TRUE LENDERS, THE VALID-WHEN-MADE DOCTRINE, AND A NATIONWIDE INTEREST RATE CAP

*Logan C. Hinderliter**

I. INTRODUCTION

In recent years, the regulatory landscape of lucrative payday loans has been a minefield. Payday loans are short-term, high-interest, unsecured loans which mature on the borrower's next payday or date of income.[1] In fees alone, consumers collectively spend as much as $9 billion on payday loans each year.[2] In fact, "[p]ayday lending is a $46 billion industry in the U.S.,"[3] with payday loans only making up one part of the much larger "alternative financial services" sector,[4] otherwise known as the "fringe banking" sector. In 2020, the two federal agencies tasked with regulating federal and state-chartered banks—the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC)—issued three new rules that impact the alternative financial services sector.[5] These rules, the so-called "valid-when-made" rules and "true lender" rule, were intended to provide clarity regarding the enforceability of interest rates on assigned loans that charge a rate permissible under federal law, but forbidden by state usury statutes.[6] The rules were meant to

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*J.D. Candidate, 2023, Seton Hall University School of Law; B.A., Wheaton College.

[1] *See What Is a Payday Loan?*, CONSUMER FIN. PROT. BUREAU (Jan. 17, 2022), https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567.

[2] Jeanette N. Bennett, *Fast Cash and Payday Loans*, PAGE ONE ECON. (Econ. Rsch. Fed. Rsrv. Bank St. Louis, St. Louis, Mo.), Apr. 2019, at 1, 2, https://research.stlouisfed.org/publications/page1-econ/2019/04/10/fast-cash-and-payday-loans. The principles on these loans are generally $500 or less. *Id.* at 1.

[3] *Fighting the Debt Trap of Triple-Digit Interest Rate Payday Loans*, PBS NEWSHOUR (Jan. 6, 2016, 8:59 PM), https://www.pbs.org/newshour/show/fighting-the-debt-trap-of-triple-digit-interest-rate-payday-loans.

[4] *See* Christine Bradley et al., *Alternative Financial Services: A Primer*, 3 FDIC Q., no. 1, 2009, at 39.

[5] *See infra* Part IV.

[6] *See* Philip Rosenstein, *FDIC Board Approves Valid-When-Made Rule, Mirroring OCC*, LAW360 (June 25, 2020, 12:55 PM), https://www.law360.com/articles/1286685/fdic-board-approves-valid-when-made-rule-mirroring-occ; Al Barbarino, *OCC Rule Aims to*

guarantee the applicability of federal preemption[7] against state usury law and, accordingly, bring legal certainty to transactions where state-by-state, court-by-court adjudications regarding the enforceability of a loan's interest rate threatened the fluidity and availability of credit.[8] Since the early 2000s, instability in this sector has grown as courts have found certain high-interest loans unenforceable based on (1) the predominant economic interest test—also known as the true lender test—which can result in a judicial determination that a loan's "true lender" is an entity other than the loan originator (i.e., one that *cannot* take advantage of federal preemption), and (2) the Second Circuit's failure to utilize the "historic"[9] "valid-when-made" doctrine in *Madden v. Midland Funding*, holding that a loan's enforceable interest rate at origination does *not* always transfer to an assignee.[10]

The true lender test and a limited application of the valid-when-made doctrine—what the new federal rules were meant to foreclose—have permitted legislatures and courts to protect consumers against predatory high-interest loans, including payday loans, installment loans, and vehicle title loans. These forms of high-interest loans have

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Settle Interest Rate Transfer Controversy, LAW360 (May 29, 2020, 9:12 PM), https://www.law360.com/articles/1278191/occ-rule-aims-to-settle-interest-rate-transfer-controversy; Jon Hill, *OCC Adopts 'True Lender' Test for Bank Lending Partnerships*, LAW360 (Oct. 27, 2020, 9:33 PM), https://www.law360.com/articles/1323367/occ-adopts-true-lender-test-for-bank-lending-partnerships.

[7] The "Supremacy Clause" of the Constitution (U.S. CONST. art. VI, § 2) creates a hierarchy in the enforceability of laws, and when there is a conflict between state law and federal law, the federal law displaces the state law. *See Preemption*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/preemption (last visited Jan. 13, 2022).

[8] *See* Rosenstein, *supra* note 6; Hill, *supra* note 6; Barbarino, *supra* note 6. Former Acting OCC Comptroller Brian P. Brooks stated that the *Madden* decision created uncertainty regarding the valid-when-made doctrine and that secondary lending markets depend on such certainty—i.e., the legal enforceability of a loan's purported interest rate—to work efficiently; to serve their essential role in the business of banking; to help banks access liquidity; to improve financial performance ratios; and to meet customer needs. Barbarino, *supra* note 6.

[9] 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 (2019) (highlighting that the popular understanding of the historic nature of the valid-when-made doctrine *can* be traced to *Nichols v. Fearson*, 32 U.S. 103 (1833), though, perhaps, it should not be).

[10] *See* DAVIS POLK & WARDWELL LLP, FEDERAL BANKING REGULATORS CAN AND SHOULD RESOLVE MADDEN AND TRUE LENDER DEVELOPMENTS 2–5 (2018). For a specific examination of the effects of *Madden*, see Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & ECON. 673, 709 (2017).

proliferated since the 1970s via the growth of interstate lending,[11] deregulation of the lending sector,[12] and the expansion of the "exportation doctrine," which allows lenders to export the interest rate caps (or lack thereof) from the state in which they are located.[13] Where such loans would otherwise be usurious per state law, federal preemption and the exportation doctrine have been used by lenders in so-called "rent-a-bank" or "rent-a-charter" and "rent-a-tribe" arrangements to avoid state consumer protections, enabling them to charge exceedingly high interest rates.[14] These lending arrangements create feedback loops where consumers, disproportionately minority and low-income,[15] frequently take on additional loans (a practice called "flipping") to pay back prior loans, often spending more on fees than the amount originally borrowed.[16] High-interest loans are often considered "debt traps," and there are countless stories of the ills of such borrowing.[17] For instance, Arthur Jackson, a warehouse worker, went to Advance America to borrow money and ended up paying an estimated $5,000 in interest over five years for a loan with an original principal of $200–$300.[18] He was charged a triple-digit interest rate, and the loan was flipped over one hundred times.[19] Mr. Jackson had to file for bankruptcy to save his home.[20]

After the OCC and FDIC released the true lender and valid-when-made rules, a Democratic-majority Congress intervened in June 2021

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[11] *See* Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 547 (2004).

[12] LAUREN K. SAUNDERS, NAT'L CONSUMER L. CTR., WHY 36%? THE HISTORY, USE, AND PURPOSE OF THE 36% INTEREST RATE CAP 2–3 (2013).

[13] *See* Schiltz, *supra* note 11, at 522.

[14] *See* Munger, *supra* note 9, at 473.

[15] *Id.*

[16] *CFPB Finds Four Out of Five Payday Loans Are Rolled Over or Renewed*, CONSUMER FIN. PROT. BUREAU (Mar. 25, 2014), https://www.consumerfinance.gov/about-us/newsroom/cfpb-finds-four-out-of-five-payday-loans-are-rolled-over-or-renewed.

[17] *See, e.g.*, *The Victims of Payday Lending*, CTR. FOR RESPONSIBLE LENDING, https://www.responsiblelending.org/issues/victims-payday (last visited Nov. 5, 2021); Cardiff Garcia & Stacey Vanek Smith, *Payday Loans and Debt Traps*, NPR: PLANET MONEY (Feb. 25, 2019, 4:15 PM), https://www.npr.org/sections/money/2019/02/25/697873308/payday-loans-and-debt-traps.

[18] *The Victims of Payday Lending*, *supra* note 17. Arthur Jackson is a pseudonym used to protect the true borrower's identity.

[19] *Id.*

[20] *Id.*

through the Congressional Review Act to repeal the true lender rule,[21] and several state attorneys general brought suits challenging the valid-when-made rules.[22] Opponents to the rules argued that the new regulations would lead to a further boom in abusive lending.[23]

In the background of this debate is the potential for a nationwide consumer interest rate cap. In 2007 Congress passed the Military Lending Act (MLA), which created a nationwide 36% annual interest rate cap on consumer loans extended to active-duty military members and their dependents.[24] The Veterans and Consumers Fair Credit Act (VCFCA), re-introduced in the Senate in 2021, proposes extending the MLA protections to all consumers.[25]

This Comment discusses the history of high-interest consumer lending in the United States, the impact of federal preemption on traditional state-law-based consumer protections, state- and court-based efforts to protect consumers, and the continued importance of solidifying reasonable valid-when-made and true lender rules, even if Congress were to pass the VCFCA. If the VCFCA—or a similar federal consumer loan interest rate cap—were to be implemented, the need for solidified valid-when-made and true lender rules becomes especially acute. When income streams from high-interest loans shrink to a significantly more-limited range, lenders will likely consolidate and increase their reliance on rent-a-bank and rent-a-tribe arrangements to make up for lost profit. One place to make up the income shortfall is in previously overlooked jurisdictions where there is now a gap in coverage between state-mandated caps and the higher federal ceiling. Notably, with more limited profit ranges, lenders might also become more aggressive in extending credit. Increased dependence on the

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[21] *Biden Signs Law Overturning True Lender Rule*, COOLEY LLP (July 2, 2021), https://www.cooley.com/news/insight/2021/2021-07-02-biden-signs-law-overturning-true-lender-rule.

[22] Jon Hill, *FDIC Seeks to Quash State AGs' Valid-When-Made Suit*, LAW360 (May 21, 2021, 9:44 PM), https://www.law360.com/articles/1387176/fdic-seeks-to-quash-state-ags-valid-when-made-suit.

[23] Rosenstein, *supra* note 6; Press Release, Consumer Fed'n of Am., New Federal Rule Will Embolden Predatory Lenders and Eviscerate State Interest Rate Caps (Oct. 27, 2020), https://consumerfed.org/press_release/new-federal-rule-will-embolden-predatory-lenders-and-eviscerate-state-interest-rate-caps.

[24] Nathalie Martin, *Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap*, 34 N. ILL. U. L. REV. 259, 297–98 (2014).

[25] Jon Hill, *Senate Dems Push for Federal Consumer Loan Rate Cap*, LAW360 (July 29, 2021, 7:21 PM), https://www.law360.com/articles/1407542/senate-dems-push-for-federal-consumer-loan-rate-cap.

exportation doctrine and a host of riskier borrowers results in a dual-factor risk: increased default potential and a higher risk of unenforceability—a danger that is potentially magnified if courts and legislatures become more aggressive in their efforts to protect consumers via expanding the application of the true lender test or adopting a holding similar to *Madden*.[26] Because of these risks, especially regarding the legal enforceability of a loan, the lending sector's secondary markets would become increasingly wary, limiting the fluid assignment of lending contracts. The uncertainty would expose banks to increased risk on their balance sheets, potentially effecting liquidity in the lending sector, which then effects the availability of new consumer credit. This Comment argues that solidified true lender and valid-when-made rules, coupled with a nationwide interest rate cap, can facilitate greater stability in the lending sector by (1) limiting the legal volatility of usurious high-interest consumer loans, and (2) curtailing the impetus for legislative and judicial intervention to protect consumers by voiding usurious loan contracts.

Part II of this Comment provides a brief history of high-interest consumer lending in the United States and historic efforts to curtail the practice. It details the relevance of the National Bank Act, explains the genesis of the exportation doctrine in *Marquette National Bank v. First of Omaha Service Corporation*, and sheds light on the conditions that led to the significant increase in high-interest lending since 1978.

Part III provides specifics on how lenders use federal preemption and the exportation doctrine in rent-a-bank and rent-a-tribe arrangements to circumvent state-based interest rate limits. This Part also details legislative and judicial responses to the explosion of high-interest lending, including the creation of the true lender test, and discusses the potential implications of the Second Circuit's interpretation of Section 85 of the National Bank Act in *Madden v. Midland Funding*.

Part IV chronicles the response of the OCC and FDIC to sector instability caused by the true lender test and *Madden*, including the issuance of the new true lender and valid-when-made rules in 2020. It

[26] The failed attorneys general challenges to the OCC and FDIC's valid-when-made rules, discussed in Part IV, forecloses other jurisdictions' adoption of a similar holding as *Madden*. Nevertheless, given the diametrically opposed approaches of recent presidential administrations regarding the rules, this Comment considers the potential relevance of *Madden* if the rules, again, were to change.

also highlights consumer advocates and lending industry professionals' reactions to the rules.

Part V discusses the history of the MLA, including its key terms and its potential extension to all consumers via the VCFCA or a similar bill, the potential impact of a nationwide cap on high-interest consumer lending, and how lenders might exploit the gap between state and federal interest rate limits. This Part argues that if a national interest rate cap were implemented, solidified true lender and valid-when-made rules are necessary to stabilize the lending sector. Part VI concludes by briefly summarizing why consistent valid-when-made and true lender rules are important, even if Congress were to implement a nationwide interest rate cap on consumer loans.[27]

II. HIGH-INTEREST CONSUMER LOANS—STATE AND FEDERAL LAW

This Part provides a brief overview of the history of high-interest consumer lending in the United States, details the structure of the federal regulatory scheme of banks, and sheds light on the relevant judicial rulings and economic factors that facilitated the contemporary growth of high-interest lending.

A. *Brief History of High-Interest Consumer Lending*

The United States has a long history of usury laws which limit "high-interest" [28] lending.[29] In 1641, approximately 148 years before the signing of the U.S. Constitution, America adopted its first usury limit in Massachusetts.[30] Eventually all thirteen of the original states adopted annual interest rate caps between 5% and 8%, which largely remained in place until the late nineteenth and early twentieth centuries.[31]

[27] Since the 2016 presidential election, the fast-changing, conflicting policies of recent presidential administrations—coupled with the political majority changeover in Congress—have created the fodder for the composition of this Comment. In this landscape, it is difficult to access contemporary data, policies, and commentary related to consumer lending that does not carry with it at least a tinge of politicization. Accordingly, this Comment strives to acknowledge differing views and promote a position that balances consumer protections with a stable, accessible lending sector.

[28] What defines "high interest" is subjective, but potential considerations include: the interest levels traditionally associated with a particular type of loan; the history of lending in a particular field; moral standards and cultural values; and the statistical ability of borrowers to successfully repay a loan on reasonable terms.

[29] *See* Martin, *supra* note 24, at 263–65.

[30] *Id.* at 263.

[31] *Id.*

In the late 1800s, following the industrialization of the United States, an illegal black market developed for small loans as the American economy shifted toward a "greater reliance on the purchase of personal goods."[32] At the time, civil usury statutes in most states limited chargeable interest rates to around 6%, which encouraged legitimate lenders to focus on extending large amounts of credit to businesses, rather than individual consumers.[33] "Salary lenders," a historical antecedent to contemporary payday lenders, stepped in and extended credit to consumers that would become due on the worker's next payday.[34] Typical loans from a salary lender would carry four-digit annual interest rates.[35]

Finding the lending practices abusive, social reformers, including the Russell Sage Foundation, sought to end black market payday lending and proposed a 36% annual interest rate cap for consumers.[36] By creating an exception to the standard rate, the new cap was meant to encourage legitimate lenders to enter the small dollar loan market.[37] Arthur Ham, working with the Russell Sage Foundation, drafted a model statute for states to implement that would permit lenders to charge an annual interest rate of 24% to 42%.[38] From 1914 to 1943, thirty-four states adopted versions of the Uniform Small Loan Laws proposed by the Foundation.[39] During the late nineteenth century, banking in the United States also grew increasingly complex and created the conditions for contemporary use of federal preemption to avoid state consumer protections.

In 1864 Congress passed the National Bank Act to establish a national banking system.[40] The legislation was intended to, inter alia, create a national currency and "a national market for federal bonds to finance the Civil War."[41] In large part, the success of national banks depended on their ability to compete with state-charted banks and other lenders.[42] Accordingly, Section 85 of the Act afforded national

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[32] SAUNDERS, *supra* note 12, at 1.

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] *Id.* at 2.

[37] *Id.*

[38] Martin, *supra* note 24, at 264.

[39] SAUNDERS, *supra* note 12, at 2.

[40] Schiltz, *supra* note 11, at 544.

[41] *Id.*

[42] *Id.*

banks a "national favorite" status, where the banks were allowed to charge the maximum interest rate permissible by the state in which they were located.[43] Doing so prohibited state legislatures from discriminating against nationally chartered banks via unequal limitations on enforceable interest rates.[44] With the passage of the National Bank Act, the United States created a dual banking system where national banks and state banks conducted lending activities parallel to one another.[45]

Today, national and state-chartered banks continue to coexist and are subject to complex regulation. State-chartered banks are primarily regulated by states, and national banks by the federal government,[46] but there is a *significant* amount of overlap in jurisdiction. For instance, state-chartered banks are frequently subject to varied federal regulations, such as the requirement to maintain deposit insurance.[47] When state-chartered banks accept federal deposit insurance, the bank becomes subject to many federal regulations, including those promulgated by the Federal Deposit Insurance Corporation (FDIC).[48] The FDIC's mission is to "maintain stability and public confidence in the nation's financial system."[49] Popularly known as the organization that insures deposits in the United States, the FDIC also serves as the primary federal regulator of state-chartered banks that are not part of the federal reserve system.[50] The FDIC is an independent agency and is managed by a five-person board of directors, which includes the Comptroller of the Currency and the Director of the Consumer Financial Protection Bureau.[51]

Nationally chartered banks are primarily subject to federal law, with their regulatory body including the Office of the Comptroller of the Currency (OCC).[52] The OCC "ensures that the federal banking system operates in a safe and sound manner," supervising nearly 1,200 banking institutions whose business makes up 70% of the banking

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43 *Id.* at 544–45.

44 *Id.* at 545.

45 *See id.* at 541.

46 Schiltz, *supra* note 11, at 541.

47 *Id.* at 541–42.

48 *Id.* at 542.

49 *What We Do*, FED. DEPOSIT INS. CORP. (May 15, 2020), https://www.fdic.gov/about/what-we-do.

50 *Id.*

51 *Id.*

52 Schiltz, *supra* note 11, at 541.

activity in the United States.[53] The Comptroller of the Currency is the chief executive officer of the OCC and also serves as a director of the FDIC.[54] The OCC charters and licenses national banks and "issues rules and regulations that govern the banks it supervises."[55] Notably, state law also plays an important role in regulating national banks. It often provides the basis for the general contract, tort, and property law of a jurisdiction in which a national bank is located.[56] State law can also control some national bank operations, such as the extent to which a national bank may establish branches.[57]

Given the interconnected nature of the United States' dual banking system, OCC and FDIC consensus on regulatory issues is key to stability in the lending sector, with a major goal being the maintenance of competitive equality between the two types of banks.[58] For instance, if a nationally chartered bank is given a competitive advantage over a state-chartered bank via a change in regulation by the OCC or a broader judicial interpretation of the banks' lending powers, the FDIC will adapt its policies to level the playing field.[59] As illustrated below, this dynamic has played itself out in the expansion of the exportation doctrine and the release of the valid-when-made and true lender rules.

B. *Exportation Doctrine—Genesis and Expansion*

In 1978 the Supreme Court dramatically expanded the interpretation of Section 85 of the National Bank Act in *Marquette National Bank v. First of Omaha Service Corporation*, creating the "[e]xportation [d]octrine."[60] In *Marquette*, the Court considered whether a national bank based in Nebraska was able to charge some of its customers—residents of Minnesota—an interest rate on credit card

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[53] *Comptroller*, OFF. OF THE COMPTROLLER OF THE CURRENCY, https://www.occ.treas.gov/about/who-we-are/comptroller/bio-michael-hsu.html (last visited Sept. 10, 2022).

[54] *Id.*

[55] *What We Do*, OFF. OF THE COMPTROLLER OF THE CURRENCY, https://www.occ.treas.gov/about/what-we-do/index-what-we-do.html (last visited Sept. 10, 2022).

[56] Schiltz, *supra* note 11, at 543.

[57] *Id.*

[58] *Id.* at 565.

[59] *Id.*

[60] *Id.* at 546.

transactions permissible in Nebraska, but usurious in Minnesota.[61] The Minnesota Supreme Court held that it could, and the Supreme Court affirmed.[62]

In the late 1970s, the First National Bank of Omaha ("First National") was a federally chartered national bank based out of Omaha, Nebraska.[63] First National was a member of the BankAmericard plan (an early version of a contemporary credit card, such as Visa) which allowed holders to purchase goods from participating merchants or take cash advance withdrawals on credit.[64] At the time, First National actively solicited citizens and merchants in Minnesota to enroll and participate in the program.[65] Per the terms of the credit card and Nebraska state law, holders could be charged an 18% interest rate on their first $999.99 in debt, with the remainder subject to a 12% interest rate.[66]

A competitor of First National, Marquette National Bank of Minneapolis ("Marquette"), brought suit in Minnesota to enjoin the bank from soliciting in Minnesota until its credit card terms complied with Minnesota state usury law.[67] Marquette claimed that First National had an unfair advantage because it (a Minnesota-based bank) was being "forced" to charge customers an annual $10 fee for its credit card services, rather than charge a higher interest rate like First National.[68] In response to Marquette's request to subject First National to Minnesota state usury law, First National claimed that Section 85 of the National Bank Act preempted the state law.[69] The Attorney General of Minnesota—perhaps realizing that state consumer protections were at risk—intervened and joined Marquette as a plaintiff, seeking a declaratory judgment and permanent injunction.[70]

The Supreme Court began its analysis by stating that Section 85 of the National Bank Act "plainly provides that a national bank may charge interest 'on any loan' at the rate allowed by the laws of the

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[61] Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 301–03 (1978).

[62] *Id.* at 301.

[63] *Id.*

[64] *Id.* at 301–02.

[65] *Id.* at 302.

[66] *Id.*

[67] *Marquette*, 439 U.S. at 304.

[68] *Id.*

[69] *Id.* at 306.

[70] *Id.*

[s]tate in which the bank is 'located.'"[71] The Court held that the National Bank Act contemplated that a national bank would be "located" in the state named in its organization certificate, and that First National "cannot be deprived of this location merely because it is extending credit to residents of a foreign [s]tate."[72] Marquette and the Attorney General contended that when Section 85 of the National Bank Act was written, the goal was to ensure that national banks could maintain competitive equality with in-state lenders, and interpreting Section 85 to cover out of state transactions would contravene the intent of legislators.[73] The Court disagreed.[74] Citing the long history of the vast and complex interconnectedness of the United States economy and other sections of the National Bank Act that contemplate interstate lending, the Court determined that legislators knew that national banks would be given distinct advantages, including the ability to export their interest rates.[75] In response to the claimant's argument that such an interpretation of Section 85 would "significantly impair the ability of [s]tates to enact effective usury laws," the Court stated that any "plea to alter [Section] 85 . . . is better addressed to the wisdom of Congress than to the judgment of this Court."[76]

Thus, the holding of *Marquette* is the genesis of what is contemporarily called the "exportation doctrine."[77] Notably, *Marquette* was decided in "the infancy" of interstate lending and technological developments since the late 1970s have allowed national banks to have a physical presence and orchestrate lending arrangements far from where they were originally chartered.[78] Moreover, since 1978, national banks' ability to export interest rates has extended far beyond the scenarios contemplated in *Marquette*, where national banks can now have branches in states in which they are not "located," national banks can be "located" in their home state *or* a favorable host state, and national banks are not necessarily "located" in a state where they have a substantial physical presence.[79]

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[71] *Id.* at 308.

[72] *Id.* at 310.

[73] *Marquette*, 439 U.S. at 313.

[74] *Id.* at 314.

[75] *See id.* at 314–18.

[76] *Id.* at 318–19.

[77] Munger, *supra* note 9, at 496.

[78] *See* Schiltz, *supra* note 11, at 547.

[79] *See id.* at 555–56.

Importantly, the exportation doctrine has not been limited to credit card arrangements—it has broad applicability across the lending sector, including high-interest consumer loans such as payday loans, car title loans, and installment loans.[80] Over time, the exportation doctrine also became applicable to federally insured *state-chartered* banks because of the inequities the doctrine brought to the dual banking system.[81]

C. *Race to the Bottom*

Following *Marquette* and the subsequent technological and regulatory developments that facilitated interstate banking, the United States experienced a "race to the bottom" for consumer protection laws. As one commentor framed it, "[*Marquette*'s holding] was like a gunshot starting a frenzied race-to-the-bottom in American usury law."[82] National banks that wished to use the exportation doctrine to charge consumers a higher interest rate—gaining a competitive advantage against fellow lenders—simply had to find a state willing to permit higher interest rates and "locate" themselves there. Looking to attract "lucrative financial service jobs," states such as Delaware and South Dakota eliminated their usury statutes.[83] To remain competitive, other states were forced to limit their usury laws or risk losing their banking industry.[84] The race to attract financial sector jobs by eliminating consumer lending interest rate caps, coupled with intense levels of inflation during the period, "squeezed the availability of credit" and spurred further deregulation.[85]

A state-by-state analysis regarding the permissibility of high-interest consumer loans is beyond the scope of this Comment, but

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[80] *See* SAUNDERS, *supra* note 12, at 4 (highlighting that nationwide interest rate regulations implemented by the Department of Defense included payday loans, car title loans, and refund anticipation loans); Munger, *supra* note 9, at 472 n.16 (listing the various types of lending considered part of the "alternative financial services . . . industry" or "fringe banking[] industry").

[81] *See* Schiltz, *supra* note 11, at 565, 567–68.

[82] Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1121 (2008).

[83] *Id.* at 1122.

[84] SAUNDERS, *supra* note 12, at 2.

[85] *Id.* at 3. For additional insight on the market dynamics that led banks to relocate to jurisdictions like Delaware see Claire Tsosie, *Why So Many Credit Cards Are from Delaware*, FORBES (Apr. 14, 2017, 5:46 PM), https://www.forbes.com/sites/clairetsosie/2017/04/14/why-so-many-credit-cards-are-from-delaware/?sh=4387f5d61119.

sufficient data is available for common closed-end loans to give a brief flavor of current usury statutes across the United States. As of July 2021, Delaware and Missouri have no usury limits on $500 six-month loans; Idaho, Utah, and Wisconsin only prohibit interest rates that would make the contracts unconscionable.[86] With permissible annual interest rates from 39% to 305%, twenty-three states allow for $500 six-month loans above the 38.5% interest rate median.[87] For $2,000 two-year loans, Delaware, Missouri, and North Dakota have no interest rate cap,[88] and Alabama, Idaho, South Carolina, Utah, and Wisconsin have no limitation other than contractual unconscionability.[89] Above the median interest rate of 32%, nineteen states allow for annual interest rates ranging from 33% to 175%.[90]

These figures are a far cry from the typical 6% cap allowed during the colonial era or the 24% to 42% carve outs advocated for by reformers trying to facilitate legitimate banks' entry into the small dollar market.[91] Based on these statistics, banks that can take advantage of federal preemption have a sufficient number of states that are willing to offer no, or only negligible, interest rate limits.

Notably, Delaware and South Dakota, two of the states that eliminated their usury laws after *Marquette*, have recently followed divergent paths regarding state interest rate caps. Today, Delaware still has few limits on closed-end consumer loans,[92] but South Dakota changed course in 2016 with approximately 76 percent of voters enacting ballot Measure 21 to implement a 36% interest rate cap on short-term loans.[93] The measure:

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[86] NAT'L CONSUMER L. CTR., STATE RATE CAPS FOR $500 AND $2,000 LOANS (2021) [hereinafter STATE RATE CAPS]. For an in-depth discussion regarding the shortcomings of the contractual unconscionability doctrine in protecting consumers from high interest loans, see Martin, *supra* note 24, at 283–92.

[87] STATE RATE CAPS, *supra* note 86.

[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] *See supra* text accompanying notes 31–39.

[92] *See* Munger, *supra* note 9, at 476 (discussing states that do not have usury limits); *see also* DEL. CODE ANN. tit. 5, §§ 2227–2238 (2021) (requiring lenders to disclose additional information to borrowers of short-term consumer loans, but not implementing a state-mandated interest rate limit).

[93] *South Dakota Payday Lending Initiative, Initiated Measure 21 (2016)*, BALLOTPEDIA, https://ballotpedia.org/South_Dakota_Payday_Lending_Initiative,_Initiated_Measure_21_(2016) (last visited Sept. 10, 2022).

> [P]rohibits all State-licensed money lenders licensed under South Dakota Codified Laws . . . from making a loan that imposes total interest, fees, and charges (including all charges for any ancillary product or service and any other charge or fee incident to the extension of credit) at an annual percentage rate greater than 36%.[94]

The lenders subject to the law "make commercial and personal loans, including installment, automobile, short-term consumer, [payday] and title loans" and are prohibited from "evading the rate limitation by indirect means."[95] It is important to note that the initiated measure "does not apply to state and national banks, bank holding companies, other federally insured financial institutions and state chartered trust companies."[96] That is, despite the will of voters in South Dakota to protect consumers from high-interest loans, federal preemption remains a hurdle for the enforceability of state usury laws because the new ballot initiative does not touch the enforceability of high-interest rates for loans originated via rent-a-bank or rent-a-tribe arrangements.

Against this backdrop, state legislatures and courts began to challenge the enforceability of high interest rates associated with consumer loans.

III. CHALLENGING HIGH-INTEREST CONSUMER LOANS

After expansion of the exportation doctrine and the race to the bottom for the deregulation of consumer loan interest rates, legislatures and courts began to realize and address the ills of high-interest consumer lending that utilizes federal preemption to avoid state consumer protections. By identifying the "true lenders" of high-interest consumer loans as non-bank entities, and limiting the valid-when-made doctrine, courts have voided lending arrangements or limited chargeable interest rates. This Part outlines the creation and impact of the true lender test and the implications of a limited interpretation of the valid-when-made doctrine.

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[94] *Guidance for Money Lenders on Initiated Measure 21*, S.D. DEP'T OF LAB. & REGUL., https://dlr.sd.gov/banking/money_lenders/guidance_initiated_measure_21.aspx (last visited Sept. 10, 2022).

[95] Press Release, S.D. Dep't of Lab. & Regul., Initiated Measure 21 Approved (Nov. 10, 2016), https://dlr.sd.gov/news/releases16/nr111016_initiated_measure_21.pdf.

[96] *Id.*

A. *Predominant Economic Interest and "True Lenders"*

One method to attack the enforceability of a loan that would be usurious, but for federal preemption, is for a state to implement a "predominant economic interest" or "true lender" test. This test allows courts to "pierce the veil" of arrangements made between entities that can take advantage of federal preemption with those that cannot, determining that the non-bank entity was the true lender, and apply state usury law.[97]

1. Development of the Test

The true lender test emerged out of state legislative action, with the first example being a 2004 Georgia bill aimed at targeting rent-a-bank schemes.[98] The bill stated, "[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."[99] The first case brought by lenders challenging the legislation was *Bankwest, Inc. v. Baker*.[100] The Eleventh Circuit originally upheld the district court's refusal to find federal preemption,[101] holding there was no conflict with the Federal Deposit Insurance Act when the Georgia law only restricted in-state payday lenders from entering into agency relationships with out-of-state lenders when the in-state lender retained the predominant economic interest in the loan.[102] The challenge to the law later became moot because changing FDIC regulations further constrained the specific type of payday lending that was taking place in Georgia, and the lenders' plans to retool their business models to comply with the federal regulations, while remaining non-compliant with the Georgia law, were too speculative to be justiciable.[103]

Following Georgia, other states have enacted similar laws. For instance, New Mexico enacted a true lender law in 2007, but it was later repealed in 2018.[104] More recently, the Illinois legislature passed the

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[97] Munger, *supra* note 9, at 499.

[98] *Id.* at 493.

[99] *Id.* (emphasis added).

[100] *Id.*

[101] *Id.*

[102] *See* Bankwest, Inc. v. Baker, 411 F.3d 1289, 1306 (11th Cir. 2005), *vacated by*, BankWest, Inc. v. Baker, 446 F.3d 1358, 1360 (11th Cir. 2006).

[103] *Baker*, 446 F.3d at 1367.

[104] Munger, *supra* note 9, at 493 n.165.

Predatory Loan Prevention Act where an entity is a lender subject to state law if it "(i) purports to act as an agent or service provider for another entity that is exempt from the [Act], and, among other requirements, (ii) 'holds, acquires, or maintains, directly or indirectly, the predominant economic interest in the loan.'"[105] Maine recently passed the Protect Consumers Against Predatory Lending Practices Act which details that an entity is a lender subject to state usury law when it: "holds, acquires, or maintains, directly or indirectly, the predominant economic interest in the loan," when it "markets, brokers, arranges, or facilitates the loans or holds the right, requirement, or first right of refusal to purchase the loan or a receivable or interest in the loan," or when "the totality of the circumstances indicate that the person is the lender and the transaction is structured to evade the requirements of the [Maine Consumer Credit Code], including the licensing requirement."[106]

2. Case Law Examples

The case law detailed below demonstrates how the true lender test is applied in practice and how lenders are flexible in adapting their arrangements to avoid the enforceability of state consumer protections. In particular, the cases focus on CashCall, Inc. and the company's use of federal preemption both via a FDIC-insured rent-a-bank scheme and a rent-a-tribe scheme to extend unsecured consumer loans. Readers should not lose track of the forest for the trees: at the core of these arrangements is a borrower seeking a loan which the lender is willing to extend in exchange for a high interest rate and, depending on the circumstances, additional collateral such as a vehicle title.[107]

i. Rent-a-Bank Arrangement

In *CashCall, Inc. v. Morrisey*, the West Virginia Supreme Court upheld a lower court's application of the predominant economic interest test for a series of consumer loans facilitated by CashCall,

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[105] *Fintech Focus: A "Predominant Economic Interest" . . . in Illinois and Maine*, MORRISON FOERSTER (Aug. 27, 2021), https://www.mofo.com/resources/insights/210827-fintech-focus-predominant-economic-interest.html.

[106] *Id.*

[107] For additional information on car title loans, a common form of high-interest lending, see *What to Know About Payday and Car Title Loans*, FED. TRADE COMM'N. CONSUMER ADVICE. (May 2021), https://www.consumer.ftc.gov/articles/what-know-about-payday-and-car-title-loans.

Inc.[108] At issue were loans issued between August 2006 and February 2007 to 292 citizens of West Virginia.[109] Via CashCall, borrowers would request a loan, the state-chartered First Bank and Trust of Millbank South Dakota ("FB&T") would originate the loan, and CashCall would buy the loan from FB&T shortly after origination.[110] The loans ranged from $1,075 to $5,000 with annual interest rates of 59% to 96%.[111] Eventually, 212 of the 292 borrowers defaulted.[112] When suit was brought against CashCall for failure to abide by West Virginia usury law, the company claimed that the loans were exempt under FB&T's right to federal preemption.[113]

In deciding against CashCall, the court based its reasoning on a 1974 West Virginia case that stated that the state's usury statute:

> [C]ontemplates that a search for usury shall not stop at the mere form of the bargains and contracts . . . but that all shifts and devices intended to cover a usurious loan or forbearance shall be pushed aside, and the transaction shall be dealt with as usurious if it be such in fact.[114]

The court also considered a handful of cases in which other federal and state courts previously applied the predominant economic interest test in rent-a-bank cases.[115]

In prioritizing function over form, the court noted several facts that led to its conclusion that CashCall, not FB&T, was the true lender: (1) "FB&T placed the entire monetary burden and risk of the loan program on CashCall,"[116] (2) CashCall's President and CEO Paul Reddman was required to *personally* guarantee each loan extended by FB&T under their arrangement, (3) CashCall paid *more* to the bank than the value of the loans originated, and (4) CashCall had to indemnify the bank against all losses, including claims from borrowers.[117]

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[108] CashCall, Inc. v. Morrisey, No. 12-1274, 2014 W. Va. LEXIS 587, at *41–43 (W. Va. May 30, 2014).

[109] *Id.* at *3.

[110] *See id.* at *2–4.

[111] *Id.* at *3.

[112] *Id.*

[113] *Cashcall*, 2014 W. Va. LEXIS 587, at *5.

[114] *Id.* at *41.

[115] *Id.*

[116] *Id.* at *20.

[117] *Id.* at *20–21 (emphasis added).

Soon after CashCall's loss in West Virginia, the lending model of CashCall using FDIC-insured banks became unworkable when state-chartered banks, under pressure from the FDIC, withdrew from their arrangements with the company.[118]

ii. Rent-a-Tribe Arrangement

CashCall, searching for a new lending model, entered into an arrangement with Western Sky Financial (Western Sky), a South Dakota limited liability corporation formed by Martin Webb, a member of the Cheyenne River Sioux Tribe.[119] The goal of the arrangement was to use, in their words, the "tribal model" to escape state-law-based consumer protections.[120] Rent-a-tribe arrangements, or here, the tribal model, are based on federal laws that grant certain Native American tribes sovereign immunity against state laws and regulations.[121] This means that loans issued under tribal law can be shielded from state-law-based interest rate caps via, again, the exportation doctrine and federal preemption.

In the arrangement between CashCall and Western Sky, CashCall extended the original funds to Western Sky, which Western Sky would then lend to borrowers after CashCall connected consumers with the company; CashCall would then purchase "each and every loan" from Western Sky before borrowers made any payments.[122] Some of the loans included triple-digit annual interest rates ranging from 134.4% to 318.52%.[123] CashCall also fully indemnified Western Sky against any consumer and regulatory suits.[124]

After the Consumer Protection Financial Bureau brought suit on behalf of the impacted borrowers, the court determined that the loans were void via the predominant economic interest test because CashCall, not Western Sky, was the true lender of the loans.[125] The holding was based on the finding that the "entire monetary burden and risk of the loan program was placed on CashCall."[126] In short, the

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[118] CFPB v. CashCall, Inc., CV 15-7522 (RAOx), 2016 U.S. Dist. LEXIS 130584, at *4 (C.D. Cal. Aug. 31, 2016).

[119] *Id.* at *5.

[120] *Id.* at *4.

[121] Munger, *supra* note 9, at 477.

[122] *CashCall*, 2016 U.S. Dist. LEXIS 130584, at *19.

[123] *Id.* at *10.

[124] *Id.* at *20.

[125] *Id.* at *17–21.

[126] *Id.* at *20.

court determined "whether an animal which looks like a duck, walks like a duck, and quacks like a duck, is in fact a duck."[127] The case was a win for consumers, but in the aggregate, such inquiries are believed by industry professionals to have a problematic effect on liquidity in the lending sector.

3. Protection of Consumers & Creation of Sector Instability

Although state legislatures and courts have been able to front the interests of consumers using the predominant economic interest test to identify non-bank entities as true lenders, doing so creates instability in the sector because of the state-by-state, court-by-court application of the rule.[128] In each case, the application of the rule requires a fact-intensive inquiry for each loan to determine if the loan's interest rate is enforceable.[129] A case-by-case determination if a loan is enforceable is unwieldy where the lending sector depends on the fluid purchase and sale of loans. That is, the true lender rule "increase[s] legal and business risks to potential purchasers of bank loans, which in turn may reduce overall liquidity in loan markets, limiting the ability of banks to sell loans to manage balance sheet risk."[130]

Accordingly, lenders spurred the OCC to propose the new "true lender rule." With this rule, the OCC attempted to "address the 'increasing uncertainty' in the legal framework that governs lending partnerships between banks or federal savings associations and third parties" and to clarify "what legal framework applies, when the loan is originated as part of a lending relationship between a bank and third party."[131] As detailed below, limiting the valid-when-made doctrine raises similar issues as the true lender test, which the OCC and FDIC tried to address with a corresponding rule.

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[127] *Id.* at *17.

[128] DAVIS POLK & WARDWELL LLP, *supra* note 10, at 6.

[129] *See, e.g.*, *CashCall*, 2016 U.S. Dist. LEXIS 130584, at *6–21 (evaluating the substantive aspects of the contracts between CashCall and Western Sky, as well as the procedural interactions of consumers with the entities, to determine that CashCall—under the totality of the circumstances—retained the predominant economic interest in the loans).

[130] DAVIS POLK & WARDWELL LLP, *supra* note 10, at 6. Readers should consider if this conceptual framework neatly applies to the type of arrangements detailed above where non-bank entities are contractually obligated to purchase *every* loan they work with national or state-chartered banks to originate.

[131] Philip Rosenstein, *OCC Proposes Rule to Settle 'True Lender' Question*, LAW360 (July 20, 2020, 10:58 PM), https://www.law360.com/articles/1293690.

B. *Valid-When-Made Doctrine*

Another method of attacking what would be a usurious loan but for federal preemption is to limit the scope of the long-standing "valid-when-made" doctrine. One purported genesis of the doctrine is the 1833 Supreme Court case *Nichols v. Fearson*, where the Court stated that "a contract, which, in its inception, is unaffected by usury . . . can never be invalidated by any subsequent usurious transaction."[132] When discussing the valid-when-made doctrine, Judge Posner later explained "once assignors were authorized to charge interest, the common law kicked in and gave the assignees the same right, because the common law puts the assignee in the assignor's shoes, whatever the shoe size."[133] There is significant contemporary debate regarding the validity of the historic nature of the valid-when-made doctrine and its popular understanding.[134] Critics argue that *Nichols* and its progeny do not provide any historical basis for the doctrine because the cases concern completely different lending transactions that are factually distinguishable from contemporary instances of rent-a-bank and rent-a-tribe schemes,[135] while supporters argue that the popular understanding of the common law rule (like Judge Posner's) is correct and key to the smooth functioning of the lending sector.[136] This Comment is not focused on arguing the validity of the valid-when-made doctrine. Rather, it is focused on the doctrine as it is currently understood and implemented by the OCC and FDIC in crafting rules in response to *Madden v. Midland Funding*.[137] Although *Madden* did not explicitly discuss the rent-a-bank schemes that have proliferated in the payday lending sector, or business dealings that endeavor to use tribal sovereignty to avoid state usury law, "its reasoning potentially applies to those arrangements."[138] Thus, the scope of the valid-when-made doctrine as codified by OCC and FDIC will be key in determining if lenders can continue to use federal preemption to avoid state usury laws, even if a federal interest rate cap were to be implemented. Subsequently, a brief overview of the Second Circuit's *Madden v. Midland Funding* is warranted.

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[132] Nichols v. Fearson, 32 U.S. 103, 109 (1833).

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

[134] *E.g.*, Adam J. Levitin, *Spurious Pedigree of the "Valid-When-Made" Doctrine*, 71 DUKE L.J. ONLINE 87 (2022).

[135] *See* Munger, *supra* note 9, at 488–90; Levitin, *supra* note 134, at 94–106.

[136] *See* DAVIS POLK & WARDWELL LLP, *supra* note 10, at 3 n.12.

[137] Rosenstein, *supra* note 131.

[138] Munger, *supra* note 9, at 489.

1. Understanding *Madden*

In *Madden v. Midland Funding*, Saliha Madden, a resident of New York, obtained a Bank of America credit card.[139] Madden's credit card was later consolidated with another national bank, FIA Card Services.[140] Madden owed approximately $5,000 on her credit card when FIA "charged-off" her debt, assigning it to Midland Funding LLC.[141] Midland Funding and its subsidiary, Midland Credit Management, Inc., (the defendants in the case) were not national banks, and after assignment, neither Bank of America nor FIA Card Services had any interest in Madden's debt.[142] In 2010, Midland sent Madden a notification stating that her debt was subject to a 27% annual percentage rate, and a year later, Madden filed a class action suit alleging, inter alia, that the 27% interest rate violated New York state law.[143]

The trial court stated that Madden's suit was essentially dead on arrival: "the [National Bank Act] would preempt any state-law usury claim against the defendants."[144] The Second Circuit reversed and vacated the trial court's judgement, stating that

> [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, we reverse the District Court's holding that the NBA preempts Madden's claims . . . .[145]

On petition, the Supreme Court denied certiorari.

A key critique of *Madden* is that the court "failed to acknowledge or address the [valid-when-made] doctrine" and instead relied on *Barnett Bank N.A. v. Nelson* where the "Supreme Court held that the National Bank Act preempts state law only if the application of state law 'significantly interferes' with a national bank's exercise of its powers."[146] The court in *Madden* did not think that the application of state usury laws to loans originated at national banks, but later assigned

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[139] Madden v. Midland Funding, LLC, 786 F.3d 246, 247–48 (2d Cir. 2015).

[140] *Id.* at 248.

[141] *Id.*

[142] *Id.*

[143] *Id.*

[144] *Id.*

[145] *Madden*, 786 F.3d at 249 (emphasis added).

[146] Munger, *supra* note 9, at 490.

to non-national bank entities, and the subsequent inability of non-national banks to charge what would otherwise be usurious interest rates, would "prevent consumer debt sales by national banks to third parties."[147] And that "[a]lthough it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states (i.e., those with firm usury limits, like New York), such an effect would not 'significantly interfere' with the exercise of a national bank power."[148]

2. The Implications of *Madden*

If extended to other jurisdictions outside of the influential Second Circuit, *Madden* potentially guts the viability of rent-a-bank or rent-a-charter schemes in those jurisdictions,[149] but it also raises larger questions regarding the continued enforceability of a loan's original interest rate after assignment. Some critics of the holding have said that *Madden* "threaten[s] to interfere with the core powers afforded to banks under federal law and undermine the smooth functioning of our financial system,"[150] even though it is squarely admitted that the decision and other "true lender developments likely reflect efforts by courts and state legislatures to address important consumer protection concerns arising from extreme and abusive conduct in payday lending."[151] Former Comptroller Otting, who served during the Trump administration, emphasized the importance of national banks' ability to dependably originate and assign loans in order to "create capacity in the marketplace for originators" and expand consumer choice, [152] a position supported by the lending industry.[153] In fact, Republicans in Congress introduced two bills in 2017 to address the instability resulting from *Madden*, both seeking to enforce the valid-when-made doctrine in all cases;[154] neither bill passed.[155] As evidenced by the hotly-contested rule changes detailed below, holdings like

[147] *Madden*, 786 F.3d at 251.

[148] *Id.*

[149] That is, so long as the purchasers are non-banks.

[150] DAVIS POLK & WARDWELL LLP, *supra* note 10, at 1.

[151] *Id.* at 5.

[152] *Id.* at 6 n.28.

[153] *See, e.g.*, Hill, *supra* note 6.

[154] DAVIS POLK & WARDWELL LLP, *supra* note 10, at 6 n.28.

[155] Modernizing Credit Opportunities Act, H.R. 4439, 115th Cong. (2017); Protecting Consumers' Access to Credit Act of 2017, H.R. 3299, 115th Cong. (2018). Note: The Protecting Consumers' Access to Credit Act had a Democratic Co-Sponsor.

Madden remain an outstanding issue for the lending industry, especially if the current rule were to change. Consistent, solidified agency guidance is needed to promote stability in the sector.

IV. SEEKING CLARITY AND NOT FINDING IT: TRUE LENDER AND VALID-WHEN-MADE RULES

In light of the expansion of the true lender test, *Madden*, failed congressional proposals to codify the valid-when-made doctrine, and the continued sector instability regarding the assignability of interest rates for loans originated at FDIC-insured or national banks, the OCC and FDIC drafted and implemented the three rules discussed below. Although the rules—as written—are either repealed or tenuously in place, clarity on the issues that led to their creation, i.e., legal certainty regarding the enforceability of a loan's interest rate after assignment remains necessary, especially if a national interest rate cap were to be implemented and use of rent-a-bank or rent-a-tribe arrangements were to expand.

A. *Valid-When-Made Rule*

To address the uncertainty posed by *Madden*, the OCC and the FDIC issued two separate, but similar valid-when-made rules in 2020.[156] The OCC rule, issued in May 2020, states that "when any national or savings bank 'sells, assigns, or otherwise transfers a loan, interest permissible before the transfer continues to be permissible after the transfer.'"[157] The FDIC rule, issued in June 2020 "clarif[ied] that loans originated by state-chartered banks remain valid throughout the lifetime of the loan."[158]

Both rules mirror what was called for by critics of the *Madden* holding: "the federal banking regulators should issue clarifying regulations, which look to existing guidance issued by federal banking regulators and are informed by the long-standing principles of the valid-when-made doctrine as articulated by courts."[159] Those advocating for consumer protections saw the new rules as a "boon to predatory lenders seeking to skirt state interest rate caps . . . ."[160] That is, by seeking to create a bright line rule to assuage assignee concerns

[156] Rosenstein, *supra* note 6.

[157] Barbarino, *supra* note 6.

[158] Rosenstein, *supra* note 6.

[159] DAVIS POLK & WARDWELL LLP, *supra* note 10, at 7.

[160] Rosenstein, *supra* note 6.

regarding the enforceability of interest rates applicable at origination—greasing the skids of the secondary lending market—the OCC and FDIC facilitated the future growth of rent-a-bank and rent-a-tribe arrangements.

Although enactment of a nationwide 36% consumer loan interest rate cap would likely temper debate over the potentially exploitative effects of the valid-when-made rules, a final, consistently accepted rule remains necessary for clarity in secondary markets where lenders can exploit the gap between the federal limit and lower state usury statutes. In turn, it is valuable to outline (1) the scope, reasoning, and history of the extant rules; (2) critiques and challenges to the rules; and (3) recent developments that reflect the shift in presidential administrations.

1. The OCC's Valid-When-Made Rule

In November 2019, during the Trump administration, "the OCC published a notice of proposed rulemaking . . . to codify its conclusion that when a national bank or savings association (bank) sells, assigns, or otherwise transfers . . . a loan, interest permissible before the transfer continues to be permissible after the transfer."[161] The OCC acknowledged that "recent developments [i.e., *Madden*] have created legal uncertainty about the ongoing permissibility of the interest term after a bank transfers a loan."[162] The new rule was designed to narrowly address this source of uncertainty.[163] In particular, the OCC stated that the proposed rule is based on the belief that "unresolved legal uncertainty" regarding the developments may disrupt banks' ability to serve customers and businesses, particularly in times of economic stress, and that "enhanced legal certainty may facilitate responsible lending by banks."[164]

In issuing the rule, the OCC reasoned that the National Bank Act's grant of authority to national banks to enter into contracts "necessarily includes the authority to assign such contracts."[165] And that the "conspicuous" silence of Section 85 of the National Bank Act regarding the assignability of interest rates originated at national banks

[161] Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33,530, 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pts. 7, 160).

[162] *Id.*

[163] *Id.* at 33,534.

[164] *Id.* at 33,530.

[165] *Id.* at 33,531.

lends credence to the bureau's ability "to interpret . . . and resolve this silence."[166] The OCC believed its new rule was a reasonable interpretation of Section 85, within the "tenets of common law," and consistent with the purpose of Section 85.[167]

In making its decision to implement the rule, the OCC readily acknowledged that the impact of *Madden* is dependent on the specific business models of individual national banks—i.e., the assignment of what would otherwise be usurious loans to non-banks—but that *Madden*'s "resulting legal uncertainty impairs many national banks' ability to rely on [assignment as a] risk management tool, which is particularly worrisome in times of economic stress when funding and liquidity challenges may be acute."[168] The OCC also said the foregoing reasoning applied equally to savings associations and that "section 1463(g) should be interpreted coextensively with section 85."[169] In totality, "the OCC conclude[d] that, as a matter of Federal law, banks may transfer their loans without impacting the permissibility or enforceability of the interest term."[170]

In responding to critiques that the new rule would "facilitate predatory lending" by promoting rent-a-bank arrangements,[171] the OCC stated—in this author's opinion, disingenuously—that "[n]othing in this rulemaking in any way alters the OCC's [strong opposition to predatory lending]," and that the agency "has issued guidance on how banks can appropriately manage the risks associated with these relationships."[172] The OCC emphasized that the new rule was aligned with recognizing state law interest rate caps and that "disparities between the interest caps applicable to particular bank loans result primarily from differences in the state laws that impose these caps."[173] In other words, the fact that some states have low interest rate caps which allow rent-a-bank schemes to function via the exportation doctrine is not a problem for the OCC to solve.

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[166] *Id.*

[167] Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. at 33,532.

[168] *Id.* at 33,533.

[169] *Id.*

[170] *Id.*

[171] *Id.* at 33,534.

[172] *Id.*

[173] Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. at 33,534.

Following the release of the new "valid-when-made rule," New York, California, and Illinois sued the OCC to block implementation.[174] The states claimed that the rule violated the Administrative Procedures Act, because of the OCC's contrived legal reasoning, that the OCC failed to follow procedure, and that the OCC failed to adequately address concerns regarding the rule's impact on rent-a-bank schemes.[175] Of particular note is the complaint's allegation that "[t]he OCC lacks the authority to issue the Rule because it does not have jurisdiction over what non-banks may do and because it cannot contravene previous court rulings that interest-rate preemption does not extend to non-banks."[176]

The OCC "vigorously defended" against claims of overreach,[177] calling the suit's assertions "meritless," stating that it was acting "squarely within its authority when it promulgated the rule"[178] to address the gaps within Section 85 of the National Bank Act. The OCC also stated that the rule does not "authorize the transfer of preemptive powers to nonbanks" and that the rule was meant to clarify the scope of authority that national banks already have under the law.[179]

For now, it looks like the rule is staying in place. In February 2022 Judge Jeffrey S. White of the U.S. District Court for the Northern District of California granted summary judgement for the OCC.[180] Finding that Section 85 of the National Bank Act "does not speak directly" to the issue of "what happens to the interest rate initially set on a loan originated by a national bank if that loan is subsequently transferred,"[181] the court held that the OCC enacted the rule under a

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[174] *See* Jon Hill, *State AGs Press Challenge to OCC's Valid-When-Made Rule*, LAW360 (Dec. 11, 2020, 10:18 PM), https://www.law360.com/articles/1337064/state-ags-press-challenge-to-occ-s-valid-when-made-rule.

[175] *Id.*

[176] Complaint at 5, California v. Off. of the Comptroller of the Currency, 2022 U.S. Dist. LEXIS 25756 (N.D. Cal. Feb. 8, 2022) (No. 20-cv-05200).

[177] Jon Hill, *OCC Defends Valid-When-Made Rule In State AGs' Suit*, LAW360 (Jan. 15, 2021, 10:33 PM), https://www.law360.com/articles/1345363/occ-defends-valid-when-made-rule-in-state-ags-suit.

[178] *Id.*

[179] *Id.*

[180] *OCC*, 2022 U.S. Dist. LEXIS 25756, at *30.

[181] *Id.* at *22, *20. Readers should note that the plaintiffs, defendant, and the court defined the issue differently. The attorneys general framed the inquiry as "to which entities does [Section 85] apply." *Id.* at *19. The OCC framed the inquiry as "whether interest charged on loans originated pursuant to [Section] 85 remains permissible

permissible construction of the statute, when, inter alia, the OCC is charged with "[assuring] the safety and soundness of national banks."[182] The court held that the rule did not extend the national bank power to set certain interest rates to non-banks, but rather allowed a national bank to assign a loan without "altering the interest rate upon which it and the borrower initially agreed," a power "commensurate with [their] power to transfer or assign loans."[183] The court also determined that the rule was neither arbitrary nor capricious.[184]

After the opinion was released, commentors stated that the holding was a "big win for the bank model,"[185] but cautioned that the war was not over.[186] In February 2022 an appeal was expected,[187] but the state attorneys general did not continue their challenge. In response to the case's outcome, Acting Comptroller Hsu issued a terse press release, stating that the "legal certainty [resulting from the case's holding] should be used to the benefit of consumers and not be abused."[188] It remains unclear whether the OCC will change its position on the rule, especially given the new Democratic presidential administration.[189] For now though, notably, true lender challenges remain viable.[190]

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when the national bank exercises its authority to sell, assign, or transfer these loans to third parties." *Id.* at *20.

[182] *Id.* at *23. Even after considering arguments that the legal uncertainty of such loans might not substantively affect the liquidity of loan originators, the court held that "it was not unreasonable for the OCC to determine greater certainty regarding the transfer of interest rates, and a larger market for transfers, would serve to promote the safety and soundness of the national banking system." *Id.* at *24–25.

[183] *Id.* at *23.

[184] *Id.* at *30.

[185] Here "bank model" presumably means rent-a-bank or rent-a-charter arrangements. Brendan Pedersen, *Bank-Fintech Partnerships Win Key Battle, but War Is Far from Over*, AM. BANKER (Feb. 13, 2022, 9:00 PM), https://www.americanbanker.com/news/bank-fintech-partnerships-win-key-battle-but-war-is-far-from-over.

[186] *Id.*

[187] *Id.*

[188] *Acting Comptroller Issues Statement on Court Decision Regarding 'Madden' Rule*, OFF. OF THE COMPTROLLER OF THE CURRENCY (Feb. 9, 2022), https://www.ots.treas.gov/news-issuances/news-releases/2022/nr-occ-2022-13.html.

[189] Pedersen, *supra* note 185.

[190] *Id.*

2. The FDIC's Valid-When-Made Rule

Following the OCC, the FDIC voted three-to-one in June 2020 to issue a new rule to clarify that interest rates associated with loans originated at state-chartered banks continue to be enforceable after assignment.[191] At the time, the Chair of the FDIC stated that *Madden* compelled the FDIC to issue the rule because it called into question "longstanding principles" and that the new rule codified the "so-called 'valid when made doctrine.'"[192] The new rule stated that "whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined at the time the loan is made" and that "interest on a loan permissible under section 27 is not affected by a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan."[193]

The reasoning in the rule issuance parallels many of the statements made by the OCC: the implicit right of banks to assign loans under federal preemptive authority, the importance of eliminating ambiguity caused by silence in the governing act, and the increased risk caused by *Madden* to banks that might need to assign their loans to increase liquidity during a financial crisis.[194] In reviewing the rule, a former chief counsel at the OCC stated that the wording of the FDIC rule is substantially similar to the wording in the OCC's final rule, that there should be no difference in outcome, and that "banks should react very positively to this development."[195] Notably, twenty-one state attorneys general urged the FDIC not to adopt the rule.[196]

Similar to the dynamic at play concerning the OCC valid-when-made-rule, those for and against the rule took varied approaches to analyzing the impact of the continued codification of the traditional valid-when-made doctrine. Lauren Saunders, Associate Director of the National Consumer Law Center, stated that "[i]t's deeply disturbing that the FDIC and OCC are encouraging high-cost lending rather than working to protect people, especially low-income families and people of color who are being hit the hardest during the COVID-19 crisis."[197]

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[191] Rosenstein, *supra* note 6.

[192] *Id.*

[193] Federal Interest Rate Authority, 85 Fed. Reg. 44,146, 44,146 (July 22, 2020) (to be codified at 12 C.F.R. pt. 331).

[194] *Id.*

[195] Rosenstein, *supra* note 6.

[196] *Id.*

[197] *Id.*

Also concerned with the nation's economic recovery, the former OCC Comptroller stated that "one effect of this rule is to make more credit available to more people, which is an important fact in the recovery from the response to COVID-19, which has made credit availability and capital more important than ever."[198] Both parties agree that consumer access to credit is important but disagree on how to balance fluidity in the lending sector with adequate consumer protections, i.e., the subject of this Comment.

Following the adoption of the FDIC's valid-when-made rule, the attorneys general of California, Washington D.C., Illinois, Massachusetts, Minnesota, New Jersey, New York, and North Carolina brought an action to stop the rule's implementation.[199] Paralleling the argument in the complaint filed against the OCC, the plaintiffs alleged that the rule extends federal preemption to non-bank entities via assignment, which "is beyond the FDIC's power [], is contrary to statute, and would facilitate predatory lending through 'rent-a-bank' partnerships designed to evade state law."[200] The complaint also alleged that the FDIC failed to follow mandated procedures in issuance of the rule, ignored evidence of the potential for regulatory evasion, and did not explain the "rejection of evidence contrary to its proposal."[201]

The FDIC challenged the plaintiffs' assertions, stating that the plaintiffs misconstrued the rule and that the rule does "'not regulate nonbanks, does not interpret state law, and does not preempt state law.'"[202] The FDIC emphasized that "[g]iven the interconnected nature of transactions and markets, the Supreme Court made clear that a regulation directed at market participants within the agency's authority does not overstep the agency's authority simply because it has substantial effects on market participants outside the agency's authority" and that indirect effects of a new rule on nonbanks does not equate to the agency acting outside the scope of its authority.[203] The FDIC also believed that the rule followed legal and historical

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[198] *Id.*

[199] Complaint at 1, California v. Fed. Deposit Ins. Corp., 2022 U.S. Dist. LEXIS 22719 (N.D. Cal. Feb. 8, 2022) (No. 20-cv-05860).

[200] *Id.* at 2.

[201] *Id.*

[202] Hill, *supra* note 22.

[203] *Id.*

precedents and promoted "healthy, orderly functioning of state banks."[204]

Like the OCC, the FDIC's valid-when-made rule survived the attorneys general attack in the Northern District of California.[205] Paralleling the reasoning of the OCC opinion, the court granted summary judgment in favor of the FDIC in February 2022.[206] The court held that there was no direct statutory language regarding a FDIC-insured bank's ability to assign a lending contract's interest rate to a non-bank when 12 U.S.C. § 1831d(a) is modeled on Section 85 of the National Bank Act (the law that governs national banks and the OCC on this issue),[207] that the FDIC subsequently had the power to interpret the governing statute to promulgate such a rule,[208] and that the new rule was not arbitrary, capricious, or manifestly contrary to the statute.[209] Like the OCC case, the state attorneys general did not take an appeal, but the fog of politics equally clouds the future of the FDIC's version of the valid-when-made rule as the OCC's.[210]

B. *True Lender Rule*

In response to courts' increasing use of the true lender test, and calls for regulators to adopt a new rule clarifying the assignability of interest rates,[211] the OCC adopted a final true lender rule in October 2020.[212] The Rule stated that a national bank makes a loan if "as of the date of origination, it [1] is named as the lender in the loan agreement or [2] funds the loan."[213] Between the proposal and adoption of the final rule, the OCC clarified that "when a loan is funded by one bank but has documentation naming another bank as its lender, the latter bank named in the loan agreement qualifies as the true lender."[214]

According to the OCC, the new rule "would enable banks to fully exercise the lending authority granted to them under Federal law and

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[204] *Id.*

[205] *See Fed. Deposit Ins. Corp.*, 2022 U.S. Dist. LEXIS 22719, at *18.

[206] *Id.* at *18–19.

[207] *See id.* at *11.

[208] *See id.* at *11–12.

[209] *Id.* at *13.

[210] *See supra* text accompanying notes 185–189.

[211] DAVIS POLK & WARDWELL LLP, *supra* note 10, at 7.

[212] National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68,742, 68,742 (Oct. 30, 2020) (to be codified at 12 C.F.R. pt. 7).

[213] *Id.*

[214] Hill, *supra* note 6.

allow stakeholders to reliably and consistently identify key aspects of the legal framework applicable to a loan."[215] In issuing the final rule, the OCC decided not to follow commentor recommendations to include a predominant economic interest prong, or other consumer safeguards, stating that the rule did not depart from the bureau's supposed "longstanding and unwavering opposition to predatory lending."[216]

On its face, the OCC's true lender rule directly conflicts with the true lender tests developed by legislatures and courts detailed in Part III of this Comment. The new rule declared that the true lender of a loan, whatever the process of arrangement or bearing of risk, is a national bank if a national bank is named on the loan. By favoring form over function, the rule was criticized as "too lax [in that it] would give unjustifiable and inexplicable cover to predatory nonbank lenders that rely on sham lending partnerships with banks."[217] Although industry groups were "generally supportive" of the rule, they also expressed reservations with the rule as written, emphasizing that it might affect mortgage warehouse lending or indirect auto financing.[218]

Unsurprisingly, state attorneys general immediately challenged the new true lender rule. Bringing suit in January 2021, the coalition of state attorneys general was more expansive than those who sued to block the valid-when-made rules and included New York, California, Colorado, the District of Columbia, Massachusetts, Minnesota, New Jersey, and North Carolina.[219] The plaintiffs sought to block the "unprecedented and ill-conceived" rule, claiming that "the OCC exceeded its statutory authority by offering an unreasonable interpretation of federal law, and acted in a manner contrary to centuries of case law, the OCC's own prior interpretation of the law, and the plain statutory language of the federal statutes it purports to interpret."[220] The suit also claimed that the rule sought to preempt

[215] Rosenstein, *supra* note 131.

[216] Hill, *supra* note 6.

[217] *Id.*

[218] *Id.*

[219] Complaint at 1, New York v. Off. of the Comptroller of the Currency, No. 1:21-Civ.-00057 (S.D.N.Y. Jan. 5, 2021). The case was dismissed by stipulation after Congress and President Biden revoked the rule as discussed *infra* in the text accompanying notes 222–227. *See* Stipulation of Voluntary Dismissal Without Prejudice, New York v. Off. of the Comptroller of the Currency, No. 1:21-Civ.-00057 (S.D.N.Y. July 12, 2021).

[220] Jon Hill, *State AGs Sue To Block OCC's 'True Lender' Rule*, LAW360 (Jan. 5, 2021, 12:58 PM), https://www.law360.com/articles/1341787.

state usury law, infringed on the state police power, and facilitated predatory lending.[221]

Congressional Democrats, recognizing the dangers posed by the new true lender rule, decided to intervene and proposed two companion resolutions in March 2021 to quash the rule via the Congressional Review Act (CRA).[222] The CRA gives Congress the ability to repeal late rulemaking of an outgoing presidential administration by passing resolutions in the House of Representatives and Senate—by a simple majority—and attaining the sitting president's signature.[223] Notably, once a rule is struck down via the CRA, agencies cannot issue a new rule that is "substantially the same."[224] Accordingly, CRA resolutions are considered more as a "sledgehammer" than a "scalpel" because legislators cannot edit the rule, only forbid the targeted rule's continuance.[225] After the resolution to end the true lender rule passed through Congress with limited bi-partisan support,[226] President Biden wielded the sledgehammer and approved the joint resolution in June 2021.[227]

Since the CRA quashed the OCC's true lender rule, uncertainty remains regarding the enforceability of loans subject to true lender tests. Although the OCC's defense of the two-factor test unsatisfactorily addressed the rule's ability to facilitate high-interest lending, clarity is still warranted regarding the enforceability of interest rates after assignment for loans originated at national banks. Assignors and assignees in the secondary lending market should clearly understand what deals they are making and the enforceability of the contracts they are purchasing and selling. A consistent federal rule would help.

If the OCC were to issue a new rule though, per the CRA's requirements, it cannot be *substantially the same* as the old rule. This statutory mandate raises questions regarding what shape a new true

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[221] Complaint, *supra* note 219, at 4.

[222] Jon Hill, *With 'True Lender' Repeal, Dems May Bag Their 1st CRA Win*, LAW360 (Apr. 16, 2021, 6:25 PM), https://www.law360.com/articles/1375184/with-true-lender-repeal-dems-may-bag-their-1st-cra-win.

[223] *Id.*

[224] *Id.*

[225] *Id.*

[226] Sylvan Lane, *Senate Votes to Repeal 'True Lender' Rule*, HILL (May 11, 2021, 6:53 PM), https://thehill.com/policy/finance/552992-senate-votes-to-repeal-occ-true-lender-rule.

[227] *See Biden Signs Law Overturning True Lender Rule*, *supra* note 21.

lender rule would take. When this issue was raised with Lauren Saunders at the National Consumer Law Center, she was confident that the bar would not be difficult to meet if a new rule is crafted in such a way that it "actually protects consumers."[228] In response to questions of if and when the agency will issue a new rule, Acting Comptroller Hsu said that the OCC is analyzing data to figure out "how [the OCC] can define and differentiate between harmful rent-a-charter arrangements and healthy partnerships that expand access to credit."[229]

In September 2021 it looked like there would be some progress on this front when President Biden nominated Saule Omarova as the next Comptroller of the OCC.[230] The administration's previous delay in nominating a Comptroller had been an issue for both Congressional Democrats and Republicans[231] and likely contributed to the agency's limited action regarding a new true lender rule. But in December 2021, Saule Omarova, withdrew her nomination.[232] Moderate Democrats failed to back her nomination while bank lobbyists and congressional Republicans vehemently opposed the appointment, even going so far as to imply that Omarova was a communist because of her national origin.[233] Given the policy differences between the Trump and Biden administrations and the current level of political partisanship, future leadership at the OCC is unclear, as is the development of a new true lender rule.

As discussed below, a *reasonable* true lender rule—a rule that balances consumer protections with legal certainty regarding the enforceability of a lending contract—remains necessary to increase stability in the sector. The implementation of a highly problematic, eleventh-hour rule and its immediate repeal by the following

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[228] Hill, *supra* note 222.

[229] Jon Hill, *OCC's Hsu Hints at What's Next After True Lender Rule Repeal*, LAW360 (Aug. 3, 2021, 9:34 PM), https://www.law360.com/articles/1408887/occ-s-hsu-hints-at-what-s-next-after-true-lender-rule-repeal.

[230] Jon Hill, *Biden Picks Ex-Davis Polk Atty, Law Prof for OCC Chief*, LAW360 (Sept. 23, 2021, 4:42 PM), https://www.law360.com/articles/1424803/biden-picks-ex-davis-polk-atty-law-prof-for-occ-chief.

[231] *See* Hill, *supra* note 229.

[232] Emily Flitter, *President Biden's Pick for a Key Banking Regulator Backs Out*, N.Y. TIMES (Dec. 7, 2021), https://www.nytimes.com/2021/12/07/business/saule-omarova-occ-nomination.html.

[233] *Id.*

administration does not increase stability,[234] nor does the unjustified politicization of the Comptroller.

V. A NATIONWIDE INTEREST RATE CAP AND THE CONTINUED IMPORTANCE OF TRUE LENDER AND VALID-WHEN-MADE RULES

Debate, implementation, legal challenges, and congressional action regarding the true lender and valid-when-made rules take place in a dual banking system that conspicuously lacks a nationwide consumer interest rate cap. The absence of a nationwide interest rate cap is a significant contributor to current discord over the true lender and valid-when-made rules. The lack of a nationwide interest rate cap motivates states to implement usury limits to protect consumers, which leads lenders to take advantage of federal preemption via the exportation doctrine, which leads state legislatures and courts to implement a predominant economic interest test or curtail the scope of the valid-when-made doctrine, which results in the OCC and FDIC issuing new rules when uncertainty associated with the assignment of lending contracts destabilizes the market.

If the federal government were to implement a nationwide consumer interest rate cap, is the debate over the valid-when-made and true lender rules moot? Not quite. Even if a nationwide interest rate cap were extended to cover all consumer loans, solidified guidance from the OCC and FDIC regarding the true lender test and valid-when-made doctrine remains necessary to better stabilize the lending sector, especially when, as discussed below, lenders might increasingly rely on federal preemption to shore up the loss of profitability of other, now illegal, loans.

A. *Veterans and Consumers Fair Credit Act (VCFCA)*

For many years, consumer advocates and legal commentors have been calling for the federal government to implement a nationwide interest rate cap when lenders are able to use the exportation doctrine

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[234] Readers should note that the FDIC has not issued a true lender rule, and it appears that it does not intend to do so. In December 2020, Leonard Chanin, Deputy to the FDIC Chairman, addressed the question as to why the FDIC has not issued its own true lender rule: "Unlike the OCC which has statutory authority to determine when a loan is made by a national bank or federal savings association, the FDIC does not have similar authority under the Federal Deposit Insurance Act to determine when a loan is made by a state bank." Alan S. Kaplinsky, *FDIC Questions Its Authority to Issue "True Lender Rule,"* BALLAD SPAHR LLP: CONSUMER FIN. MONITOR (Dec. 9, 2020), https://www.consumerfinancemonitor.com/2020/12/09/fdic-questions-its-authority-to-issue-true-lender-rule.

to avoid state consumer protections.[235] Although many states have mustered the political will to limit interest rates,[236] the federal government has largely failed to do so, excluding the few exceptions discussed below. This has led some commentators to propose solutions that strengthen state law to further prohibit non-bank entities from entering into rent-a-bank and rent-a-tribe arrangements;[237] however, state-based solutions perpetuate the patchwork problem that industry members lament,[238] and given the recent OCC and FDIC rule developments, these solutions seem less viable in protecting consumers.

Further, of contemporary importance for the whole sector is the Veterans and Consumers Fair Credit Act (VCFCA), a federal bill which proposes a nationwide consumer loan annual interest rate cap of 36%.[239] Consumer advocates consider the 36% interest rate cap to be the "dividing line" between safe, affordable loans that allow consumers to access sufficient credit and debt traps that encourage borrowers to enter into new loans to pay off the old.[240]

1. The Goal of the VCFCA

First introduced in November 2019,[241] and again in July 2021,[242] the VCFCA would institute a 36% annual interest rate cap on consumer loans,[243] with carveouts for mortgages; loans to finance a vehicle where the vehicle serves as collateral; and loans made by federal credit unions that are already subject to the interest rates caps of the Federal Credit Union Act.[244] The VCFCA extends interest rate protections present in the Military Lending Act (MLA), which

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[235] *See, e.g.*, SAUNDERS, *supra* note 12, at 4, 7; Martin, *supra* note 24, at 261–62; *CFA Joins Orgs to Support Landmark Bill to Protect Consumers and Veterans from Predatory Lending*, CONSUMER FED'N AM. (July 29, 2021), https://consumerfed.org/testimonial/cfa-joins-orgs-to-support-landmark-bill-to-protect-consumers-and-veterans-from-predatory-lending.

[236] *See* STATE RATE CAPS, *supra* note 86.

[237] *See* Munger, *supra* note 9, at 500–06.

[238] *See* DAVIS POLK & WARDWELL LLP, *supra* note 10, at 6.

[239] Hill, *supra* note 25.

[240] *Id.*

[241] Veterans and Consumers Fair Credit Act, S. 2833, 116th Cong. (2019); Veterans and Consumers Fair Credit Act, H.R. 5050, 116th Cong. (2019).

[242] Veterans and Consumers Fair Credit Act, S. 2508, 117th Cong. (2021).

[243] Hill, *supra* note 25.

[244] S. 2508 § 2(a).

currently covers active-duty military members and their dependents,[245] to all consumers by amending Chapter 2 of the Truth in Lending Act.[246]

Democratic Senator Sherrod Brown, Chairman of the Senate Banking Committee, stated the goal of the legislation is to "cut off access to loans at interest rates so high they ruin people's lives."[247] Ashley Harrington, the Federal Advocacy Director and Senior Counsel at the Center for Responsible Lending, has said that predatory lenders are continually seeking loopholes to federal and state laws meant to prevent abusive lending practices and that the VCFCA "is the most effective way of ending the debt trap."[248] Harrington's statement echoes other commentors who have characterized state regulations and lenders' endeavors to avoid usury law as a "complex game of whack-a-mole,"[249] and that the time for states to maintain their traditional purview over usury has come and gone.[250]

While consumer advocates argue in favor of the law, some trade groups such as the American Financial Services Association and the Consumer Bankers Association have put forth concerns regarding the viability of the bill's more expansive definition of Annual Percentage Rate (APR), labeling it an "all-in" APR, because it includes certain fees and charges not traditionally considered part of a loan's interest rate.[251] In particular, industry groups worried that the bill would limit the availability of rewards credit cards when the cards charge additional fees that would count toward the card's APR.[252] Other critics of the VCFCA have questioned if it is appropriate to extend the lending limitations of the Military Lending Act beyond "a small segment of the population" to all Americans, based on what they see as unsubstantiated data underlying the Department of Defense's (DoD) statement that the MLA is "working as intended."[253] Because the MLA serves as the foundation of the VCFCA, including the

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[245] DEP'T OF DEF., REPORT ON THE MILITARY LENDING ACT AND THE EFFECTS OF HIGH INTEREST RATES ON READINESS 1 (2021).

[246] S. 2508 § 2(a).

[247] Hill, *supra* note 25.

[248] *Id.*

[249] Martin, *supra* note 24, at 273.

[250] *Id.* at 304.

[251] *See* Hill, *supra* note 25.

[252] *Id.*

[253] *See id.*

provision of many of the bill's key terms and definitions,[254] the MLA warrants some discussion.

2. VCFCA Relationship to the MLA

In 2007 Congress passed the MLA to protect active-duty military members and their families from entering predatory lending relationships.[255] At the time, military leaders were troubled by the effect of abusive lending practices on military members, compromising the nation's "military readiness."[256] A year prior to the MLA's passage, the DoD issued a report detailing that one-sided lending practices, such as payday lending, were "harm[ing] the morale of troops and their families, and add[ing] to the cost of fielding an all-volunteer fighting force."[257] Lenders were taking advantage of military members that lacked sophistication in financial matters, concentrating business near military bases,[258] and even using military-sounding names in marketing, such as "military loans," in order to take advantage of affinity.[259] The 2006 report found that "payday lenders, which charged annual percentage rates ranging from 390 to 780 percent, were significantly more likely to be located in areas adjacent to military installations than other areas of similar population."[260] Following many of the recommendations made by the DoD, Congress passed the MLA and directed the DoD to prescribe and implement lending regulations by October 2007.[261]

Responding to lenders taking advantage of loopholes in the MLA via a narrow definition of consumer credit, the DoD modified the bill's regulations to include transactions where "'credit [is] offered to a covered borrower for personal, family, or household purposes' that is either 'subject to a finance charge' or 'payable by a written agreement in more than four installments.'"[262] The modified definition of consumer credit is consistent with the Truth in Lending Act and extends to all forms of consumer credit, other than those explicitly excluded: "residential mortgages and other mortgage-secured credit";

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[254] *See* Veterans and Consumers Fair Credit Act, S. 2508, 117th Cong. § 2 (2021).

[255] Martin, *supra* note 24, at 298.

[256] *Id.*

[257] *Id.*

[258] *Id.* at 298–99.

[259] DEP'T OF DEF., *supra* note 245, at 2.

[260] *Id.*

[261] *See id.* at 3.

[262] *Id.* at 4 (citing 32 C.F.R. § 232.3(f) (2022)).

credit to finance a motor vehicle, secured by the motor vehicle; or credit intended to finance other personal property, "secured by the personal property being purchased."[263]

In addition to having an expansive definition regarding the forms of lending covered by the MLA, the DoD drafted the definition of "interest" in such a way as to prevent lenders from shifting interest to other fees so as to circumvent the limit.[264] For the MLA, the maximum military annual percentage rate (MAPR) includes:

> (1) [p]remiums of fees for credit insurance, debt cancellation, or debt suspension products[;] (2) [f]ees for credit-related ancillary products sold with the credit transaction[;] (3) [f]inance charges as defined by the Consumer Financial Protection Bureau in 12 CFR 1026, known as "Regulation Z[;]" [and] (4) [a]ny application or participation fee, except an application fee charged by a federal credit union or insured depository institution for a short-term, small loan once in any 12 month period.[265]

Exclusions to the MAPR include a "bona fide credit card fee that does not exceed the average amount of similar charges by large U.S. credit card issuers," such as foreign transaction or cash advance fees, and "application fee[s] for a short-term, small loan made by a federal credit union or insured depository institution once in any 12-month period." [266] Like the MLA, the VCFCA does exclude some bona fide credit card fees, other than a periodic rate, from counting toward a loan's interest rate limit.[267]

In response to a request by the House of Representatives, the DoD released a report in May 2021 that considers the impact of a MAPR lower than 30%.[268] Although much of the report focuses on the potential impact of a 30% interest rate cap on active-duty military members and their dependents, discussion of the impact of the extant 36% cap sheds light on the potential effects of the VCFCA on consumers' ability to access credit writ large. In the report, the DoD stated that it "believes the MLA is currently working as intended and that Service members continue to have ample access to necessary

[263] *Id.* (citing 32 C.F.R. § 232.3(f)(2) (2022)).

[264] *Id.* at 5.

[265] DEP'T OF DEF., *supra* note 245, at 5–6.

[266] *Id.* at 6.

[267] Veterans and Consumers Fair Credit Act, S. 2508, 117th Cong. § 2(a) (2021).

[268] DEP'T OF DEF., *supra* note 245, at 1.

credit."[269] Since Congress enacted the MLA, DoD financial educators and military aid societies are reporting fewer instances of active duty members seeking assistance after entering into predatory lending arrangements.[270] And to date, "the [DoD] has no indication that Service members and their families lack adequate access to necessary, responsible credit."[271] It is undetermined how dependent these conclusions are on the regulations themselves, or the regulations combined with the DoD's financial literacy efforts, inter alia, but the results appear promising regarding the continued availability of consumer credit opportunities if Congress were to enact a 36% nationwide consumer interest rate cap.

Critics of the extension of the MLA model to all consumers via the VCFCA found the DoD's evaluative statements regarding service members' continued access to credit after the passage of the MLA to be conclusory.[272] These critiques seem a bit disingenuous given that they dismiss further findings of the same report that indicate that an interest rate cap of 30% would have limited effect on the MLA's class of consumers' ability to access credit.[273] The DoD stated that many lenders already offer credit opportunities below 30%, that nearly one quarter of active-duty members are already stationed in states that enforce interest rate caps of 30% or below, and that federal credit unions are already limited to a 28% cap on small loans under National Credit Union Administration regulations.[274] Regarding credit cards, the DoD determined that a rate cap "as low as 28 percent would likely have no impact on Service members' access," with the caveat that "credit card issuers meet exemptions for eligible *bona fide* fees when calculating the MAPR."[275] Although consumer advocates would find these results promising, the Department took no official stance on lowering the MAPR from 36% to 30%.[276]

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[269] *Id.* at 7.

[270] *Id.* It is important to note that military aid societies might be serving as temporary bridges for active-duty military members to access credit in some emergency situations. If the VCFCA were passed, such temporary financial assistance from philanthropic organizations is unlikely to be as widely available.

[271] *Id.*

[272] *See* Hill, *supra* note 25.

[273] *See* DEP'T OF DEF., *supra* note 245, at 16.

[274] *Id.*

[275] *Id.* at 17.

[276] *Id.* at 18.

The future of the VCFCA is uncertain, but it warrants attention that a 36% interest rate cap appears to have broad bi-partisan support from the voting public. According to a 2020 poll conducted by Morning Consult on behalf of the Center for Responsible Lending, 70 percent of voters support an annual interest rate cap of 36% on payday and consumer installment loans.[277] Of the 30 percent that oppose the 36% interest rate cap, three out of five do so on the ground that the cap should be even lower.[278]

B. *VCFCA and State Law Consumer Protections*

Although a federal 36% annual interest rate cap on consumer loans would significantly curtail high-interest lending, the VCFCA allows states to maintain their consumer law protections if they are more stringent than the national standard. The VCFCA states that "[n]othing in this section may be construed to preempt any provision of State law that provides *greater protection* to consumers than is provided under this section."[279] The "greater protection" language indicates that states are free to impose additional restrictions on lenders beyond the 36% cap.

This term is key for states such as New Jersey, Oklahoma, Vermont, Arkansas, and California that have a 30%, or lower, annual interest rate limit (including fees) on a closed-end $2,000 two-year loan.[280] The state median interest rate for such loans is 32%[281] and the state median interest rate for a similar $500 six-month loan is 38.5%, with twenty-one more states having a cap at 36% or below.[282]

If Congress passed the VCFCA, it is unclear if states would alter the interest rate caps they have on the books, especially when one considers that the extant limits are what the elected officials in those jurisdictions considered to be an appropriate consumer protection. Where state laws are not changed, and the VCFCA allows state usury limits to stay on the books, lenders will likely exploit a potential gap in

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[277] Charla Rios, *New Morning Consult Poll Shows Broad, Bipartisan Support Among Voters for 36% Interest Rate Cap on Payday and Installment Loans*, CTR. FOR RESPONSIBLE LENDING (Feb. 4, 2020), https://www.responsiblelending.org/media/new-morning-consult-poll-shows-broad-bipartisan-support-among-voters-36-interest-rate-cap.

[278] *Id.*

[279] Veterans and Consumers Fair Credit Act, S. 2508, 117th Cong. § 2(a) (2021) (emphasis added).

[280] STATE RATE CAPS, *supra* note 86.

[281] *Id.*

[282] *Id.*

consumer protections through the continued use of federal preemption and the exportation doctrine—extending loans that are below the 36% cap, but above the rate a specific state would permit. Grounding this assessment is a presumption that lenders will, if the market permits, charge the maximum allowable rate to consumers by law. In 2009 a study on payday lending showed "a strong relationship between actual payday loan prices and the payday loan price ceiling imposed by [state usury laws]."[283] That is, payday lenders frequently charge interest rates based on the legality of the rate, not the consumers' creditworthiness.[284]

Lenders exploiting the gap, the continuation of the true lender test, and uncertainty regarding the future of the extant valid-when-made rules leaves the lending sector with quite a bit of the same legal uncertainty that previously existed. Notably though, if the VCFCA were to pass, some of the secondary market risk caused by the legal uncertainty would be more limited than it is now, because at the most, the enforceable interest rate is 36%, rather than potentially the triple-digit rates highlighted in Part III. With a reasonable and consistent nationwide interest rate cap, presidential administrations, courts, and legislatures might also be less willing to revive *Madden* or expand the application of the true lender test to combat the abuses of high-interest lending when the underlying loans themselves are less exploitative. For the greatest level of legal and market stability, however, a nationwide interest rate cap *and* solidified true lender and valid-when-made rules remain necessary, providing adequate security to lenders regarding the enforceability of interest rates of loans they originate and later assign. As evidenced by critiques to the true lender rule and *Madden*, lenders want to extend credit where there is certainty regarding their ability to later assign the loan. Legal certainty supports lenders as they search for parties to purchase the loans, which allows banks to shift the loans, and their risk, off balance sheets. This process minimizes the banks' exposure, permitting the banks to offer additional credit opportunities to other consumers, which further facilitates economic development.

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[283] Munger, *supra* note 9, at 484.

[284] *Id.*

VI. CONCLUSION

Consumer lending in the United States has a complex history that illustrates the importance of balancing access to credit with regulations that ensure lending is on fair terms. Fostering a dual banking system, the federal government has had a significant impact on a traditional realm of state policymaking: what constitutes an acceptable interest rate. Federal law, judicial interpretations of the valid-when-made doctrine and Section 85 of the National Bank Act, technological developments, and larger market forces have all contributed to the growth of an abusive high-interest consumer lending sector. Via the application of the true lender test and limiting the valid-when-made doctrine, state legislatures and courts have responded, challenging the validity of lending arrangements that utilize the exportation doctrine and federal preemption to circumvent state usury limits. When courts utilize the true lender test or limit the valid-when-made doctrine, legal uncertainty arises regarding the enforceability of loans that depend on the exportation doctrine to charge higher interest rates.

Uncertainty regarding the enforceability of an interest rate, and potentially the entire loan, limits lenders' ability to find willing purchasers in secondary markets. When purchasers are scarcer, fluidity in the lending sector lessens, stifling other consumers' ability to access credit, which, in extreme circumstances, can impact bank liquidity and imperil larger economic growth. The valid-when-made and true lender rules recently issued by the FDIC and OCC were meant to serve as a full course correction, but they have failed to achieve that end, and instead have potentially eroded some of the few remaining protections for consumers against high-interest loans. Concurrently, in the interest of balancing consumer protections with access to credit, legislators have proposed the Veterans and Consumers Fair Credit Act which includes a nationwide 36% annual interest rate cap. This cap has the potential to resolve some sector instability when the legal volatility of usurious high-interest consumer loans is more constrained and when courts and presidential administrations become less willing to intervene and apply the true lender test or revive *Madden* to protect consumers. The VCFCA, however, is not a cure-all.

If Congress passed the VCFCA, lenders will likely, if possible, continue to charge consumers the highest legally permissible interest rates. Depending on the state, consumers have a gap in coverage between state-mandated interest rate limits and the federal 36% cap, a gap that can be exploited through the exportation doctrine. Were the

VCFCA to pass, utilization of the exportation doctrine would likely expand when lenders' profits are constrained to a more limited range, amplifying the need to charge a greater swath of borrowers the highest interest rates permissible. Also, with a more limited profit range, lenders might become more aggressive in extending credit, increasing default risk. With a greater proportion of consumer loans relying on federal preemption, a greater proportion of loans are subject to potential invalidation via the application of the true lender test, or a modified rule which follows *Madden*. The dual-factor risk of increased legal uncertainty and heightened default potential will slow the fluid assignment of loans into secondary markets. Even if the unenforceability risk is mitigated by courts and state legislatures becoming less willing to intervene to void or limit abusively-high interest rates, a greater proportion of loans would nevertheless be relying on federal preemption—loans which might attract stricter scrutiny when a larger pool of borrowers default. Accordingly, with the passage of a national consumer loan interest rate limit, the need for solidified true lender and valid-when-made rules becomes even more acute. Solidified rules would enable banks and secondary-market assignees to have sufficient legal certainty regarding the enforceability of their lending contracts, thus increasing the fluid assignment of loans, freeing lenders of risk on their balance sheets, resulting in the greater availability of credit for other consumers.

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