THE HILL

Rent-a-bank schemes trample voters' and states' rights

BY LAUREN SAUNDERS, OPINION CONTRIBUTOR — 02/08/18 05:55 PM EST

Americans really do not like high interest rates. Whenever given a chance, Republicans and Democrats alike overwhelmingly vote to kick out high-cost lenders. In 2016, South Dakota voters chose President Trump by 61 percent but approved a 36 percent interest rate cap by 75 percent. Montana voters also vote for a 36 percent cap in 2010, another conservative election year. In 2008, Arizonans and Ohioans approved rate caps of 36 percent and 28 percent, respectively.

Payday lenders have tried for decades to use rent-a-bank arrangements to evade state laws against 300 percent APR loans. Two bills pending before Congress would bless these schemes. These bills would flout the will of voters and trample on states' historic ability — back to the founding of our nation — to prevent predatory lending.

Usury has been prohibited since biblical times. At the time of the American Revolution, the states followed English practice and imposed general usury rates of six to eight percent. At the turn of the 20th Century, most states adopted model small loan laws raising rates to about 36 percent for small loans. In our constitutional system of limited federal government, interest rate limits have primarily been set at the state level. Even the National Bank Act of 1863 subjected banks to either the state rate or a true federal interest rate limit.

In 1978, a Supreme Court decision created a loophole that resulted in a deregulatory race to the bottom for banks. But from 1776 to today, with the exception of mortgages, states have retained the power to limit rates charged by nonbank lenders. Nearly every state does, though rates vary for different types and sizes of loans.

Regulation of nonbank rates is especially important because nonbanks have fewer restraints on predatory lending than banks, which are not monoline businesses, have broader reputations to protect, and typically do not want their names associated with interest rates of 100, 200 or 300 percent.

But with rent-a-bank schemes, the bank can hide in the background or enable loans with interest rates obscured.

For example, one “fintech” payday lender offers a line of credit at about 100 percent in Arkansas, Montana, Montana, South Dakota and other states that limit rates to 36 percent or less. They also make 365 percent APR installment loans that — for now at least — are made only in states where those rates are permitted. High-cost lenders thus can offer loans that would otherwise be illegal. Some have default rates that are astoundingly high, with charge-offs up to 50 percent or higher.

Some lenders with high default rates have tried to offer loans of up to 96 percent in West Virginia and Maryland. But courts have seen through the fig leaf of the bank’s name on the loan.

Other payday lenders are watching these efforts carefully and salivating at the prospect of congressional endorsement of rent-a-bank schemes.

HR 4439 would allow nonbanks to ignore state rate caps as long as the fine print specifies a bank as the lender. HR 3299 states that if a loan rate is valid at the nanosecond of origination, the loan rate remains valid even if it is immediately assigned to a lender for whom the rate would be illegal.

These “true lender” and “valid-when-made” bills are opposite sides of the same coin. Both allow high-cost lenders to use banks to originate loans under programs marketed, designed, and driven by state-regulated lenders. Both bills would gut 200 years of states’ rights to set interest rate limits.

With the growth of online lending platforms, some have argued that lenders should be able to charge the same rate all over the country. I support a national 36 percent rate cap for small loans (lower for large ones), and uniform national rates at reasonable levels are worth discussing. But in the absence of any limits at the federal level, state interest rate limits are the simplest and most effective check we have today against predatory lending.

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