

# RENT-A-BANK: BANK PARTNERSHIPS AND THE EVASION OF USURY LAWS

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## ABSTRACT

*“Rent-a-bank” arrangements are the vehicle of choice for subprime lenders seeking to avoid state consumer protection laws. In a rent-a-bank arrangement, a nonbank lender contracts with a bank to make loans per its specifications and then buys the loans from the bank. The nonbank lender then claims to shelter in the bank’s federal statutory exemptions from state regulation. The validity of these arrangements is the most bitterly contested legal question in consumer finance.*

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

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

*Courts’ attempts to address such arbitrages have resulted in an unpredictable doctrinal muddle. This Article argues that the best approach to disaggregated lending is a presumption that the privileges*

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*of a banking charter do not extend beyond banks, coupled with an anti-evasion principle that looks to substance over form and captures rent-a-bank transactions based on derivatives rather than outright sales of loans. Such an approach would create greater certainty about the legality of transactions, while effectuating both state consumer protection laws and federal bank regulation policy.*

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## INTRODUCTION

How did a small business end up paying over 122 percent interest on a loan? Homes by DeRamo, a small, family-owned, Sarasota, Florida, construction business, needed cash in 2015 for operating expenses.<sup>1</sup> An outfit called World Business Lenders, LLC<sup>2</sup> offered a \$400,000 loan, but it required the business’s owners, Vincent and Tracy DeRamo, to personally guarantee the loan and pledge their home as collateral.<sup>3</sup> Florida’s usury law caps interest charges at an 18 percent annual rate.<sup>4</sup> So how was World Business Lenders able to charge over

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1. Complaint ¶ 7, *DeRamo v. World Bus. Lenders, LLC*, No. 8:17-cv-01435 (Fla. Cir. Ct. June 16, 2017) [hereinafter *DeRamo Complaint*].

2. For background on World Business Lenders, see Zeke Faux, *Wall Street Finds New Subprime With 125% Business Loans*, BLOOMBERG (May 22, 2014, 12:00 AM), <https://www.bloomberg.com/news/articles/2014-05-22/wall-street-finds-new-subprime-with-125-business-loans> [<https://perma.cc/G2UQ-BTTJ>].

3. *DeRamo Complaint*, *supra* note 1, ¶ 8. The DeRamos took out an initial three-hundred-day loan, *see id.* at 9, refinanced it with another three-hundred-day World Business Lenders loan (paying a 15 percent prepayment penalty), *see id.* at 55, and then took out a supplementary loan from World Business Lenders, *id.* ¶ 22.

4. FLA. STAT. § 687.02 (2021).

122 percent annually?<sup>5</sup> Because World Business Lenders had “rented” a bank.

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

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5. The loan documents, included as attachments to the complaint, all provide for a daily interest rate of between 0.331513939726 percent and 0.335945205479 percent. DeRamo Complaint, *supra* note 1, at 13, 55, 158. On an annualized simple interest basis with a 365-day year, this is between 121 percent and 122.6 percent. The DeRamos’ loans were only for three hundred days, however, so in their pleadings they annualized the ratio of finance charges to principal, which resulted in rates between 72 percent and 74 percent interest. DeRamo Complaint, *supra* note 1, ¶ 26.

6. Federal law does not exempt banks from state usury laws so much as provide a choice of law rule that enables banks to “export” the usury cap from their home state to other states. *See* 12 U.S.C. §§ 85, 1463(g), 1831d. This means that a bank based in a state with no usury cap is not subject to other states’ usury caps when it does business in those states. Florida law also specifically exempts banks from its usury laws. FLA. STAT. § 687.12 (2021).

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

8. Examples of other devices include high-cost lenders basing themselves offshore and claiming that foreign usury limits apply, *see, e.g.*, First Amended Complaint ¶ 7, Consumer Fin. Prot. Bur. v. NDG Fin. Corp., No. 15-cv-5211, 2016 U.S. Dist. LEXIS 177756 (S.D.N.Y. Dec. 2, 2016), or partnering with Native American tribes or tribal members and sheltering in tribal immunity, *see infra* Part III.B; Complaint at 3–5, FTC v. AMG Servs., Inc., No. 2:12-cv-00536, 2012 U.S. Dist. LEXIS 183159 (D. Nev. Dec. 28, 2012); First Amended Complaint ¶ 19, CFPB v. CashCall, Inc., No. 1:13-cv-13167 (D. Mass. Mar. 21, 2014).

9. Financial services firms refer to these relationships solely as “bank partnership” relationships. Critics use the term “rent-a-bank” to describe the relationship. Neither is a neutral term. “Rent-a-bank” may seem inflammatory, but the anodyne “bank partnership” masks the true nature of the relationship and effectively accedes to these arrangements’ legitimacy as a policy matter. Moreover, the contractual documents for these relationships often explicitly disclaim the existence of a partnership. *See, e.g.*, Elevate Credit, Inc., Registration Statement (Form S-1) Exhibit 99.1, § 18 (Nov. 9, 2015) [hereinafter Elevate Registration Statement] (“This Agreement is not intended to constitute, and shall not be construed to establish, a partnership or joint venture among any of the Parties.”); *id.* § 19(a) (“This Agreement will not create a joint venture, partnership or other formal business relationship or entity of any kind, or an obligation to form any such relationship or entity.”); Elevate Credit, Inc., Annual Report (Form 10-K) 791 (Feb. 2, 2019) [hereinafter Elevate 2019 Annual Report] (“Intent of the Parties . . . This Agreement will not create a joint venture, partnership or other formal business relationship or entity of any kind, or an obligation to form any such relationship or entity.”).

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

In a rent-a-bank arrangement, a nonbank contracts to buy loans that a bank has made for it on spec.<sup>10</sup> The nonbank then claims to shelter in the bank's exemption from state usury laws and other consumer protection laws, as well as the benefit of the choice-of-law provisions applicable to the bank.<sup>11</sup> And because the loan is not directly made by the nonbank, the nonbank claims that it is exempt from state licensure requirements for nonbank lenders.<sup>12</sup> In exchange for renting out its regulatory privileges, the bank collects a fee.<sup>13</sup>

In the case of Homes by DeRamo, World Business Lenders negotiated the loan terms,<sup>14</sup> but Bank of Lake Mills,<sup>15</sup> a tiny two-branch community bank in Wisconsin with no Florida presence, formally made the loan.<sup>16</sup> Within weeks of making the loans to the DeRamos' business, Bank of Lake Mills assigned the loans to World Business Lenders.<sup>17</sup> The assignment was signed on behalf of the bank by a Vice President of World Business Lenders with a power of attorney for the bank.<sup>18</sup> The documentation of the DeRamos' loan bears indicia that World Business Lenders was the intended assignee from the get-go: World Business Lenders' address appears in numerous places in the loan documentation,<sup>19</sup> and the loan documentation even provides for venue and enforcement in New York, where World Business Lenders was located at the time.<sup>20</sup>

The DeRamo case follows a pattern of other transactions undertaken by World Business Lenders with Bank of Lake Mills and a

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10. *Predatory Lender's Rent-a-Bank Scheme: What Is It and What Can We Do To Stop It?* RESPONSIBLELENDING.ORG, <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-rentabank-jan2020.pdf> [<https://perma.cc/W8BK-SW4E>].

11. *Id.*

12. *Id.*

13. *Id.*

14. DeRamo Complaint, *supra* note 1, ¶¶ 10, 18.

15. *Id.* ¶ 8.

16. *Locations*, BANK OF LAKE MILLS, <https://www.bankoflakemills.com/about-us/locations-hours> [<https://perma.cc/JCX2-3CDM>].

17. DeRamo Complaint, *supra* note 1, at 152, 182. World Business Lenders, LLC subsequently assigned the loans to a securitization vehicle called WBL SPE II, LLC, *id.* at 184, 187, a wholly owned subsidiary of World Business Lenders, LLC, that World Business Lenders uses to obtain financing, Verified Petition ¶¶ 2, 6, World Bus. Lenders, LLC v. Arena Ltd. SPV, LLC, No. 653229/2019 (N.Y. Sup. Ct. May 31, 2019).

18. DeRamo Complaint, *supra* note 1, ¶ 24.

19. *See, e.g., id.* ¶¶ 10, 18.

20. *Id.* at 17.

pair of other banks.<sup>21</sup> In other words, Bank of Lake Mills was little more than a front for World Business Lenders to evade state regulation.

The DeRamos challenged the loans as usurious.<sup>22</sup> Because of Bank of Lake Mills's involvement, World Business Lenders was able to respond that the loans' documentation provided that they would be governed by Wisconsin law, which has no usury rate for business loans, rather than Florida law.<sup>23</sup> As the bank's assignee, World Business Lenders claimed it could shelter in the bank's exemption from state usury laws.<sup>24</sup> What's more, because the DeRamos had defaulted on the loan, World Business Lenders sought to foreclose on their home in a counterclaim.<sup>25</sup>

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21. See, e.g., Class Action Complaint, Quantum-Mac Int'l, Inc. v. World Bus. Lenders, LLC, No. 1:20-cv-02353 (N.D. Ga. June 2, 2020) (recognizing Axos Bank, former BOFI Federal Bank, as rent-a-bank partner for World Business Lenders); Kaur v. World Bus. Lenders, LLC, 440 F. Supp. 3d 111, 116 (D. Mass. 2020) (recognizing BOFI Federal Bank as World Business Lenders' rent-a-bank partner); Verified Complaint, B&S Med. Supply, Inc., N.Y. v. World Bus. Lenders, LLC, No. 17-cv-03234-RMB (S.D.N.Y. May 2, 2017) (recognizing Liberty Bank, Utah, as rent-a-bank partner for World Business Lenders); Verified Complaint, World Bus. Lenders, LLC v. Queens Med. Servs., P.C., No. 600802/2016 (N.Y. Sup. Ct. Feb. 5, 2016) (detailing a loan made by Bank of Lake Mills on Mar. 10, 2015, and sold to World Business Lenders on March 16, 2015); Verified Complaint, World Bus. Lenders, LLC v. Michael's Landscaping Constr., LLC, No. 611675/2016 (N.Y. Sup. Ct. July 26, 2016) (describing a loan made by Bank of Lake Mills on December 9, 2015, and sold to World Business Lenders on December 14, 2015); Verified Complaint, World Bus. Lenders, LLC v. PM Recycling LLC, No. 509595/2016 (N.Y. Sup. Ct. June 6, 2016) (loan made by Bank of Lake Mills on November 26, 2014, and sold to World Business Lenders on December 2, 2014).

22. The DeRamos alleged that they were also told that their refinancing of the loan and a subsequent additional loan would be at 15 percent. DeRamo Complaint, *supra* note 1, ¶¶ 14, 22. The only 15 percent figure in the loan documents is for the prepayment premium. *Id.* at 13. While the interest rate was in fact disclosed in the DeRamos' actual loan agreement, it was in the form of a miniscule daily rate with twelve decimal places. *Id.* On the term sheet for the transaction, entitled "Business Loan Summary," no interest rate was quoted, only a total dollar figure for the interest charges. *Id.* at 9. The only number given as a percentage on the term sheet was the prepayment penalty—15 percent. *Id.* No annual percentage rate was ever given because as a business loan, the Truth in Lending Act's requirement of disclosure of the annual percentage rate, 15 U.S.C. § 1632, did not apply.

23. Defendants, World Business Lenders, LLC's and WBL SPE II, LLC's Answer, Defenses and Counterclaims at 6–7, DeRamo v. World Bus. Lenders, LLC, No. 8:17-cv-01435 (M.D. Fla. June 23, 2017).

24. *Id.*

25. *Id.* at 9–14.

The DeRamos' case ultimately settled privately,<sup>26</sup> but it is illustrative of a larger phenomenon in subprime lending. Rent-a-bank arrangements are common in online payday lending, consumer installment lending, “marketplace lending,” and subprime small business lending.<sup>27</sup> Moreover, rent-a-bank lending appears likely to expand in response to the tightening of state usury laws,<sup>28</sup> new federal regulations,<sup>29</sup> and signals that federal banking regulators will tolerate rent-a-bank relationships.<sup>30</sup>

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26. Mediator's Report, *DeRamo v. World Bus. Lenders, LLC*, 2017-CA-2438-NC (Fla. Cir. Ct. Dec. 26, 2017).

27. See *High-Cost Rent-a-Bank Loan Watch List*, NAT'L CONSUMER L. CTR., <https://www.nclc.org/issues/high-cost-small-loans/rent-a-bank-loan-watch-list.html?print=pdf> [<https://perma.cc/VU2V-CWBM>].

28. On October 10, 2019, California enacted the Fair Access to Credit Act (A.B. 539), which created a rate cap of 36 percent on loans between \$2,500 and \$10,000. See Bill Information for A.B. 539, CAL. LEGIS. INFO., [https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill\\_id=201920200AB539](https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=201920200AB539) [<https://perma.cc/5JYL-Z43U>]. Previously no rate cap had applied. In response, three nonbank fintech lenders, CURO, Elevate, and ENOVA, each indicated in an investor call that it was considering moving to the bank partnership model to avoid the usury cap:

California passed a law that caps interest rates on personal loans between \$2,500 and \$10,000 . . . . As a result, we will stop originating loans through a direct lending channel in California once the law goes into effect. However, we do not believe that it'll have a material impact on our business due to our diversified operating model and additional opportunities. One of those opportunities is to expand our underwriting and technology licensing to our three existing FDIC regulated bank partners in new geographies. In addition, we are continuously looking for additional banks that share our commitment to providing innovative consumer-focused products.

*Elevate Credit's (ELVT) Management on Q3 2019 Results - Earnings Call Transcript*, SEEKING ALPHA (Nov. 4, 2019, 4:06 PM), <https://seekingalpha.com/article/4302399-elevate-credits-elvt-management-on-q3-2019-results-earnings-call-transcript?part=single> [<https://perma.cc/Ry3K-WR6F>]; *Enova International (ENVA), Q3 2019 Earnings Call Transcript*, THE MOTLEY FOOL (Oct. 26, 2019, 12:23 AM), <https://bit.ly/3rSLg8l> [<https://perma.cc/GCB3-3H6X>] (“And instead of originating near-prime loans, we plan to market and provide underwriting services for national banks originating in California.”); *CURO Group Holdings Corp. (CURO) Q3 2019 Earnings Call Transcript*, MOTLEY FOOL (Oct. 25, 2019, 4:23 PM), <https://bit.ly/3pSHIXn> [<https://perma.cc/PK3J-HR6U>] (“[Analyst]: . . . [A]ssuming that you are successful at some point in potentially creating a substitute product with the bank in California, . . . how [should] we . . . think about the start-up process for that type of initiative? . . . [President & Chief Executive Officer]: . . . [W]e do have a signed agreement . . .”).

29. 12 C.F.R. §§ 7.1031, 7.4001, 160.110, 331.4(e) (2020).

30. The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency filed an amicus brief defending a rent-a-bank relationship. See Amicus Brief of the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency in Support of Affirmance and Appellee, *Rent-Rite Super Kegs W. Ltd. v. World Bus. Lenders, LLC* (*In re Rent-Rite Super Kegs W. Ltd.*), No. 1:19-cv-01552-REB, 2019 WL 4569774 (D. Colo. Sept. 10, 2019).

The potential expansion of rent-a-bank lending threatens to gut state consumer protection laws, such that one consumer group has called it “the biggest threat in decades to states’ historic power to prevent predatory lending.”<sup>31</sup> Yet rent-a-bank lending stands on an uncertain and contested legal foundation. A critical legal question remains unresolved: Can a nonbank that acquires a loan from a bank shelter in the bank’s exemption from state regulation? While this question applies first and foremost to usury laws, it also applies to other state laws regulating the substantive terms of loans and requiring nonbank lenders to be licensed and subject to state supervision.

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

Courts have split on the issue, which has arisen primarily in the context of usury laws. Some have followed the “valid-when-made” rule that holds that the nonbank can shelter in the bank’s usury law exemption if the bank was itself the original lender.<sup>32</sup> Others follow the “*Madden* rule,” from the Second Circuit’s 2015 decision in *Madden v.*

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31. NAT’L CONSUMER L. CTR., TESTIMONY OF LAUREN SAUNDERS NATIONAL CONSUMER LAW CENTER ON BEHALF OF ITS LOW INCOME CLIENTS BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE ON RENT-A-BANK SCHEMES AND NEW DEBT TRAPS: ASSESSING EFFORTS TO EVADE STATE CONSUMER PROTECTIONS AND INTEREST RATE CAPS 2 (2020), <https://bit.ly/2JJcDAx> [<https://perma.cc/A7DA5LZT>].

32. See, e.g., *Hudson v. ACE Cash Express, Inc.*, No. IP 01-1336-C H/S, 2002 U.S. Dist. LEXIS 11226, at \*9 (S.D. Ind. May 30, 2002); *Olvera v. Blitt & Gaines, PC*, 431 F.3d 285, 288 (7th Cir. 2005); *Phipps v. FDIC*, 417 F.3d 1006, 1013 (8th Cir. 2005); *Krispin v. May Dep’t Stores Co.*, 218 F.3d 919, 924 (8th Cir. 2000); *Munoz v. Pipestone Fin., LLC*, 513 F. Supp. 2d 1076, 1079 (D. Minn. 2007); *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359, 1364 (D. Utah 2014); *Rent-Rite Superkegs W., Ltd. v. World Bus. Lenders, LLC* (*In re Rent-Rite Superkegs W., Ltd.*), 603 B.R. 41, 60 (Bankr. D. Colo. 2019), *rev’d in part sub nom. Rent-Rite Super Kegs W. Ltd. v. World Bus. Lenders, LLC* (*In re Rent-Rite Super Kegs W. Ltd.*), No. 1:19-cv-01552-REB, 2019 WL 4569774 (D. Colo. Sept. 10, 2019); *Robinson v. Nat’l Collegiate Student Loan Tr.* 2006-2, No. 20-cv-10203-ADB, 2021 U.S. Dist. LEXIS 68342, at \*12–13 (D. Mass. Apr. 7, 2021); *Sims v. Opportunity Fin., LLC*, No. 20-cv-04730-PJH, 2021 WL 1391565, at \*5 (N.D. Cal. Apr. 13, 2021) (finding that because a bank was the lender of record, the loan was not subject to usury law). None of the cases prior to *Rent-Rite* actually invoked the valid-when-made rule. While some of these cases were addressing the question of complete preemption in the context of removal from state court, others were addressing substantive preemption in a merits context, but there is no indication that the analysis would be materially different. For an exhaustive doctrinal treatment of history of the valid-when-made rule, see the companion piece to this Article, Adam J. Levitin, *The Spurious Pedigree of the “Valid-When-Made” Doctrine*, 71 DUKE L.J. ONLINE (forthcoming 2022).

*Midland Funding, LLC*.<sup>33</sup> The *Madden* rule holds that the exemption is strictly limited to banks and not transferrable to nonbanks.<sup>34</sup> Yet others apply the “true lender” doctrine, which looks to whether the bank or the nonbank was the real party in interest in the transaction.<sup>35</sup>

Adding to the doctrinal confusion, two federal banking regulators have issued nonidentical rules that aim to codify valid-when-made.<sup>36</sup>

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33. *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

34. *See id.* at 253.

35. *See, e.g., Rent-Rite SuperKegs W. Ltd. v. World Bus. Lenders, LLC (In re Rent-Rite SuperKegs W. Ltd.)*, 623 B.R. 335, 342 (D. Colo. 2020) (remanding for true lender determination); *Dep’t of Ins. & Fin. Servs. v. Comdata Network, Inc.*, No. 17-003313, 2019 WL 3857904, at \*10 (Mich. Dep’t of Ins. & Fin. Servs. Aug. 7, 2019) (finding that the nonbank was the true issuer of a credit card program so the bank exception to state licensing requirements did not apply), *aff’d in part, rev’d in part sub nom. Comdata Network, Inc. v. Mich. Dep’t of Ins. & Fin. Servs.*, No. 19-747-AV (30th Jud’l Cir. Mich. May 19, 2020); *Fulford v. Marlette Funding, LLC*, No. 2017-CV-30376, 2019 WL 4451038, at \*5 (D. Colo. June 5, 2019); *Meade v. Avant of Colo., LLC*, 307 F. Supp. 3d 1134, 1150–52 (D. Colo. 2018); *CFPB v. CashCall, Inc.*, No. CV-15-7522-JFW, 2016 WL 4820635, at \*6 (C.D. Cal. Aug. 31, 2016) (applying the totality of the circumstances test to determine whether CashCall or Western Sky was the true lender); *CashCall, Inc. v. Md. Comm’r of Fin. Regul.*, 139 A.3d 990, 1005 (Md. Ct. App. 2016) (holding that a party that was the de facto lender was a “credit services” business subject to Maryland usury law); *Eul v. Transworld Sys.*, No. 15 C 7755, 2017 WL 1178537, at \*6 (N.D. Ill. Mar. 30, 2017); *Commonwealth v. Think Fin., Inc.*, No. 14-cv-7139, 2016 WL 183289, at \*11 (E.D. Pa. Jan. 14, 2016); *Cmty. State Bank v. Knox*, 523 Fed. App’x 925, 930 (4th Cir. 2013) (finding that state-law usury claims were not completely preempted by the FDIA merely because a state-chartered bank was the named lender); *Ubaldi v. SLM Corp.*, 852 F. Supp. 2d 1190, 1201 (N.D. Cal. 2012) (noting that, “where a plaintiff has alleged that a national bank is the lender in name only, courts have generally looked to the real nature of the loan to determine whether a non-bank entity is the de facto lender”); *CashCall, Inc. v. Morrissey*, No. 12-1274, 2014 WL 2404300, at \*1, \*7 (W. Va. May 30, 2014); *West Virginia v. CashCall, Inc.*, 605 F. Supp. 2d 781, 783 (S.D.W. Va. 2009); *Discover Bank v. Vaden*, 489 F.3d 594, 601, 603 n.9, 607 (4th Cir. 2007) (noting that the FDIA would apply only if the bank were the “real party of interest”), *rev’d on other grounds*, 556 U.S. 49 (2009); *Spitzer v. Cnty. Bank of Rehoboth Beach*, 846 N.Y.S.2d 436, 439 (N.Y. App. Div. 2007); *BankWest, Inc. v. Baker*, 411 F.3d 1289, 1299 (11th Cir. 2005) (upholding Georgia statute deeming a purported agent of a bank to be the de facto lender if it has the predominant economic interest), *reh’g granted, opinion vacated*, 433 F.3d 1344 (11th Cir. 2005) (en banc), *opinion vacated due to mootness*, 446 F.3d 1358 (11th Cir. 2006); *Easter v. Am. W. Fin.*, 381 F.3d 948, 957–59 (9th Cir. 2004) (applying true lender doctrine under Washington state law); *Krispin v. May Dep’t Stores*, 218 F.3d 919, 959 (8th Cir. 2000) (explaining that the close relationship between a bank and department store made the bank the real party in interest); *Glaire v. La Lanne-Paris Health Spa, Inc.*, 528 P.2d 357, 363 (Cal. 1974); *Daniel v. First Nat’l Bank of Birmingham*, 227 F.2d 353, 355 (5th Cir. 1955), *reh’g denied with opinion*, 228 F.2d 803 (5th Cir. 1956); *see also FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148 n.15 (5th Cir. 1981) (noting that there was no allegation that the assignee was the true lender and suggesting that analysis would be different if there were such an allegation).

36. *Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred*, 85 Fed. Reg. 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pts. 7 & 160) (codifying OCC valid-when-made rule); *Federal Interest Rate Authority*, 85 Fed. Reg. 44,146 (July 22, 2020) (to be codified at 12 C.F.R. pt. 331) (codifying FDIC valid-when-made rule). The finalized rules were

Further complicating the debate is that the doctrines affecting rent-a-bank relationships affect other transactions in which banks sell loans to nonbanks, particularly bank sales of defaulted loans to debt buyers and securitization.

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

Key parts of the financial regulatory system are entity-based. The entity-based system is binary: either an entity is a bank and subject to the pervasive oversight of bank regulation, or it is not. Such a binary system makes sense when the regulated economic activity corresponds neatly to entity type, but that is frequently no longer the case in consumer lending.

Lending involves several discrete activities: designing a credit product; marketing it and prospecting for borrowers; underwriting borrowers; funding the loan; servicing the loan; and holding the credit risk and interest rate risk. Historically, these activities were all aggregated in the same institution, typically a bank, that would design, market, underwrite, fund, service, and hold a loan until maturity. The bank would not only be the “nexus of contracts” for producing loans,<sup>37</sup>

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promptly challenged by a number of state attorneys general as failing to comply with the Administrative Procedure Act and, in the case of the OCC, with the procedural requirements of the National Bank Act. Complaint at 1–4, *Becerra v. Off. of the Comptroller of the Currency*, No. 20-cv-5200 (N.D. Cal. July 29, 2020); Complaint at 4–6, *Becerra v. FDIC*, No. 20-cv-5860 (N.D. Cal. Aug. 20, 2020). These challenges remain pending as of the date of this Article and are beyond the scope of this Article. The Office of Comptroller of the Currency also issued a rule that would overrule true lender doctrine by deeming a bank to be the lender for the purpose of usury laws for any loans it initially makes or funds. National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68,742 (Oct. 30, 2020) (to be codified at 12 C.F.R. pt. 7) (the “OCC True Lender Rule”). The OCC True Lender Rule was overturned by a joint resolution of Congress under the Congressional Review Act. S.J. Res. 15, Pub. L. No. 117-24, 135 Stat. 296 (2021).

37. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) (detailing the theory of the firm as a “nexus of a set of contracting relationships”); see also William W. Bratton, Jr., *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 415 (1989) (defining the “nexus of contracts” approach as indicating that “the firm is a legal fiction that serves as a nexus for a set of contracting relations among individual factors of production”); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1426 (1989) (describing the nexus of contracts theory as “a shorthand for the complex arrangements of many sorts that those who associate voluntarily in the corporation will work out among themselves”).

but all factors of production would be internal to the bank, rather than outsourced. The complete lending cycle existed in the bank.<sup>38</sup>

Over the past few decades, however, a new phenomenon has emerged in consumer lending: the different components of the lending cycle are split up and performed by multiple institutions, rather than by a single “lender.”<sup>39</sup> In this system, banks often play only a supporting role. While a bank might provide the initial funding for a loan, the underwriting, the servicing, and the holding of risk might all be performed by other entities, or the bank might perform some of these functions not as a principal in its own capacity, but as the agent for another party.

Sometimes, this disaggregation reflects the outcome of a make-or-buy decision for banks. The efficiency of outsourced production may exceed the efficiency of in-house production, such that vertical integration of production may not be optimal for a firm.<sup>40</sup> It may be cheaper, for example, for a bank to pay for a third party to provide a service than for the bank to produce the service itself. For example, it may make economic sense for a bank to hire a third party to market its loans.

Yet disaggregation may not merely reflect a bank outsourcing factors of production and thus acting as a buyer of externally produced factors of production. Instead, when lending is disaggregated, it may reflect a *nonbank* outsourcing factors of production and buying them

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38. The bank might farm out some functions to affiliated entities, but they were all within the same firm. See *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 262 N.W.2d 358, 359–60 (Minn. 1977) (describing the role played by a bank affiliate in soliciting applications for credit card lending).

39. “Disaggregation” of the lending function is a different phenomenon than the much-noted “disintermediation.” Disintermediation refers to the shift from relying on banks to intermediate between sources of capital and borrowers to other funding channels, such as securitization and money market mutual funds. See, e.g., Steven L. Schwarcz, *Regulating Shadow Banking*, 31 REV. BANKING & FIN. L. 619, 626–27 (2012) [hereinafter Schwarcz, *Regulating Shadow Banking*]; Zachary J. Gubler, *Regulating in the Shadows: Systemic Moral Hazard and the Problem of the Twenty-First Century Bank Run*, 63 ALA. L. REV. 221, 271 (2012); Steven L. Schwarcz, *Securitization, Structured Finance, and Covered Bonds*, 39 J. CORP. L. 129, 131–32 (2013). Whereas disintermediation refers to the funding channel for lending, disaggregation refers to a division of the components in the lending cycle. These components include the source of funding, but also marketing, underwriting, and servicing.

40. The classic explorations of make-versus-buy are R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937), and Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 *AM. ECON. ASS'N PAPERS & PROC.* 112 (1971).

from the bank, such that the bank is acting as a seller of regulatory privileges to the nonbank.

Either way, the upshot of the disaggregation of lending is that lending transactions often involve a mosaic of firms, some bank and some nonbank. The regulatory system, however, persists in a binary approach to regulation that enables transactions to claim bank treatment even when a bank is only minimally involved in a transaction. The entity-based regulatory system is thus vulnerable to regulatory arbitrages like rent-a-bank because the same type of transactions can be performed through a range of entities and entity combinations.

The rent-a-bank arbitrage is particularly appealing to subprime lenders because federal law effectively exempts banks from state usury laws without imposing an equivalent federal law. Federal law provides that banks are subject only to the usury law of their home state, no matter where they operate.<sup>41</sup> Because banks have substantial ability to choose their home state, by picking a favorable home state that allows bank loans to be at the contractually agreed upon rate (like Delaware,<sup>42</sup> Nevada,<sup>43</sup> South Dakota,<sup>44</sup> or Utah<sup>45</sup>), a bank can functionally be exempt from usury laws, no matter where it operates. Federal law lacks a generally applicable usury limitation,<sup>46</sup> and the Consumer Financial Protection Bureau is expressly forbidden from promulgating a federal usury regulation.<sup>47</sup>

The rationale behind the special treatment for banks is that they should not be saddled with the burden of complying with inconsistent state usury laws because they are already subject to a strict, bank-specific regulatory regime focused on ensuring banks' safety and soundness. A key feature of bank regulation is regulators' exercise of soft power through supervisory pressure. Regulators can use informal

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41. *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 301 (1978); 12 U.S.C. §§ 85, 1463(g)(1), 1831d.

42. DEL. CODE ANN. tit. 5, §§ 943, 953, 963, 965, 973 (2021).

43. NEV. REV. STAT. § 99.050 (2020).

44. S.D. CODIFIED LAWS § 54-3-1.1 (2021).

45. UTAH CODE ANN. § 15-1-1 (LexisNexis 2021).

46. The Military Lending Act caps the interest rate on certain loans made to military members and their dependents. *See* 10 U.S.C. § 987(b) (mandating a 36 percent military APR limit). Additionally, there is a usury cap for federal credit unions. 12 U.S.C. § 1757(5)(A)(vi) (mandating a 15 percent usury cap for federal credit unions, temporarily increasable by regulation).

47. 12 U.S.C. § 5517(o).

moral suasion through the oversight process to ensure that banks will not make excessively risky loans<sup>48</sup> and can, if needed, back up such suasion with cease and desist orders for unsafe banking practices.<sup>49</sup> Riskier loans generally have high interest rates to compensate for the risk.<sup>50</sup> Thus, by preventing banks from making risky (and therefore high-cost) loans, the bank regulatory system is assumed to compensate or substitute for usury laws.<sup>51</sup>

The problem with this assumption is that even if borrower default rates are high, they can be offset by recoveries from high interest rates, such that a diversified portfolio of high-risk and high-rate loans can be profitable and therefore actually enhance bank safety and soundness. Thus, banking regulators are unlikely to use their soft supervisory power to stop high-cost lending solely on the basis of the loans' price. Diversification, however, mitigates the risk on high-cost loans to the bank, but not to individual borrowers. By definition, a set of consumers will default and the losses from those defaults will be offset by the higher charges paid by other borrowers, meaning that both groups of borrowers suffer: one from the consequences of default, the other from higher borrowing costs. Consumer protection is actually in tension with safety and soundness because limiting high-cost lending can limit bank profitability.

This Article relates to two separate areas of the financial regulation literature. First is the literature about the regulation of “shadow banks”—nonbank entities that perform the same functions as banks, but outside the bank regulatory regime.<sup>52</sup> As bank-type

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48. This supervisory guidance is not legally binding, but it functions as law in that banks will almost always follow the guidance lest they antagonize their regulator. *See Guidance, Supervisory Expectations, and the Rule of Law: How Do the Banking Agencies Regulate and Supervise Institutions?: Hearing Before the S. Comm. on Banking, Hous., and Urb. Affs.*, 116th Cong. 44 (2019) [hereinafter *Tahyar Testimony*] (written testimony of Margaret E. Tahyar).

49. 12 U.S.C. § 1818(b)–(c).

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

51. *See, e.g.*, National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 44,223, 44,227 (July 22, 2020) (to be codified at 12 C.F.R. pt. 7) (listing a range of other federal regulations unrelated to the cost of a loan as allaying concerns about predatory lending).

52. *See generally, e.g.*, MORGAN RICKS, *THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION* (Univ. of Chicago Press 2016) [hereinafter RICKS, *THE MONEY PROBLEM*] (describing “the structure of monetary institutions” and arguing that the “existing monetary framework is outdated and defective”); David Min, *Housing Finance Reform and the Shadow Money Supply*, 43 IOWA J. CORP. L. 899 (2018) (providing an overview of the historical importance of housing finance liabilities for the U.S. money supply and reviewing the housing reform debate

activities expand outside of the confines of the bank-based regulatory system, the result has been unregulated financial markets that reproduce the very risks that bank regulation meant to shield against. The shadow banking literature, which emerged after the 2008 financial crisis, has focused on wholesale markets such as money market mutual funds, repurchase agreements (repos), credit derivatives, and securitization and is primarily concerned with the systemic risks shadow banking poses to the overall financial system.<sup>53</sup>

This Article extends the shadow banking literature into the retail markets of consumer finance. In retail markets the risk posed by shadow banking is primarily not to systemic stability, but to consumer protection laws through abuse of federal preemption of state law. In consumer finance, however, shadow banking operates with a twist.

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on safe assets and money supply); Kathryn Judge, *Information Gaps and Shadow Banking*, 103 VA. L. REV. 411 (2017) (examining the effect of information-related incentives on banking and securities regulation and arguing that information gaps are sources of systemic risk in shadow banking); Iris H-Y Chiu, *Transcending Regulatory Fragmentation and the Construction of an Economy-Society Discourse: Implications for Regulatory Policy Derived from a Functional Approach to Understanding Shadow Banking*, 42 IOWA J. CORP. L. 327 (2016) (discussing the limitations and optimal use of a functional approach to shadow banking); Anna Gelpern & Erik F. Gerding, *Inside Safe Assets*, 33 YALE J. ON REG. 363 (2016) (providing an overview of safe assets and highlighting market instability deriving from the legal fiction of “risk-free” contracts); Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. CHI. L. REV. 357 (2016) (reviewing government interventions facilitating various shadow banking products and arguing for the withdrawal of government support and subsidization of the shadow banking system); David Min, *Understanding the Failures of Market Discipline*, 92 WASH. U. L. REV. 1421 (2015) (arguing that market discipline should be most effective in the shadow banking sector, while outlining the times in which market discipline has failed); Chrystin Ondersma, *Shadow Banking and Financial Distress: The Treatment of “Money-Claims” in Bankruptcy*, 2013 COLUM. BUS. L. REV. 79 (arguing that current bankruptcy rules increase the unique risks associated with money claims in the shadow-banking sector and that rules should be adjusted to give money claimants more options for prompt payment); Jonathan Macey, *It’s All Shadow Banking, Actually*, 31 REV. BANKING & FIN. L. 593 (2012) (arguing that shadow banking is functionally the same as traditional banking and that regulation should address excessive risk-taking in both traditional and shadow banking); Morgan Ricks, *Money and (Shadow) Banking: A Thought Experiment*, 31 REV. BANKING & FIN. L. 731 (2012) (arguing that by viewing shadow banking as a monetary phenomenon, one can raise questions about why other monetary systems have state regulation while this one does not); Stephen L. Schwarcz, *Regulating Shadow Banking*, 31 REV. BANKING & FIN. L. 619 (2012) (exploring how to regulate shadow banking to minimize systemic risk and maximize economic efficiency through correcting four types of market failures: information failure, rationality failure, principal-agent failure, and incentive failure); Erik F. Gerding, *The Shadow Banking System and Its Legal Origins* (Aug. 23, 2011) (unpublished manuscript), <https://ssrn.com/abstract=1990816> [<https://perma.cc/ZK5C-CXWV>] (providing an overview of shadow banking and the effect of regulatory arbitrage).

53. See, e.g., RICKS, *THE MONEY PROBLEM*, *supra* note 52 *passim*; Gelpern & Gerding, *supra* note 52, at 409 (“The [shadow banking] paradigm entrenches discontinuity between markets, actors, and transactions on opposite sides of the [regulatory] perimeter.”).

Instead of nonbanks avoiding federal banking regulation while performing bank functions, in consumer finance, nonbanks also pretend to be banks to evade state regulation.<sup>54</sup>

The other related literature is about the problems that have arisen from federal preemption of state consumer financial protection laws, particularly state usury laws, without the substitution of equivalent federal protections.<sup>55</sup> Most of the preemption literature predates the

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54. Other methods of achieving similar ends are obtaining an industrial loan company charter or the new “fintech” charter offered by the Office of Comptroller of the Currency. These methods both bring with them federal safety and soundness regulation, either by virtue of FDIC insurance for industrial loan companies or OCC chartering.

55. See generally Roderick M. Hills, Jr., *Exorcising McCulloch: The Conflict-Ridden History of American Banking Nationalism and Dodd-Frank Preemption*, 161 U. PA. L. REV. 1235, 1277–87, 1298–99 (2013) (arguing that the OCC’s preemption policy, which overrides bank-specific state statutes yet preserves state common law rules that affect banking policies, creates disharmony and allows the banks to self-regulate in areas where state law is preempted); Carliss N. Chatman, *HOLA Preemption and the Original Intent of Congress: Are Federal Thrifts Necessary To Stabilize the Housing Market?*, 18 FORDHAM J. CORP. & FIN. L. 565 (2013) (arguing that the federal Homeowner Loan Act’s preemption of state banking regulations not only worsened the 2008 market collapse, but also continue to negatively interfere with states’ rights and homeowner “access to justice”); Raymond Natter & Katie Wechsler, *Dodd-Frank Act and National Bank Preemption: Much Ado About Nothing*, 7 VA. L. & BUS. REV. 301 (2012) (contending that the Dodd-Frank Act’s impact on preemption of state law is immaterial); Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143 (2009) [hereinafter Levitin, *Hydraulic Regulation*] (arguing that because the majority of consumer debt is in the hands of secondary-market entities which are not protected by federal preemption, states are able to regulate federally chartered banks indirectly); Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110 (2008) (analyzing state usury laws and arguing that the methodology states use to calculate price caps is so varied that it makes compliance with both federal and state law difficult); Howell E. Jackson & Stacy A. Anderson, *Can States Tax National Banks To Educate Consumers About Predatory Lending Practices?*, 30 HARV. J.L. & PUB. POL’Y 831 (2007) (noting that the preempted ability of states to directly regulate residents’ financial activities has led to novel legislative proposals, including taxing certain problematic consumer loans to fund state financial literacy programs); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1 (2005) (analyzing the current state of predatory lending law and arguing progressive state solutions to the problem are being preempted by deregulatory federal law passed in the name of national uniformity); Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518 (2004) (arguing that expansion of the exportation doctrine—which allows a depository institution chartered in one state to charge interest rates permitted under the law of that state to borrowers in other states, including states under whose law those rates are not permitted—has undermined state consumer protection laws); Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1 (2002) (arguing that federal legislation is necessary to prevent “rent-a-bank” schemes in which predatory lenders partner with national banks to use preemption to evade state-mandated interest limitations); Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About*

2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, which substantially transformed legal standards for preemption,<sup>56</sup> but a sizeable literature has since specifically focused on the *Madden* case.<sup>57</sup>

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*the Role of Usury Laws in Today's Society*, 51 S.C.L. REV. 589 (2000) (explaining that federal law enables national banks to evade state usury laws by allowing them to export the regulations of their home state nationwide as a form of federal preemption).

56. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, § 1045, 124 Stat. 1376, 2014–15 (codified at 12 U.S.C. § 25b).

57. See Christopher K. Odinet, *Predatory Fintech and the Politics of Banking*, 106 IOWA L. REV. 1739, 1793 (2021) (noting how the *Madden* decision triggered regulatory interventions); Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477, 532–34 (2020) (questioning the historicity of the doctrine and the “vital importance” of valid-when-made for fintech companies); Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093, 1113–17 (2019) (taking a neutral position on the historicity of the valid-when-made doctrine while noting the detrimental effects it can have on low-income consumer loan customers); Jayne Munger, Note, *Crossing State Lines: The Trojan Horse Invasion of Rent-a-Bank and Rent-a-Tribe Schemes in Modern Usury Law*, 87 GEO. WASH. L. REV. 468, 488–89 (2019) (disagreeing with the application of the valid-when-made doctrine in *Madden*); Christopher Baiamonte, Note, *Stopping Third-Party Debt Buyers From Using National Bank Act Preemption To Dodge State Usury Laws*, 69 SYRACUSE L. REV. 127, 150 (2019) (questioning the relevance of valid-when-made because of transactional dissimilarities and the *Erie* doctrine disavowing general federal common law); John Hannon, Note, *The True Lender Doctrine: Function Over Form as a Reasonable Constraint on the Exportation of Interest Rates*, 67 DUKE L.J. 1261, 1266–71 (2018) (agreeing with the historicity of valid-when-made); Lenore Palladino, *Small Business Fintech Lending: The Need for Comprehensive Regulation*, 24 FORDHAM J. CORP. & FIN. L. 77, 97 n.127 (2018) (agreeing, in a footnote, with the historicity of the valid-when-made doctrine); Piotr Danisewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy passim* (July 5, 2018) (unpublished manuscript), <https://ssrn.com/abstract=3208908> [<https://perma.cc/JY2E-X2SA>] (providing an empirical study on the impact of the *Madden* decision credit availability and bankruptcy filings); Daniel Kaplan, Note, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015): *The Second Circuit Threatens To Disrupt Capital Markets*, 8 NEB. L. REV. BULL. 1, 3 (2017) (agreeing with the historicity of valid-when-made); Colleen Honigsberg, Robert J. Jackson, Jr. & Richard Squire, *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & ECON. 673, 691–709 (2017) (reporting results of an empirical study on the impact of the *Madden* decision on the discount of notes and on credit availability); Brian Knight, *Federalism and Federalization on the Fintech Frontier*, 20 VAND. J. ENT. & TECH. L. 129, 145 (2017) (agreeing with the historicity of the valid-when-made doctrine, describing it as “one of ‘two cardinal rules in the doctrine of usury’” (quoting *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833))); 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, 26 (2017) (accepting of the historicity of valid-when-made, describing it as “a valid and dependable legal principle for loan origination, sales, and securitization markets”); Angel Rzeslawski, Note, *The National Bank Act and the Demise of State Consumer Laws*, 68 HASTINGS L.J. 1421, 1437 (2017) (accepting the valid-when-made doctrine, but noting that other circuits follow the Second Circuit’s lead); Andrew Silvia, Note, *Madden v. Midland Funding LLC: Uprooting the National Bank Act’s Power of Preemption*, 92 CHI.-KENT L. REV. 653, 660 (2017) (agreeing with, and extolling, the historicity of valid-when-made as a cardinal rule of usury law); Zachary Adams Mason, Note, *Online Loans Across State Lines: Protecting Peer-to-Peer Lending Through the Exportation Doctrine*, 105 GEO. L.J. 217, 240 (2016) (agreeing with the historicity of

This Article proceeds in five parts. Part I reviews the status of banks and nonbanks under state usury laws. It shows how banks have been effectively exempted from state usury laws, whereas nonbanks remain subject to them. It also shows how consumer lending has become disaggregated over the past several decades with different components of a single lending transaction being handled by different institutions. In disaggregated lending, nonbanks often work in tandem with banks, but the regulatory system is still based on the binary divide between banks and nonbanks.

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

Part III presents a case study of the state-of-the-art rent-a-bank arrangements used by Elevate Credit, Inc., a subprime fintech lender. This section is the first detailed profile of a fintech lender in the scholarly literature.<sup>58</sup> The case study underscores the replication of the

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valid-when-made); Michael Marvin, Note, *Interest Exportation and Preemption: Madden's Impact on National Banks, the Secondary Credit Market and P2P Lending*, 116 COLUM. L. REV. 1807, 1832–35 (2016) (claiming that *Madden* ignores Supreme Court precedent on valid-when-made); Kevin Petrasic, Helen Lee & Katherine Lamberth, *Solicitor General in Madden Supports, But Fails To Ensure, the Application of Federal Preemption Doctrine to the Secondary Loan Market and Fate of "Valid-When-Made" Principle*, 29 J. TAX'N & REGUL. FIN. INST. 42, 44 (2016) (agreeing with the historicity of valid-when-made, describing it as "well-established"); Kirby M. Smith, Comment, *Banking on Preemption: Allowing National Bank Act Preemption for Third-Party Sales*, 83 U. CHI. L. REV. 1631, 1670 (2016) (accepting valid-when-made as a historical doctrine, but stating that context makes older cases merely persuasive, not binding).

58. A small literature has emerged about fintech in the consumer finance space, but it does not include a detailed examination of the contractual structure of any fintech lending operation. See generally Matthew Adam Bruckner, *Preventing Predation and Encouraging Innovation in Fintech Lending*, 72 CONSUMER FIN. L.Q. REP. 370 (2019) (providing background information on fintech lending, but focusing on how state and federal regulators can reduce the potentially discriminatory consequences of fintech lending); Matthew Adam Bruckner, *The Promise and Perils of Algorithmic Lenders' Use of Big Data*, 93 CHI.-KENT L. REV. 3, 37 (2018); Matthew A. Bruckner, *Regulating Fintech Lending*, 37 BANKING & FIN. SERVS. POL'Y REP. 1 (2018) (explaining fintech lending and cautioning against the restriction of innovation by fintech regulators); Christopher K. Odinet, *Consumer Bitcredit and Fintech Lending*, 69 ALA. L. REV. 781 (2018) (exploring the operations and offerings of fintech lenders from a market perspective, and offering commensurate regulatory recommendations); Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232 (2018); Robert P. Bartlett, Adair Morse, Richard Stanton & Nancy Wallace, *Consumer-Lending Discrimination in the Fintech Era* (NBER, Working Paper No. 25943, 2019), <http://www.nber.org/papers/w25943> [<https://perma.cc/68S8-KSR6>] (finding that algorithmic consumer lending reduces, but does not eliminate, discriminatory consumer loan pricing); Anupam Chander, *The Racist Algorithm?*, 115 MICH. L.

firm via contract in rent-a-bank schemes, the high level of transactional sophistication used for little purpose other than evasion of usury laws, and the ability of nonpublic firms to entirely mask the existence of a rent-a-bank arrangement simply by using derivative contracts rather than outright loan sales.

The remainder of this Article turns to the hotly contested doctrinal status of rent-a-bank transactions. Part IV lays the ground by reviewing the *Madden* litigation where the issue came to a head. It presents the valid-when-made doctrine, the *Madden* rule, and true lender doctrine as three different approaches to the question taken by courts and regulatory agencies. The doctrinal confusion in this area reflects courts' difficulty in reconciling an institution-based regulatory system with the reality that lending transactions are often disaggregated with a range of institutions handling different transactional components.

Part V turns to a normative consideration of the policy trade-offs among the doctrinal approaches. This Article argues that the best approach, as a matter of consumer protection policy and bank regulatory policy, is the institutional identity presumption of the *Madden* rule, buttressed by the anti-evasion principle evinced by the true lender doctrine. The *Madden* rule prevents a regulatory vacuum and has substantial administrability and certainty benefits, while the anti-evasion principle protects against sophisticated transactional attempts to evade the *Madden* rule through derivative transactions such as those illustrated by the Elevate Credit case study. In order to effectuate application of the anti-evasion principle, banks seeking to enforce loans in court should be required to disclose any transfer of an economic interest in such loans to nonbanks.

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REV. 1023 (2017) (discussing the effect of algorithmic decision-making on discriminatory outcomes); Frank Pasquale, *Democratizing Higher Education: Defending and Extending Income Based Repayment Programs*, 28 LOY. CONSUMER L. REV. 1 (2015) (arguing for lower interest rates and more generous debt forgiveness in the reauthorization of the Higher Education Act). A contemporary article by Christopher K. Odet, *Predatory Fintech and the Politics of Banking*, 106 IOWA L. REV. 1739 (2021), contains an extended consideration of the structure of rent-a-banks, including a high-level case study of Elevate Credit that relies on Elevate's 10-K, rather than the underlying contracts and does not track the evolution of Elevate from an online payday lender into a fintech firm, *see id.* at 1760–65.

## I. THE DISAGGREGATION OF CONSUMER LENDING

Usury laws have been the cornerstone of consumer financial protection in America since colonial times.<sup>59</sup> Every state has a usury statute of some sort that caps the level of charges on a loan.<sup>60</sup> These statutes vary considerably in their design and application, with some covering only interest, and others extending to various types of loan charges.<sup>61</sup> Many states have different limitations for different types of loan products or different types of lenders and borrowers. Thus, the permitted rate on payday loans or other small-dollar loans might be different than that for auto loans or for installment loans, the permitted rate might be different for banks than for nonbanks, or the permitted rate might be different for consumers than that for businesses.

This Part briefly reviews the function of usury laws as a borrower protection, before turning to a history of the unraveling of bank usury laws in the United States. It then considers how the various components of consumer lending have become increasingly disaggregated institutionally and how this structure has interfaced with the entity-based structure of usury laws.

### A. Functions of Usury Laws

Usury laws are fundamentally a borrower protection, even though they can protect a reckless lender as well. Usury laws also paternalistically intervene in freedom of contract by creating an irrebuttable presumption that the conditions necessary for efficient Coasean bargaining could not have existed if the interest rate in a contract is above the specified usury level. This presumption protects

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59. See Drysdale & Keest, *supra* note 55, at 604 (“Usury laws are, at core, the earliest form of consumer protection law.”).

60. See *50-State Survey of Consumer Finance Laws*, CONF. OF STATE BANK SUPERVISORS (Nov. 19, 2020), <https://www.csbs.org/50-state-survey-consumer-finance-laws> [<https://perma.cc/2GY8-VAUE>].

61. See *generally id.* (offering an interactive map summarizing usury laws for each state). For purposes of this Article, I refer to all manner of regulated charges on a loan as “interest.” State laws vary considerably in how they define such charges. Some refer to “interest,” which is not always defined. See, e.g., ARK. CONST. amend. 89, § 3; N.Y. GEN. OBLIG. LAW § 5-501(1) (McKinney 2021). Others use the federal Truth-in-Lending Act (“TILA”) terminology of “finance charge,” see, e.g., COLO. REV. STAT. §§ 5-1-301(20), 5-2-201 (2021), while others include charges that lie outside that of the TILA “finance charge,” but which might be within the ambit of the federal Military Lending Act’s broader definition of “annual percentage rate,” see, e.g., 815 ILL. COMP. STAT. 122/2-5(e-5) (2021).

borrowers from lender market power and informational asymmetries, and it helps prevent negative externalities from overindebtedness.

Usury laws shield borrowers from situations in which the lender has market power. Such market power might be due to limited or imperfect competition.<sup>62</sup> Alternatively, the lender's market power might also stem from the consumer's financial duress or misperception of limited credit options. If a consumer needs funds immediately or if a consumer thinks that he is such a poor credit risk that he is lucky that anyone will lend to him, then the consumer might simply take the first offer available and not shop for better terms.

Additionally, usury laws protect consumers from lenders taking advantage of informational asymmetries and behavioral biases. A consumer might fail to understand a deal because of misinformation or a cognitive limitation. Or a consumer might simply be unduly optimistic about repayment possibilities.

Usury laws protect not just consumers themselves, but also third parties from negative externalities of overindebtedness. To the extent that a usurious interest rate leads a consumer to get stuck in a debt trap, such that the consumer is spending all disposable income on debt service, rather than on other investments, it may harm the consumer's dependents and ultimately the public fisc if it results in the consumer becoming a public charge.<sup>63</sup>

While usury laws prevent lenders from exploiting market power or informational and cognitive problems and may also reduce negative externalities of overindebtedness, they also restrict credit to a subset of borrowers who, because of their riskiness, cannot obtain credit at nonusurious rates. Indeed, the typical neoclassic economic analysis of usury regulations is that they merely cut riskier borrowers out of the market, which may actually be detrimental to those would-be

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62. Such limited competition might be a function of market structure, such as situations where lenders compete for a loan broker's business, not the borrower's business directly. That is the situation in indirect auto lending, Adam J. Levitin, *The Fast and Usurious: Putting the Brakes on Auto Lending Abuses*, 108 GEO. L.J. 1257, 1319 (2020) [hereinafter Levitin, *The Fast and Usurious*], online lending through lead generators, Adam J. Levitin, *Led Down the Financial Garden Path 2* (May 15, 2020) (unpublished manuscript) (on file with author), and was historically the situation with mortgage loan brokers and yield spread premium compensation, Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 297 (2007).

63. Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom To Contract*, 24 J. LEGAL STUD. 283, 301–02 (1995).

borrowers' welfare.<sup>64</sup> Usury laws might also fairly be critiqued as arbitrary in regard to the specific interest rate that triggers the presumption of unreasonable advantage taking and as poorly tailored, given that they are one-size-fits-all for consumers. Some consumers may be able to responsibly assume greater risk than others because of their greater resources or sophistication.

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

### B. *Marquette and the Race to the Bottom*

While state usury laws were the traditional bulwark of consumer credit protection, they were substantially undermined in the 1970s and 1980s by a U.S. Supreme Court decision that set off a legislative race to the bottom. Usury deregulation started with banks. Banks are either federally chartered (national banks) or state chartered (state banks) and are governed by different laws. In 1978, in *Marquette National Bank v. First of Omaha Service Corporation*,<sup>65</sup> the Supreme Court held that under section 85 of the National Bank Act,<sup>66</sup> a national bank was allowed to export the interest rate allowed in its "home" state to other states in which it did business.<sup>67</sup> Thus, when a Nebraska-based national

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

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

66. 12 U.S.C. § 85.

67. *Marquette Nat'l Bank*, 439 U.S. at 301. Technically, banks can export the greater of the maximum rate allowed in the state in which the bank is "located" or 1 percent of the applicable Federal Reserve ninety-day commercial paper rate. 12 U.S.C. § 85. Subsequent OCC opinion letters interpreted the "location" of a national bank for the purposes of section 85 as being the state of whatever branch of the bank had the closest nexus to the loan, rather than being the state where the national bank is located on its charter certificate or where its main office is located. See Off. of the Comptroller of the Currency, OCC Interpretive Letter 686 (Sept. 11, 1995), as reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-001; Off. of the Comptroller of the Currency, OCC Interpretive Letter 707 (Jan. 31, 1996), as reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-022; Off. of the Comptroller of the Currency, OCC Interpretive Letter 782 (May 21, 1997), as reprinted in [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) P 81-209; Off. of the Comptroller of the Currency, OCC Interpretive

bank made loans in Minnesota, it was still subject to the Nebraska usury cap rather than the lower Minnesota usury cap.

The effect of the *Marquette* ruling is frequently referred to by the shorthand of federal “preemption” of state usury laws, but as a technical matter, that is inaccurate. *Marquette* did not void state usury laws, which remained effective for all entities other than national banks located in other states. Rather, it created a federal choice-of-law rule regarding which state’s usury law would apply to a national bank doing out-of-state business.<sup>68</sup>

National banks’ newfound ability to export their home state’s usury rate to other states gave national banks a substantial competitive advantage over state-chartered banks, particularly in the high interest rate environment of the late 1970s and early 1980s, when prime interest rates veered close to or even over some state usury caps.<sup>69</sup> Among the highest rate bank credit products are credit cards, so, unsurprisingly, national banks with major credit card lending operations began relocating to states with no or lax usury laws to take advantage of the *Marquette* decision.<sup>70</sup> These banks relocated (or created credit card-issuing national bank subsidiaries) to Delaware, South Dakota, Utah, and Nevada—states that permitted whatever interest rate the parties agreed to by contract.<sup>71</sup> By 1988, eighteen states had removed interest rate ceilings for bank transactions.<sup>72</sup>

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Letter 822 (Feb. 17, 1998), as reprinted in [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) P81-265 (“[A]n interstate national bank may be ‘located’ for purposes of section 85 in both its home state and its host state or states.”); Off. of the Comptroller of the Currency, OCC Interpretive Letter 1171 (June 1, 2020), <https://bit.ly/2LeIbQd> [<https://perma.cc/AN83-Q3YS>].

68. As a sign of the doctrinal confusion, section 27 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831d, a parallel provision to section 85 of the National Bank Act, adopted in 1980 in the wake of *Marquette* provides that state constitutions and statutes to the contrary are “preempted for the purposes of this section.” 12 U.S.C. § 1831d(a).

69. See Donna C. Vandenbrink, *Usury Ceilings and DIDMCA*, FED. RSRV. BANK CHI. ECON. PERSPS., Sept./Oct. 1985, at 25, 27.

70. ADAM J. LEVITIN, CONSUMER FINANCE: MARKETS AND REGULATION 468–69 (2018) [hereinafter LEVITIN, CONSUMER FINANCE].

71. See *supra* notes 42–45; cf. Robin Stein, *The Ascendancy of the Credit Card Industry*, FRONTLINE (Nov. 23, 2004), <https://to.pbs.org/3rRU5iK> [<https://perma.cc/AM7R-28AP>] (explaining how the rise of credit cards motivated some banks to relocate to South Dakota to avoid New York’s usury laws).

72. Randall S. Kroszner & Philip E. Strahan, *Regulation and Deregulation of the US Banking Industry: Causes, Consequences, and Implications for the Future*, in ECONOMIC REGULATION AND ITS REFORM: WHAT HAVE WE LEARNED? 503 (Nancy L. Rose ed., 2014).

*Marquette* governs only national banks, but in 1980, Congress passed a federal parity statute that gave all state banks treatment equal to national banks, unless a state chose to opt out of the provision.<sup>73</sup> The federal parity law only allowed state banks to export their home state's usury limit, not to match the imported limit allowed for out-of-state banks.<sup>74</sup> To wit, if Illinois had an 8 percent usury limit, an Illinois-chartered bank could charge 8 percent in Illinois or in Michigan, even if Michigan had a 6 percent usury rate. But a national bank based in Indiana, which has a 12 percent usury limit, could charge 12 percent in either Illinois or Michigan. Thus, under the federal parity statute, the Illinois state bank would remain at a competitive disadvantage to the Indiana-based national bank.

States responded to protect their state-chartered institutions' competitive equality with state parity laws that permitted state banks to charge the maximum rate that could be charged by a national bank doing business in the state.<sup>75</sup> Accordingly, in the above example, the Illinois-chartered bank would be able to charge 12 percent in Illinois because an Indiana-based national bank could export the 12 percent Indiana rate into Illinois. When combined with the federal parity statute, this meant that the Illinois-chartered bank could also export the 12 percent Indiana rate into Michigan. Given that several states have no usury limit for bank loans when there is a written loan agreement, bank usury law largely became a matter of the lowest common denominator—the contractually agreed-upon rate.

The *Marquette* decision thus set off a race-to-the-bottom among states with the result that state usury laws were effectively gutted for

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73. Depository Institutions Deregulation and Monetary Control Act (“DIDMCA”) of 1980, 12 U.S.C. § 1831d. 12 U.S.C. § 1831u(f) separately addresses usury caps in state constitutions. The DIDMCA parity provision allows state-chartered, FDIC-insured banks to charge the greater of the maximum rate allowed in the state in which the bank is located or 1 percent above the Federal Reserve ninety-day commercial paper discount rate for the applicable Federal Reserve District. 12 U.S.C. § 1831d. The opt-out provision, § 527 of DIDMCA, is not currently codified; it was previously codified at 12 U.S.C. § 1730g (note). Puerto Rico and Iowa have opted out of the federal parity statute. Catherine M. Brennan & Nora R. Udell, *What's Old Is New Again: The Future of Bank Partnership Programs from Small Dollar Installment Loans to Mortgages to Everything*, 72 CONF. ON CONSUMER FIN. L. Q. REP. 425, 430 (2018).

74. See 12 U.S.C. § 1831d(a) (allowing state insured banks to charge at the rate allowed by the state in which the bank is located).

75. John J. Schroeder, “Duel” Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions, 36 IND. L. REV. 197, 203 (2003); NAT'L CONSUMER L. CTR., CONSUMER CREDIT REGULATION § 3.7.1 n.672 (3d ed. 2020) (listing parity statutes).

*banks*. Notably, the erosion of state usury laws in the wake of *Marquette* did not extend to *nonbanks*. While states lost the ability to control pricing of consumer credit issued by banks, their ability to regulate nonbanks remained intact.

C. *The Changing Institutional Landscape of Consumer Credit*

In 1978, when *Marquette* was decided, the fact that it only directly affected banks seemed of little importance, because banks comprised the substantial majority of the nonmortgage consumer credit market.<sup>76</sup> Indeed, in 1978, banks and other depositories made up 73 percent of the U.S. consumer credit market in terms of receivables outstanding.<sup>77</sup> At that time, nonbank lenders consisted primarily of finance companies, pawn shops, and retailers (including car dealerships) offering store credit.<sup>78</sup> Thus, *Marquette*'s most immediate impact was in the credit card market because most other types of standard bank loan products—mortgages, auto loans, and student loans—have lower interest rates than credit cards, such that usury caps would rarely be at issue except in periods of extremely high market interest rates.

Yet 1978 also happened to be the high-water mark for banks' role in consumer credit. In particular, by the 1990s, securitization began to play a major role in financing nonmortgage consumer credit, rising to one-third of the market by the early 2000s.<sup>79</sup> By 2008, banks' share of nonmortgage consumer credit outstanding had fallen from its 1978 height of 73 percent to just 43 percent.<sup>80</sup> Subsequent changes to accounting rules render later data noncomparable.<sup>81</sup>

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

77. Table F.222 of the Financial Accounts of the United States - Z.1, BD. OF GOVERNORS OF THE FED. RSRV. SYS., <https://www.federalreserve.gov/releases/z1/20210610/html/f222.htm> [<https://perma.cc/YG84-AGUB>] (last updated June 10, 2021).

78. See PHILIP A. KLEIN, *THE CYCLICAL TIMING OF CONSUMER CREDIT, 1920-67*, at 4 (1971).

79. Table F.222 of the Financial Accounts of the United States - Z.1, Historical Annuals Tables 1975-1984, BD. OF GOVERNORS OF THE FED. RSRV. SYS., <https://www.federalreserve.gov/releases/z1/20160609/annuals/a1975-1984.pdf> [<https://perma.cc/9EP9-SW5Y>].

80. *Id.*

81. See Nancy Leinfuss, *New U.S. Accounting Rules May Derail Consumer Lending*, REUTERS (Oct. 9, 2009, 3:20 PM), <https://www.reuters.com/article/us-securitization-fasb-abs-analysis/new-u-s-accounting-rules-may-derail-consumer-lending-idUSTRE59856S20091009> [<https://perma.cc/PM4K-DG3H>] (noting that Statement of Financial Accounting Standards 167 would result in many securitization exposures being brought back onto bank balance sheets).

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

The financial regulation literature has long focused on securitization as one of the exemplars of financial “disintermediation,” meaning a shift away from bank intermediation between sources of capital and borrowers.<sup>82</sup> But securitization is not just an example of financial disintermediation. It is also a type of disaggregated consumer lending, as the following section explains, because securitization structures inherently split the lending function into discrete functions played by separate entities. While banks are often still involved in consumer lending, many of the key activities in the lending cycle are performed by nonbanks.

Consumer lending consists of a set of separate activities. First, a credit product must be designed—how will the product operate and be priced? Then the product must be marketed and potential borrowers identified and wooed. Once actual borrowers apply for the product, they must be underwritten, meaning that they must be qualified and priced according to their risk profile. If the borrower qualifies and agrees to the loan, the loan must be funded, meaning that the borrower will receive the money. After the loan is made, it must still be serviced, with billing statements sent out and payments collected, as well as other administrative tasks, and any defaults must be managed. And someone must hold both the credit risk and interest rate risk on the loan.

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

Today, consumer lending is increasingly disaggregated. Securitization, a financing technique that funds most mortgages in the United States,<sup>83</sup> represents a classic example of disaggregation in

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82. See, e.g., Schwarcz, *Regulating Shadow Banking*, *supra* note 39, at 626–27.

83. Table L.218 of the Financial Accounts of the United States - Z.1, BD. OF GOVERNORS OF THE FED. RSRV. SYS., <https://www.federalreserve.gov/releases/z1/20210610/html/l218.htm> [<https://perma.cc/LWC4-5H8E>] (last updated June 10, 2021). Securitization historically also funded a large share of the credit card market, but today no longer does so because of a change

consumer lending. While securitization transactions can be quite complex, the basic idea is straightforward. A financial institution (bank or nonbank) that sponsors the securitization owns a pool of loans that it either made itself or purchased.<sup>84</sup> The sponsor then sells the loans to a special purpose entity (“SPE”) it has set up.<sup>85</sup> The SPE engages in no business other than owning the loans. The SPE’s purpose is to insulate the loans from all risks other than those inherent in the loans themselves, including operational risks and competing creditors.<sup>86</sup> The SPE then issues bonds that are to be repaid solely from the collections on the loans.<sup>87</sup> The SPE uses the proceeds of the bond issuance to pay the sponsor for the loans.<sup>88</sup> The loans have thus been effectively funded by the bond investors, not the sponsor.

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

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in accounting rules, SFAS 166 and 167, that went into effect in 2010. Xiaoli (Shaolee) Tian & Haiwen Zhang, Impact of FAS 166/167 on the Securitization of Credit Card Loans 29 (Jan. 31, 2017) (unpublished manuscript), <https://ssrn.com/abstract=2779147> [<https://perma.cc/KUB9-FSX5>]. These new accounting standards changed the treatment of variable interest entities, such as securitization vehicles. *Id.* at 9. Additionally, securitization-dependent monoline card issuers have largely disappeared, having either failed (Advanta), see Harold Brubaker, *Lawsuit Offers a Painful Look at Advanta’s Collapse*, PHILA. INQUIRER (June 19, 2013), [https://www.inquirer.com/philly/business/20130619\\_Lawsuit\\_offers\\_a\\_painful\\_look\\_at\\_Advanta\\_s\\_collapse.html](https://www.inquirer.com/philly/business/20130619_Lawsuit_offers_a_painful_look_at_Advanta_s_collapse.html) [<https://perma.cc/V5BM-2YH2>], been purchased by a full service bank (MBNA, purchased by Bank of America), see Julie Creswell & Eric Dash, *Bank of America To Buy MBNA, a Prime Issuer of Credit Cards*, N.Y. TIMES (July 1, 2005), <https://www.nytimes.com/2005/07/01/business/bank-of-america-to-buy-mbna-a-prime-issuer-of-credit-cards.html> [<https://perma.cc/WL52-9K55>], or become full service retail banks with a deposit funding base, such that they do not need to rely on capital markets funding (Capital One).

84. ADAM J. LEVITIN, BUSINESS BANKRUPTCY: FINANCIAL RESTRUCTURING AND MODERN COMMERCIAL MARKETS 119 (2d ed. 2018).

85. A special purpose entity is a business entity created to perform a specific transactional task, rather than serve as a general operating company.

86. See LEVITIN, BUSINESS BANKRUPTCY, *supra* note 84, at 120.

87. See *id.*

88. See *id.*

SPE's only obligations are contractual and knowable in advance, so investors can price for the risk of competing demands on the SPE's assets.

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

On the back end, securitization further separates the economic exposure to the loan from legal title to the loan; the bond investors have the economic exposure, while the SPE has legal title. Additionally, someone has to manage the loan, as invoices must be sent out, payments collected, and defaults addressed. The SPE cannot do this work itself because the whole point of the transaction is to isolate the economic risk on the securitized loan from operational risks. Therefore, the SPE must hire an agent (called a servicer) to manage the loan. The servicer is typically compensated with some of the loan collections, typically part of the interest and late fees.<sup>89</sup> The servicer might be an affiliate of the sponsor or it might be an unaffiliated entity. Either way, the need for a servicer further disaggregates the lending process. The result is that the front end is split off from the legal title to the loans, which is split from practical control over the loans, which is split from economic exposure to the loans. Securitization disaggregates lending.

Both the front-end and back-end exposure can be further split, as can the servicing. The sponsor can handle the entire front end itself, but it might have purchased the loans from another entity. And it might have underwritten the loans using automated underwriting software provided by a third party. Indeed, that is how most mortgage lending works, with lenders using Fannie Mae and Freddie Mac's automated underwriting platforms and underwriting to Fannie and Freddie's underwriting criteria — which is required for selling loans to Fannie and Freddie — rather than to their own.<sup>90</sup>

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89. Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 37–45 (2011).

90. ADAM J. LEVITIN & SUSAN M. WACHTER, *THE GREAT AMERICAN HOUSING BUBBLE: WHAT WENT WRONG AND HOW WE CAN PROTECT OURSELVES IN THE FUTURE* 85 (2020);

On the back end, securitization structures commonly divide interest rate (prepayment) risk from credit risk and allocate them differently, with credit risk frequently being assumed by a guarantor that may or may not be affiliated with the sponsor.<sup>91</sup> And servicing rights are sometimes divided, such that one entity services performing loans, while another one handles defaulted loans.<sup>92</sup> The variation, though not infinite, is extensive.

Disaggregation exists outside of securitization too. For example, even without securitization, both the initial funding and economic exposure might ultimately be provided by a party other than the nominal lender. For example, most auto loans are “indirect loans” in which the consumer enters into a retail installment sale contract with the dealer, who then sells the contract to a financial institution.<sup>93</sup> Depending on the timing of the sale to the financial institution, the funding may be coming from the dealer (who initially floats the loans) or from the loans’ purchaser. Likewise, many online payday and installment loans operate through lead generators that advertise the loans and collect loan applications, which are then auctioned off to prospective funders.<sup>94</sup> Various types of fintech firms present another type of disaggregation.<sup>95</sup>

Another way to understand disaggregation is as an application of Jensen and Meckling’s theory of the firm as a “nexus of a set of contracting relationships.”<sup>96</sup> Jensen and Meckling understand the

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*Selling Guide: Chapter A*, FANNIE MAE (July 7, 2021), <https://selling-guide.fanniemae.com/Selling-Guide/Doing-Business-with-Fannie-Mae/Subpart-A2-Lender-Contract> [<https://perma.cc/FGD5-R86V>]; *Selling Guide: Chapter B*, FANNIE MAE (July 7, 2021) <https://selling-guide.fanniemae.com/Selling-Guide/Origination-thru-Closing/Subpart-B3-Underwriting-Borrowers> [<https://perma.cc/KQ8C-PCFV>].

91. Cf. LEVITIN & WACHTER, *supra* note 90, at 188 (“Every PLS deal has its own particular waterfalls for allocating credit and interest rate risk and its own set of credit enhancements . . . resulting in a unique payment structure.”).

92. See, e.g., Alex Weis & John Njoku, *CMBS: An Introduction*, CORNELL REAL EST. REV., May 2009, at 1, 1–2; Peng Liu & Daniel Quan, *Foreclosure of Securitized Commercial Mortgages—A Model of the Special Servicer*, 46 J. REAL EST. FIN. & ECON. 321, 322–23 (2013).

93. See Levitin, *The Fast and the Usurious*, *supra* note 62, at 1277 (explaining the structure of the indirect auto lending market).

94. See, e.g., UPTURN, LED ASTRAY: ONLINE LEAD GENERATION AND PAYDAY LOANS 1–2 (2015), [https://www.upturn.org/static/reports/2015/led-astray/files/Upturn\\_-\\_Led\\_Astray\\_v.1.01.pdf](https://www.upturn.org/static/reports/2015/led-astray/files/Upturn_-_Led_Astray_v.1.01.pdf) [<https://perma.cc/3GPK-95B7>].

95. See Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235, 242, 276 (2019) (describing fintech’s role in the “fragmentation” of the “financial supply chain”).

96. See Jensen & Meckling, *supra* note 37, at 311.

“firm” as a single entity or set of affiliated entities, with all of the contracts occurring implicitly within the entity or among affiliated entities bound by corporate control.<sup>97</sup> This arrangement that enabled corporate agents to fill in omitted terms in incomplete and implicit contracts now occurs with explicit contracts among unaffiliated entities.<sup>98</sup> Disaggregation means that the firm now consists of a set of formally unaffiliated entities, bound together by contract such that they operate as a single unit. Disaggregated lending produces a disembodied nexus of contracts that is not formally a firm consisting of corporate affiliates, even if it functions as one.

#### *D. Disaggregated Lending’s Effect on Consumer Protection*

Key parts of the consumer protection regulatory system assume concomitant form and function, but disaggregated lending splinters function among multiple entities with varying forms. The mismatch creates an opportunity for regulatory arbitrage, and the differential treatment of banks and nonbanks for usury law (as well as for state licensure and other consumer protections) incentivizes financial institutions to engage in the arbitrage.

Overall, the financial regulatory system is a mix of entity-based and activity-based regulation. For example, there are regulatory regimes specific to consumer credit, such as Truth in Lending Act disclosures, that apply irrespective of entity type.<sup>99</sup> But other parts of the regulatory regime are specific to particular entity types, such as banks or money transmitters, because of the special functions these entities play in the financial system and the types of activities in which they are presumed to engage. Thus, banks are the only type of entity allowed to hold insured demand deposits, an activity that necessitates regulation of the risk of bank lending to ensure that the bank will be able to honor its deposit liabilities. If the bank’s loans go bad, it will not be able to repay the depositors.

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97. *See id.*

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

99. 15 U.S.C. § 1631.

Entity-based regulation presents a risk of a mismatch if there is an expansion of the type of entity performing an activity. The limitations of entity-based regulation are precisely why “shadow banking” has raised so much regulatory concern in wholesale financial markets. Shadow banking refers to the various institutions and transactions that replicate the financing functions traditionally provided by banks.<sup>100</sup> Because prudential regulation—regulation to ensure the safety and soundness of financial institutions—is an entity-based regulatory system, the rise of shadow banking has posed a major challenge to regulators’ ability to guarantee the financial system’s safety and soundness and to protect against systemic risk.<sup>101</sup>

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

To be sure, nothing in the federal bank regulatory system expressly prohibits banks from making high-cost loans. Rather, the federal regulatory system relies on the “soft” tools of bank supervision to dissuade banks from engaging in practices deemed excessively risky.<sup>102</sup> Herein lies the first flaw in the idea that federal bank regulation is a substitute for usury laws: there is no guarantee that a bank regulator will actually use these tools. Indeed, a regulator is unlikely to act if it disagrees philosophically with usury laws as an interference with “freedom” of contract. Whereas usury laws can be raised as a defense or even as a private right of action,<sup>103</sup> consumers cannot force bank regulators to use their supervisory powers.

Even aside from discretion regarding supervisory actions, there is a bigger flaw in the logic of federal preemption. Federal bank regulator supervision is not a substitute for usury laws because the key bank

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100. See, e.g., Schwarcz, *Regulating Shadow Banking*, *supra* note 39, at 623–25.

101. *Id.*

102. See *Tahyar Testimony*, *supra* note 48, at 37–39.

103. See, e.g., *Madden v. Midland Funding, LLC*, 786 F.3d 246, 248 (2d Cir. 2015).

regulatory concern is not about *consumer* protection. Instead, it is about *bank* protection—protecting the safety and soundness of the bank.

Bank safety and soundness is not synonymous with consumer protection. Among other things, banks can diversify their risks in a way consumers cannot. If a bank makes thousands of high-cost loans knowing that a percentage will default, the revenue on those that perform (or perform for a while) may outweigh the losses from defaults. Indeed, high-cost lending might be profitable. It is hard for a regulator concerned with safety and soundness to tell a bank to cease engaging in a profitable activity because a bank is only safe-and-sound if it is profitable.

From a consumer protection perspective, however, diversification is irrelevant. If a consumer's loan is the one that defaults because of an excessively high cost, it does not matter to the consumer that other consumers were able to pay off the loan. The welfare loss of one consumer cannot be offset by another consumer's welfare gain.<sup>104</sup> Simply put, supervision by federal bank regulators is not a substitute for usury laws.

## II. RENT-A-BANK ARRANGEMENTS

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

This Part considers the contours of rent-a-bank relationships and provides a history of their development as a response to regulation of payday loans, and the subsequent and incomplete regulatory pushback against rent-a-bank relationships.

Rent-a-bank arrangements represent yet another version of the disaggregation of the lending cycle. The basic design of a rent-a-bank transaction is straightforward. A nonbank lender contracts with a bank to make loans according to the nonbank lender's specifications and then sells the loans to the nonbank lender. In a rent-a-bank transaction, the bank's role is likely limited to the initial funding of the loan and

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104. In this regard, consumer protection resembles Pareto efficiency, not Kaldor-Hicks efficiency.

perhaps some servicing support, although the bank's name will be on the loan as the lender. The nonbank (or set of affiliated nonbank entities) will handle the other aspects of the loan: design, marketing, underwriting, servicing, and holding of all or most of the risk. The precise allocation of marketing and servicing duties is not critical to rent-a-bank structures. Instead, the key features are the bank taking its underwriting marching orders from the nonbank and the nonbank acquiring the lion's share of financial exposure on the loans.

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

Similarly, it is common in rent-a-bank arrangements for the bank not to sell *all* of the loans to the nonbank lender. The bank might retain \$1 million exposure on the loans. Or it might sell the loans only after holding them for a limited time period, perhaps only two days.<sup>105</sup> Or a bank may sell only a derivative interest or partial derivative interest in the loans. The idea is that a partial, delayed, or derivative sale strengthens the claim that the bank is the real lender in the transaction. Yet the bank's retained *de minimis* exposure or a *de minimis* holding period would seem to underscore the sham transaction: what is its purpose other than to enable the bank to claim that it is the true lender?

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

It is important to distinguish rent-a-bank relationships from run-of-the-mill outsourced production. Banks are no different than other businesses in that they face a make-or-buy decision regarding any particular good or service they use. The efficiency of vertical integration versus outsourcing will depend on many factors. For example, banks require various types of computer software to operate their businesses, such as loan servicing software that enables them to keep track of balances and payments and legal notices for particular borrowers. A bank could have its own employees code the software or

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105. See, e.g., *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359, 1360 (D. Utah 2014).

it could purchase the software from a third party that specializes in writing such software or the bank could contract with a third party to handle all the loan servicing, leaving the software issue up to that third party. If the third party can provide the software or handle the servicing more efficiently than the bank, the bank will likely opt for third-party provision.

From an economic standpoint, the choice of internal versus external production is irrelevant. What matters from an economic standpoint is that the bank is the nexus of contracts among the various factors of production. Those contracts may be either explicit contracts with outsourced providers or implicit ones within the firm.

From a regulatory standpoint, however, things look different. Banks are distinct from regular businesses. Whereas a regular business corporation can be created more or less as a matter of right, the issuance of a banking charter is discretionary to the chartering authority and requires regulatory consideration of various factors, including the public interest.<sup>106</sup>

The issuance of banking charters is regulated because the charter carries with it privileges not granted to regular businesses, most notably the right to take money deposits, pay checks from deposits, and lend money.<sup>107</sup> While nonbanks engage in lending and payments, they require a special license to engage in these activities.<sup>108</sup> More importantly, they are not permitted to combine the activities: nonbank lenders cannot accept deposits, and nonbank money transmitters cannot make loans. The combination of deposit-taking, payments, and lending activities is of particular regulatory concern because of the risks those activities pose to the monetary system and to the economy writ large. Because banks fund loans with deposits, the possibility of losses on the loans poses a risk to deposits and to the payment system

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106. See generally Margaret E. Tahyar, *Are Banking Regulators Special?*, BANKING PERSPS., Quarter 1 2018, at 23, 24 (“[A] generation has grown to accept that the granting of bank charters is so up to the discretion of the bank regulators that the regulator need not even give reasons for a denial.”); OFF. OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER’S LICENSING MANUAL: CHARTERS 29 (2019), <https://www.occ.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/charters.pdf> [<https://perma.cc/E4QR-NZ5L>] (requiring evaluation of the banking needs of the community).

107. OFF. OF THE COMPTROLLER OF THE CURRENCY, EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES 3 (2016) (identifying “three core banking functions: receiving deposits, paying checks, or lending money”).

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

on which the economy depends. Restricting the set of institutions that are allowed to engage in the combination of core banking activities facilitates regulatory oversight because it defines the set of institutions on which regulators must focus their supervisory efforts. If wildcat banking<sup>109</sup> were permitted, regulators would not even know which businesses to supervise.

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

This is not to say that bank regulation cannot tolerate external production. But it requires that the bank be the entity ultimately answerable for the product, meaning that the bank must be acting as the principal in the production relationship, rather than the agent.<sup>110</sup>

Likewise, the nature and extent of outsourcing also matter from a regulatory perspective. Some activities are so fundamental to the business of banking that their outsourcing begs the question of what is left for the bank to do. In particular, designing and underwriting loans, taking deposits, and paying checks are so fundamental that the bank’s outsourcing of these activities undermines banking as a regulatory category. It does not matter that nonbanks may engage in any one of these activities. The point is that if the bank has been licensed to perform these activities, the license is granted with the expectation that it is the bank, and not some other party, that will be performing the activity, as the license is personal to the bank.

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109. Wildcat banking refers to the creation of banks that operate without any special licensing regime.

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

Relatedly, this suggests that the extent of outsourcing matters. For example, banks regularly rely on credit scores purchased from third parties for underwriting, but this is different from outsourcing product pricing, setting applicable credit score cutoffs, or determining what other factors should be considered in underwriting.

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

- (1) a loan product design that is proposed by a nonbank to the bank;
- (2) an outsourcing of all or nearly all factors of production of loans (marketing, underwriting, funding, and servicing);
- (3) an outsourcing of the various factors of production of loans to a single nonbank or its affiliates; and
- (4) the transfer of most or all of the credit risk on the loans either to the nonbank and its affiliates or to third parties through a transaction arranged or facilitated by the nonbank.

In other words, in a rent-a-bank relationship, a single nonbank and its affiliates initiate the relationship, propose the outsourcing, provide all or nearly all of the factors necessary to make the loans and either acquire most of the economic exposure to the loans or facilitate the transfer of the economic exposure to a third party.

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

The second and third points emphasize that in the rent-a-bank situation, the nonbank and its affiliates provide all or nearly all of the

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

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

### *B. Payday Lending*

Rent-a-bank partnerships first emerged in the context of payday lending. The history of rent-a-bank partnerships in the payday context is important because it shows how the issue was initially, although unevenly, addressed by regulatory action. The regulatory conception of the issue was too narrow and left the door open to rent-a-bank lending other than payday lending, which is where the practice has since moved.

Payday lending involves making short-term, small-dollar loans with maturity dates designed to coincide with the borrower's payday or government benefit distribution date. The idea is that on payday the borrower will have an influx of funds that can be used to repay the lender. Payday loans typically have a maturity of between one week

and one month, although some payday loans are longer-term installment loans with periodic payments scheduled to align with the borrower's payday.<sup>111</sup>

Payday loans are unsecured because the lender either takes a postdated check from the borrower (dated for the borrower's payday) or gets an automated clearing house ("ACH") authorization from the borrower.<sup>112</sup> If the borrower fails to repay voluntarily, the lender can then exercise its right to draw on the borrower's bank account, which it hopes will be replenished with funds on payday. A payday loan thus gives the lender accelerated repayment ability through a self-help right against the borrower's bank account, rather than having to first get a judgment and then a writ of execution or garnishment to collect.

Payday loans first emerged as a product in the mid-1990s.<sup>113</sup> They developed out of the informal practice of some check cashers of purchasing a consumer's personal check, rather than a check from a third party, and agreeing to hold it for a period of time before cashing it.<sup>114</sup> This process was known as "deferred presentment" or "check holding." Typically, check cashers would agree to hold the check until the borrower's next payday in exchange for a fee. By calling the transactions check cashing, rather than lending, payday lenders sought to evade state usury and other consumer credit laws. Eventually, some states legitimized the practice and allowed regulated deferred presentment transactions.<sup>115</sup>

Payday loans are effectively or expressly prohibited in sixteen states and the District of Columbia.<sup>116</sup> In other states, payday loans are a highly regulated product. In states that allow payday lending, regulations vary considerably, but they generally require payday

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111. See Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,864, 47,911, 47,927 (July 22, 2016) (codified at 12 C.F.R. § 1041 (2018)).

112. *Id.* at 47,872.

113. See GARY RIVLIN, *BROKE, USA: FROM PAWNSHOPS TO POVERTY, INC.—HOW THE WORKING POOR BECAME BIG BUSINESS* 72–73 (2010).

114. See *A Short History of Payday Lending Law*, PEW CHARITABLE TRS. (July 18, 2012), <https://www.pewtrusts.org/en/research-and-analysis/articles/2012/07/a-short-history-of-payday-lending-law> [<https://perma.cc/4XG6-BKFH>].

115. *Id.*

116. See generally PEW CHARITABLE TRS., *STATE PAYDAY LOAN REGULATION AND USAGE RATES* (2012) (outlining payday loan usage rates in different states). A rate cap enacted in Nebraska effectively prohibited payday lending in 2020, NEB. REV. STAT. § 45-918 (2020) (36 percent APR limit for payday loans); Illinois passed a similar rate cap in 2021, 815 ILL. COMP. STAT. 122/2-5 (2021) (36 percent military APR limit for all consumer loans).

lenders to obtain a license from the state, be subject to state examination, and make certain disclosures to borrowers.<sup>117</sup> State payday lending regulations restrict the terms of products, particularly the types, amounts, and frequency of fees, the length of loan maturities, and the frequency of loan renewals.<sup>118</sup> Thus, even in states that allow payday lending, there are usury caps specific to the payday loans.

This regulatory landscape set the scene for rent-a-bank partnerships because payday lenders that did not want to be subject to state regulations sought out bank partners that were not subject to state usury laws. Most banks have never had much interest in making payday loans themselves because of skepticism about the profitability of the product except at extremely high interest rates that would trigger reputational risk and regulatory animosity.<sup>119</sup> However, a number of small banks have been willing to partner with payday lenders on terms that turn a tidy profit for the bank with little investment or effort. The first instance of a rent-a-bank arrangement is unknown, but they began to appear by 1997.<sup>120</sup> While rent-a-bank arrangements were most common for payday lending, they also appeared in their first phase in the early 2000s with nonbank subprime credit card issuers and tax refund anticipation lenders.<sup>121</sup>

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

The original wave of rent-a-bank arrangements was met with substantial pushback from both state and federal regulators. A number of states sued rent-a-bank lenders,<sup>122</sup> as did private litigants.<sup>123</sup> More

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117. LEVITIN, CONSUMER FINANCE, *supra* note 70, at 627.

118. *Id.*

119. See SHEILA BAIR, LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES 10 (2005) (“[M]ost bank officials we interviewed perceived the product as too high risk to offer profitably except at extremely high interest rates . . .”).

120. New York v. Cnty. Bank of Rehoboth Beach, No. 6046-03, at 4 (N.Y. Sup. Ct. Jan. 2, 2007).

121. Complaint at 5–6, FTC v. CompuCredit Corp., No. 1:08-cv-1976 (N.D. Ga. June 10, 2008) (concerning marketed subprime credit card loans); Anderson v. H&R Block, Inc., 287 F.3d 1038, 1040–41 (11th Cir. 2002) (concerning tax refund anticipation loans); Beneficial Nat’l Bank v. Anderson, 539 U.S. 1, 4 (2003) (concerning tax refund anticipation loans).

122. See JEAN ANN FOX, UNSAFE AND UNSOUND: PAYDAY LENDERS HIDE BEHIND FDIC BANK CHARTERS TO PEDDLE USURY 12, 25–28 (2004) (listing state enforcement actions).

123. Ironically, one upshot of these suits was a Supreme Court decision clarifying that no state law usury claim could stand against a national bank that was a partner in a rent-a-bank arrangement. See *Beneficial Nat’l Bank*, 539 U.S. at 3–5, 11.

significantly, federal bank regulators acted to discourage banks from partnering with payday lenders. The federal bank regulators did not act in concert; the Office of the Comptroller of the Currency (“OCC”) acted first and most strongly, while the Federal Deposit Insurance Corporation (“FDIC”) acted later and hesitantly, and the Federal Reserve Board never took any formal action at all.<sup>124</sup>

In 2000, the OCC issued an Advisory Letter highlighting its concerns about rent-a-bank relationships, noting that it would closely review bank activities in this regard, and explaining its expectations for how banks would responsibly structure payday lending activities.<sup>125</sup> In 2001, the OCC issued a Bulletin regarding third-party relationships that emphasized proper risk management and oversight of third-party lending programs.<sup>126</sup> Critically, both the Advisory Letter and the Bulletin emphasized the safety-and-soundness concerns rent-a-bank lending poses to a bank, rather than the consumer protection concerns.

Neither of these nonbinding documents ever forbade payday rent-a-bank relationships outright, much less non-payday rent-a-bank relationships. Instead of prohibiting payday rent-a-banking expressly, the OCC acted through soft power, clarifying its expectations of banks not through the formal notice-and-comment rulemaking process, but through nonbinding guidance and supervisory actions. Thus, in January of 2002, on the heels of the Bulletin, the OCC ordered a national bank to cease its rent-a-bank payday lending program out of safety-and-soundness concerns.<sup>127</sup> The next month, the Comptroller gave a speech directly addressing rent-a-bank relationships. He noted:

Let me raise one other caution about preemption. The benefit that national banks enjoy by reason of this important constitutional doctrine cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank.

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124. Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 872–73 (2007). One large partnering bank left the Federal Reserve System to avoid scrutiny. *Id.* at 873.

125. OFF. OF THE COMPTROLLER OF THE CURRENCY, AL 2000-10, OCC ADVISORY LETTER 1–2 (2000).

126. OFF. OF THE COMPTROLLER OF THE CURRENCY, OCC 2001-47, OCC Bulletin 1 (2001).

127. Press Release, Off. of the Comptroller of the Currency, OCC Orders Eagle To Cease Payday Lending Program (Jan. 3, 2002), <https://www.occ.gov/news-issuances/news-releases/2002/nr-occ-2002-1.html> [<https://perma.cc/53MQ-RLHD>].

Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.<sup>128</sup>

After detailing the problem of rent-a-bank arrangements, the Comptroller stated:

Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity to manage effectively a multistate loan origination operation that is in reality the business of the payday lender.<sup>129</sup>

During the course of the year following the speech, the OCC brought supervisory actions against another three national banks for rent-a-bank payday lending.<sup>130</sup> By 2003, the OCC could brag in its Annual Report that

[a]ll national banks with known payday lending activities through third-party vendors were ordered in FY 2003 to exit the payday lending business. By undertaking enforcement actions against those banks, the OCC addressed safety and soundness concerns about the management of these payday loan programs, and ended significant consumer protection violations.<sup>131</sup>

The FDIC moved more slowly. The FDIC Chairman expressed concerns about rent-a-bank relationships in 2000, noting, “It may be legal—but I don’t like it.”<sup>132</sup> The FDIC, however, took no action until 2003, when it issued examination guidelines for state-chartered banks

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128. John D. Hawke, Jr., Comptroller of the Currency, Remarks Before the Women in Housing and Finance in Washington, D.C. 10 (Feb. 12, 2002) (transcript available at <https://www.occ.treas.gov/news-issuances/speeches/2002/pub-speech-2002-10.pdf> [<https://perma.cc/S5KX-T4AS>]).

129. *Id.*

130. Consent Order, Peoples Nat’l Bank, No. AA-EC-02-03 (Off. of the Comptroller of the Currency Jan. 30, 2003); Press Release, Off. of the Comptroller of the Currency, OCC Takes Action Against ACE Cash Express, Inc. and Goleta National Bank (Oct. 29, 2002), <https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-85.html> [<https://perma.cc/UN7L-HDCX>]; Press Release, Off. of the Comptroller of the Currency, Peoples National Bank To Pay \$175,000 Civil Money Penalty and End Payday Lending Relationship with Advance America (Jan. 31, 2003), <https://www.occ.gov/news-issuances/news-releases/2003/nr-occ-2003-6.html> [<https://perma.cc/C2CH-DY6M>].

131. OFF. OF THE COMPTROLLER OF THE CURRENCY, ANNUAL REPORT 17 (2003).

132. Press Release, Fed. Deposit Ins. Corp., Chairman Tanoue Denounces “Charter Renting” as a Means of Funding Predatory Payday Lenders (June 14, 2000), <https://archive.fdic.gov/view/fdic/1736> [<https://perma.cc/73G4-BMKY>].

partnering with payday lenders.<sup>133</sup> The guidelines required that payday loan portfolios be classified as substandard for regulatory risk management, be charged off after sixty days, and be subjected to higher capital requirements (up to dollar-for-dollar capital).<sup>134</sup> Yet the bark was much worse than the bite, because these requirements only applied to loans on the bank's books. If the bank were selling the loans regularly, such as on a daily basis, the impact would be negligible. In 2005, however, the FDIC issued stronger guidelines, which limited the frequency of loan rollovers, making it more difficult for state-chartered banks to engage in payday rent-a-bank relationships.<sup>135</sup> This guidance, combined with enforcement actions in 2007,<sup>136</sup> ended most payday rent-a-bank arrangements.

#### *D. The Incomplete Regulatory Pushback*

Like the OCC, the FDIC did not outright forbid payday rent-a-bank arrangements, much less rent-a-bank relationships for things like installment loans, which are not implicated by the rollover limitations. Nonetheless, as a practical matter, the FDIC shut down most rent-a-bank operations by state-chartered banks, such that two scholars, writing in 2007, observed that “by early 2006, the ‘rent-a-charter’ era had come to an end.”<sup>137</sup>

These scholars wrote prematurely. Not only did some rent-a-bank payday lending persist after 2006,<sup>138</sup> but the rent-a-bank model was ultimately adopted by other types of subprime lenders: “marketplace

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133. Press Release, Fed. Deposit Ins. Corp., FDIC Issues Examination Guidance for Payday Lending (July 2, 2005), <https://www.fdic.gov/news/press-releases/2003/pr7003.html> [https://perma.cc/PJN8-M3AP].

134. FED. DEPOSIT INS. CORP., GUIDELINES FOR PAYDAY LENDING 3, 5 (2003) (explaining FDIC's 2001 Subprime Guidance, including that the dollar-for-dollar capital charge applies to all payday loan portfolios); *id.* at 6 (setting out the rules for substandard classification and sixty-day charge off).

135. FED. DEPOSIT INS. CORP., GUIDELINES FOR PAYDAY LENDING (2005), <https://www.fdic.gov/news/financial-institution-letters/2005/fil1405a.html> [https://perma.cc/W3ZC-6EXA].

136. See Order To Cease and Desist, Order for Restitution, and Order To Pay at 1, First Bank of Del., FDIC-07-256b & FDIC-07-257k (Oct. 9, 2008) (detailing the Bank's alleged violations of law and unsafe or unsound banking practices).

137. Mann & Hawkins, *supra* note 124, at 873.

138. See *supra* Part II.C (describing FDIC's regulatory responses).

lenders,”<sup>139</sup> subprime installment lenders,<sup>140</sup> and subprime small business lenders.<sup>141</sup> At most, the FDIC ended an era of payday-focused rent-a-banking. The model then shifted to other sectors of the subprime lending market.

The following Part presents a deep dive into a rent-a-bank arrangement, tracing a lender from its origins as a rent-a-bank payday lender, through its transformation into a rent-a-tribe lender, and then back into its reinvention as a fintech installment lender with a new rent-a-bank structure. The story illustrates the whack-a-mole nature of states’ attempts to address rent-a-banking via litigation.

### III. CASE STUDY OF ELEVATE CREDIT, INC.

Elevate Credit, Inc. (“Elevate”) is a nonbank fintech firm that specializes in subprime lending and represents a state-of-the-art rent-a-bank arrangement.<sup>142</sup> A close examination of Elevate’s business is instructive for understanding how sophisticated rent-a-bank arrangements can be and the challenges they pose to an entity-based regulatory system. Elevate’s structure shows how it has been carefully designed to protect Elevate from claims that it is violating usury laws, or at least to muddy the waters in regard to the resolution of any such claim.

Critically, the Elevate case study is possible only because it is a reporting company under the Securities Exchange Act of 1934.<sup>143</sup> If Elevate were not a reporting company it would be impossible to discern the details of its relationships with its bank partners or even that such relationships existed. Without such knowledge, a consumer or regulator would not be able to challenge the legality of Elevate’s loans; they would merely appear to be loans made by a bank and nothing more.

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139. *E.g.*, Fulford v. Marlette Funding, LLC, No. 2017-cv-30376, 2019 WL 4451038, at \*3 (D. Colo. June 5, 2019); Meade v. Avant of Colo., LLC, 307 F. Supp. 3d 1134, 1150–51 (D. Colo. 2018); Meade v. Marlette Funding LLC, No. 17-cv-00575-PAB-MJW, 2018 U.S. Dist. LEXIS 46814, at \*8–9 (D. Colo. Mar. 21, 2018).

140. *See supra* Part II.C (diving into rent-a-bank arrangements).

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

142. Elevate Credit, Inc., Annual Report (Form 10-K) 6–8 (Feb. 26, 2021).

143. 15 U.S.C. § 78a. Every issuer of a security that is traded on a national securities exchange is required to register the security with the exchange. 15 U.S.C. § 78l. Issuers of registered securities are required to file periodical public reports that discuss their business. 15 U.S.C. § 78m. Such issuers are known as reporting companies.

The case study starts with the history of Elevate's origins in an entity called Think Finance, Inc. ("Think"), which used a rent-a-bank arrangement. In the face of regulatory pressure, Think switched to a "rent-a-tribe" model in which it partnered with Native American tribes to use their sovereign immunity to evade state usury laws. When regulatory problems emerged with that model, Think spun off Elevate, which returned to a rent-a-bank model that has been carefully engineered to obfuscate the fact that Elevate's partner banks play only a minimal role in its transactions. This history illustrates the cat-and-mouse nature of the rent-a-bank problem that exists because the entity-based regulatory regime is vulnerable to being gamed by well-counseled businesses.

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

Elevate is a publicly traded Delaware corporation<sup>144</sup> that was spun off from Think in 2014.<sup>145</sup> Elevate's history is itself instructive, as it presents a study of the cat-and-mouse dynamic of regulation and its circumvention.

Think started off around 2001 as PayDay One Holdings, LLC, an Internet payday lender based in Fort Worth, Texas.<sup>146</sup> In 2005, PayDay One Holdings changed its name to PayDay One Holdings, Inc.<sup>147</sup> In 2007 it changed its name yet again to ThinkCash, Inc., and then once more in 2010 to Think Finance, Inc.<sup>148</sup>

Prior to 2007, Think made only direct payday loans.<sup>149</sup> Starting in 2007, however, Think began to engage in indirect lending in states where usury laws were a binding constraint using a rent-a-bank arrangement through partnerships with Urban Trust Bank FSB (now

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144. Elevate Credit, Inc., Second Amended and Restated Certificate of Incorporation of Elevate Credit, Inc. (Form 8-K) (Apr. 11, 2017).

145. Kelly Ann Doherty, *Think Finance Announces Business Restructuring and Spinoff of New Company, Elevate*, BUSINESSWIRE (May 1, 2014, 12:00 PM), <https://www.businesswire.com/news/home/20140501006196/en/Think-Finance-Announces-Business-Restructuring-and-Spinoff-of-New-Company-Elevate> [<https://perma.cc/6C4B-JSJU>].

146. Statement of Undisputed Facts in Support of the Plaintiff's Motion for Partial Summary Judgment Against Defendants ¶¶ 1, 4, *Commonwealth v. Think Fin., Inc.*, No. 2-14-cv-07139 (E.D. Pa. Aug. 14, 2019) [hereinafter *Think Finance Undisputed Facts*].

147. See Plaintiff's Motion for Partial Summary Judgment Against Defendants Kenneth Rees and National Credit Adjusters, LLC at Exhibit A, *Commonwealth v. Think Fin., Inc.*, No. 2-14-cv-07139 (E.D. Pa. Aug. 14, 2019).

148. *Think Finance Undisputed Facts*, *supra* note 146, ¶ 2.

149. *Id.* ¶¶ 4, 6.

renamed Axiom Bank) and First Bank of Delaware.<sup>150</sup> The details of the Urban Trust Bank relationship are not public other than the name of the product, Elastic, which is still one of Elevate's main products and is discussed in detail below. In contrast, the details of the First Bank of Delaware product "Think Cash" are public as the result of the Commonwealth of Pennsylvania's litigation against Think.<sup>151</sup>

For Think Cash, different Think affiliates entered into three related contracts with the First Bank of Delaware: (1) a marketing and servicing agreement; (2) a master participation agreement; and (3) a guaranty agreement. Pursuant to the marketing and servicing agreement, a Think subsidiary marketed the Think Cash product using First Bank of Delaware's name and trademarks, took loan applications from consumers, and serviced the loans in exchange for one hundred dollars per loan fee for each funded loan from First Bank of Delaware.<sup>152</sup> The First Bank of Delaware formally made and funded the loans, but Think provided the marketing, underwriting, and technology platform.<sup>153</sup>

Under the master participation agreement, another Think subsidiary agreed to purchase, on a daily basis, a 99 percent participation interest in each ThinkCash loan made by First Bank of Delaware.<sup>154</sup> In exchange, Think was obligated to pay a monthly participation fee of one hundred dollars per loan plus a percentage of the revenue generated by the 99 percent participation interests to First Bank of Delaware.<sup>155</sup> Additionally, Think was required to maintain a

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150. *Id.* ¶¶ 6–8, 11, 25.

151. *See* Commonwealth v. Think Fin., Inc., No. 14-CV-7139, 2016 WL 183289, at \*1 (E.D. Pa. Jan. 14, 2016).

152. *Id.* ¶ 33.

153. *Id.* ¶ 6.

154. *Id.* ¶ 34. A participation is a type of a derivative interest. LEVITIN, BUSINESS BANKRUPTCY, *supra* note 84, at 113–14. In a participation, the participation seller owns a loan and sells off an undivided fractional economic interest in the loan, but retains complete legal title to the loan. *Id.* This means that the purchaser of a participation interest is economically exposed to the performance of the loan, but does not have contractual privity with the borrower on the loan. *See id.* at 114. Instead, the purchaser's only contractual privity is with the seller of the participation interest, so its remedies in the event of nonperformance on the loan would lie solely against the seller, not the borrower.

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

155. Think Finance Undisputed Facts, *supra* note 146, ¶ 35.

reserve account at First Bank of Delaware that could be used to offset its obligations.<sup>156</sup> Think later reduced its participation purchase percentage to 90 percent, but indemnified First Bank of Delaware for any losses that exceeded 2.5 percent of the loan balance.<sup>157</sup> Finally, under the guaranty agreement, Think’s holding company guaranteed the obligations of its subsidiaries under the other contracts.<sup>158</sup> Think was not the formal lender on the loans because it did not fund them, nor was it the creditor of record, so it claimed that it was merely a servicing agent of First Bank of Delaware.<sup>159</sup>

In 2008, the FDIC initiated an enforcement action against First Bank of Delaware for its unsafe and unsound third-party lending activity, including with Think.<sup>160</sup> First Bank of Delaware entered into a consent order where it agreed to discontinue its various rent-a-bank relationships.<sup>161</sup> Nevertheless, First Bank of Delaware continued to work with Think until 2011, albeit through a restructured program. Specifically, a pair of new Think subsidiaries began providing the marketing, underwriting, technology platform and loan servicing to First Bank of Delaware, while the participation interests were purchased by a newly created special purpose vehicle (“SPV”), Universal Finance II, LLC, that outside investors funded.<sup>162</sup>

Universal Finance promised its investors a 17 percent annual return, guaranteed by Think Finance.<sup>163</sup> Think Finance also agreed to purchase from Universal Finance interest in any defaulted loans in exchange for receiving all residual net income after the 17 percent paid to investors as an “administrative fee.”<sup>164</sup> Additionally, pursuant to an

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156. *Id.* ¶ 36.

157. *Id.* ¶ 38.

158. *Id.* ¶ 37.

159. Brief of Defendant Kenneth E. Rees’s [sic] in Support of Motion to [sic] for Summary Judgment Statement at 5–6, *Commonwealth v. Think Fin., Inc.*, No. 2-14-cv-07139 (E.D. Pa. Apr. 1, 2019).

160. Order to Cease and Desist, Order for Restitution, and Order to Pay at 1, *First Bank of Delaware*, FDIC-07-256b & FDIC-07-257k (Oct. 9, 2008). I served as an expert witness for the FDIC in this matter. The First Bank of Delaware dissolved in 2012. Complaint ¶ 43, *Commonwealth v. Think Fin., Inc.*, No. 2-14-cv-07139 (E.D. Pa. Dec. 17, 2014) [hereinafter *Think Finance Complaint*].

161. *Think Finance Undisputed Facts*, *supra* note 146, ¶ 40.

162. *Id.* ¶¶ 42–43. Universal Finance II, LLC’s owner and managing member was the brother of a First Bank of Delaware director. *Id.* ¶ 45.

163. *Id.* ¶¶ 44, 51.

164. *Id.* ¶ 51.

administrative agency agreement, a Think Finance entity managed Universal Finance.<sup>165</sup>

As its business expanded, Think Finance found itself needing an additional source of funding for the loans. In the summer of 2010, Think contracted with a Chicago-based investment firm called Victory Park Capital to provide the funding for the loans.<sup>166</sup> Victory Park Capital purchased the right to purchase up to \$90 million in participation interests in various Think Finance products from Universal Finance, with Think Finance guarantying Victory Park Capital a 20 percent return.<sup>167</sup>

In October 2010, however, the FDIC ordered First Bank of Delaware to cease its relationship with Think.<sup>168</sup> Desperate to find a new partner to replace First Bank of Delaware, Think unsuccessfully contacted eighty banks<sup>169</sup> before it embarked on a new strategy for evading state usury laws: rent-a-tribe.

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

As the rent-a-bank model collapsed in the face of federal regulatory pressure, Think Finance shifted to partnering with Native American tribes.<sup>170</sup> Native American tribes are themselves not subject to state usury laws because of sovereign immunity.<sup>171</sup>

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165. *Id.* ¶ 52.

166. *Id.* ¶ 56; *About Us*, VICTORY PARK CAP., <https://www.victoryparkcapital.com> [<https://perma.cc/GN57-AYNT>].

167. Think Finance Undisputed Facts, *supra* note 146, ¶¶ 58–60.

168. *Id.* ¶ 62.

169. *Id.* ¶ 65.

170. *Id.* ¶ 67; Think Finance Complaint, *supra* note 160, ¶ 47.

171. See *Michigan v. Bay Mills Indian Cmty.*, 572 U.S. 782, 825 (2014) (Thomas, J., dissenting) (“[P]ayday lenders . . . often arrange to share fees or profits with tribes so they can use tribal immunity as a shield for conduct of questionable legality.”). Regarding application of state law to tribal payday lending, *cf.* *Otoe-Missouria Tribe of Indians v. N.Y. State Dep’t of Fin. Servs.*, 769 F.3d 105, 115–16 (2d Cir. 2014) (upholding denial of a motion for preliminary injunction against state regulators from interfering with tribal lending business allegedly taking place off tribal lands); *Williams v. Big Picture Loans*, 929 F.3d 170, 174 (4th Cir. 2019) (dismissing the suit because the lending entities affiliated with the Native American tribe were entitled to sovereign immunity as “arms of the Tribe”).

Think formed partnerships with three tribes.<sup>172</sup> In these “rent-a-tribe” partnerships,<sup>173</sup> Think again provided the complete turnkey infrastructure for marketing, underwriting, funding, and collecting the loans, including providing customer leads, a technology platform, investors to fund the loans, and payment processing and collection platforms.<sup>174</sup> Think also trained customer service agents to handle calls, drafted call scripts, drafted and administered contracts, hosted websites, monitored tribal employees, identified third-party collection agencies, and facilitated the sale of delinquent accounts.<sup>175</sup>

When consumers obtained credit through the rent-a-tribe arrangement, the loan agreements purported to be loan agreements with the tribes and to be subject solely to tribal law and jurisdiction. Yet the tribes maintained only a minimal economic interest in the loans. Instead, a Cayman Islands company called GPL Servicing Ltd., which was controlled by Victory Park Capital,<sup>176</sup> purchased a participation interest of between 90 and 99 percent.<sup>177</sup> In exchange for the participation interest, the tribes were paid a fee based on the gross revenue from the enterprise.<sup>178</sup> The arrangement depended on the tribe, with one tribe getting 4 percent, another 4.5 percent, and the third a graduated amount.<sup>179</sup>

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172. Think Finance Undisputed Facts, *supra* note 146, ¶ 102.

173. See generally Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?*, 69 WASH. & LEE L. REV. 751 (2012) (providing a broad overview of the rent-a-tribe model of payday lending).

174. Think Finance Complaint, *supra* note 160, ¶ 48.

175. Complaint ¶ 30, Consumer Fin. Prot. Bureau v. Think Fin., LLC, No. 4:17-cv-00127 (D. Mont. Nov. 15, 2017) [hereinafter CFPB Complaint].

176. Disclosure Statement Accompanying Second Modified First Amended Joint Chapter 11 Plan of Reorganization of Think Finance, LLC and Its Subsidiary Debtors and Debtors in Possession at 4, *In re* Think Fin., LLC, No. 17-33964 (Bankr. N.D. Tex. Sept. 26, 2019) [hereinafter Think Finance Disclosure Statement]. GPL stands for Great Plains Lending, the first of the tribal lending entities with which Think Finance partnered. Second Amended Complaint ¶ 94, Commonwealth v. Think Fin., Inc., No. 2-14-cv-07139-JCJ (E.D. Pa. Dec. 21, 2017) [hereinafter Second Amended Think Finance Complaint]. GLP Servicing, Ltd. was originally named VPC/TF Fund II Ltd. *Id.*

177. CFPB Complaint, *supra* note 175, ¶ 45.

178. Second Amended Think Finance Complaint, *supra* note 176, ¶¶ 101, 103, 104.d; CFPB Complaint, *supra* note 175, ¶ 46. For a period of time, the tribes’ expenses were also reimbursed. *Id.* ¶ 47.

179. Second Amended Think Finance Complaint, *supra* note 176, ¶¶ 101, 103, 104.d.

GPL Servicing was structured so that Victory Park exercised all of the voting shares and thus all of the management rights.<sup>180</sup> The nonvoting shares were held by various investors, including a Think affiliate.<sup>181</sup> As with the previous Universal Finance arrangement, Think guaranteed a 20 percent annual return for GPL Servicing investors.<sup>182</sup> Any return above the 20 percent went to Think.<sup>183</sup> In other words, Victory Park was simply providing the funding through a structure that imitated a loan, while Think held the equity interest in the venture.

Think flew high for a while. In 2013, Forbes ranked it number two on its list of America's Most Promising Companies,<sup>184</sup> and from 2010 to 2015 it was on the Inc. 5000 List of Fastest Growing Companies.<sup>185</sup> Think even bragged that it was the original fintech, noting that “[b]efore the term ‘fintech’ was coined, Think Finance was an established leader and innovator in the marketplace for online lending.”<sup>186</sup>

Think's days were numbered, however. In 2013, the Department of Justice (“DOJ”) commenced Operation Choke Point, an anti-consumer fraud operation that targeted banks that provided ACH processing for consumer fraudsters.<sup>187</sup> While the DOJ brought only a handful of prosecutions,<sup>188</sup> Operation Choke Point spooked the banking industry.<sup>189</sup> Soon after, many banks allegedly cut ties with

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180. Cf. Think Finance Undisputed Facts, *supra* note 146, ¶ 103 (“GPL Servicing . . . [was] a Cayman Islands limited partnership controlled by VPC.”).

181. Think Finance Disclosure Statement, *supra* note 176, at 4–5.

182. Second Amended Think Finance Complaint, *supra* note 176, ¶¶ 90.a, 91; cf. CFPB Complaint, *supra* note 175, ¶ 48 (listing an 18 percent guaranteed return).

183. Second Amended Think Finance Complaint, *supra* note 176, ¶ 90.a; CFPB Complaint, *supra* note 175, ¶ 49.

184. Think Finance Disclosure Statement, *supra* note 176, at 3.

185. *Id.*

186. *Id.*

187. *Guilty Until Proven Innocent? A Study of the Propriety and Legal Authority for the Justice Department's Operation Choke Point: Hearing Before the Subcomm. on Regul. Reform, Com. and Antitrust L. of the H. Comm. on the Judiciary*, 113th Cong. 7–8 (2014) (written testimony of Adam J. Levitin, Professor, Georgetown University Law Center).

188. See Complaint, *United States v. Four Oaks Fincorp, Inc.*, No. 5:14-cv-00014-BO (E.D.N.C. Jan. 8, 2014); Complaint, *United States v. CommerceWest Bank*, No. 15-cv-00379 (C.D. Cal. Mar. 10, 2015); Complaint, *United States v. Plaza Bank*, No. 15-cv-00394 (C.D. Cal. Mar. 12, 2015).

189. See Kevin Wack, *Beware the Tidy Narrative About Operation Choke Point*, AM. BANKER: BANKSHOT (Nov. 8, 2018, 3:09 PM), <https://www.americanbanker.com/opinion/beware-the-tidy-narrative-about-operation-choke-point> [<https://perma.cc/S7CW-SLBL>].

payday lenders and high-cost installment lenders. Think struggled to find banks to continue processing payments for the tribal lending entities,<sup>190</sup> and had to eventually turn to a Canadian payments processor.<sup>191</sup> Around the same time, the State of New York sent a cease and desist letter to one of Think's tribal partners, which responded with a lawsuit, funded by Think,<sup>192</sup> seeking an injunction against the State.<sup>193</sup> The district court denied the request for a preliminary injunction in an opinion that cast doubt on the tribe's sovereign immunity claim.<sup>194</sup>

As a result of Operation Choke Point and the New York litigation, Victory Park Capital started to get cold feet about its arrangement with Think.<sup>195</sup> As consumer class actions and state and federal enforcement actions against Think piled up, Victory Park eventually pulled the plug on Think's financing, precipitating Think's bankruptcy filing in October 2017.<sup>196</sup>

Around the time that Think's troubles with the ACH system were emerging, Think undertook two important developments. First, it developed an installment loan product called "RISE" that it would offer directly in states in which usury caps were not a constraint.<sup>197</sup> RISE replaced Think's original PayDay One product.<sup>198</sup>

Second, in May 2014, Think, apparently with Victory Park Capital's support, spun off both its direct lending and branded consumer products portfolio into a new independent company called Elevate Credit, Inc. ("Elevate").<sup>199</sup> Elevate had the same shareholders

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190. Second Amended Think Finance Complaint, *supra* note 176, ¶¶ 110–12.

191. Think Finance Undisputed Facts, *supra* note 146, ¶ 129.

192. *Id.* ¶ 213.

193. Second Amended Think Finance Complaint, *supra* note 176, ¶ 112.

194. Otoe-Missouria Tribe of Indians v. N.Y. State Dep't of Fin. Servs., 974 F. Supp. 2d 353, 361 (S.D.N.Y. 2013), *aff'd*, 769 F.3d 105 (2d Cir. 2014).

195. Second Amended Think Finance Complaint, *supra* note 176, ¶¶ 111–13.

196. Think Finance Disclosure Statement, *supra* note 176, at 6–7.

197. Second Amendment Think Finance Complaint, *supra* note 176, ¶ 115.

198. Think Finance Undisputed Facts, *supra* note 146, ¶ 18.

199. Think Finance Disclosure Statement, *supra* note 176, at 3; Think Statement of Undisputed Facts, *supra* note 146, ¶ 224. The spin-off has subsequently been challenged as a fraudulent transfer. While the complaint was filed under seal, the court order granting the sealed filing motion inadvertently gives away the nature of the suit. *See* Order Granting Emergency Motion For Leave To File Complaint Under Seal, Think Fin. Litig. Tr. v. Elevate Credit, Inc. (*In re* Think Fin., LLC), No. 17-33964 (Bankr. N.D. Tex. Aug. 13, 2020) ("The Clerk of Court's Office is directed to accept as filed under seal the Trust's Complaint to Avoid and Recover Transfers Pursuant to 11 U.S.C. §§ 544, 548 and 550, and §§ 24.001 et seq. of the Texas Uniform Fraudulent Transfer Act.").

as Think.<sup>200</sup> The rump business left in the Think entity continued to provide technology and administrative services to the tribal lenders up until its 2017 bankruptcy.<sup>201</sup> In the face of a new regulatory environment, Elevate, Think's real successor, moved back to a revamped version of Think's original rent-a-bank model. The remainder of this section examines the current Elevate rent-a-bank model in detail.

*C. Elevate Credit, Inc.*

Elevate operates as a state-licensed lender making direct loans itself in several states. It operates primarily, however, through bank partnerships with two small state-chartered and FDIC-regulated banks, Republic Bank & Trust Company of Kentucky (\$6.5 billion in total assets, 1,086 employees)<sup>202</sup> and FinWise Bank ("FinWise") of Utah (\$326 million in total assets, ninety-eight employees).<sup>203</sup> Not coincidentally, both Kentucky and Utah allow unlimited interest on smaller contractual loans.<sup>204</sup> The fact that Elevate makes the loans itself in states where there the usury cap is not an obstacle underscores that its relationship with the banks is solely about evading state usury laws and not because of value the banks otherwise bring.

Elevate lends to nonprime consumers and consumers with thin credit files or no credit scores.<sup>205</sup> It offers two credit products, Elastic and RISE, in the United States.<sup>206</sup> Elastic is a line of credit product for

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200. Think Finance Disclosure Statement, *supra* note 176, at 17.

201. *See id.* at 3.

202. Republic Bank & Trust Company, FED. DEPOSIT INS. CORP., <https://www7.fdic.gov/sdi/main.asp> [<https://perma.cc/UY96-2PWX>] (last updated Mar. 31, 2021).

203. FinWise Bank, FED. DEPOSIT INS. CORP., <https://www7.fdic.gov/sdi/main.asp> [<https://perma.cc/T67Y-4Y23>] (last updated Mar. 31, 2021).

204. Kentucky law provides,

Notwithstanding the provisions of any other law, a bank may take, receive, reserve, and charge on money due or to become due on any contract or other obligation in writing, where the original principal amount is fifteen thousand dollars (\$15,000) or less, interest at any rate allowed national banking associations by the laws of the United States of America.

KY. REV. STAT. ANN. § 286.3-214 (West 2021); UTAH CODE ANN. § 15-1-1 (LexisNexis 2021) ("The parties to a lawful written, verbal, or implied contract may agree upon any rate of interest for the contract, including a contract for services, a loan or forbearance of any money, goods, or services, or a claim for breach of contract.").

205. *See* Elevate Credit, Inc., Annual Report (Form 10-K) 15 (Feb. 14, 2020) [hereinafter Elevate 2020 Annual Report].

206. *Id.* at 7.

loans between \$500 and \$4,500 for up to ten months.<sup>207</sup> Elastic is offered in some forty states, solely through a bank partnership with Republic Bank.<sup>208</sup> The weighted average effective annual percentage rate (“APR”) on Elastic loans is 98 percent,<sup>209</sup> well above most states’ usury caps.

The RISE product varies by state. It is sometimes an installment loan product and sometimes a line of credit product. Elevate is a licensed nonbank lender in several states where it offers RISE directly.<sup>210</sup> It also offers RISE through a credit services organization in one state,<sup>211</sup> but in nineteen states it offers RISE through a partnership with FinWise Bank.<sup>212</sup> The partnership RISE product is for a loan between five hundred and six hundred dollars, with a maturity of seven to twenty-six months.<sup>213</sup> The weighted average effective APR on the RISE loans is 129 percent,<sup>214</sup> again well above most states’ usury caps.<sup>215</sup>

Elevate’s secret sauce for all of its products is its proprietary underwriting technology platform. Elevate boasts,

Our proprietary risk analytics infrastructure utilizes a massive (approximately 80+ terabyte[s]) Hadoop database composed of more than ten thousand potential data variables related to each of the 2.4 million customers we have served and about 8.6 million applications that we have processed. Our team of over 50 data scientists uses our proprietary technology to build and test scores and strategies across the entire underwriting process, including segmented credit scores, fraud scores, affordability scores and former customer scores. We use a variety of analytical techniques from traditional multivariate regression to machine learning and artificial intelligence to continue to enhance our underwriting accuracy while complying with applicable US and UK lending laws and regulations.<sup>216</sup>

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207. *Id.* at 15.

208. *Id.* at 9.

209. *Id.* The annual percentage rate is a standardized measure of the cost of credit as a yearly rate. 12 C.F.R. § 1026.14(a) (2021) (addressing open-end credit calculation); 12 C.F.R. § 1026.22(a) (2021) (close-end credit calculation).

210. *See* Elevate 2020 Annual Report, *supra* note 205, at 115.

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

212. Elevate 2020 Annual Report, *supra* note 205, at 8.

213. *Id.*

214. *Id.*

215. *State Rate Caps for \$500 and \$2,000 Loans*, NAT’L CONSUMER L. CTR. (July 2021), [https://www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/payday\\_loans/FS\\_State\\_Rate\\_Caps\\_2021.pdf](https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/FS_State_Rate_Caps_2021.pdf) [<https://perma.cc/V2GF-TP5P>].

216. Elevate 2019 Annual Report, *supra* note 9, at 8.

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

*D. Elevate's Rent-a-Bank Nexus of Contracts*

Elevate has separate but similar rent-a-bank arrangements for both its Elastic and RISE products. The arrangements differ primarily in the identity of the partner bank and the extent of the partner bank's retained interest in the loans, but are otherwise materially the same. Critically, in both of the arrangements, Elevate—not the bank—created and proposed the product.

Elevate's relationships with Republic Bank and FinWise each consists of three contracts (and amendments thereto): a joint marketing agreement;<sup>217</sup> a technology license and support agreement;<sup>218</sup> and a participation interest purchase and sale agreement.<sup>219</sup> Another important set of contracts is Elevate's funding agreements.

Notably, while the bank is a party on each of the agreements, a different Elevate-affiliated entity is the counterparty:

- The joint marketing agreements have either Elevate@Work, LLC, or EF Marketing, LLC, as the Elevate parties.<sup>220</sup> Both are single-member LLCs, the sole member of which is another Elevate entity (Elastic Financial, LLC, or EF Financial, LLC, respectively), which is itself a single-member LLC, with Elevate Credit, Inc. as the sole member.<sup>221</sup>
- The technology license agreements are between the banks and an Elevate Credit, Inc. subsidiary called Elevate Decision Sciences,

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217. Elevate Registration Statement, *supra* note 9, Exhibit 10.5, 1; Elevate 2019 Annual Report, *supra* note 9, at 679.

218. Elevate Registration Statement, *supra* note 9, Exhibit 10.6, 1; Elevate 2019 Annual Report, *supra* note 9, at 736.

219. Elevate Registration Statement, *supra* note 9, Exhibit 99.1, 1; Elevate 2019 Annual Report, *supra* note 9, at 782.

220. Elevate@Work, LLC, subsequently changed its name to Elastic Marketing, LLC. Elevate Credit, Inc., Quarterly Report (Form 10-Q), Exhibit 10.1 (June 30, 2018).

221. Elevate 2019 Annual Report, *supra* note 9, at 325, 603.

LLC.<sup>222</sup> Elevate Decision Sciences is another single-member LLC, with Elevate Credit, Inc. as the sole member.<sup>223</sup>

- The participation interest purchase and sale agreements are between the banks and SPVs structured as Cayman Island exempted companies, Elastic SPV, Ltd., and EF SPV, Ltd., respectively.<sup>224</sup> The SPVs are not formally part of Elevate Credit, Inc.'s corporate group; their nominal equity is held in trust, but they conduct no business other than facilitating Elevate's financing of Elastic and RISE loans, and they are consolidated for financial reporting purposes.<sup>225</sup> Elevate provides all the management services for the SPVs through administrative services agreements.<sup>226</sup>

Each agreement is discussed in turn below.

1. *The Joint Marketing Agreements.* The joint marketing agreements are the lynchpin of the relationship between Elevate and its partner banks. The joint marketing agreements set forth Elevate's responsibility to design and market the loans, but the agreements give the banks the right to approve the terms of the loan. For example, the joint marketing agreement with FinWise Bank provides that FinWise may offer loans to consumers who apply

at one or more websites, direct mail or other marketing channels operated or identified by [EF Marketing, LLC] and approved by [FinWise Bank] and who meet applicable credit standards and other qualifications established by [FinWise Bank]. [FinWise Bank] may change the terms and conditions applicable to the Loans, fees charged to Borrowers, maximum amount of credit lines, the Program Guidelines, the Credit Policy, the Credit Model Policies and the Underwriting Criteria.<sup>227</sup>

At first blush, it would seem that FinWise controls the terms of the loans and the underwriting criteria, but an inspection of the definitions

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222. *Id.* at 325.

223. *Id.*

224. *Id.* at 41, 77. The ownership of Cayman Island exempted companies is not public, but Cayman Islands SPVs are generally "orphan" SPVs with the equity held by a charitable or purpose trust. *See* CONYERS, DILL & PEARMAN, *SECURITIZATION IN THE CAYMAN ISLANDS* 4 (2016) (explaining orphan SPV structures).

225. Elevate 2019 Annual Report, *supra* note 9, at 87.

226. *Id.* at 739; Elevate Registration Statement, *supra* note 9, Exhibit 10.7, 1.

227. Elevate 2019 Annual Report, *supra* note 9, at 679.

for the contract shows that the arrangement is more complex. “Program Guidelines” are defined as the “guidelines proposed by [EF Marketing, LLC] and approved by [FinWise Bank] . . . including . . . the Credit Policy or Underwriting Criteria . . . [and] the Credit Model Policies . . . .”<sup>228</sup> In other words, Elevate created and proposed the entire design of the RISE product, including the underwriting guidelines. While FinWise has to ultimately sign off on the product, it did not design the product, and presumably FinWise would not have entered into the joint marketing agreement with Elevate without having a good idea of what the RISE product would look like.

How the contractual relationship has played out in fact is unclear. For example, has FinWise ever refused a proposal from Elevate? Has FinWise ever sought to change the program’s terms? The contract contemplates the possibility that the answer to both questions could be no, with FinWise merely rubber-stamping Elevate’s proposals. Indeed, if Elevate is the entity with the lending expertise, with its enormous database and team of data scientists that almost outnumbers FinWise’s entire workforce, it is hard to see how FinWise could possibly exercise any material input into the loans’ terms. Elevate’s agreement with Republic Bank for Elastic is materially similar.<sup>229</sup>

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

- (A) acquiring, scrubbing and managing lead lists, (B) preparing and distributing product offerings and associated marketing materials, including pre-qualified offers, as approved by FB, (C) developing and placing internet, print media, radio and television advertising, (D) designing and developing websites, (E) compensating third parties

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228. *Id.* at 701.

229. As explained in the joint marketing agreement,

“*Program Guidelines*” shall mean those guidelines established by RB for the administration of the Program, including, but not limited to, underwriting standards for the Accounts (which shall include, without limitation, specific criteria for evaluating an Applicant’s ability to repay the Account, including the Initial Advance and all Subsequent Advances thereunder), the credit, charge-off and collection policies for the Accounts, and all other operating procedures for the Accounts, as such guidelines may be amended, modified or supplemented from time to time by RB in accordance with the terms of this Agreement.

Elevate Registration Statement, *supra* note 9, Exhibit 10.5, 25.

that provide marketing services in relation to the Program, (F) subject to FB's approval, delivering all notices and disclosures required by applicable Law with each solicitation, and (G) contracting with mutually agreed third parties to offer the Program to their clients.<sup>230</sup>

In exchange for these services, FinWise pays EF Marketing a marketing fee for each new loan that is made.<sup>231</sup> This fee is offset by other fees paid by Elevate entities to FinWise.<sup>232</sup> Thus, pursuant to the joint marketing agreement, Elevate proposes the loan product's design and underwriting criteria and handles marketing of the loan in exchange for a fee from FinWise. The terms of Elevate's agreement with Republic Bank for Elastic are materially similar.<sup>233</sup>

2. *Technology License Agreement.* The technology license agreements are licenses for the banks to use Elevate's software in exchange for a per-loan fee.<sup>234</sup> The software is described as "an internet-based consumer credit platform that permits the collection, verification, scoring, evaluation, funding, and account management of installment loans."<sup>235</sup> It includes "an internet website landing page," "an accounting and loan tracking system" to ensure compliance with all applicable laws, and "internet-based financial wellness materials for Borrowers."<sup>236</sup> It also generates credit bureau reporting files in the standard Metro II data format used by the major consumer reporting agencies.<sup>237</sup> The software is hosted on hardware located in a data center under contract with Elevate.<sup>238</sup>

For Elastic, the software also enables automatic draws on the borrower's bank account.<sup>239</sup> The software automates virtually the entire loan process from the time a consumer applies for a loan to the

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230. Elevate 2019 Annual Report, *supra* note 9, at 680.

231. *Id.* at 682.

232. *Id.* at 682–83.

233. Elevate Registration Statement, *supra* note 9, Exhibit 10.5, § 2(a), (d).

234. Elevate 2019 Annual Report, *supra* note 9, at 705, 719.

235. *Id.* at 719.

236. Elevate Credit, Inc., Quarterly Report (Form 10-Q) Exhibit 10.2, § 4 (Aug. 10, 2018) [hereinafter Elevate Quarterly Report for Third Quarter 2018].

237. Elevate 2019 Annual Report, *supra* note 9, at 719; Elevate Quarterly Report for Third Quarter 2018, *supra* note 236.

238. Elevate 2019 Annual Report, *supra* note 9, at 719; Elevate Quarterly Report for Third Quarter 2018, *supra* note 236. For RISE, this was Amazon Web Services as of the contract date. See Elevate 2019 Annual Report, *supra* note 9, at 707.

239. Elevate Quarterly Report for Third Quarter 2018, *supra* note 236.

underwriting, funding, and servicing of the loan. All the bank needs to do is press go.

The RISE technology license requires Elevate to provide the bank with “reasonable access to its Technical Information, credit and business models underlying the Credit Model Policy, including all pricing, credit, and underwriting assumptions thereto and the Credit Model Documentation,” and the bank has a right to test and validate the information.<sup>240</sup> The Elastic license merely requires Elevate to provide “reasonable cooperation” in connection with Republic Bank’s testing and validation of the software.<sup>241</sup> Republic Bank does not have a contractual right to access the underlying software’s coding, for instance, for Elastic.

It is unclear whether the banks have ever in fact exercised their access, testing, and validation rights under the contracts. Given that Elevate is the party with the technical expertise, the partner banks may not even have the wherewithal to test and validate the software. Notably, the reasonable access provision contradicts another provision of the technology license, which forbids the bank to look under the hood at the software’s code.<sup>242</sup> The license agreement structure means that the loans are made using software that is a black box to the bank, such that the bank does not actually understand the underwriting decisions.

The technology license agreement also includes an account servicing provision in which Elevate undertakes to perform most of the loan servicing duties. This includes maintaining account information, providing initial account opening disclosures and periodic billing statements, posting payments to borrowers’ accounts, and producing reports on the accounts.<sup>243</sup> Thus, it is Elevate, not Republic Bank, that

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240. Elevate 2019 Annual Report, *supra* note 9, at 720.

241. Elevate Registration Statement, *supra* note 9, Exhibit 10.6, Exhibit A, § D.

242. *See id.* at Exhibit 10.6, § 4 (“Licensee shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part . . . .”); *see also* Elevate 2019 Annual Report, *supra* note 9, at 708 (“FB shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part . . . .”).

243. Elevate Registration Statement, *supra* note 9, Exhibit 10.6, Exhibit D, § 1; Elevate 2019 Annual Report, *supra* note 9, at 726. The Elastic Participation Agreement says that Republic will service loans or arrange for a third party to service the loans. Elevate Registration Statement, *supra* note 9, Exhibit 99.1, § 3(a).

maintains the relationship with the customer from loan origination through the life of the loan.

3. *Participation Agreement.* The third leg of Elevate's contractual rent-a-bank nexus is the participation purchase and sale agreement. Elevate's participation purchase and sale agreements are technically option contracts that give Elastic SPV and EF SPV an option, but not an obligation, to purchase participation interests in the loans made by Republic Bank and FinWise Bank, respectively. Specifically, Elastic SPV has the option to purchase a 90 percent participation interest from Republic Bank, while EF SPV has the option to purchase a 96 percent participation interest from FinWise.<sup>244</sup> The purchase price is equal to the outstanding principal amount of the loan times the participation percentage plus a purchase premium and a participation fee.<sup>245</sup> This fee offsets the marketing and technology license fees paid by the banks to the Elevate entities.

The Elastic Participation Agreement means that Republic Bank retains the Elastic loans on its books and is outwardly the legal party in interest in the loans, even though it only has a 10 percent economic interest in the loans. The RISE participation agreement means that FinWise Bank retains the RISE loans on its books and is outwardly the legal party in interest, even though it only has a 4 percent economic interest.<sup>246</sup> By structuring the participation purchases as options, it would appear that Republic Bank and FinWise Bank could find themselves in a position where they make Elastic or RISE loans, only to discover that they are holding 100 percent of the economic exposure on those loans because the Elevate entities have elected not to exercise their purchase option. A closer look at the participation agreements, however, shows that there is virtually no chance that Elevate entities will not exercise the option.

Using the Elastic Participation Agreement as the paradigm, we see that Elastic SPV's option is to purchase a participation interest in any advance funded at least three business days prior.<sup>247</sup> But Elastic SPV must notify Republic Bank of its election to purchase "not less

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244. Elevate 2019 Annual Report, *supra* note 9, at 76–77; Elevate Registration Statement, *supra* note 9, Exhibit 99.1, § 2(b).

245. Elevate 2019 Annual Report, *supra* note 9, at 76–77; Elevate Registration Statement, *supra* note 9, Exhibit 99.1, § 2(b).

246. Elevate 2019 Annual Report, *supra* note 9, at 76–77.

247. Elevate Registration Statement, *supra* note 9, Exhibit 99.1, § 2(a).

than three (3) Business Days prior to the related Purchase Date.”<sup>248</sup> In other words, Elastic SPV must notify Republic Bank at the time of origination if it will be purchasing the loans. While the actual purchase does not happen for three days,<sup>249</sup> Elastic SPV is already contractually obligated for the purchase, and the purchase obligation is collateralized with an account at the bank. This means that Republic Bank never has to loan without knowing if Elastic SPV will buy the participation interest. Moreover, if Elastic SPV has purchased an interest in an initial advance to a borrower, it is deemed to have agreed to purchase an interest in any Subsequent Advance.<sup>250</sup> For a revolving line of credit, this means that once one dollar is advanced, Elastic will buy all subsequent advances. The original RISE participation agreement is not publicly available, only its amendments, but presumably it has similar terms.

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

The SPVs are themselves nothing more than pass-through conduits used for bankruptcy remoteness purposes. Their use ensures that the investors in the SPV will not have to compete with Elevate’s other creditors for rights in the participation interests in the event of Elevate’s bankruptcy (hardly an impossibility in light of Think Finance’s 2017 bankruptcy). The funding for the SPVs comes through a credit agreement with none other than the same entity that funded Think Finance—an investment firm called Victory Park Capital.<sup>251</sup> Specifically, Elastic SPV and EF SPV each have a loan facility with Victory Park Capital (multiple Victory Park Capital funds are lenders to each SPV).<sup>252</sup> Those loan facilities are guaranteed by Elevate Credit,

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248. *Id.* § 2(b).

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

250. *Id.* § 2(a).

251. Elevate 2019 Annual Report, *supra* note 9, at 146.

252. *Id.*

Inc. through a credit default protection agreement, such that any credit losses on the loans fall on Elevate Credit, Inc., in exchange for a fee.<sup>253</sup>

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

#### *E. Contractual Doublespeak*

Looking at the entirety of Elevate's relationships with Republic Bank and FinWise Bank, it is impossible to conclude that the banks play any meaningful role in the lending process. To be sure, they nominally retain the entire loan, but the sale of the participation interest shifts almost all of the credit risk to the Elevate SPVs. The banks play no meaningful role in the design of the products, in their marketing, in the underwriting of borrowers, or in the servicing of the loans. Instead, the only purpose of the banks' involvement with the products appears to be facilitating evasion of state usury laws. This is particularly clear with RISE, because Elevate offers the product directly in states where it can do so without violating the state's usury laws. Elevate does not offer RISE directly in states with a usury cap, but instead partners with a FinWise Bank in those states. There is no obvious gain from adding FinWise Bank to the mix, much less only in the states with usury caps. To the contrary, adding in the bank partner only adds transaction costs and operational inefficiencies. The only purpose for FinWise Bank's involvement is to enable Elevate to claim that RISE is not violating usury laws.

Elevate appears to be aware of the issue. In both the contracts and its annual report, Elevate takes pains to insist that its bank partners maintain control over the entire product, even though it provides the marketing, the website, the technology platform, and the underwriting, funding, and servicing of the loans.<sup>254</sup> For example, Elevate states in its annual report:

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253. *Id.* at 135.

254. According to the Elastic Participation Agreement,

RB and ESPV each acknowledge and agree that it is the intention of the Parties that RB is the sole lender with respect to the Accounts and the Receivables, and ESPV shall

Under the terms of our agreement with Republic Bank, we provide them with marketing services related to the Elastic program and license them our technology platform and proprietary credit and fraud scoring models to originate and service Elastic customers. However, as the originator of the Elastic lines of credit, Republic Bank reviews and approves all marketing materials and campaigns and determines the underwriting strategies and score cutoffs used in processing applications. In addition, Republic Bank defines all program parameters and provides full compliance oversight over all aspects of the program.<sup>255</sup>

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

Credit and fraud determinations are made in seconds and approximately 94% of loan applications for all products are fully automated with no manual review required, based on our proprietary credit and fraud scoring models and affordability assessments. Once approved, the customer is provided the loan amount and relevant terms of credit being offered. Of the approximately 6% of loan applications requiring manual review, in the US the majority require further documentation, which can be provided via scanning, fax, email or mail, others may have failed a fraud rule in the applicable underwriting methodology, and are managed based on the rule failed, and others are reviewed to address “know your customer” and/or [Office of Foreign Asset Control] requirements.<sup>256</sup>

This means that for 94 percent of loans, the bank has no real involvement in the underwriting decision. The underwriting criteria

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not assert that it is the lender of the Accounts and the Receivables in connection with any litigation, regulatory purpose or any other purpose.

Elevate Registration Statement, *supra* note 9, Exhibit 99.1, § 19(e). Additionally, in the Form 10-K, the parties state,

We do not originate and do not ultimately control the pricing or functionality of Elastic lines of credit originated by Republic Bank, Rise loans originated by FinWise Bank (“FinWise”) and the Today Card originated by Capital Community Bank (“CCB”) (collectively the “Bank-Originated Products” and the “Bank Partners” or the “Banks.”)

Elevate 2019 Annual Report, *supra* note 9, at 43.

255. Elevate Credit, Inc., Annual Report (Form 10-K) 9 (Feb. 26, 2021) (Elastic); *id.* at 8 (RISE).

256. Elevate 2019 Annual Report, *supra* note 9, at 19. Additionally, the form states that “[a]s a result of our proprietary technology and risk analytics, approximately 94% of loan applications are automatically decisioned in seconds with no manual review required.” *Id.* at 8.

are proposed by Elevate (subject to the bank's approval), and the actual underwriting is done automatically in almost all cases by the software Elevate licensed to the bank. While that software should reflect the agreed-upon criteria, it is contractually a black box to the bank.<sup>257</sup> As for the other 6 percent of cases, the underwriting is still automated through the black box software, but with manual document collection and data input. In other words, for all intents and purposes, the underwriting is all done by Elevate, even if it is the bank that presses the go button.

Likewise, the structuring of the transactions as sales of participation interests seems designed to give Elevate a stronger basis for claiming that the banks are in fact the lender—after all, the loans remain on the banks' books the entire time. Indeed, from a consumer's perspective, this arrangement is potentially deceptive. The consumer might reasonably believe that the bank was the real party in interest on the loans and therefore that the applicable usury law was the one applicable to the bank, not the one applicable to Elevate entities.

There is no obvious reason why Elevate would choose to use a participation purchase structure rather than an outright sale other than to strengthen its claim to shelter in the banks' regulatory status. A purchase of a participation interest is inherently a riskier investment than a purchase of a loan outright in part because the holder of the participation interest lacks the ability to control the loan completely. Elevate largely sidesteps these risks via contract, but that is the point—the only reason to go to so much trouble creating an ersatz loan purchase is because an actual loan purchase would reduce Elevate's claim that the bank is the actual lender. Whether Elevate's state-of-the-art rent-a-bank structure holds up remains to be seen; Elevate has been sued by the District of Columbia for violating the District's usury laws.<sup>258</sup>

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257. See Elevate Registration Statement, *supra* note 9, Exhibit 10.6, § 4 (“Licensee shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part . . . .”); Elevate 2019 Annual Report, *supra* note 9, at 708 (“FB shall not itself, or through any parent, subsidiary, Affiliate or any other third party: (a) modify, decode, decompile, disassemble, reverse engineer or otherwise translate the Software, Documentation or Tools, in whole or in part . . . .”).

258. Complaint for Violations of the Consumer Protection Procedures Act at 3–4, District of Columbia v. Elevate Credit, Inc., 2020-CA-002697 (D.C. Sup. Ct. June 5, 2020). The District of Columbia has also sued Opportunity Financial, another nonbank lender that partners with a bank (again, FinWise Bank, one of Elevate's partner banks) for violation of the District's usury and

There are two key takeaways here. First, this case study underscores the sophisticated and deliberate design of rent-a-bank structures that have been constructed to provide insulation from legal challenges. And second, but for Elevate being a public reporting company, the details of its rent-a-bank arrangements, and even their very existence, would be unknown. The use of a sale of participation interests, rather than a sale of the loans outright, makes Elevate's involvement in the loans all but invisible. This Article's conclusion will return to the significance of this point.

#### IV. THREE COMPETING DOCTRINAL APPROACHES

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

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

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

The legal viability of rent-a-bank schemes is premised on a doctrine called valid-when-made. This doctrine holds that if a loan was not subject to a state usury law when it was made, it can never subsequently become so upon transfer.<sup>259</sup> Thus, if a loan is made by a

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lending licensing laws. Complaint for Violations of the Consumer Protection Procedures Act at 2, District of Columbia v. Opportunity Fin., LLC, 2021-CA-001072 (D.C. Sup. Ct. Apr. 5, 2021).

259. See *Kaur v. World Bus. Lenders, LLC*, 440 F. Supp. 3d 111, 121 (D. Mass. 2020) (describing the supposed doctrine as "if the interest rate in the original loan agreement was non-usurious, the loan cannot become usurious upon assignment—so, the assignee lawfully may

bank that is exempt from state usury laws by virtue of the National Bank Act of 1864 (“NBA”) or Federal Deposit Insurance Act (“FDIA”), the loan will remain exempt from state usury laws in the hands of a nonbank transferee that is not exempt from state usury laws.

Proponents of valid-when-made argue that it is a “well established” common law doctrine and that it is a “cardinal rule” of banking law and essential for the functioning of banking markets.<sup>260</sup> Specifically, they argue that the doctrine is necessary to protect bank liquidity<sup>261</sup> and to vindicate banks’ powers to charge interest and to sell loans.<sup>262</sup> Without the doctrine, its proponents argue, there is uncertainty about whether higher rate loans are sellable, which can lead to inefficient pricing in secondary markets.<sup>263</sup>

Valid-when-made proponents further argue that the doctrine was incorporated into section 85 of the NBA, the interest rate exportation provision for national banks.<sup>264</sup> The NBA incorporates the common law as it existed in 1864,<sup>265</sup> and valid-when-made is purported to have

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charge interest at the original rate” (quoting *Rent-Rite Superkegs W., Ltd. v. World Bus. Lenders, LLC* (*In re Rent-Rite Superkegs W., Ltd.*), 603 B.R. 41, 66 (Bankr. D. Colo. 2019))).

260. Brief of the Clearing House Ass’n, L.L.C., Fin. Servs. Roundtable, Consumer Bankers Ass’n, and Loan Syndications and Trading Ass’n as *Amici Curiae* in Support of Rehearing and Rehearing *en Banc* at 5–6, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d. Cir. 2015) (No. 14-02131-cv) (quoting *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833)); Brief of the Structured Fin. Indus. Grp., Inc., and the Sec. Indus. and Fin. Mkts. Ass’n as *Amici Curiae* in Support of Defendants-Appellees’ Petition for Rehearing and Suggestion for Rehearing *en Banc* at 8, *Madden v. Midland Funding, LLC*, 86 F.3d 246 (2d. Cir. 2015) (No. 14-02131-cv); *see also* Petition for Panel Rehearing and Rehearing *en Banc* by Defendant-Appellees at 13–14, *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d. Cir. 2015) (No. 14-02131-cv) (arguing that the valid-when-made doctrine is a “cardinal principle” and “essential for [the bank’s] operations”).

261. *See, e.g.*, Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33,530, 33,532–33 (June 2, 2020) (to be codified at 12 C.F.R. pts. 7 & 160); Federal Interest Rate Authority, 85 Fed. Reg. 44,146, 44,149, 44,151 (July 22, 2020) (to be codified at 12 C.F.R. pt. 331).

262. Reply in Support of Motion to Dismiss by Defendants Chase Card Funding LLC, Chase Issuance Trust, and Wilmington Trust Company at 8–9, *Petersen v. Chase Card Funding, LLC*, No. 19-cv-00741 (W.D.N.Y. Oct. 8, 2019).

263. *See, e.g.*, *Marvin*, *supra* note 57, at 1839–40.

264. National Bank Act § 16, 12 U.S.C. § 85.

265. *See Voisine v. United States*, 136 S. Ct. 2272, 2286 (2016) (“[W]e presume that Congress legislates against the backdrop of the common law . . . .”); *Samantar v. Yousuf*, 560 U.S. 305, 320 (2015) (instructing courts to follow “[t]he canon of construction that statutes should be interpreted consistently with the common law . . . [to] interpret a statute that clearly covers a field formerly governed by the common law”); *Isbrandtsen Co., Inc. v. Johnson*, 343 U.S. 779, 783 (1952) (“[S]tatutes which invade the common law . . . are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident.”).

been part of the usury common law that was incorporated into the statute.<sup>266</sup> They further claim that it is incorporated into section 1831d of the FDIA,<sup>267</sup> enacted in 1980,<sup>268</sup> which preempts state usury laws for state-chartered banks, because FDIA section 1831d is patterned on section 85 of the NBA and is read *in pari materia* with the NBA.<sup>269</sup> Proponents also argue that the doctrine follows from the common law of contracts because the assignee of a contract takes all the contractual rights of an assignor. Accordingly, a nonbank transferee merely steps into the shoes of a bank from which it acquires a loan and accedes to all the bank's rights and privileges, including exemption from state usury laws.<sup>270</sup>

The Office of the Solicitor General and the OCC endorsed the valid-when-made doctrine in a brief opposing granting a writ of certiorari in *Madden*.<sup>271</sup> The OCC and FDIC subsequently endorsed the doctrine in another amicus brief.<sup>272</sup> In 2020, the OCC and FDIC codified the doctrine in a pair of nonuniform rulemakings.<sup>273</sup>

The OCC rule provides that “interest on a loan that is permissible under [the National Bank Act] shall not be affected by the sale,

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266. See Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. at 33,532; Letter from Structured Fin. Ass'n and Bank Pol'y Inst. on Proposed Rule on Federal Interest Rate Authority, RIN 3064-AF21 (Feb. 4, 2020), <https://bit.ly/393X1jy> [<https://perma.cc/M877-8PJW>]; see also *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991) (noting a presumption that Congress legislates in light of the common law); *SCA Hygiene Prods. Aktiebolag v. First Quality Baby Prods., LLC*, 137 S. Ct. 954, 966 (2017) (discussing the “presumption that Congress legislates against the background of general common-law principles”).

267. Depository Institutions Deregulation and Monetary Control Act of 1980 § 521, 12 U.S.C. § 1831d.

268. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 521, 94 Stat. 193 (codified as amended in scattered sections of 12 U.S.C.).

269. See *Greenwood Tr. Co. v. Massachusetts*, 971 F.2d 818, 827 (1st Cir. 1992); Amicus Brief of the Fed. Deposit Ins. Corp. and Off. of the Comptroller of the Currency in Support of Affirmance and Appellee at 5–6, *Rent-Rite Superkegs W., Ltd. v. World Bus. Lenders, LLC* (*In re Rent-Rite Superkegs W., Ltd.*), 603 B.R. 41, 66 (Bankr. D. Colo. 2019) (No. 19-cv-01552) [hereinafter FDIC/OCC Amicus Brief].

270. FDIC/OCC Amicus Brief, *supra* note 269, at 14–16.

271. The Solicitor General opposed a grant of certiorari on the grounds that the case was not a good vehicle, but still argued that it was wrongly decided. Brief for the United States as Amicus Curiae at 13, 17, *Midland Funding, LLC v. Madden*, 577 U.S. 1214 (2016) (No. 15-610) (jointly filed by the Solicitor General and the Office of the Comptroller of the Currency).

272. FDIC/OCC Amicus Brief, *supra* note 269, at 3.

273. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pts. 7 & 160); Federal Interest Rate Authority, 85 Fed. Reg. 44,146 (July 22, 2020) (to be codified at 12 C.F.R. pt. 331).

assignment, or other transfer of the loan.”<sup>274</sup> In other words, for national banks, the OCC rule provides that section 85 of the NBA applies to a loan even if it has been transferred to a nonbank.

The FDIC rule, in contrast, purports to clarify the timing for evaluating an interest rate for purposes of the FDIA by providing that whether interest on a loan is permissible under the FDIA “is determined as of the date the loan was made” and is not affected by “the sale, assignment, or other transfer of the loan, in whole or in part.”<sup>275</sup> State attorneys general have challenged both the OCC and FDIC rules.<sup>276</sup>

### B. *The Madden Rule*

An alternative approach to the application of state usury laws to a nonbank assignee of a bank emerged in the Second Circuit’s 2015 decision in *Madden v. Midland Funding*.<sup>277</sup> *Madden* involved a putative class action brought against a nonbank debt buyer, Midland Funding, for violation of New York’s usury law.<sup>278</sup> Midland had purchased the defaulted credit card debt of named plaintiff Saliha Madden from FIA Card Services, N.A., a national bank subsidiary of Bank of America, N.A., itself another national bank.<sup>279</sup> Madden was a New York resident.<sup>280</sup> The debt had an annual interest rate of 27 percent and purported to be governed by Delaware law.<sup>281</sup> Delaware allows credit card debt to have whatever interest rate is agreed upon contractually,<sup>282</sup> whereas New York has a 16 percent usury cap.<sup>283</sup> After Midland attempted to collect the debt of approximately five thousand dollars

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274. 12 C.F.R. § 7.4001(e) (2020); *see also* 12 C.F.R. § 160.110(d) (2020) (providing identical regulation for federal savings associations).

275. 12 C.F.R. § 331.4(e) (2020).

276. Complaint at 2, California *ex rel.* Becerra v. FDIC, No. 20-cv-5860 (N.D. Cal. Aug. 20, 2020); Complaint at 2, California *ex rel.* Becerra v. Off. of the Comptroller of the Currency, No. 20-cv-5200 (N.D. Cal. July 29, 2020).

277. *Madden v. Midland Funding*, 786 F.3d 246 (2d Cir. 2015).

278. *Id.* at 247.

279. *Id.* at 247–48.

280. *Id.* at 247.

281. *Id.* at 248.

282. DEL. CODE ANN. tit. 5, § 943 (West 2021).

283. The Second Circuit cites New York’s 25 percent annual rate for criminal usury. *Madden*, 786 F.3d at 248 (citing N.Y. PENAL LAW § 190.40 (Consol. 2021)). The civil usury rate applicable to a bank in New York is 16 percent annually. N.Y. GEN. OBLIG. LAW § 5-501(1) (McKinney 2021); N.Y. BANKING LAW § 14-a(1) (McKinney 2021).

from *Madden*, she brought suit for violation of New York's usury law and the federal Fair Debt Collection Practices Act.<sup>284</sup>

The district court held that the NBA would preempt any usury claim against Midland, the nonbank debt buyer,<sup>285</sup> but on appeal, the Second Circuit reversed.<sup>286</sup>

[b]ecause neither defendant is a national bank nor a subsidiary or agent of a national bank, or is otherwise acting on behalf of a national bank, and because application of the state law on which *Madden*'s claims rely would not significantly interfere with any national bank's ability to exercise its powers under the NBA . . . .<sup>287</sup>

For NBA preemption to apply to an entity other than a national bank, the application of state law "must significantly interfere with a national bank's ability to exercise its power under the NBA."<sup>288</sup> This "significantly interfere" standard comes from the U.S. Supreme Court's decision in *Barnett Bank of Marion County, N.A. v. Nelson*,<sup>289</sup> which the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 codified.<sup>290</sup> The Second Circuit reasoned that while "it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states," such an effect does not significantly interfere with national bank powers.<sup>291</sup>

### C. "True Lender" Doctrine

1. *True Lender as an Application of Usury's Anti-Evasion Doctrine.* The valid-when-made rule and the *Madden* rule are both bright-line rules. Whereas valid-when-made looks solely at the loan originator, *Madden* looks instead to the identity of the party holding the loan. Many courts, however, have eschewed such bright line rules in favor of the true lender doctrine that determines the application of usury law based on which party has the real economic interest in the loan.

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284. *Madden*, 786 F.3d at 248.

285. *Id.* at 247.

286. *Id.* at 255.

287. *Id.* at 247.

288. *Id.* at 250.

289. *Barnett Bank of Marion Cnty., N.A. v. Nelson*, 517 U.S. 25 (1996).

290. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, 12 U.S.C. § 25b(b)(1)(B).

291. *Madden*, 786 F.3d at 251.

True lender doctrine has its roots in a long-standing anti-evasion principle in usury law. Historically, courts have looked through a transaction's form to its substance to determine if the form is but a mere contrivance to evade usury laws.<sup>292</sup> As the Supreme Court noted in 1835,

The ingenuity of lenders has devised many contrivances, by which, under forms sanctioned by law, the statute may be evaded. . . . Yet it is apparent, that if giving this form to the contract will afford a cover which conceals it from judicial investigation, the statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction. If that be in fact a loan, no shift or device will protect it.<sup>293</sup>

As the *Ruling Case Law* treatise summarized:

The cupidity of lenders, and the willingness of borrowers to concede whatever may be demanded or to promise whatever may be exacted in order to obtain temporary relief from financial embarrassment, as would naturally be expected, have resulted in a great variety of devices to evade the usury laws; and to frustrate such evasions the courts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that the mere form is immaterial, but that it is the substance which must be considered.<sup>294</sup>

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292. See, e.g., *Whitworth v. Adams*, 26 Va. (1 Rand.) 333, 337–38 (1827) (“[T]he only question in all [usury] cases like the present is, *what is the real substance of the transaction, not what is the colour and form.*” (quoting *Lowe v. Waller*, 2 Doug. 736, 740, 99 Eng. Rep. 470, 472 (K.B. 1781))); *Scott v. Lloyd*, 34 U.S. (1 Pet.) 418, 459 (1835) (“If the real contract was for a loan of money, without any view to a purchase, it is plainly within the statute of usury . . . .”); *Andrews v. Pond*, 38 U.S. (1 Pet.) 65, 76 (1839) (“[A]lthough the transaction . . . appears . . . free from the taint of usury, yet if . . . any part of it[] was intended as a cover for usurious interest, [its] form . . . will not protect [it] from the consequences of usurious agreements . . . .”); *Wetmore v. Brien*, 40 Tenn. (1 Head) 723, 727 (1859) (“[I]f the note were made . . . as an artifice to evade the usury laws . . . the purchaser . . . will be held guilty of usury, if the discount shall have been greater than the legal rate of interest.”); *Mo., Kan. & Tex. Tr. Co. v. Krumseig*, 172 U.S. 351, 356 (1899) (“[T]he question always is whether it was or was not a subterfuge to evade the laws against usury.”); *Seeman v. Phila. Warehouse Co.*, 274 U.S. 403, 408 (1927) (“[T]he form of the transaction must not ‘disguise its real character.’” (quoting *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298, 310 (1864))); *Sachs v. Ginsberg*, 87 F.2d 28, 30 (D.C. Cir. 1936) (“It was the duty of the trial court to look beyond the form . . . and, if found to be a loan and usurious, to bring it within the terms of the statute, no matter how righteous the cloak of formality which was used to conceal its real character.”).

293. *Scott*, 34 U.S. at 446–47.

294. 27 RULING CASE LAW 211 (William M. McKinney & Burdett A. Rich eds., 1920).

Numerous state supreme courts have adopted similar statements,<sup>295</sup> as have federal courts of appeals when applying state law.<sup>296</sup>

This anti-evasion principle has been recently codified in one state<sup>297</sup> and has been reanimated in a string of modern cases dealing

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295. See, e.g., *Pope v. Marshall*, 4 S.E. 116, 118 (Ga. 1887) (“[W]hether a given transaction is a purchase of land or a loan of money . . . depends, not upon the form of the words used in contracting, but upon the real intent and understanding of the parties.”); *Crim v. Post*, 23 S.E. 613, 616 (W. Va. 1895) (“The law evidently intends that the search for usury shall penetrate to the substance.”); *Barry v. Paranto*, 106 N.W. 911, 912 (Minn. 1906) (“It is elementary that no device or scheme intended for the purpose of evading the laws against usury will prevent the courts from giving force to the statute and declaring contracts made in violation thereof null and void.”); *First Nat’l Bank of Ada v. Phares*, 174 P. 519, 521 (Okla. 1918) (“In deciding whether any given transaction is usurious or not, the courts will disregard the form which it may take, and look only to the substance of the transaction in order to determine whether all the requisites of usury are present.” (quoting 39 CYCLOPEDIA OF LAW AND PROCEDURE 918 (William Mack ed., 1912))); *Bank of Lumpkin v. Farmers’ State Bank*, 132 S.E. 221, 221 (Ga. 1926) (“The ingenuity of man has not devised a contrivance by which usury can be legalized . . . [T]he name by which the transaction is denominated is altogether immaterial, if it appears that a loan of money was the foundation and basis of the agreement which is under consideration.”); *Fid. Sec. Corp. v. Brugman*, 1 P.2d 131, 136 (Or. 1931) (“The courts do not permit any shift or subterfuge to evade the law against usury. The form into which parties place their transaction is unimportant. Disguises are brushed aside and the law peers behind the innocent appearing cloaks in quest for the truth.”); *Beacham v. Carr*, 166 So. 456, 459 (Fla. 1936) (“[C]ourts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that the mere form is immaterial, but that it is the substance which must be considered.” (quoting 27 RULING CASE LAW, *supra* note 294)); *Milana v. Credit Disc. Co.*, 163 P.2d 869, 871 (Cal. 1945) (“The courts have been alert to pierce the veil of any plan designed to evade the usury law and in doing so to disregard the form and consider the substance.”); *Austin v. Ala. Check Cashers Ass’n*, 936 So. 2d 1014, 1031–32 (Ala. 2005) (“[I]f . . . [the transaction] is in substance a receiving or contracting for the receiving of usurious interest for a loan or forbearance of money the parties are subject to the statutory consequences, no matter what device they may have employed to conceal the true character of their dealings.” (quoting *Hurt v. Crystal Ice & Cold Storage Co.*, 286 S.W. 1055, 1057 (Ky. Ct. App. 1926))).

296. *Anderson v. Hershey*, 127 F.2d 884, 886 (6th Cir. 1942) (relying on the fact “[t]he courts of Kentucky in usury cases look behind the form of the transaction to its substance”); *Daniel v. First Nat’l Bank of Birmingham*, 227 F.2d 353, 355 (5th Cir. 1956) (“Usurious contracts are condemned by public policy both state and national. . . . That public policy cannot be defeated by the simple expedient of a written contract, but the real substance of the transaction must be searched out.”).

297. The anti-evasion principle was codified in the 2004 Georgia Payday Lending Act, which responded to rent-a-bank payday lending. GA. CODE ANN. § 16-17-1(c) (West 2020) (“[V]arious payday lenders have . . . attempt[ed] to disguise these transactions or to cause these transactions to appear to be ‘loans’ made by a national or state bank chartered in another state . . . even though the majority of the revenues . . . are paid to the payday lender.”). The Georgia Payday Lending Act included a provision that prohibited

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

with rent-a-bank or rent-a-tribe situations under the name of true lender doctrine. These cases attempt to determine which entity was the true lender for the purposes of determining which usury laws apply.<sup>298</sup> Thus, when determining whether New York law applied to a payday lender in a rent-a-bank arrangement, the New York Supreme Court's Appellate Division noted that

we must look to the reality of the arrangement and not the written characterization that the parties seek to give it, much like Frank Lloyd Wright's aphorism that "form follows function." Thus, an examination of the totality of the circumstances surrounding this type of business association must be used to determine who is the "true lender," with the key factor being "who had the predominant economic interest" in the transactions.<sup>299</sup>

While "true lender" is often defined with reference to predominant economic interest, it is ultimately a totality-of-the-circumstances inquiry about which party is serving as the lender. No court has attempted to articulate an exclusive list of factors or their weights, much less whether any factor is determinative.

Notably, only a few courts have outright rejected true lender doctrine.<sup>300</sup> Even some of the modern cases that are cited as supporting

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*Id.* § 16-17-2(b)(4) (West 2020), *upheld by* BankWest, Inc. v. Baker, 411 F.3d 1289, 1293 (11th Cir. 2005), *vacated and appeal dismissed as moot*, 446 F.3d 1358 (11th Cir. 2006) (per curiam). The Georgia Court of Appeals subsequently held that a payday lender could be liable for violating the usury laws through a rent-a-bank transaction. *Ga. Cash Am., Inc. v. Greene*, 734 S.E.2d 67, 75 (Ga. Ct. App. 2012). Subsequently, numerous courts have adopted a similar position, whether in the context of a complete preemption analysis for removal purposes or substantive preemption in a merits ruling. *See supra* note 32 (listing cases). Some have claimed that the true lender doctrine originates with the Georgia statute. *See, e.g.*, John D. Skees, *The Resurrection of Historic Usury Principles for Consumption Loans in a Federal Banking System*, 55 CATH. U. L. REV. 1131, 1154 (2006); Hannon, *supra* note 57, at 1280. The existence of a pair of true lender cases from two years prior to the statute, *see infra* note 298, plus Georgia's well-developed jurisprudence on disguised usury, *see supra* note 295, suggest that the statute was reflective of an established doctrine, rather than the origin of the doctrine. Indeed, the Georgia court of appeals applied the doctrine to a transaction that took place before the enactment of the statute, implying a common law true lender doctrine that had merely been codified. *See Ga. Cash Am., Inc.*, 734 S.E.2d at 75.

298. *Goleta Nat'l Bank v. O'Donnell*, 239 F. Supp. 2d 745, 748 n.2 (S.D. Ohio 2002); *Goleta Nat'l Bank v. Lingerfelt*, 211 F. Supp. 2d 711, 714 n.4, 719 (E.D.N.C. 2002).

299. *Spitzer v. Cnty. Bank of Rehoboth Beach*, 45 A.D.3d 1136, 1138 (N.Y. App. Div. 2007).

300. *Beechum v. Navient Sols., Inc.*, No. 15-8239-JGB-KKx, 2016 U.S. Dist. LEXIS 129782, at \*18 (C.D. Cal. Dec. 20, 2016); *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359, 1367 (D. Utah 2014); *Hudson v. ACE Cash Express, Inc.*, No. IP 01-1336-C H/S, 2002 U.S. Dist. LEXIS 11226, at \*9 (S.D. Ind. May 30, 2002). Despite the deep historical roots of the true lender doctrine, the OCC promulgated a true lender rule that abjured the doctrine. The OCC rule deemed a bank to

the valid-when-made doctrine indicate that the analysis would be different if a true lender allegation had been made.<sup>301</sup> Indeed, a key case often cited as support for valid-when-made actually engages in something like a true lender analysis.<sup>302</sup>

2. *True Lender Doctrine's Application to Disaggregated Lending.* Yet it is also worth noting that no court has yet attempted to apply a true lender analysis to a state-of-the-art rent-a-bank arrangement. Applying true lender analysis to a structure such as Elevate's requires first disregarding the corporate separateness of the various affiliated Elevate entities, as well as the unaffiliated SPV.

For the Elevate entities, collapsing corporate separateness is a straightforward enough step, as they are all under common control. The Elastic SPV or RISE SPV presents a slightly more complicated situation, as the equity interest in the SPV is not held by an Elevate-affiliated entity. Yet it is hard to see the SPVs as anything other than creatures controlled by Elevate: they were created for undertaking the Elevate transactions, carry on no other business, have no employees of their own, and transfer all of their economic risk to Elevate through Elevate's guaranties of the SPVs' obligations.

Notably, Elevate is required to consolidate the SPVs for accounting purposes.<sup>303</sup> The accounting consolidation is based on an economic reality test that looks to whether Elevate has control over activities that both have a significant effect on the SPVs' economic performance and significant economic exposure for the SPVs.<sup>304</sup> Retention of loan servicing gives Elevate the requisite control over the SPV's performance, and the guaranties mean that Elevate is obligated to absorb the expected losses of the SPV. The accounting treatment is

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be the lender for purposes of the interest rate exportation provision of the NBA if the bank were merely "named as the lender in the loan agreement" or "funds the loan." National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68,742, 68,742 (Oct. 30, 2020). In other words, the OCC rule hewed strictly to a form over substance approach that would preclude usury (but not licensing) challenges to rent-a-bank arrangements. Congress, however, overturned the OCC's true lender rule under the Congressional Review Act procedure on a bipartisan vote. S.J. Res. 15, Pub. L. No. 117-24, 135 Stat. 296 (2021). While congressional nullification of the OCC's rule is not the same as an outright endorsement of true lender doctrine, it strongly suggests that Congress believes that it is best left to states to determine the application of usury laws.

301. See *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148 n.15 (5th Cir. 1981).

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

303. Elevate 2020 Annual Report, *supra* note 205, at 87.

304. See FIN. ACCT. STANDARDS BD., FIN. ACCT. FOUND., STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 167, at ii (2009).

not a legal determination, but it is telling because it looks to the economic reality of the transaction. Elevate's accounting treatment indicates that the use of the SPV is in part contrivance to create a legal cutout to separate Elevate and its funder, Victory Park Capital, from the transaction's legal risks.

Even after the various Elevate entities and the SPVs are consolidated for the purposes of true lender analysis, there are still the issues that a bank is the lender of record for both Elastic and RISE and that the loans remain on the bank's balance sheets because it is only a partial participation interest that is sold, not the loans themselves. Again, the nature of the arrangement should make readily clear that it is nothing more than a contrivance to evade usury laws—all of the loans' terms are proposed by Elevate; the banks otherwise do not make similar loans (or even market the loans to their other customers); the participation interest sales are nearly of 100 percent exposure; and the banks have purchased every element of the lending process from Elevate (marketing, underwriting, servicing, and almost all of the funding). The fact that the bank retains nominal control of the underwriting standards is beside the point if the bank does not engage in this sort of collaboration on underwriting standards for its credit products generally, excluding other rent-a-bank style transactions. Thus, there should be little difficulty in concluding that Elevate is the true lender for Elastic and RISE products, no matter the nominal involvement of the banks as lenders of record.

While the application of true lender doctrine to Elevate's products is fairly straightforward, it is less so for marketplace lenders that truly transfer the majority of the credit risk to unaffiliated capital market investors. Elevate's guaranties of the SPVs mean that the economic exposure on the loans circled right back to Elevate through a chain of contracts. How does true lender doctrine apply, however, when the economic exposure on the loans is separated from the design and production of the loans?

Consider Avant, a marketplace lender that makes loans at rates under 36 percent APR.<sup>305</sup> Avant makes the loans directly in states in which the usury caps are not a binding constraint, but in a handful of states where the usury cap is below 36 percent, Avant partners with

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305. *Personal Loans*, AVANT, <https://www.avant.com/personal-loans> [<https://perma.cc/V8R9-DY4V>] (“APRs ranging from 9.95%-35.99%.”).

WebBank, a Utah-chartered industrial bank.<sup>306</sup> One of those states is Colorado, which has a 21 percent usury cap.<sup>307</sup> Based on this, Colorado sued Avant and another marketplace lender, Marlette, for violating its usury statute.<sup>308</sup>

Colorado alleged that WebBank would serve as the initial funder and lender of record on the loans.<sup>309</sup> WebBank, however, would allegedly sell without recourse the receivables on the loans—but not the account relationship—within two business days to an Avant-affiliated entity.<sup>310</sup> Avant allegedly handled all marketing, paid the costs of underwriting, decided which loan applicants would receive loans under the agreed-upon underwriting criteria, handled all servicing and compliance, indemnified WebBank for all claims arising from the partnership, and also paid all of WebBank’s legal fees associated with the program.<sup>311</sup> Moreover, if a consumer was declined for a loan, only Avant allegedly had a right to solicit the consumer for other products; WebBank had no right to contact the would-be customers.<sup>312</sup> Avant and WebBank allegedly shared in the profit on the loans, but WebBank’s share was allegedly only around one percent of the total profit.<sup>313</sup>

Thus far, the description of the Avant program does not differ significantly from that of Elevate’s arrangements. The bank serves as a front for a loan product designed, marketed, underwritten, and serviced by the nonbank that is precluded by usury laws from directly making the loans itself. Avant, however, adds in a twist in the way it financed the loans. Avant retained some of the loans on its own balance sheet<sup>314</sup>—a situation not much different from Elevate’s after its guaranties of the SPVs’ obligations to Victory Park Capital are

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306. Second Amended Complaint ¶¶ 28, 57, *Zavislan v. Avant of Colo. LLC*, No. 2017-cv-30377 (D. Colo. Nov. 30, 2018).

307. COLO. REV. STAT. ANN. § 5-2-501 (West 2021).

308. Second Amended Complaint, *Zavislan v. Avant of Colo. LLC*, No. 2017-cv-30377 (D. Colo. Nov. 30, 2018); Second Amended Complaint, *Fulford v. Marlette Funding, LLC*, No. 2017-cv-30376, 2019 WL 4451038 (D. Colo. June 5, 2019).

309. Second Amended Complaint ¶ 30, *Zavislan v. Avant of Colo. LLC*, No. 2017-cv-30377 (D. Colo. Nov. 30, 2018).

310. *Id.* ¶¶ 31, 51.

311. *Id.* ¶¶ 37, 46, 52.

312. *Id.* ¶ 47.

313. *Id.* ¶ 55.

314. *Id.* ¶ 53.

considered. Avant, however, also shifted some of the exposure on the loans to third-party investors.<sup>315</sup>

Avant sold some of the receivables to institutional investors and securitized others, with Avant continuing to act as servicer for the securitization vehicles.<sup>316</sup> Avant does not seem to guaranty the asset-backed securities issued against the receivables generated through its program with WebBank.<sup>317</sup> In other words, the economic exposure on the securitized receivables has truly shifted to third-party investors.

So who is the true lender in the Avant situation?

- Is it the third-party securitization investors or securitization vehicles that hold the predominant economic interest in the receivables? The investors have the economic exposure to the loans, but they did not make the loans. Instead, they merely bought the receivables in the secondary market.
- Is it WebBank, which owns the loan accounts? WebBank has almost no economic interest in the loans nor does it have much of a role in the lending process, as it does not design, market, underwrite, or service the loans.
- Is it Avant, which designed, marketed, underwrote, and serviced the loans? Avant does not hold an ongoing economic interest in the securitized loans.

The point is that there is no single party that neatly fits the bill of being the true lender because control is divided from economic exposure. Avant has disaggregated the lending process more completely than Elevate. While it is easy to predict how true lender analysis should apply to Elevate, it is less clear with Avant. Although Colorado sued

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315. *Id.*

316. *Id.* ¶¶ 53, 59, 60. The securitizations were both of the loans retained by Avant and loans sold to third parties that Avant repurchased. *Id.* Curiously, Victory Park Capital has been involved in at least some Avant securitizations. *Victory Park Capital, KKR Lead \$175MM Securitization of Avant Consumer Loans*, ABLADVISOR (Nov. 20, 2015, 7:45 AM), <https://bit.ly/3nlVwCJ> [<https://perma.cc/W94U-4HSZ>].

317. Avant's securitization deals are all Rule 144A unregistered transactions, so the deal documents are not publicly available. Avant's securitizations, however, appear to be without recourse, but have credit enhancements including senior-subordinate tranching, excess spread, overcollateralization, and pre-funded reserve accounts. *See, e.g., Kroll Bond Rating Agency Assigns Preliminary Ratings to Avant Loans Funding Trust 2016-A*, BUS. WIRE (Feb. 08, 2016, 2:29 PM), <https://bwnews.pr/35a2vbl> [<https://perma.cc/Z765-ABLH>]. For explanation of these different types of credit enhancements, see Adam J. Levitin & Susan M. Wachter, *Explaining the Housing Bubble*, 100 GEO. L.J. 1177, 1191 n.44, 1192 n.47 (2012).

both Avant and the securitization vehicles that purchased the receivables under a true lender theory, the issue was never resolved, as the case settled.<sup>318</sup> Uncertainty about the application of true lender doctrine to this novel fact pattern likely contributed to Colorado's willingness to settle.

#### *D. Taking Stock of the Doctrinal Landscape*

To summarize, courts have taken a variety of approaches when dealing with disaggregated lending situations. Under valid-when-made, usury laws do not apply to nonbanks in rent-a-bank transactions. In contrast, under the *Madden* rule, the nonbank would be subject to state usury laws only if it purchased the loans outright. Under true lender doctrine, the nonbank would be subject to state usury laws irrespective of how the transaction was structured if it were deemed the real party in interest. Yet it is unclear how true lender doctrine would actually apply to more complex transactions that disaggregate the various interests in the loan among numerous unaffiliated parties.

The doctrinal confusion about how to address rent-a-banks is a symptom of a judicial system attempting to make sense of the mismatch between the regulatory system and economic realities of disaggregated lending. The upshot of this doctrinal confusion is that there is little predictability or consistency about how courts will analyze any particular disaggregated lending situation.

### V. RECONCILING LEGAL DOCTRINE WITH DISAGGREGATED LENDING

This Part turns to the normative question of how to reconcile the law and the economic realities of disaggregated lending. It argues that the best approach is to backstop an easily administrable presumption similar to the *Madden* rule with an anti-evasion principle like the true lender doctrine. In other words, the initial presumption should be that only banks benefit from federal preemption of state usury laws. If the bank, however, is alleged not to be the key party in the transactional design and operation, then courts should inquire into the specific facts and circumstances of the lending arrangement, and in particular, look at which party originated the product arrangement. If the idea for the

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318. Assurance of Discontinuation, Avant of Colo., LLC & Marlette Funding, LLC (Colo. Adm'r of the Unif. Consumer Credit Code & Att'y Gen. of Colo. Aug. 7, 2020), <https://coag.gov/app/uploads/2020/08/Avant-Marlette-Colorado-Fully-Executed-AOD.pdf> [<https://perma.cc/4CKU-ZYR2>].

loan product emerged from the nonbank, rather than the bank, that fact should weigh heavily toward treating the nonbank as the lender.

This Part begins with a consideration of the policy defects of valid-when-made. It then turns to the benefits of the *Madden* rule, before considering the need for the *Madden* rule to be buttressed by an anti-evasion doctrine and disclosures.

#### A. *The Dangers Posed by Valid-When-Made*

The valid-when-made position stands on three legs: its supposed historicity, its supposed importance for bank safety and soundness, and its supposed importance for ensuring the provision of credit to marginal borrowers. This section addresses each in turn before turning to the real effect of valid-when-made, namely the creation of a regulatory vacuum.

1. *The Spurious Pedigree of the Valid-When-Made Doctrine.* A key argument for the valid-when-made doctrine is its supposed historicity. Proponents claim that it is a “well-established and widely accepted” common law doctrine that is a “cardinal rule” of banking law endorsed by multiple U.S. Supreme Court decisions.<sup>319</sup> By virtue of being part of the common law, the doctrine was supposedly incorporated into section 85 of the NBA and thus again into section 1831d of the FDIA, because that provision is patterned on the NBA.

The doctrine’s deep historical roots have been claimed by the Office of the Solicitor General,<sup>320</sup> the OCC and FDIC,<sup>321</sup> law firms

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319. See, e.g., FDIC/OCC Amicus Brief, *supra* note 269, at 10. It is also worth noting that the valid-when-made doctrine is federal common law. This would seem to create a problem for the doctrine. The Supreme Court made clear in *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), that federal courts cannot create federal common law governing state law claims when sitting in diversity jurisdiction. *Id.* at 79. Usury claims are state law claims, so to the extent that there is diversity jurisdiction, there is no basis for a federal common law rule. Jurisdiction might be federal question jurisdiction based on section 85 of the National Bank Act of 1864, 12 U.S.C. § 85, and section 1831d of the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1831d, but neither statute can support as broad of a doctrine as valid-when-made. Instead, any federal common law under either statute would have to be confined to the scope of the statute.

320. See *supra* note 271 and accompanying text.

321. See FDIC/OCC Amicus Brief, *supra* note 269, at 10.

representing major financial institutions,<sup>322</sup> and trade associations.<sup>323</sup> The doctrine's historical basis has been endorsed *sua sponte* by a federal bankruptcy court, as well as accepted by much of the scholarly literature.<sup>324</sup>

The doctrine's supposed historicity is actually an implicit policy argument: this is how we've always done things, so don't go fouling them up with a change in doctrine. In other words, the supposed historicity suggests to courts that they are not writing on a blank slate, but are facing the overwhelming weight of precedent. Moreover, the doctrine's supposed historicity is fundamentally a claim to legitimacy as the already existing state of the law. By claiming a historical pedigree for the doctrine, its proponents implicitly reject the idea that the problem of how to apply usury laws when high-cost loans are transferred between banks and nonbanks is a new problem that necessitates courts accounting for public policy considerations like consumer protection.

The doctrine's actual historicity, however, has never actually been probed. As a companion doctrinal analysis to this Article shows, the historicity of the valid-when-made doctrine is entirely spurious.<sup>325</sup> The doctrine is a modern invention. There is no mention of the doctrine in any reported case or treatise prior to 2019, and no case can be found that is consistent with the doctrine prior to 1979.<sup>326</sup>

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322. See, e.g., SULLIVAN & CROMWELL LLP, OCC PROPOSES A RULE TO ESTABLISH WHEN A BANK IS THE "TRUE LENDER" OF A LOAN 2 (2020) ("For centuries—predating the enactment of the NBA in 1864—caselaw and market practice had established that an interest rate valid at the origination of the loan remained valid even after the originator (whether or not a bank) sold or assigned the loan to another party (whether or not a bank)."); DAVIS POLK & WARDWELL LLP, FEDERAL BANKING REGULATORS CAN AND SHOULD RESOLVE MADDEN AND TRUE LENDER DEVELOPMENTS 1 (2018), [https://www.davispolk.com/sites/default/files/madden-true-lender-federal-regulatory-fix-whitepaper\\_final.pdf](https://www.davispolk.com/sites/default/files/madden-true-lender-federal-regulatory-fix-whitepaper_final.pdf) [<https://perma.cc/XQ2F-A55J>] ("A long-settled legal principle known as the 'valid-when-made' doctrine has served for almost two centuries as the bedrock for bank lending.").

323. See, e.g., Letter from Nathaniel L. Hoopes, Exec. Dir., Marketplace Lending Ass'n, to the Off. of the Comptroller of Currency (2019), <https://bit.ly/2Lfwfwu> [<https://perma.cc/P53B-P3VZ>]; Letter from Kristi Leo, President, Structured Fin. Ass'n & Naeha Prakash, Senior Vice President, Bank Pol'y Inst. to Fed. Ins. Deposit Corp. (Feb. 4, 2020), <https://bit.ly/2XmDbed> [<https://perma.cc/Q4AF-FNRE>] (noting "centuries-old fundamental market expectations").

324. See *supra* note 57 and accompanying text.

325. Adam J. Levitin, *The Spurious Pedigree of the "Valid-When-Made" Doctrine*, 71 DUKE L.J. ONLINE (forthcoming 2022).

326. *Id.*

2. *Valid-When-Made Does Not Meaningfully Protect Bank Liquidity.* The second policy claim made for valid-when-made is that it is important for bank safety-and-soundness because it protects banks' liquidity. In particular, proponents of the doctrine claim that the doctrine is economically necessary because, without it, banks could not sell loans in the secondary market.<sup>327</sup> Without the doctrine, they claim, banks could purportedly find themselves illiquid, and there would be uncertainty over the validity of sale transactions that would result in reduced sale prices for banks and confusion in secondary markets.<sup>328</sup> Thus, Judge Posner, when confronted with the issue, noted that the only effect of applying usury law to "assignees would be to make the credit market operate less efficiently."<sup>329</sup>

Yet it is hard to see how the doctrine is essential to the banking system given that the system has operated successfully for centuries without it. If the doctrine never existed until recently, it could hardly be a precondition for bank credit markets to function. Moreover, valid-when-made only affects the ability of banks to transfer otherwise usurious loans to nonbanks. Valid-when-made is not necessary for a secondary market in nonusurious loans, and indeed, banks regularly sell their nonusurious loans without incident even in jurisdictions that have rejected valid-when-made.

As for higher cost loans, there is a circularity to the liquidity argument. Without the doctrine, would banks be likely to make those higher-cost loans in the first place? In most instances, and particularly for very high-cost loans, the answer is no. The overwhelming majority of bank loans charge rates beneath the usury cap of the borrower's home state. The rent-a-bank model indicates that banks only make these high-cost loans because they are guaranteed a buyer; the banks do not want to hold the risk on these loans and do not even market them to their own customers.<sup>330</sup>

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327. FDIC/OCC Amicus Brief, *supra* note 269, at 17 (stressing that any other position would be "uneconomic" and "disastrous in terms of bank operations"); *Rent-Rite SuperKegs W., Ltd. v. World Bus. Lenders, LLC* (*In re Rent-Rite SuperKegs W., Ltd.*), 603 B.R. 41, 66 (Bankr. D. Colo. 2019) ("Any contrary legal standard would interfere with the proper functioning of state banks . . .").

328. See, e.g., *Marvin*, *supra* note 57, at 1839-40 (arguing that "*Madden* will undermine secondary credit markets and create widespread price confusion").

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

330. Elevate's Elastic product is not mentioned anywhere on Republic Bank's website. FinWise Bank's website does not advertise Elevate's RISE product, but on its lending page says "If you have received offers from our other Partners, please click the button below." *Lending*,

Indeed, the third policy argument for valid-when-made, discussed further below, is that the doctrine helps expand provision of credit to marginal borrowers. That could be true if and only if the doctrine encourages banks to make loans that they would not otherwise make. Therefore, without the doctrine, banks would rarely have to worry about the liquidity of portfolios of otherwise usurious loans, as they simply would not have such loans on their books.

A careful look at the modern banking system also shows that valid-when-made would actually do little work to protect bank liquidity in the current regulatory and market structure. First, since 1913, when banks are pressed for liquidity (such as in a financial crisis), they turn to the Federal Reserve's discount window, where they are able to obtain liquidity by borrowing against illiquid assets like loans, rather than selling the loans into secondary markets.<sup>331</sup> Borrowing from the Federal Reserve's discount window can be undertaken nearly instantaneously.<sup>332</sup> In contrast, selling a loan portfolio takes time to negotiate, diligence, and document, and that is time that a bank does not have when it is facing a liquidity crisis. Moreover, to the extent that banks rely on loan sales to relieve liquidity problems (and rarely in crisis situations), it is through sales of performing loan portfolios to other banks, which are nearly all exempt from state usury laws. Only defaulted receivables are likely to be sold to nonbanks (as in the *Madden* case), but those defaulted receivables sell at such a heavy discount—generally one to three cents on the dollar—that they do not provide meaningful liquidity relief.

Second, the principal secondary market in loans is the market for mortgages. State usury laws are specifically preempted for most

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FINWISE BANK, <https://www.finwisebank.com/lending> [<https://perma.cc/EQY4-TRW4>]. The webpage also says that “[o]ur Partners include American First Finance, Liberty Lending, Lendingpoint, OppLoans, Mulligan Funding, Behalf and rise.” *Id.* Upon pressing on the link, it takes the reader to another page with a very brief summary of each of the partner products and a “Learn More” link that takes the consumer to the partner’s website. *Strategic Partnerships*, FINWISE BANK, <https://www.finwisebank.com/strategic-partnership-products> [<https://perma.cc/4XNA-CXX2>].

331. 12 U.S.C. § 347b(a).

332. See David Henry, *U.S. Banks Borrow at Discount Window After Fed Offers Stigma Relief*, REUTERS (Mar. 26, 2020, 4:56 PM), <https://www.reuters.com/article/us-health-coronavirus-fed-banks/u-s-banks-borrow-at-discount-window-after-fed-offers-stigma-relief-idUSKBN21D3JA> [<https://perma.cc/APW8-PH23>].

mortgages, regardless of the entity that holds them.<sup>333</sup> In other words, the largest bank asset class is already exempted from usury laws without regard to institution type, so valid-when-made does not work in this area.

Third, there are over five thousand FDIC-insured banks, virtually all of which benefit from NBA or FDIA preemption.<sup>334</sup> Banks can and do sell loans to each other. Even without a valid-when-made doctrine, there is a sizeable potential secondary market for non-mortgage loans that is unaffected by state usury laws.

In short, the liquidity argument for valid-when-made does not hold water in the contemporary market. The only liquidity it produces is liquidity in high-cost, risky loans that banks would be unlikely to make in the first place unless they believed that they had a guaranteed buyer—which is precisely the case with rent-a-bank loans. This means that the only policy argument with traction for valid-when-made is that it is necessary to ensure provision of credit to riskier borrowers. But as the following section addresses, this is a dubious policy goal and one that really reflects a collateral attack on the wisdom of state usury laws,

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333. 12 U.S.C. §§ 1735f-7, 1735f-7a. The broad express preemption for mortgages suggests that Congress did not intend such broad preemption for other types of loans.

334. *Statistics at a Glance*, FED. DEPOSIT INS. CORP. (Sept. 30, 2020), <https://www.fdic.gov/analysis/quarterly-banking-profile/statistics-at-a-glance/2020sep/industry.pdf> [<https://perma.cc/65WH-9Z6L>]. Every state except Iowa either: (1) allows all loans at any rate agreed upon by contract, e.g., ARIZ. REV. STAT. § 44-1201(A) (LexisNexis 2021); (2) exempts all banks from usury laws, e.g., CAL. CONST. art. XV, § 1, or (3) has bank parity statutes that explicitly or effectively allow the banks chartered by a state to charge the highest rate allowed to a bank with a charter from another state or a federal charter, e.g., D.C. CODE § 26-1401.08 (2021); 205 ILL. COMP. STAT. 5/5(11) (2021); MASS. GEN. LAWS ch. 167F, § 2(31) (2021); MINN. STAT. § 48.61, subdiv. 8 (2020); N.Y. BANKING LAW § 12-a (McKinney 2021); N.J. STAT. ANN. § 17:9A-25.5(B) (West 2020); see also Schroeder, *supra* note 75, at 203 (noting that all but two states had parity laws in 2003, one of which has since adopted a parity law); NAT'L CONSUMER L. CTR., *supra* note 75 (listing parity statutes). Only Iowa's State Banks are incapable of purchasing all loans from all other state-chartered banks, irrespective of the interest rate on the loan. Iowa has 249 state-chartered banks, which collectively hold less than 0.5 percent of all assets in the U.S. banking system. See *Number of Banks*, IOWA DIV. BANKING, <https://bit.ly/3b4eiLY> [<https://perma.cc/G6DQ-PWVP>] (displaying a chart that records 249 state-chartered banks for the third quarter of 2020); *Iowa State Chartered Banks: Net Loans and Leases, Total Deposits, and Total Assets*, IOWA DIV. BANKING, <https://bit.ly/3kBiwxy> [<https://perma.cc/NG64-HZED>] (displaying a chart that records \$91 billion of total assets held by Iowa state chartered banks at the end of the third quarter of 2020); *Total Assets, All Commercial Banks*, FRED, <https://bit.ly/2PI0bK5> [<https://perma.cc/KKE7-4ZR4>] (depicting total commercial banking assets of \$20.22 trillion on September 23, 2020 based on the data retrieved from the Board of Governors of the Federal Reserve System).

a surprisingly popular body of laws that have been adopted by referendum in a number of states.

3. *Credit Provision to Less-Creditworthy Borrowers Does Not Depend on Valid-When-Made.* Valid-when-made proponents also argue that the doctrine helps ensure the provision of credit to less creditworthy borrowers. Whether credit provision to such marginal borrowers is desirable is a hotly debated question beyond the scope of this Article.<sup>335</sup> But even if it were desirable, it is far from clear why valid-when-made is necessary to achieve such an end. Nothing prevents banks themselves from making loans to riskier borrowers and charging appropriate risk premiums. Banks, after all, are generally not subject to state usury laws.

Banks, however, have little interest in serving this population. The risks, including reputational risk, offset the profits. Instead, it is primarily nonbanks that focus on subprime consumer and small business installment and non-card-based revolving lending. Without a valid-when-made doctrine, loans made by these nonbanks, even if in partnership with banks, are likely to be subject to state usury laws. Therein is the real point: valid-when-made is merely a collateral attack on state usury laws. If state usury laws are ill-advised as a policy matter, they should be addressed directly, rather than through a roundabout evasion combining rent-a-bank transactions and a concocted modern doctrine.

4. *Valid-When-Made Produces a Regulatory Vacuum.* Valid-when-made is effectively a collateral attack on state usury laws in the guise of a historical claim. Moreover, valid-when-made is actually an affirmatively bad policy position because it produces a regulatory vacuum. NBA and FDIA preemption are part of a bundle of regulatory benefits and burdens specific to banks. Allowing federal preemption of state usury laws for banks to be assigned to a nonbank would result in

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335. See Atkinson, *supra* note 57, at 1147–53 (arguing that credit is of limited benefit to low-income Americans); *Modernizing Consumer Protection in the Financial Regulatory System: Strengthening Credit Card Protections: Hearing Before the S. Comm. on Banking, Hous., and Urb. Affs.*, 111th Cong. 216 (2009) (statement of Adam J. Levitin, Professor, Georgetown University Law Center) (stating that credit cards are more complicated than any other financial product with complex price terms, hidden fees, and overleverage that has led to nearly one trillion dollars of outstanding credit card debt).

a regulatory vacuum in which the nonbank would be exempt from state law, but also not subject to federal regulation.<sup>336</sup>

That is precisely the effect of valid-when-made. It enables nonbanks to evade compliance with state usury laws as well as state licensure and supervision requirements without substituting any, much less an equivalent, federal regulatory regime. For this reason, valid-when-made should be rejected as a policy position. It is a poor way of addressing concerns over the restrictiveness of some states' usury laws and undermines the state-based regulatory system that has proven more resilient against regulatory capture than federal banking regulators.<sup>337</sup>

### B. *Benefits of the Madden Rule*

The doctrinal confusion about how to handle disaggregated lending makes it difficult to predict *ex ante* how any particular lending arrangement will hold up if challenged as violating state usury or licensing laws. Uncertainty is undesirable in commercial markets because it impedes efficient business planning. The fact-specific nature of true lender doctrine only furthers uncertainty, but either the valid-when-made rule or the *Madden* rule can resolve uncertainty equally well.

The *Madden* rule is a better approach than the valid-when-made rule because it creates transactional certainty without producing regulatory vacuums. The *Madden* rule respects the clear statutory boundaries of federal banking law while effectuating state usury laws. Banking law is predicated on there being a fundamental difference between banks and nonbanks. This is why banking law restricts entry into banking through the limited granting of charters, as opposed to state law free chartering of corporations. It is also why banks are subject to an extensive and detailed regime of regulation and why banks have certain privileges that accompany that regulatory regime.

The *Madden* rule captures this regulatory distinction between banks and nonbanks. It grants banks the full measure of their regulatory privilege, including interest rate exportation, but confines that privilege to the banks—the entities that are also subject to the

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336. See Levitin, *Hydraulic Regulation*, *supra* note 55, at 188–89 (arguing that a regulatory vacuum would exist if banking entities not subject to federal regulation also benefitted from federal preemption).

337. *Id.* at 199–205 (noting that complete capture of all state attorneys general is much less likely than capture of federal regulators).

concomitant regulatory burden. In other words, the *Madden* rule takes seriously the conceit that bank safety-and-soundness regulation is actually an adequate substitute for usury laws. Limiting banks' privileges to banks is the only way an entity-based regulatory system can in fact function. If banks can freely transfer their regulatory privileges to nonbanks, there would be no purpose to a banking charter. Rent-a-bank arrangements threaten the very concept of banks as special entities.

The *Madden* rule also preserves state usury laws. The unspoken heart of the valid-when-made doctrine is a distaste for state usury laws. Usury laws are popular regulations; a number of states have adopted them in recent years by overwhelming margins in popular referenda.<sup>338</sup> Perhaps because of their popularity, the financial services industry has never attacked state usury laws head-on, but instead has always chipped around the edges, carving out certain types of institutions and loans. Yet behind this approach rests a belief that state usury laws are outmoded restrictions on contracts that unnecessarily restrain the financial services industry.<sup>339</sup> Valid-when-made is not an attack on the level of state usury caps, but on their very existence. Whatever one thinks of the merits of state usury laws, they are still the laws on the books and should be respected as such. If they are misguided, they

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338. See e.g., Pat Ferrier, *Colorado Election: Proposition 111, Capping Interest on Payday Loans, Passes*, COLORADOAN (Nov. 7, 2018, 3:18 PM), <https://www.coloradoan.com/story/news/politics/elections/2018/11/06/colorado-election-proposition-111-passes-limits-interest-payday-loans/1890551002> [<https://perma.cc/KP4X-MAYB>] (reporting that the passage of Proposition 111 in Colorado will cap the annual interest rate on payday loans at 35 percent and eliminates other finance charges and fees); Michael Calhoun & Charla Rios, *Study Finds Strong Continuing Support for South Dakota's Capping Consumer Loan Rates at 36% Interest*, BROOKINGS (Jan. 24, 2020), <https://www.brookings.edu/research/study-finds-strong-continuing-support-for-south-dakotas-capping-consumer-loan-rates-at-36-interest> [<https://perma.cc/UV3J-ENLB>] (reporting the passage of a ballot resolution limiting consumer loan interest rates to 35 percent); Megan Leonhardt, *Nebraska Becomes the Latest State To Cap Payday Loan Interest Rates*, CNBC (Nov. 4, 2020, 12:44 PM), <https://www.cnbc.com/2020/11/04/nebraska-becomes-the-latest-state-to-cap-payday-loan-interest-rates.html> [<https://perma.cc/R4BW-46RR>] (reporting Nebraska voters' overwhelming support of a ballot initiative that caps rates on payday loans at 36 percent); *Ohio Lender Interest Rate Cap, Referendum 5 (2005)*, BALLOTEDIA, [https://ballotpedia.org/Ohio\\_Payday\\_Lender\\_Interest\\_Rate\\_Cap,\\_Referendum\\_5\\_\(2008\)](https://ballotpedia.org/Ohio_Payday_Lender_Interest_Rate_Cap,_Referendum_5_(2008)) [<https://perma.cc/P8GT-9UC4>] (showing the passage of the Ohio Payday Lender Interest Rate Cap Referendum, which caps the maximum interest rate payday lenders can charge at 28 percent and the maximum loan amount at five hundred dollars).

339. See, e.g., Marvin, *supra* note 57, at 1844 (arguing that *Madden* will lead to "weighty consequences" by cutting down the nascent P2P lending market and raise borrowing costs for consumers).

should be repealed, rather than evaded through regulatory arbitrage. The *Madden* rule avoids a collateral attack on state usury laws.

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

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

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

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

For example, consider World Business Lenders' loan purchase arrangements, Avant's purchases of receivables (but not the loan accounts), and Elevate Credit's participation purchase arrangements. Under the *Madden* rule, World Business Lenders would be the lender because it purchased the loans themselves from the bank partner. Avant's treatment would be unclear because of the bank's retained interest in the loan account, and Avant's retained residual interest in the securitized loans. While the account itself has minimal economic value, at least two courts have held that in the context of credit card securitization it is sufficient grounds for not following *Madden*.<sup>340</sup> Thus, Avant might not be treated as the lender under *Madden*. Likewise, Elevate Credit would not be treated as the lender under *Madden* because it had not purchased the loans from the bank partner, only a

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340. Cohen v. Cap. One Funding, LLC, 489 F. Supp. 3d 33, 54 (E.D.N.Y. 2020); Petersen v. Chase Card Funding, LLC, No. 19-cv-00741-LJV-JJM, 2020 U.S. Dist. LEXIS 172413, at \*17-18 (W.D.N.Y. Sept. 21, 2020).

derivative interest in them. The *Madden* rule invites evasion both through sales of receivables, not accounts, and through contracts such as participation sales and credit derivatives.

Thus, the *Madden* rule needs to be buttressed by the anti-evasion principle from historical usury doctrine. Courts have recognized that “[t]he ingenuity of lenders has devised many contrivances by which, under forms, sanctioned by law, the [usury] statute may be evaded.”<sup>341</sup> Thus, the Supreme Court noted that “if giving [credence to the] form to the contract will afford a cover which conceals it from judicial investigation, the [usury] statute would become a dead letter. Courts, therefore, perceived the necessity of disregarding the form, and examining into the real nature of the transaction.”<sup>342</sup> An anti-evasion principle effectively incorporates true lender doctrine, as it looks to the true economic nature of the relationship by determining which party has the economic risk and control regarding the loans.

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

The case of Elevate Credit, Inc., is again instructive in this regard. The only reason Elevate’s participation purchases are available for review is because Elevate is a public reporting company.<sup>343</sup> Likewise, the dealings of World Business Lenders and Avant are visible only as the result of litigation. If Elevate were not a reporting company, its involvement in the Elastic and RISE credit products would be invisible to borrowers. As far as borrowers could tell, the lenders on their loans would be Elevate’s bank partners. As a result, borrowers would not be able to vindicate their rights under state usury laws by bringing a true lender challenge to the relationship; they would have no idea that a true lender challenge would even be a possibility. Banking regulators would theoretically be able to learn of the participations, but it would

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341. *Scott v. Lloyd*, 34 U.S. (1 Pet.) 418, 419 (1835).

342. *Id.*

343. The only reason the details of Think Finance’s earlier rent-a-bank and rent-a-tribe dealings are known is because of litigation brought by the Commonwealth of Pennsylvania that took five years to reach summary judgment. *See supra* Part III.

take quite a bit of sleuthing to piece together the relationship of the various Elevate entities with one of its bank partners, not least because the contracts are all with different Elevate entities whose names do not always indicate affiliation. The same is true for Avant's purchase of receivables.

To address the possibility of evasion through derivative contracts, including participations, the Consumer Financial Protection Bureau ("CFPB") should require disclosure of the transfer of a material economic interest in all consumer loans. The CFPB has the power to prohibit deceptive and abusive acts and practices.<sup>344</sup> Failure to inform a consumer of the transfer of an economic interest in a loan is potentially deceptive because it omits a material fact regarding the consumer's legal rights. Likewise, it is potentially "abusive" because it "takes unreasonable advantage of . . . a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service," namely the consumer's lack of understanding that the loan is usurious under the applicable law.<sup>345</sup> If a bank has disclosed that it parted with an economic interest in a loan, then in an action to enforce the loan, the consumer debtor should be able to seek discovery regarding the terms of such transfer to potentially raise a usury defense.

#### *D. Bringing True Lender Doctrine Up to Date*

Yet even with adequate disclosure, the anti-evasion principle might not be sufficient to address modern rent-a-bank arrangements for two reasons: disaggregation, and clever legal counsel that masks substance with process.

1. *Disaggregation as Evasion.* First, disaggregated lending can make it difficult to identify a single party that is the true lender. Although there are multiple parties that might contend for that role,

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344. 12 U.S.C. §§ 5531, 5536. Such a requirement should also exist for business loans, but the ability to enact a parallel requirement for business loans, including small business loans, is more complicated, because federal banking regulators lack a general power to prohibit unfair and deceptive acts and practices. FED. DEPOSIT INS. CORP., FIL-44-2014, INTERAGENCY GUIDANCE REGARDING UNFAIR OR DECEPTIVE CREDIT PRACTICES (Aug. 22, 2014), <https://www.fdic.gov/news/financial-institution-letters/2014/fil14044.html> [<https://perma.cc/8XTF-7YCG>] (noting that the Dodd-Frank Act resulted in the repeal of federal banking regulators' authority to issue unfair and deceptive practices regulations).

345. 12 U.S.C. § 5531(d)(2)(A).

the traditional framing of true lender doctrine conceives there as being a single true lender. In particular, applications of the doctrine often look to see which party holds the predominant economic interest, a formulation that may be too rigid to deal with disaggregated lending arrangements.

Consider, for example, the difficulty in applying “true lender” doctrine to Avant, the nonbank marketplace lender that securitized without recourse the loan receivables generated through a rent-a-bank operation.<sup>346</sup> Clearly the bank that formally makes the loans is not the true lender in Avant’s transactions. But is the true lender Avant or the securitization vehicle (or the securitization investors)?

The securitization vehicle (and indirectly the securitization investors) holds the predominant economic interest in the loans, but it does not exercise control over the lending. In that circumstance, does it make sense to tag it as the true lender?

In contrast, Avant exercises control over the lending process and holds the predominant economic interest in the loans until they are securitized in a transaction it sponsors, but does not hold a direct economic interest thereafter, although it retains the residual interest in the securitization. Once Avant no longer holds the predominant economic interest, it is unlikely to be tagged as the true lender.

In short, neither entity neatly fits the traditional bill of true lender: the economic interest is with the securitization vehicle, but the nerve center for the whole operation is with Avant, which has a substantial economic interest in the transaction, just not in the performance of the loans themselves after securitization.

In terms of effectuating the usury laws, it probably does not matter which party is ultimately deemed the true lender, so long as one is tagged with the liability. If the securitization vehicle or investors are liable, funding will dry up, which will have a similar effect to holding the nonbank liable as the true lender.

The danger, however, is that a court is unwilling to deem any party individually the true lender because neither conforms precisely to the older iterations of the doctrine. If the plaintiff sues Avant, Avant will point to the securitization vehicle as the true lender, and vice versa, with the possible result that neither is deemed the true lender. In other words, there is a loan, but somehow no lender!

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346. See *supra* Part IV.C.2.

True lender doctrine should move past older articulations of the doctrine that were limited by the nature of the transactions before the courts and look to the party that is the lynchpin and nerve center of the lending transaction, namely the nonbank mastermind of the deal—here, Avant.

2. *Process as Evasion.* True lender doctrine also faces a second difficulty, however: transactions planned with evasion of true lender doctrine in mind. This is exactly what good legal counsel will advise in light of the current state of the law. For example, it is easy to muddy the waters by taking steps that make it look as if the bank exercises more control over the lending than it really does. This can be accomplished by having the bank undertake processes with predetermined conclusions where the predetermination cannot be readily proven. Thus, a bank might have a committee meet to evaluate the nonbank's proposed underwriting standards for the loans. Everyone involved understands that the committee will approve the underwriting standards without any material changes, but unless someone blunders by putting this in writing, it is difficult for a court to second guess. With good legal advice in transaction planning, the theater of process becomes part of evasion.

In the absence of conflicts of interest, courts are generally reluctant to second guess substantive decisions so long as there is adequate process—this is the essence of corporate law's famed business judgment rule. Yet when process itself becomes part of the evasion, courts must push further. The convening of a committee meeting should not alone suffice. Instead, courts should demand evidence about the nature of the committee's inquiries and deliberations and how the process compares to the process used for loan products where a nonbank partner is not involved or that have lower interest rates.

Put another way, when process becomes a tool of evasion, stricter scrutiny is necessary. That scrutiny should look at the bank's motivations for the transaction: Is the bank able to articulate a credible reason for why it is engaged in the transaction in partnership with the nonbank? If the product idea emerged from the bank, and the bank sought out a nonbank partner with operational capabilities it lacked, then the bank's engagement in the product should be taken seriously in the true lender evaluation. But if the nonbank approached the bank with the product idea, and the product is not one that the bank would offer on its own, then the court should be skeptical of the substance of

the bank's involvement and the nonbank should be presumptively treated as the true lender. The *Madden* rule creates such a presumption when the nonbank is the actual assignee of the loan, but the *Madden* presumption should be broadened to situations in which the idea for the loan product emerged from the nonbank rather than the bank.

#### CONCLUSION

This Article has shown how over the last few decades the market structure of consumer lending has frequently shifted. Traditionally, one financial institution would design, market, underwrite, service, and hold the risk on a loan. Today, lending is frequently institutionally disaggregated with those components divided among multiple institutions, including both banks and nonbanks.

The shift from unified to disaggregated lending has resulted in a mismatch with financial regulatory regimes that are keyed to institutional type, treat banks differently from nonbanks, and assume that there is only a single institution involved in making a loan. This mismatch has created fertile ground for regulatory arbitrage that is the hallmark of shadow banking—the provision of banking-type services by nonbanks without bank regulation.<sup>347</sup> While shadow banking is mainly seen as a systemic risk concern, its regulatory arbitrage also threatens to undermine a long-standing set of state-law consumer protections.

Because banks are generally exempt from state usury laws, nonbanks have taken to partnering with banks in rent-a-bank arrangements that involve the banks making loans on spec for nonbanks to purchase. The nonbanks then claim to shelter in the banks' exemption from state usury laws.

Courts have taken inconsistent approaches when considering such arrangements. This Article argues that consumer protections are best served by limiting the privileges of banks to the ambit of bank regulation, and not allowing them to be rented out by nonbanks that seek to operate in a regulatory vacuum. In particular, this Article argues that courts should adopt the Second Circuit's entity-based *Madden* rule when evaluating the application of usury laws to nonbanks, but should couple it with usury law's long-standing anti-

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

evasion principle that is capable of catching state-of-the-art derivative-based rent-a-bank transactions.

For such an approach to succeed, however, it must be coupled with disclosure requirements that mandate that lenders disclose the transfer of any economic interest in a loan they seek to enforce. The combination of the *Madden* rule and an anti-evasion principle buttressed by disclosure would ensure that the usury laws are enforced predictably and consistently, thereby preventing nonbanks from usurping the privileges of banking charters without also complying with the concomitant regulatory obligations.