded. The Supreme Court, as early as, I think, 1838, and probably earlier than that, has said that we are going to look beyond the form of a transaction, because predatory lenders are very creative, and we are going to prevent evasions. True Lenders is one form of evasion where a State-regulated lender hid behind a bank, but the payday lender or the regulated lender is the true lender.

Mr. LAWSON. Okay. Mr. Knight, did you want to comment on that?

Mr. KNIGHT. Yes. I just to elaborate that the doctrine is not universally applied. Some courts apply it, and some courts adopt a more contractual analysis of whomever the lender is on the contract is deemed to be the lender. As I mentioned earlier, it seems that the emerging trend is to look at who has the predominant economic interest in the loan. So if a bank already has a purchaser lined up for the loan, that weighs against the bank being the true lender in the court's mind, versus a loan that the bank intends to hold for a while.

For example, the *Madden* decision doesn't deal with True Lender because the bank held the loan until it defaulted.

Mr. LAWSON. Professor Johnson, how do you feel about that?

Ms. JOHNSON. The True Lender doctrine—first of all, I agree with my fellow witness that it is a longstanding doctrine. And what we are talking about with these new transactions, at the end of the day the payday lender or the nonbank lender performs all of the servicing functions, all of the debt collection functions. The bank itself might have an interest that effectively amounts to 10 percent, maybe 20 percent of the receivables. To me, that is not a situation where the bank is in control. He is describing a scenario where the loans are on the books of the bank.

In the cases that we are talking about, including pending cases—and I would direct you to read my statement where I talk about Kabbage, a fintech lender which has partnered with Celtic Bank in Utah—at the end of the day, the nonbank, Kabbage, is basically doing all of the lending functions, all of the servicing-related functions, and so Kabbage should be the true lender.

Simply saying the bank is involved somehow in a way with the partnership does not do away with the fact that the predominant economic interest is still with these nonbanks. Therefore, if we are not going to cap the interest rates, we should do something else about what the nonbanks can do in terms of servicing these debts and collecting on these debts.

Mr. LAWSON. Professor Johnson, in capping the interest rates, will that provide more opportunities for individuals, especially in minority communities, where they have to go, oftentimes, to payday lenders in order to make it to their next paycheck?

Ms. JOHNSON. Capping interest rates may drive down payday lenders in the community, but it doesn't mean that there are not other lending alternatives. As my fellow witnesses identified, you have millions of dollars being spent in advertising by the for-profit, nonbank lenders, whereas credit unions and some of these other entities don't have all of that advertising. So the person in your community may not realize they can just simply go to a credit union and get the same type of loan, except at a better interest rate, on better terms, and not only being paid back over a longer period of time, also benefitting from budgeting and other services provided by the local bank or community bank or credit union.

Mr. LAWSON. Ms. Limon, would you like to comment on that?

Ms. LIMON. Thank you. I would say that States are doing different things. There are multiple options. California has a pilot program. But I think that another piece that is really important to highlight is that as we have this conversation about rent-a-banks, they are really going around State laws. In July of 2019, before the bill had passed in California, before it had been signed by the governor, there was a conversation with these companies about how they were going to evade the law, and that, I think, is what we are trying to get at, how we ensure that these companies don't evade the law by finding a partner outside of the State to do business as usual and offer products that are not good for consumers.

Mr. MEEKS. The gentleman's time has expired.

Mr. LAWSON. Thank you.

Mr. MEEKS. I now recognize the gentleman from Georgia, Mr. Loudermilk, for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman, and I thank the panel for being here. This is a very important discussion we are having here, because what we need to be focused on is how do we make finance available, especially to most vulnerable communities. And I think what my friends on the other side of the aisle are doing is going to be harmful to those very communities. I am talking about rural and minority communities, because those are the ones that have a problem getting access to capital.

And I appreciate the comment that was just made about a conversation of evading the law. I know of the conversation, but I don't know that anything has transpired with that. So, Mr. Knight, I would like to ask you a series of quick questions, because I think what has happened is we have demonized something that has been standard operating practice in the financial services market for a couple of centuries.

Now, since we have been here today, some have tried to portray the OCC and FDIC rulemaking on valid-when-made as a new regulatory giveaway to banks. My understanding is the *Madden* decision deviated from nearly 2 centuries of precedent in banking law. Is that true?

Mr. KNIGHT. I believe so.

Mr. LOUDERMILK. Do these proposed rules change the agencies' underlying policy, or do they simply codify the agencies' longstanding position?

Mr. KNIGHT. They codify the longstanding position.

Mr. LOUDERMILK. Two centuries' worth of longstanding positions.

Mr. KNIGHT. Yes.

Mr. LOUDERMILK. That has worked very well.

Mr. KNIGHT. Yes.

Mr. LOUDERMILK. When I make a loan, I really don't care what happens on the back side of it, as long as my interest rate is the same all the way through. I am okay if it goes down, but I need to know that that interest rate is going to stay the same. And the person loaning the money to me needs to be profitable so they can make more money. I think that is an important position to have.

Another question: Nonbank lenders are not permitted to export interest rates unless they are partnering with a bank or credit union that originates the loan, is that true?

Mr. KNIGHT. I would clarify that the bank or credit union is the one exporting the interest rates, because they are the lender.

Mr. LOUDERMILK. So there is a bank, a regulated bank, on the back side of this. Correct?

Mr. KNIGHT. Correct.

Mr. LOUDERMILK. In order to benefit from the bank's interest rate exportation authority, nonbank fintech lenders must submit to regulation as third-party service providers by the banking regulators, and the bank is accountable for the actions of its fintech partners. Is that correct?

Mr. KNIGHT. In the bank partnerships we are talking about, that is what the law says.

Mr. LOUDERMILK. And that is what we are worried about, is these fintech partnerships.

Do Federal banking regulators check to make sure these loans are made lawfully during the exam process?

Mr. KNIGHT. Yes.

Mr. LOUDERMILK. They do. Is there widespread abuse of these bank partnerships by payday lenders?

Mr. KNIGHT. Not to my knowledge.

Mr. LOUDERMILK. Do you know of any that are exporting it?

Mr. KNIGHT. I do not know of any.

Mr. LOUDERMILK. Okay. I haven't heard of any either. Kabbage was brought up. I had a small business. We had lines of credit. We were going through a traditional bank and credit unions for small-business lending. After the Dodd-Frank Act, my business no longer qualified for those loans. Had there been a Kabbage available, I would have been able to save a lot of employees that I had to lay off because I couldn't have access to capital. So I think we need to be very careful in demonizing businesses that are actually providing funding to markets that traditional banks and credit unions can't.

Ms. APONTE-DIAZ. Can I add something?

Mr. LOUDERMILK. I am not quite done yet. Why has the availability of credit decreased and personal bankruptcies increased in the three States since the Second Circuit made the *Madden* decision?

Mr. KNIGHT. Based on a recent study, the authors link it to the lack of access to marketplace lending and the inability of borrowers who would otherwise be able to either refinance an existing loan or deal with exigent circumstances like a medical bill, the inability to access credit.

Mr. LOUDERMILK. And low-dollar loans are an issue. I apologize, but I have a short amount of time, and I always run out of time.

Regarding another issue which we are talking about, a national interest rate cap, here is a concern I have. The small-dollar loans are a big problem. Forty percent of Americans can't afford a $2,500 emergency that they have. They need access to credit. The problem we have, as a George Washington University study indicated, is that the break-even APR of a $2,600 loan is 36 percent. That is the break-even APR, which means if you are going to borrow below that, you need to have some higher interest rates. Right?

So a 36 percent national interest rate cap would effectively eliminate loans under this amount. A study by the Federal Reserve Bank of New York indicates that up to 60 million Americans do not qualify for traditional bank—

Mr. MEEKS. The gentleman's time has expired.

Mr. LOUDERMILK. Mr. Chairman, may I submit the study for the record?

Mr. MEEKS. Without objection, it is so ordered.

Mr. LOUDERMILK. Thank you. I yield back.

Mr. MEEKS. The gentleman from Washington, Mr. Heck, is now recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman, and I want to thank all the members of the panel as well for their presence today, and more importantly, for their advocacy on behalf of people who need a voice. Frankly, the older I get, the more I have come to the conclusion that if we are not here to give a voice to people who don't have one, I am not quite sure why we are here.

I appreciate much of the conversation thus far. I appreciate what I think is an important element of this, which is the access to credit issue and the implications of this proposed policy, and the oft-cited data point, which Congresswoman Pressley cited, that 40 percent of American households don't have $400 to meet an emergency need. And that is a balancing consideration of this debate going forward.

I do think there should be a balancing consideration of what is it that States have actually done, albeit too few of them, and the graph happens to be up right now as I speak. I am from Washington State, and we are pretty proud of our efforts at consumer protection. Years ago, we enacted a payday lending limitation statute, which was very hard-won. We are talking tooth-and-nail, knock-down, drag-out. And by just about every measurable account, it is working.

Now I don't pretend to be a total expert, but here is what I do know. I know the reports are good from consumer organizations and the regulator. I know that the number of payday lending locations has declined by 90 percent, payday lending dollar volume is down 83 percent, and perhaps best of all, the number of complaints filed with our regulator has decreased from hundreds per year to 40. It seems to be working.

That begs a question for me in the broader context of this. I think, Ms. Saunders, I would like to ask you, is there a compelling argument for State preemption, or Federal preemption of State statute, State policy, when there is arguably a comparable consumer protection regime?

Ms. SAUNDERS. No, there is not. As I said in my opening statement, it is as American as apple pie for States to have interest rate caps to protect their residents. All of the States have them. Of course, it goes back to the Bible, and most States have them today.

Unfortunately, although, Washington State has good laws, and it is a modest law, no more than eight rollovers, and yet the payday lenders couldn't live on that abusive model. But in Washington State, although you only allow 29 percent on a $2,000 loan, there is a rent-a-bank lender, OppLoans, that is using FinWise bank in Utah, which is making 160 percent APR loans up to $4,000 in Washington State. And there is nothing under the National Bank Act that allows nonbank lenders to obliterate the centuries-old usury caps that States like Washington have, to protect your citizens.

Mr. HECK. So your point of view, and I am asking in all sincerity, is that Washington State law does not protect its consumers to a sufficient degree, notwithstanding the data I shared and the reports I get?

Ms. SAUNDERS. The Washington State laws are quite good, but there are a couple of lenders that are starting to evade them using this rent-a-bank model. And if we don't put a lid on it right now, you are going to see a lot more problems.

Mr. HECK. Isn't there a way to solve that without an overall rate cap?

Ms. SAUNDERS. Well, I think an overall rate cap would cut off the worst of the high-cost rent-a-bank lenders, but we also can simply stop banks from exporting high-rate loans into States like Washington that don't allow it.

Mr. HECK. So remember my premise here, which is that we are here to provide and extend protection to people who are vulnerable. I think it is worth keeping in mind that Federal preemption is a two-edged sword, and that what one hand giveth, the other hand can taketh away.

And I always feel compelled to remind people that if we want to go down the road of Federal preemption, understand there is another side of that coin, that if Federal preemption seeks to, if the policymakers seek to, they can remove those consumer protections.

I have had this argument or debate or good-hearted back-and-forth with my colleagues on this committee for quite some time as it relates to insurance regulation. I live in a State where the insurance commissioner is doing a great job, and I don't want somebody to come in and set a lower standard than he has set. And the same danger presents itself when it comes to this area.

But I will take into account and further plumb your feedback on our law—

Mr. MEEKS. The gentleman's time has expired.

Mr. HECK. —and I guess I am going to stop talking.

Mr. MEEKS. The gentleman from Ohio, Mr. Davidson, is now recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman. And thank you to our witnesses. I appreciate your efforts to make sure we get this right.

Mr. Knight, I think you said it perhaps best, that Congress could enact legislation that would restrict the supply of lending, but we wouldn't be able to dramatically affect the demand. And so, what happens when we have big disconnects between supply and demand? Normally black markets form, right? So, we have large black markets all around the United States, it is a significant part of U.S. GDP, and a lot of that is attributable to broken market systems. And some of those are the result of legislation.

So could you highlight how a rate cap would do just that, limit supply without checking demand?

Mr. KNIGHT. Yes, absolutely. Ironically, one of the great progressive reforms in this very area was the Uniform Small Loan Law of 1916 by the Russell Sage Foundation, and their recognition was that usury rates were too low to attract legitimate lenders and that they needed to actually allow people to make profitable loans. And when they made those reforms, they were opposed by the religious leaders and all who wanted the much lower rates, but also loan sharks, who wanted to continue to operate illegally and not face legitimate competition. And so the risk we run if we set an interest rate that is binding and limits and constricts credit is that either we cut people out of the legal system and they have to go seek some inferior alternative, including loan sharks, or we have to distort credit products so that they are inferior to what they would have gotten otherwise, and, therefore, are a worse fit than they could have had, had we left the market.

Mr. DAVIDSON. Thanks for that basic explanation. And my colleague, Mr. Green, was highlighting what is the alternative. Well, the alternative is to make the economy grow, to create more jobs than there are people to fill them, to see wages rising instead of stagnant, to have wages at the bottom portion of the economy growing faster than wages at the top of the economy, to get past the broken status quo of stagnant growth and on to the economy that we are enjoying today. And we did that largely through deregulation, tax reform, and incentivizing investment in the United States and growth. We still have a long way to go, but we are making progress.

Ms. Saunders, as you are aware, this past year Ohio passed a law that regulated payday lenders, or lenders in question related to this year. Pew, a consumer advocacy group, very similar to your organization, NCLC, has said that the Ohio legislature got payday loan reform right. The structure of the loan has an interest rate component plus fees.

Here is an example of what Ohio's law allows. If you lend $300 for 4 months under current Ohio law, the APR could be as high as 161 percent, depending on what day of the month the loan is originated. It doesn't appear that Pew thinks a 36 percent rate cap is the right reform. They also support bank lenders that charge rates at least double the 36 percent rate. Why is there a disconnect between Pew and NCLC?

Ms. SAUNDERS. I think Ohio is following the path of Colorado. Ohio voters voted to cap rates at 28 percent, overwhelmingly, back in 2008, but the payday lenders decided to call themselves mortgage lenders in order to be able to charge a fee allowed for mortgages, and they got around it. And the legislature, where there is a lot of big payday loan money, unfortunately, blessed that.

Eventually, after a lot of hard work, going up against big money from predatory lenders, the Ohio Legislature came up with something that allows high-rate loans, like Colorado did. But eventually, Colorado voters voted for a 36 percent rate cap.

Mr. DAVIDSON. And fees. And then what will happen is the same challenge of black markets.

Professor Johnson, I like your framework, and as another Ohio person, thanks for coming to share your expertise in the field. I like kind of the rubric that you laid out, but I don't necessarily understand the mechanisms of how it works, for example, debt entrapment. Could you explain how someone is forced to take this loan?

Ms. JOHNSON. Okay. So by debt entrapment, I don't mean that somebody is being forced to take the loan. By that, I mean that you have set up a scenario where a person is signing up for a loan, not really understanding the consequences of that loan. For example, if we talked about the payday loan rule that was to take effect this past year, it would have required you to do the ability to repay, right? So underwriting, ability to repay, that should be something that should happen now.

Mr. DAVIDSON. So, sound underwriting practices would help make a difference. And frankly, I would like to go into a lot of areas where we totally disregard sound underwriting practices and we socialize the risk. We distribute the risk over everyone, including people who can qualify for lower rates.

So, thanks for the hearing, and—

Mr. MEEKS. The gentleman's time has expired. The gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Mr. Chairman, and thank you to the witnesses for being here. I apologize that I wasn't here earlier. I also sit on the Foreign Affairs Committee, and we were dealing with the unique challenges that women face in global health, and I wanted to be there for that presentation.

But now that I am here, I do want to ask this. APR does matter, and if you don't think it matters, we don't take those 300 percent loans. I always tell my two daughters, "Don't listen to what people say. Watch what they do." You go to the beach and they say, "Oh, the water is warm." I say, "Why aren't you in it?" "Hell, no. I am not getting in that cold water." We don't take those loans, because we think they are predatory. That is why we don't take them.

But I did want to talk about State rights versus Federal preemption. It is interesting. I have been around long enough to listen to Republicans always talk about strong State rights, except when they don't like them, and then they are against the State rights and the Federal Government should be involved.

California Assemblymember Limon, you passed a law, and it seems to be working. Obviously, it is early on. Can you comment on the process you went through, and the State went through, to do that?

Ms. LIMON. This was a very extensive process. It has been tried for well over 2 decades. But we really put an incredible coalition together, faith groups, the Urban League, veterans' groups, responsible lenders, all to try to come up with a solution to one product, which was the fastest-growing product in the market, that caused the most harm to the consumer.

And we passed this law and it was signed, and now what you see is that there are companies evading it. And I actually want to use Mr. Knight's description, if I may. He talked about the rent-a-bank scheme being an impersonation of the true lender. And based on that description, I argue that the rent-a-bank schemes ongoing in California will clearly show that the nonbank lender is the lender.

I want to give an example of what is happening. When you see a title lender like LoanMart advertising their loans on a website, between 60 to 220 percent, and in the fine print at the bottom of this website you see that it says that the loan is made by a bank in Utah. That is what we are talking about. They are evading State law. The State law is very clear that it is 36 percent plus the Federal rate, and now they are using a bank outside of the State to evade an existing law.

Mr. VARGAS. Ms. Aponte-Diaz, you stated at one point that the underbanked actually get hurt taking these predatory loans because, in fact, oftentimes, they get unbanked. Could you explain that a little bit?

Ms. APONTE-DIAZ. Yes. I have spent the last 7 years in California talking to payday borrowers, to folks who have gotten the installment loans, and there is not one of those former payday borrowers who said, "I would go back and do this again," or "I would go to the black market." Once they get out of that debt trap, they are done with it, and look for better access to credit.

I'm sorry. Can you repeat your question one more time?

Mr. VARGAS. Yes. You said that what happens, you snuck it in there quickly—

Ms. APONTE-DIAZ. Oh, the unbanked. Yes. I am so sorry. For payday lending, and increasingly installment lending, you have to give your bank account information so that it can be deducted directly from your bank account. So what we see often is, maybe the borrower doesn't have enough money to pay their rent or groceries or utilities, and the payday lenders come and still take that money out. And so, if there is no money in there, then you have your overdraft fees over and over, and then those lead to bank closures. So I was arguing that we are not trying to help the unbanked.

Mr. VARGAS. You had to sneak it in there. I just wanted to hear your explanation. I appreciate it. Thank you very much.

Ms. APONTE-DIAZ. Thank you.

Mr. VARGAS. I do want to ask one last question—I have about a minute left—the issue that you can't loan to anyone $2,600 or less at 36 percent because it is just not doable. Professor, could you comment on that, or whomever would like to?

Ms. SAUNDERS. I would just say that I don't think that is true. Self-Help Credit Union, an affiliate of the Center for Responsible Lending, certainly does it. In South Dakota and Montana, when the voters capped rates at 36 percent, we actually saw an increase in credit union small-dollar loans.

Mr. VARGAS. That is what I believed, but I have heard it almost as if it was coming from Moses here that this was in case the law. But I also have to thank you. See, most of it does go back to the Bible. As a former Jesuit, I appreciate that, and you do have usurious laws in the Bible too, that we don't violate.

Mr. Knight, I have 20 seconds left, would you like to comment on any of that?

Mr. KNIGHT. I would just say that I think it is fantastic if credit unions can fill some of this gap, but there is a capacity question as to how much of the gap they can actually fill. And it is an open question.

Mr. VARGAS. I wanted to give the Republicans an opportunity, because everybody seems to just talk to you and not to the others. I wanted to make sure you had equal—

Mr. MEEKS. The gentleman's time has expired. The gentleman from North Carolina, Mr. Budd, is now recognized for 5 minutes.

Mr. BUDD. I thank the Chair. Mr. Knight, I appreciate you being here. So much of the discussion surrounding the *Madden case*—I think I have heard it mentioned earlier, from some of my colleagues—has to do with the valid-when-made doctrine, which says that a loan does not become valid when transferred to a third party. The idea behind valid-when-made is that a loan is valid from the beginning; it can't suddenly change when transferred to another person or company. And to my understanding, this has been part of the banking law in the U.S. for about 100 years. So far, so good?

Mr. KNIGHT. I think it has been a part for longer than that. If I may, I want to note one thing, just for completeness.

Mr. BUDD. Please.

Mr. KNIGHT. There is a counterargument that says that the early cases largely dealt with note assignment, and so the fact that it was two subsequent loans is relevant. I disagree with that.

Ms. JOHNSON. But those were the early cases.

Mr. KNIGHT. Those were the early cases, but those cases, as we acknowledge, banking changes rapidly, and more recent cases have held that a subsequent transaction does not invalidate the loan. And I think if you look at sort of the notion behind it, there isn't a reason why a subsequent downstream transaction that does not change the borrower's obligations should relieve the borrower of their obligations.

Ms. JOHNSON. The *Madden* decision did not involve—

Mr. BUDD. I reclaim my time. Thank you, Mr. Knight. However, the *Madden* v. *Midland* Second Circuit decision in 2015 kind of branched away from this longstanding principle, and it ruled that loans could become invalid when sold from a bank to a nonbank. So as a result of this decision, credit markets have become volatile, many borrowers have seen their access to credit diminish, as we have talked about today, and it is at a time when we should be doing everything we can to provide small businesses and consumers—I even heard my colleague from Georgia mention that lack of capital access as a small business owner—better access to credit and financing alternatives. So, it seems unwise to put caps on consumer loans.

So Mr. Knight, in your opinion, was the *Madden* decision wrongly decided?

Mr. KNIGHT. I believe it was.

Mr. BUDD. And in what ways has the *Madden* decision actually hurt low-income borrowers, hurt low-income borrowers' access to credit?

Mr. KNIGHT. Based upon the academic evidence I have seen, we have seen a constriction in credit and a resulting—there is evidence of a link to an increase in bankruptcy as people who need to access credit to address either an emergent situation or an existing loan, where they need to be able to refinance an existing loan, are not able to do so. And one of the weird wrinkles of this is that you can be under a credit card debt at 30 percent and not be able to access a marketplace loan at 25 percent to refinance it, because in the latter case, the bank is planning to sell the loan. That strikes me as nonsensical.

Mr. BUDD. So just striving for clarity here, we have this decision, this *Madden* decision. We cap these rates, trying to help people, because I think on both sides, we really want to help people here, absolutely. But it ends up hurting people? That is what I am hearing from you.

Mr. KNIGHT. It appears to be rationing credit, and that appears to be having a harmful result.

Mr. BUDD. More bankruptcies.

Mr. KNIGHT. That appears to be the evidence.

Ms. JOHNSON. Can I respond to that bankruptcy—

Mr. BUDD. Great. Thank you. I want to continue on. I would like to make two observations and then tie them together into a question. The first is that it is incredibly troubling that millions of Americans lack the resources to pay for a $400 emergency expense. I think we all can agree that that is very troubling. But today, as we speak, hard-working Americans are living paycheck to paycheck. When times get tough, they may need to borrow money from somewhere.

The second observation is the basic principle that our financial services economy is built on risk-based pricing. Many of the people I have described have credit scores just right above 600, and today they have access to credit, and lenders lend to them in accordance with State and Federal laws designed to promote safe and responsible lending.

So here is my question, Mr. Knight. If we cap the interest rates at 36 percent, what is going to happen to access for credit for the unbanked and the underbanked folks across our country? Will their need for credit just magically disappear, or is it more likely they will turn to unregulated credit if regulated creditors turn them down?

Mr. KNIGHT. The need for credit will not disappear, and so to the extent a borrower who previously could access credit and is now capped out of the market, they will either search for illegal or otherwise alternative credit or suffer the consequence that they were seeking to avoid with a loan.

Mr. BUDD. Thank you. I believe I am out of time. Thank you for your time.

Mr. MEEKS. The gentleman yields back. I now recognize the gentleman from Texas, Mr. Taylor, for 5 minutes.

Mr. TAYLOR. Thank you, Mr. Chairman. I appreciate this hearing.

I just wanted to quickly do a lightning round. So a bank, the profit margin is about 10 percent, right? And other businesses have higher profit margins. Some have lower profit margins. What is an unacceptable profit margin, in your mind, for payday lenders? And I will start with Mr. Knight. I am just looking for a number—8 percent, 10 percent, 100 percent? What is an unacceptable profit margin for a payday lender in your mind, Mr. Knight?

Mr. KNIGHT. I don't have a numerical answer. I'm sorry.

Mr. TAYLOR. Ms. Saunders?

Ms. SAUNDERS. I focus on the impact on the consumer, not on the profit.

Mr. TAYLOR. Got it. Okay. Professor?

Ms. JOHNSON. No magic number. I am more concerned about the terms of the loan as well as the interest rate.

Mr. TAYLOR. Okay. Ms. Aponte-Diaz?

Ms. APONTE-DIAZ. We have asked the payday lenders for a description. Like they are telling us they need to pay for their storefronts, for their employees, and we have asked over and over for details about why they have to charge 100 percent to make ends meet, and we have not seen the documents on that. But what we have seen is that there are 40 percent default rates on these high-cost installment loans.

Mr. TAYLOR. Sorry to cut you off, but do you have a number?

Ms. APONTE-DIAZ. No.

Mr. TAYLOR. I will come back to you in a second. Ms. Limon?

Ms. LIMON. No numerical number. It is to do right by the consumer.

Mr. TAYLOR. Okay. So, there are publicly-traded payday lenders. Have you looked at their profit and loss statements?

Ms. APONTE-DIAZ. No.

Mr. TAYLOR. Why? You can go look at their FTC filings, right?

Ms. APONTE-DIAZ. Right.

Mr. TAYLOR. So, you have a K-1. You can go look at that. You haven't looked at that?

Ms. APONTE-DIAZ. I have not personally, but—

Mr. TAYLOR. Okay. Mr. Knight?

Mr. KNIGHT. Yes. There are a couple of studies that look at that, and payday lenders are not particularly profitable relative to other finance companies. In fact, they tend to be significantly less profitable than more traditional finance companies.

Mr. TAYLOR. Do you want to put a number on that?

Mr. KNIGHT. I don't have the exact—don't quote me on this, but I believe they are about a third as profitable.

Mr. TAYLOR. I have seen numbers in the 8 to 12 percent range, in terms of profitability.

Mr. KNIGHT. Yes.

Mr. TAYLOR. So sometimes higher than banks, sometimes lower than banks, but I haven't seen anything that indicates—what generally lowers prices is competition, right? So if you have lots of people competing to provide something, it drives the margins down to where it sort of comes to be a risk-adjusted rate of return. So, hey, that is an acceptable rate of return.

And then in terms of pricing, thinking about processing a payday loan, if you were going to process a payday loan, you would need to buy a credit report, right? You would need to have a human being standing at a teller to fill out the forms. Those are some of the prices that go into not just the interest rate on the money but the actual processing of the form. Do you want to speak to that, Mr. Knight?

Mr. KNIGHT. My understanding, based upon the research I have seen, is that a lot of the expense about payday loans is overhead.

It is location, because this is largely a convenience-driven business, and it is staff, because it is human-intensive and the hours are long. And so, yes, a lot of the cost is what we would consider to be overhead.

Mr. TAYLOR. Right. And if we put lots of regulatory burdens on lenders and make it really difficult to lend, then we are actually making fewer competitors, and that, in turn, should drive up prices and make the margins higher. If it is harder to do, it gets more expensive, as a general rule of thumb.

Ms. APONTE-DIAZ. Excuse me, sir. Just to add, what we have seen is $8 billion stripped in payday lending and car title loans in fees across the country, so $8 billion.

Mr. TAYLOR. I don't know what that means.

Mr. Knight, just thinking about what banks do, they typically hire consultants to do their IT work, right? So, banks hire consultants to do their IT systems, their mobile banking applications for small regional banks. They have to go hire someone to go do that for them. They hire companies to do loan processing, to actually create the document processing management system. They go to outside credit bureaus to go get their credit reports, because they don't do that internally.

And so, they interact with the Federal Government, with the SBA loan program. It is very normal for all businesses, but in particular, in this case, to use outside vendors to provide services for them. What would be the benefit to a bank to use an outside vendor to help them underwrite smaller loans?

Mr. KNIGHT. To the extent that this vendor has a good model and good technology—and I should note that ultimately the bank has to own the model. And my understanding is, from talking to some of these companies, the bank does own the model. They don't just accept the model whole cloth. They push back, they work on it, and it is a collaborative process. But to the extent that this new customer, this partner, can bring new technology, new capabilities, it can benefit the bank.

Mr. TAYLOR. Okay. Thank you. Mr. Chairman, I yield back.

Mr. MEEKS. The gentleman yields back. All time has expired.

Without objection, a statement from the California Attorney General, Xavier Becerra, and a statement from Hope Credit Union, both supporting the preservation of State laws that better protect consumers, are entered into the record.

Without objection, it is so ordered.

I would like to thank our distinguished witnesses for their testimony today. Your testimony has been very important and very insightful to all of the Members, I am sure.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereas, at 12:46 p.m., the hearing was adjourned.]

A P P E N D I X

February 5, 2020

Testimony of Graciela Aponte-Diaz

Director of Federal Campaigns, Center for Responsible Lending

Before the United States House Committee on Financial Services

"Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps."

February 5, 2020

Testimony of the Center for Responsible Lending

California borrower story:

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 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.[i]

Good morning Chairwoman Waters, Ranking Member McHenry and Members of the United States House Committee on Financial Services. Thank you for the opportunity to provide testimony today. My name is Graciela Aponte-Diaz, and I am the Director of Federal Campaigns for the Center for Responsible Lending. The Center for Responsible Lending (CRL) is a nonprofit, nonpartisan 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 community development financial institutions. For thirty years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed families, and families of color, primarily through financing safe, affordable home loans and small business loans. In total, Self-Help has provided $6.4 billion in financing to 87,000 homebuyers, small businesses and nonprofit organizations and serves more than 80,000 mostly low-income families through more than 40 retail credit union branches in North Carolina, California, Florida, Illinois, South Carolina, Virginia, and Wisconsin.

The borrower story shared above demonstrates how predatory loans can devastate the financial well-being and health of families. While California recently enacted a new law to protect residents from these types of harmful loans, some lenders, including Speedy Cash, have already publicly stated their interest in setting up "rent-a-bank" schemes in an attempt to evade state interest rate caps. Worse, there are already a number of predatory lenders that are engaging in these schemes, offering loans well over 100% APR, and operating in more than 20 states that have strong laws intended to limit the interest rates. Instead of taking enforcement actions to address these abuses, the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) have recently proposed a rule that would embolden predatory lenders to continue to offer these loans through "rent-a-bank" schemes.[ii]

My testimony today will:

I. Describe how "rent-a-bank" schemes are being used in an attempt to evade state interest rate caps;
II. Discuss how "rent-a-bank" schemes and predatory loans severely harm financially vulnerable consumers, disproportionately burden communities of color, and exacerbate racial wealth disparities;
III. Highlight how current FDIC and OCC actions are emboldening predatory lenders and threatening state usury caps across the country; and
IV. Conclude with policy recommendations for addressing this evasion of state laws that is opening the door to a surge in abusive lending practices.

CRL urges federal policymakers to step up and protect all consumers from predatory loans, often with interest rates of more than 100%, that are devasting people's lives. To do so, the FDIC and OCC should order supervised banks to cease and desist from so-called "bank partnerships" where the non-bank lender is offering loans to consumers at rates that are illegal under the laws of the state where the consumer lives. The FDIC and OCC should rescind their proposed rules that do nothing to stop these "rent-a-bank" schemes, but would instead embolden and even encourage predatory lenders to engage in "rent-a-bank" schemes. In addition, Congress should swiftly enact a federal interest rate cap of 36% for all consumer loans, including all loan fees.

I. <u>"Rent-a-bank" schemes are being used in an attempt to evade state interest rate caps</u>

"Rent-a-bank" schemes were used in the 1990s to mid-2000s, where non-bank lenders partnered with banks, which are exempt from state interest rate laws, in an attempt to evade state interest rate caps and offer payday loans with outrageous interest rates. In response federal regulators—the FDIC, OCC, and Federal Reserve—cracked down on this practice.

In 2002, the OCC strongly condemned "rent-a-bank" schemes. Former Comptroller of the Currency, John D. Hawke Jr., called the schemes "an abuse of the national charter,"[iii] 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."[iv] 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."[v]

Unfortunately, this scheme is reemerging, and the same regulators who acted to prevent these abuses previously are now permitting it to go unchecked. In fact, rather than reaffirm the agencies' strong opposition to this abuse, the FDIC and OCC have issued proposed rules that lenders could interpret as blessing this practice, encouraging predatory non-bank lenders to issue loans at rates illegal under state law, some with APRs as high as 80%-100% or more.

A. How "rent-a-bank" schemes work

The non-bank lender decides to offer loans at rates that are illegal under state law. Because national and federally-insured banks are generally exempted from state interest rate laws, the non-bank lender finds a bank willing to become the nominal "originator" of the loans the non-bank lender offers. The non-bank lender is the public face of the loan program. Neither the customers nor the general public are aware of the financial gymnastics behind the transaction that purport to legitimize a loan that would be illegal in the hands of the non-bank lender alone.

Typically, the non-bank lender is involved both on the front end of the loan program—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. While the bank may make some underwriting decisions, at least nominally, it typically does so by using criteria, software, or analysis primarily designed or provided by the non-bank company. In more recent incarnations, the bank may also claim to retain ownership of the "loan" or "account" and only to sell receivables. Even in cases whether the bank may retain a share of the receivables, 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—especially for large loans—and may exceed what is legal in many states. Increasingly, these models are being used by predatory lenders charging extraordinarily high rates that result in harmful outcomes for consumers.

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 any doubt as to how the "bank partnership" model works:

The bank originates the loan; the loan acquires the bank's right to "rate exportation" (ie, the right to ignore usury laws in all states but the bank's home state); and the non-bank handles marketing, consumer interactions, servicing and/or other tasks associated with the loan.[vi]

Here are recent examples of companies considering rent-a-bank evasions in order to lend at rates illegal under state law. Each example involves a publicly traded company reporting to their investors in anticipation of the passage of the recently enacted California law that caps interest rates on loans larger than $2,500. Each of these companies was lending at rates of 135% to 199%, which the California law now prohibits (as of January 1, 2020). In each case, the company's senior management openly told investors, in essence, "do not worry; if the California law passes, we will partner with a bank in order to evade it." Here are relevant excerpts from each of the companies' statements on the matter:

> *Example 1:*
> Elevate Credit—which currently operates "rent-a-bank" schemes in many states through FDIC-supervised banks Republic Bank & Trust and FinWise Bank—was explicit about its intent to evade the new California law should it be enacted:
>
> ***"As you know, in California a piece of legislation named AB539 continues to move ahead...So what does this mean for Elevate? ... [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."*** [vii]
>
> *Example 2:*
> Enova was equally blatant about its plan to continue offering loans at the same high rates as before, disregarding the legislature's clear determination that such rates are unacceptably harmful to California families:
>
> ***"One potential change is a California bill that will cap interest rate at roughly 38% on personal loans between $2,500 and $10,000... [W]e will likely convert our near-prime product to a bank-partner program, which will allow us to continue to operate in California at similar rates to what we charge today."*** [viii]

As these statements make clear, "rent-a-bank" schemes can entail little more than inserting a bank into an economic transaction between a non-bank lender and its customer, in an attempt to shield the non-bank from state usury laws, without materially altering the economics of the transaction from the non-bank lender's perspective—or the borrower's.

B. Non-bank lenders currently involved in "rent-a-bank" schemes frequently peddle extremely high-cost debt

"Rent-a-bank" schemes currently facilitate some undeniably egregious lending practices. The chart below offers a few examples.

Non-bank lender	Type of loan	APR	FDIC or OCC supervised bank
OppLoans	**Consumer installment loans** ($500 to $4,000)	160%	FinWise Bank, Utah (FDIC)
Elevate's "Rise" brand	**Consumer installment loans** ($500 to $5,000)	99% to 149%	FinWise Bank, Utah (FDIC)
Elevate's "Elastic" brand	**Lines of credit** ($500 to $4,500)	109%	Republic Bank & Trust, Kentucky (FDIC)
Enova's "NetCredit" brand	**Consumer installment loans** ($1,000 to $10,000)	99.99%	Republic Bank & Trust, Kentucky (FDIC)
LoanMart	**Auto-title loans**, typical loan is $2,500	60-222%	Capital Community Bank, Utah (FDIC)
World Business Lenders (WBL)	**Small business loans**, including personal mortgages at rates up to 139% that are resulting in foreclosure, including loans for hundreds of thousands of dollars at over 120% APR	75% to 139%	Bank of Lake Mills, Wisconsin (FDIC) and Axos Bank (OCC)

It is hard to overstate the harms associated with interest rates of 99% to 149% on loans of $500 to $4,000, like those made by Elevate through a scheme with FDIC-regulated FinWise Bank, or the over-sized loans at 75% to 139% APR made by World Business Lenders, through the connivance of FDIC-regulated Bank of Lake Mills, Wisconsin, or OCC-regulated Axos Bank. Yet neither the OCC nor the FDIC has done anything to shut down these abuses. And in fact, as discussed in section III below, the agencies have defended a World Business Lender loan in an amicus brief (without any acknowledgment that the bank may not be the true lender).

II. <u>"Rent-a-bank" schemes severely harm financially vulnerable consumers, disproportionately burden communities of color, and exacerbate racial wealth disparities</u>

In recent years, the harms of high-cost lending have been more comprehensively and thoroughly documented than ever before.[ix] 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,[x] high checking account fees and closed accounts,[xi] and bankruptcy. [xii]

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.[xiii]

A. Consumer High-Cost Installment Loans

There has been substantial growth in the issuance of larger loans with longer terms with rates ranging from 100%-200% APR. The move to longer-term high-cost installment lending is occurring among brick and mortar payday lenders, but also through lenders operating online. Many of these online lenders, making excessively priced loans with direct access to a borrowers' bank account and no safeguards of affordability, seek to disguise their harmful lending practices under the guise of "fintech." The "fintech" label does not wipe away the underlying harms and consequences of these unaffordable loans. Regardless of whether the loan is made through an "app" or a storefront, high-cost loans, made without regard to the borrower's ability to afford them, result in high default rates—sometimes staggeringly high, as exemplified by a brazen "rent-a-bank" schemer, Elevate Financial. **In both 2016 and 2017, Elevate reported charged-off debt amounting to 52% of their domestic revenues.**[xiv]

High default rates signal unaffordability, but also significant harms to consumers. Defaults push struggling families into deeper financial distress, often including aggressive collection efforts, lawsuits, and wage garnishment, as well as increased difficulty meeting other expenses and obligations. They also make it harder for borrowers to obtain more affordable loans, and thus reduce access to better credit and increase reliance on more abusive products. This debt trap is the high-cost lender's chosen business model.

B. Auto title loans

FDIC-regulated Capital Community Bank currently facilitates auto title lending through a rent-a-bank scheme with Loan Mart at rates of 60% to 222% APR. Loan Mart is operating in states that currently prohibit car title lending, including the District of Columbia, Michigan, South Dakota, and Washington. The FDIC has done nothing to shut down this abuse, which is on-going.

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. 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. More than a third of auto title borrowers have reported pledged the only working car in their household as security for their auto title loan.[xv]

Research has found that an astounding one in five auto title borrowers have their car repossessed.[xvi] In Virginia, a state that allows longer-term car title loans, lenders seized over 70,000 cars between 2014 and 2017.[xvii]

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.[xviii]

C. Particular harm to communities of color

By turning a blind eye to these evasions, the federal banking regulators are enabling practices that increase and further entrench racial wealth disparities. 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 federally operated or sanctioned 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.[xix]

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.[xx] 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.[xxi] In light of this targeting, it is unsurprising that a disproportionate share of payday borrowers come from communities of color, even after controlling for income.[xxii] The disparity in payday loan borrowing 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.[xxiii]

Online high-cost lenders may focus more on subprime credit scores than geography. But the historical discrimination against communities of color is also reflected in credit scoring.[xxiv] Lenders that focus on subprime borrowers will inevitably disproportionately target borrowers of color. The algorithms and big data that "fintech" lenders use may also result in disparate impacts on these communities.[xxv]

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.[xxvi] High-cost loans, with their high association with lost bank accounts,[xxvii] 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—and perpetuates discrimination today.[xxviii] Schemes to evade state interest rate limits therefore not only harm families in economic distress, but also exacerbate existing racial inequities.

III. FDIC and OCC actions embolden predatory lenders and threaten state usury caps across the country

A. *FDIC and OCC inaction, and harmful action, to date*

Non-bank lenders such as Elevate, OppLoans, Enova, Loan Mart and World Business Lenders currently lend at rates that are illegal under state law, through the use of "rent-a-bank" schemes with banks regulated by the FDIC or the OCC. Neither regulator has done anything to shut down these abuses. This silence by the regulators has emboldened non-bank lenders to more openly acknowledge seeking so-called "bank partnerships" to further these schemes, as exemplified above by Elevate, Curo and Enova, whose senior management publicly touted their plans to evade new California rate caps in this way.

Instead of taking steps to stop this abuse, federal regulators are signaling support of this lending practice. Just a few months ago, in September 2019, the OCC and FDIC took the unusual step of filing an amicus brief in an obscure bankruptcy case in which World Business Lenders had used FDIC-supervised Bank of Lake Mills to make a loan of $550,000 at 120% APR with a one-year term. A 120% APR would be a staggering rate on a $5,000 loan; on a $550,000 loan it is, in the words of the bankruptcy court judge, "stupendously high."[xxix] The loan required payments equating to $3,775 *daily*.[xxx] Yet the federal banking regulators weighed in on this case, *in support of* World Business Lenders' right to collect on this loan—and without even suggesting that Bank of Lake Mills may not be the true lender.

B. *Recent FDIC/OCC proposed rule risks giving predatory lenders the greenlight to use "rent-a-bank" schemes*

In November 2019, the OCC and FDIC proposed rules[xxxi] that could have the effect of encouraging predatory non-bank lenders to run their loans through banks in an attempt to evade state interest rate caps. CRL, along with more than 100 civil rights, and consumer, small business, and community and faith-based organizations submitted comments in opposition to the proposed rules.[xxxii] The proposal threatens to take away powers that states have had since the time of the American Revolution to protect their residents. Our comment letters explain that the proposals are outside the OCC's and FDIC's statutory authorities; they are not justified by any evidence of problematic impact on legitimate bank operations; and the agencies have failed to consider the strong likelihood that the proposal will unleash a torrent of predatory lending.

C. FDIC and OCC's proposal would not only give cover for the expansion of larger, longer high-cost loans through "rent-a-bank"; it would also embolden a return of short-term balloon-payment payday loans and balloon-payment vehicle title loans

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. But the proposal would also clearly embolden a return of short-term balloon-payment payday loans and balloon-payment vehicle title loans.

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.

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. Currently, to our knowledge, "rent-a-bank" schemes are not being used to offer short-term loans. One FDIC action that led to the end of these schemes was its 2005 payday loan guidelines, which advised limiting borrowers' indebtedness in payday loans to 90 days within 12 months. Lenders then lost interest in the schemes because their business model was built on trapping borrowers in debt for far longer. If this guidance is repealed, as some lenders have been pushing, and the proposed rule is finalized, only the self-restraint of banks would prevent short-term "rent-a-bank" lending from returning.

D. FDIC and OCC's proposal gives comfort to other predatory lenders considering entering "rent-a-bank" market

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:

"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)."[xxxiii]

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. There has been no rate cap in California on loans over $2,500 since 1985 when predatory lenders fought to deregulate.

As noted above, 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 attempt to evade the new interest rate cap. These lenders discussed with investors their plans even before it was enacted. These shameless declarations of their intentions make patently clear that the involved lenders would be forming these partnerships for the purpose of attempting to evade the law, and that the involved banks would be renting out their charters to these lenders. These lenders have been met with resistance,[xxxiv] 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 FDIC/OCC's proposal would embolden these schemes—a fact the FDIC/OCC proposal conspicuously fails to consider.

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.[xxxv]

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.[xxxvi]

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate	FINANCE CHARGE The dollar amount the credit will cost you	Amount Financed The amount of credit provided to you or on your behalf	Total of Payments 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 attempt 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."*[xxxvii]

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,[xxxviii] and that in its November 2019 10Q, it announced that it had discontinued that agreement in September 2019.[xxxix] Notably, MetaBank has a history of working with payday lenders and helping third parties offer predatory products in an attempt to evade the law.[xl]

Two other high-cost lenders, Enova dba NetCredit, and Elevate dba Rise and Elastic, also noted plans to attempt 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 attempt to evade the new law.

The immediately pending threat of 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 FDIC and OCC. Notably, FDIC Chairman McWilliams testified in front of this Committee at a December 2019 hearing, following the issuance of both agencies' proposals, that she was unaware of these developments,[xli] despite letters having been sent to her intended to alert her to these developments.[xlii]

E. FDIC/OCC proposed rules threaten state interest rate caps

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.

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 to address the problems they face.[xliii] With good reason, the Constitution preserves the rights and role of states within our federalist republic.

The FDIC/OCC proposals fail to recognize states' historical and primary role in regulating and enforcing usury and how the proposal would undermine that role. 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 in an attempt to avoid state consumer protection laws.

Interest rate limits are the simplest and most effective protection against predatory lending.[xliv] Since the time of the American Revolution, states have set interest rate caps to protect their residents from predatory lending.[xlv] 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 37.5% for a $500, six-month loan, 31% for a $2000, two-year loan, and 25% for a $10,000, five-year loan.[xlvi] 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.

Policy trends at the state and federal levels for more than a decade have been to rein in the harms of the unsafe loans, ranging from the 2006 passage of the 36% rate cap in the Military Lending Act to voter-enacted 36% rate caps in South Dakota and Colorado, in 2016 and 2018, respectively. Ballot initiatives in Montana (2010), Arizona (2008) and Ohio (2008) were also met with large majorities supporting interest rate caps in those states. Most recently, California's new law caps installment loans of $2,500 - $10,000 at approximately 36%. Since 2005, no new state has legalized payday lending. States with rate caps that prevent the payday loan debt trap are home to about 100 million people—nearly a third of the U.S. population.
States are typically successful in enforcing their interest rates against the products to which interest rate caps apply.[xlvii] But the inaction from the FDIC and OCC and their recent proposed rule risks undermining these regulatory landscapes and severely hamstringing states' ability to enforce rate caps.

F. States with strong interest rate caps oppose "rent-a-bank" schemes

Residents and legislators in states with strong interest rate caps have fought hard for these crucial protections, against payday lenders and their very well-resourced lobby. Whether through a ballot initiative or a legislative battle, residents of those states have used the democratic process and won. There is bi-partisan support for strong interest rate caps. In fact, in both South Dakota (76%) and Colorado (77%), residents voted overwhelmingly in favor of an interest rate cap of 36% APR. Despite the payday lenders' outsized-spending, 76% of South Dakota voters said yes to lowering the rates of payday loans, car-title loans, and other high-cost installment loans to 36% annually. Most recently, in California, opponents of the rate cap bill poured millions of dollars into campaigns and lobbying. Despite their efforts, community and faith-based organizations, labor and veterans' groups, and consumer advocates led a three-year campaign and won. The residents in these states have spoken: They do not want exorbitantly high interest rate loans in their states.

This month, a bi-partisan coalition of attorneys general submitted a comment letter opposing the OCC's proposed rule.[xlviii] The attorneys general that filed the comment letter represent California, Colorado, Hawaii, Illinois, Iowa, Maryland, Massachusetts, Michigan, New Jersey, New Mexico, New York, North Carolina, Oregon, Pennsylvania, South Dakota, Virginia, Washington, Wisconsin, and the District of Columbia.

> ***As stated in the letter, "States have long played a critical role in protecting residents from high-cost loans. While federal law provides a carve out from state law for federally-regulated banks, state law continues to protect residents from predatory lending by non-banks such as payday, auto title, and installment lenders. Congress affirmed that role with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, preserving more protective state laws. Yet, the new regulations proposed by OCC would extend the National Bank Act exemption for federally-regulated banks to non-bank debt buyers such as payday lenders. The proposed rule is a sharp reversal in policy and a deliberate attempt to evade state laws that target predatory lending."*** [xlix]

Case Study: South Dakota, Two Years After a 36% rate cap

"I think that now that I don't have all those payday loans to pay off, I actually have money. I actually have money to set aside and with a partner, we set money aside and we have a savings account now. We have a savings account now, so without the stress of additional payments and with finding you and helping me rebuild my credit, I have a brand new car. And before then, I couldn't even get a brand new car, or I couldn't even get a credit card. Now I have both, and now we have a home of our own. So, it's all coming together. I'm finally at where I always wanted to be years ago." –Wambli Bear Runner, Black Hills Community Loan Fund Client

In 2016, South Dakota voters spoke loud and clear that they did not want triple-digit interest rates in their state. In 2018, two years following enactment of the rate cap, South Dakotans continue to show strong support for the rate cap. In a recent CRL report, "The Sky Doesn't Fall: Life After Payday Lending in South Dakota," data, polling, and community interviews demonstrate that South Dakotans are faring better without these predatory products in the state.[l] They continue to have access to credit through safer financial products, and where payday loan shops once dotted the landscape, churches, restaurants, and other wealth-creating and community-building institutions exist.

To understand South Dakotans' views towards the changes in the state since the enactment of the 36% rate cap, CRL commissioned a poll among Republican primary voters in South Dakota.[li] The poll was conducted in August of 2018, nearly two years following the enactment of the rate cap, and it revealed strong levels of support for keeping the rate cap in place and strong opposition to any legislative attempt to allow higher rates than those the voters' approved.

In thinking about the ballot initiative specifically, if asked to vote on the same measure again today, the vast majority **(82%) of those who voted yes in 2016 said in 2018 that they would vote yes again to cap the cost of payday loans in South Dakota at an annual interest rate of 36%.**[lii]

IV. Recommendations for addressing the evasion of state laws and preventing lenders from trapping consumers in a cycle of debt

1. **The FDIC and OCC should rescind their proposed rules, which risk giving banks and lenders a greenlight to use rent-a-bank schemes.** These schemes will usher in a new wave of triple-digit interest rate loans across the country, even in states that seek to prohibit them.

2. **The FDIC and OCC should step up to stop "rent-a-bank" schemes by FDIC- and OCC - supervised banks.** To date, no enforcement actions have been taken to address the new wave of the evasion of state interest rate caps by FDIC- and OCC-supervised banks.

3. **The FDIC should preserve its 2005 payday loan guidelines advising limiting indebtedness in payday loans to 90 days in 12 months; its 2007 guidelines advising a rate cap of 36%; and its 2013 guidelines advising ability-to-repay assessments for bank payday ("deposit advance") loans. The OCC should reinstate its 2013 guidelines addressing bank payday loans.** The 2005 and 2013 guidelines are important to keeping banks out of rent-a-bank schemes or direct lending involving short-term balloon payment payday loans. The 2007 guidance describes responsible installment loans (which the ongoing FDIC rent-a-bank schemes are flouting).

4. **Congress should enact a rate cap of 36% or less, while not pre-empting the laws of states with even stronger rate caps.** In 2006, upon the finding by the U.S. Department of Defense that predatory lending "undermines the military readiness," Congress enacted with bi-partisan support a 36% rate cap for consumer credit, including for payday and car title loans, to active duty military and covered dependents. Congress should extend the same protection to veterans and all Americans, preventing the harms of the debt traps, by supporting HR 5050, the Veterans and Consumers Fair Credit Act.

5. **The Consumer Financial Protection Bureau must reverse its course of seeking to repeal the ability-to-repay provisions of its 2017 rule addressing payday, car-title, and certain high-cost installment loans.** The 2017 rule aimed to stop the debt trap caused by short-term payday and car title loans (while advising that the Bureau would address problems with high-cost installment lending in a future rulemaking). The rule established the common-sense principles of requiring lenders to determine a borrower's ability to repay the loan in light of their income and expenses. The CFPB proposed the repeal of the heart of the rule, without legal justification, in 2019. Rescinding the rule will allow payday and car title lenders' debt trap business model to continue as usual and leave millions of people across our country burdened with the unavoidable harms of this crushing debt.

V. <u>Conclusion</u>

Predatory lenders have a long history of attempting to evade consumer protection laws. If federal regulators and Congress allow this to go on, more predatory lenders will enter the "rent-a-bank" market to attempt to bypass state laws, leaving millions of people vulnerable to the harms of high-cost lending—even when it directly contradicts the affirmative public policy decisions of their home states.

[i] CFPB complaints database #1377341 (California borrower)

[ii] 84 Fed. Reg. 64229 (Nov. 21, 2019) and 84 Fed. Reg. 66845 (Dec 6, 2019)

[iii] 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.

[iv] https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html.

[v] 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.

[vi] *See 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.

[vii] Elevate Credit Inc. earnings call pages 5-6, 10 (July 29, 2019) at SeekingAlpha.com

[viii] Enova International Inc., earnings call, pages 3, 9-10 (July 26, 2019) at SeekingAlpha.com

[ix] *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).

[x] *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.

[xi] 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.

[xii] 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.

[xiii] 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.

[xiv] Elevate Credit, Inc., 10-K at 39 (filed March 9, 2018), http://bit.ly/2FmFdzc

[xv] CFPB Payday Rule, 82 Fed. Reg. at 54573 & n. 592 (internal citations omitted).

[xvi] 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.

[xvii] Virginia Bureau of Financial Institutions." 2017 Annual Report," page 57, http://bit.ly/2UOkDj1

[xviii] 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-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.*

[xix] *See* CFPB Payday Rule, 82 Fed. Reg. at 54556-57.

[xx] *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.").

[xxi] 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), https://www.responsiblelending.org/research-publication/mile-high-money-payday-stores-target-colorado-communities-color.

[xxii] 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.*

[xxiii] 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.

[xxiv] *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.

[xxv] *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/.

[xxvi] 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.

[xxvii] 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).

[xxviii] 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/; 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/.

[xxix] *In re Rent-Rite Super Kegs West, Ltd. v, World Business Lenders, LLC,* Bankruptcy Case No. 17-21236 TBM Chapter 7, Adv. Pro. No. 18-1099 TBM, Corrected Memorandum and Order Denying all Claims, (May 20, 2019) at 8https://www.docketbird.com/court-documents/Rent-Rite-Super-Kegs-West-LTD-v-World-Business-Lenders-LLC/Corrected-Written-Opinion-related-document-s-44-Written-Opinion-48-Order-Dismissing-Adversary-Proceeding/cob-1:2018-ap-01099-00049

[xxx] Id. At 5.

[xxxi] 84 Fed. Reg. 64229 (Nov. 21, 2019) and 84 Fed. Reg. 66845 (Dec 6, 2019)

[xxxii] CRL, NCLC, *OCC Rent A Bank Rule Proposal Comment Letter 2020*, available at https://www.responsiblelending.org/research-publication/occ-rent-bank-rule-proposal-comment-letter-2020 and Community, Consumer, Civil Rights, and Faith Groups Strongly Oppose OCC's Proposed Rule on State Interest Rate Limits, available at https://www.responsiblelending.org/research-publication/community-consumer-civil-rights-and-faith-groups-strongly-oppose-occs-proposed

[xxxiii] On file with National Consumer Law Center.

[xxxiv] *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.

[xxxv] https://db4nnybic3xty.cloudfront.net/pdf/SRC/2018/california/store/california.pdf (See "Installment Bank Line Loan Price Disclosure" at the bottom).

[xxxvi] Loan document on file with CRL.

[xxxvii] CURO Group Holdings Corp., Earnings Call, pp. 3, 7-8 (July 30, 2019) at SeekingAlpha.com.

[xxxviii] CURO 2018 10K at 46.

[xxxix] CURO 10Q, Nov. 2019, at 44, https://fintel.io/doc/sec-curo-10q-curo-group-holdings-2019-november-04-18209.

[xl] 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.

[xli] 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."

[xlii] 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).

[xliii] *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").

[xliv] See NCLC, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016), https://www.nclc.org/issues/misaligned-incentives.html.

[xlv] James M. Ackerman, Interest Rates and the Law: A History of Usury, 1981 Ariz. St. L.J. 61 (1981).

[xlvi] 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.

[xlvii] *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.

[xlviii] Multi-state Attorneys General comment letter to the OCC, January 21, 2020, available at https://oag.ca.gov/system/files/attachments/press-docs/Multistate%20comment%20--%20OCC%20Madden%20%28FINAL%29.pdf

[xlix] State *of* California Department *of* Justice, Attorney General Becerra Slams Proposal That Would Allow Predatory Lenders to Take Advantage of California's Most Vulnerable Communities, January 22, 2020, available at https://oag.ca.gov/news/press-releases/attorney-general-becerra-slams-proposal-would-allow-predatory-lenders-take

[l] Charla Rios, Diane Standaert, Yasmin Farahi, *The Sky Doesn't Fall: Life After Payday Lending in South Dakota*, (2020), Center for Responsible Lending, available at https://www.responsiblelending.org/research-publication/sky-doesnt-fall-life-after-payday-lending-south-dakota

[li] Gonzales Research and Media Services, "South Dakota Survey," August 2018. The poll was conducted by Gonzalez Research and Media Services from August 21 through August 28, 2018. A total of 509 registered Republican voters in South Dakota, who vote in the state's primary elections and indicated that they are likely to vote in the November 2018 general election, were queried by live telephone interviews, utilizing both land line and cell phone numbers. The margin of error is a range of plus or minus 4.4 percentage points.

[lii] If you were voting on the Payday Lending Initiative again today, would you vote: "Yes" in favor of keeping the cost of payday loans in South Dakota to a maximum annual interest rate of 36 percent or "No" in opposition to keeping the cost of payday loans in South Dakota to a maximum annual interest rate of 36 percent.

THE OHIO STATE UNIVERSITY

Testimony of Creola Johnson

President's Club Professor of Law,
The Ohio State University Moritz College of Law

Before the House Financial Services Committee
on
Rent-A-Bank Schemes and New Debt Traps:
Assessing Efforts to Evade
State Consumer Protections and Interest Rate Caps

February 5, 2020

Chairwoman Waters, Ranking Member McHenry, and members of the committee, it is an honor for me to appear today. Thank you for the opportunity to share some thoughts on the partnerships between payday lenders and national banks and how they result in high-cost financial debt traps for many Americans.

My name is Creola Johnson, and I am the President's Club Professor of Law, at the Michael E. Moritz College of Law located at The Ohio State University. I teach advertising law, bankruptcy law, commercial law, and consumer law courses. I also research and write extensively about consumer finance issues, including subprime mortgages, credit card indebtedness, student loans, and debt relief scams.

I was the first academic to publish a law review article about the payday lending industry, and it was entitled: *Payday Loans: Shrewd Business or Predatory Lending?*.[1] My conclusion was that payday loans are predatory, and, as I will explain further momentarily, they continue to be predatory products that are harmful to the majority of borrowers. Even more borrowers will be harmed if rent-a-bank partnerships are legitimized on a national level.

In order to complete my first article on payday loans, I obtained funding from the Office of Research at The Ohio State University.[2] I was able to conduct research by having several consumers participate in a survey where they actually obtained payday loans.[3] My survey findings uncovered businesses whose ultimate goal was to get consumers to quickly sign contracts agreeing to pay back money in a single balloon payment and to pay a finance charge amounting to a triple-digit interest rate. Instead of providing requested loan details, the lenders surveyed wanted to essentially keep borrowers in the dark about the consequences of signing those loan contracts.[4] For example, in violation of federal law, 77 percent of the payday lenders surveyed would not even allow the participants to read the printed loan contract before signing it.

I've been asked to describe briefly the various forms of arrangements/partnerships which reveal the payday lender as the "true lender," according to enforcement authorities and class-action litigants.

1. Simple rent-a-bank partnership—In a simple agreement between the bank and the payday lender, the bank is identified as the lender on the borrower's

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[1] *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, *26-98 (2002) [hereafter "Johnson, *Payday Loans*"], *available at* https://scholarship.law.umn.edu/cgi/viewcontent.cgi?article=1743&context=mlr

[2] *See Id.* at 1 (funding was provided by the University Seed Grant Program).

[3] The payday loan survey was conducted at payday loan businesses located in Franklin County, Ohio. *Id.*

[4] *Id.* at 45 (survey finding that payday lenders violated the Truth in Lending Act by their "failure to provide the APR in response to oral inquiries about the cost of the loan, failure to provide the APR in payday loan advertisements, and failure to provide the consumer with written disclosures prior to contract consummation"). Payday lenders in the survey not only violated state and federal laws, but the industry's standards of best practices.

loan document. However, the payday lender immediately buys the loan from the bank and does every function related to the loan. In these partnerships, the payday lender bears at least 90% of the risk of borrowers' defaulting on their loans.[5] The payday lender then claims the right to charge consumer borrowers triple-digit interest rates because the lender is in partnership with a state- or nationally-charted bank that is exempt from usury laws by the National Bank Act.[6]

2. Broker partnership—Under this arrangement, payday lenders claim to be exempt organizations that are allowed to charge consumer borrowers broker fees in order to secure loans for them. These payday lenders, however, are simply using the banks to fund their operations in order to skirt state usury laws.[7]
3. Rent-a-tribe partnership—This is an agreement between a payday lender and a Native American tribe and, as a result of the partnership, the payday lender relies on the tribe's tribal immunity to charge usurious interest rates. For instance, Cashcall, Inc., a non-bank payday lender started partnering with different tribes after the FDIC issue guidance for banks to cease rent-a-bank partnerships.[8] These rent-a-tribe partnerships were simple in the beginning, but have gotten relatively complex. Although the tribal entities claim to be the lenders, litigation has revealed that the payday lenders retain almost all of the revenue and perform all loan-related functions.[9] After years of

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[5] *See Goleta National Bank v. O'Donnell,* 239 F.Supp.2d 745 (S.D. Ohio 2002); See, e.g. West Virginia v. CashCall, Inc., 605 F.Supp.2d 781, 787 (S.D. W.Va. 2009) (holding that a payday lender did not have to issue usurious loans if it was "found to be a de facto lender"); *Flowers v. EZPawn*, 307 F.Supp.2d 1191, 1205 (N.D. Okla. 2004) (allowing a class-action lawsuit against payday lender to proceed in state court where plaintiffs allegations demonstrate that the payday lender was the true lender and not County Bank where the payday lender "exerts[ed] ownership and control over [the payday] loans[,] . . . carri[ed] out all interactions with the borrowers, accept[ed] the ultimate credit risk, collect[ed] and pocket[ed] virtually all of the finance charges and fees, and own[ed] and control[ed] the branding of the loans")

[6] For further discussion, *see* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 868 (2007) (describing how that "from about 2000 to 2005, banks facilitated the growth of the national payday lending providers by partnering with them, so that the providers could avoid local usury restrictions through the shelter of federal rules preempting the application of those restrictions to banks").

[7] West Virginia sued payday lender CashCall for violating state law by, among other things, issuing loans at usurious interest rates. Under the agreement between CashCall and First Bank and Trust of Millbank (located in South Dakota), CashCall had to purchase all loans originated by the bank with three days of a borrower obtaining a loan. See, *e.g.*, West Virginia v. CashCall, Inc., 605 F.Supp.2d 781, 787 (S.D. W.Va. 2009) (agreeing with lower court's finding that the payday lender was not an exempted credit repair organization). For further discussion, *see* Diane Standaert & Sara Weed, Center for Responsible Lending, Payday Lenders Pose as Brokers to Evade Interest Rate Caps (July 2010) https://bit.ly/2Mqj6zJ.

[8] *See CFPB v. CashCall, Inc.*, No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *1-2 (C.D. Cal. Aug. 31, 2016) (stating that CashCall's rent-a-bank scheme as a" lending model was successful for CashCall until … two state-charted banks withdrew from the arrangement under pressure from the FDIC"); *Pennsylvania by Shapiro v. Think Fin., Inc.*, No. 14-CV-7139, 2018 WL 637656, at *2 (E.D. Pa. Jan. 31, 2018) (describing how Think Finance, Inc., a payday lender, initially partnered with First Bank of Delaware to offer exorbitantly-priced payday loans to consumers and then partnered with Native American tribes to do the same).

[9] *See, e.g., Solomon v. Am. Web Loan*, No. 4:17CV145, 2019 WL 1320790, at *21 (E.D. Va. Mar. 22, 2019) (holding that plaintiffs had sufficiently alleged that the payday lender was the true lender based plaintiffs' allegation that the tribe "serve as a nominal creditor as it receives only 1% of the revenues from the loans," and that they payday lenders are the

litigation, courts now agree that payday lenders cannot rely on these partnerships to charge borrowers interest rates that are violation of usury laws that are applicable in the states where the borrowers reside.[10]

4. Complex rent-a-bank partnership—This partnership is referred to as bank-sponsored lending program. It is structured as a participation-based relationship, where the bank keeps all the loans on its books and sells to the payday lender a participation interest of up to 95 percent of the loan receivables.[11] As was the case in the simple rent-a-bank partnerships, in these bank-sponsored participation-interest partnerships, the payday lender performs all of the loan servicing functions and receives the majority of the revenue.[12] In a lawsuit filed by the Pennsylvania attorney general, Think Finance, Inc., an online non-bank lender had attempted to circumvent usury laws by using two different partnerships, rent-a-bank and rent-a-tribe, with several different entities involved.[13] In the rent-a-bank program, one of the related entities was an investor which provided over $90 million of the loan funding in exchange for a fixed 20% return, and then that investor formed an entity called a "special purpose vehicle" to purchase participation interests in the loans. Pennsylvania argued that this complicated structure was just a means of charging usurious interest rates. The court, however, held this bank-involved partnerships did not violate state law and dismiss the claims against the investor because, according to the court, Pennsylvania alleged nothing more than "passive" involvement by the investor and its affiliate.

With this overview in mind, I want to focus on what I describe as the over-arching themes of the business model of payday lending: (1) "keeping borrowers in the dark" and (2) "keeping them on the hook paying as long as possible."

Through my research, I found that payday lenders want to keep borrowers in the dark. That is what rent-a-bank partnerships do. The consumer's interactions are *only* with the payday lender, but the contract identifies some other entity as the

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actual lenders because they buy the loans from the tribe and "they perform all substantive lending functions and bear the economic risk"). Nathalie Martin & Joshua Schwartz, Regulation in the Fringe Economy Symposium: The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?, 69 WASH & LEE L. REV. 751, 755 (2012)

[10] *See, e.g.*, *Solomon v. Am. Web Loan*, No. 4:17CV145, 2019 WL 1320790, at *21 (E.D. Va. Mar. 22, 2019).

[11] *See* Pepper Hamilton, LLP, Participation-Based 'Bank Sponsor' Lending Programs: Exploring the Advantages and Risks, JD Supra (Blog), May 4, 2019, available at 2019 WLNR 13837781 (attorneys stating that under this structure, "the bank has no choice but to be actively involved, [and] there is less risk that the participation-based lending program will be characterized as an unlawful 'rent a charter' scheme").

[12] *See id.*

[13] *See Commonwealth of Pennsylvania by Shapiro v. Think Finance, Inc.*, No. 14-cv-7139, 2018 WL 637656, at *1 (E.D. Pa. Jan. 31, 2018) (allowing the attorney general to pursue its claim against defendants that partnered with Native American tribes in "rent-a-tribe" schemes, where the "tribal entity would act as the nominal lender and the Defendants, the defacto lender, would avoid state regulation under the cloak of the tribe's sovereign immunity").

lender. In my first published article, I discussed pending litigation involving Ace Cash Express, Inc., a Texas-based payday lender offering loans at stores physically located in the State of Ohio.[14] Consumers, however, signed loan contracts that stated Goleta National Bank was the lender even though this California-based bank had no officers or employees in Ohio.[15] Goleta's $17 fee charged on each $100 loan resulted in an Annual Percentage Rate ("APR") of 440%.

In 2001, Goleta filed a lawsuit against the superintendent of financial institutions of the Ohio Department of Commerce to get a court order restraining the superintendent from enforcing the Ohio Small Loan Act against ACE for lending at usurious rates in violation of state law. Goleta contended that the National Bank Act preempted the superintendent's authority to enforce Ohio law against ACE because the company was Goleta's agent. Under the agreement between ACE and Goleta, ACE actually bore 90% of the loan risk. The court held that meant that ACE was not acting as Goleta's agent, and, therefore, Goleta had no standing as it could not prove any injury to itself.[16] The court noted that a ruling against ACE would not prevent Goleta from actually lending in Ohio. However, "Goleta simply would be prevented from covering ACE, for a fee, <u>with the umbrella of a national bank in order to enable ACE to circumvent Ohio's usury laws</u>."[17]

I like the court's use of "umbrella" as a metaphor. Except, this is no ordinary umbrella that payday lenders want to use. Much like the umbrella in the James Bond movie "For Your Eyes Only,"[18] the rent-a-bank "umbrellas" have sharp spikes protruding in order to pin down consumers and then trap them in cycles of long-term indebtedness.

After numerous lawsuits against ACE and others, federal regulators began cracking down on rent-a-bank partnerships in 2005, and we thought such partnerships had been nearly eliminated in 2010.

By that time, I had decided to do additional research about payday lending and discovered a host of practices, that amounted to subterfuge to hide unlawful lending practices in violation of state usury laws. I have documented those practices in my article entitled "*America's First Consumer Financial Watchdog Is on A Leash: Can the CFPB Use Its Authority to Declare Payday-Loan Practices Unfair, Abusive, and Deceptive?*."[19] In that article, I explained that how payday

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[14] *Id.* at 45. *See Goleta National Bank v. O'Donnell*, 239 F.Supp.2d 745 (S.D. Ohio 2002).
[15] *See* 239 F. Supp.2d at 747.
[16] *Id.* at 757
[17] *Id.* at 756.
[18] *See* Gadgets from James Bond Movies, https://www.gq.com/story/best-james-bond-007-gadgets.
[19] *See* Creola Johnson, *America's First Consumer Financial Watchdog Is on A Leash: Can the CFPB Use Its Authority to Declare Payday-Loan Practices Unfair, Abusive, and Deceptive?*, 61 CATH. U. L. REV. 381 (2012), [hereafter, "Johnson, *America's First Consumer Financial Watchdog*"]
available at https://scholarship.law.edu/cgi/viewcontent.cgi?article=1011&context=lawreview.

lenders had reincarnated the lending model nationwide by entering into partnerships with Native American tribes and claiming –hiding under the umbrella of— *"tribal immunity"* to avoid state laws.[20]

For a time, payday lenders were successful in using rent-a-tribe partnerships to claim tribal immunity to charge consumers triple and quadruple-digit interest rates and trap them in long periods of indebtedness. However, several recent court rulings demonstrate that the tide has turned. In 2019, the U.S. Court of Appeals for the Second Circuit made it clear that an online lending operation could not use a rent-a-tribe partnership to claim that a tribe was authorized to issue loans ostensibly from a reservation in Montana to circumvent a Vermont law capping loans at 24% in order to charge residents of Vermont interest rates as high as 376%.[21] The Second Circuit stated:

> Plain Green is a payday lending entity [claiming tribal affiliation but is] cleverly designed to enabled Defendants to skirt federal and state consumer protection laws under the cloak of tribal sovereign immunity. That immunity is a shield, however, *not a sword.* .... Tribes and their officers are not free to operate outside of Indian lands without conforming their conduct in these areas to federal and state law. [22]

As a result of this ruling, the tribe and the lenders funding its operations must comply with Vermont law.[23]

Because class-action litigants and enforcement authorities have been successful in securing numerous settlements against payday lenders using rent-a-tribe partnerships, payday lenders have resurrected their partnerships with banks as a way to escape usury laws.[24]

The Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corp. (FDIC) proposed rules would enable payday lenders to partner with banks to circumvent consumer protection laws in about half the states. Consider that while the above-mentioned tribal lender would be restricted by the 24% APR in Vermont, a payday lender in partnership with a bank will be able rely on the exemption doctrine to charge triple-digit interest rates to people who can

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[20] *See* Johnson, *America's First Consumer Financial Watchdog*, ("Using this doctrine, lenders argue that because their businesses are located on or headquartered within the borders of a Native American reservation, they are bound by the laws of that reservation only, not the laws [capping interest rates in] ... the state in which the borrower resides."). *See also* 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, 762-63 (2012).

[21] *See* Gingras v. Think Fin., Inc., 922 F.3d 112 (2d Cir. 2019) (describing the rent-a-tribe scheme's operation and its funding by Think Finance, Inc.).

[22] *Id.* (emphasis supplied).

[23] *See id.* at 128.

[24] *See* Pepper Hamilton, LLP, Participation-Based 'Bank Sponsor' Lending Programs: Exploring the Advantages and Risks, JD Supra (Blog), May 4, 2019, *available at* 2019 WLNR 13837781.

least afford them. Not only would the OCC and the FDIC empower payday lenders and banks to circumvent state laws but would in effect overturn the Second Circuit's decision in *Madden v. Midland Funding*, where the court ruled that a usury law would apply to a non-bank purchasing loans from a bank.[25]

Pending cases against non-bank lenders show how they are using rent-a-bank partnerships to issue high-cost loans in violation of state law. For illustrative purposes, consider Kabbage, Inc., which is a non-bank online lender that gives cash advance loans to small businesses.[26] Kabbage funds its lending operation, in part, from its partnership with Celtic Bank, a state-chartered bank in Utah, a state with no maximum interest rate for small business and commercial loans.[27] According to several lawsuits, the borrowers only interact with Kabbage but Celtic Bank is named as the lender in each loan transaction charging APRs as high as 95%.[28] Kabbage then buys all loans within two days of origination and thereafter performs all lending-related functions, including servicing the loans. Kabbage bears 100% of the risks, and, as result, litigants assert that Kabbage has violated usury laws in California, Colorado, Massachusetts, and New York.[29] In fact, in a joint webinar presentation with the National Federation of Independent Business, Kabbage's co-founder and chief operating officer acknowledged that Kabbage is the direct lender.[30]

Borrowers argue that Kabbage's loan terms amount to contracts of adhesion because, in addition to the borrowers agreeing to pay usurious interest rates, borrowers waive the right to a jury trial, waive the right to participate in a class action, waive the right to seek legal redress in their home state, and waive the right to assert claims for compensatory, consequential and punitive damages.[31] Borrowers also grant Kabbage a security interest on all the borrowers' assets and

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[25] The Second Circuit is the only U.S. Court of Appeals to hold that non-bank assignees are not entitled to preemption protection simply by virtue of holding loans that were originated with a national bank. *Madden v. Midland Funding, LLC*, 786 F.3d 246, 249-53 (2d Cir. 2015), *cert. denied,* 136 S. Ct. 2505 (2016).

[26] *See Barnabas Clothing, Inc. v. Kabbage, Inc.*, No. CV 18-3414 PSG (SSX), 2018 WL 9669565, at *1 (C.D. Cal. June 8, 2018) (alleging that, in addition to violating state usury laws, perpetuated an illegal scheme, when "Kabbage entered into a criminal enterprise known as a 'rent-a-bank' scheme with Celtic Bank, a foreign bank chartered in Utah (a state, unlike California, with no maximum interest rate for commercial loans)").

[27] *See, e.g.*, Complaint, Barnabas Clothing, Inc., et al, v. Kabbage, Inc., No. CV 18-3414 PSG (SSX), *available at* 2018 WL 1608431 (Cal.Super. Mar. 22, 2018) [hereafter Barnabas Complaint];

[28] *See, e.g., id.*; Complaint, Bright Kids NYC, Inc., et al vs. Kabbage, Inc., et al, No. 1:19-cv-09221-JMF, (S.D.N.Y. Oct. 4, 2019), *available at* https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2019/10/Bright_Kids_NYC_v._Kabbage.pdf) [hereafter Bright Kids Complaint].

[29] *See, e.g.,* Barnabas Complaint, (alleging that small business and its owner "at all times dealt exclusively with Kabbage" and "had absolutely no dealings of any kind with Celtic Bank on any of these loan transactions."); Bright Kids Complaint.

[30] *See, e.g.,* Bright Kids Complaint, *supra.*

[31] *See, e.g.,* Barnabas Complaint, *supra*; Complaint, supra, Complaint, NRO Boston, LLC, et al, vs. Kabbage, Inc., et al, No. 17-11976, 2017 WL 4569540 (D. Mass. Oct. 12, 2017) (alleging that the Kabbage included "unconscionable and unfair provisions in connection with the loan agreements, which were contracts of adhesion" in violation of Massachusetts law).

the individuals that own the borrowers must personally guarantee all debts owed to Kabbage.[32] In all these cases, Kabbage moves to compel arbitration and essentially prevents small-business entrepreneurs from obtaining judicial relief.[33] In one of the arbitration cases, the arbitrator found that Celtic Bank was the lender despite the fact that Kabbage is contractually obligated to purchase 100% of the receivables arising from the loan transactions.[34] As a result of the forgoing, Kabbage is not only perfectly positioned to get away with charging usurious interest rates, but to perpetrate the worst lending and collection practices.[35]

Today, I must once again argue that rent-a-bank partnerships are no better than when then appeared 20 years ago. Rent-a-bank partnerships will enable payday lenders to have far more funding to trap far more consumers and small-business owners than was possible years ago. The rent-a-bank partnerships will allow payday lenders to use funding from banks to perpetrate nationwide the following practices (discussed extensively in my law review articles):

1. Debt entrapment practices - These are practices that ensure a borrower will not be able to repay the loan by the initial due date and will eventually default or have to do something to extend the life of the loan. Debt entrapment practices include approving borrowers for credit with only minimal or non-existent credit checks, issuing to borrowers loans with large principal amounts and triple-digit interest rates, and establishing short maturity dates for loan repayment.[36]
2. Debt treadmill practices - These are practices designed to make sure that the lender will receive, at a minimum, continuing stream of fee payments from the borrower. Debt treadmill practices include: multiple rollovers fees to extend the loan's due date, multiple back-to-back loans, rapacious electronic debits to borrowers' bank accounts, and illegal garnishments of consumer borrowers' wages.[37]

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[32] *See, e.g.,* Bright Kids Complaint, *supra.*

[33] *See Barnabas Clothing, Inc. v. Kabbage, Inc.*, No. CV 18-3414 PSG (SSX), 2018 WL 9669565, at *1 (C.D. Cal. June 8, 2018) (granting Kabbage's motion to compel arbitration).

[34] *See e.g.,* Plaintiffs' Brief in Opposition to Defendants' Motion to Compel Arbitration and Stay Proceeding, Bright Kids vs. Kabbage, No. 1:19-cv-09221-JMF (S.D.N.Y. Jan. 3, 2020) (discussing Kabbage's use of arbitration clauses to have lawsuits filed against it tossed out of federal court).

[35] *See, e.g.,* NRO Complaint, *supra* (alleging that Kabbage violated state law in a number of ways, including racking up finance charges by requiring borrowers "to enter into a new loan agreement every time money is drawn from the line of credit").

[36] *See* Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending*, 69 WASH. & LEE L. REV. 649, 650 (2012), *available at* https://scholarlycommons.law.wlu.edu/cgi/viewcontent.cgi?article=4274&context=wlulr (describing in detail debt entrapment practices and arguing that Congress should pass a federal law capping interest rates on payday loans to protect the civilian population from predatory lending).

[37] *See id.*

3. Debt criminalization practices - These are practices perpetrated by payday lenders to make borrowers fear imminent arrest for crimes if they do not comply with the payday lenders' demands for payments. Such criminalization practices include (1) threatening to pursue prosecution of consumers for committing a crime; (2) filing police reports to initiate criminal charges against consumers; and (3) misusing civil contempt proceedings to obtain arrest warrants against consumers.[38]

As I close my remarks today, I ask that Congress pass H.R. 5050, the "Veterans and Consumers Fair Credit Act," which would establish a 36% nationwide rate cap for consumer loans.[39]

[38] *See* Creola Johnson, *Creditors' Use of Consumer Debt Criminalization Practices and Their Financial Abuse of Women*, 34 COLUM. J. GENDER & L. 5 (2016), *available at* https://academiccommons.columbia.edu/doi/10.7916/D88W3RVX.

[39] *See* The Veterans and Consumers Fair Credit Act, H.R. 5050 and S. 2833, 116th Congress (2019).

MERCATUS CENTER
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TESTIMONY

INNOVATION AND COMPETITION IN LENDING IMPROVES ACCESS TO CREDIT

Brian Knight
Director and Senior Research Fellow, Program on Innovation and Governance, Mercatus Center at George Mason University

US House of Representatives Committee on Financial Services

February 5, 2020

Good morning, Chairwoman Waters, Ranking Member McHenry, and members of the committee. Thank you for inviting me to testify.

My name is Brian Knight and I am the director of the Program on Innovation and Governance and a senior research fellow at the Mercatus Center at George Mason University. Much of my research focuses on the role of technological innovation in the provision of financial services. Any opinions I express today are my own and do not necessarily reflect the views of my employer.

First, let me congratulate Chairwoman Waters and Ranking Member McHenry. The topic of innovation in financial services is an important one and I applaud your interest and leadership in it. I also appreciate you soliciting input from a broad array of perspectives and look forward to a collegial and respectful discussion. It is an honor to testify.

The key point I want to leave you with is that innovation and competition in lending, of which the bank-partnership model is a key part, is helping to improve access to credit, especially for borrowers poorly served by the traditional market.

We are witnessing an important evolution in the credit markets, powered by innovative firms partnering with banks, frequently smaller banks. Fintech firms, many of which partnering with banks, now account for 38 percent of unsecured personal loan balances, up from only 5 percent five years ago.[1] There is evidence that these partnerships allow some borrowers to access credit on better terms then they would receive from a traditional lender.[2] There is also evidence that these partnerships allow for

1. TransUnion, "FinTechs Continue to Drive Personal Loan Growth," news release, February 21, 2019, https://newsroom.transunion.com/fintechs-continue-to-drive-personal-loans-to-record-levels/.
2. Julapa Jagtiani and Catharine Lemieux, "Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information" (Working Paper No. 17-17, Federal Reserve Bank of Philadelphia, Philadelphia, PA, July 6, 2017); Julapa Jagtiani and Catharine Lemieux, "The Roles of Alternative Data and Machine Learning in Fintech Lending: Evidence from the LendingClub Consumer Platform" (Working Paper No. 18-15, Federal Reserve Bank of Philadelphia, Philadelphia, PA, January 2019).

greater access to credit for borrowers in parts of the country that are underserved by traditional lenders and that innovative lending can be less racially discriminatory than traditional lending.[3]

These partnerships are mutually beneficial for both the fintech firm and the bank. The bank receives access to technology beyond what it could develop on its own; customers outside of a bank's immediate geographic area help the bank to diversify its business, improve management of its balance sheet, and enhance servicing capacity. Fintech firms receive assistance with regulatory compliance and they become able to do business nationwide under a consistent regulatory regime in conjunction with their bank partner.

It is important to keep in mind that these relationships are highly regulated. Fintech firms that partner with banks are frequently regulated under the Bank Services Company Act and are subject to examination by the bank's federal regulator for the services the fintech firm provides the bank.[4] Additionally, the fintech partner is frequently subject to examination by a state bank regulator if the partner bank is state chartered and is covered by consumer protection laws enforced by the Consumer Financial Protection Bureau and the Federal Trade Commission. Likewise, the bank is accountable for the actions of its fintech partner taken in furtherance of the partnership.[5] Bank regulators have shown themselves to be willing and able to police bank partnerships and hold both banks and their partners accountable for bad acts.[6]

While these partnerships between banks and innovative technology companies have displayed significant promise, they have been threatened by recent litigation that has disrupted long-settled expectations. In the case of *Madden v. Midland Funding, LLC*,[7] the US Court of Appeals for the Second Circuit held that New York law governed a loan that was originally validly issued by a bank under Delaware law and that it was therefore usurious when it was sold to a debt collector after default. In effect, the court held that the legality of a validly made loan could change depending on who held it after it was made, even if the terms of the loan did not change. This holding has been criticized as an incorrect interpretation of the law by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Obama Administration's solicitor general.[8]

While this case does not directly deal with the type of bank partnership at the heart of innovative lending, it appears to have had a significant and negative impact on credit markets because it calls into question the ability of banks to sell their loans to fintech partners. One study found that, in the wake of

3. Julapa Jagtiani and Catharine Lemieux, "Do Fintech Lenders Penetrate Areas That Are Underserved by Traditional Banks?" (Working Paper 18-13, Federal Reserve Bank of Philadelphia, Philadelphia, PA, March 2018); Usman Ahmed et al., "Filling the Gap: How Technology Enables Access to Finance for Small- and Medium-Sized Enterprises," *Innovations* 10, no. 3-4 (2015): 35–48; Bartlett et al., "Consumer-Lending Discrimination in the FinTech Era" (NBER Working Paper No. 25943, National Bureau of Economic Research, Cambridge, MA, June 2019).
4. 12 U.S.C. § 1867(c).
5. Federal Deposit Insurance Corporation, "Guidance for Managing Third-Party Risk" (Financial Institution Letter No. FIL-08-044, Federal Deposit Insurance Corporation, Washington, DC, June 6, 2008). "[T]he FDIC evaluates activities conducted through third-party relationships as though the activities were performed by the institution itself. In that regard, it must be noted that while an institution may properly seek to mitigate the risks of third-party relationships through the use of indemnity agreements with third parties, such agreements do not insulate the institution from its ultimate responsibility to conduct banking and related activities in a safe and sound manner and in compliance with law."
6. Federal Deposit Insurance Corporation, *In the Matter of Bank of Lake Mills Lake Mills, Wisconsin, FDIC Order for Restitution and Order to Pay Civil Money Penalty*, 2017; Federal Deposit Insurance Corporation, *In the Matter of Freedom Stores, Inc., as an Institution-Affiliated Party of Bank of Lake Mills Lake Mills, Wisconsin, Order for Restitution and Order to Pay Civil Money Penalty*, 2017; Office of the Comptroller of the Currency, *In the Matter of Peoples National Bank, Paris, Texas, Consent Order*, 2003; Office of the Comptroller of the Currency, *In the Matter of Advance America, Cash Advance Centers, Inc. Agent and Bank Service Provider for: Peoples National Bank, Paris, Texas*, 2003.
7. 786 F.3d 246 (2015).
8. Brief for the United States as Amicus Curiae Supporting Saliha Madden, Midland Funding, LLC, et al. vs. Saliha Madden (2016) (No. 15-610).

the *Madden* decision, funding for marketplace loans aimed at borrowers with FICO credit scores under 700 decreased significantly in New York and Connecticut compared to outside the Second Circuit because of concerns that any loan made to those borrowers may become invalid if sold to a non-bank marketplace lender.[9] A subsequent study found a reduction in marketplace lending credit availability to New York and Connecticut residents,[10] especially to low-income residents, as well as an increase in personal bankruptcies, a phenomenon the authors link to the inability of low-income borrowers to access credit in order to refinance debt or address exigent circumstances such as medical bills.

These unfortunate results highlight the potential harm of impeding increased innovation and competition in credit markets. Consumer protection is essential, but denying consumers access to credit does not necessarily protect them because it does not remove the underlying issues motivating the need for credit. Rather, allowing more innovation and competition in credit markets, especially for those insufficiently served by traditional products, presents a better path to what everyone wants: a credit market that allows consumers to make informed choices that best serve their needs.

Thank you again for the opportunity to testify. I look forward to your questions.

9. Colleen Honigsberg, Robert J. Jackson Jr., and Richard Squire, "How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment," *Journal of Law and Economics* 60 (2017): 673.
10. Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy" (working paper, 2019).

Written Statement for the Record

Assemblymember Monique Limón
Member, California State Assembly
Chair of Assembly Committee on Banking and Finance

Before the United States House of Representatives
Committee on Financial Services

Rent-a-Bank Schemes and New Debt Traps:
Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps.

February 5, 2020

Chairwoman Waters, thank you for holding this hearing and inviting me to testify on how rent-a-bank schemes undermine the roles of states in protecting consumers.

My name is Monique Limón. I serve in the California State Legislature as an Assembly Member and Chair of the Committee on Banking and Finance. During my time as Chair, I have prioritized the issue of small-dollar consumer lending and have introduced bills dealing with short-term payday loans, consumer installment loans, auto title loans, and loan brokers. My primary focus as Chair has been to learn about these markets by evaluating data from our state regulator and meeting regularly with lenders, consumers, and consumer law experts. My goal in this work has been to identify areas where consumer outcomes can be improved and work to advance legislation to strengthen consumer protections.

Overview of High-Cost Consumer Lending in California

Since the mid-1990s, California has taken a permissive stance on lending products marketed to nonprime consumers. Despite a longstanding state law that caps interest rates on loans smaller than $2,500 at about 30%, the Legislature enacted a law in 1996 that permits payday lenders to charge around 400% for short-term loans of $300.[1] Although the payday loan industry markets its product as a solution to emergencies or one-time cash shortfalls, it is clear that the industry relies on heavy repeat borrowing to generate profits. According to data provided by payday lenders in California, 70% of industry revenue, or nearly $300 million annually, is generated from borrowers who take out seven or more payday loans each year.[2] With such high rates of repeat borrowing of high-cost loans, it is not surprising that academics have found that access to payday loans causes an increase in personal bankruptcy filings.[3]

Over the last decade, many payday lenders began to market larger and longer-term installment loans to California consumers. Because of the state's interest rate ceiling of about 30% for loans smaller than $2,500, lenders pushed borrowers to loans of $2,500 or more, where interest rates were not regulated. CashCall, a high-cost lender, is credited with pioneering this approach.[4] CashCall experimented with various interest rates until it found a profitable breakeven at 135% in 2009. Triple-digit interest rates allowed CashCall to operate a profitable business model even though its model assumed a default rate of 35-40%.[5] As investors and competitors witnessed CashCall's profitability in spite of high default rates, copycat business models entered California.

Since CashCall showed that the model could be profitable, more than a dozen large lenders began to offer similar products in California. As more lenders entered the market, rather than

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[1] http://www.leginfo.ca.gov/pub/95-96/bill/sen/sb_1951-2000/sb_1959_bill_960830_enrolled.html

[2] See page 25: https://dbo.ca.gov/wp-content/uploads/sites/296/2019/08/CA-Payday-Loans-Annual-Report-2018-FINAL-8-8-19.pdf

[3] Paige Marta Skiba & Jeremy Tobacman, 2019. "Do Payday Loans Cause Bankruptcy?," Journal of Law and Economics, University of Chicago Press, vol. 62(3), pages 485-519

[4] https://www.latimes.com/projects/la-fi-reddam-cashcall-loanme/

[5] The information about CashCall's business model was provided by CashCall Chief Financial Officer Delbert Meeks in a 2013 court filing as part of a class action lawsuit against the lender (Case No. C 08-03174 MEJ).

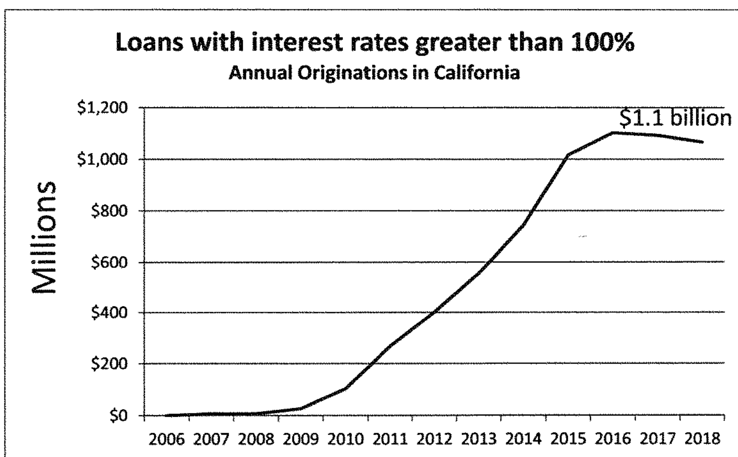
competition driving prices down, interest rates continued to climb, with rates higher than 200% becoming commonplace. Figure 1 below provides example loan terms that were posted on lenders' websites on 3/24/2019. The websites advertised the "quick," "easy" availability of these products.

Figure 1

Lender	Loan Amount	Loan Term (months)	Monthly Payment	Total Repayment	APR
Advance America	$2,550	24	$449	$10,782	206%
Check'n Go	$2,600	9	$612	$5,508	218%
Elevate	$2,600	16	$483	$7,726	224%
LoanMe	$2,600	47	$388	$18,255	184%
SpeedyCash (aka CURO)	$2,600	42	$281	$11,806	132%

By 2015, lenders were originating more than $1 billion of triple-digit interest rate loans in California each year.[6] For a product that was nearly nonexistent at the beginning of the Great Recession, the growth rate is stunning, as shown in Figure 2 below. In 2018, high-cost installment lenders generated more than $1 billion in interest and fee revenue from California borrowers, more than double the $400 million earned from short-term payday loans.

Figure 2



[6] https://calmatters.org/politics/2019/05/will-california-crack-down-predatory-lending-pink-slip-loans/

Triple-digit Interest Rates Push Consumers to Financial Ruin

Loans with triple-digit interest rates harm consumers for two primary reasons. First, high interest rates make a loan less affordable, often causing the borrower's monthly payment to be double or even triple the amount of a similarly structured loan with an interest rate of 36% or less.[7] High monthly payments substantially increase the probability that a borrower will fall behind on her loan, whether due to volatility in her income or due to an unexpected expense that depletes her monthly budget, and eventually default.

Second, high interest rates reduce the incentive for a lender to underwrite loans by reasonably evaluating a borrower's ability to repay. This system of misaligned incentives fosters an economically inefficient segment of the credit market, wherein a lender can remain consistently profitable despite a large portion of its customers defaulting on their debts.[8]

Data from California lenders show that high-cost loans fail borrowers at a very high rate. Four large high-cost lenders submitted their loan data to a third-party consulting firm that produced a report on borrower outcomes in California.[9] This report, which was funded by a high-cost lender, showed that 38% of high-cost loans went into collection status.[10] The report also found that 22% of the loans analyzed were refinanced. Assuming some portion of those refinanced loans were ultimately sent to collections, the actual default rate based on the individual borrowers is even higher than 38%.

Data provided by lenders to the state banking regulator support the conclusions of the report. Figure 3 displays a table of charge-off rates from several large lenders based on their lending activity in California in 2017 and 2018. While charge-off data is not perfectly comparable between lenders or over time, the data provide insight on the magnitude of the problem in California. Figure 4 displays a chart comparing how these default rates compare with other financial products. Note that the default rate on high-cost installment loans is nearly four times as large as the default rate for subprime auto loans in California over a similar period.[11]

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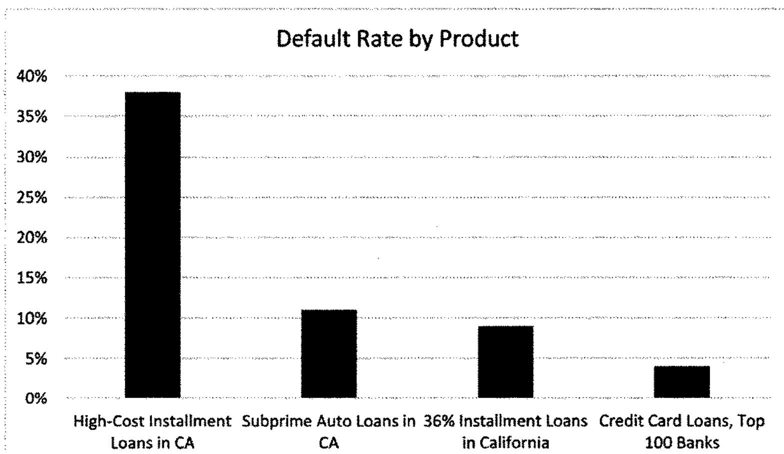
[7] A two-year, $2,600 loan with a 36% interest rate requires a monthly payment of $154. Table 1 cites monthly payments for a loan of the same size and term to be $449, or 2.9x the monthly payment of a 36% loan.
[8] This system of misaligned incentives is clearly explained and analyzed in a National Consumer Law Center report that can be accessed here: https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-misaligned-incentives.pdf.
[9] The report's conclusions are summarized here:
http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201920200AB539#
[10] In mandated lobbying disclosures, CURO reported paying over $50,000 to Ankura Consulting Group, who published the report. See page 5 here: http://cal-access.sos.ca.gov/PDFGen/pdfgen.prg?filingid=2418444&amendid=0
[11] Data for subprime auto loans were collected from credit bureaus by Urban Institute and published here: https://apps.urban.org/features/debt-interactive-map/?type=auto&variable=autoopen_pct&state=6

Figure 3

Lender	2017 Active Loans 12/31/17	2017 Charged-off Loans	2017 Default Rate	2018 Active Loans 12/31/18	2018 Charged-off Loans	2018 Default Rate
Elevate Credit	26,741	18,383	41%	21,109	16,542	44%
Enova	18,923	18,621	50%	22,567	22,948	50%
LoanMe	46,445	24,839	35%	46,445	24,839	35%
Title Max	10,092	3,707	27%	12,301	7,227	37%

* Default rate is number of charged-off loans divided by the sum of active loans and charged-off loans

Figure 4



Loan charge-offs represent a tax-deductible business expense for a lender, but signal an impending crisis for borrowers and their families. Lenders assign the amount owed to debt collectors or sell the loan off in the secondary market to a debt buyer. The consumer's credit score is negatively affected, and they are subject to aggressive collections practices, which can ultimately result in their car being repossessed, their paycheck garnished, their bank account closed, and even bankruptcy.

History of California Legislature's Attempts to Reform High-Cost Loan Markets

Efforts to curb high-cost lending in California accelerated in the state legislature over the past three years. Prior to 2017, bills that sought to limit fees, interest rates, or payday loan transactions failed to advance in the legislative process. By 2017, two important factors helped to motivate reform efforts.

First, Members of the Legislature became more aware of the growing number of Californians burdened by high-cost loans and defaults. Data provided by the state financial regulator allowed Members to quantify the problem. Stories of individual borrowers' struggles were documented in the media, and Members heard from constituents harmed by high-cost loans. Additionally, religious leaders, community activists, and consumer organizations amplified concerns to legislators across the state.

Another important factor that buoyed reform efforts was the growth of affordable credit options offered by lenders serving nonprime and traditionally underserved consumers. Some lenders leverage large datasets to assess risk for consumers without credit scores or with credit scores that do not accurately reflect their ability to repay a loan. Other lenders leverage technology to reduce the cost of acquiring customers and servicing loans. The emergence of affordable options for nonprime consumers helped to allay concerns of legislators who had previously assumed that reform efforts would cut-off access to credit.

Legislators introduced several bills in 2017 and 2018 with varying approaches in how to address high-cost lending. Unlike previous efforts, these bills advanced out of committees and some even passed one house of the Legislature. None of the bills, however, made it through the entire legislative process. Two bills failed to receive adequate support when a majority of legislators deemed interest rate caps of 19% and 24% overly restrictive. Other bills failed to gain adequate support because they failed to cover the full range of loans affected by triple-digit rates. While not successful, the deliberation around the 2017 and 2018 bills helped to inform a comprehensive solution that could earn broad support.

2019 Effort Succeeds on Balanced Approach and Strength of Coalition

Last year, I introduced Assembly Bill 539, the Fair Access to Credit Act, to address the issue of unconscionable interest rates and the subsequent high default rates that jeopardize the financial well-being of over 100,000 California families each year. Assembly Bill 539 proposed the following changes to California's lending laws, applicable to loans of $2,500 - $10,000.

- Establish an interest rate ceiling of 36% plus the Federal Funds Rate.
- Set a minimum loan term of one year and maximum loan term of five years.
- Prohibit prepayment penalties.

When thinking about the right approach, I considered establishing underwriting standards, rather than a rate cap, to ensure that lenders were evaluating a borrower's ability to repay. In conversations with lenders, I learned that statutory underwriting standards could stymie innovation and reduce competition in the space. Many lenders actually preferred the clear rules of the road that a reasonable interest rate cap would bring, compared to the Legislature telling them how to make loan approval decisions. Additionally, an interest rate cap is easier to enforce from a regulatory perspective. The regulator can easily review marketing materials, Truth in Lending disclosures, and the loan agreement to evaluate a lender's compliance with the law.

Lender support was a key component in advancing Assembly Bill 539, but the effort could not have succeeded without the broad coalition of consumer advocates who worked to pass the bill. The coalition was spearheaded by Californians for Economic Justice, which brought together leading voices in local governments, religious communities, civil rights groups, and antipoverty advocates to support the bill. The coalition supporting the bill also included veterans groups who were concerned that the Military Lending Act only protected active duty members and their families, labor organizations who were concerned that high-cost loans harmed blue-collar workers, and economic development organizations who knew that high-cost loans eroded wealth in communities struggling against decades of discriminatory policies.

This broad coalition of supporters helped to deliver strong bipartisan support to advance the bill to the Governor. The bill passed on a 60 – 4 margin in the State Assembly and a 30 – 5 margin in the State Senate, with over 40% of Republicans voting "aye" on the bill. The bill was signed by the Governor and became law on January 1, 2020. The support for Assembly Bill 539 shows that consumer protections and regulating high interest rates is a truly bipartisan objective.

- Republican Assemblymember Jordan Cunningham, a co-author of the bill, stated that he was "proud to support AB 539 to cap unreasonable interest rates on consumer loans and protect people from predatory lenders. All of the world's major religions have rules against usury, or the charging of exorbitant interest rates, because it harms communities and families."[12]
- Democrat Assemblymember James Ramos, another co-author, stated that "high-cost payday lenders are inflicting financial harm on vulnerable families, charging sky high interest rates that can put families in worse positions than before they took out a loan. The Fair Access to Credit Act of 2019 will put a cap on these high interest rates and allows families to utilize these services for emergency funds without getting locked into drawn out, expensive repayments schemes that will harm their financial well-being."[13]
- Republican Senator Ling Ling Chang stated, "I proudly voted for AB 539, which cracks down on high-interest predatory lenders. A 200% interest loan isn't morally sound -

[12] https://www.facebook.com/AsmCunningham/videos/361011628099697/
[13] https://a40.asmdc.org/press-releases/20190916-ramos-co-authored-predatory-lending-bill-heads-governors-desk

especially when these predatory practices disproportionately impact veterans and vulnerable families."[14]

High-cost Lenders Declare Intent to Evade California Law via Rent-a-bank Schemes

After Assembly Bill 539 cleared major legislative hurdles, the executive teams of three publicly-traded, high-cost lending companies – Elevate Credit, Enova, and CURO – began their attempts to allay investors' concerns that California's reform efforts would negatively affect their companies' financial results. All three corporations controlled subsidiaries that held licenses from the state of California to make consumer loans, but those licenses required the lenders to follow state laws, including limitations on loan charges. If Assembly Bill 539 became law, these companies would not be able to make loans with interest rates that exceed the new cap.

In the summer of 2019, executives at the three companies told investors during quarterly earnings calls that they were exploring the use of bank partnerships to make loans that perpetuated the high-cost and high-default model that the California Legislature specifically acted to stop.[15]

- David Fisher, CEO of Enova, boldly claimed on July 26, 2019, that Enova would "likely convert our near-prime product to a bank-partner program, which will allow us to continue to operate in California at similar rates to what we charge today." Fisher went on to state, "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. And again, I think given the increased opportunity in California from all the subprime instalment lenders that will leave the State, the storefront guys that won't be able to compete. And again, the subprime title lenders who are really impacted by this bill, such a large opportunity for NetCredit. Happy to -- almost happy to pay those couple of points of margin to capture that opportunity."
- Jason Harvison, CEO of Elevate Credit, revealed on July 29, 2019, that Elevate "expect[s] to be able to continue to serve California consumers via bank sponsors that are not subject to the same proposed state level rate limitations... 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." In other words, Harvison was communicating that Elevate would continue to make loans at similar triple-digit rates in California.
- Don Gayhardt, CEO of CURO, stated on August 2, 2019, that CURO continues "to work on a number of new product and partnership opportunities that could give us the ability to serve our California customers with larger, longer-term loan products."

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[14] https://chang.cssrc.us/content/july-2019-newsletter
[15] https://www.nclc.org/issues/ib-rent-a-bank.html

The companies' plans to partner with banks in attempts to evade state interest rate caps did not come as a surprise. Enova and Elevate have been engaged in rent-a-bank schemes around the country for some time. Enova partners with Republic Bank, a state chartered bank from Kentucky, to originate loans that exceed rate caps in some states.[16] Elevate partners with both Republic Bank and FinWise Bank, a state chartered bank from Utah, to evade state consumer protection laws.[17] Likewise, CURO had been publicly discussing its plans to forge bank partnerships with Meta Bank, a nationally chartered bank, for more than a year.[18]

After Assembly Bill 539 was signed into law, I sent letters to the CEOs of all three companies.[19] In those letters, I informed them of the new consumer protections that the California Legislature established on a broad, bipartisan basis. I let them know that I was aware of their plans to evade the law and that I would be working to ensure that our state enforcement agencies carried out the intent of the bill.[20] I concluded by asking them to serve California consumers exclusively with loans that comply with the interest rate protections established by our state laws.

The new law went into effect on January 1, 2020. As of February 2, 2020, it does not appear that any of the three companies were yet offering products in California at rates above 36%. During Enova's earnings call on January 29, 2020, however, CEO David Fisher said that there are "opportunities both within the AB 539 law, but *also kind of outside of it* [emphasis added] for us to roll out additional compliance products in California, which we hope to do this year." The other companies may disclose more about their plans in the coming weeks. CURO is scheduled to report earnings on February 6, 2020, and Elevate Credit is scheduled to report earnings on February 10, 2020.

In addition to the three companies' plans, at least two privately-held companies appear to be breaking California law today. LoanMart is marketing auto title loans through a rent-a-bank scheme with Capital Community Bank, a state chartered bank out of Utah.[21] LoanMart represents that its annual interest rates range from 60% - 222%, indicating that none of its loans comply with California's rate cap.[22] Similarly, OppLoans is marketing loans of 160% to California consumers through a rent-a-bank scheme with FinWise Bank.[23]

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[16] https://www.netcredit.com/rates-and-terms/arkansas - showing that Enova offers loans through Republic Bank with interest rates up to 99.99% in Arkansas, despite the state capping interest rates at 17%.
[17] https://www.risecredit.com/frequently-asked-questions and https://www.elastic.com/FAQs/
[18] https://www.businesswire.com/news/home/20180430006202/en/CURO-MetaBank%C2%AE-Announce-Agreement-Offer-Consumers-Innovative
[19] https://www.sacbee.com/news/politics-government/capitol-alert/article238501288.html
[20] https://www.americanbanker.com/news/stern-warning-to-lenders-mulling-end-run-around-california-rate-caps?feed=00000152-a2fb-d118-ab57-b3ff6e310000
[21] https://www.800loanmart.com/about-us-contact-us/ - see bottom of page
[22] https://www.800loanmart.com/title-loans-faq/ - under "What interest rates does LoanMart offer?"
[23] https://www.opploans.com/rates-and-terms/#california

Rent-a-bank Schemes Threaten Balanced and Deliberative Legislative Solution

If left unaddressed, rent-a-bank schemes undermine state laws that have been established to protect consumers. This problem is not unique to California. The OppLoans and FinWise scheme appears to evade twenty-four states' rate caps, both in states where legislatures passed laws and in states where voters overwhelmingly approved rate caps through ballot initiatives.[24] States have a longstanding interest in protecting their consumers, and rent-a-bank evasions that seek to undermine the will of democratically elected representatives are a threat to states' sovereign powers.

Rent-a-bank schemes not only threaten consumer protections and state sovereignty, but the schemes also undermine the role of prudential banking regulators. In common originate-to-hold models, the FDIC and OCC have the ability to monitor the loan performance of a bank's balance sheet over time, and the agencies have the authority to provide supervisory guidance to ensure that banks are making lending decisions that support the safety and soundness of the banking system. In rent-a-bank models, however, the agreements between the bank and high-cost lender are predicated on the bank offloading the risk of the loan immediately after origination. Such arrangements may temporarily hide the risky behavior of banks, but the bank may later bear liability for the role it plays in facilitating these schemes.

Rent-a-bank Schemes Represent Rogue Behavior, and Not All Bank Partnerships Are Bad

Of the 4,000 banks supervised by the FDIC, only a small handful of banks facilitate rent-a-bank schemes. Similarly, of the thousands of state-licensed lending companies across the country, only a small percentage are seeking out and forging relationships with banks in order to originate high-cost loans. Yet these few entities are effectively evading consumer protection laws in dozens of red and blue states across the country. In addition to putting millions of consumers at risk of high-cost loans and associated defaults, rent-a-bank schemes place a burden on state enforcement agencies that choose to bring cases against such companies.

Before I conclude my testimony, I want to be clear that not all bank partnerships are bad for consumers. Bank partnerships that provide products where the interests of lenders and borrowers are aligned can be a healthy part of the financial system. We have seen responsible innovation from companies that successfully leverage technology to improve underwriting, lower the costs of providing credit, and ultimately give consumers better options than were previously available. To the degree that responsible companies partner with banks to extend their reach and provide healthy, affordable credit options, I am not asking for the federal government to stand in the way. Relatedly, if fintech companies can help banks to better serve their existing customers, I want to foster a regulatory environment that permits healthy relationships.

[24] https://www.nclc.org/issues/issue-brief-stop-payday-lenders-rent-a-bank-schemes-november-2019.html

As a fundamental test, I believe that bank partnerships that involve consumer credit should be premised on the bank following the FDIC's 2007 guidance on offering affordable small-dollar loans. Among other consumer protections, the guidance encourages banks to offer small-dollar credit with APRs no greater than 36%.[25] As another testament to the truly bipartisan nature of this issue, the guidance was issued under the leadership of Chairwoman Shelia Bair, a Republican appointed by President George W. Bush.

Federal Government Can Solve This Problem

States like California will fight against rent-a-bank schemes that seek to undermine state consumer protection laws, but the federal government should also address this issue. Through legislative or administrative action, the federal government should advance solutions that protect state sovereignty, protect consumers, and create a fair and competitive credit market with all lenders playing by the same rules.

One approach that the federal government should take is establishing a national cap on interest rates. I support the establishment of a national rate cap around the 36% standard. In order to be effective, the cap must apply to all classes of lenders, banks and nonbanks alike. In addition to capping rates, it is also important for proposed legislation to consider various fees and charges assessed by the lender. In line with the 2007 FDIC guidance, any origination fees should bear a direct relationship to the costs of originating a loan.

In parallel with efforts to establish a national rate cap, Congress should work with or compel the FDIC to stop supervised banks from facilitating evasion of state consumer protection laws. I urge Chairwoman McWilliams to establish an enforceable regulation that clearly states that bank partnerships cannot offer consumer credit products with APRs above 36%. A clear standard will serve to protect consumers and will give potential bank partners easy-to-understand rules about the types of products that they can develop with banks, allowing them to focus on new ways to design and innovate products that serve consumers. A clear standard will also foster a fair and competitive credit market by aligning the incentives of borrowers and lenders and by establishing a shared understanding among all lenders of the rules of the road.

Chairwoman Waters and Members of the Committee, thank you for bringing attention to this issue. While states will continue their work to protect consumers, I am hopeful that Congress and our federal banking regulators will step up to their responsibility in eradicating rent-a-bank schemes and supporting a healthy credit market for consumers and lenders alike.

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[25] https://www.fdic.gov/news/news/financial/2007/fil07050a.html

NCLC National Consumer Law Center
Fighting Together for Economic Justice

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

State Consumer Protections and Interest Rate Caps

February 5, 2020

I. Introduction and Summary

Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for the opportunity to testify on the National Consumer Law Center's low income clients. Since 1969, NCLC has worked for consumer justice and economic security for low-income and other disadvantaged people in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

Today we are facing the biggest threat in decades to states' historic power to prevent predatory lending: "Rent-a-bank" lending, where state-regulated lenders launder their loans up to 160% annual percentage rate (APR) through banks in order to evade state interest rate caps. These schemes are spreading around the country and are starting to explode. Payday lenders have state brazenly and openly that they plan to use rent-a-bank schemes to evade California's new law outlawing their destructive products. Every state is at risk.

The rogue banks that enable these schemes clearly feel comfortable that today's regulators will turn a blind eye to this misuse of the bank charter. That is not surprising, because the Federal Deposit Insurance Corp. (FDIC) and Office of the Comptroller of the Currency (OCC) have directly supported a predatory rent-a-bank lender that is making mortgages to small business owners at APRs up to 139% and have proposed rules that would encourage these schemes. Those proposed rules are outside the agencies' authority, are unnecessary, and are extremely dangerous for consumers and small businesses.

Congress can help stop predatory rent-a-bank lending by:

- Passing the Veterans and Consumers Fair Credit Act, H.R. 5050 (Garcia) and S. 2833 (Merkley), which would cover banks and extend to veterans and all consumers the 36% rate cap that today protects active duty servicemembers and their families.
- Supporting the power of states to protect their residents through interest rate limits, including by opposing the FDIC and OCC proposed rent-a-bank rules.
- Passing the Forced Arbitration Injustice Reform (FAIR) Act, H.R. 1423 (Johnson) and S. 610 (Blumenthal).

I will discuss each of these issues in more detail below.

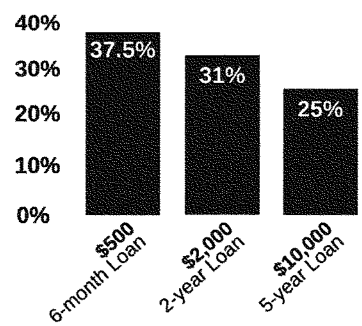
II. The Importance of States' Historic Power to Limit Interest Rates

Since the founding of our nation, states have limited interest rates as the primary protection against predatory lending. At the time of the American Revolution, every state had interest rate limits.[1] Interest rate limits are the simplest and most effective protection against predatory lending.[2]

Starting with a 1978 Supreme Court decision, a deregulatory race to the bottom eliminated interest rate caps for most banks.[3] The Court interpreted the National Bank Act to allow national banks to charge any rate allowed by their home state and export that rate to other states. In response, many states exempted banks from rate caps and banks moved to those states. Federal and state law changes eventually exempted most state- and federally-chartered banks from rate caps. A handful of states entirely eliminated their rate caps for nonbank lenders as well. Others retained their limits on nonbanks but carved out limited exceptions for short-term payday loans.

Today, the vast majority of states retain interest rate caps for many nonbank installment loans and other forms of loans. For example, 45 states and the District of Columbia (DC) limit the interest rate on a $500, 6-month loan. In most states, rate caps decrease as the loan size increases. The median rate among states with caps is 37.5% APR for a $500, 6-month loan; 31% APR for a $2,000, 2-year loan, and 25% APR for a $10,000, 5-year loan.[4]

Median State APR Limit by Size of Loan in States that Cap Rates



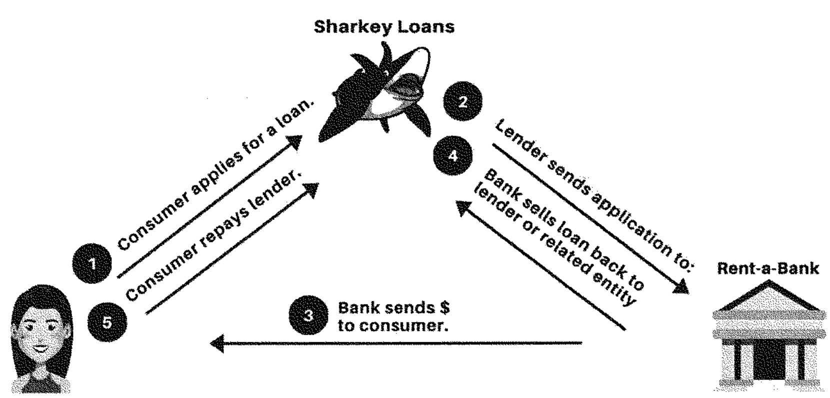
The American public strongly supports interest rate caps. In recent years, overwhelming, bipartisan majorities in have capped rates at 36% or less in Arizona (2008), Colorado (2018), Montana (2010), Ohio (2008), and South Dakota (2016).[5]

III. Rent-a-Bank Lending Joins a Long Line of Usury Evasions

Attempts to evade usury laws are as old as the laws themselves. But courts consistently look beyond form to the substance of the transaction to prevent subterfuge. For example, in one case in 1835, the U.S. Supreme Court described courts' abhorrence of usury evasions:

> "The ingenuity of lenders has devised many contrivances by which, under forms sanctioned by law, the [usury] statute may be evaded. [. . .] Yet it is apparent, that if giving [its stated] 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."[6]

Rent-a-bank lending is one of the newer forms of evasion. After banks escaped interest rate limits, high-cost lenders started using arrangements with banks. In rent-a-bank lending, a state-regulated entity claims that it is merely the agent, service provider or assignee of the bank that funds the loan but then quickly sells the loan or receivables. Because the funds originally come from the bank, the lender claims that state usury laws are preempted, even if the loan has



been assigned to a non-bank entity that is charging interest above what it can charge directly.

Two decades ago, payday lenders making short-term balloon-payment loans first tried using rent-a-bank schemes. In 2000, the OCC described the older payday loan rent-a-bank arrangements in terms that are strikingly similar to today's schemes:

> "[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."[7]

Payday lenders argued that they were only the agent, service provider or assignee of the bank.[8] 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 automated-consumer-information database that the payday lender itself used in other states) to electronically approve applications."[9]

In these older payday loan rent-a-bank schemes, the payday lenders not only performed services as an agent of the bank but also were assignees of loans or participation interests 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."[10] Another lender made arguments reminiscent of current arguments that an assignee steps 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."[11]

In the early 2000s, all of the federal bank regulators eventually shut down the rent-a-bank arrangements with short-term payday lenders. Former Comptroller of the Currency John Hawke explained in a 2002 speech:

> "The benefit that national banks enjoy by reason of this important constitutional doctrine [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....

"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 to manage effectively a multistate loan origination operation that is in reality the business of the payday lender."[12]

Despite the success of shutting down short-term loan rent-a-bank schemes, high-cost lenders that make longer-term installment loans have periodically tried to use banks regulated by the FDIC to evade state interest rate limits. When given the opportunity, courts have often shut down these schemes.[13]

Applying the longstanding anti-evasion principle, courts have recognized that federal bank preemption does not apply where a nonbank lender is the true lender. A true lender analysis often focuses on which party has the "predominant economic interest." Other factors include what party designed, brands or holds the intellectual property on the loan product and collateral; markets, offers, and processes loan applications; services the loans and handles customer service, purchases, has first right of refusal, or ultimately holds the bulk of the loans, receivables or participation interests; or has the ability to change the entity that originates the credit or to whom the credit or receivables are sold.[14] No single fact defines a rent-a-bank scheme, just as there is no single form of usury evasion. Rent-a-bank schemes continually evolve and must be challenged.[15]

Despite some successful challenges in the past, rent-a-bank lending is now making a comeback, aided by several developments:

- Forced arbitration clauses have taken away consumers' access to the courts when the law has been violated, and class action bans prevent them from joining together to challenge a well-heeled lawbreaker that is harming thousands or millions of people.
- The willingness and resources of state enforcement authorities to challenge rent-a-bank schemes have been uneven, even in states where voters have strongly endorsed rate caps.

- Rent-a-bank schemes have become more sophisticated, cloaking themselves as "fintech" lenders, using lines of credit without APR disclosures, or using complicated arrangements with the sale of receivables instead of whole loans to special purpose vehicles that benefit, but are not directly owned by, the nonbank lender.
- Lower-cost lenders have tested the waters and paved the way for high-cost lenders.
- Federal and state bank regulators have been unwilling to police their banks and are, to the contrary, actively supporting legal theories that benefit rent-a-bank lenders, as discussed below.

IV. High-Cost Rent-a-Bank Lending is Starting to Explode

We are now seeing an alarming explosion of blatant high-cost rent-a-bank schemes in the last two years, most in the last year, with more threatened. Evasion of state usury laws by state-regulated lenders should never be permitted, even if the rate charged is not stratospheric.[16] But in this testimony I will focus on the most outrageous high-cost lenders.

Today's high-cost rent-a-bank loans are mostly installment loans from $400 to $10,000, generally at rates of 100% APR to 160% APR, though some are lines of credit. These longer-term high-cost loans are an even bigger, deeper and harder to escape debt trap than short-term payday loans.[17] We have included many stories of the distress caused by high-cost longer-term loans in our comments recently submitted to the OCC.[18] Here is one example from Elevate, one of the lenders that is planning to move to a rent-a-bank model in California to evade the state's new rate caps designed to address precisely these loans:

> "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."[19]

Only a small number of banks are involved in rent-a-bank lending, but they can have a big impact. I am currently aware of six banks currently facilitating high-cost loans offered by non-bank companies at rates well over 36% and usually well above 100% APR: **Axos Bank (formerly Bank of Internet or BOFI Bank), Bank of Lake Mills (Wisconsin), Capital Community Bank (Utah), FinWise Bank (Utah), Republic Bank & Trust (Kentucky),** and **TAB Bank (Utah).**

All but one of these banks, Axos Bank (a federal savings association), are state-chartered banks that are regulated by the FDIC and by their chartering states: Utah for three of them and Kentucky and Wisconsin for the other two.

These six banks are, so far, helping several nonbank lenders make usurious loans in excess of what states allow.[20] We are currently aware of the following loans being made through rent-a-bank schemes in states that do not allow these rates:[21]

- ChoiceCa$h (LoanMart)/Community Capital Bank: car title loans up to $2500 with APRs up to **222% APR** (16 states and DC);[22]
- EasyPay Finance/TAB Bank: loans for auto repairs, furniture, home appliances, pets, and wheels and tires, such as a $1,500 loan at **188.99% APR** (30 states).[23]
- Elastic (Elevate)/Republic Bank & Trust: lines of credit from $500 to $4,500 with effective APRs up to **109%** (above state limits in 14 states and DC);[24]
- NetCredit (Enova)/Republic Bank & Trust: installment loans of $2,500 to $10,000 with APRs up to **99.99% APR** (22 states and DC);[25]
- OppLoans/FinWise Bank: installment loans of $400 to $5,000 with APRs of **160%** (24 states and DC);[26]
- Rise (Elevate)/FinWise Bank: installment loans of $500 to $5,000 with APRs of **99% to 149%** (16 states and DC);[27]

- World Business Lenders/Axos Bank or Bank of Lake Mills: small business loans (or disguised personal loans), typically secured by the owner's personal residence, with APRs of **75% to 139%** or higher (various states).[28]

In addition, as discussed in the next section, CURO Group Holdings Corp., which currently offers both short-term and long-term payday loans through its SpeedyCash brand, has told investors that it plans to begin a rent-a-bank operation in California.

V. Plans to Evade California's New Law Show High-Cost Rent-a-Bank Lenders Feel Comfortable with Today's Regulators

Rent-a-bank schemes are getting increasingly bold. In California, a new law that took effect January 1, 2020 limits the rates on loans up to $10,000. The bill was passed to address the harmful effects of installment loans over $2,500 at rates up to 200%.[29]

Yet before the bill had even passed, several California payday lenders informed their investors that they would nonetheless continue to charge triple-digit interest rates by blatantly evading the new usury law through forging rent-a-bank relationships with banks.[30] Three publicly traded payday lenders in California have announced plans to begin new rent-a-bank operations. Elevate, CURO Group Holdings (which includes the Speedy Cash brand, among others) and Enova International (with subsidiaries that include NetCredit and CashNetUSA) told investors that they plan to use banks to continue business as usual so that they can disregard California law and continue to make high-cost loans.[31] Shortly thereafter, Enova's NetCredit began making rent-a-bank loans through Republic Bank & Trust in several states, discussed above.

At least two high-cost lenders, OppLoans and LoanMart, appear to be already offering usurious rent-a-bank loans in California. To my knowledge, other rent-a-bank loans in California have not yet been rolled out.

The willingness of payday lenders to speak publicly and brazenly about using rent-a-bank schemes to evade state interest rate limits speaks volumes about the comfort they have with today's bank regulators. While both the OCC and FDIC have said that they view these schemes "unfavorably,"[32] they are well aware of the predatory rent-a-bank schemes operating today at their banks and they have done nothing about it. The same holds for the state bank regulators in Kentucky, Utah and Wisconsin, the home states of the state-chartered banks involved in these schemes. The clear signal predatory lenders have gotten is that the coast is clear.

If these brazen efforts to flout the law succeed, every state may see high-cost lenders laundering their loans through banks to evade state usury laws. Rent-a-bank schemes could also be used not only for installment loans but also for short-term payday loans, as in the 1990s. The OCC's repeal of its guidance against bank payday loans (aka "deposit advance products")[33] – and the possibility that the FDIC will soon do the same – heightens the risk that rent-a-bank short-term payday loans will return.

VI. The OCC and FDIC are Supporting a Rent-a-Bank Lender that Makes Mortgages Up to 139% APR that Endanger the Homes of Small Business Owners

The FDIC and OCC are actively supporting a predatory rent-a-bank scheme despite a truly shocking fact pattern. In July 2019, the FDIC filed an amicus brief supporting World Business Lenders (WBL) in a district court bankruptcy case, *Rent-Rite Super Kegs v. World Business Lenders.*[34] The FDIC 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 in Wisconsin.

The brief makes the same arguments in support of WBL's right to charge 120% APR as the OCC and FDIC raise to justify new proposed federal interest rate rules, discussed below. Not one word of the agencies' brief expresses any concern about the astonishing interest rate. The FDIC and 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. The agencies did not raise the possibility that the bank might not be the true lender or qualify their support for WBL's right to charge 120% APR in any way.

The FDIC's and OCC's support for WBL shows exactly the kind of abusive lending that will flourish if their rent-a-bank rulemaking is finalized. The *Rent-Rite* case is not an aberration. Several cases filed against WBL – including some that were publicly available before the OCC and FDIC made the decision to support WBL – reveal 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 facts described below are taken from the complaints as alleged. There is a striking similarity among them. 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. WBL even appears to have use of a power of attorney for both Bank of Lake Mills and Axos Bank.

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.[35] The loans were offered by Danjon Capital in collusion with World Business Lenders, but were purportedly with funds lent by Bank of Lake Mills. After executing the first note and mortgage, Danjon refused to release the funds unless Speer executed a lease agreement for "restaurant equipment" despite the fact that Speer was never in the restaurant business and the equipment referenced included two backpack leaf blowers unrelated to restaurant use. The complaint alleges that the defendants disguised residential mortgage loans made to consumers primarily for personal, family, or household use as commercial loans in order to avoid Connecticut's licensure and other laws.

In *Vincent Deramo Jr. et al. v. World Business Lenders, LLC*, filed in Florida in 2017, a general contractor and his wife allege that a representative of World Business Lenders contacted them, claiming to be an agent for Bank of Lake Mills, and offered a $400,000 loan, secured by their home.[36] Despite the promise of 15% APR, they allege that WBL actually charged them over 72% APR. The documents were prepared by WBL and were mailed to WBL and the plaintiffs had no contact with the bank. The mortgage was assigned from the bank to WBL through a signature of the vice president of WBL as power of attorney for the bank.

In *B&S Medical Supply et al v. World Business Lenders et al.*, filed in New York in 2017, the complaint alleges that 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.[37] 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. WBL corresponded with Simon, referring to itself as the "Lender" and saying that it would service the loan and have the right to collect payments.

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.[38] The loan paperwork listed BOFI/Axos Bank as the lender, but the loan was presented by WBL. All the forms were WBL forms, 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."[39]

In *Adoni et al. v. World Business Lenders, LLC, Axos Bank and Circadian Funding,* filed in New York in October 2019, Jacob Adoni alleges that he has been threatened with threats to foreclose on his home after receiving a $90,000 loan at 138% APR secured by his personal residence.[40] 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."[41]

That is the lender the FDIC and OCC are supporting. Their supervision of their banks is not stopping the bank from letting itself be used—up to the point of handing over a power of attorney for the bank—by a predatory lender in order to evade state interest rate limits. The bank itself has been named in some of 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.[42]

The FDIC's and OCC's direct support for World Business Lenders on the same grounds used to justify proposed rent-a-bank rules shows exactly what should be expected to happen if the rules are finalized: predatory lending, which not only may leave people in financial ruin but jeopardizes their homes and businesses.

VII. The Proposed Rules by the FDIC and OCC are Unlawful, Unnecessary, and Harmful

The FDIC and OCC have proposed rules that state that when a bank sells, assigns, or otherwise transfers a loan, interest permissible prior to the transfer continues to be permissible following the transfer. In other words, if a bank originates a loan at 160% in Colorado, where voters adopted a 36% interest rate cap in 2018, the loan could be sold to a nonbank lender that could charge new interest at 160%.

The proposals do not include any exception for transactions structured to evade state usury laws. The proposed rules are stated as a flat rule without exceptions. Thus, it does not appear to matter to the FDIC or OCC if the bank is a mere fig leaf, quickly originating and reselling the loans or receivables, with little interest or involvement in a lending program primarily run by a state-regulated business that makes the lion share of the profits.

The FDIC and OCC claim that view rent-a-bank schemes "unfavorably" and that their proposals do not address the question whether the bank "is a real party in interest with respect to a loan or has an economic interest in the loan under state law, e.g., which entity is the "true lender."[43] But that is cold comfort. There is no stated exception in the proposed rules for situations where the bank is not the real party in interest. Courts may simply rely on the rules on their face to permit any assignee of a loan, including one where the bank is not the true lender, to ignore state usury laws. States may challenge rent-a-bank schemes, but legal challenges take resources and years. The FDIC and OCC have demonstrated the impact they expect their proposals to have by directly supporting World Business Lenders' 120% APR loan and by failing to stop rent-a-bank schemes.

Rent-a-bank schemes also undermine the goals of the Community Reinvestment Act (CRA), yet the FDIC and OCC are encouraging these schemes at the same time that they are proposing to weaken the CRA.[44] Rent-a-bank schemes enable banks to help predatory lenders target communities that the banks are not serving with responsible products, offering loans the banks do not directly offer in their own branches. This is exactly the kind of predatory lending that the CRA is designed to prevent.

The FDIC and OCC claim that the proposed rules are necessary to address the "uncertainty" caused by a Second Circuit decision, *Madden v. Midland*,[45] and to protect banks' ability to manage liquidity and risks. But even the FDIC admits that it "is not aware of any widespread or significant negative effects" due to the nearly 5-year old *Madden* decision.[46] The OCC, as well, offers no evidence to the contrary. Neither agency has disputed the *Madden* court's finding that limiting debt buyer interest does not significantly impact banks. Nor have they cited any actual or significant secondary market problems impacting banks in other contexts. Even the recent cases filed against credit card securitization trusts – which neither agency cites – do not support the proposed rules.[47] Mere allegations early in a lawsuit with an uncertain impact do not justify overbroad rules that will have certain, tremendous, and far-reaching harm to consumers.[48]

The legal issues posed by the proposed rules are discussed at length in our comments.[49] I will only summarize them here:

- Neither the FDIC nor the OCC has the authority to preempt state usury laws as applied to nonbank companies, and the OCC has failed to follow the procedures and standards required by Congress in 2010 in the Dodd-Frank Act.
- The older, so-called "valid-when-made" state usury law cases that the FDIC and OCC cite arise in a very different context (primarily about whether later events change how a rate is calculated) than assignment of loans to an entity with different rights and obligations under the law.[50] A bank's legal rights as a bank cannot be assigned, just as a doctor could sell a medical practice but could not assign the right to operate that practice to a doctor without a license in the state.
- The proposed rules oversimplify diverse rulings in many different contexts to an absolute rule so overbroad that it appears to allow a bank to increase the interest rate after the fact to a level not even permitted under the NBA or the Federal Deposit Insurance Act.

Perhaps most strikingly, neither the FDIC nor the OCC considered the harm that their proposals could cause or the likelihood that predatory lenders will be all too happy to step into the shoes of banks that can charge sky-high interest rates without limit.

VIII. Congress Should Cap Interest Rates for All Lenders at 36% and Support States' Power to Impose Lower Rate Caps

Predatory rent-a-bank lending exists for two simple reasons: there are no federal interest rate limits for most lenders, and most banks are exempt from state rate caps. We can prevent an explosion of predatory lending and protect consumers and small businesses from loan sharks by adopting a national interest rate cap and by preventing banks from being used to evade state rate caps. Congress can also help by restoring consumers' access to the courts.

First, Congress must pass the Veterans and Consumers Fair Credit Act, H.R. 5050 (Garcia) and S. 2833 (Merkley), which would apply to all lenders, bank and nonbank, and would extend to veterans and all consumers the 36% interest rate cap that current applies to servicemembers and their families. The VCFCA would address the most harmful loans and the most abusive misuse of bank charters by preventing banks from originating high-cost loans with triple-digit APRs.

Consumers benefit when rate caps drive out predatory lending. In states that have capped rates, consumers are better off and find better ways to cope with financial challenges:

- Former borrowers generally agree that they are better off without payday loans and express relief that the loans are no longer available.
- People use a variety of strategies to manage their finances, including borrowing from family and friends, negotiating payment plans with utility companies or other creditors, and using pawn shops or traditional credit products like credit cards.
- Consumers do not turn to illegal internet loans in large numbers.[51]

Second, we must uphold the states' historic power to limit interest rates. This is especially important in the absence of a federal rate cap, but even if Congress caps rates at 36%, states have appropriately set lower rates for large loans. The FDIC and OCC must abandon their proposed rules and the agencies, along with the state bank regulators in Kentucky, Utah and

Wisconsin, must stop their banks from engaging in rent-a-bank lending. Legislation to strengthen the integrity of state rate caps and prevent rent-a-bank lending should be considered. State attorneys general, state regulators, and private litigators can also address rent-a-bank lending in court.

Third, Congress must restore accountability and consumers' access to the courts by passing the Forced Arbitration Injustice Repeal (FAIR) Act, H.R. 1423 (Rep. Johnson) and S. 610 (Sen. Blumenthal). Rent-a-bank lenders violate state usury laws and other consumer protection laws. But forced arbitration clauses and class action bans take away consumers' and small businesses' day in court and their ability to band together when thousands or millions of people are harmed. Congress must eliminate this get-out-of-jail-free card.

IX. Conclusion

Rent-a-bank schemes jeopardize the states' role under our federalist system in protecting consumers. These schemes eviscerate the oldest, simplest and most effective protection against predatory lending: interest rate limits. Control over predatory lending is taken away from states and handed over to a few rogue banks that facilitate outrageous loans they do not make in their own branches. Allowing state-regulated lenders to launder their loans through banks is having the very result that the Second Circuit in *Madden* was trying to prevent: "an end-run around usury laws."[52]

Thank you for inviting me to testify today. I look forward to your questions.

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[1] James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 Ariz. St. L.J. 61 (1981).
[2] *See* NCLC, *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016), https://www.nclc.org/issues/misaligned-incentives.html (NCLC, *Misaligned Incentives*).
[3] *Marquette Nat'l Bank v. First of Omaha Corp.*, 439 U.S. 299 (1978); *see generally* NCLC, Consumer Credit Regulation (2d ed. 2015), *updated at* www.nclc.org/library.
[4] The median APR for the $500 loan is slightly different from what we calculated last year as two states that previously did not have rate caps, New Mexico and Ohio, now cap the rate for a $500 loan but at fairly high levels. The APR for the $2000 loan has not changed. We have not updated the calculations for the $10,000 loan since 2018. *See* NCLC, Fact Sheet, State Annual Percentage Rate (APR) Caps for $500, $2,000, and $10,000 Installment Loans (March 2019), https://www.nclc.org/images/pdf/high_cost_small_loans/fact-sheet-apr-caps-for-installment-loans.pdf, and Carolyn Carter et al., NCLC, A Larger and Longer Debt Trap? Analysis of States' APR Caps

for a $10,000 Five-Year Installment Loan (2018), https://www.nclc.org/issues/a-larger-and-longer-debt-trap-installment-loan.html.

[5] *See, e.g.*, Pat Ferrier, Fort Collins Coloradoan, "Colorado election: Proposition 111, capping interest on payday loans, passes" (Nov. 6, 2018) (77% of voters voted to approve a 36% rate cap); South Dakota Official Election Returns and Registration Figures, Primary Election (June 7, 2016), https://sdsos.gov/elections-voting/assets/ElectionReturns2016_Web.pdf (76% in favor of a 36% rate cap);
Matt Volz, Missoulian, Montana voters approve payday loan, real estate tax initiatives (Nov. 3 2010). http://bit.ly/2KqQ7rb (73% of Montana voters approved a 36% rate cap); Ohio Payday Lender Interest Rate Cap, Referendum 5 (2008),
https://ballotpedia.org/Ohio_Payday_Lender_Interest_Rate_Cap,_Referendum_5_(2008)#cite_note-ohsos-1 (63% in favor of a 28% rate cap); Arizona Payday Loan Reform, Proposition 200 (2008),
https://ballotpedia.org/Arizona_Payday_Loan_Reform,_Proposition_200_(2008) (60% of voters opposed continuing an exemption from the state's rate cap) . In Arizona, the payday lenders later found a loophole for auto title loans. In Ohio, the payday lenders found a loophole in the mortgage laws. The Ohio legislature later closed that loophole but allowed higher-cost loans than the voters had approved.

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

[7] OCC Advisory Letter No. 2000-10 (Nov. 27, 2000).

[8] *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).

[9] *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).

[10] *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."); *Georgia Cash America v. Greene*, 734 S.E.2d 67, 73 (Ct. App. Ga. 2012) (agreeing that there existed "a genuine issue of material fact regarding whether Cash America actually received [only] a 49 percent economic interest for its services and even if it did so, whether it nevertheless, by contrivance, device, or scheme, attempted to avoid the provisions" of Georgia law making an entity the true lender if it held the predominant economic interest).

[11] *Think Finance*, 2016 WL 183289 at *13 (rejecting the argument).

[12] 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 (emphasis added).

[13] *See, e.g., CashCall, Inc. v. Morrisey,* 2014 WL 2404300 (W. Va. May 30, 2014); CashCall, Inc. v. Maryland Commissioner of Financial Regulation, 139 A.3d 990 (Md. 2016).

[14] *See, e.g., Ubaldi v. SLM Corp.,* 852 F. Supp. 2d 1190 (N.D. Cal. 2012) (nonbank defendant used its own copyrighted forms, promissory notes, brands and platforms); *Flowers v. EZPawn Oklahoma, Inc.*, 307 F. Supp. 2d 1191 (N.D. Okla. 2004) (adopting report of magistrate indicating that payday lenders that owned and controlled

the branding of the loans were the true lenders); *Glaire v. La Lanne-Paris Health Spa, Inc.*, 12 Cal. 3d 915, 924-25 (1974) (finance company's practice of purchasing vast majority of gym's membership installment contracts contemporaneously with their execution was functional equivalent of extending loans directly); *Eul v. Transworld Systems*, 2017 WL 1178537 (N.D. Ill. Mar. 30, 2017) (the nonbank designated who would administer the loans, designated the servicer, and directed who the loans would be sold to after origination).

[15] *See, e.g., Georgia Cash America v. Greene*, 734 S.E.2d 67 (Ct. App. Ga. 2012) (after defendant adjusted its contract with bank to receive only a 49% participation interest, triable issue remained on whether it used a contrivance, device or scheme to evade the law).

[16] *See* Amicus Brief of National Consumer Law Center, Center for Responsible Lending and Colorado Public Interest Research in support of plaintiff in Martha Fulford v Avant of Colorado LLC et al and Web Bank, (Jan. 14, 2019), https://www.nclc.org/images/pdf/litigation/AmicusBrief-Avant.pdf.

[17] NCLC, *Misaligned Incentives, supra*.

[18] Comments of Center for Responsible Lending, NCLC et al., OCC Interest Rate Proposal at 38-48 & Appx. B (Jan. 21, 2020), https://www.nclc.org/images/pdf/rulemaking/comments-occ-interest-rates-and-apps.pdf.

[19] #1487339 (California borrower)

[20] In addition, FinWise Bank is also involved in partnerships with other very high-cost lenders such as American First Finance but it is not clear if the loans are evading state interest rate limits.

[21] Some of these loans are summarized in our 2-page fact sheet, "Stop Payday Lenders' Rent-a-Bank Scheme" (Nov. 2019), http://bit.ly/StopRent-a-BankSchemes, which is attached as an appendix to this testimony.

[22] *See* https://www.800loanmart.com/ ("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/choicecash/.

[23] EasyPay is not available in New York. Loans are offered through TAB Bank to residents in Alabama, Arkansas, Colorado, Connecticut, Florida, Georgia, Hawaii, Iowa, Indiana, Louisiana, Massachusetts, Maryland, Maine, Michigan, Minnesota, Mississippi, Montana, North Carolina, Nebraska, New Jersey, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, West Virginia, Wyoming and District of Columbia. Loans all other states is administered by EasyPay Finance. *See* https://www.easypayfinance.com/privacy-policy/ ("Additional Important Information)". The individual loan documents, which indicate that EasyPay Finance is the "servicer" and "agent" of TAB Bank, are on file at NCLC.

[24] Until January 2020, Elastic's website had an FAQ that listed the states where Elastic was not available. Elastic was and likely still is available in DC and 14 states that do not allow a 100% APR on a line of credit: Alaska, Arizona, Arkansas, Florida, Kentucky, Louisiana, Maryland, Minnesota, Montana, Nebraska, Nevada, Oregon, SouthDakota, Texas. 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. Elevate Credit, Inc., Form 10-Q for the period ending Sept. 30, 2019, S.E.C. file no. 001-37680 at 21, https://www.sec.gov/Archives/edgar/data/1651094/000165109419000048/elevate10-qxq22019.htm ("Elevate 10-Q").

[25] NetCredit loans are available directly in some states and through Republic Bank & Trust in DC and 22 states: Alaska, Arizona, Arkansas, Florida, Hawaii, Indiana, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Montana, Nebraska, New Jersey, Ohio, Oklahoma, Oregon, Rhode Island, Texas, Tennessee, Washington, Wyoming. *See* https://www.netcredit.com/ (bottom of page); https://www.netcredit.com/rates-and-terms.

[26] Loans are available directly through OppLoans in 12 states and through FinWise Bank in DC and 24 states that do not allow 160% APR: Alaska, Arizona, California, District of Columbia, Florida, Hawaii, Indiana, Kansas, Kentucky, Louisiana, Maine, Michigan, Minnesota, Montana, Nebraska, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Virginia, Washington, and Wyoming. *See* https://www.opploans.com/rates-and-terms/. FinWise sells the receivables back to OppLoans or a related entity.

[27] Rise offers loans directly in some states and through FinWise Bank in DC and 16 states that do not allow its rates: Alaska, Arizona, Florida, Hawaii, Kentucky, Louisiana, Michigan, Minnesota, Montana, Nebraska, Nevada, Ohio,

Oklahoma, Oregon, South Dakota, Texas, and Wyoming. *See* https://www.risecredit.com/how-online-loans-work#WhatItCosts (select each state). FinWise sells a 95% interest in the loans to an entity controlled by Elevate for which Elevate is the primary beneficiary. *See* Elevate 10-Q at 22, 43.

[28] *See* https://www.wbl.com/. ("Business loans are offered by Axos Bank®, Member FDIC, or by World Business Lenders, LLC or its affiliate, WBL California, LLC, dba WBL ..."). These loans are described in Section V.

[29] Calif. Office of the Governor, Press Release, "Governor Newsom Signs Legislation to Fight Predatory Lending in California" (Oct. 10, 2019), https://www.gov.ca.gov/2019/10/10/governor-newsom-signs-legislation-to-fight-predatory-lending-in-california/; Calif. Assembly Bill No. AB 539 (effective Jan. 1, 2020).

[30] *See* NCLC, "Payday Lenders Plan to Evade California's New Interest Rate Cap Law Through Rent-A-Bank Schemes" (Oct. 2019), http://bit.ly/rent-a-bank-ib (quoting earnings calls).

[31] *See* NCLC, Issue Brief: Payday Lenders Plan to Evade California's New Interest Rate Cap Law Through Rent-A-Bank Schemes (October 2019), https://www.nclc.org/issues/ib-rent-a-bank.html.

[32] *See, e.g,* FDIC, Proposed Rule, Federal Interest Rate Authority, 84 Fed. Reg. 66845, 66846 (Dec. 6, 2019) ("FDIC Proposal").

[33] OCC, News Release 2017-118, Acting Comptroller of the Currency Rescinds Deposit Advance Product Guidance (Oct. 5, 2017).

[34] *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.

[35] Complaint, Speer v. Danjon Capital et al., No. 3:19-cv-01778 (D. Conn. filed Nov. 12, 2019), https://www.nclc.org/images/Speerv.DanjonCapital.pdf.

[36] Complaint, Vincent Deramo Jr. et al. v. World Business Lenders, LLC and WBL SPE II, LLC, (filed May 16 2017 in Cir. Ct., Sarasota, FL, removed to federal court June 16, 2017 as No, 8:17-cv-1435-RAL-MAP), https://www.nclc.org/images/Deramov.WBL_.pdf.

[37] Complaint, *B&S Medical Supply, Boris Simon v. World Business Lenders, Liberty Bank, Inc.*, No. 1:17-cv-03234 (S.D.N.Y. filed May 2, 2017), https://www.nclc.org/images/BandSMedSupplyv.WBL_.pdf.

[38] Complaint, *Kaur et al v. World Business Lenders et al.* (removed to D. Mass. June. 19, 2019 as 1:19-cv-11364), https://www.nclc.org/images/Kaurv.WBL_.pdf.

[39] *Id.* at 21.

[40] 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), https://www.nclc.org/images/Adoni-v.-World-Business-Lenders.pdf.

[41] *Id.* at 5.

[42] 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.

[43] FDIC, Federal Interest Rate Authority, 84 Fed. Reg. 66845, 66846 (Dec. 6, 2019); *accord* OCC, Permissible Interest on Loans that are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64229, 64232 (Nov. 21, 2019).

[44] *See* https://ncrc.org/treasurecra/.

[45] 786 F.3d 246 (2nd Cir. 2015).

[46] FDIC Proposal, "Federal Interest Rate Authority," 84 Fed. Reg. 66845, 66850 (Dec. 6, 2019).

[47] *See, e.g.,* Class Action Complaint, Petersen et al. v. Chase Card Funding, LLC, et al., No. 1-19-cv-0741 (W.D.N.Y. filed June, 6, 2019).

[48] Indeed, the magistrate in one case has recommended dismissing the case. While I take no position on those cases, I note that a bank's use of a passive securitization trust in an active credit card program run by the bank is very different from a rent-a-bank situation or the debt buyers in *Madden*.

[49] Comments of Center for Responsible Lending, NCLC et al., OCC Interest Rate Proposal (Jan. 21, 2020), https://www.nclc.org/images/pdf/rulemaking/comments-occ-interest-rates-and-apps.pdf.

[50] For example, *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103 (1833) and *Gaither v. Farmers' & Mechanics' Bank of Georgetown*, 26 U.S. (1 Pet.) 37 (1828) both address the question whether subsequent transactions can retroactively change the *rate itself* to result in a higher, usurious rate.
[51] *See* NCLC, After Payday Loans: How do Consumers Fare When States Restrict High-Cost Loans? (Oct. 2018), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/ib_how-consumers-fare-restrict-high-cost-loans-oct2018.pdf.
[52] 786 F.3d at 251–52.