Note

Crossing State Lines: The Trojan Horse Invasion of Rent-a-Bank and Rent-a-Tribe Schemes in Modern Usury Law

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Abstract

Modern American society fosters a capitalist culture that depends on the extension of credit to purchase both basic and luxury items. Although the federal banking system has comprehensive regulation to control potential excesses, the nonbank lending industry is subject to a patchwork system of state laws that inadequately protects borrowers from predatory lending. Specifically, current state regulations leave a gap that permits an alternative lender to partner with a bank or a Native American tribe to evade the state maximum interest rates for loans to borrowers within that state. Nicknamed "rent-a-bank" and "rent-a-tribe" schemes, these devices allow predatory lending to continue even in states that have enacted laws to curb abusive practices. As these schemes are not generally prohibited, creative consumer advocates have found ways to sue these nonbank lenders, but courts have two applicable tests to choose between: the "predominant economic interest" test, which looks to the substance of the arrangement, or the "contractual" test, which promotes a legal fiction and allows these schemes to persist.

As significant barriers to resolution exist at the federal level, states should adopt an amendment to their consumer protection laws prohibiting these

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schemes directly. This Note discusses how these arrangements work and why they exist, and it proposes a model statutory provision for states to adopt, designed to deter entry into these schemes and to abolish the practice.

Table of Contents

Introduction

Faced with a decision one morning on whether to spend the last of her money on food or gas to get to work, Dawn Schmitt, a high school science teacher, went online.[1] She found a company called MyNextPaycheck and requested a short-term loan, and "within minutes, $200 was deposited into her bank account."[2] To keep up with an annual percentage rate ("APR") of 350%, Ms. Schmitt was soon forced to take out more payday loans to keep up with payments on the original $200 loan.[3] She was bankrupt within months.[4] As one consumer advocate put it, "Access to credit of this kind is like giving starving people poisoned food. It doesn't really help, and it has devastating consequences."[5]

Ms. Schmitt tried to contact the company, but the phone number provided led to a disconnected line.[6] Eventually, she tracked down a physical address for MyNextPaycheck, which was located "on an American Indian reservation in Northern California."[7] The payday lender, run by Charles Hallinan, had used a rent-a-tribe scheme, a practice in which a lender uses tribal immunity as a shield to circumvent state interest rate limits.[8]

To understand how this problem could occur, it is imperative to consider the broader society that fosters these schemes. Modern American capitalist society is a credit culture.[9] The majority of the

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1 Jeremy Roebuck, *Teacher: $200 Payday Loan Pushed Me to Brink of Bankruptcy*, Phila Inquirer (Oct. 10, 2017, 7:12 PM), https://perma.cc/GT3C-NB4J.

2 *Id.*

3 *See id.*

4 *Id.*

5 Andres Khouri & James Rufus Koren, *Borrow $5,000, Repay $42,000—How Super High-Interest Loans Have Boomed in California*, L.A. Times (Jan. 19, 2018, 8:10 AM), http://www.latimes.com/business/la-fi-installment-loans-20180119-htmlstory.html [https://perma.cc/6NQL-WX2L].

6 Roebuck, *supra* note 1.

7 *Id.*

8 *See id.* A jury found Mr. Hallinan, "known as the 'godfather of payday lending,'" guilty of racketeering conspiracy charges in November 2017. Jeremy Roebuck, *Federal Jury Finds Main Line Payday Lender Hallinan Guilty of Racketeering Conspiracy*, Phila Inquirer (Nov. 27, 2017, 3:50 PM), http://www.philly.com/philly/news/crime/main-line-payday-lender-hallinan-convicted-of-racketeering-conspiracy-20171127.html [https://perma.cc/B3SC-LX7B].

9 *See* Charles R. Geisst, Collateral Damaged: The Marketing of Consumer Debt to America 13–18 (2009) (arguing that calling it "credit" versus "debt" has contributed to a positive nationwide attitude towards the American debt explosion in the 20th and 21st centuries).

> The twentieth-century U.S. and the culture of consumption have become so closely intertwined that it is difficult for Americans to see consumerism as an ideology or to consider any serious alternatives or modifications to it. Participation in the con-

economy operates on the fundamental notion that people and companies can buy goods and services on credit, through the use of credit cards or loans.[10] As prices increase and average incomes for families outside of the top 20% remain stagnant, there is increasing demand for loans to cover basic needs, like education, housing, cars, and emergency costs such as healthcare.[11] As of late 2017, total consumer debt in the United States had reached nearly $13 trillion, with an increase of over $100 billion in the second quarter of 2017 alone.[12] This trend highlights the rising importance of comprehensive oversight and control of the market, particularly of the subprime consumer lending market, which provides financing for borrowers who do not meet high credit standards.[13]

> sumer culture requires wage work, time, and effort . . . . But this trade-off seems *natural* today, an inevitable compromise between freedom and necessity.

Liza Peñaloza & Michelle Barnhart, *Living U.S. Capitalism: The Normalization of Credit/Debit*, 38 J. Consumer Res. 743, 758 (2011) (quoting Gary Cross, An All-Consuming Century (2000) (emphasis added)).

10 *See* M. Greg Braswell & Elizabeth Chernow, *Consumer Credit Law & Practice in the U.S.*, U.S. Fed. Trade Commission, https://www.ftc.gov/sites/default/files/attachments/training-materials/law_practice.pdf [https://perma.cc/XK54-EEBC]; Matthew Saltmarsh, *Rethinking the 'Credit Culture*,' N.Y. Times (Oct. 26, 2007), http://www.nytimes.com/2007/10/26/business/world business/26iht-wbcredit.1.8065690.html?pagewanted=all [https://perma.cc/JS68-GBTF] ("It has long been thought that a competitive and liberal credit market was best for consumers and industry. But more voices are suggesting now that consumers in countries where credit conditions have been tightest will emerge in better shape when the crisis is over.").

11 Geisst, *supra* note 9, at 166. In the 1990s, "[t]he increase in house prices and the heightened use of credit cards were accompanied by low growth in real wages, as had been the case for two decades. To achieve the American Dream, average American families were going into more debt given the low growth in incomes, factoring in inflation." *Id.*; *see* Khouri & Koren, *supra* note 5; Drew Desilver, *For Most U.S. Workers, Real Wages Have Barely Budged in Decades*, Pew Res. Ctr. (Aug. 7, 2018), http://www.pewresearch.org/fact-tank/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades [https://perma.cc/RX7H-S3N2].

12 Press Release, Fed. Reserve Bank of N.Y., Total Household Debt Increases, Driven by Mortgage, Auto and Credit Card Debt (Aug. 15, 2017), https://www.newyorkfed.org/newsevents/news/research/2017/rp170815 [https://perma.cc/8T7Y-N3B2]. But with the economy improving and the unemployment rate decreasing, this is not, in itself, a bad thing. *See* Chris Arnold, *Americans' Borrowing Hits Another Record. Time to Worry?*, NPR (Sept. 12, 2017, 5:04 AM), https://www.npr.org/2017/09/12/550250789/americans-borrowing-hits-another-record-time-to-worry [https://perma.cc/8QN4-DHVK]. Economists have noted, however, that this trend will be particularly troubling if the economy should take another downspin. *See id.* Moreover, one economist remarked that consumers are only paying off about half of their credit card debt each month, indicating that many Americans are being charged higher interest rates. *See id.* ("Being in debt is a very stressful way to live . . . . There's a lot of people who are just in a hole and so stressed out over it. We believe that group is growing.").

13 *See* Native Assets Research Ctr., First Nations Dev. Inst., Building Trust: Consumer Protection in Native Communities 1–2 (2011), https://www.firstnations.org/wp-content/uploads/publication-attachments/2011-Building_Trust.pdf [https://perma.cc/G89E-Y2HW] ("Until recently, the federal government has been unable to pass effective legislation to

While banks offer loans with extensive underwriting guidelines, ensuring that the borrower has the means and will to repay the loan, alternative lenders, such as payday lenders and some marketplace lenders, are less stringent.[14] For many consumers, a bank's standards for granting credit can be a high bar to meet, as consumers may not have steady income or may have had difficulty repaying loans in the past.[15] Capitalizing on this opportunity, alternative lenders stepped in to fill that gap, creating a "fringe financial market."[16] These lenders claim a need to charge higher interest rates on loans to cover losses from those who are unable to repay.[17] As in Ms. Schmitt's case described above, however, the high interest rates often trap borrowers into a cycle of debt, as they are forced to keep borrowing to pay their interest rate payments.[18]

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combat abusive lending practices, and an increasing number of states are acknowledging that predatory lending practices harm their constituents and are looking at ways to combat these abuses." (footnote omitted)); Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 520–21 (2004); Saltmarsh, *supra* note 10 ("Credit is good. It needs to do good . . . . But credit needs to be supervised.").

14 *See* FED. DEPOSIT INS. CORP., RISK MANAGEMENT EXAMINATION MANUAL FOR CREDIT CARD ACTIVITIES 40 (2007), https://www.fdic.gov/regulations/examinations/credit_card/pdf_version/ch7.pdf [https://perma.cc/KB8S-U7SE].

15 *Cf.* Brittany Jones-Cooper, *The Reason Why Most People Get Rejected for a Personal Loan*, YAHOO! FIN. (Jan. 24, 2018), https://finance.yahoo.com/news/reason-people-get-rejected-personal-loan-184003098.html [https://perma.cc/GF2P-W3QV] (noting low credit scores as a reason for high percentage of personal loan application denials).

16 JEAN ANN FOX & EDMUND MIERZWINSKI, CONSUMER FED'N OF AM. & U.S. PUB. INTEREST RESEARCH GRP., RENT-A-BANK PAYDAY LENDING 3 (2001), https://consumerfed.org/pdfs/paydayreport.pdf [https://perma.cc/U6Y7-ZL6A].

> One consequence of deregulation of interest rates, high credit card interest rates and high bank fees has been the rapid growth of the alternative financial services (or fringe banking) industry, which includes check cashing outlets, payday loan companies, rent-to-own stores, high cost second mortgage companies, sub-prime auto lenders, traditional pawn shops and the growing business of auto title pawn companies.

Id.; *see also* MICHAEL S. BARR, NO SLACK: THE FINANCIAL LIVES OF LOW-INCOME AMERICANS 57–59 (2012).

17 *See* Tim Worstall, *Why Payday Loans Are So Expensive*, FORBES (Dec. 20, 2011, 1:44 PM), https://forbes.com/sites/timworstall/2011/12/20/why-payday-loans-are-so-expensive [https://perma.cc/VQ5G-SJ3P].

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> [I]n a study conducted in Indiana in late 1999, researchers found a default rate of 77.2%. This cycle of default and accompanying loan renewal extends the duration of an average two-week loan to almost five months. This study also found that the average payday loan customer renews his loan approximately ten times, and one borrower renewed his loan sixty-six times.

Charles A. Bruch, Comment, *Taking the Pay out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. CIN. L. REV. 1257, 1272 (2001) (footnotes omitted).

Some states have implemented usury[19] limits to curb excess interest rates, a maximum interest rate that a lender can charge on a certain loan.[20] Lenders typically are subject to the usury limits of the state in which the borrower resides.[21] Banks insured by the Federal Deposit Insurance Corporation ("FDIC") can, however, export the usury limit of the state in which they are located and thus often choose to "locate" in states that do not have usury limits.[22] This practice, sometimes referred to as the "exportation doctrine," has created a gap between rules that apply to banks and rules that apply to nonbank lenders.[23] Some alternative lenders have therefore partnered with banks to take advantage of the exportation doctrine, through the use of "rent-a-bank" or "rent-a-charter" schemes.[24] Another method lenders use is a "rent-a-tribe" scheme, in which they partner with a Native American tribe to claim sovereign immunity from state usury laws.[25] These gaps between the treatment of different lenders and the variations in state usury laws have led to abuse, which disproportionately affects minorities and lower-income individuals.[26]

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19 "Usury" means "the charging of an illegal rate of interest as a condition to lending money" or "[a]n illegally high rate of interest." *Usury*, BLACK'S LAW DICTIONARY (10th ed. 2014).

20 *See Legal Status of Payday Loans by State*, PAYDAY LOAN CONSUMER INFO., https://paydayloaninfo.org/state-information [https://perma.cc/3TZF-MGHT]. Eighteen states and the District of Columbia have set usury limits prohibiting high-cost lending, compared with 32 states that effectively have no limits. *Id.* Laws to limit excessively high interest rates have existed for over two hundred years. *See generally* CHARLES R. GEISST, BEGGAR THY NEIGHBOR: A HISTORY OF USURY AND DEBT 1–12 (2013).

21 *See* Bruch, *supra* note 18, at 1259. In contrast, many European countries have usury limits set at the national level. *See* Saltmarsh, *supra* note 10.

22 *See* Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 313 (1978).

23 *See* Schiltz, *supra* note 13, at 521–22.

24 *See* John D. Skees, Comment, *The Resurrection of Historic Usury Principles for Consumption Loans in a Federal Banking System*, 55 CATH. U. L. REV. 1131, 1134 (2006).

25 *See* CFPB v. CashCall, Inc., No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *6–7 (C.D. Cal. Aug. 31, 2016). Native American tribes have sovereign immunity from state regulations but are still subject to federal regulation. *See* Michigan v. Bay Mills Indian Cmty., 134 S. Ct. 2024, 2028 (2014) (reaffirming existence of tribal sovereign immunity from state suits).

26 *See* PEW CHARITABLE TRS., PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY 10 (2012), http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf [https://perma.cc/5YQF-3QY2] (providing graphs showing the usage of payday loans across income levels). "Individuals' income and education, along with their race and ethnicity, are highly correlated with the likelihood that they are unbanked or underbanked." BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2016, at 31 (2017) [hereinafter FED. RESERVE REPORT], https://www.federalreserve.gov/publications/files/2016-report-economic-well-being-us-households-201705.pdf [https://perma.cc/QAS5-TS4R]. It is not just nonbank lenders that take advantage of these gaps; banks themselves have capitalized on their ability to export interest

Borrowers like Ms. Schmitt have little recourse as victims of these types of arrangements. The difficulty is that these transactions are not strictly prohibited in all states; nor have federal regulators prohibited them.[27] Some states have implemented statutes targeting these schemes by broadening the definition of a lender to include loan arrangers[28] or lenders with a "predominant economic interest" in the loan.[29] Taking their cue, some courts developed a "predominant economic interest" test to pierce the veil of these arrangements and determine whether the bank or tribal entity is the true lender in the arrangement or whether it is the alternative lender, who would be in violation of the state's usury limit.[30] But in other states, courts have upheld a conflicting doctrine, the judicial valid-when-made doctrine, through a "contractual" test, which says that a loan that is not usurious when made does not become usurious when transferred to another entity.[31] The application of this doctrine effectively means that the bank's exportation doctrine or the tribal entity's sovereign immunity attaches to the loan itself and transfers with it.

These schemes are still used because they are successful. But the sole purpose of them is to evade state usury laws.[32] This Note explains why these transactions are still legal and why they should be abolished, and it argues that because of competing interests at the federal level, states are in the best position to close the loophole. States harmed by these schemes should amend their laws to strictly prohibit such arrangements by expanding the definition of lender to include "a person who arranges a loan and to whom the loan or a significant economic interest in the loan is subsequently transferred, except to the extent that such person is expressly exempted from the application

rates. For example, one nationally chartered bank made $31 million outside of its home state on loans with an average APR of 454%. *See* Bruch, *supra* note 18, at 1277–78.

27 *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace Before the Subcomm. on Fin. Inst. & Consumer Credit of the H. Comm. on Fin. Servs.*, 115th Cong. 7–8 (2018) (written testimony of Adam J. Levitin, Professor, Georgetown University Law Center), https://financialservices.house.gov/uploadedfiles/01.30.2018_adam_levitin_testimony.pdf [https://perma.cc/KT9G-CCZK].

28 *See, e.g.*, Colo. Rev. Stat. § 5-3.1-102(5)(a) (2017).

29 *See* Ga. Code Ann. § 16-17-2(b)(4) (2018).

30 *See, e.g.*, CFPB v. CashCall, 2016 WL 4820635, at *6 (noting multiple jurisdictions that apply the predominant economic interest test to determine the true lender in the transaction).

31 *See* Hudson v. ACE Cash Express, Inc., No. IP 01-1336-C H/S, 2002 WL 1205060 (S.D. Ind. May 30, 2002); Charles M. Horn & Melissa R.H. Hall, *The Curious Case of* Madden v. Midland Funding *and the Survival of the Valid-When-Made Doctrine*, 21 N.C. Banking Inst. 1, 1 (2017).

32 *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 8.

of this statute by federal statutory law." This amendment would render the schemes illegal under state law, provide courts and state consumer financial protection agencies with more authority to quash the use of these devices, and better protect borrowers.

Part I of this Note discusses the rent-a-bank and rent-a-tribe schemes and the parties involved, and then illustrates the destructive nature of these arrangements and why they should be abolished. Part II describes (1) the judicial valid-when-made doctrine and the controversial decision in *Madden v. Midland Funding, LLC*,[33] which has raised questions concerning the continued validity of that doctrine, and (2) the predominant economic interest test, an alternative standard that courts use in deciding these cases. Part III describes the barriers at the federal level, including federalism concerns, the scope of Consumer Financial Protection Bureau ("CFPB") authority, and the bank industry's interests, all of which create significant barriers to any near-term resolution of the problems created by rent-a-bank and rent-a-tribe schemes. Finally, Part IV proposes a model statutory provision that states should adopt to deter and punish bad actors, which would expand the definition of persons subject to state consumer protection laws.

I. The Recent Invention of Devices to Evade State Usury Laws

Alternative "fringe" lenders have developed two strategies to circumvent state usury laws—the rent-a-bank and rent-a-tribe schemes. Those strategies use a bank's charter or a Native American tribe's sovereign immunity as a shield against the application of state interest rate caps to short-term consumer loans. Section I.A explains how these schemes operate in practice and describes the interests of the banks and Native American tribes that participate. Section I.B identifies who the alternative lenders are, and Section I.C describes how destructive the predatory lending industry is and contends that rent-a-bank and rent-a-charter strategies should be prohibited.

A. Rent-a-Bank and Rent-a-Tribe Schemes

1. Rent-a-Bank or Rent-a-Charter Schemes

In 1864, Congress enacted the National Bank Act to establish a system of national banks that would create a national currency and provide a market for government bonds in order to fund the Civil

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33 786 F.3d 246 (2d Cir. 2015).

War.[34] Congress established the national bank charter to "provide[] an attractive alternative" to a state charter, giving rise to the current dual-banking system.[35]

States traditionally regulate usury, and when addressed in federal statutes, the topic has typically been covered by express federal preemption.[36] Section 85 of the National Bank Act specifically governs the extent to which national banks are subject to state usury limits.[37] In 1978, however, the Supreme Court ruled that nationally chartered banks can "export" the interest rate of the state in which they are "located"—the "exportation doctrine."[38] And in 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[39] established new rules for preemption of state laws, but it specifically provided that the new rules would not apply to the question of usury preemption under section 85, leaving the exportation doctrine intact.[40] State-chartered banks were granted a similar exportation doctrine in the Federal Deposit Insurance Act.[41] As a result, many banks now choose to locate in a state that has no state usury limit, such as Delaware or South Dakota, to avoid being subject to a limit at all.[42]

Nevertheless, banks, unlike alternative lenders, are subject to a comprehensive, interrelated state and federal regulatory regime with several agencies responsible for oversight.[43] State-chartered banks are regulated by the appropriate state regulator and the FDIC,[44] while

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34 Schiltz, *supra* note 13, at 544.

35 *See id.* at 540, 544. Indeed, soon thereafter, the Supreme Court referred to the national banks as "National favorites" and found that "[i]t could not have been intended . . . to expose them to the hazard of unfriendly legislation by the States . . . ." Tiffany v. Nat'l Bank of Mo., 85 U.S. (18 Wall.) 409, 413 (1873).

36 For a detailed discussion of the expansion over time of the exportation doctrine, see Schiltz, *supra* note 13.

37 *See* 12 U.S.C. § 85 (2012); Evans v. Nat'l Bank of Savannah, 251 U.S. 108, 111 (1919) ("The National Bank Act establishes a system of general regulations. It adopts usury laws of the States only in so far as they severally fix the rate of interest.").

38 *See* Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299 (1978); *see also* 12 U.S.C. § 85. "But this exemption does not exist in a void. It is part and parcel of an extensive federal regulatory regime for banks." *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 8.

39 Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of the U.S. Code).

40 12 U.S.C. §§ 25b, 85 (2012).

41 *Id.* § 1831d(a).

42 *See* Nathalie Martin, *Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap*, 34 N. Ill. U. L. Rev. 259, 264 (2014).

43 *See* Schiltz, *supra* note 13, at 540.

44 *See* 12 U.S.C. § 1831a.

nationally chartered banks are subject to regulation by the Office of the Comptroller of the Currency ("OCC").[45]

Rent-a-bank or rent-a-charter schemes are agreements in which a lender partners with a bank to "rent" the bank's charter and use the exportation doctrine as a shield to avoid the state's usury limits.[46] In these arrangements, the alternative lender takes care of all the marketing and advertising, and the bank's name is placed on the loan documents.[47] The bank subsequently sells the loan to the lender, sometimes within twenty-four hours.[48] Some rent-a-bank agreements also provide that the bank does not face any meaningful economic risk from the loan transactions, due to indemnification from the fringe lender.[49] The bank's charter thereby gives the alternative lender's activities complete immunity from state usury laws (except in the bank's home state) and creates "a significant barrier to state regulation of fringe market lending."[50] While the OCC has been active in ordering national banks to refrain from engaging in these activities,[51] the FDIC still permits state banks to partake in these schemes.[52] As a result, lenders shifted to partnering with state banks and Native American tribes.

2. *Rent-a-Tribe Schemes*

Native American tribes have sovereign immunity from state laws and regulations.[53] Tribes are viewed as extraconstitutional, "possessing instead an inherent, natural sovereignty that preceded or otherwise remained separate from the sovereign authority of the United

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45 *See id.* §§ 26, 93a.

46 *See* Fox & Mierzwinski, *supra* note 16, at 3.

47 *See* CashCall, Inc. v. Morrisey, No. 12–1274, 2014 WL 2404300, at *15 (W. Va. May 30, 2014) (finding rent-a-bank scheme where payday lender had entered into agreement with local bank so that lender would market loans as agent of bank and bank would make loans, then transfer them to lender within three days).

48 *See* Skees, *supra* note 24, at 1134.

49 *See* CFPB v. CashCall, Inc., No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *6 (C.D. Cal. Aug. 31, 2016).

50 Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. Rev. 589, 605 (2000).

51 *See* Office of the Comptroller of the Currency, *Special Supervision and Enforcement Activities*, Q.J., March 2003, at 137, 143.

52 *See* Fed. Deposit Ins. Corp., FIL-52-2015, FDIC Clarifying Its Approach to Banks Offering Products and Services, Such as Deposit Accounts and Extensions of Credit, to Non-bank Payday Lenders (2015).

53 *See* Michigan v. Bay Mills Indian Cmty., 134 S. Ct. 2024, 2028 (2014) (reaffirming existence of tribal sovereign immunity from state suits).

States. . . ."[54] Although the treatment of tribal sovereign rights has evolved over time to become subject to more federal legislation, "tribal immunity has been recognized as a fundamental and inherent attribute of tribal sovereignty."[55] The Supreme Court, in 2014, definitively upheld this principle of tribal immunity.[56] For this reason, unless a tribe or Congress specifically waives their immunity, Native American tribes cannot be brought into court for violations of state law.[57]

In the 2000s, lenders started using rent-a-tribe schemes to claim sovereign immunity from state laws.[58] In a rent-a-tribe scheme, the lender partners with a Native American tribe and acts as an agent of the tribe, subject to tribal law, and thus claims immunity from state law.[59] It operates similarly to a rent-a-bank scheme, in that the lender markets, advertises, and provides funds for the service, then the tribal entity originates the loan to the borrower, which can be done nationwide over the internet, and subsequently sells the loan to the lender according to a prior arrangement.[60] APRs charged in these schemes

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54 Andrea M. Seielstad, *The Recognition and Evolution of Tribal Sovereign Immunity Under Federal Law: Legal, Historical, and Normative Reflections on a Fundamental Aspect of American Indian Sovereignty*, 37 TULSA L. REV. 661, 675 (2002).

55 *See id.* at 665, 686.

56 *See Bay Mills Indian Cmty.*, 134 S. Ct. at 2028 (rejecting Michigan's attempt to enjoin Indian tribe's right to buy land outside their reservation to operate casino under the Indian Gaming Regulatory Act and upholding their sovereign immunity rights).

57 *See* Seielstad, *supra* note 54, at 666.

58 *See* Jeremy Roebuck, *How a Main Line Payday Lender Used an Indian Tribe and an Empty Computer Server to Make Millions*, PHILA. INQUIRER (Nov. 2, 2017, 8:21 PM), http://www.philly.com/philly/news/pennsylvania/philadelphia/hallinan-payday-lending-trial-guidiville-indian-tribe-20171102.html [https://perma.cc/YY39-7YPK].

59 Not all tribal lending businesses are usurious moneylenders, of course. For example, in 2006, the Navajo Nation capped interest rates at 15% above the prime interest rate. *See* NATIVE ASSETS RESEARCH CTR., *supra* note 13, at 9. Further, many tribes support U.S. actions to end predatory lending. Indeed, some tribal groups are stepping up to advocate for various tribes to institute laws limiting predatory lending because of the harm to their people, as well as a fear that failure to regulate this effectively themselves may result in a loss of their sovereign immunity rights. *See id.* at 2, 12–13. But many smaller tribes do not cap interest rates and have found online consumer lending to be a viable way to earn money. *See Stop the Senate Banking Committee from Interfering with Tribal Sovereignty*, NATIVE AM. FIN. SERVS. ASS'N, https://nativefinance.org/stop-the-senate-banking-committee [https://perma.cc/J6B6-836V] ("After decades of stunted economic growth, eCommerce has proven to be a financial lifeline for tribes who struggle with overwhelming poverty and a lack of access to the financial opportunities afforded to other Americans."); Ben McLannahan, *US Authorities in Crackdown on "Rent-a-Tribe" Payday Lenders*, FIN. TIMES (June 28, 2015), https://www.ft.com/content/82ca6198-1dc3-11e5-aa5a-398b2169cf79 [https://perma.cc/HGG9-2RCU].

60 *See* Hilary B. Miller, *The Future of Tribal Lending Under the Consumer Financial Protection Bureau*, ABA BUS. L. TODAY (Mar. 4, 2013), https://www.americanbar.org/content/dam/aba/publications/blt/2013/03/future-tribal-lending-201303.pdf [https://perma.cc/DNH8-7LNM].

can run as high as around 800%.[61] When a potential plaintiff tries to bring a suit for violation of a state's usury limit, the lender claims sovereign immunity as an "arm" of the tribe. Even for courts sympathetic to borrowers, "'sovereign immunity is not a discretionary doctrine that may be applied as a remedy depending on the equities of a given situation . . . .' Rather it presents a pure jurisdictional question."[62] As a result, very few cases have been successfully brought.[63]

The banks and Native American tribes engaging in these transactions are outliers in their respective groups, which highlights that these schemes are neither particularly desirable nor widely lauded.[64] This small segment of actors, however, can have a significant impact on a wide section of the borrowing population[65] and consequently should be closely examined. Moreover, while the number of banks or Native American tribes involved may be few, the number of alternative lenders engaging in these practices is more significant.

B. *Payday and Marketplace Lenders*

The average creditworthy borrower who walks into a bank and asks for and receives a short-term loan is likely to pay an APR of less than 20%.[66] Not all potential borrowers, however, have the necessary credentials to receive a short-term loan from a bank.[67] There are two main types of lenders who have stepped in to meet this demand: payday lenders and, increasingly, marketplace lenders.

The practice of "wage buying" dates back to the 19th century, when an early version of today's payday lenders issued loans in return for a portion of the borrower's future paycheck.[68] At the time, wage

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61 *See* McLannahan, *supra* note 59.

62 Ameriloan v. Superior Court, 86 Cal. Rptr. 3d 572, 582 (Cal. Ct. App. 2008) (quoting Warburton/Buttner v. Superior Court, 127 Cal. Rptr. 2d 706, 715 (Cal. Ct. App. 2002)).

63 *See* Ben Walsh, *Outlawed by the States, Payday Lenders Take Refuge on Reservations*, HUFFINGTON POST (Dec. 6, 2017), https://www.huffingtonpost.com/2015/06/29/online-payday-lenders-reservations_n_7625006.html [https://perma.cc/7DUV-CNZM] ("But by working with Native American tribes, companies . . . have largely managed to stay one step ahead of consumer protection laws.").

64 *See Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 8.

65 *See* Matt Gelb, *Jenkintown Man Accused of Scamming 70,000 Victims*, PHILA. INQUIRER (June 23, 2015, 1:08 AM), http://www.philly.com/philly/news/20150623_Jenkintown_man_accused_of_scamming_70_000_victims.html [https://perma.cc/E3PN-K3ZK].

66 *See* Martin, *supra* note 42, at 267.

67 *See* Jones-Cooper, *supra* note 15.

68 *See* Astra Taylor, *Why It's So Hard to Regulate Payday Lenders*, NEW YORKER (Aug. 3, 2016), https://www.newyorker.com/business/currency/why-its-so-hard-to-regulate-payday-lenders [https://perma.cc/5DRL-AL67].

lenders attempted to avoid state usury laws by characterizing the transaction as a "purchase" of the borrower's future wage payment.[69] Modern payday lenders provide short-term, high-interest loans for consumers who borrow against their future paychecks.[70] That is, a consumer in need of cash can borrow a small amount from the payday lender that is due two weeks later with a very high interest rate.[71] Many consumers are unable to repay the loan after two weeks and become ensnared in a never-ending cycle of debt as the loans are rolled over.[72]

More than 30 states allow for short-term, high-interest loans borrowed against future paychecks, while 18 have tried to prohibit them.[73] Many payday lenders, however, have adapted to state attempts to regulate them.[74] One strategy they have employed to avoid state regulation is using a rent-a-bank or rent-a-tribe scheme.

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69 *See* Paul Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENV. L. REV. 387, 391–92 (2005).

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> A payday loan [has been defined as] a loan of short duration, typically two weeks, at an astronomical annual interest rate. Payday loans are the current version of salary buying or wage buying. The fees, charges, and interest on a payday loan are between 15 percent and 30 percent of the principal for a two-week loan, constituting a pretext for usury. Because the maturity date of these loans is usually set to coincide with the borrower's next payday, the loans are often called 'payday loans.'

Ga. Cash Am., Inc. v. Strong, 649 S.E.2d 548, 550 n.2 (Ga. Ct. App. 2007) (internal quotations omitted) (quoting Clay v. Oxendine, 645 S.E.2d 553, 555 (Ga. Ct. App. 2007)).

71 Researchers have noted that borrowers take out payday loans to cover recurring everyday expenses more often than to cover emergency or special situations. *See* PEW CHARITABLE TRS., *supra* note 26, at 13–14.

72 For example, "[i]n 1999[,] 420,000 North Carolina borrowers generated 2.9 million transactions," which translates to an average of 6.9 transactions per borrower. FOX & MIERZWINSKI, *supra* note 16, at 9; *see* Taylor, *supra* note 68. Researchers estimate the annual market to be approximately $46 billion, with approximately 12 million consumers taking out loans from payday lenders every year, while the lenders make over $7 billion in fees. *See* PEW CHARITABLE TRS., *supra* note 26, at 2–4, 13.

73 Timothy E. Goldsmith & Nathalie Martin, *Interest Rate Caps, State Legislation, and Public Opinion: Does the Law Reflect the Public's Desires?*, 89 CHI.-KENT L. REV. 115, 116–17 (2014).

74 Stacy Cowley, *Payday Loan Limits May Cut Abuse But Leave Some Borrowers Looking*, N.Y. TIMES: DEALBOOK (July 22, 2016), https://www.nytimes.com/2016/07/23/business/dealbook/payday-loan-limits-may-cut-abuse-but-leave-some-borrowers-looking.html [https://perma.cc/M2G4-4NDS] ("But lenders found loopholes, and their loan volume grew: To skirt the rate caps, payday lenders register as mortgage lenders or as credit service organizations, which are allowed to charge fees for finding loans for their customers."). A 2004 rule in Georgia set interest-rate caps and penalties, but "short-term lenders simply adapted, promoting alternative financial products to sidestep regulation. The result was that Georgians who might once have taken out payday loans (disproportionately, single mothers and minorities) now tend to hold auto-title loans or installment loans instead." *See* Taylor, *supra* note 68.

Another type of lender entering the consumer lending market is the marketplace lender, or peer-to-peer lender.[75] Marketplace lenders are financial technology companies that have developed algorithms to provide online platforms connecting lenders and borrowers and "offering faster credit for consumers and small businesses."[76] These new types of lenders are currently subject to the same laws and regulations as other types of consumer lenders.[77] While many of these lenders follow fair lending practices,[78] some have charged borrowers APRs of around 200–300%.[79] As of late 2014, the U.S. consumer lending market was estimated to be around $7.4 billion, with a predicted annual growth rate of approximately 50%.[80] A few of these lenders have also found the rent-a-tribe or rent-a-bank schemes to be attractive strategies to sidestep state usury laws.[81] Therefore, as this market continues to grow, it becomes increasingly important to clearly define the rules that apply to them.

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75 *See* CONSUMER FIN. PROTECTION BUREAU, UNDERSTANDING ONLINE MARKETPLACE LENDING 1 (2016), http://files.consumerfinance.gov/f/201603_cfpb_understanding-online-market-place-lending.pdf [https://perma.cc/HM3P-Z5KP].

76 U.S. DEP'T OF TREASURY, OPPORTUNITIES AND CHALLENGES IN ONLINE MARKETPLACE LENDING 1 (2016), https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf [https://perma.cc/F6FM-ES7E]; *see* CONSUMER FIN. PROTECTION BUREAU, *supra* note 75, at 1. Some prominent examples include LendingClub, Inc., Marlette Funding, Inc., and Prosper. *See Members*, MARKETPLACE LENDING ASS'N, http://marketplacelendingassociation.org [https://perma.cc/T6EK-285H].

77 Falguni Desai, *An Inside Look at Fintech Marketplace Lenders*, FORBES (Feb. 27, 2016, 5:48 PM), https://www.forbes.com/sites/falgunidesai/2016/02/27/an-inside-look-at-fintech-market place-lenders/#16a8a838ae73 [https://perma.cc/6APH-2ZKT].

78 *See The Marketplace Lending Best Practices*, MARKETPLACE LENDING ASS'N, http://marketplacelendingassociation.org/industry-practices/ [https://perma.cc/V93M-FB9G].

79 *See, e.g.*, Pennsylvania v. Think Fin., Inc., No. 14-cv-7139, 2016 WL 183289, at *11 (E.D. Pa. Jan. 14, 2016).

80 *See* MORGAN STANLEY RESEARCH, GLOBAL MARKETPLACE LENDING: DISRUPTIVE INNOVATION IN FINANCIALS, 1, 23–24 (May 19, 2015), https://bebeez.it/wp-content/blogs.dir/5825/files/2015/06/GlobalMarketplaceLending.pdf [https://perma.cc/4R67-M5WY] ("While marketplace lending is still ~1% of unsecured consumer . . . lending in the US, we think it can reach ~10% by 2020 . . . .").

81 *See, e.g.*, Bethune v. Lendingclub Corp., No. 16 Civ. 2578 (NRB), 2017 WL 462287, at *1 (S.D.N.Y. Jan. 30, 2017); Beechum v. Navient Solutions, Inc., No. EDCV 15-8239-JGB-KKx, 2016 WL 5340454, at *2 (C.D. Cal. Sept. 20, 2016); *see also* Meade v. Marlette Funding, LLC, No. 2017-CV-30377, at 28 (D. Colo. Aug. 13, 2018) (denying defendants' motions to dismiss and granting motions to intervene, finding triable issue of fact that defendants operated rent-a-bank schemes).

C. These Schemes Are Destructive to Borrowers

Consumer lending has become a major industry in the United States, with many complex issues of morality and utility to address.[82] Historically, "the transaction at the heart of banking—the loan—has always been as much about morality as market exchange. . . . The conversation about debt and usury, then, is a discussion about the commonly agreed-upon principles of what is right and wrong."[83] In recent history, however, the morality behind usury has largely been forgotten, as the fringe lending industry has generated many predatory lending practices that disproportionately affect lower-income people and minorities, a problem exacerbated by an inadequate regulatory regime.[84] Specifically, while the mainstream U.S. banking industry (which serves the top approximately 80% of wage earners) is subject to a complex regulatory framework, the fringe lending industry (often the only option for the bottom 20% of wage earners) is only regulated by a patchwork system of state laws.[85] Thus, although the availability of credit is important for class mobility in the United States, the current system available to those at the bottom of the income ladder is grossly abused by businesses that claim they need to charge high interest rates to provide this service but in reality are hugely profitable enterprises.[86] Accordingly, one major problem in particular—the loophole that allows rent-a-bank and rent-a-tribe schemes to persist—can and should be resolved because of its patently destructive effect on financially strapped Americans.

The Federal Reserve Bank of New York reported that, as of September 2017, "total household indebtedness was $12.96 trillion, a $116 billion (0.9%) increase from the second quarter of 2017," continuing its upward trend for the 13th consecutive quarter.[87] Additionally, the Federal Reserve Board of Governors reported that in 2016, sixteen

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82 For a detailed history of consumer lending in the United States, see generally GEISST, *supra* note 9.

83 MEHRSA BARADARAN, HOW THE OTHER HALF BANKS 102 (2015). Indeed, every major religion has expressly prohibited usury or the charging of interest at some point, and most ancient cultures forbade it because it was considered morally wrong. *See id.* Interestingly, the Jews interpreted the Torah only to forbid the lending of money to other Jews, but lending to non-Jews was considered fine. *See id.* at 102–04; GEISST, *supra* note 20, at 13 ("Along with prostitution, arson, and murder, [collecting interest] was considered an execrable crime under religious law, although it was more gingerly tolerated in the secular world.").

84 *See* BARADARAN, *supra* note 83, at 109.

85 *See id.* at 110.

86 *See id.*

87 Research & Stats Grp., *Quarterly Report on Household Debt and Credit*, FED. RES. BANK OF N.Y. 1, 1 (2017) (noting about 4.9% of this is in some stage of delinquency).

million adults—about seven percent—did not have a bank account, and about 50% of those people had used some form of alternate financial service within the past year.[88] The report also noted that "lacking a bank account or using alternative financial services is disproportionately prevalent both among lower-income respondents and among black and Hispanic respondents."[89] Moreover, regardless of income bracket, black and Hispanic individuals are more likely to be denied access to credit.[90] Payday lenders, in particular, are capitalizing on this, as many choose to set up shop in lower-income areas.[91] All of this data paints a troubling picture that lower-income and minority populations are disproportionately being forced to find alternative methods of obtaining credit, which are less well-regulated than the traditional bank method.[92]

As a result, the expansion of the fringe banking sector has been euphemistically referred to as "the democratization of credit," but "it is imperative to examine whether too much of this is destructive debt rather than productive credit."[93] American society embraces credit as a way of life as the widespread availability of credit contributed to the creation and rise of the middle class, and today a "majority of the American public borrow their way up the income ladder . . . ."[94] Thus, most Americans see credit as a path to wealth; however, as a large proportion of people in the bottom income bracket do not have access to traditional means of obtaining credit, like credit cards, they must turn to alternative means.[95] Furthering this cycle, not only does fringe lending often result in never-ending debt, but those who do successfully repay their loans may not receive a positive credit report reflecting successful repayment.[96] This limits the borrower's options moving forward, as it fails to provide a boost to their credit history that would

88 FED. RESERVE REPORT, *supra* note 26, at 31 ("Just over half of those who are unbanked have used some form of alternative financial service in the prior year—such as a check cashing service, money order, pawn shop loan, auto title loan, paycheck advance, or payday loan.").

89 *Id.*

90 *Id.* at 34.

91 *See* BARADARAN, *supra* note 83, at 121 ("The rise of fringe banking correlates directly with the decline of banks in poor communities."); Bruch, *supra* note 18, at 1272.

92 "Twenty-six percent of all adults and 54 percent of non-Hispanic black adults are either unbanked or underbanked." FED. RESERVE REPORT, *supra* note 26, at 2.

93 Drysdale & Keest, *supra* note 50, at 665.

94 BARADARAN, *supra* note 83, at 110.

95 *Id.* In the 19th century, loan sharks, often associated with organized crime, arose to provide this service, which then transitioned into the more euphemistically named "alternative lenders." *See* GEISST, *supra* note 20, at 174.

96 Drysdale & Keest, *supra* note 50, at 665.

allow them access to a bank in the future. As wages remain stagnant while individual indebtedness rises, access to credit is critically important not only to improve Americans' standard of living but also to pay for basic needs.[97]

The current fringe lending industry thrives because of the inequality of access to credit and therefore claims to provide a "service" to the community, but there is room for improvement.[98] Proponents argue the necessity of high interest rates,[99] but several studies have found that borrowers who take out payday loans are actually worse off than consumers who do not have access to payday loans.[100] Research by the Pew Charitable Trusts further notes that annual interest rate payments "with three digits are unnecessary for profitability."[101] Additionally, a 2009 study on payday loan pricing showed "a strong relationship between actual payday loan prices and the payday loan price ceiling imposed by [state usury laws]," demonstrating that payday lenders charge the maximum rate allowed by law, not based on the creditworthiness of the borrower.[102] Indeed, Richard Cordray, director of the Consumer Financial Protection Bureau from 2012 to 2017, noted that "the payday [lending] industry depends on people becoming stuck in these loans for the long term, since almost half their business comes from people who are basically paying high-cost rent on the amount of their original loan."[103]

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97 *See* Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q.J. Econ. 517, 521–22 (2011).

98 As Mehrsa Baradaran argues in her book on fringe lending, "[t]he question of whether payday loans are categorically good or bad for borrowers is unanswerable, in part, because it is the wrong question. . . . The more relevant question is whether there are better, less costly, alternatives." Baradaran, *supra* note 83, at 130–31.

99 Cowley, *supra* note 74 ("[T]he industry says that high volume and prices are needed to cover its operating costs. Some research backs that claim: A Federal Deposit Insurance Corporation study of payday lending's profitability concluded that high delinquency rates and the overhead of running retail stores justified the industry's interest rates.").

100 *See* Melzer, *supra* note 97, at 521; Bart J. Wilson et al., *An Experimental Analysis of the Demand for Payday Loans*, 10 B.E. J. Econ. Analysis & Pol'y 1,1 (2010); Michael S. Barr, Financial Services, Savings & Borrowing Among LMI Households in the Mainstream Banking & Alternative Financial Services Sectors, Presentation to the Federal Trade Commission (Oct. 30, 2008), https://perma.cc/BP4D-S4JV.

101 Ann Carrns, *Banks Urged to Take On Payday Lenders with Small, Lower-Cost Loans*, N.Y. Times (Feb. 16, 2018), https://www.nytimes.com/2018/02/16/your-money/banks-payday-loans .html [https://perma.cc/3DD3-FKZV].

102 *See* Baradaran, *supra* note 83, at 131.

103 Richard Cordray, *Director Richard Cordray Remarks at the Payday Field Hearing*, CFPB (Mar. 25, 2014), www.consumerfinance.gov/newsroom/director-richard-cordray-remarks-at-the-payday-field-hearing [https://perma.cc/2PHD-XE2H].

Moreover, those lenders who are choosing to engage in the market are generally not small businesses.[104] The largest chain of payday lenders is Advance America, with 2,100 locations in 28 states, owned by Grupo Salinas, a Mexican conglomerate.[105] The other largest companies are almost all owned by private equity firms.[106] And it is not only large institutional firms that back these lenders; some of them are run by individuals who see it as a viable way to make a lot of money at the expense of the poor. In 2015, Adrian Rubin was charged with running a rent-a-tribe scheme from which he earned tens of millions of dollars over a 14-year period by charging interest rates of around 780%.[107] He defrauded over 70,000 people.[108] Another case involves racecar driver Scott Tucker, who ran an online payday lending business from which he made more than $3.5 billion by exploiting more than four million people and charging interest rates of around 700%.[109]

People often wrongly assume that borrowers who take out payday loans are financially irresponsible, which creates a stigma that hurts efforts to regulate the industry.[110] But the reality is that about 12 million Americans each year use payday loans, "spending an average of $520 on fees to repeatedly borrow $375."[111] The Federal Reserve Board of Governors reports that about 44% of U.S. adults do not have sufficient savings to cover an emergency $400 expense, such as an unexpected car repair or medical bill.[112] And while about 45% of those would put the expense on a credit card, 5% would consider taking out a payday loan; this number increases to 9% among those who

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104 *See* Carrns, *supra* note 101.

105 Stacy Cowley, *Payday Lending Faces Tough New Restrictions by Consumer Agency*, N.Y. TIMES (Oct. 5, 2017), https://www.nytimes.com/2017/10/05/business/payday-loans-cfpb.html [https://perma.cc/P7YE-4QNB].

106 *Id.* "As one commentator observed about a Washington, DC, check-cashing outlet: 'The primitive hands-on processing and tawdry exterior of the outlets both exude welcome to poor customers and mask [the firm's] close ties to and substantial financing from large corporations and big banks.'" BARADARAN, *supra* note 83, at 123.

107 *See* McLannahan, *supra* note 59.

108 *See* Gelb, *supra* note 65.

109 Brendan Pierson, *Race Car Driver Tucker Gets More Than 16 Years for Lending Scheme*, REUTERS (Jan. 5, 2018, 4:20 PM), https://www.reuters.com/article/us-usa-paydaylending-crime/race-car-driver-tucker-gets-more-than-16-years-for-lending-scheme-idUSKBN1EU20L [https://perma.cc/8MUC-GSFF].

110 *See* BARADARAN, *supra* note 83, at 118.

111 PEW CHARITABLE TRS., AMERICANS WANT PAYDAY LOAN REFORM, SUPPORT LOWER-COST BANK LOANS (2017), https://www.pewtrusts.org/-/media/assets/2017/04/americans-want-payday-loan-reform.pdf [https://perma.cc/G47T-SDCX].

112 FED. RESERVE REPORT, *supra* note 26, at 26.

actually experienced a financial hardship within the past year.[113] Studies further indicate that the people who use payday lending are not the most destitute, but rather those with low-to-moderate income, and they borrow to pay for essential things, such as food and medical care, choosing to borrow only after extensive research.[114] A lack of financial literacy is not the problem; instead, there is a real need for short-term loans that banks are not providing, and unfortunately payday lenders "are exploiting [this] fundamental void in our financial system."[115]

Therefore, modern American society should take a firm stand on what is acceptable or not, because, as one scholar argued, "equality in the credit market leads to a more fair and just society."[116] Today, "high-cost lending is the fastest growing segment of the consumer lending business,"[117] and the lawful use of rent-a-bank and rent-a-tribe schemes shows that the United States has descended a long way from a moral condemnation of usurious loans. As one scholar describes the current landscape, "The problem of loan-sharking was brushed aside by making [high interest rates], once typical only of organized crime, perfectly legal—and therefore, enforceable no longer by just hired goons and the sort of people who place mutilated animals on their victims' doorsteps, but by judges, lawyers, bailiffs, and police."[118] Further, the cases of Adrian Rubin and Scott Tucker illustrate the significant effect that these schemes have on the borrowing public. This problem can be solved, but first, it is important to look at what states and courts are already doing.

II. Competing Judicial Doctrines

Courts have applied two different tests in deciding whether a loan should be subject to a state's usury laws, but those tests are inconsistently applied and have resulted in uncertainty as to the governing rules in this area.[119] This confusion has resulted, in part, because rent-

113 *Id.* at 26–27.

114 *See* Baradaran, *supra* note 83, at 115–16.

115 *See id.* at 124, 129. Baradaran provides a compelling argument for how the federal government and the mainstream banking system have failed many Americans and why they should be responsible for providing this basic service to all Americans. *See id.* at 136–37.

116 *Id.* at 110.

117 Goldsmith & Martin, *supra* note 73, at 118.

118 Baradaran, *supra* note 83, at 110 (quoting David Graeber, Debt: The First 5,000 Years 376 (2011)).

119 *See* Horn & Hall, *supra* note 31, at 12–13. Another wrench thrown into efforts to bring suit is the use of arbitration clauses in the lending agreements, which courts have so far upheld, resulting in less judicial oversight. *See* Bethune v. LendingClub Corp., No. 16 Civ. 2578 (NRB), 2017 WL 462287, at *4 (S.D.N.Y. Jan. 30, 2017) (upholding arbitration provision in lending

a-bank and rent-a-tribe arrangements are not strictly prohibited. Consequently, a court's decision to pierce the veil of the arrangement or not, in deciding who the "true lender" is, can depend on how egregious the facts are and how obviously the scheme is purporting to skirt the state's usury limit.

"True lender" claims were first asserted against payday lenders who used rent-a-bank arrangements to evade state usury limits, and similar claims have been successfully asserted more recently in rent-a-tribe schemes.[120] The primary tension is between the "contractual" test, which adheres to the valid-when-made doctrine, which accepts the legal identity of the lender listed on the loan documentation without examining the underlying substance of the transaction, and the predominant economic interest test, which evaluates the substance of the arrangement by analyzing which party bears the "predominant" economic risk of the loan.

A. *The Contractual Approach and the Valid-When-Made Doctrine*

The valid-when-made doctrine states that if the loan was not usurious when the loan was made, the loan remains legal throughout its term, regardless of any transfer of ownership.[121] Accordingly, in these cases, the bank's federal preemption of state usury law or the tribal entity's sovereign immunity transfers with the loan document itself.[122] This doctrine has recently become a source of controversy because of the Second Circuit's decision in *Madden v. Midland Funding, LLC*,[123] which did not apply the doctrine in analyzing a transaction involving an assignment of a loan. The doctrine does have some advantages with regard to third-party debt collection and securitization because it provides a bright-line rule that is easy for parties to follow, but reliance on the doctrine in rent-a-bank and rent-a-tribe schemes essentially upholds a legal fiction.[124] Furthermore, it is far from clear whether the principles embodied in the original valid-when-made doctrine should apply to those particular loan arrangements. This Section discusses the

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agreement in class action case alleging violations of state usury laws through a rent-a-bank arrangement).

120 *See, e.g.*, CFPB v. CashCall, Inc., No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *1–2 (C.D. Cal. Aug. 31, 2016) (noting that CashCall switched from using a rent-a-bank scheme to a rent-a-tribe scheme when the FDIC began to crack down on their rent-a-bank scheme).

121 Horn & Hall, *supra* note 31, at 1.

122 *See id.* at 6–15.

123 786 F.3d 246 (2d Cir. 2015).

124 *See Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 9.

development of the doctrine, the Second Circuit's controversial decision in *Madden*, and the current status of the debate over the use of the doctrine.

1. *History of the Valid-When-Made Doctrine*

Prior to the Second Circuit's decision in *Madden*, the valid-when-made doctrine governed bank assignments of loans to other entities.[125] The doctrine is particularly useful for situations where a bank has originated a loan and subsequently sells the loan to a third party, such as a debt collector or a securities broker-dealer for securitization, because it provides a clear and consistent rule that creates legal certainty for bona fide assignments of loans.[126] For situations where another lender is using the bank as a front to claim the bank's exportation doctrine, however, the doctrine prevents borrowers from gaining any relief and instead promotes a legal fiction.

Discussion of the origin of the doctrine is important because a large part of the argument for the use of the valid-when-made doctrine is its purportedly long history. If that history does not in fact exist, then strict adherence to it should be reexamined in favor of upholding longstanding antiusury principles. An 1833 Supreme Court case, *Nichols v. Fearson*,[127] is considered the genesis of the valid-when-made doctrine. In *Nichols*, the Court stated that "a contract, which, in its inception, is unaffected by usury[] can never be invalidated by any subsequent usurious transaction."[128] When considered in light of the facts of the case, however, this statement has a slightly different meaning than the modern valid-when-made doctrine. *Nichols* involved the original issuance of a promissory note and the subsequent transfer of that note with a "discount beyond the legal rate of interest."[129] The question presented was whether that *subsequent* transfer and the usurious rate attached to it rendered the original contract usurious.[130] The Court held that a second, usurious transaction does not render an original, legally valid contract also usurious.[131] "In other words, usurious transaction #2 does not infect valid transaction #1."[132] Thus, the

125 *See, e.g.*, Krispin v. May Dep't Stores Co., 218 F.3d 919 (8th Cir. 2000).

126 Horn & Hall, *supra* note 31, at 1.

127 32 U.S. (7 Pet.) 103 (1833).

128 *Id.* at 109.

129 *See id.* at 106.

130 *See id.* at 109.

131 *See id.* at 109–10.

132 *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 11.

result in *Nichols* can be distinguished from the modern valid-when-made doctrine, which claims that an extension of credit that would be usurious for a lender other than a bank is valid even if the loan is immediately assigned by a bank to a nonbank lender.

In the modern version of the valid-when-made doctrine, "the primary—or perhaps only—legal inquiry that must be made concerning the validity of a loan that is subsequently transferred is whether the loan, at inception, was lawfully made."[133] In 2005, Judge Richard Posner explained that, under the doctrine, "once assignors were authorized to charge interest, the common law kicked in and gave the assignees the same right, because the common law puts the assignee in the assignor's shoes, whatever the shoe size."[134] Judge Posner also observed, however, that the validity of the transfer was based in part on an understanding that "assignees do not deal with consumers. It was the assignors who persuaded the plaintiffs to pay high interest rates . . . ."[135] Here, however, it is the alternative nonbank lender who markets loans directly to consumers. The bank or the tribe does not deal with the borrower, and its name is provided only on the final loan documents, which are immediately assigned to the alternative lender. Therefore, in situations where an alternative nonbank lender has marketed the loan and dealt directly with consumers, it is highly questionable whether the valid-when-made doctrine should apply.

2. Madden v. Midland Funding

In 2015, the Second Circuit created serious questions regarding the scope of the valid-when-made doctrine in *Madden*. The Second Circuit rejected a debt collector's claim of federal preemption based on the exportation doctrine that the lending bank could have invoked if it still held the loan.[136] *Madden* did not involve a rent-a-bank or rent-a-tribe scheme, but its reasoning potentially applies to those arrangements, as it was the first time a federal appellate court determined whether the National Bank Act preempted state law usury claims when a bank was listed on the loan documents but the loan was transferred to another entity.[137]

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133 Horn & Hall, *supra* note 31, at 6.

134 Olvera v. Blitt & Gaines, P.C., 431 F.3d 285, 289 (7th Cir. 2005).

135 *Id.*

136 *See* Madden v. Midland Funding, LLC, 786 F.3d 246, 254–55 (2d Cir. 2015) (holding that the bank's federal preemption of the New York state usury limit did not transfer with the loan when it was transferred to a third-party debt collector).

137 *See* Ubaldi v. SLM Corp., 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012) ("Whether or not the Court may consider what entity is the actual 'de facto' lender when a national bank is listed

The undisputed facts were that Saliha Madden had a credit card with Bank of America, which charged a 27% interest rate, valid under Delaware law.[138] Ms. Madden was a resident of New York, however, which capped interest rates at 25%.[139] After she defaulted, Bank of America sold her debt to a third-party debt collector, Midland Funding, LLC ("Midland"), which continued to apply the same 27% interest rate to her debt.[140] Because Midland was not a bank and was therefore subject to the usury laws of the state in which the borrower resided, Ms. Madden filed a class action suit alleging that the interest accrued after the loan was transferred to Midland was in violation of New York's usury laws.[141] Midland argued that the National Bank Act preempted Ms. Madden's state law claim based on the exportation doctrine.[142] The Second Circuit held for the plaintiffs and rejected Midland's preemption claim, reasoning that third-party debt collectors are distinct entities from nationally chartered banks and therefore cannot rely on the preemption provided to national banks under section 85 of the National Bank Act.[143] The court further held that rejecting Midland's preemption would not "significantly interfere" with the lending bank's exercise of its powers under the National Bank Act.[144] The Second Circuit relied on *Barnett Bank N.A. v. Nelson*,[145] in which the Supreme Court held that the National Bank Act preempts state law only if the application of state law "significantly interferes" with a national bank's exercise of its powers.[146] The Second Circuit did not directly address the valid-when-made doctrine and instead found that Midland was not acting on the bank's behalf and that requiring Midland to follow state usury laws would not "significantly interfere" with the lending bank's exercise of its powers under the National Bank Act.[147]

Midland filed a petition for certiorari, and the Supreme Court requested the opinion of the Solicitor General. The Solicitor General

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on the loan documents to decide whether the [National Bank Act] preempts state law appears to be a question of first impression within this circuit, and indeed has not yet been directly addressed by any federal appellate court.").

138 *Madden*, 786 F.3d at 247–48.

139 *Id.* at 248.

140 *Id.*

141 *See id.*

142 *Id.* at 249.

143 *See id.* at 250–52.

144 *See id.* at 251–52.

145 517 U.S. 25 (1996).

146 *See id.* at 33.

147 *See Madden*, 786 F.3d at 251.

stated that the case had been incorrectly decided, largely because of the Second Circuit's failure to address the valid-when-made doctrine, but the Solicitor General also advised that the *Madden* decision did not provide an attractive vehicle for determining whether Midland's preemption claim was valid.[148] The Supreme Court denied Midland's petition for certiorari, perhaps in part because there was not yet a circuit split on the issue.[149] Subsequently, there has been extensive debate over the question of whether the Second Circuit should have addressed the valid-when-made doctrine and whether that doctrine should have produced a different outcome in the case.[150]

3. *The Current Debate and Congress*

The post-*Madden* dispute about the valid-when-made doctrine centers on whether it should be strictly followed in all cases or whether it should be only selectively applied. Proponents of the doctrine claim that it "derives from the common law and its application has been a cornerstone of U.S. banking law for over 100 years"[151] and is accordingly a "cardinal rule of usury."[152] Opponents argue that it is a modern construction based on a misinterpretation of an early Supreme Court case,[153] and as a consequence should not be applied to every assignment of a loan by a national bank.[154] Professor Adam J. Levitin argued, in his testimony before the House of Representatives Committee on Financial Services, that the exportation doctrine cannot be assigned by a national bank as a type of property, and state usury

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148 *See* Brief for the United States as Amicus Curiae at 1, 6–7, Midland Funding, LLC v. Madden, 136 S. Ct. 2505 (2016) (No. 15-610), https://www.justice.gov/sites/default/files/osg/briefs/2016/06/01/midland.invite.18.pdf [https://perma.cc/XYV4-JAGU].

149 *See* Midland Funding, LLC v. Madden, 136 S. Ct. 2505 (2016).

150 *See e.g.*, *Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 11–12; DAVIS POLK, FEDERAL BANKING REGULATORS CAN AND SHOULD RESOLVE *Madden* and True Lender Developments (2018), https://www.davispolk.com/files/madden-true-lender-federal-regulatory-fix-whitepaper_final.pdf [https://perma.cc/8B2T-RCN7].

151 *Valid When Made*, MARKETPLACE LENDING ASS'N, http://marketplacelendingassociation.org/wp-content/uploads/2017/08/Valid-When-Made-1-Pager-Final.pdf [https://perma.cc/ATR5-972B].

152 Brief for the United States as Amicus Curiae, *supra* note 148, at 4.

153 *See* Nichols v. Fearson, 32 U.S. (7 Pet.) 103 (1833).

154 *See Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 11–12 (arguing that the principle that could conceivably be derived from *Nichols* is that if a second transaction is usurious it does not poison the first transaction, but *Nichols* did not touch on the current form of the valid-when-made principle).

law should accordingly apply to a loan originated by a national bank after it has been transferred.[155]

Two bills were recently introduced in Congress to address this controversy, but those bills seek to uphold the valid-when-made doctrine in all cases, which some state officials have rejected as deeply flawed when applied to fictitious transactions like rent-a-bank schemes.[156] Instead of setting a federal interest rate cap or taking steps to protect borrowers, the proposed bills would reverse *Madden* and codify the valid-when-made doctrine, thereby creating a legislative rule that would be binding on the courts. The Protecting Consumers' Access to Credit Act of 2017[157] "provide[s] that a loan that is made at a valid interest rate remains valid with respect to such rate when the loan is subsequently transferred to a third party and can be enforced by such third party even if the rate would not be permitted under state law."[158] Similarly, the Modernizing Credit Opportunities Act[159] seeks to provide that the bank's exportation doctrine applies, regardless of any later assignment.[160]

These bills may clarify the liability of banks and nonbank lenders under these agreements, yet they disregard the potential effect of a sweeping valid-when-made doctrine in protecting rent-a-bank schemes from challenges by state officials and consumers.[161] As evidence of a rejection of the valid-when-made doctrine, some state courts have refused to apply it to rent-a-bank schemes and have instead sought to identify the "true lender" based on a predominant economic interest test, but that test has its own limitations.

B. The Predominant Economic Interest Test

When a case is brought against a nonbank lender allegedly involved in a rent-a-bank scheme, the lender typically raises a preemption defense based on the exportation doctrine.[162] In contrast with the valid-when-made doctrine, some commentators have noted that "[i]t

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155 *See id.* at 12.

156 *See* H.R. 4439, 115th Cong. (2017); H.R. 3299, 115th Cong. (2018).

157 H.R. 3299.

158 Scott M. Pearson, *Bipartisan Bill to Provide "True Lender" Fix Introduced in House*, CONSUMER FIN. MONITOR (Dec. 11, 2017), https://www.consumerfinancemonitor.com/2017/12/11/bipartisan-bill-to-provide-true-lender-fix-introduced-in-house [https://perma.cc/2ZX6-ZQ3Z].

159 H.R. 4439.

160 *See* Pearson, *supra* note 158.

161 *See Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 8–9.

162 *See supra* notes 38–41 and accompanying text.

is a long-standing judicial principle that substance, not form, dictates whether a transaction is a loan subject to usury laws."[163] Accordingly, courts have created the predominant economic interest test to determine whether the bank or the alternative lender is the "de facto" or "true" lender in the transaction.[164] Although this doctrine provides a substantive alternative to the valid-when-made doctrine, it has been inconsistently applied and was developed from one state's statute that does not exist in other states.

The phrase "predominant economic interest" first appeared in a 2004 Georgia statute.[165] The statute reads, "A purported agent shall be considered a de facto lender if the entire circumstances of the transaction show that the purported agent holds, acquires, or maintains a predominant economic interest in the revenues generated by the loan."[166] The first case to reference the statute was the 2004 district court decision in *Bankwest, Inc. v. Baker*,[167] which was appealed to the Eleventh Circuit.[168] The Eleventh Circuit upheld the district court's rejection of federal preemption and affirmed the denial of a preliminary injunction against the payday lender.[169] The appellate court further found that "predominant economic interest" meant "earning more than 50% of the revenue from a payday loan."[170] Thus, an arrangement whereby a nonbank lender earns, say, 49% of the revenue is presumably permissible under this interpretation of "predominant economic interest."

While in Georgia the predominant economic interest doctrine developed to interpret the statutory language, other states' courts have adopted the test as an alternative to the valid-when-made doctrine, absent a corresponding state statute. Since *Bankwest* was decided in 2005, there have been seven other cases in which a court considered the predominant economic interest test, including three more in Georgia[171] and one each in California,[172] West Virginia,[173] Colorado,[174] and

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163 *See* Drysdale & Keest, *supra* note 50, at 637.

164 *See, e.g.*, Bankwest, Inc. v. Baker, 411 F.3d 1289, 1298–99 (11th Cir. 2005).

165 Ga. Code Ann. § 16-17-2(b)(4) (2018). New Mexico enacted a similar law in 2007; however, it was repealed effective January 1, 2018. *See* N.M. Stat. Ann. § 58-15-34Q(1) (2007).

166 Ga. Code Ann. § 16-17-2(b)(4) (2018).

167 324 F. Supp. 2d 1333 (N.D. Ga. 2004).

168 *Baker*, 411 F.3d at 1299.

169 *See id.* at 1293.

170 *Id.* at 1299.

171 *See* Glenn v. State, 644 S.E.2d 826, 827 n.4, 828 (Ga. 2007) (holding that in-state lenders are separate and distinct from out-of-state banks and are therefore not similarly situated); Ga. Cash Am., Inc. v. Greene, 734 S.E.2d 67, 76 (Ga. Ct. App. 2012) (finding as triable issue of fact for jury whether Cash America was the true lender where they claimed to have only received

New York.[175] In these cases, there have generally been two steps of inquiry.

First, the court looks at whether the claim is being made against the bank or the nonbank lender, then, in some cases, determines which party established the allegedly usurious interest rates.[176] If the bank is named as a defendant and is responsible for setting the interest rates, the claim may be preempted and removed to federal court, where it becomes very difficult for plaintiffs to prove a violation of the state's usury limit.[177] On the other hand, if the claim is made against the nonbank lender, courts move on to the second step.[178]

Second, the court examines the totality of the circumstances to determine which party retains the predominant economic interest in the loans.[179] In some cases, this determination is a factual issue for the jury.[180] In *CFPB v. CashCall, Inc.*,[181] involving a rent-a-tribe scheme, the Central District of California declared that "[t]he key and most determinative factor is whether [the tribal entity] placed its own money at risk at any time during the transactions, or whether the en-

49% of the revenue); *see also* Parm v. Nat'l Bank of Cal., 242 F. Supp. 3d 1321, 1337, 1341 (N.D. Ga. 2017) (finding that the Georgia statute does not provide a private right of action against aiders and abettors).

172 *See* CFPB v. CashCall, Inc., No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *6 (C.D. Cal. Aug. 31, 2016) ("[T]he entire monetary burden and risk of the loan program was placed on CashCall, such that CashCall, and not Western Sky, had the predominant economic interest in the loans and was the 'true lender' and real party in interest.").

173 *See* CashCall, Inc. v. Morrisey, No. 12–1274, 2014 WL 2404300, at *15 (W. Va. May 30, 2014) (affirming lower court's use of predominant economic interest test to determine true lender).

174 *See* Meade v. Avant of Colo., LLC, 307 F. Supp. 3d 1134, 1145 (D. Colo. 2018) (rejecting lender's argument that complete preemption applies to arrangements).

175 *See* People v. Cty. Bank of Rehoboth Beach, 846 N.Y.S.2d 436, 437–39 (N.Y. App. Div. 2007) (remanding case because key factor was who held predominant economic interest in loans, therefore triable questions of fact remained).

176 *Compare In re* Cmty. Bank of N. Va., 418 F.3d 277, 296 (3d Cir. 2005), West Virginia v. CashCall, Inc., 605 F. Supp. 2d 781, 785 (S.D. W. Va. 2009), Flowers v. EZPawn Okla., Inc., 307 F. Supp. 2d 1191, 1204–05 (N.D. Okla. 2004), *and* Colorado *ex rel.* Salazar v. ACE Cash Express, Inc., 188 F. Supp. 2d 1282, 1284 (D. Colo. 2002), *with* Discover Bank v. Vaden, 489 F.3d 594, 601–02 (4th Cir. 2007), *and* Krispin v. May Dep't Stores Co., 218 F.3d 919, 924 (8th Cir. 2000).

177 *See Vaden*, 489 F.3d at 599–600; *Krispin*, 218 F.3d at 924–25.

178 *See* West Virginia v. CashCall, 605 F. Supp. 2d at 781; *ACE Cash Express*, 188 F. Supp. 2d at 1282.

179 *See, e.g.*, CFPB v. CashCall, No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *6 (C.D. Cal. Aug. 31, 2016).

180 *See, e.g.*, Ga. Cash Am., Inc. v. Greene, 734 S.E.2d 67, 76 (Ga. Ct. App. 2012).

181 No. CV 15-7522-JFW (RAOx), 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016).

tire monetary burden and risk of the loan program was borne by [the payday lender].”[182]

In all of the foregoing cases, the courts looked beyond the form of the agreement to the underlying economic reality, in sharp contrast to the contractual approach. The application of two different standards has resulted in substantial differences in legal outcomes between courts and significant confusion regarding the application of state usury laws to loan assignments. And as described in Section III, it is unlikely that Congress will close the rent-a-bank and rent-a-tribe loopholes in the foreseeable future because of competing interests at the federal level.

III. Interests at the Federal Level Prevent Resolution

Regulators and the public have frowned upon rent-a-bank and rent-a-tribe schemes since their inception in the 1990s. There are, however, no per se prohibitions against them. The schemes continue to exist because, at the federal level, competing interests have prevented any meaningful statutory or regulatory change from occurring. Some of these interests include concerns about federalism, the scope of the CFPB’s authority, and the considerable power of the financial industry.

A. Usury Laws and Federalism

Usury law, “the oldest continuous form of commercial regulation,” has existed for centuries, dating back to early civilizations.[183] In the United States, regulations concerning consumer protection have long been considered a matter primarily of state, not federal, interest.[184] Massachusetts implemented the first American usury law in 1641, with a cap of eight percent, leading to a uniform practice among all thirteen original states to implement similar interest rate caps.[185] These caps were effective until around the turn of the 19th century, when lenders found ways of avoiding state law to charge higher interest rates, sometimes exceeding 500%.[186]

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182 *Id.* at *6.

183 Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 Minn. L. Rev. 1110, 1113 (2008) (quoting Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 Pepp. L. Rev. 151, 151 (1988)).

184 *See* Schiltz, *supra* note 13, at 525.

185 *See* Martin, *supra* note 42, at 263.

186 *See id.* at 263–64. One way that lenders circumvented state law in the early 19th century was through realizing that the state usury limit only applied to a written contract that stated the

Traditional lenders eventually pushed wage lenders out of business, but in the last thirty years, payday lending and other alternative types of lending have exploded due to the diminishing effectiveness of state usury regulations.[187] The Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corporation*,[188] which established the exportation doctrine, resulted in competition among states that eliminated their usury limits to attract banks to establish headquarters within those states; Delaware, South Dakota, and Nevada were leaders in that competition.[189] Today, only 18 states and the District of Columbia have usury limits,[190] compared to 43 states in 1922.[191] There is also wide variety among states on which types of loans (consumer, automobile, etc.) are subject to interest rate caps and what rates are considered excessive.[192]

A federal interest rate cap would solve this problem because both banks and Native American tribes would then be subject to the cap, but attempts to set a federal cap have been met with determined resistance from the financial industry, even though most Americans agree on its utility.[193] One commenter posits a couple of reasons why there is little public activism in pushing for a federal interest rate cap: first, people mistakenly believe there already is a limit in place, and second, people do not realize how prevalent high interest rate loans are and that a rate of 300% is actually common.[194] In 2006, Congress did pass the Military Lending Act,[195] which placed a 36% federal interest rate

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annual rate of interest. *See* GEISST, *supra* note 9, at 51. Until the Truth in Lending Act was passed in 1968, a loan that was made for a shorter amount of time was not required to state the *annual* rate of interest; it only provided the monthly rate, therefore the state limit did not apply, even though the effective annual rate of interest would be excessively high. *See id.*

187 *See* Martin, *supra* note 42, at 264; Peterson, *supra* note 183, at 1111.

188 439 U.S. 299 (1978). The Court's decision in *Marquette* allowed banks to begin "exporting" the usury limit of the state where they are located. *See supra* Section I.A.1.

189 *See* Martin, *supra* note 42, at 264.

190 *See Legal Status of Payday Loans by State*, *supra* note 20.

191 *See* GEISST, *supra* note 9, at 48.

192 *See* Horn & Hall, *supra* note 31, at 3–4. Indeed, some states have hybrid restrictions that set limits for some types of loans but not others, such as auto loans. *See id.* This means that in those states, payday lenders often adapt their product offerings to take advantage of the absence of a usury limit on certain types of loans. *See* Gillian B. White, *When Payday Loans Die, Something Else Is Going to Replace Them*, ATLANTIC (Oct. 20, 2017), https://www.theatlantic.com/business/archive/2017/10/payday-loan-occ/543453 [https://perma.cc/RD9S-B5BE]; *see also* Goldsmith & Martin, *supra* note 73, at 117 n.11.

193 *See* Martin, *supra* note 42, at 269–73 (outlining various surveys that prove overwhelming public support for a federal usury cap, including bipartisan support); PEW CHARITABLE TRS., *supra* note 111.

194 Martin, *supra* note 42, at 272–73.

195 10 U.S.C. § 987 (2012).

cap on consumer loans to active-duty military members and their families, but this federal cap has not been extended outside the military.[196] Indeed, the Dodd-Frank Act expressly bars the CFPB from setting a federal interest rate limit.[197] However, the CFPB has made some attempts to regulate the alternative lending industry in other ways.

B. The CFPB Has Been Blocked in Their Efforts to Curb Predatory Lending

The CFPB was created by the Dodd-Frank Act to "enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive."[198] During the tenure of its first director, Richard Cordray, the CFPB took action to curb alternative lenders' more egregious practices, despite the prohibition on a federal interest rate cap, through enforcement actions and regulation.

For example, in 2013, the CFPB brought an action in California against CashCall, Inc., a payday lending company, for operating a rent-a-tribe scheme, alleging violation of the Consumer Financial Protection Act ("CFPA"), which makes it unlawful for any covered person "to engage in any unfair, deceptive, or abusive act or practice."[199] The CFPB claimed that CashCall had violated the CFPA by servicing and collecting on loans made illegal by state usury laws.[200] The CFPB's suit was successful in district court, but the conflict between a federal regulatory agency and alleged state law violations may make suits brought in other jurisdictions difficult, as there is currently a circuit split on whether a violation of a federal law can be predicated on a state law violation.[201]

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196 *See id.* § 987(b); *see* Martin, *supra* note 42, at 297–98.

197 12 U.S.C. § 5517(o) (2012).

198 *Id.* § 5511(a).

199 *Id.* § 5536(a)(1)(B); CFPB v. CashCall, Inc., No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at *10 (C.D. Cal. Aug. 31, 2016). The case is currently on appeal with the Ninth Circuit. *See* Statement of Decision Re Defs.' Mot. for Certification of Interlocutory Appeal & Stay Pending Appeal, CFPB v. CashCall, Inc., 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016) (No. 15-7522-JFW).

200 *See* CFPB v. CashCall, Inc., 2016 WL 4820635, at *4.

201 *Compare* Currier v. First Resolution Inv. Corp., 762 F.3d 529, 537 (6th Cir. 2014) (finding that the relevant question was "whether the plaintiff alleged an action that falls within the broad range of conduct prohibited by the [Fair Debt Collection Practices] Act"), *with* Gallego v. Northland Grp. Inc., 814 F.3d 123, 127 (2d Cir. 2016), *and* Beler v. Blatt, Hasenmiller, Leibsker

In October 2017, shortly before Mr. Cordray's five-year term expired, the CFPB proposed new regulations aimed at curbing predatory lending.[202] The recent change in leadership at the CFPB, however, combined with vigorous lobbying efforts from the payday-loan industry, has resulted in the withdrawal of these proposed rules.[203] Thus, the future of any further regulation by the CFPB is uncertain.[204]

C. *The Banking Industry's Fear of a Domino Effect*

A major impediment to any federal legislation on the issue of lenders' attempts to circumvent state usury laws is the powerful influence of the banking industry and the preemption of state usury laws under section 85 of the National Bank Act. Section 85 provides a potentially very effective shield to payday lenders because both legislators and courts are unwilling to limit its application, based on apprehension about potential knock-on effects. As discussed in Section I.A, banks have a considerable interest in protecting the exportation doctrine, which effectively allows them to charge any interest rate, and arguably allows other lenders to secure the same privilege through assignment if the valid-when-made doctrine is applied. Further, banks have an interest in protecting the future validity of any loans they originate and later seek to assign, as discussed in Section II.B, with the valid-when-made doctrine and the controversy over the *Madden* decision.

& Moore, LLC, 480 F.3d 470, 474 (7th Cir. 2007) (finding that the Fair Debt Collection Practices Act is not "an enforcement mechanism" for state law).

202 Taylor, *supra* note 68.

> The [proposed] rules attempt to make it more difficult for borrowers to roll over their loans, and also aim to cut down on the number of times that lenders can take money out of borrowers' bank accounts without getting additional authorization. Most notably, it would also require some lenders to verify that borrowers have the ability to repay a loan while still providing for their own living expenses.

Id.; *see* Sylvan Lane, *New CFPB Director Puts Target on Payday Loan Rules*, HILL (Jan. 17, 2018, 8:33 PM), https://thehill.com/policy/finance/369465-new-cfpb-director-puts-target-on-payday-loan-rules [https://perma.cc/KJ62-PE3N].

203 *See* Alan Rappeport, *Payday Rules Relax on Trump's Watch After Lobbying by Lenders*, N.Y. TIMES (Feb. 2, 2018), https://www.nytimes.com/2018/02/02/us/politics/payday-lenders-lobbying-regulations.html?emc=edit_nn_20180205&nl=morning-briefing&nlid=76217865&te=1 [https://perma.cc/K352-SAQP].

204 *See* Lane, *supra* note 202 ("The CFPB announced this week that it would delay compliance with new regulatory rules for short-term, high-interest loans, commonly known as payday loans. The agency said it is considering how to roll back those rules."); *see also* William Simpson, Note, *Above Reproach: How the Consumer Financial Protection Bureau Escapes Constitutional Checks & Balances*, 36 REV. BANKING & FIN. L. 343, 360–63 (2016) (describing the debate surrounding the constitutionality of the CFPB).

Banks may have significant economic interests at risk, but rent-a-bank arrangements are not in their best interest, as they can damage the bank's reputation.[205] A solution, therefore, must necessarily seek to achieve a reasonable balance between the economic interests of banks and the protection of consumers from exploitation by nonbank lenders. Additionally, because banks are generally exempt from state usury laws under the exportation doctrine, a solution to the rent-a-bank problem at the state level would not significantly interfere with their power to make bona fide loans free from the application of state usury laws.

IV. A State Resolution Is More Realistic and Feasible

There are several possible approaches to closing this loophole: federal legislation, judicial administration, or state legislation. Although several commentators have noted that a federal usury limit would be an effective remedy,[206] the CFPB is statutorily prohibited from doing so and Congress is unlikely to enact such legislation, given the political influence wielded by the banking industry.[207] As a result, some courts have used the predominant economic interest test to pierce the veil of these arrangements, but they are more likely to do so in cases where the injustice to borrowers is extreme.[208] Other courts have adhered to the valid-when-made doctrine, a convenient bright-line rule that nonetheless permits lenders to persist in using these devices. Furthermore, a judicial approach provides a remedy only after the fact, whereas the legislature can take preventative action that leads to more effective protection for borrowers.

The states are yet another victim in these schemes, however, as they are harmed by this disregard for the laws that they implemented to protect their citizens from predatory lending. Further, states have a long-established public policy interest in protecting the borrowers who live within their borders.[209] Accordingly, they should amend their con-

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205 *See Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace*, *supra* note 27, at 8.

206 *See, e.g.*, Martin, *supra* note 42, at 262; Bruch, *supra* note 18, at 1286–87.

207 *See supra* Part III.

208 *See* Marc P. Franson & Peter C. Manbeck, *Pa. Decision Highlights "True Lender" Risks*, LAW360 (Feb. 8, 2016, 10:36 AM), https://www.law360.com/articles/755023/pa-decision-highlights-true-lender-risks [https://perma.cc/RGD6-FZK2].

209 *See, e.g.*, Cedar Rapids Cellular Tel., L.P. v. Miller, 280 F.3d 874, 879–80 (8th Cir. 2002) ("The State of Iowa has an important interest in enforcing its consumer protection statutes."); Goleta Nat'l Bank v. Lingerfelt, 211 F. Supp. 2d 711, 716 (E.D.N.C. 2002) ("[T]he State does have a vital interest in protecting its citizens from predatory lending, usury, and other forms of deceptive trade practices."); Commc'ns Telesys. Int'l v. Cal. Pub. Utilities Comm'n, 14 F. Supp.

sumer protection statutes to prohibit these arrangements explicitly. The proposed amendment would expand the definition of lender to include "a person who arranges a loan and to whom the loan or a significant economic interest in the loan is subsequently transferred, except to the extent that such person is expressly exempted from the application of this statute by federal statutory law." This language renders these transactions illegal and balances the bank industry's competing interests. Section IV.A breaks the model statutory provision into its three components and explains the reasoning behind each one. Section IV.B pinpoints specific areas in existing state statutes where this model language can be adopted in whole or in part. Finally, Section IV.C argues that the proposed provision would not significantly interfere with a bank's exercise of its authority under the National Bank Act and, therefore, this solution adequately balances the banking industry's interests with the public interest in protecting borrowers from predatory lending.

A. A Model Statutory Provision with Three Essential Parts

Expanding the definition of a lender to include "a person who arranges a loan and to whom the loan or a significant economic interest in the loan is subsequently transferred, except to the extent that such person is expressly exempted from the application of this statute by federal statutory law" rejects the legal fiction presented on the face of the loan documents, renders these transactions illegal, and provides more support to consumer protection agencies and courts in enforcing state laws. Consequently, each phrase within this model statutory provision is designed to target an essential element of these schemes: first, to distinguish transactions for which the valid-when-made doctrine is better suited; second, to codify a version of the predominant economic interest test; and third, to explicitly exempt banks and Native American tribes from its scope.

1. Person Who Arranges a Loan

The concept of a "person who arranges a loan" relies on Judge Posner's explanation of the reasoning behind the valid-when-made doctrine.[210] Judge Posner stated that because a borrower had dealt with the bank directly and agreed to a certain interest rate, the borrower should not be allowed to challenge the terms of that loan after

2d 1165, 1171 (N.D. Cal. 1998) ("[T]he State of California has significant interests in protecting consumers within its borders from unfair business practices . . . .").

210 *See supra* Section II.A.1.

it is transferred to another party solely by reason of that transfer.[211] Consequently, in Judge Posner's opinion, the bank's right to export interest rates from its home state should continue to apply in those cases. If a nonbank lender, however, markets and arranges the terms of the loan, the exportation doctrine should not apply, even if a bank or a tribe is the nominal originator of the loan. For example, referring back to Ms. Schmitt's situation, she was granted the loan online by an alternative nonbank lender, and only through extensive research was she able to trace the loan back to a Native American tribe.[212] She therefore agreed to a loan marketed and arranged by an alternative nonbank lender, and she should be able to assume that her state's consumer protection laws apply to such a loan. By using the concept of a "person who arranges a loan," the proposed provision captures this distinction between arranger and originator and distinguishes the reasoning behind the valid-when-made doctrine.

2. *And to Whom the Loan or a Significant Economic Interest in the Loan Is Subsequently Transferred*

The proposed language is not a blanket inclusion of all loan arrangers because a key aspect of this solution is deterrence. The provision should, instead, strictly prohibit rent-a-bank and rent-a-loan arrangements. Naming the schemes directly would encourage lenders to contract around them, but defining specific characteristics of the schemes would clarify the prohibited behavior. Therefore, the second part of the model provision qualifies the term "person who arranges a loan" by adding the requirement that the "loan or a significant economic interest in the loan" be subsequently transferred to the arranger. This language captures two ideas: one is to include the subsequent transfer of the loan from the bank or tribal entity to the arranger, and the second is to capture the judicially developed predominant economic interest test, but with the broader qualifier of "significant" rather than "predominant," to ensure inclusion of all arrangements.

First, "the subsequent transfer" should be included to ensure that the essential aspects of the scheme are clearly described. Further, by capturing a transfer of either the loan or a significant economic interest in the loan, the proposed provision prevents lenders from structuring the transaction around a straight transfer of the loan. Otherwise,

211 *See* Olvera v. Blitt & Gaines, P.C., 431 F.3d 285, 289 (7th Cir. 2005); *supra* INTRODUCTION.

212 *See* Roebuck, *supra* note 1.

lenders would merely contract to receive a prearranged economic interest in the loan without actually transferring the title of the loan.

Second, the judicially created predominant economic interest test should be codified in the statutory language, dropping only the qualifier "predominant" in favor of "significant." The predominant economic interest test is preferable to the valid-when-made doctrine because it subjects the arrangements to close scrutiny and allows for judicial flexibility, preferring substance over form. The Eleventh Circuit in *Bankwest* and the Second Circuit in *Madden* declined to apply the valid-when-made doctrine to some loan assignments,[213] so there is support for codifying an alternative approach. The "predominant" qualifier, however, should be discarded because it allows nonbank lenders to contract around it by limiting the economic interest to under 50%. Therefore, the broader "a significant economic interest" makes it more difficult to structure the transaction around the law in a way that makes economic sense for the parties and would then have a much lower threshold of around 10–15%. In addition, as discussed in Section II.B, the predominant economic interest test has a two-part inquiry that should be applied by courts in future interpretations of the proposed statutory language. The two-part inquiry would require, first, that those alleging one of these schemes bring a case directly against the alternative lender, not the bank or Native American tribe and, second, that the court consider the totality of the circumstances in deciding whether the arrangement violates the statutory provision.

3. *Except to the Extent That Such Person Is Expressly Exempted from the Application of This Statute by Federal Statutory Law*

Finally, the phrase "except to the extent that such person is expressly exempted from the application of this statute by federal statutory law" would acknowledge preemption by the National Bank Act and recognize tribal sovereign immunity. Banks and Native American tribes are not widely involved in these sorts of transactions, but the impact of the few that are involved is significant. Thus, even though they are exempted from any liability under state law, the model provision should make it clear that enforcement actions may be brought against these transactions specifically. As a result, this solution deters bad actors from entering into these arrangements because being implicated in one of these schemes could damage the bank or tribe's repu-

213 *See* Madden v. Midland Funding, LLC, 786 F.3d 246, 251 (2d Cir. 2015); Bankwest, Inc. v. Baker, 411 F.3d 1289, 1299 (11th Cir. 2005); *supra* Section II.A.2.

tation. As a result, neither banks nor Native American tribes would likely protest because the reputational risk to both parties incentivizes them to step back and allow these provisions to be adopted.

As illustrated, each part of the model statutory provision serves an important purpose in deterring bad actors and supporting enforcement efforts. Nevertheless, not every state would need to adopt the solution proposed here in whole; some states may only need to amend part of an existing statute to close this loophole.

B. Examples of How to Adopt the Model Statutory Provision

Currently, 18 states and the District of Columbia have established usury laws prohibiting nonbank lenders from giving high-cost loans to borrowers within their borders.[214] A disadvantage of this solution is that it is not a silver bullet that, once adopted in one instance, would abolish these schemes nationwide. But uniform adoption is not necessary for the statutory provision to have some effect where it is adopted. Of course, the more states that do adopt it, the closer they will come to eradicating this practice completely. At the moment, states can be grouped into three categories: states with direct prohibitions already, states with indirect "loan arranger" statutes, and states without any indirect or direct prohibitions.

First, Georgia's laws already include a prohibition against these schemes, from which courts developed the predominant economic interest test.[215] If Georgia were to amend its statute, the state should consider dropping the "predominant" qualifier in favor of "significant," to capture transactions with more than 10–15% economic interest. West Virginia's laws also include a prohibition that "[a] regulated consumer lender shall not . . . [p]ay any fees, bonuses, commissions, rewards or other consideration to any person, firm or corporation for the privilege of using any plan of operation, scheme or device for the organization or carrying on of business under this article."[216] This prohibition is a roundabout way of prohibiting lenders from entering into a rent-a-bank or rent-a-tribe scheme. Even though the existing statute already addresses the "rent" aspect of these schemes, West Virginia

214 These states include Arizona, Arkansas, Colorado, Connecticut, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, South Dakota, Vermont, and West Virginia. *Legal Status of Payday Loans by State*, *supra* note 20.

215 *See* GA. CODE ANN. § 16-17-2(b)(4) (2018); Glenn v. State, 644 S.E.2d 826, 827 n.4 (Ga. 2007).

216 W. VA. CODE ANN. § 46A-4-110a(1)(b) (LexisNexis 2015).

should amend the statute to prohibit them more directly by adopting the proposed statutory provision.

The second category includes Colorado, Massachusetts, and New Hampshire, all of which incorporate "loan arranger" definitions in their consumer protection laws.[217] Consequently, these states would only need to amend their definition slightly to include the substance of such arrangements to target them more effectively. For example, Massachusetts's statute provides that "[a]ny person directly or indirectly engaging, for a fee, commission, bonus or other consideration, in the business of negotiating, arranging, aiding or assisting the borrower or lender . . . whether such loans are actually made by such person or by another party, shall be deemed to be engaged in the business of making small loans."[218] Although this provision includes loan arrangers under its purview, it could be improved by adding the proposed language to explicitly prohibit the use of these devices.

As for the final category, the remaining states and the District of Columbia would need to adopt the proposed statutory provision in full, either by extending their definition of "lender" or expanding their statute on prohibited practices. For example, Arizona and South Dakota could expand their definition of "lender" subject to their respective state credit services laws.[219] The Connecticut and Montana state legislatures could add this language to their list of prohibited acts.[220] And this model statutory provision could be affixed to the scoping provision of Pennsylvania's laws.[221] Each of these state statutes contain a section to which this language could be adopted in full to prohibit the use of these devices.

C. *Balancing of Interests*

A state-level solution is particularly effective at balancing the public interest in protecting borrowers with the bank industry's fear of a domino effect if a solution is implemented at the federal level. The

217 *See* COLO. REV. STAT. § 5-3.1-102(5)(a) (2017); MASS. ANN. LAWS ch. 140, § 96 (LexisNexis 2016); N.H. REV. STAT. ANN. § 399-A:1 (2017).

218 MASS. ANN. LAWS ch. 140, § 96.

219 *See* ARIZ. REV. STAT. ANN. § 6-601.5 (1999); S.D. CODIFIED LAWS § 54-4-36 (2017).

220 *See* CONN. GEN. STAT. ANN. § 36a-561 (West 2011); MONT. CODE ANN. § 31-1-703 (2017). Likewise, the North Carolina state legislature could append it as a subsection to their statute on "evasion," which attempts to prohibit acts that evade their laws, but which does not currently reference these schemes specifically. *See* N.C. GEN. STAT. § 53-166 (2017).

221 7 PA. STAT. AND CONS. STAT. ANN. § 6217 (West 1995). The language could also be added as another bullet point to New Jersey's statute on criminal usury, which begins with "[a] person is guilty of criminal usury when . . . " N.J. STAT. ANN. § 2C:21-19 (West 2015).

principal goal of this solution is to protect borrowers by deterring use of these devices and providing a tool to support enforcement efforts against bad actors. Conversely, the bank industry is primarily concerned with protecting the broad exercise of their powers under the National Bank Act. The proposed state provision would have only a limited effect on a bank's activities, in a very narrow area, in contrast to a theoretical parallel federal statute, which would apply in conjunction with the National Bank Act and therefore might broadly affect bank activities beyond the narrow scope of this proposed statutory provision. After all, even with the adoption of this language, the bank can still make the loans directly; other lenders are merely prevented from "renting" a bank charter for the purpose of making usurious loans. Consequently, the adoption of a statutory provision at the state level balances these interests, while prohibiting the use of these devices and protecting consumers.

The proposed statutory provision is designed to deter entry into these arrangements and to provide an enforcement mechanism for state consumer protection agencies, consumer protection organizations, and the affected borrowers. The 32 states that do not currently have an effective usury limit should strongly consider adopting one, as high-cost lending is highly destructive to borrowers, often trapping them in a cycle of debt. But, in the meantime, the other 18 states and the District of Columbia should incorporate this model statutory provision, in whole or in part, to end the use of schemes designed to cross state lines and circumvent their laws.

Conclusion

The long history of antiusury law demonstrates that the practice of lending at usurious interest rates is against the public interest. But, as a result of a trend towards deregulation, the United States has created a culture that allows lenders to take routine advantage of Americans at the bottom of the income ladder. Many states have tried and failed to protect consumers, while other states have bowed to corporate interests. Specifically, the patchwork system of state usury laws has created a gap that lenders are exploiting by using schemes involving the appropriation of a bank's charter or a Native American tribe's sovereign immunity. Barriers to a solution at the federal level are significant and unlikely to be solved in the near future. Therefore, resolution is left to the states to protect their citizens from attempts to bypass consumer protection laws. Courts have developed a judicial approach that subjects these arrangements to close scrutiny, but the cases that are brought come down to a choice between a bright-line rule—the valid-when-made doctrine—and a complicated and unclear test—the predominant economic interest test—where the bright-line rule benefits corporations at the expense of financially strapped Americans.

Alternative lenders have thus far managed to remain one step ahead of efforts to limit their activities and protect borrowers. And, as long as the gap between state regulation and federal law exists, many will find ways to exploit it. Accordingly, all states should take concrete steps to end these abusive practices and should adopt an amendment to their consumer protection laws that prohibits these schemes directly. The model statutory provision would expand the definition of "lender" to include "a person who arranges a loan and to whom the loan or a significant economic interest in the loan is subsequently transferred, except to the extent that such person is expressly exempted from the application of this statute by federal statutory law." This amendment would allow state consumer protection agencies and other consumer protection groups to enforce violations more effectively against bad actors and contribute to a nationwide termination of these schemes.