S. 1642 & H.R. 3299: Rent-a-Bank Bill Could Open the Floodgates to Predatory Lenders

Center for Responsible Lending

Updated January 2018

Rent-a-Bank Bill Will Facilitate Predatory Lending That Harms Financially Distressed Consumers

The so-called "Madden fix" bill would make it easier for predatory payday lenders and other non-banks using rent-a-bank arrangements or partnerships to override state interest rate caps and make loans of 300% annual interest or higher. Unaffordable payday loans and other triple-digit interest predatory loans have devastating consequences for already financially distressed borrowers—trapping them in a cycle of debt and increasing the likelihood of delinquency on other bills, delayed medical care, bankruptcy, and eviction.

Rent-a-Bank Bill Will Allow Lenders to Override Longstanding, Critical State Interest Rate Caps

This bill gravely threatens the strongest available tool against predatory lending—state interest rate limits. The bill would override the Second Circuit's 2015 *Madden v. Midland* decision, which held that a debt buyer purchasing charged-off credit card debt could not add additional interest above state interest rates. This decision was consistent with longstanding law that nonbank creditors are covered by state interest rate limits. This bill would effectively reverse that decision, permitting predatory non-bank lenders to use banks' preemption rights to violate state interest rate caps—including in the 15 states plus the District of Colombia whose state interest rate limits currently save borrowers over $2.2 billion annually in payday loan fees.

How Rent-A-Bank Arrangements Work

Banks benefit from preemption of state interest rate caps through the National Bank Act and related laws. But outside of mortgages, nonbank lenders have always been subject to state interest rate caps. Through rent-a-bank arrangements, a nonbank lender uses a bank to originate its loans and attempts to evade state interest rate caps. For example, high-cost online lender Elevate uses Republic Bank to make loans that exceed state interest rate caps. Elevate does not disclose an APR for its "Elastic" product, but a $380 advance repaid with monthly minimum payments would cost $480 to repay over five months, which carries a fee-inclusive annual rate of about 100%—nearly three times the 36% legal rate approved by voters in Montana and S. Dakota, where the Elastic product is offered.

Federal Banking Regulators Have Long Frowned Upon Rent-A-Bank Schemes

The Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Reserve Board, and FDIC all shut down rent-a-bank lending in the early-to-mid 2000s. Comptroller John D. Hawke, who served from 1998-2004 under Presidents Clinton and Bush, called the schemes "an abuse of the national charter"[1] and stated, "It is a matter of great concern to us when a national bank essentially rents out its charter to a third-party vendor who originates loans in the bank's name and then relinquishes responsibility for how these loans are made . . . . [w]e are particularly concerned where an underlying purpose of the relationship is to afford the vendor an escape from state and local laws that would otherwise apply to it."[2] Currently, it does not appear that national banks are engaged in rent-a-bank schemes, but some state-chartered banks are. Federal regulators may not continue to contain these schemes, particularly if this legislation were to become law.

Consumer and Civil Rights Groups, and 20 State Attorneys General, Oppose this Bill's Provision

More than 150 organizations, including consumer advocate, civil rights, and faith organizations across the country, have come out against this rent-a-bank. In addition, when this provision was included in other legislation earlier this year, twenty State Attorneys General warned that the provision "would restrict states' abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps."[3]

Fintech Companies Making Responsible Loans Do Not Need the Rent-a-Bank Bill

State interest rate caps have not impacted responsible marketplace loans. The leading marketplace lenders do not make loans above 36%, and the majority of their loans are well below that rate, comfortably within state caps. Only the highest rate marketplace loans are impacted, and only then in some states. But the rent-a-bank bill will permit predatory lenders to abuse bank partnerships to enable high-cost loans of 100% APR or higher.

Permitting Fintech Companies to Exceed State Interest Rate Caps Poses Severe Risk of Consumer Harm

The mere fact that a lender uses the label "fintech" or "marketplace lender" does not ensure that it is making a responsible, affordable loan. Consider the following:

- **There are signs that some online lenders are making large numbers of loans that consumers will not have the ability to repay:**
  - News reports show that delinquencies and charge-offs at marketplace lenders are rising.[4]
  - One lender has had so many of its loans fail, that it had to repay investors for their losses in consecutive securitizations of the loans it bundled up and sold to Wall Street.[5]
  - One online lender reportedly failed to verify a borrower's income for a full two-thirds of its loans in 2016.[6]
  - Moody's credit-rating firm likens this industry to mortgage lending in the years leading up to the 2008 financial crisis in that "the companies that market the loans and approve them quickly sell them off to investors," relieving themselves of the risk of the loan later going bad.[7]
- **Marketplace loans often carry very high rates:**
  - Many marketplace lenders make very large loans of $30,000-$50,000 or higher, and even 36% is a very high rate for such loans. Many states have tiered rate caps in recognition that interest becomes more unaffordable the larger the loan. Iowa, for example, caps interest at 21% for loans over $10,000.
  - OnDeck, a lender focused on small business lending, makes loans at up to 99% APR.[8]

This bill would weaken lenders' incentive to underwrite properly by making it easier to make high-rate loans. High interest rates result in misaligned incentives that can lead to lender profits even with borrower catastrophe.[9] Skewed incentives are already a problem in the marketplace loan industry. This bill could make that problem worse.

The Rent-a-Bank Bill Is Not Necessary to Ensure Access to Affordable Credit

The only evidence provided that the *Madden* decision has purportedly affected access to credit is one research paper that shows, at most, a trivial impact. Yet this bill would dramatically weaken lenders' incentive to underwrite properly by making it easier to make high-rate loans that borrowers don't have the ability to repay.

Rent-A-Bank Schemes Run Counter to 2010 Wall Street Reform Act

The rejection of rent-a-bank models is consistent with Congressional action in the Wall Street Reform Act. While reaffirming the principle of bank preemption of some state laws, Dodd-Frank reversed a Supreme Court decision that extended preemption to operating subsidiaries of national banks, limiting preemption to the bank itself. Rent-a-bank schemes are even less connected to actions of the bank itself than activities of bank subsidiaries are. Thus, the effort to extend preemption to nonbank entities runs counter to Dodd-Frank.

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[1] http://www.occ.gov/static/news-issuances/news-releases/2002/nr-occ-2002-10.pdf.

[2] https://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-3.pdf.

[3] Letter from Eric T. Schneiderman, New York Attorney General, and 20 other State Attorneys General, to Paul Ryan, Speaker, U.S. House of Representatives, et. al. (June 7, 2017), addressing the same provision included in the Financial CHOICE Act, *available at* https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf.

[4] Matt Scully, "Consumer Loans Souring Fast in Bonds Tied to Online Lenders", Bloomberg (Nov. 15, 2016), https://www.bloomberg.com/news/articles/2016-11-15/consumer-loans-souring-fast-in-some-bonds-tied-to-online-lenders; Kevin Wack,"Spike in delinquency rate mars outlook for personal loans," American Banker (Jan. 18, 2018), https://www.americanbanker.com/news/spike-in-delinquency-rate-mars-outlook-for-personal-loans.

[5] Steve Daniels, "Online lender Avant's reboot still hasn't yielded profit", Crain's Chicago Business (May 27, 2017), *available at* http://www.chicagobusiness.com/article/20170527/ISSUE01/170529902/online-lender-avants-reboot-still-hasnt-yielded-profit.

[6] Matt Scully, "Biggest Online Lenders Don't Always Check Key Borrower Data", Bloomberg (June 14, 2017), *available at* https://www.bloomberg.com/news/articles/2017-06-14/biggest-online-lenders-don-t-always-check-key-borrower-details.

[7] See, Corkery, "Pitfalls for the Unwary Borrower Out on the Frontiers of Banking," New York Times (Sept. 13, 2015), https://www.nytimes.com/2015/09/14/business/dealbook/pitfalls-for-the-unwary-borrower-out-on-the-frontiers-of-banking.html?mcubz=0.

[8] On Deck Capital, Inc. Annual Report, Form 10-K, p. 7 (Mar. 2, 2017) ("The APRs of our term loans currently range from 6.0% to 99.0%.").

[9] Lauren Saunders et al., National Consumer Law Center, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default (July 2016), https://www.nclc.org/issues/misaligned-incentives.html.