# Georgia's Payday Loan Law

***A Model for Preventing Predatory Payday Lending***


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A Georgia statute passed in May 2004 imposes stiff penalties for payday lending by non-banks and in-state banks, and is the first state law to expressly prohibit payday lenders from contriving with out-of-state banks to evade state usury limits. Soon after its enactment, several payday lenders and their bank "partners" sued the state seeking a court ruling that the Act was unconstitutional. The effort failed. The Georgia Act is a good example of state legislation against abusive lending practices and lender contrivances to circumvent state law.

### *Payday Loans and the Rent-a-Charter Ruse*

Payday loans are marketed as short-term cash advances, but are designed so most borrowers cannot repay them, resulting in multiple refinancings with attendant fees, and trapping borrowers in a cycle of long-term debt at annual interest rates in excess of 400 percent. These loans are illegal under the usury laws of many states, but payday lenders have developed various contrivances to circumvent state law. In one such scheme, known as "rent-a-charter" or "rent-a-bank," payday lenders make their loans through the nominal auspices of out-of-state banks, which are exempted from state usury laws.

In a typical charter-renting scheme, the payday lender markets the loans, accepts applications, interacts with customers, and retains the predominant economic interest in the transaction. All face-to-face customer interactions are conducted by the payday lender, and take place at the payday shop. While the scheme rests on the payday lender's claim to be acting as a mere "agent" for the out-of-state bank, the payday lender is the de facto lender. The bank's economic interest in the loan is generally limited to the fee it receives from the payday lender for the use of its charter.

Rent-a-charter has been widely criticized by state and federal regulators, and has been strongly discouraged and substantially curtailed by the OCC, the Federal Reserve, the Office of Thrift Supervision, and, more recently, the FDIC.[1] At the time the Georgia Act was passed, the FDIC remained the lone federal regulator still to tolerate the practice, and the challenge to the Georgia Act arose out of four "partnerships" between payday lenders and FDIC-member banks. During the course of the litigation, the FDIC joined the other federal regulators in imposing strict requirements on banks that partner with non-banks in making payday loans, causing the payday lenders to terminate the payday programs at issue, and rendering the case moot.

### *The Georgia Act*

The Georgia Act amended the criminal code to include a new criminal offence of "payday lending," as defined in the Act.[2] The Act was passed with bipartisan support, and was the first state law to expressly prohibit charter renting by payday lenders. In other states, Attorneys General have challenged rent-a-charter under existing usury laws, looking past the banks' status as nominal lender and recognizing the payday lenders as the de facto loan originators. But the Georgia Act expressly states that the privileged status of out-of-state and national banks will not be extended to the banks' purported non-bank agents where the agent retains the predominant economic interest in the loan. The Georgia Act caps small consumer loans at Georgia's small loan usury rate of 60 percent per year, adds stiff criminal and civil penalties for violators, and bars non-bank lenders from partnering with banks to avoid Georgia's usury laws.

### *The Lenders' Unsuccessful Challenge to the Georgia Act: An Overview*

Soon after the Georgia Act was passed, several payday lenders and their out-of-state bank "partners" sued Georgia's Attorney General and Secretary of State in the United States District Court for the Northern District of Georgia, to prevent enforcement of the law against them. The district court rejected the lenders' arguments and its decision was affirmed on appeal to the Eleventh Circuit Court of Appeals. The appeals court thereafter granted the lenders' request for rehearing before the full court, and vacated the prior decisions. However, before the rehearing occurred, the state moved to dismiss the appeal as moot, after certain regulatory actions of the FDIC caused the bank partners to leave the payday lending business. Over the lenders' objection, the court dismissed the appeal, and the case was subsequently dismissed.

### *A Summary of Bankwest v. Baker*

In *Bankwest v. Baker*,[3] the plaintiff banks and payday lenders sought an injunction preventing the state of Georgia from enforcing the Act. The lenders pressed three claims: that Section 27(a) of the Federal Deposit Insurance Act (FDIA) preempts the Georgia Act, that the Georgia Act violates the dormant aspect of the U.S. Constitution's Commerce Clause, and that the Georgia Act violates the Federal Arbitration Act. The court rejected the Commerce Clause claim, and refused to rule on the arbitration issue on the ground that the lenders had no standing to challenge these provisions. Although the decision has been vacated, the Court of Appeal's analysis of the lenders' preemption claim is instructive:

> ***Is the FDIC's view on preemption entitled to deference? No.*** Courts do not defer to agency opinions on preemption because preemption (as opposed to the substantive meaning of an agency's statute) involves matters more within the expertise of the court than the agency.
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> ***Does the FDIA preempt state law governing agents of federally insured state banks? No.*** Congress did not intend to "occupy the field" of state bank regulation. To the contrary, "the FDIA itself makes it clear that … the *states* remain the 'primary regulatory authority' over state banks.[4] Section 27(a) of the FDIA preempts state law on the interest rates chargeable

by out-of-state banks, but this is all it preempts. It has no bearing on other aspects of the loan, such as the relationship between out-of-state banks and in-state lenders.

***Is the Georgia Act preempted by the FDIA? No.*** The Georgia Act does not preclude out-of-state banks from making the payday loans, whether directly or through non-bank agents (including payday lenders) – so long as the bank is the real lender, such that it retains at least a 50 percent interest in the loan revenue. The Georgia Act does not seek to impose Georgia interest rates on out-of-state banks, and therefore is not preempted.

***Can the "Aider and Abettor" liability provisions of the Georgia Act be applied to impose liability on out-of-state banks that assist in violations by non-bank lenders? Yes.*** The lenders argued that the Act was invalid because its aider and abettor provisions could be used to prosecute out-of-state banks. The state disavowed any intent to prosecute out-of-state banks, and the district court held that the Act does not apply to them. The Court of Appeals declined to decide whether the Act permits such prosecutions, determining that even if it does, it is not preempted.

### *The Dissent and the Granting of Rehearing En banc*

The dissent in *Bankwest* agreed that states are entitled to regulate non-banks whose relationship with an out-of-state bank is a sham. It disagreed that the record established a sham, and contended that the existence of a sham must be determined by federal law. The dissent's analysis centered on its view that the banks, not the payday lenders, retained most of the risk, did most of the work, and were the de facto lenders. The dissent's view of the facts runs counter to what federal regulators and others have concluded about typical rent-a-charter schemes.[5] The Eleventh Circuit agreed to rehear the matter before the full court, and these issues were the focus of its interest on rehearing.[6] The rehearing never occurred, however, because the appeal was dismissed as moot.

### *The Dismissal of the Appeal on Mootness Grounds*

In March 2005, the FDIC tightened its requirements for payday lending by member-banks and their non-bank "partners," limiting, among other things, the number and duration of payday loans that may be made to any customer.[7] Additionally, the FDIC advised plaintiff BankWest "that it should exit the payday lending business unless it could immediately present to the FDIC a plan as to how it intended to satisfy the FDIC's stated concerns."[8] As a result of the FDIC's actions, the lenders stopped offering payday loans in Georgia, and the State urged the dismissal of the appeal for mootness.

The lenders contended that they were developing new payday loan products to comply with FDIC requirements, and that the case was not moot because their efforts were hindered by uncertainty about whether the Act applied to them. The court rejected their arguments, and dismissed the appeal, finding that, "the precise nature of the new but different loan programs and the manner in which they are to be administered in Georgia remain far too speculative and abstract at this juncture to create an actual case or controversy."[9] On June 15, 2006, by stipulation of the parties, the case was dismissed, without prejudice.

### *Implications for Future Litigation over Georgia's Prohibition on Payday Lending By Non-Banks Engaged in Rent-A-Charter Schemes*

The FDIC's recent actions appear to have put a stop to the rent-a-charter abuse, at least for now, although the lenders advised the Court of Appeals that they were working on developing new payday lending plans that would satisfy the FDIC, though likely run afoul of the Georgia Act. Should they develop such plans, and seek to renew their challenge of the Georgia Act, the analysis of the Court of Appeals should provide a useful starting point for defeating such claims, even though the decision was later vacated. Even the dissent agreed that state law is not preempted where it targets a sham by a non-bank lender, even when the arrangement involves a state or national bank. Moreover, the legitimacy of the Georgia Act's anti-"rent-a-charter" provisions, and the illegitimacy of lenders' preemption claim, is underscored by the courts around the country that refused to find preemption of state claims against the nominal "agents" of national or out-of-state banks where the "agent" was alleged to be the de facto lender.[10] More broadly, the Georgia Act is a useful example of how state laws can proscribe both predatory lending and lender attempts at subterfuge, including those involving out-of-state or national banks.

**About the Center for Responsible Lending**

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[1] In 2002, then Comptroller of the Currency John Hawke described this practice by national banks as "an abuse of the national charter." Remarks of John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance, Washington, D.C., Feb. 12, 2002. http://www.occ.gov/ftp/release/2002-10a.doc at 10.

[2] Ga.Code Ann. § 16-17-1 *et seq.*

[3] 324 F.Supp.2d 1333 (N.D. Ga. 2004), *aff'd*, 411 F.3d 1289 (11th Cir. 2005), *vacated for reh'g en banc*, 433 F.3d 1344 (11th Cir. (en banc) 2005), *vacated for remand to panel for consideration of mootness*, 2006 WL 1329700 (11th Cir. (en banc) April 27, 2006), *prior decisions vacated as moot*, 446 F.3d 1358 (11th Cir. 2006).

[4] 411 F.3d at 1301 (emphasis in original). The court cited three FDIA provisions that illustrate the point: 12 U.S.C. § 1813(r), which defines "State bank supervisor" as the state officer, agency or other entity with primary regulatory authority over state banks; 12 U.S.C. §1820(h)(1)(A), which grants the State bank supervisor regulatory authority over state banks with respect to state laws governing fair lending and consumer protection, among other things; and 12 U.S.C. §1831a(i), which provides that the FDIA provision governing the activities of insured state banks "shall not be construed as limiting the authority of… any State supervisory authority to impose more stringent restrictions."

[5] *See, e.g.,*Remarks of John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance, Washington, D.C., Feb. 12, 2002. http://www.occ.gov/ftp/release/2002-10a.doc at 10. On the basis of the record before it, the dissent expressed doubt, for example, that the payday lenders sought out the banks (as opposed to vise-versa) to establish the "agency" relationship, that they did so to evade the usury laws, or that the payday lenders actually retained the predominant economic interest in the loan. These facts were alleged by the State and accepted by the majority decision.

[6] Feb. 15, 2006 letter from the Clerk of the Eleventh Circuit Court of Appeals to Counsel of Record, listing five questions on which counsel were asked to focus their briefs. www.ca11.uscourts.gov/enbanc/index.php, File Name: eb04-12420letter&order.pdf.

[7] FDIC revised Guidance for Payday Lending, FIL-14-2005, www.fdic.gov/news/news/financial/ 2005/fil1405.html.

[8] 446 F.3d at 1362.

[9] *Id.*, at 1367.

[10] *See, e.g.,Flowers v. EZPawn Oklahoma, Inc.*, 307 F.Supp.2d 1191 (N.D.Okla. 2004); *Goleta Nat'l Bank v. O"Donnell*, 239 F.Supp.2d 745 (S.D.Ohio 2002); *Goleta Nat'l Bank v. Lingerfelt*, 211 F.Supp.2d 711 (E.D.N.C. 2002); *State of Colorado ex. Rel. Salazar v. ACE Cash Express, Inc.*, 188 F.Supp.2d 1282 (D.Colo. 2002).