

# Predatory Fintech and the Politics of Banking

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*ABSTRACT: With American families living on the financial edge and seeking out high-cost loans even before COVID-19, the term financial technology or “fintech” has been used like an incantation aimed at remedying everything that’s wrong with America’s financial system. Scholars and supporters from both the public and private sector proclaim that innovations in financial technology will “bank the unbanked” and open new channels to affordable credit. This exuberance for all things tech in finance has led to a quiet yet aggressive deregulatory agenda, including, as of late, a federal assault via rulemaking on the ability of states to police the cost and privilege of extending credit within their borders. This deregulation and the ethos behind it have made space for growth in high-cost, predatory lending that reaches across state lines via websites and smart phones and aggressively targets cash-strapped families. These loans are made using a business model whereby funds are funneled through a group of lightly regulated banks in a way designed to take advantage of federal preemption. Fintech companies rent out and profit from the special legal status of these bank partners, which in turn keeps the bank’s involvement in the shadows. Stripping down predatory fintech’s practices and showing them for what they really are, this Article situates fintech in the context of this country’s longstanding dual banking wars, both between states and the federal government and between consumer advocates and banking regulators. And it points the way forward for scholars and regulators willing to shake off fintech’s hypnotic effect. This means, in the short term, using existing regulatory tools to curtail the dangerous lending identified here, including by taking a more expansive view of what it means for a bank to operate safely and soundly under the law. In the long term, it*

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*means having a more comprehensive and national discussion about how we regulate household credit in the digital age, specifically through the convening of a Twenty-First Century Commission on Consumer Finance. The Article explains how and why the time is ripe to do both. As the current pandemic wipes out wages and decimates savings, leaving desperate families turning to predatory fintech finance ever more, the need for reform has never been greater.*

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## I. INTRODUCTION

In the years since the 2008 financial crisis, and with renewed vigor since the onset of the coronavirus pandemic, law and policy makers have been enamored with the promise of financial technology or “fintech.” Tech industry enthusiasts and think tanks proclaim that fintech will democratize finance, bank the unbanked, and furnish access to affordable credit for all. Fintech lending firms boast their use of sophisticated machine learning algorithms and alternative data to reshape credit scoring and open the market to those who have long been shut out of mainstream finance. Industry executives proclaim that “Fintechs have a unique capability to extend financial inclusion, improve the daily lives of people and spur growth.”<sup>1</sup> They argue that “[w]hile the virus may have forced us to adjust the way we operate, it hasn’t halted either [fintech’s] progress or our commitment to this cause.”<sup>2</sup>

Yet the truth of some fintech lending for many struggling households has a much darker side—one that in many ways is just a dressed-up version of age-old, high-cost payday lending. What’s worse is that a small but deeply problematic corner of the banking system is providing the transmission lines for this high-cost, tech-driven credit, and banking regulators are proving to be reliable allies in beating back attempts by state consumer watchdogs to tamp down on this predatory fintech finance. While the United States is preoccupied with a pandemic and a mounting recession, a struggle of federalism in the banking sector is playing out in real time.

In the past ten years since the financial crisis, housing costs have increased 26 percent, medical expenses have risen 33 percent, and college tuition has gone up by 45 percent.<sup>3</sup> Even before the pandemic, nearly half of all Americans were employed in low-wage jobs with median incomes of only \$18,000 per year, despite a period of low unemployment and a purportedly booming economy.<sup>4</sup> Compared to previous generations, today’s shrinking

1. Bassim Haider, *COVID-19 Underlines the Importance of Fintech in Emerging Markets*, WORLD ECON. F. (May 15, 2020), <https://www.weforum.org/agenda/2020/05/covid-19-importance-mobile-solutions-emerging-markets> [<https://perma.cc/PEZ2-G6UA>]; *Beyond COVID-19: New Opportunities for Fintech Companies*, DELOITTE, <https://www2.deloitte.com/us/en/pages/financial-services/articles/beyond-covid-19-new-opportunities-for-fintech-companies.html> [<https://perma.cc/5VXQ-SF48>]; Kanika Saigal, *How Fintech Can Save Us from Covid-19*, EUROMONEY (May 5, 2020), <https://www.euromoney.com/article/b1hgkklb7jbkw/how-fintech-can-save-us-from-covid-19> [<https://perma.cc/XD72-NG7Q>].

2. Haider, *supra* note 1; see Sharmista Appaya, Helen Luskien Gradstein & Thervina Mathurin-Andrew, *Fintech Can Help in the Response to COVID-19. But Where Should Policymakers Start?*, WORLD BANK: BLOGS (May 12, 2020), <https://blogs.worldbank.org/psd/fintech-can-help-response-covid-19-where-should-policymakers-start> [<https://perma.cc/2ZR3-ENFH>].

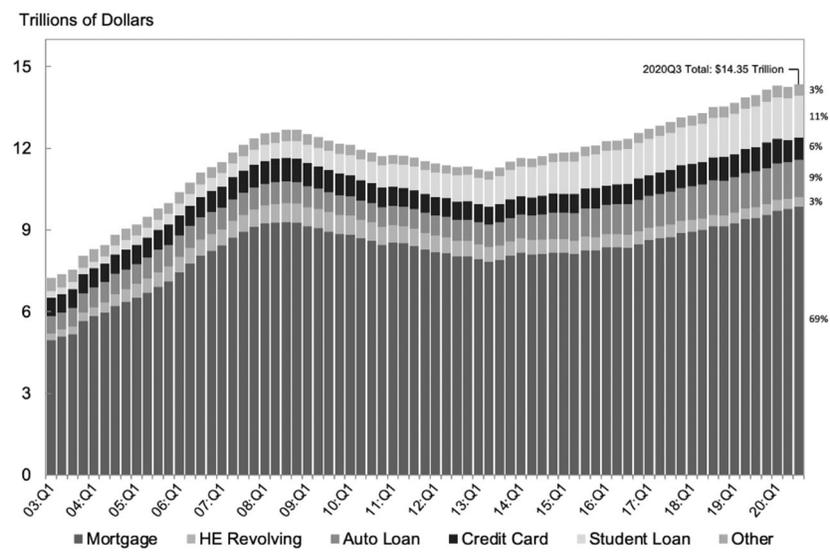
3. Christopher Maloney & Adam Tempkin, *America’s Middle Class Is Addicted to a New Kind of Credit*, BLOOMBERG (Oct. 29, 2019, 3:57 PM), <https://www.bloomberg.com/news/articles/2019-10-29/america-s-middle-class-is-getting-hooked-on-debt-with-100-rates> [<https://perma.cc/BU2H-STN7>].

4. Martha Ross & Nicole Bateman, *Low-Wage Work Is More Pervasive than You Think, and There Aren’t Enough “Good Jobs” to Go Around*, BROOKINGS (Nov. 21, 2019), <https://www.brookings.edu/>

middle class trails behind in both homeownership and savings for retirement—a financial situation felt with particular acuity by Millennials.<sup>5</sup>

Against the backdrop of income inequality and now massive unemployment and economic pain caused by the coronavirus, an explosion in online fintech lending is no surprise. Household borrowing is at an all-time high.<sup>6</sup> As of the third quarter of 2020, household debt stood at \$14.3 trillion—greater than the 2008 peak during the financial crisis. Figure 1 shows total household debt balances by debt category.<sup>7</sup>

Figure 1. Total Debt Balances by Credit Category (2003–2020)<sup>8</sup>



blog/the-avenue/2019/11/21/low-wage-work-is-more-pervasive-than-you-think-and-there-arent-enough-good-jobs-to-go-around [https://perma.cc/JA27-V62M].

5. Hillary Hoffower, *6 Findings That Show the Dire State of America's Middle Class*, BUS. INSIDER (May 23, 2019, 4:40 PM), <https://www.businessinsider.com/america-shrinking-middle-class-debt-homeownership-retirement-savings-2019-5> [https://perma.cc/93T7-YGT5]; Christopher Ingraham, *The Staggering Millennial Wealth Deficit, in One Chart*, WASH. POST (Dec. 3, 2019, 8:45 AM), <https://www.washingtonpost.com/business/2019/12/03/precariousness-modern-young-adulthood-one-chart> [https://perma.cc/YqEN-6WDY] (showing wealth disparities between Baby Boomers, Generation X, and Millennials over time).

6. Press Release, Fed. Rsr. Bank of N.Y., Total Household Debt Rises for 19th Straight Quarter, Now Nearly \$1 Trillion Above Previous Peak (May 14, 2019), <https://www.newyorkfed.org/newsevents/news/research/2019/20190514> [https://perma.cc/996F-PPVS].

7. FED. RSRV. BANK OF N.Y., QUARTERLY REPORT ON HOUSEHOLD DEBT AND CREDIT 2020: Q3, at 3 (2020), [https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC\\_2020Q3.pdf](https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2020Q3.pdf) [https://perma.cc/5UJ8-AY8C].

8. *Id.*

This spike in borrowing is being fueled, in part, by what has become known as America's new credit addiction<sup>9</sup>—loans made over the internet and facilitated by partnerships between a small handful of state banks and flashy fintech companies. Many of these loans made to struggling families come at an extremely high-cost, carrying annual interest rates well over 100 percent.<sup>10</sup> Moreover, these loans are made using a structure that aims to take advantage of the special legal treatment given to banks—benefits that have been forged over a long history and that are tied to a social contract between the banking sector and the public.<sup>11</sup> Through these fintech-bank partnerships, nonbank credit accessed through smart phone apps and online portals is able to escape important state consumer protections and safety and soundness laws.<sup>12</sup>

Yet, the fact of predatory lending alone doesn't tell the whole story. In this Article, I add to the existing fintech literature<sup>13</sup> by placing these predatory fintech-bank partnerships in the context of the larger *dual banking wars* that have played over the course of American history.<sup>14</sup> The concept of *dual banking* has historically referred to a system of banks having either federal or state charters. "*Wars*" refers to efforts by states and the federal government to assert authority over each other in banking regulation.<sup>15</sup> This system stretches back from the early days of the Republic, to the Civil War, to the Great Depression, and all the way up to the financial crisis of 2008.<sup>16</sup>

9. Maloney & Tempkin, *supra* note 3.

10. See *infra* Section III.B.3.

11. See *infra* Section IV.B; see also Mehra Baradaran, *Banking and the Social Contract*, 89 NOTRE DAME L. REV. 1283, 1287–312 (2014) (discussing the history of the social contract).

12. See *infra* Section IV.B.

13. See, e.g., Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235, 235 (2019); Saule T. Omarova, *New Tech v. New Deal: Fintech as a Systemic Phenomenon*, 36 YALE J. ON REGUL. 735, 735 (2019); John L. Douglas, *New Wine into Old Bottles: Fintech Meets the Bank Regulatory World*, 20 N.C. BANKING INST. 17, 17 (2016); William Magnuson, *Regulating Fintech*, 71 VAND. L. REV. 1167, 1167 (2018); Vincent Di Lorenzo, *Fintech Lending: A Study of Expectations Versus Market Outcomes*, 38 REV. BANKING & FIN. L. 725, 725 (2019); Yesha Yadav, *Fintech and International Financial Regulation*, 53 VAND. J. TRANSNAT'L L. 1109, 1109–10 (2020); Howell E. Jackson, *The Nature of the Fintech Firm*, 61 WASH. U. J.L. & POL'Y 9, 9–10 (2020); Matthew A. Bruckner, *Regulating Fintech Lending*, 37 BANKING & FIN. SERVS. POL'Y REP. 1, 1–2 (2018); Jeremy Kidd, *Fintech: Antidote to Rent-Seeking?*, 93 CHI.-KENT L. REV. 165, 165 (2018); Charles W. Mooney, Jr., *Fintech and Secured Transactions Systems of the Future*, 81 LAW & CONTEMP. PROBS. 1, 1 (2018); Christopher G. Bradley, *Fintech's Double Edges*, 93 CHI.-KENT L. REV. 61, 61 (2018); Saule T. Omarova, *Dealing with Disruption: Emerging Approaches to Fintech Regulation*, 61 WASH. U. J.L. & POL'Y 25, 25 (2020); Brian Knight, *Federalism and Federalization on the Fintech Frontier*, 20 VAND. J. ENT. & TECH. L. 129, 131 (2017).

14. See generally WILLIAM JAMES BROWN, *THE DUAL BANKING SYSTEM IN THE UNITED STATES* (1968) (providing an overview of the dual banking system).

15. See generally *id.* (describing the tension between the federal and state governments regarding the bank system); Arthur E. Wilmarth, Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225 (2004) (discussing attempts by the Office of the Comptroller of the Currency to craft regulations that broadly preempt state banking laws).

16. See generally BROWN, *supra* note 14 (providing the history of the dual banking system).

We are living in the age of a new dual banking war, but one that is quite different from those of the past. The new duality deals not with *banks* but with *nonbanks*—those institutions that provide financial products and services to the public but that neither hold bank charters nor form part of the traditional financial architecture.<sup>17</sup> These companies range from payday lenders and check cashers to money transmitters and, most importantly for purposes of this project, fintech finance companies.<sup>18</sup> Examples abound of the new dual banking system conflict playing out as states assert authority over an area of the banking and finance sector that has historically been reserved to them, while, at the same time, the federal government asserts greater dominance and a desire for singular control.<sup>19</sup> Fintech credit firms and the growth in their lending programs with banks are at the heart of this struggle.<sup>20</sup>

Many in the banking industry declare that these partnerships are “win-wins” because they allow the bank to take advantage of the fintech’s technological know-how, modern feel, and Silicon Valley ethos. As noted by House Financial Services Committee member Congressman Bill Foster of Illinois: “the big bank CEOs . . . all have a ten-year plan to convert their banks into basically tech firms.”<sup>21</sup> In academic circles, some have argued that competition has driven fintechs to partner with banks. For example, Rory Van Loo argues that regulators encouraged (even pushed) fintechs to partner with banks.<sup>22</sup>

Fintech firms, for their part, say that partnerships with banks make good business sense. Banks are cornerstone institutions of the American economy and, because of their long history, have loyal customer bases. These customers, with their sticky relationships by way of checking and savings accounts, as well as automated online bill payments, make for ready-made audiences when it comes to online financial products and services.<sup>23</sup> Also, fintechs say that they are able to take advantage of the compliance infrastructure that is already so well developed in the banking sector.

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17. See *infra* Sections IV.A.1–2.

18. ADAM J. LEVITIN, CONSUMER FINANCE: MARKETS AND REGULATION 75–76 (2018) [hereinafter LEVITIN, CONSUMER FINANCE].

19. See *infra* Part IV.

20. See Maloney & Tempkin, *supra* note 3.

21. *Fireside Chat with Congressman Bill Foster: AI and the Evolving Financial Services Landscape*, ONLINE LENDING POL’Y INST. (Oct. 23, 2019), <https://www.onlinelendingpolicysummit.com/2019-highlights> [<https://perma.cc/AFY7-QANG>] (select “Congressman Bill Foster” video; then move slide bar to 14:43).

22. Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232, 259–61 (2018) [hereinafter Van Loo, *The Case of Fintech*] (arguing, among other things, that current financial regulatory policy creates barriers to entry that favor banks and disfavor digital innovation in finance).

23. Bruce Lynn, *Transaction Banking: Why Sticky Relationships Matter*, GLOB. TREASURER (Mar. 25, 2015), <https://www.theglobaltreasurer.com/2015/03/25/transaction-banking-why-sticky-relationships-matter> [<https://perma.cc/MQA5-G7BS>].

Yet, I argue here that the true reason for this dance of bank and tech is not merely to take advantage of business synergies. It is so that the loans made by fintechs—and, indeed, the fintech companies themselves—can take advantage of the special legal treatment that is accorded to chartered banks while at the same time side-stepping the regulatory burdens that are typically imposed on nonbank companies engaged in consumer lending.

To be sure, the so-called “renting” of banks by nonbank companies is not new. In prior decades a number of storefront payday lenders started partnering with out-of-state banks for these regulatorily-advantaged purposes.<sup>24</sup> However, in the early 2000s bank regulators—at the urging of consumer groups—cracked down on these high-cost loan partnerships, and they essentially came to a halt.<sup>25</sup> But in this post crisis, COVID-19 world of tightened credit, the rise of a so-called new middle class, and a zeal among politicians and government regulators to promote innovation at all costs, partnerships like these have appeared again.<sup>26</sup> But this time, the interplay between fintech firms, regulated banks, and the politics of tech adds a new dimension to the dual banking system conflict.<sup>27</sup> This dimension is giving political cover to predatory fintech lenders and clouding what should otherwise be a clear headed and aggressive approach by financial regulators in stamping out these harmful practices.

This Article clears the air of the fintech hype and approaches many of these online partnerships for what they really are—predatory lending by another name—and shows how they are being used to quietly reshape consumer finance regulation and its federalism balance. Four parts help us get there. Part II explains what’s at stake by summarizing the precarious condition of household finance in the United States, both before the pandemic when many families already lived at the margins and struggled to make ends meet, and since the advent of COVID-19 when hundreds of thousands have lost their jobs and witnessed their meager savings disappear. This Part also explains America’s reliance on credit and its problem with debt,

24. Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 *YALE J. ON REGUL.* 143, 187–88 (2009).

25. *Id.*

26. See Antoine Gara, Nathan Vardi & Jeff Kaufflin, *The Forbes Investigation: Inside the Secret Bank Behind the Fintech Boom*, *FORBES* (Dec. 17, 2019, 7:04 AM), <https://www.forbes.com/sites/antoinegara/2019/12/17/the-forbes-investigation-inside-the-secret-bank-behind-the-fintech-boom> [<https://perma.cc/9VQ5-LD9M>].

27. See, e.g., *WebBank v. Meade*, No. 17-CV-00786-PAB-MLC, 2018 WL 1399914, at \*5 (D. Colo. Mar. 19, 2018) (regarding a bank seeking to prevent the enforcement of state law as it claims to fall under federal authority); see also *Cross River Bank v. Meade*, No. 17-CV-00832-PAB-KMT, 2018 WL 1427204, at \*4 (D. Colo. Mar. 22, 2018) (dismissing bank’s complaint for declaratory judgment that state usury laws are preempted by the FDIC); *Cross River Bank v. Zavislan*, No. 18-1171, 2018 WL 5292045 (10th Cir. Aug. 17, 2018) (dismissing bank’s appeal in *Cross River Bank v. Meade* discussing whether Federal Deposit Insurance Act preempts state lending laws).

as nearly all aspects of life in the United States require borrowing money. This, in turn, has led to the rise in nonbank online lending. The combination of a dearth in the availability of consumer credit in the wake of the financial crisis on the one hand and rapid innovations in technology on the other have created the perfect conditions for Silicon Valley tech firms to enter the consumer finance space. Part III describes the partnership model between banks and fintech online lenders, and, in seeking to understand the fintech-bank business in more detail, I conduct a case study of the relationship between the subprime online lender Elevate Credit, Inc. and its three state-chartered bank partners. Part IV sets these partnerships in the context of the U.S. dual banking system and explains the law that governs these relationships. In doing so, this Part points out the law's shortcomings, including how fintechs and their bank partners take advantage of special federal laws that allow high-cost loans to be made on a nation-wide basis, while at the same time allowing nonbank fintech companies to often escape many state laws. Lastly, Part V provides policy prescriptions—one short term and one long-term. In the immediate, financial regulators need to adopt a more robust and consumer-oriented view for how these fintech-bank partnerships are regulated: one focused on ending predatory fintech. In the long-term (and particularly in the aftermath of the presidential election and as U.S. leaders confront the COVID-19 economic fallout), these new conflicts in federalism and finance should be harnessed so as to create an opportunity for a more comprehensive discussion and series of steps for addressing consumer finance and banking in the digital age.

## II. FINTECH, BANKING, AND FINANCIAL FRAGILITY

Political enthusiasm for fintech is the outgrowth of a larger issue. In the United States, finding ways to help financially struggling households access affordable credit has been a perpetually vexing problem. The struggle to handle unexpected financial shocks like the loss of a job or an unexpected medical expense, to say nothing of making ends meet when wages are unstable and the cost of living continues to rise, poses real challenges for many Americans. The use of technology to transform the lives of these individuals has particular allure when all other policy prescriptions have seemingly failed. And indeed, fintech does hold promise. The greater and more effective use of technology has the potential<sup>28</sup> to broaden access to

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28. The study of this “promise” is underway. See, e.g., Julapa Jagtiani & Catharine Lemieux, *Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information* 26–28 (Fed. Rsv. Bank of Phila., Working Paper No. 17-17, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3005260](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3005260) [<https://perma.cc/C5ZB-PZGF>] (exploring the pros and cons of loans made by fintech lenders in comparison to “traditional banking channels”); see also Seth M. Freedman & Ginger Zhe Jin, *Learning by Doing with Asymmetric Information: Evidence from Propser.com* 3 (Nat’l Bureau of Econ. Rsch., Working Paper No. 16855, 2011), <http://www.nber.org/papers/w16855> [<https://perma.cc/7SHD-W9DU>] (conducting an in-depth analysis of “peer-to-peer lending”);

financial products and services on terms that are more affordable and in ways that make simple transactions easier.<sup>29</sup> Fintech innovation, when regulated correctly, can generate positive societal results.<sup>30</sup>

But to understand why these fintech innovations matter, it's important to know how many people come to the table in the first place and why borrowing drives so much of the post-2008 and the current COVID-19 economy.

#### A. HOUSEHOLDS IN FINANCIAL DISTRESS

Struggles with debt have long plagued American households. Even before the coronavirus outbreak, working class and middle-income Americans were, to quote one observer, “living in near-permanent recession.”<sup>31</sup> COVID-19 has worsened this condition in unparalleled ways by wiping out savings, heralding massive housing insecurity and the loss of wages on a grand scale across many sectors. What makes predatory fintech *predatory* is not that it burdens households, but that it preys on those who are already heavily burdened.

##### 1. Before the Pandemic

Before the coronavirus pandemic emerged, many individuals in the United States were financially unprepared for any form of sustained interruption in their earnings.<sup>32</sup> For many years now, income inequality and stagnant wages have exacerbated the ability of many households to accumulate savings.<sup>33</sup> This is particularly true for ethnic and racial minorities, who lost significant wealth during the Great Recession that was never

Brandon Ivey, *FDIC Fintech Originators Face Risks*, INSIDE MORTGAGE FIN. (Dec. 8, 2020), <https://www.insidemortgagefinance.com/articles/219972-fdic-fintech-originators-face-risksv=preview> [<https://perma.cc/U9MA-KWB3>] (concluding that fintechs face major risks when using creditor underwriting models).

29. See Rory Van Loo, *Rise of the Digital Regulator*, 66 DUKE L.J. 1267, 1278, 1318 (2017) (arguing that pro-consumer fintech tools have the potential to help consumers if regulated well).

30. Rory Van Loo, *Digital Market Perfection*, 117 MICH. L. REV. 815, 833–35 (2019) (summarizing arguments that pro-consumer technological advisers in finance and other sectors can benefit consumers).

31. Max Burns, *The Economy Is Booming Under Trump—But Not for the People Who Voted for Him. And That's a Big Problem*, INDEPENDENT (Dec. 3, 2019, 6:08 PM), <https://www.independent.co.uk/voices/trump-us-economy-jobs-numbers-obama-a9231391.html>; see Alexia Fernández Campbell, *The Average Worker Isn't Seeing Trump's "Economic Miracle." Here's Why.*, VOX (Mar. 1, 2019, 3:50 PM), <https://www.vox.com/policy-and-politics/2019/3/1/18246233/economic-growth-workers-wages-economy> (analyzing consumer price index and income growth data showing wage growth, after factoring in for inflation, shows a growth of only 1.9 percent rather than the heralded 3 percent).

32. See generally LISA SERVON, *THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES* (2017) (discussing America's banking system and alternatives to traditional banking).

33. See Pamela Foohey & Nathalie Martin, *Fintech's Role in Exacerbating or Reducing the Wealth Gap*, 2021 U. ILL. L. REV. 459, 466–75 (2021).

recovered.<sup>34</sup> Census data from 2018 revealed that while the economy had been growing a little above two percent per year, the benefit of this growth has been concentrated among the highest income earners.<sup>35</sup> Median household income remained flat between 2017 and 2018.<sup>36</sup> Black and brown households were particularly ignored by the so-called pre-COVID “booming economy.”<sup>37</sup> Between 2017 and 2018, the poverty rate remained constant at 20 percent for Black households and 17.6 percent for Hispanic households.<sup>38</sup>

Going into the crisis, less than half of American households had sufficient savings to cover three months of their necessary expenses.<sup>39</sup> Among lower-income Americans, that percentage was less than one-quarter.<sup>40</sup> This reflects multiple reports finding that many American households have very little savings to carry them through rough waters.<sup>41</sup>

34. See *id.*; Edward Wolff, *The Decline of African-American and Hispanic Wealth Since the Great Recession*, VOX EU (Dec. 23, 2018), <https://voxeu.org/article/decline-african-american-and-hispanic-wealth-great-recession> [https://perma.cc/gC2H-3ELU]; Valerie Wilson, *10 Years After the Start of the Great Recession, Black and Asian Households Have Yet to Recover Lost Income*, ECON. POL’Y INST. (Sept. 12, 2018, 5:10 PM), <https://www.epi.org/blog/10-years-after-the-start-of-the-great-recession-black-and-asian-households-have-yet-to-recover-lost-income> [https://perma.cc/R4LK-GPUZ].

35. Victoria Guida, *Income Inequality Is Highest on Record, Boosting Democrats’ Message*, POLITICO (Sept. 26, 2019, 4:32 PM), <https://www.politico.com/news/2019/09/26/income-inequality-is-highest-on-record-boosting-democrats-message-003706> [https://perma.cc/3HAN-J8XJ].

36. JESSICA SEMEGA, MELISSA KOLLAR, JOHN CREAMER & ABINASH MOHANTY, U.S. CENSUS BUREAU, *INCOME AND POVERTY IN THE UNITED STATES: 2018*, at 1 (2020) [hereinafter *INCOME AND POVERTY*], <https://www.census.gov/content/dam/Census/library/publications/2019/demo/p60-266.pdf> [https://perma.cc/H7XZ-M8MK].

37. Press Release, Donald J. Trump, *The Trump Economic Boom Is Benefiting All Americans* (May 6, 2019), <https://www.presidency.ucsb.edu/documents/press-release-the-trump-economic-boom-benefiting-all-americans> [https://perma.cc/LgGR-DNA8]; Jonathan Allen, *Trump’s Economy Is Roaring. Will It Carry Him in 2020?*, NBC NEWS (May 3, 2019, 12:15 PM), <https://www.nbcnews.com/politics/2020-election/trumps-economy-roaring-will-it-carry-him-2020-n1001691> [https://perma.cc/3SBQ-6FCN].

38. *INCOME AND POVERTY*, *supra* note 36, at 15.

39. Kim Parker, Juliana Menasce Horowitz & Anna Brown, *About Half of Lower-Income Americans Report Household Job or Wage Loss Due to COVID-19*, PEW RSCH. CTR. (Apr. 21, 2020), <https://www.pewsocialtrends.org/2020/04/21/about-half-of-lower-income-americans-report-household-job-or-wage-loss-due-to-covid-19> [https://perma.cc/GJR4-3LQG].

40. See *id.*

41. See, e.g., Ann Carrns, *Even in Strong Economy, Most Families Don’t Have Enough Emergency Savings*, N.Y. TIMES (Oct. 25, 2019), <https://www.nytimes.com/2019/10/25/your-money/emergency-savings.html> [https://perma.cc/7JGA-88QT]; Eric Rosenbaum, *Millions of Americans Are Only \$400 Away from Financial Hardship. Here’s Why*, CNBC (May 23, 2019, 12:47 PM), <https://www.cnbc.com/2019/05/23/millions-of-americans-are-only-400-away-from-financial-hardship.html> [https://perma.cc/B6FY-PLRN]; Emmie Martin, *This Chart Shows How Much Money Americans Have in Savings at Every Age*, CNBC (Nov. 23, 2020, 11:30 AM), <https://www.cnbc.com/2019/03/11/how-much-money-americans-have-in-their-savings-accounts-at-every-age.html> [https://perma.cc/933H-ZANT].

Aside from being ill-prepared for a protracted loss of income, many families in the United States were already struggling with debt.<sup>42</sup> Not having enough money to build savings often means not having enough money to meet many routine expenses and particularly not unexpected ones. This results in borrowing,<sup>43</sup> not only for daily expenses and unexpected bills, but also for big ticket purchases like vehicles.<sup>44</sup>

The most prevalent source of short term, small dollar borrowing in the United States are payday loans. These are unsecured loans that give individuals an advance on their forthcoming paychecks.<sup>45</sup> Loan amounts range from \$100 to \$500, with some up to \$1,000 or more.<sup>46</sup> The repayment term is anywhere from two weeks to one month.<sup>47</sup>

Payday loans are routinely decried by consumer advocates because of their high-cost and the predatory lending tactics of the companies that offer them. These loans carry an average annual percentage rate (“APR”) of 400 percent or higher.<sup>48</sup> For comparison, consider that a typical borrower with a poor credit score might pay around 25 percent APR or more in interest on a non-payday unsecured consumer loan.<sup>49</sup> Importantly, the payday loan business model also depends upon a consumer’s inability to afford their loans and the subsequent need to borrow (and pay additional fees) over and over again.<sup>50</sup> As one report by the Center for Responsible Lending notes, “[h]alf

42. See Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477, 480 (2020). See generally LENDOL CALDER, *FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT* (1999) (chronicling the evolution and rise of consumer credit among American households); Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093 (2019) (describing how access to credit is not available for lower income families).

43. See David U. Himmelstein, Robert M. Lawless, Deborah Thorne, Pamela Foohey & Steffie Woolhandler, *Medical Bankruptcy: Still Common Despite the Affordable Care Act*, 109 AM. J. PUB. HEALTH 431, 431 (2019); Lorie Konish & Sharon Epperson, *One-Third of Credit Card Users Have Debt Due to Medical Costs. These Steps Can Help You Manage Those Bills*, CNBC (Dec. 16, 2019, 4:36 PM), <https://www.cnbc.com/2019/12/13/33percent-of-credit-card-debt-is-medical-bills-how-to-manage-those-debts.html> [<https://perma.cc/gNQZ-Y52E>].

44. See Patrick George, *America’s Auto Loan Debt Is Truly Out of Control*, JALOPNIK (Oct. 2, 2019, 4:56 PM), <https://jalopnik.com/americas-auto-loan-debt-is-truly-out-of-control-1838713860> [<https://perma.cc/gWHY-WLDW>]; R.J. Cross, Tony Dutzik, Ed Mierzwinski & Matt Casale, *Driving into Debt: The Hidden Costs of Risky Auto Loans to Consumers and Our Communities*, U.S. PIRG, <https://uspig.org/feature/usp/driving-debt> [<https://perma.cc/XGF9-QJVU>].

45. See Michael H. Anderson, *An Economic Perspective on Subprime Lending*, 89 CHI.-KENT L. REV. 53, 58–59 (2014).

46. *Id.* at 57.

47. *See id.* at 55.

48. See Timothy E. Goldsmith & Nathalie Martin, *Interest Rate Caps, State Legislation, and Public Opinion: Does the Law Reflect the Public’s Desires?*, 89 CHI.-KENT L. REV. 115, 119–20 (2014).

49. Amy Livingston, *How Payday Loans Work—Biggest Dangers & 14 Better Alternatives*, MONEY CRASHERS, <http://www.moneycrashers.com/how-do-payday-loans-work-dangers-payday-loan-alternatives> [<https://perma.cc/Z6DB-BUJC>].

50. See SUSANNA MONTEZEMOLO, CTR. FOR RESPONSIBLE LENDING, *PAYDAY LENDING ABUSES AND PREDATORY PRACTICES* 2 (2013), <http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf> [<https://perma.cc/EK3Z-KLUX>].

of repeat loans were opened at the borrower's first opportunity, 87% within two weeks, and 94% within one month of the previous loan."<sup>51</sup> This means that many borrowers find themselves in a debt trap, whereby they intend to take out only one payday loan but end up caught in an endless cycle of debt.<sup>52</sup> A payday loan borrower on average "takes out eight loans of [about] \$375 . . . and spends [about] \$520 on interest."<sup>53</sup>

Payday lenders are also predatory in how they target consumers. Studies have found that payday lenders locate disproportionately in areas with large Black and Hispanic populations,<sup>54</sup> suggesting that such lenders target communities of color who are already economically subordinated.<sup>55</sup> The negative effects of payday loan borrowing are so widely acknowledged that a number of states have banned payday lenders altogether,<sup>56</sup> and Congress prohibits payday lenders from operating on military bases and from charging service members interest rates above a certain amount.<sup>57</sup>

Unfortunately, even without the exigencies of a pandemic and an economic shutdown, U.S. households have far too often found themselves seeking out short term, high-cost loans to get by. Federal Reserve data from 2019 noted that 40 percent of U.S. adults couldn't afford even a \$400 unexpected expense without having to go into debt.<sup>58</sup> Twelve percent couldn't pay the amount through any means at all.<sup>59</sup>

51. *Id.* at 3 (footnote omitted).

52. Sumit Agarwal, Tal Gross & Bhashkar Mazumder, *How Did the Great Recession Affect Payday Loans?*, 40 *ECON. PERSPS.*, no. 2, 2016, at 1, 3.

53. PEW CHARITABLE TRS., *PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY* 4 (2012), [http://www.pewtrusts.org/~media/legacy/uploadedfiles/pes\\_assets/2012/pewpaydaylendingreportpdf.pdf](http://www.pewtrusts.org/~media/legacy/uploadedfiles/pes_assets/2012/pewpaydaylendingreportpdf.pdf) [<https://perma.cc/P6EA-38T5>].

54. See generally Robin A. Prager, *Determinants of the Locations of Payday Lenders, Pawnshops and Check-Cashing Outlets* (Fed. Rsv. Bd., Working Paper No. 2009-33, 2009), <https://www.federalreserve.gov/pubs/feds/2009/200933/200933pap.pdf> [<https://perma.cc/8WEJ-WGVJ>] (providing small dollar lending location data).

55. Desiree Evans, *Predatory Payday Lenders Target Black and Latino Communities*, *FACING S.* (Mar. 27, 2009), <https://www.facingsouth.org/2009/03/predatory-payday-lenders-target-black-and-latino-communities.html> [<https://perma.cc/MZS4-8L4T>]; Ashlee Kieler, *Report Spotlights Impact of Payday Lenders on Most Vulnerable Communities*, *CONSUMERIST* (Jan. 30, 2015, 11:44 AM), <https://consumerist.com/2015/01/30/report-spotlights-impact-of-payday-lenders-on-most-vulnerable-communities> [<https://perma.cc/LS5V-WgX2>].

56. Chintal A. Desai & Gregory Eliehausen, *The Effect of State Bans of Payday Lending on Consumer Credit Delinquencies*, 64 *Q. REV. ECON. & FIN.* 94, 96 (2017) (noting that 16 states and D.C. ban or effectively ban payday lending).

57. 10 U.S.C. § 987 (2018); 32 C.F.R. §§ 232.1–232.13 (2020); Paul Kiel & Mitchell Hartman, *Military Lending Act Fails to Protect Service Members from Predatory Lending: ProPublica*, *HUFFPOST* (Dec. 6, 2017), [https://www.huffpost.com/entry/military-lending-act-fail\\_n\\_3280980](https://www.huffpost.com/entry/military-lending-act-fail_n_3280980) [<https://perma.cc/VH73-VV88>].

58. BD. OF GOVERNORS OF THE FED. RSRV. SYS., *REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2018* (2019), <https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-dealing-with-unexpected-expenses.htm> [<https://perma.cc/HZK2-SVRD>].

59. *Id.*

## 2. During and After the Pandemic

The COVID crisis has revealed America's pre-existing and highly unstable household finance problem. In May 2020, the coronavirus pandemic gave rise to a record 14.7 percent unemployment rate, the highest rate in recorded history.<sup>60</sup> An April 2020 survey by the Pew Research Center reported that 43 percent of adults said someone in their household lost a job or took a reduction in pay due to the pandemic.<sup>61</sup> That number goes up to a little over half for low-income adults.<sup>62</sup> Of those surveyed, one in four said they would not be able to pay some of their bills or could only make partial payments in the month of April.<sup>63</sup>

Black and brown families are, as always, the hardest hit. A March and April 2020 survey conducted by the Urban Institute revealed that Hispanic and low-income families had a particularly difficult time arranging child-care, resulting in someone being forced to remain home and away from work.<sup>64</sup> One-quarter of those surveyed reported food insecurity, but this condition rose to one-third of all Black and Hispanic families.<sup>65</sup> During this period, about ten percent said they were late on mortgage or rental payments, 13 percent only made partial utility payments, and 16 percent went without medical care because they could not afford it.<sup>66</sup> Moreover, these financial hardships have spillover effects for mental health, leading to problems that will have long-last effects.<sup>67</sup>

Efforts by Congress to help families were useful in the short term, but were largely lacking. The Coronavirus Aid, Relief, and Economic Security ("CARES") Act<sup>68</sup> gave families money and temporary debt relief. The law provided for direct payments and expanded unemployment benefits,<sup>69</sup> and it

60. U.S. BUREAU OF LAB. STATS., UNEMPLOYMENT RATE RISES TO RECORD HIGH 14.7 PERCENT IN APRIL 2020 (2020), <https://www.bls.gov/opub/ted/2020/unemployment-rate-rises-to-record-high-14-point-7-percent-in-april-2020.htm> [<https://perma.cc/SR8C-99FT>].

61. Parker et al., *supra* note 39.

62. *Id.*

63. *Id.*

64. MICHAEL KARPMAN, DULCE GONZALEZ & GENEVIEVE M. KENNEY, URB. INST., PARENTS ARE STRUGGLING TO PROVIDE FOR THEIR FAMILIES DURING THE PANDEMIC 1 (2020), [https://www.urban.org/sites/default/files/publication/102254/parents-are-struggling-to-provide-for-their-families-during-the-pandemic\\_2.pdf](https://www.urban.org/sites/default/files/publication/102254/parents-are-struggling-to-provide-for-their-families-during-the-pandemic_2.pdf) [<https://perma.cc/52ET-WES2>].

65. *Id.* at 6.

66. *Id.*

67. Courtney Nagle, *The Mental Impact of Financial Stress and Tips for Dealing with COVID-19 Impacts*, NFCC (May 15, 2020), <https://www.nfcc.org/resources/blog/the-mental-impact-of-financial-stress-and-tips-for-dealing-with-covid-19-impacts> [<https://perma.cc/U8LM-Q48A>].

68. Congress passed and the President signed the CARES Act into law on March 27, 2020. Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (2020). The full text of the bill is available at <https://www.congress.gov/116/plaws/publ136/PLAW-116publ136.pdf> [<https://perma.cc/SY6L-HCSL>].

69. See *id.*; Emily Peck, *Trump's Labor Department Takes a Hacksaw to Coronavirus Paid Sick Leave*, HUFFPOST (Apr. 2, 2020, 6:52 PM), <https://www.huffpost.com/entry/trumps-labor->

also put a hold on some debt obligations through foreclosure, eviction, and student loan moratoria.<sup>70</sup>

All of these efforts came up short.<sup>71</sup> The \$1,200 to \$2,400 (plus \$500 per child) payments only took a small bite out of many people's significant financial obligations.<sup>72</sup> One-third of households said that the funds, while useful, would not sustain them for even a month.<sup>73</sup> Also, the degree to which individuals actually received the enhanced unemployment benefits in time to provide meaningful support has been uncertain. Many state unemployment agencies suffered from a constant inability to process the claims quickly, and the expanded benefits only lasted through July 2020, even as the pandemic rages and the economy continues to suffer.<sup>74</sup>

The moratoria were also problematic, as they left out millions of struggling families.<sup>75</sup> The eviction moratorium only helped one-quarter of all renters, as it only applied to federal housing programs and leased premises subject to federally-related mortgages, leaving many at the mercy of state and

departmenthacksaws-coronavirus-paid-sick-leave\_n\_5e865661c5b6a9491833a797 [https://perma.cc/9H2B-NP3Z].

70. See generally Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *The Folly of Credit as Pandemic Relief*, 68 UCLA L. REV. DISCOURSE 126 (2020) [hereinafter Foohey, Jiménez & Odinet, *Credit as Pandemic Relief*] (explaining the CARES Act's provisions to support households); Pamela Foohey, Dalié Jiménez & Christopher K. Odinet, *CARES Act Gimmicks: How Not to Give People Money During a Pandemic and What to Do Instead*, 2020 U. ILL. L. REV. ONLINE 81 [hereinafter Foohey, Jiménez & Odinet, *CARES Act Gimmicks*] (describing how the CARES Act's promises of financial support did not come to fruition); see also generally Kristen Evans, *What You Need to Know About Student Loans and the Coronavirus Pandemic*, CFPB (Apr. 9, 2020), [https://perma.cc/GB49-RRLZ] (explaining the CARES Act's provisions related to student loans).

71. Foohey, Jiménez & Odinet, *CARES Act Gimmicks*, *supra* note 70, at 81–82.

72. See Anita Sharpe, Tom Moroney, Christopher Palmeri & Laurie Calkins, *Americans Agonize Over Coronavirus Stimulus Payments, Worried That \$1,200 Isn't Enough*, TIME (Apr. 17, 2020, 4:09 PM), <https://time.com/5823508/coronavirus-stimulus-checks> [https://perma.cc/3UD2-TVU9].

73. Nicole Lyn Pesce, *84% of Americans Say They Need Another Stimulus Check*, MARKETWATCH (Apr. 23, 2020, 9:40 AM), <https://www.marketwatch.com/story/1-in-3-americans-say-their-stimulus-checks-wont-sustain-them-for-even-a-month-2020-04-08> [https://perma.cc/M89S-UGZA].

74. See Foohey, Jiménez & Odinet, *Credit as Pandemic Relief*, *supra* note 70, at 129; Ben Zipperer & Elise Gould, *Unemployment Filing Failures: New Survey Confirms that Millions of Jobless Were Unable to File an Unemployment Insurance Claim*, ECON. POL'Y INST. (Apr. 28, 2020, 7:00 AM), <https://www.epi.org/blog/unemployment-filing-failures-new-survey-confirms-that-millions-of-jobless-were-unable-to-file-an-unemployment-insurance-claim> [https://perma.cc/8KMW-2DXC]; Megan Cassella & Katy Murphy, *States Overwhelmed by Previously Unimaginable Layoff Numbers*, POLITICO (Apr. 1, 2020, 4:49 PM), <https://www.politico.com/news/2020/04/01/unemployed-workers-benefits-coronavirus-159192> [https://perma.cc/PVR5-7AT3]; Annie Gowen, *'A Very Dark Feeling': Hundreds Camp Out in Oklahoma Unemployment Lines*, WASH. POST (July 20, 2020, 5:20 PM), [https://www.washingtonpost.com/national/a-very-dark-feeling-hundreds-camp-out-in-oklahoma-unemployment-lines/2020/07/20/44d59cb6-c77a-11ea-99f3-bbdfb1af38\\_story.html](https://www.washingtonpost.com/national/a-very-dark-feeling-hundreds-camp-out-in-oklahoma-unemployment-lines/2020/07/20/44d59cb6-c77a-11ea-99f3-bbdfb1af38_story.html) [https://perma.cc/9QB9-4NZZ].

75. See Foohey, Jiménez & Odinet, *Credit as Pandemic Relief*, *supra* note 70, at 129–35 (detailing the foreclosure and eviction moratoria).

local governments for help.<sup>76</sup> Also, the CARES Act did not explain how mortgage servicers<sup>77</sup> and landlords are supposed to recoup missed mortgage and rental payments, which has resulted in significant uncertainty and anxiety among many individuals seeking to avail themselves of the supposed benefits of the law.<sup>78</sup> In essence, the relief offered to those eligible amounted to a modification of their debts.<sup>79</sup> The debts, however, remain. As of this writing, a debt collection pandemic is on the rise.<sup>80</sup> Because minority households often incur higher amounts of debt relative to their income, are more likely to default, and are more likely to be sued by debt collectors, these groups stand to suffer the most.<sup>81</sup> The ultimate long-term effects of this pandemic on the economy and how families financially manage through it remain to be seen. By some accounts, this recession will be “at least twice as severe as 2007–09.”<sup>82</sup>

### B. *THE RISE OF ONLINE LENDING*

Even before the pandemic, people were going online to deal with their credit problems. In place of loans that are repayable on payday have come a wave of installment loans delivered to consumers online.<sup>83</sup> These loans have much longer repayment periods when compared to payday loans, but they come with equally crippling interest rates.

The shift to digital credit is sometimes called alternative finance because loans are obtained through channels outside the banking system—the loans come from nonbank companies, which are sometimes called shadow banks. This move toward nonbank fintech companies resulted from a number of factors affecting the banking sector. First, fintech companies create a user

76. *Id.* at 132.

77. CHRISTOPHER K. ODINET, FORECLOSED: MORTGAGE SERVICING AND THE HIDDEN ARCHITECTURE OF HOMEOWNERSHIP IN AMERICA 40–47 (2019) [hereinafter ODINET, FORECLOSED] (detailing the mortgage servicing industry); *see also* Christopher K. Odinet, *Banks, Break-Ins, and Bad Actors in Mortgage Foreclosure*, 83 U. CIN. L. REV. 1155, 1175 (2015) (discussing reforms in mortgage servicing).

78. Foohey, Jiménez & Odinet, *Credit as Pandemic Relief*, *supra* note 70, at 130–31.

79. Atkinson, *supra* note 42, at 1101 & n.28; *see also* Foohey, Jiménez & Odinet, *Credit as Pandemic Relief*, *supra* note 70, at 130 (explaining that at some point debt will still have to be repaid).

80. *See* Pamela Foohey, Dalié Jiménez & Christopher Odinet, *INSIGHT: The Cares Act Could Put People on the Street—Here’s a Solution*, BLOOMBERG L. (Apr. 28, 2020, 3:00 AM), <https://news.bloomberglaw.com/us-law-week/insight-the-cares-act-could-put-people-on-the-street-heres-a-solution> [<https://perma.cc/K3YG-34GP>].

81. *See* Emanuel Nieves, *What We’ve Learned About Debt in Black Communities*, PROSPERITY NOW (Feb. 7, 2019), <https://prosperitynow.org/blog/what-weve-learned-about-debt-black-communities> [<https://perma.cc/BBY9-VTGZ>].

82. Claudia Sahm, *The Coronavirus Recession Is Severe, and the Damage to the U.S. Economy Will Last Years*, WASH. CTR. FOR EQUITABLE GROWTH (Apr. 29, 2020), <https://equitablegrowth.org/the-coronavirus-recession-is-severe-and-the-damage-to-the-u-s-economy-will-last-years> [<https://perma.cc/8QTQ-UBFU>].

83. Maloney & Tempkin, *supra* note 3.

experience that is more in line with the preferences of twenty-first century consumers.<sup>84</sup> Fintechs offer an all-online interface with a social media-style aesthetic and branding that appeals to notions of financial democratization and that furnishes a near real-time digital interactive experience.<sup>85</sup> In contrast, banks, which are notoriously slow to change, are saddled with systems and processes that are seen as being of another era. Second, and most importantly, many banks now face stricter regulatory standards since the 2008 recession and the reforms that followed.<sup>86</sup> This has caused them to be more conservative in their lending, with some choosing to forgo or minimize their unsecured consumer credit activities.<sup>87</sup> Indeed, since the coronavirus took hold, banks have significantly narrowed who they lend money to and on what terms.<sup>88</sup> Third, reputational risk arising from financial crisis misbehavior has resulted in banks recommitting themselves to more core functions—such as payments, deposits, and standardized loans—rather than branching out to new innovations in their financial offerings.<sup>89</sup> Fourth and lastly, banks have higher operating costs.<sup>90</sup> Some of these are related to the actual cost of regulatory compliance and some are related to the expenses necessary in order to operate a large financial institution.

Online lending companies operate in a role somewhat like middlemen in that they match investors with money to spare and borrowers in need of loans.<sup>91</sup> Many online lenders in the fintech space were first known as “peer-to-peer” or “P2P” lenders because they connected borrowers and retail investors via online platforms.<sup>92</sup> With the increase in institutional investors as the primary funders of these loans, the market for online lending became

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84. CHRIS BRUMMER, *FINTECH LAW IN A NUTSHELL* 18–28 (2019) [hereinafter BRUMMER, *FINTECH LAW*].

85. *Id.*

86. *Id.*

87. Christopher K. Odet, *Consumer Bitcredit and Fintech Lending*, 69 ALA. L. REV. 781, 801 (2018) [hereinafter Odet, *Fintech Lending*].

88. Hannah Lang, *Banks Tighten Lending Standards as Coronavirus Crimps Demand: Survey*, AM. BANKER (May 4, 2020, 3:04 PM), <https://www.americanbanker.com/news/banks-tighten-lending-standards-as-coronavirus-crimps-demand-survey> [<https://perma.cc/GC2W-RL8P>].

89. BRUMMER, *FINTECH LAW*, *supra* note 84, at 10–18.

90. *Id.* at 4.

91. See KPMG, *THE PULSE OF FINTECH 2018: BIENNIAL GLOBAL ANALYSIS OF INVESTMENT IN FINTECH* 5 (2018) [hereinafter KPMG REPORT], <https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2018/07/h1-2018-pulse-of-fintech.pdf>.

92. Angela M. Herrboldt, *Marketplace Lending*, SUPERVISORY INSIGHTS, Winter 2015, at 12, 12 [hereinafter *FDIC Commentary*], [https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin15/si\\_winter2015.pdf](https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin15/si_winter2015.pdf) [<https://perma.cc/LC83-UCV8>]; see Odet, *Fintech Lending*, *supra* note 87, at 798. For a theorizing of the role of intermediaries, see generally Kathryn Judge, *Intermediary Influence*, 82 U. CHI. L. REV. 573 (2015). See also Charles K. Whitehead, *Reframing Financial Regulation*, 90 B.U. L. REV. 1, 8 (2010) (proposing regulatory changes in response to new market entrants and developments).

referred to as “marketplace’ lending.”<sup>93</sup> Today, the blending of names and monikers has become less relevant, as even those companies that operate online but have little other technological advancement still bill themselves as “fintechs.” Indeed, this umbrella effect is part of the problem identified here: fintech credit firms ranging from those that offer affordable interest rates and terms are lumped together with those that charge triple digit rates and prey on the poor. Of particular note, companies in the fintech credit industry boast their ability to provide borrowers with quicker and easier access to credit compared to that offered by banks.<sup>94</sup> The loan decision turn-around time can be as short as a few days,<sup>95</sup> with the application being accessed, completed, and submitted entirely online.<sup>96</sup> This has garnered them significant support among political leaders who place their hopes on what tech can do to solve systemic problems.<sup>97</sup>

Over the past seven years, fintech/online lending companies have taken an ever-growing portion of the unsecured consumer credit market from banks and other more traditional, brick-and-mortar finance companies. The credit reporting company TransUnion stated that in 2018, fintech loans comprised 38 percent of all non-credit card, unsecured personal loan balances, comparing these companies to the activities of banks, credit unions, and other nonbank finance companies.<sup>98</sup> This number is up from a mere five percent of

93. Jason J. Kilborn, *Crowdfunding and Crowdlending in the US: Regulations, Exemptions, and Outcomes* 11 (Apr. 1, 2019) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3362591](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3362591) [<https://perma.cc/82DV-D6A4>]; see also TANIA ZIEGLER ET AL., *THE AMERICAS ALTERNATIVE FINANCE INDUSTRY REPORT: HITTING STRIDE* 22 (2017) (describing Marketplace/P2P Lending); Kevin Davis & Jacob Murphy, *Peer-to-Peer Lending: Structures, Risks and Regulation*, *JASSA FINANCIAL APPLIED FIN.*, no. 3, 2016, at 37, 38 (describing the key characteristics of “P2P” lending).

94. U.S. DEP’T OF TREASURY, *OPPORTUNITIES AND CHALLENGES IN ONLINE MARKETPLACE LENDING* 5 (2016) [hereinafter *TREASURY REPORT*], [https://www.treasury.gov/connect/blog/documents/opportunities\\_and\\_challenges\\_in\\_online\\_marketplace\\_lending\\_white\\_paper.pdf](https://www.treasury.gov/connect/blog/documents/opportunities_and_challenges_in_online_marketplace_lending_white_paper.pdf) [<https://perma.cc/3TJB-RSN6>]. See generally Andrew Verstein, *The Misregulation of Person-to-Person Lending*, 45 *U.C. DAVIS L. REV.* 445 (2011) (explaining the early threats to fintech lending).

95. See *TREASURY REPORT*, *supra* note 94, at 5; see also Dori Zinn, *How Long It Really Takes to Get Approved for a Personal Loan*, *STUDENT LOAN HERO* (June 5, 2018), <https://studentloanhero.com/featured/how-long-does-it-take-to-get-approved-for-a-personal-loan> [<https://perma.cc/Y94K-5XF2>] (describing the length in which personal loans are granted).

96. *TREASURY REPORT*, *supra* note 94, at 5.

97. See, e.g., *Congressman Gregory Meeks on Win-Win Fintech*, BAREFOOT INNOVATION GRP. (Aug. 14, 2018) [hereinafter *Meeks Podcast*], <https://www.jsbarefoot.com/podcasts/2018/8/13/congressman-gregory-meeks-on-win-win-fintech> [<https://perma.cc/6NWD-J8YE>] (to obtain a transcript of this podcast, click “Link to Full Episode Transcription” under “More Links”).

98. *FinTechs Continue to Drive Personal Loan Growth*, TRANSUNION (Feb. 21, 2019), <https://newsroom.transunion.com/fintechs-continue-to-drive-personal-loans-to-record-levels> [<https://perma.cc/5Z7U-PE5H>].

market share in 2013.<sup>99</sup> Table 1 shows the rise in fintech lending market share compared to incumbents.<sup>100</sup>

Table 1. Market Share by Credit Firm-Type (Non-Credit Card, Unsecured Personal Loan Balances)<sup>101</sup>

Year	Bank	Credit Union	Nonbank Finance Co.	Fintech Lender
2018	28%	21%	13%	38%
2017	30%	22%	13%	35%
2016	32%	23%	16%	29%
2015	35%	25%	19%	21%
2014	39%	28%	22%	11%
2013	40%	31%	24%	5%

The credit reporting company Experian noted that as of March 2019, financial technology loans comprised nearly 50 percent of the non-credit card, unsecured consumer loan market.<sup>102</sup>

Online lending firms share a number of similarities. First, they all promise flexible repayment options, affordable credit pricing, a simple and easy application process, and quick loan processing to the end user. Second, the consumer experience is entirely online, with no need to meet with or speak to a lending representative. Third, the marketing is specifically geared toward making borrowing seem easy, sleek, and clean, with company websites often featuring images of young adults settled in cafes or chatting with friends.<sup>103</sup> For example, the online lender Elevate declares: “[w]e provide innovative, tech-enabled online credit solutions for a brighter financial future.”<sup>104</sup> And the credit firm Speedy Cash promises “easy, fast & friendly cash loans.”<sup>105</sup>

But the most distinctive and hyped commonality among these nonbank lenders is the way they supposedly engage in the process of determining whether and to what extent a person is creditworthy<sup>106</sup>—in other words: how

99. *Id.*

100. *Id.*

101. *Id.*

102. EXPERIAN, FINTECH VS. TRADITIONAL FIS: TRENDS IN UNSECURED PERSONAL INSTALLMENT LOANS 3 (2019), <http://go.experian.com/IM-20-EM-AA-FintechTrendseBookTY> [<https://perma.cc/X6U2-5D6X>].

103. COMMONBOND, <https://www.commonbond.co> [<https://perma.cc/9MS5-G8SG>].

104. ELEVATE, <https://www.elevate.com> [<https://perma.cc/EL7U-PUB7>].

105. SPEEDY CASH, <https://www.speedycash.com> [<https://perma.cc/JM5Q-P3HK>].

106. *Underwrite*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/underwrite> [<https://perma.cc/S8JD-QKZ2>].

they conduct their underwriting.<sup>107</sup> Many nonbank online lenders argue that their unique underwriting processes are significantly more reliable in predicting creditworthiness.<sup>108</sup> This claim is supported by the firm's supposed use of alternative data aimed at gaining a more complete picture of a borrower's financial capacity, compared to the methods used by banks and more traditional lenders.<sup>109</sup> Alternative data generally means information other than that which is generally collected in a consumer report.<sup>110</sup> It includes information such as where borrowers live, their text messaging habits, their health records, what clubs they belong to, educational history, academic transcripts, standardized test scores, career trajectory, and digital footprint, including social media activity.<sup>111</sup> One industry executive noted that "how many times a person says 'wasted' in their [social media] profile . . . has some value in predicting whether they're going to repay their debt."<sup>112</sup> A particular online lender declared on its website: "[A]ll data is credit data."<sup>113</sup> Machine learning algorithms<sup>114</sup> then process this nontraditional borrower information with an aim of finding correlations between seemingly irrelevant

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107. See Odet, *Fintech Lending*, *supra* note 87, at 784–85; Christopher K. Odet, *The New Data of Student Debt*, 92 S. CAL. L. REV. 1617, 1681–88 (2019) [hereinafter Odet, *Student Debt*]; Laura Noonan, *AI in Banking: The Reality Behind the Hype*, FIN. TIMES (Apr. 11, 2018), <https://www.ft.com/content/b497a134-2d21-11e8-a34a-7e7563bobof4>.

108. See *supra* Section IV.A.

109. Odet, *Fintech Lending*, *supra* note 87, at 804, 848.

110. *Id.* at 853–54; see TREASURY REPORT, *supra* note 94, at 5.

111. TREASURY REPORT, *supra* note 94, at 5; CATHY O'NEIL, WEAPONS OF MATH DESTRUCTION: HOW BIG DATA INCREASES INEQUALITY AND THREATENS DEMOCRACY 156–57 (2016); Mikella Hurley & Julius Adebayo, *Credit Scoring in the Era of Big Data*, 18 YALE J.L. & TECH. 148, 165 (2016); Odet, *Student Debt*, *supra* note 107, at 1619; Odet, *Fintech Lending*, *supra* note 87, at 785, 853–54; Kelly Dilworth, *Alternative Lenders Offer Cheaper Loans for More of Your Data*, CREDITCARDS.COM (Apr. 20, 2015), <https://www.creditcards.com/credit-card-news/alternative-lenders-startups-loans-data-1273.php> [<https://perma.cc/RJD7-WW8C>].

112. Ben McLannahan, *Being 'Wasted' on Facebook May Damage Your Credit Score*, FIN. TIMES (Oct. 15, 2015), <https://www.ft.com/content/d6daedee-706a-11e5-9b9e-690fdae72044>; see also *The Surprising Ways that Social Media Can Be Used for Credit Scoring*, KNOWLEDGE@WHARTON (Nov. 5, 2014), <http://knowledge.wharton.upenn.edu/article/using-social-media-for-credit-scoring> [<https://perma.cc/75PE-JJS4>] (explaining how social media has impacted credit scores for potential borrowers).

113. See O'NEIL, *supra* note 111, at 158; Hurley & Adebayo, *supra* note 111, at 165; Odet, *Fintech Lending*, *supra* note 87, at 853; Odet, *Student Debt*, *supra* note 107, at 1617.

114. For an explanation of the basics of algorithms, see Andrew Tutt, *An FDA for Algorithms*, 69 ADMIN. L. REV. 83, 92 (2017).

datapoints (such as a borrower’s smart phone operating system or online shopping habits<sup>115</sup>) and a propensity to repay a loan.<sup>116</sup>

The use of alternative data and machine learning for credit scoring is what the industry argues makes it different from traditional banking, which largely relies on mainstream credit scores like FICO and Vantage. For example, the online lender Elevate states that it was “the first to develop a risk-based pricing model utilizing technology and risk analytics focused on the non-prime credit industry.”<sup>117</sup> The credit firm Upstart declares that it is “the first lending platform to leverage artificial intelligence and machine learning to price credit and automate the borrowing process.”<sup>118</sup>

### III. BANK-FINTECH PARTNERSHIPS: A CASE STUDY

Yet, it is the dominant business model of many of these fintech nonbank companies that raises unique and predatory dual banking issues.<sup>119</sup> There are a number of fintech companies that engage in high-cost online lending with the help of small, out-of-the-way banks. These are the purveyors of predatory fintech finance. In this Part, I provide an overview of a particularly noteworthy and representative example—Elevate Credit, Inc. (“Elevate”) and its bank partner lending programs.<sup>120</sup> Predatory firms like Elevate and its bank partners use soaring rhetoric about what fintech can do to revolutionize finance, yet the falsity of their claims can be seen in the details. These particulars lie under the hood and constitute complex financial relationships

115. See Tobias Berg, Valentin Burg, Ana Gombović & Manju Puri, *On the Rise of the FinTechs—Credit Scoring Using Digital Footprints* (FDIC Ctr. for Fin. Rsch., Working Paper No. 2018-04, 2018), <https://www.fdic.gov/bank/analytical/cfr/2018/wp2018/cfr-wp2018-04.pdf> [<https://perma.cc/R5GS-GM74>] (providing analysis on the types of digital consumer habits that creditors can use to assess the likelihood a debtor will default on their loans).

116. See Chris Anderson, *The End of Theory: The Data Deluge Makes the Scientific Method Obsolete*, WIRED (June 23, 2008, 12:00 PM), <https://www.wired.com/2008/06/pb-theory> [<https://perma.cc/6PBZ-TVWX>]; David Weinberger, *Our Machines Now Have Knowledge We’ll Never Understand*, WIRED (Apr. 18, 2017, 8:22 PM), <https://www.wired.com/story/our-machines-now-have-knowledge-well-never-understand> [<https://perma.cc/93TX-HMJD>] (showing how machine learning has allowed computers to tackle problems using critical analysis not comprehensible to humans).

117. *Our Solutions*, ELEVATE [hereinafter *Elevate’s Solutions*], <https://www.elevate.com/products.html> [<https://perma.cc/VD2B-N5F4>].

118. *Upstart Opens R&D Center in Columbus*, UPSTART: BLOG, <https://www.upstart.com/blog/upstart-opens-rd-center-in-columbus> [<https://perma.cc/7EST-XKQJ>]. These statements also come from job advertisements on Upstart’s website for data scientist and machine learning specialist positions. See *Open Positions*, UPSTART, <https://www.upstart.com/careers/open-roles> [<https://perma.cc/338D-H3PT>].

119. Gerald Tsai, Dir., Fintech and Applications, Fin. Insts. Supervision and Credit, Fed. Rsr. Bank of S.F., Remarks at the 4th Bund Summit on Fintech (July 9, 2017).

120. For a recent article conducting a case study of Elevate Credit, Inc. using contracts between the nonbank and its bank partners, see Adam J. Levitin, *Rent-a-Bank: Bank Partnerships and the Evasion of Usury Laws*, 71 DUKE L.J. (forthcoming 2021), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3684244](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3684244) [<https://perma.cc/U5RT-4SDK>].

that are often difficult to untangle. Indeed, the rhetoric of fintech combined with the inherent complexity of the financial sector has long led many social justice advocates to steer away from banking and credit markets when focusing their efforts.<sup>121</sup> This Part aims to shine a light on these predatory schemes.

#### A. HIGH LEVEL

In the typical partnership model, a nonbank fintech firm enters into an agreement with a depository institution (a bank), which is almost always chartered at the state level.<sup>122</sup> Although a given borrower completes the loan application through the fintech credit firm's website or with the company's smartphone app, it is the bank partner that actually makes the loan.<sup>123</sup> The marketing, credit scoring, and underwriting process is performed by the fintech company through the use of its own proprietary technology and risk assessment program.<sup>124</sup>

Typically, within a few hours or days after the loan is originated, the bank partner sells the loan or some interest in it to the nonbank fintech company.<sup>125</sup> The fintech then sells the interest to a pre-arranged wholesale buyer or else sponsors a securitization of a large pool of loans for sale as securities in the capital markets.<sup>126</sup> An illustration of the fintech-bank partnership model between fintech firms and chartered banks is shown in Figure 2.

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121. Only since the financial crisis has the "rigged" economy, including the design of the financial sector, become a mainstream political topic. See Kristen Bialik, *State of the Union 2019: How Americans See Major National Issues*, PEW RSCH. CTR. (Feb. 4, 2019), <https://www.pewresearch.org/fact-tank/2019/02/04/state-of-the-union-2019-how-americans-see-major-national-issues> [<https://perma.cc/4LE9-M7SE>]; Elizabeth Warren *Wants to Remake American Capitalism*, ECONOMIST (Oct. 24, 2019), <https://www.economist.com/leaders/2019/10/24/elizabeth-warren-wants-to-remake-american-capitalism> [<https://perma.cc/3JDG-TTB6>].

122. KPMG REPORT, *supra* note 91, at 6–8; see also *id.* at 2 (providing an overview of fintech market activity and regulation worldwide); RYAN M. NASH & ERIC BEARDSLEY, GOLDMAN SACHS, *THE FUTURE OF FINANCE PART 1: THE RISE OF THE NEW SHADOW BANK* 9 (2015), [http://www.betandbetter.com/photos\\_forum/1425585417.pdf](http://www.betandbetter.com/photos_forum/1425585417.pdf) [<https://perma.cc/4MSN-TFKD>] (measuring macro-level data on the growth of "shadow banking"); *FDIC Commentary*, *supra* note 92, at 13 (illustrating the bank partnership model).

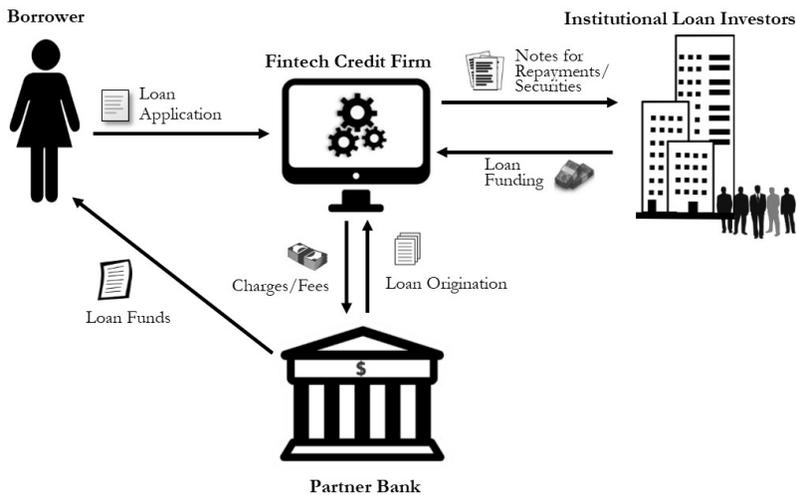
123. See TREASURY REPORT, *supra* note 94, at 6–8.

124. *Id.* at 9.

125. Odinet, *Fintech Lending*, *supra* note 87, at 792.

126. *Id.* at 788–89.

Figure 2. Fintech-Bank Partnership Model



### B. CASE STUDY: ELEVATE CREDIT

To see how this business model operates up close, this Section examines the partnership between Elevate and its three bank partners—FinWise Bank, Republic Bank, and Capital Community Bank. Elevate is a nonbank online lending company that exhibits the general corporate characteristics and uses the same business model as is characteristic of many predatory fintech lending programs, thus making it particularly useful as a case study.

#### 1. The Corporate Culture

Predatory fintech firms have been successful, in part, because they are able to bill themselves as innovative tech firms that seek to expand access to credit. Sloganeering around this idea is a core part of Elevate’s stated belief system, and, so I argue, has helped fend off attacks that seek to lump the firm in with typical brick and mortar payday lending companies. For example, as part of its “core beliefs” statement, Elevate declares that it “is reinventing the non-prime lending industry by giving consumers access to responsible and transparent credit options.”<sup>127</sup> Further, Elevate declares that “the highest cost of credit is no credit at all,” that “non-prime credit is here to stay” and should “be priced to risk with no hidden or punitive fees.”<sup>128</sup> The business’ general mantra is “Good Today, Better Tomorrow,” and the company proclaims: “We have a passion for serving the New Middle Class.”<sup>129</sup> On its website, Elevate

127. *About Us*, ELEVATE, <https://www.elevate.com/company.html> [<https://perma.cc/2Y8K-QFGW>].

128. *Id.*

129. *Elevate’s Solutions*, *supra* note 117.

declares that “with its bank partners” the company “has originated \$7 billion in non-prime credit to more than 2.2 million non-prime consumers” through the use of “responsible, tech-enabled online credit solutions [that] provide immediate relief to customers today and help them build a brighter financial future.”<sup>130</sup>

In order to better understand the company’s loan products and the firm’s fintech-bank partnership structure, I looked to Elevate’s 2019 10-K annual report filed with the Securities and Exchange Commission (the “SEC”).<sup>131</sup> In these documents, the nonbank company says its stated market consists of consumers “who are not well-served by traditional bank products and who are looking for better options than payday loans, title loans, pawn and storefront installment loans.”<sup>132</sup>

## 2. The Marketing and Underwriting

As mentioned above, fintech lenders laud (often overly so) their use of alternative data and machine learning to score borrowers. This, in part, is how they argue to policymakers that they deserve special light-touch treatment. The invocation of decision-making through data and science is often an effective shield to significant regulatory interrogation.<sup>133</sup> True to form, Elevate describes its underwriting process as having all the trappings, including “highly automated loan originations [and] cost-effective servicing.”<sup>134</sup>

Elevate says it employs a team of over 50 data scientists “to build and test scores and strategies across the entire underwriting process.”<sup>135</sup> These scientists help develop a host of models to assist in the credit scoring process, ranging “from traditional multivariate regression[s] to machine learning and artificial intelligence,” all in an effort “to enhance our underwriting

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130. *Elevate Nominated for Diversity & Inclusion Award from the Council for Inclusion in Financial Services (CIFS)*, ELEVATE (May 30, 2019, 8:30 AM), <https://investors.elevate.com/news-events/news/news-details/2019/Elevate-Nominated-for-Diversity-Inclusion-Award-from-the-Council-for-Inclusion-in-Financial-Services-CIFS/default.aspx> [<https://perma.cc/Y9H5-26AW>]; *see also* Elevate Credit, Inc., Annual Report (Form 10-K), at 12 (Mar. 8, 2019) [hereinafter *Elevate Annual Report on Form 10-K*], <https://www.sec.gov/Archives/edgar/data/1651094/000165109419000028/elevate10-kx2018.htm> [<https://perma.cc/N9EN-7T5Z>] (listing Elevate’s competitive advantages).

131. Elevate Annual Report on Form 10-K, *supra* note 130.

132. *Id.* at 6.

133. *See generally* Hilary J. Allen, *Regulatory Sandboxes*, 87 GEO. WASH. L. REV. 579 (2019) (describing the rise of special regulatory regimes for fintech companies); Ross P. Buckley, Douglas Arner, Robin Veidt & Dirk Zetzsche, *Building Fintech Ecosystems: Regulatory Sandboxes, Innovation Hubs and Beyond*, 61 WASH. U. J.L. & POL’Y 55 (2020) (same); Sonja B. Starr, *Evidence-Based Sentencing and the Scientific Rationalization of Discrimination*, 66 STAN. L. REV. 803 (2014) (criticizing the use of “technocratic framing” to allow for the use of protected classes in legal decision-making, specifically in criminal sentencing).

134. Elevate Annual Report on Form 10-K, *supra* note 130, at 8.

135. *Id.*

accuracy.”<sup>136</sup> Through these innovations, Elevate reports that about “95% of loan applications” it receives are scored and “decisioned in seconds with no manual review required.”<sup>137</sup> When a consumer submits a loan application, Elevate “provides credit decisions in seconds and funds as soon as the next business day.”<sup>138</sup> These promises, in turn, play into the narrative that fintech firms like Elevate are engaged in ground-breaking work that is brushing aside the old ways of underwriting and expanding opportunities for affordable credit.

### 3. The Cost of Credit

Yet despite its promises of affordable credit, the truth of its business model lies in the cost the company (and its bank partners) charge customers to borrow money. Rather than being anything close to affordable, Elevate is engaged in a system of high-cost and predatory fintech lending.

The company markets four different loan products.<sup>139</sup> *Rise* is offered as an installment loan in 13 states, as a CSO-originated product<sup>140</sup> in two states, as a line of credit product in two other states, and, importantly, as an installment loan product in 16 states through a “third-party bank.” The 10-K does not explain why the offerings vary by state, but, as described in Section IV.B below, it is because of state restrictions on lending that vary by jurisdiction. The *Elastic* product is a line of credit that is offered in 40 states and is also originated by a bank partner. *Sunny* is an installment loan offered in the United Kingdom, and the *Today Card* is a credit card that is also originated by a bank partner.

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136. *Id.*

137. *Id.*

138. *Id.* at 7.

139. *Id.* at 9. The company notes its high APR, which was 129 percent at the end of 2018 and was 251 percent at the end of 2013. *Id.* at 6. Elevate boasts that it has “saved [its] customers more than \$4.8 billion over what they would have paid for payday loans” by using a payday loan (or, what Elevate calls “legacy non-prime” loans) APR comparison of 400 percent. *See id.* at 11–12.

140. *Id.* at 16. A CSO is an abbreviation for a credit service organization, which is a special designation under the laws of some states (such as Texas). *See* DIANE STANDAERT & SARA WEED, CTR. FOR RESPONSIBLE LENDING, PAYDAY LENDERS POSE AS BROKERS TO EVADE INTEREST RATE CAPS: THE NEXT CHAPTER IN PAYDAY LENDER SUBTERFUGE 2 (2010), <https://www.responsiblelending.org/payday-lending/policy-legislation/states/CRL-CSO-Issue-Brief-FINAL.pdf> [<https://perma.cc/X85E-FJDT>]. Under the CSO model, a company (usually a high-cost lender that cannot operate in the given jurisdiction as freely as in other states) qualifies as a CSO. The CSO then helps borrowers match with lenders (i.e., those that fund the loans). For doing this, the CSO charges a brokerage fee or some similarly denominated charge. In the end, the loan is just as high-cost as if the CSO had made a payday loan itself. For example, a borrower will go to CSO for a two-week loan of \$300, and the CSO will arrange the credit for a fee of \$60. The third-party lender will then make the loan at the allowable interest rate—for instance, at 36 percent APR or \$4.14. While this may not seem like much, when the \$60 and the \$4.14 are combined and turned into an APR on a \$300 loan with a term of two weeks, it equals 557 percent. *Id.*

The product break-down for each of these is particularly revealing. Table 2 provides select product information taken from Elevate’s 10-K. Note that for the *Rise* installment loan and the *Elastic* line of credit loan, Elevate’s bank partners (FinWise Bank and Republic Bank) originate the credit with interest rates nearing or above 100 percent.

Table 2. Select Loan Product Information (2018)<sup>141</sup>

Product	Rise (Install Loan)	Rise (LoC)	Rise (Inst-L: FinWise)	Elastic (LoC: Republic)
Market	13 states	2 states	16 states	40 states
Loan Amt	\$300–\$5,000	\$300–\$5,000	\$300–\$5,000	Up to \$4,500
Loan Term	4–26 months	N/A	7–26 months	N/A
Interest R	60%–299%	60%–299%	99%–149%	97%

Markedly, the notes to this information contained in the 10-K state that for “some legacy customers” the interest rate on *Rise* loans is “as high as 365%.”<sup>142</sup> Also, several of these numbers appear at odds with earlier statements in the company’s introductory section stating that Elevate “reduced the effective APR of our products” from an “effective APR” of 251 percent at the end of 2013 to 129 percent in 2018.<sup>143</sup>

Another important point about these loans is that they exhibit one of the most signature characteristics of typical payday loans—rollover.<sup>144</sup> Elevate discloses, albeit indirectly, that part of its business model anticipates that borrowers will roll-over their loans. The company somewhat masks this attribute when it says that “[a]pproximately 53% of *Rise* installment customers in good standing had refinanced or taken out a subsequent loan as of December 31, 2018, with 31% of the outstanding *Rise* installment loan balances on that date consisting of new customer loans and 69% related to returning customer loans.”<sup>145</sup> The average APR for all *Rise* installment loans at the end of 2018 was 118 percent.<sup>146</sup>

141. Elevate Annual Report on Form 10-K, *supra* note 130, at 15–17.

142. *Id.* at 15.

143. *Id.* at 6.

144. Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8, 20 (2003).

145. Elevate Annual Report on Form 10-K, *supra* note 130, at 16.

146. *Id.* at 15.

#### 4. The Bank Partnerships and Funding

As noted throughout, much of the regulatory arbitrage that allows for these predatory fintech activities comes from the involvement of banks. For Elevate, many of these high-cost installment loans are originated by FinWise Bank of Utah.<sup>147</sup> Additionally, the *Elastic* line of credit loan, with its 97 percent interest rate, “designed to be a financial safety net for non-prime consumers,”<sup>148</sup> is offered in 40 states<sup>149</sup> through Republic Bank of Kentucky.<sup>150</sup> The 10-K reveals, as representative of other fintech-bank partnerships,<sup>151</sup> that Elevate “provide[s] FinWise Bank with marketing services related to the Rise brand” and licenses to the bank Elevate’s “website, technology platform and proprietary credit and fraud scoring models in order to originate” loans “in certain states not otherwise covered by the Elevate-originated Rise brand.”<sup>152</sup> Elevate notes in this filing that “FinWise Bank reviews and approves all marketing materials . . . and determines the underwriting strategies and score cutoffs” for applications, as well as “provides full compliance oversight over all aspects of the program.”<sup>153</sup> Almost identical statements are made with respect to the contractual agreement with Republic Bank.<sup>154</sup>

The under the hood financing of Elevate’s lending program merits mention. As with all bank-fintech partnerships, although the bank partner originates the loan, the nonbank fintech purchases the loan and then typically offloads it thereafter. Elevate does this as well when it comes to the *Rise* loans originated by FinWise Bank and the *Elastic* loans made by Republic Bank. In both cases, debt financing is the backbone of the operation. Victory Park Capital,<sup>155</sup> a Chicago-based global investment firm, indirectly serves as the debt financing partner.<sup>156</sup>

For the *Elastic* line of credit product, Republic Bank originates the loans and then a “participation interest” in the loan portfolio is purchased by a company called Elastic SPV, Ltd., which is an Elevate-related entity located in the Cayman Islands.<sup>157</sup> Elastic SPV, Ltd. makes this purchase through a line of

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147. *Id.* at 16–17.

148. *Id.* at 17.

149. *Id.* at 7.

150. *Id.* at 17.

151. *See infra* Section IV.A.

152. Elevate Annual Report on Form 10-K, *supra* note 130, at 17.

153. *Id.*

154. *Id.* The *Today Card* is the newest Elevate product and is only in a testing period at present. However, it (with an APR of between 29.99 and 34.99 percent and with an annual fee) is being issued by yet another bank partner—Capital Community Bank of Utah. *Id.* at 17–18.

155. *About Us*, VICTORY PARK CAP., <https://www.victoryparkcapital.com/about-us> [<https://perma.cc/4TUZ-F3UE>].

156. Elevate Annual Report on Form 10-K, *supra* note 130, at 43.

157. *Id.* at 44.

credit from Victory Park Capital.<sup>158</sup> Cayman law allows for the margin earned by the SPV—the difference between what it must pay Victory Park Capital on its debt and what borrowers pay for Elevate loans—to escape taxation under U.S. law.<sup>159</sup> This exact same structure occurs with the *Rise* lending program when FinWise originates the loans and participations are acquired by another Cayman Island entity: EF SPV, Ltd.<sup>160</sup>

An important aspect of the partnership that is revealed only indirectly in the 10-K is that the loans that are originated by the three bank partners are not actually sold to the fintech lender.<sup>161</sup> Instead, the loans remain on the books of the bank partners, and participations (up to about 90/95 percent of each loan originated<sup>162</sup>) are sold by the bank to the nonbank fintech company (or, rather, its Cayman Island entities).<sup>163</sup> The term “loan participation” is typically used in the context of syndicated lending, whereby multiple lenders join together to make a very large loan to a borrower, and thereby spread the risk of default among themselves.<sup>164</sup> In this case, however, the term is used differently. The participation interest appears to be merely a contractual right to the economic benefits of the loans. Although revealed only subtly in the 10-K, the reason that Elevate only purchases participations, rather than whole loans, is in an attempt to get around usury limits that are described more fully below in Section IV.A.<sup>165</sup> By ensuring that the loans remain nominally titled in the name of the originating banks, Elevate and its partners hope to avoid litigation under state consumer finance laws. Without the connection and involvement of the bank, these high-cost loans would be illegal in many states. The partnership is, in essence, a regulatory arbitrage scheme meant to allow high-cost predatory lending to proliferate online, all while enjoying the political cover accorded by being labeled a “fintech.”

#### IV. PROBLEMS IN DUAL BANKING AND THE LAW OF FINANCE

These relationships between banks and online companies, like those between Elevate and its various partners, exist for one reason and one reason only: *regulatory arbitrage*.<sup>166</sup> They are aimed at taking advantage of the special

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158. *Id.*

159. Kadhim Shubber, *Why This Subprime Lender Funds Loans Through the Cayman Islands*, FIN. TIMES (Jan. 19, 2016), <https://ftalphaville.ft.com/2016/01/19/2150488/why-this-texas-subprime-lender-routes-loans-through-the-cayman-islands>.

160. *Id.*

161. Odinet, *Fintech Lending*, *supra* note 87, at 790–92.

162. Elevate Annual Report on Form 10-K, *supra* note 130, at 129, 146.

163. *See id.* at 129.

164. *Loan Participation*, BLACK'S LAW DICTIONARY (11th ed. 2019).

165. *See* Elevate Annual Report on Form 10-K, *supra* note 130, at 105.

166. Rory Van Loo argues that fintechs partner with banks in this way because the fintechs themselves are not able to compete with banks due to entry barriers created by the current financial regulatory environment. *See* Van Loo, *The Case of Fintech*, *supra* note 22, at 259 (“Even if the OCC does not consciously seek to protect banks from competition, it lacks the institutional

legal treatment accorded to banking institutions in order to make high-cost loans across state lines. More importantly, this is done under the mantle of fintech, which cloaks the partnership and the lending in such a way as to give it political cover. As Congressman Gregory Meeks, senior member of the House Financial Services Committee and chair of the House Subcommittee on Consumer Protection and Financial Institutions, noted in a 2019 interview: “I’m finding that a lot of these FinTechs are partnering with the small community banks. So, it helps strengthen them also and that too helps those in rural America and urban America.”<sup>167</sup>

This hypnotic effect has resulted in fintech firms receiving significant leeway from government officials, particularly financial regulators. In turn, predatory fintech firms have sought to put themselves in a position to take advantage of this enthusiasm for all things tech and, as described in this Part IV, are finding success in many regulatory circles. More broadly, these territorial battles over fintech credit have fueled a subtle but important resurgence in the age-old battle over America’s dual banking system. While predatory credit is a problem in the current moment, the outcome of this current dual banking war will have far reaching implications on consumer finance in the United States.

#### A. FINANCIAL REGULATION

The expanse of financial institution law is vast. The goal here, however, is not to cover all or even most of its terrain. Instead, this Section provides the law of these fintech-bank partnerships by first describing the regulatory environment for the parties themselves and then the murky law at their intersection.

##### 1. Bank Regulation

Within these partnerships—and within this regulatory battle—first are the banks themselves.

Much has been written about the history of banking in the United States. Since the beginning of the country, there has been a state/federal divide in

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incentive to divert its resources away from safety and soundness monitoring to developing fintech licenses.”). While this may be true for some fintech firms, for others it would seem that the ability to operate in the gap such that the fintech can take advantage of favorable federal laws aimed at banks while not themselves having to bear the regulatory burdens of being a bank is the more likely motivation. This can be buttressed, at least in part, on the fact that when a tailored charter was offered to fintechs, none applied for it. See Brendan Pedersen, *Why Is It so Hard for a Fintech to Become a Bank?*, AM. BANKER (Nov. 18, 2020, 9:30 PM), <https://www.americanbanker.com/podcast/why-is-it-so-hard-for-a-fintech-to-become-a-bank> (noting that when most fintechs are faced with the realities of what it takes to become a chartered bank, they decide they do not wish to proceed).

167. Meeks Podcast, *supra* note 97.

banking, and this divide has always been contentious.<sup>168</sup> First, a banking institution can be chartered by a state through a state banking department.<sup>169</sup> Second, a banking institution can also be chartered by the federal government through the OCC, if a national bank or savings association form is chosen, or the National Credit Union Administration, if a credit union form is selected.<sup>170</sup> Thus, there are state-chartered banks<sup>171</sup> and federally-chartered banks.<sup>172</sup> One looking to open a bank makes the choice and may choose to switch back and forth between charters.<sup>173</sup>

Then there are non-chartering federal agencies that play a regulatory role in the case of certain banks. The two main players are the Board of Governors of the Federal Reserve System (the “Federal Reserve”) and the Federal Deposit Insurance Corporation (the “FDIC”). Banks, wherever they are chartered, may be members of the FDIC and/or the Federal Reserve. When this happens, there are overlapping regulators. To remediate the multiplicity problem, one regulator is considered primary for prudential purposes.<sup>174</sup> For example, all OCC-chartered banks are primarily regulated by OCC, even though they are also Federal Reserve members and participate in the FDIC insurance program.<sup>175</sup> For state-chartered banking companies, the system is more complicated. The state chartering regulator serves an important role, but a relevant federal regulator is conventionally considered to be primary. If the state bank is FDIC-insured, but not a member of the Federal Reserve System, then the FDIC is the primary regulator.<sup>176</sup> If the state bank is a member of the Federal Reserve System and FDIC-insured, the FDIC yields to the Federal Reserve as the primary regulator.<sup>177</sup> For a state bank that is a member of neither, the state regulator is the uncontested primary regulator.<sup>178</sup>

Banking companies can also be divided into a number of different types. When it comes to the types of banking companies that take deposits from customers, there are commercial banks, savings associations (sometimes

168. Carl Felsenfeld & Genci Bilali, *Is There a Dual Banking System?*, 2 J. BUS. ENTREPRENEURSHIP & L. 30, 31 (2008). See generally ROBERT V. REMINI, ANDREW JACKSON AND THE BANK WAR: A STUDY IN THE GROWTH OF PRESIDENTIAL POWER (1967).

169. RICHARD SCOTT CARNELL, JONATHAN R. MACEY & GEOFFREY P. MILLER, THE LAW OF FINANCIAL INSTITUTIONS 90 (6th ed. 2017).

170. *Id.*

171. Felsenfeld & Bilali, *supra* note 168, at 31.

172. JACK RASMUS, ALEXANDER HAMILTON AND THE ORIGINS OF THE FED 8–9 (2019); Joseph H. Sommer, *The Birth of the American Business Corporation: Of Banks, Corporate Governance, and Social Responsibility*, 49 BUFF. L. REV. 1011, 1020 (2001); Felsenfeld & Bilali, *supra* note 168, at 36.

173. See Felsenfeld & Bilali, *supra* note 168, at 55.

174. LEVITIN, CONSUMER FINANCE, *supra* note 18, at 133–36 (discussing bank supervision).

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

called “thrifts”), and credit unions.<sup>179</sup> These institutions are the most familiar to everyday Americans because these are where savings accounts, checking accounts, and credit cards—prevalent consumer financial products and services—are often found. Then there are a number of special purpose or special status companies, such as Edge Act corporations, which are used as vehicles for foreign banking activities; limited purpose banks, such as credit card banks; community development banks, which focus on certain income-based needs; and industrial loan companies, which provide niche financial services and can more easily be owned by non-financial companies.

Each of these entities are subject, at various levels, to numerous regulatory requirements and limitations, including capital and liquidity demands, and applicable bank holding company rules.<sup>180</sup> These areas are often referred to as areas of *prudential* regulation. This means that the regulation is related to the safety and soundness of the bank itself (and, to some general degree, to the safety and soundness of the entire banking system).

In contrast to prudential regulation, consumer protection deals not with the safety and soundness (which often means profitability) of the bank, but rather how the bank treats its customers. This includes rules dealing with disclosures, communications, the transfer of consumer funds, advertising tactics, and costs, to name a few. Since 2010, the task of regulating banking consumer protection has largely fallen to the newly created Consumer Financial Protection Bureau (the “CFPB”).

## 2. NonBank Regulation

At their core, fintech firms that partner with banks to make predatory loans are simply nonbank financial companies. The term fintech merely obscures their true nature. They are, as the name “nonbank” suggests, companies that provide bank-like products and services, but are not themselves actually banks in the legal sense. The nonbanks of this Article are those that offer consumer financial products and services, rather than those engaged in commercial or corporate financial matters.<sup>181</sup>

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179. CARNELL ET AL. *supra* note 169, at 90.

180. JILL M. HENDRICKSON, REGULATION AND INSTABILITY IN U.S. COMMERCIAL BANKING: A HISTORY OF CRISES 187–94 (2011).

181. Nonbanks have garnered a great deal of attention in the past, but not the consumer finance kind. Past debates dealt with so-called *nonbank banks*. See, e.g., Marc Weinreich, *The Nonbank Bank Conundrum*, 4 ANN. REV. BANKING L. 187, 187 (1985). In that context, it was possible to be a bank for *chartering* purposes but not a bank for *Bank Holding Company Act* purposes. *Id.*; see 12 U.S.C. § 1841(c) (2018). The concept of a *nonbank bank* also arose with great controversy in connection with the Glass–Steagall Act of 1933, which was aimed, among other things, at creating a barrier between a bank’s commercial activities (normal deposits and lending) and its investment activities (trading and investing in securities). *Id.* §§ 24, 78, 377, 378; Harvey N. Bock, *The Glass–Steagall Act and the Acquisition of Member Banks by Unregulated Bank Holding Companies*, 100 BANKING L.J. 484, 485 (1983). In this case, a flurry of regulatory activity and court

The regulation of these firms is and has historically been the domain of the states.<sup>182</sup> These companies are required to be licensed by individual state financial services regulators, commissions, or departments.<sup>183</sup> Nonbanks of this type range from providers of loans, like payday lenders, to those that transmit money, like Paypal and Western Union, to check cashing companies and nonbank mortgage finance companies.<sup>184</sup> Still, others include unsecured consumer loan providers, debt collectors, loan servicing companies, and credit reporting agencies.<sup>185</sup>

The major distinction between nonbanks and banks is that the former do not have bank charters.<sup>186</sup> Also, nonbanks are typically used by individuals that are unserved or underserved by the banking sector.<sup>187</sup> Nonbanks have grown significantly over the past several years, largely driven by the movement of consumer financial products and services away from the banking sector, combined with either a distrust of the banking system stemming from 2008 (or, in the case of Black and brown Americans, because of decades of mistreatment<sup>188</sup>) or a lack of proper qualifications enabling one to seek services from it.<sup>189</sup>

Unlike with banks, nonbanks do not have a linear history. This is because while banks are rather homogenous, nonbanks are not. There are many different types. Providers of consumer loans existed all the way back to the 1800s, when sewing machines were sold on credit.<sup>190</sup> Debt collection is as old as time, but only developed as a defined sector in the 1800s.<sup>191</sup> Nonbank mortgage lenders came about during the Industrial Age when banks only made home loans to their own deposit customers, leaving many Americans to

cases attempted to draw the line (or, rather, weaken it) with respect to permissible versus impermissible securities-related activities by banks. Weinreich, *supra*, at 202; Nancy R. Guller, Note, *The Separation of Banking from Commerce: The Nonbank Bank Dilemma*, 7 ANN. REV. BANKING L. 407, 408–09 (1988).

182. CONF. OF ST. BANK SUPERVISORS, *Chapter One: Introduction to the Nonbank Industry*, in REENGINEERING NONBANK SUPERVISION 1, 1 (2019) [hereinafter *CSBS Chapter One*], [https://www.csbs.org/sites/default/files/chapter\\_one\\_-\\_introduction\\_to\\_the\\_nonbank\\_industry\\_cover\\_footer\\_1\\_v2.pdf](https://www.csbs.org/sites/default/files/chapter_one_-_introduction_to_the_nonbank_industry_cover_footer_1_v2.pdf) [<https://perma.cc/EC3A-TR5E>].

183. See, e.g., ALA. CODE § 5-19-22 (2009); OKLA. STAT. tit. 14A, § 3-503 (2017); CAL. FIN. CODE § 22112 (West 2015); LA. STAT. ANN. § 9:3558 (2009). See generally CARNELL ET AL., *supra* note 169 (describing the federalism of the regulation of banking).

184. LEVITIN, CONSUMER FINANCE, *supra* note 18, at 75–76.

185. See *CSBS Chapter One*, *supra* note 182, at 2–3.

186. *Id.* at 3.

187. *Id.*

188. See Nick Timiraos, *First Black Fed President Warns of Systemic Racism's Economic Toll*, WALL ST. J. (July 6, 2020, 4:55 PM), <https://www.wsj.com/articles/first-black-fed-president-warns-of-systemic-racisms-economic-toll-11594027802> [<https://perma.cc/PSW2-LP5A>].

189. *CSBS Chapter One*, *supra* note 182, at 2.

190. ANNE FLEMING, CITY OF DEBTORS: A CENTURY OF FRINGE FINANCE 109–10 (2018); see *CSBS Chapter One*, *supra* note 182, at 3.

191. *CSBS Chapter One*, *supra* note 182, at 3.

look elsewhere for financing.<sup>192</sup> Money transmitter companies came on the scene with the telegraph in the 1870s and then grew to provide international services in the beginning of the 1900s through the advent of the steamship.<sup>193</sup> Fintech companies are the latest iteration of nonbank consumer finance companies.

Yet, in all of these cases, the sector remained dominated by state law, primarily through licensing.<sup>194</sup> The power to engage in the licensing and regulation of nonbanks comes from the inherent police powers of the states and is an extension of a state's general authority to incorporate business entities of various types.<sup>195</sup>

Licensing and attendant laws for nonbanks are important.<sup>196</sup> They allow regulators to monitor finance companies to make sure they are operating in a safe and sound manner, and they ensure that business practices do not cause harm to consumers through either "negligence, non-compliance, or intentional" wrongdoing.<sup>197</sup> Also, because nonbanks have no deposits from which to draw upon to cover expenses, in some cases (such as with money transmitter companies) it is necessary to ensure that nonbanks have the financial wherewithal to meet their obligations to consumers.<sup>198</sup> In the lending context, state regulation ensures a fair and transparent process for consumers seeking to obtain credit.<sup>199</sup>

### 3. Partnership Regulation

When it comes to the regulation of bank-fintech partnerships, the bank versus nonbank distinction comes starkly into focus. This typology creates friction and opportunities for arbitrage when the two corporate forms intertwine their operations and activities, as here.

For the *banks*, regulation is triggered because the relationships that banks enter into with third parties have prudential implications. The performance and reputation of the third party can have an adverse effect on the bank's solvency and reputation. Likewise, the third party's performance can negatively affect how consumers are treated. *Nonbanks* are also subject to direct regulation because of the nature of their business. The players are the

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192. *Id.*

193. *Id.*

194. LEVITIN, CONSUMER FINANCE, *supra* note 18, at 75–76.

195. Susan Pace Hamill, *From Special Privilege to General Utility: A Continuation of Willard Hurst's Study of Corporations*, 49 AM. U. L. REV. 81, 93–94 (1999).

196. See generally CONF. OF ST. BANK SUPERVISORS, *Chapter Two: Overview of Nonbank Supervision*, in REENGINEERING NONBANK SUPERVISION (2019) (summarizing nonbank supervision for stakeholders and state supervisors).

197. *Id.* at 3.

198. *Id.* at 6.

199. *Id.*

CFPB, the federal prudential banking regulators, and the state licensing regulators.

It's helpful to address the CFPB's authority in this area first. It is perhaps the most statutorily complicated and doing so first will help explain why it is not best suited to address this issue in the short term. The CFPB's regulatory involvement in these partnerships comes in three forms. First, the CFPB has the power to issue regulations under a number of federal consumer protection laws, such as the Fair Credit Reporting Act, the Equal Credit Opportunity Act, and the Fair Debt Collection Practices Act.<sup>200</sup> As I've written before,<sup>201</sup> fintech firms (and their bank partners) engage in various activities, ranging from servicing loans to collecting debts to running credit scores, any one of which makes them subject to these various laws, and thus the CFPB's rulemaking authority. The CFPB can also issue regulations under its broad ability to police *covered persons*<sup>202</sup> when they engage in unfair, deceptive, or abusive acts and practices ("UDAAP").<sup>203</sup> Fintech firms that partner with banks are considered *covered persons* in a number of ways. First, they service extensions of credit because they collect payments and handle loan administration even after the loan itself is sold or securitized.<sup>204</sup> Second, the fintech company could be considered to broker the loan since it acts as an intermediary between the consumer and the bank.<sup>205</sup> Lastly and more indirectly, since the fintech company handles marketing, application intake, and underwriting, it is also a "service provider" to a covered person,<sup>206</sup> since the bank itself is considered a covered person because it originates the loan.<sup>207</sup>

The CFPB also has the power to bring enforcement actions against: (i) those subject to the various consumer financial laws, (ii) covered persons and their service providers for UDAAP violations, and (iii) those that provide substantial assistance related to UDAAP violations. This enforcement power is the compliment to the rulemaking authority described above—the bureau can both interpret the relevant laws through rulemaking and enforce them against violators, including both fintech firms and their bank partners.

Lastly, the CFPB has what is known as supervisory authority. This means the agency has the right to monitor and inspect the operations and records of certain entities to ensure compliance with federal consumer protection

200. 12 U.S.C. § 5481(12) (2018) (listing the 18 "enumerated consumer laws").

201. Odinet, *Fintech Lending*, *supra* note 87, at 787–88.

202. The bureau's UDAAP regulatory authority can only be exercised against "covered person[s]." 12 U.S.C. § 5481(6) (providing a definition of firms that are covered); *see also id.* § 5481(5), (15) (defining "consumer financial product or service," and "financial product or service").

203. *Id.* § 5531.

204. *See id.* § 5481(15)(A)(i). If the fintech lender makes the loan directly, then it is covered persons by virtue of itself extending credit. *Id.*

205. *See id.*; *Broker*, BLACK'S LAW DICTIONARY (11th ed. 2019).

206. *See* 12 U.S.C. § 5481(26)(A).

207. *See id.* § 5481(15)(A)(i).

laws.<sup>208</sup> If the CFPB sees something that appears to violate those laws, it can issue a confidential warning to the institution, which usually results in swift action in order to avoid public enforcement. However, this supervisory power is limited when it comes to banks. The CFPB cannot supervise depository institutions that have less than \$10 billion dollars.<sup>209</sup>

Next are the federal prudential regulators, which have significant authority to police these partnerships because of their power over the partnering banks themselves.<sup>210</sup> Like the CFPB, bank regulators have supervisory authority over their respective banking institutions that allows them to conduct wide-ranging examinations. Typically, each bank is given a full-scope, on-site examination on an annual basis by its applicable prudential regulator.<sup>211</sup> During this time, the examiners take a hard look at the bank's records, policies, and procedures, and then the bank is given a CAMELS score using a system that factors in the firm's capital, assets, management, earnings, liquidity, and exposure to market risk.<sup>212</sup> Bank regulators can also factor in any other considerations "that bear[] significantly on the [bank's] overall condition."<sup>213</sup> In sum, the regulator examines the bank and makes a determination, with significant discretion, as to its safety and soundness.

Part of this safety and soundness supervisory power includes the "authority to supervise third-party servicers that enter into contractual arrangements with" banks, including those that provide technological services.<sup>214</sup> The scope of what constitutes a technology service provider is broad. The definition encompasses firms that provide "core processing; information and transaction processing" related to a host of banking functions, including lending.<sup>215</sup> Thus, it easily covers the fintech nonbanks with which banks partner.

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208. See LEVITIN, CONSUMER FINANCE, *supra* note 18, at 136–38.

209. See 12 U.S.C. § 5515(a)(1).

210. For a discussion of prudential supervision, see MICHAEL P. MALLOY, § 1B.01 *Survey of Regulators*, in *BANKING LAW & REGULATION* (2d ed. 2021). See generally David Beam & Margaux Nair, *Finding the Right Prudential Regulatory Regime for Digital Currency Service Providers*, FINTECH L. REP., Nov./Dec. 2014, at 20 (explaining prudential regulation and the various approaches).

211. See 12 U.S.C. § 481 (describing the OCC's authority to examine national banks); see also *id.* § 483 (describing the Federal Reserve's authority to examine state-chartered, noninsured member banks); *id.* § 1820(b)(2)(A) (describing the FDIC's authority to examine state-chartered, insured member banks).

212. See Uniform Financial Institutions Rating System, 61 Fed. Reg. 67,021, 67,022 (Dec. 19, 1996).

213. *Id.* at 67,025.

214. *Supervision of Technology Service Providers*, FFIEC IT EXAMINATION HANDBOOK INFOBASE, <https://ithandbook.ffiec.gov/it-booklets/supervision-of-technology-service-providers/introduction.aspx> [https://perma.cc/QG8Y-4L4C] (citing 12 U.S.C. §§ 1464(d)(7), 1867(c)(1)).

215. FED. FIN. INSTS. EXAMINATION COUNCIL, RISK MANAGEMENT OF OUTSOURCED TECHNOLOGY SERVICES 1 n.2 (2000) [hereinafter *OUTSOURCED TECHNOLOGY SERVICES*], [https://www.ffiec.gov/PDF/pr112800\\_guidance.pdf](https://www.ffiec.gov/PDF/pr112800_guidance.pdf) [https://perma.cc/P63Q-AR47]; see also BD. OF GOVERNORS OF THE FED. RESRV. SYS., GUIDANCE ON MANAGING OUTSOURCING RISK 2 (2013),

Examination guidance makes clear that just because a bank uses a third-party technology service provider<sup>216</sup> does not mean that the bank's responsibility to ensure that "activities are conducted in a safe and sound manner and in compliance with applicable laws and regulations" is diminished; rather the same standards are applied "just as if the institution were to perform the activities in-house."<sup>217</sup> Moreover, a bank must conduct a risk assessment before entering into any kind of third-party relationship to determine whether outsourcing "may be inconsistent with the institution's strategic plans, too costly, or introduce unforeseen risks."<sup>218</sup>

In the fintech context, this means that banks are not allowed to offload their legal responsibilities to the third parties with whom they contract. When it comes to underwriting and targeting consumers (the chief functions of fintech partners), banks must exercise significant oversight, including "risk assessments and robust due diligence for the selection of [the third party], contract development, and ongoing monitoring of [the third party's] performance."<sup>219</sup> Importantly, banks must audit their service providers periodically to monitor and correct risk problems.<sup>220</sup> Additionally, the relevant banking regulator has the authority to directly examine the third-party service provider,<sup>221</sup> which is done on a 24-, 36-, or 48-month cycle, depending on the company's risk assessment.<sup>222</sup> In essence, banks must serve as what Rory Van Loo describes as "regulatory gatekeepers," because the

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<https://www.federalreserve.gov/supervisionreg/srletters/sr1319a1.pdf> [<https://perma.cc/M6B6-3U5C>] ("[S]ervice providers' is broadly defined to include all entities that have entered into a contractual relationship with a financial institution to provide business functions or activities." (footnote omitted)).

216. See *Outsourcing Technology Services*, FFIEC IT EXAMINATION HANDBOOK INFOBASE, <https://ithandbook.ffiec.gov/it-booklets/outsourcing-technology-services/introduction.aspx> [<https://perma.cc/L6ME-VXLX>].

217. FED. FIN. INSTS. EXAMINATION COUNCIL, SUPERVISION OF TECHNOLOGY SERVICE PROVIDERS 1 (2012) [hereinafter *TECHNOLOGY SERVICE PROVIDERS*], [https://ithandbook.ffiec.gov/media/274876/ffiec\\_itbooklet\\_supervisionoftechnologyserviceproviders.pdf](https://ithandbook.ffiec.gov/media/274876/ffiec_itbooklet_supervisionoftechnologyserviceproviders.pdf) [<https://perma.cc/6W2S-6AW6>].

218. OUTSOURCED TECHNOLOGY SERVICES, *supra* note 215, at 1.

219. TECHNOLOGY SERVICE PROVIDERS, *supra* note 217, at 1.

220. *Id.* at 10.

221. 12 U.S.C. § 1867(c)(1) (2018) ("[W]henever a depository institution that is regularly examined by an appropriate Federal banking agency . . . causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises . . . such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the depository institution itself on its own premises."); see also *id.* § 1464(d)(7) (providing for the "[r]egulation and examination of savings association service companies, subsidiaries, and service providers").

222. TECHNOLOGY SERVICE PROVIDERS, *supra* note 217, at 8.

regulator assigns the regulated entity with the duty to itself regulate other market actors.<sup>223</sup>

Technology service providers, like fintech nonbank partners, are supposed to be examined on a number of bases.<sup>224</sup> The most important is to determine the company's *operational risk* as it deals with the bank partner. This relates to the failure or inadequacy of the company's internal systems or processes, as well as employee misconduct or mistakes and the effects of adverse external events.<sup>225</sup> *Reputational risk* is also an issue because negative public perception of the service provider can affect the reputation of the bank that partners with it, thus harming the ability of the bank to provide services to its customers.<sup>226</sup> *Strategic risk* refers to instances where the third party furnishes the bank with inaccurate information, which in turn results in the bank making bad strategic choices.<sup>227</sup> *Legal risk* is particularly important in the fintech-bank partnership model. This refers to instances where the third party fails to abide by the appropriate legal requirements for doing business or specifically in furnishing the services, thereby exposing the bank to litigation or liability more broadly.<sup>228</sup> And lastly is *market risk*, which can deal with credit, interest rates, liquidity, and price concerns.<sup>229</sup> For example, if the fintech prices a loan incorrectly in its underwriting, this could result in harm to the bank if the loan defaults before the bank is able to sell it to someone else.

Lastly are the state regulators. They occupy an interesting position because they are in theory very powerful, but can often be very weak in practice. They benefit from significant legal powers, some stemming from state laws and some from federal laws.<sup>230</sup> As noted above, fintech nonbanks must typically obtain a license to do business.<sup>231</sup> Aside from the granting of

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223. Rory Van Loo, *The New Gatekeepers: Private Firms as Public Enforcers*, 106 VA. L. REV. 467, 485–87 (2020) (summarizing bank regulators' mandates to police contractual parties for consumer protection violations).

224. TECHNOLOGY SERVICE PROVIDERS, *supra* note 217, at 8–9.

225. *Id.*

226. *Id.*

227. *Id.*

228. *Id.*

229. *Id.*

230. For a discussion of state financial supervisors and their statutory powers, see Seth Frotman, *Reimagining State Banking Regulators: How the Principles Underlying the Consumer Financial Protection Bureau Can Serve as a Blueprint for a New Regulatory Federalism*, 72 ME. L. REV. 241 (2020), <https://digitalcommons.maine.edu/cgi/viewcontent.cgi?article=1733&context=mlr> [<https://perma.cc/95MB-H2GX>]. Provisions of the Dodd–Frank Act also empower these state officials to enforce certain federal laws. See 12 U.S.C. § 5552(a)(1) (2018).

231. Odinet, *Fintech Lending*, *supra* note 87, at 812.

the license,<sup>232</sup> most state regulators have supervisory powers<sup>233</sup> like those of the bank regulators, although the scope of that supervisory authority can vary among jurisdictions. Examinations, like in the banking context, are meant to ensure that there are no violations of the licensing laws, which would include analyzing whether the nonbank lacks<sup>234</sup> “the financial responsibility, experience, character, and general fitness” to engage in the regulated activity.<sup>235</sup> This can lead to suspension or revocation of the license, as well as the imposition of fines.<sup>236</sup>

Aside from these state law powers, state financial regulators also can enforce both the CFPB’s UDAAP regulations and all the federal consumer financial laws with respect to the firms they license.<sup>237</sup> Thus, through federal law, these state regulators have significant tools at their disposal when it comes to enforcement.

The weakness of state regulators, however, is that they are not always well-staffed or resourced. Some receive financial support from their legislatures, while others support themselves only from the fees paid by the licensed entities. In both cases the amounts can vary widely. While the staff of the New York Department of Financial Services is very large and its resources are robust, agencies in places like Louisiana and Oklahoma are relatively small.<sup>238</sup>

#### B. *REGULATORY ARBITRAGE*

Despite arguments to the contrary, the primary motivation for these partnerships is to take advantage of regulatory arbitrage—operating in such a way as to take maximum advantage of regulatory loopholes, usually at the

232. See, e.g., IOWA CODE § 536.4 (2019) (describing the application, grant or refusal of lending licenses); ALASKA STAT. § 06.20.060 (2018); ARK. CODE ANN. § 23-39-505 (West 2012); CONN. GEN. STAT. ANN. § 36a-565 (West 2020); FLA. STAT. ANN. § 516.05 (West 2019); N.H. REV. STAT. ANN. § 399-A:5 (LexisNexis 2020).

233. See, e.g., IOWA CODE § 536.10 (“For the purpose of discovering violations of this chapter or securing information lawfully required by the superintendent, the superintendent may at any time . . . investigate the loans and business and examine the books, accounts, records, and files of every licensee and of every person engaged in the business described in section 536.1 . . .”); *id.* § 537.2305 (“[T]he licensing authority may at any time investigate the loans, business, and records of any lender.”); ALASKA STAT. § 06.01.010; ARIZ. REV. STAT. ANN. § 6-125 (2020); DEL. CODE ANN. tit. 5, § 127 (West 2020); MASS. GEN. LAWS. ch. 167, § 2 (2016); NEV. REV. STAT. ANN. § 658.101 (LexisNexis 2020); OKLA. STAT. tit. 6, § 209 (2019); 19 R.I. GEN. LAWS ANN. § 19-14-23 (West 2016).

234. See, e.g., IOWA CODE § 536.9.

235. *Id.* § 536.4(2).

236. *Id.* § 536.9(2).

237. 12 U.S.C. § 5552(a)(1) (2018).

238. Compare *Our History*, N.Y. DEP’T OF FIN. SERVS., [https://www.dfs.ny.gov/our\\_history](https://www.dfs.ny.gov/our_history) [<https://perma.cc/A76P-UXHF>], with *About OFI*, LA. OFF. OF FIN. INST., <http://www.ofi.state.la.us> [<https://perma.cc/T94N-ZESC>], and *About Us*, OKLA. DEP’T OF CONSUMER CREDIT, [https://www.ok.gov/okdocc/About\\_Us/index.html](https://www.ok.gov/okdocc/About_Us/index.html) [<https://perma.cc/M53P-VYEX>].

expense of consumers.<sup>239</sup> This practice raises significant dual banking challenges because of the intersection of banks and nonbanks and the dividing lines between states and the federal government and between prudential regulation and consumer protection. The prior Section outlined these complicated divisions inherent in the dual banking system. The Section that follows explains how the gaps and gores in financial regulation allow predatory fintech lending to escape or effect a work-around to much of the regulatory framework.

### 1. Usurious Loans

The first reason, and indeed the most significant reason, that fintech nonbank firms and state-chartered banks partner has to do with the interest and fees charged on loans (i.e., usury).<sup>240</sup> Avoiding usury laws is at the heart of these partnerships.

With some exceptions, states set the rules on usury.<sup>241</sup> Indeed, there is no general, federal usury law, and, importantly for our purposes, Congress specifically prohibited the CFPB from creating one when the agency was formed in 2010.<sup>242</sup> The result of state dominance in the area of usury is that each state has its own set of general rules, exceptions, and special one-offs when it comes to how much can be charged for the benefit of borrowing money. There is usually a general rule for all loans, followed by various special rules for certain kinds of loans and certain kinds of lenders.<sup>243</sup>

If a company only lends money in a single state, then compliance is not terribly complicated. If a lender makes loans in multiple states, then abiding by each state's individual usury rule can become a challenge. Indeed, the variance can be quite significant. Colorado allows loans as high as 45 percent,<sup>244</sup> while Virginia caps loans at six percent.<sup>245</sup>

This is where the fintech-bank partnership and regulatory arbitrage come into play.

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239. See *AT&T Commc'ns of Cal., Inc. v. Pac-W. Telecom, Inc.*, 651 F.3d 980, 984 (9th Cir. 2011); Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 236 (2010); Erik F. Gerding, *Bank Regulation and Securitization: How the Law Improved Transmission Lines Between Real Estate and Banking Crises*, 50 GA. L. REV. 89, 107 (2015).

240. *Usury*, BLACK'S LAW DICTIONARY (11th ed. 2019).

241. See LEVITIN, CONSUMER FINANCE, *supra* note 18, at 458–59; CHARLES R. GEISST, BEGGAR THY NEIGHBOR: A HISTORY OF USURY AND DEBT 7 (2013); BRIAN M. MCCALL, THE CHURCH AND THE USURERS: UNPROFITABLE LENDING FOR THE MODERN ECONOMY 73 (2013); Brian M. McCall, *Learning from Our History: Evaluating the Modern Housing Finance Market in Light of Ancient Principles of Justice*, 60 S.C. L. REV. 707, 711 (2009).

242. LEVITIN, CONSUMER FINANCE, *supra* note 18, at 461; see 12 U.S.C. § 5517(0).

243. For a discussion of usury law's statutory construction, see Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1138–48 (2008).

244. COLO. REV. STAT. ANN. § 5-12-103 (West 2019).

245. VA. CODE ANN. § 6.2-301 (West 2010).

In what has become a famous (or perhaps infamous) case in banking and financial law, in *Marquette National Bank of Minneapolis v. First of Omaha*, the U.S. Supreme Court interpreted the National Bank Act as giving nationally-chartered banks the ability to charge the highest interest rate allowed in the state where the bank is located to borrowers located not only *in that state* but also to borrowers located *in any other state*.<sup>246</sup> This means, for instance, that a national bank located in Iowa can not only charge the highest interest rate allowable in Iowa to anyone located in Iowa, but it can also charge that same Iowa state law rate to a borrower located in Oklahoma, Louisiana, or any other state.<sup>247</sup> Even if Louisiana, Oklahoma, or another state's laws prohibit interest at such a rate, the loan is nevertheless free from being usurious. This concept has become known as "interest rate exportation."<sup>248</sup>

After *Marquette*, in yet another dual banking row, states started enacting "parity laws" that allowed their state-chartered banks to charge the maximum rates of interest allowable by any national bank "doing business" in that particular state.<sup>249</sup> In doing so, the state's usury law was thrown out the window when it came to state-chartered banks. For example, though the statutory usury limit for an Iowa state bank might be 11 percent, if a national bank making loans in Iowa could charge 23 percent (because of interest rate exportation under *Marquette*), then the Iowa state bank could similarly charge 23 percent. The goal of these parity laws was to put state banks on equal footing with national banks when it came to usury.<sup>250</sup> In a final effort to give state-chartered banks a competitive edge, in 1980 Congress passed the Depository Institutions Deregulation and Monetary Control Act.<sup>251</sup> A portion of this law granted interest rate exportation abilities to any state-chartered financial institution that was federally insured (in other words, to all FDIC-insured state-chartered banks).<sup>252</sup> This allowed a state-chartered bank to charge out-of-state borrowers the same interest rate allowable for in-state

246. See *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314-18 (1978).

247. See CARNELL ET AL., *supra* note 169, at 499-502.

248. MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, *FINANCIAL REGULATION: LAW AND POLICY* 133 (2d ed. 2018).

249. LEVITIN, *CONSUMER FINANCE*, *supra* note 18, at 468.

250. *Id.*

251. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132.

252. 12 U.S.C. § 1831d(a) (2018); *Greenwood Tr. Co. v. Massachusetts*, 971 F.2d 818, 827 (1st Cir. 1992) (upholding the statute's conferral of interest rate exportation powers over state-chartered banks); BARR ET AL., *supra* note 248, at 126-27. The 1980 legislation actually gives state-chartered, FDIC-insured banks a choice to charge the greater of: (i) the maximum rate allowed in the state in which the bank is located or (ii) one percent above the Federal Reserve 90-day commercial paper discount rate for the relevant Federal Reserve District where the bank is located. 12 U.S.C. § 1831d(a).

borrowers.<sup>253</sup> Thus, today, a state-chartered bank located in Iowa can charge an Oklahoma borrower the Iowa-stipulated interest rate, even if that rate is higher than what would otherwise be allowed under Oklahoma law. By the end of the twentieth century, when it came to *bank lending*, any semblance of a robust system of usury rules had been eliminated.<sup>254</sup>

The ability to export the interest rates of one state (up to the amount allowed for national banks located in that state) to credit products offered in other states is at the heart of the predatory fintech lending model. Fintech companies are nonbank firms, *which are still subject to state usury laws*. Fintechs are not free to uniformly make high-cost loans online and across state lines in contravention of the decisions of state legislatures about the proper and safe cost of borrowing. But, partnerships with banks located in states with generous or no usury limits allow for nonbank fintech firms to get around these limitations.<sup>255</sup> The fintech firm handles the marketing, application intake, and credit underwriting, while the bank does the loan origination. The business model and structure are meant to give the loan the FDIC interest rate benefit, but the marketing, technology, and credit administration of the nonbank fintech firm—all without the need to worry about important state consumer finance law aimed at preventing high-cost, dangerous lending.

## 2. Unlicensed Lenders

Another motivation driving these partnerships, that again raises unique dual banking issues, deals with state licensing. As noted in Section IV.A.2, nonbanks that provide consumer financial products and services are required to be licensed by individual state financial services regulators.<sup>256</sup> Thus, if a fintech credit firm intends to originate loans itself, then it must obtain a license to do so in each state where it seeks to do business.<sup>257</sup>

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253. The title V preemption provisions of DIDMCA were actually quite a bit more complicated and did not completely preempt state laws in all cases. For a discussion, see generally Donna C. Vandenberg, *Usury Ceilings and DIDMCA*, 9 ECON. PERSPS., Sept./Oct. 1985, at 25.

254. LEVITIN, CONSUMER FINANCE, *supra* note 18, at 468–69.

255. *WebBank and Alt Lending's 'Perfect Storm'*, PYMNTS.COM (Dec. 15, 2015), <https://www.pymnts.com/news/2015/webbank-and-alt-lendings-perfect-storm> [<https://perma.cc/6NGQ-DQ69>]; Telis Demos & Peter Rudegeair, *Behind the Boom in Online Lending: A Tiny Utah Bank*, WALL ST. J. (Dec. 13, 2015, 5:47 PM), <https://www.wsj.com/articles/behind-the-boom-in-online-lending-a-tiny-utah-bank-1450046828> [<https://perma.cc/H3JZ-CV9J>]. See generally Susie Cagle, *Would You Take Out a Loan for a Pair of Jeans?*, RACKED (Nov. 29, 2017, 10:00 AM), <https://www.racked.com/2017/11/29/16710502/affirm-loan-shopping> [<https://perma.cc/F696-DJ3A>] (describing Cross River Bank's relationship with the fintech lending company Affirm).

256. See, e.g., ALA. CODE § 5-19-22 (2020); OKLA. STAT. ANN. tit. 14A, § 3-503 (West 2017); LA. STAT. ANN. § 9:3558 (2009); CAL. FIN. CODE § 22112 (West 2015). See generally CARNELL ET AL., *supra* note 169 (describing the federalism of the regulation of banking).

257. Odinet, *Fintech Lending*, *supra* note 87, at 812.

The fintech lending community opposes licensure requirements.<sup>258</sup> Making loans throughout the United States and over the internet can mean that the fintech must be licensed in each state. The fintech-bank partnership business model is designed, in part, to avoid multi-state licensing. Under the partnership model, the fintech credit firm handles the loan application and underwriting, but the partner bank is the party that originates the loan. In form, the entity originating the loan is indeed the *bank*, not the *nonbank* fintech firm. State licensing rules do not apply to state banks because they are otherwise already chartered by a single state under a different legal regime altogether. As such, and because of their support role, many fintechs have argued that they do not need to be licensed (and are thus not subject to supervision) by any state regulator because they are not originating the loan.<sup>259</sup> Instead, they claim their role is relegated to merely assisting the originator (the state bank) by providing tech-related support—which, as noted in Section IV.A.3, is already subject to third-party bank regulation.

This argument is very important to nonbank fintech credit firms (and, indirectly, their bank partners) because lending without a license can have significant consequences. For example, in many states a loan made by an unlicensed lender is void.<sup>260</sup> In other states, the loan remains enforceable, but the interest rate is changed to what is allowable for unlicensed lending or the terms are otherwise modified to reduce the amount collectable.<sup>261</sup> Thus, the partnership, at least facially, allows both the nonbank fintech firm and the bank to avoid these state law licensing regimes.

258. See Gregory Hesse, *Clearing a Path for Fintechs to Navigate Through the State Licensing*, PAYMENTS JOURNAL (Feb. 28, 2018), <https://www.paymentsjournal.com/clearing-path-fintechs-navigate-state-licensing> [<https://perma.cc/YKJ2-BYES>].

259. See, e.g., Press Release, Consumer Fin. Prot. Bureau, Consumer Financial Protection Bureau Settles Lawsuit Against Think Finance Entities (Feb. 5, 2020), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-settles-lawsuit-against-think-finance-entities> [<https://perma.cc/42SW-JH44>] (describing settlement with prominent fintech that operated without a license in certain states in connection with its partnership with tribal lending companies); see also Scott A. Cammarn, Jonathan Watkins & Marshall G. Jones, *Marketplace Lending #8: Colorado Scores in Madden 2020*, NAT'L L. REV. (June 24, 2020), <https://www.natlawreview.com/article/marketplace-lending-8-colorado-scores-madden-2020> [<https://perma.cc/HRH5-2HJK>] (detailing a case holding that loans to Colorado consumers originated by an out-of-state bank are subject to Colorado's usury rate).

260. CAL. FIN. CODE §§ 22100(a), 22750(b) (West 2015); see ARIZ. REV. STAT. ANN. §§ 6-601(5)-(7), 6-602(B), 6-603(A), 6-613(B) (2019); IND. CODE ANN. §§ 24-4.5-5-202, 24-4.5-3-502(3) (LexisNexis 2018); MASS. GEN. LAWS ch. 140, §§ 96, 110 (2017); N.H. REV. STAT. ANN. §§ 399-A:1, 399-A:2(I), (IV) (LexisNexis 2020); N.Y. BANKING LAW §§ 340, 355 (LexisNexis 2018); N.C. GEN. STAT. § 53-166(a), (d) (2019); Bunch v. Terpenning, 2009 OK 106, ¶ 19, 229 P.3d 574, 580 (interpreting a prior version of, but similar to existing, OKLA. STAT. ANN. tit. 14A, § 3-502); Complaint at 6, CFPB v. CashCall, Inc., No. 1:13-cv-13167 (D. Mass. Dec. 16, 2013), [https://files.consumerfinance.gov/f/201312\\_cfpb\\_complaint\\_cashcall.pdf](https://files.consumerfinance.gov/f/201312_cfpb_complaint_cashcall.pdf) [<https://perma.cc/HR38-D8S9>] (collecting statutory citations).

261. COLO. REV. STAT. ANN. §§ 5-5-201(1), 5-2-301(1)(a), (b), 5-1-301(17) (West 2019).

### 3. Opaque Operations

There is also something noteworthy about the actual “banks” with which predatory fintech credit firms routinely partner in terms of the types of charters they receive and the way they conduct their lending operations. First, as a matter of form, these entities consist almost exclusively of *state-chartered commercial banks* and *industrial loan companies/banks*. As described in this Section, these banks *look* different than traditionally conceived banks and this bears on the dual banking system and its regulatory architecture.<sup>262</sup>

Industrial loan companies (sometimes called industrial loan banks) merit special discussion because they are a favorite in these fintech-bank partnerships. The origins of industrial loan banks are rather obscure. They first appeared in the early part of the twentieth century as small financial institutions that were created by individual states.<sup>263</sup> The primary purpose was to make unsecured loans to low- and moderate-income individuals, largely for industrial workers (as the name suggests) who were unable to access credit from banks.<sup>264</sup>

Over time, however, commercial banks, savings associations, and credit unions supplanted industrial loan banks as the primary providers of consumer credit. In the modern era, industrial loan banks have mostly been used as a way for nonfinancial firms, such as automobile and other manufacturing companies, to offer banking-like services such as credit to customers, without being subject to the panoply of regulations for full-fledged commercial banks.<sup>265</sup> Industrial loan banks have otherwise since faded into obscurity over the decades—until fintech brought them back.

Because industrial loan banks are creatures of state law, each state can place specific restrictions on their activities.<sup>266</sup> Today, only six states charter industrial loan banks—Hawaii, Indiana, Minnesota, Utah, California, and

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262. See generally MEHRSA BARADARAN, *HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY* (2015) (explaining the many ways banks enjoy significant public support in exchange for the historical obligation to serve society).

263. See Kenneth Spong & Eric Robbins, *Industrial Loan Companies: A Growing Industry Sparks a Public Policy Debate*, FED. RSRV. BANK OF KAN. CITY ECON. REV., Fourth Quarter 2007, at 41, 42–43, <https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.360.9728&rep=rep1&type=pdf> [<https://perma.cc/42MR-AKPP>].

264. See Marvin Holz, *The Regulation of Consumer Credit*, 1943 WIS. L. REV. 449, 451–53.

265. The most controversial industrial loan bank activity has come in recent times from Wal-Mart and Home Depot, with the attempts of both companies being squashed by opponents that argued allowing the two retail giants to obtain industrial loan banks would cause too many conflicts of interest. Nevertheless, many recognizable names in the American economy own industrial loan banks, such as Toyota, Target, Harley-Davidson, General Electric, General Motors, and American Express. See JAMES R. BARTH, TONG LI, APANARD ANGINAND, YUAN-HSIN CHIANG & LI LI, MILKEN INST., *INDUSTRIAL LOAN COMPANIES: SUPPORTING AMERICA'S FINANCIAL SYSTEM* 4–5 (2011) [hereinafter MILKEN INST.], <https://assets1b.milkeninstitute.org/assets/Publication/ResearchReport/PDF/ILC.pdf> [<https://perma.cc/WS6U-9388>].

266. See Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539, 1547 (2007).

Nevada.<sup>267</sup> Most industrial loan banks, however, are chartered in Utah, making it the most important state for these types of financial entities. Utah currently has 15 active industrial banks, all of which are insured by the FDIC and thereby enjoy preemption of state usury law, as described in Section IV.B.1. A number of these banks are the most egregious and chronic partners in predatory fintech schemes.<sup>268</sup>

Aside from industrial loan companies, there are also a number of state-chartered commercial banks partnering with nonbank fintechs. Here again, most are chartered in Utah, with some exceptions. Non-Utah state banks that are active in fintech lending activities include Republic Bank, a Kentucky state-chartered commercial bank, and Cross River Bank, a New Jersey state-chartered commercial bank.<sup>269</sup>

Table 3 shows state-chartered financial institutions (most of which are industrial loan companies) and their nonbank fintech partners, along with APR<sup>270</sup> information on their credit products. The superscript <sup>NM</sup> indicates that the entity is not a member of the Federal Reserve system, and thus is not subject to that agency's prudential regulatory authority. All of these entities, however, are insured by the FDIC, thereby (as explained in Section IV.A.1) making the FDIC the primary prudential regulator.

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267. See MILKEN INST., *supra* note 265, at 2–3.

268. See *Industrial Banks*, UTAH DEP'T OF FIN. INSTS., <https://dfi.utah.gov/financial-institutions/industrial-banks> [<https://perma.cc/4RM2-8SXX>].

269. See *infra* Table 3.

270. APR stands for annual percentage rate. It is an expression of the total cost of credit on an annualized basis. See *Interest Rate*, BLACK'S LAW DICTIONARY (11th ed. 2019). The rules for how to calculate APR and when it must be disclosed to a borrower are contained primarily in the Truth in Lending Act and its Regulation Z. See 15 U.S.C. §§ 1601–1603r (2018); 12 C.F.R. §§ 1026.1–1026.61 (2020).

Table 3. Fintech and Bank Partners; Cost of Credit Information

State-Chartered Partner	Fintech Firm Partner	Credit Product APR
Celtic Bank <sup>NM</sup> (UT)	Lending Club	8.05–35.89% <sup>271</sup>
	Prosper	7.95–35.99% <sup>272</sup>
	Avant	9.95–35.99% <sup>273</sup>
First Electronic Bank <sup>NM</sup> (UT)	Personify Financial	35–199.99% <sup>274</sup>
Republic Bank & Trust Co. <sup>NM</sup> (KY)	Elastic (Elevate Credit)	Up to 109% <sup>275</sup>
	NetCredit (Enova Int'l)	34–155% <sup>276</sup>
WebBank <sup>NM</sup> (UT)	Avant	9.95–35.99% <sup>277</sup>
	DigniFi	9.99–36.00% <sup>278</sup>
	Fingerhut	29.99% <sup>279</sup>
	Gettington	29.99% <sup>280</sup>
	Klarna	19.99% <sup>281</sup>
	Lending Club	8.05–35.89% <sup>282</sup>
	Petal	12.99–29.49% <sup>283</sup>
	Prosper	7.95–35.99% <sup>284</sup>
	Upgrade	6.94–35.97% <sup>285</sup>
	Zero	24.99% <sup>286</sup>

271. *Rates and Fees for Personal Loans*, LENDINGCLUB, <https://help.lendingclub.com/hc/en-us/articles/214463677-Rates-and-fees-for-personal-loans> [<https://perma.cc/7CC5-Q426>].

272. *Personal Loans*, PROSPER, <https://www.prosper.com/personal-loans> [<https://perma.cc/CM45-Y9GP>].

273. AVANT, <https://www.avant.com> [<https://perma.cc/WKX9-Y7RP>].

274. *Rates, Terms and Licensing Information*, PERSONIFY FIN., <https://www.personifyfinancial.com/rates-terms-and-licensing-information> (last visited Mar. 29, 2021) (range calculated based on each state's APR).

275. Elevate Credit, Inc., Quarterly Report (Form 10-Q), at 46 (Aug. 9, 2019), <https://www.sec.gov/Archives/edgar/data/1651094/000165109419000048/elevate10-qxq22019.htm> [<https://perma.cc/372W-656K>].

276. *Rates & Terms*, NETCREDIT, <https://www.netcredit.com/rates-and-terms> [<https://perma.cc/2SjX-VG67>] (range calculated based on each state's APR).

277. AVANT, *supra* note 273.

278. DIGNIFI, <https://www.dignifi.com> [<https://perma.cc/5HXA-UYUB>].

279. *Apply for Your Fingerhut Credit Account*, FINGERHUT, <https://www.fingerhut.com/creditApp> [<https://perma.cc/74JW-3UKK>].

280. *Online Consent for Electronic Disclosures*, GETTINGTON (Mar. 16, 2020), <https://www.gettington.com/content/TermsandConditions> [<https://perma.cc/GD2V-E2X3>].

281. *What Is Financing and How Does It Work?*, KLARNA, <https://www.klarna.com/us/customer-service/what-is-financing-and-how-does-it-work> [<https://perma.cc/Q9L8-S8WJ>].

282. *Rates and Fees for Personal Loans*, *supra* note 271.

283. PETAL, <https://www.petalcard.com> [<https://perma.cc/K4HZ-JU5P>].

284. *Personal Loans*, *supra* note 272.

285. *What Products are Available Through Upgrade?*, UPGRADE, <https://upgrade.zendesk.com/hc/en-us/articles/115004183027-What-products-are-available-through-Upgrade> (last visited Mar. 29, 2021).

286. ZERO CARDHOLDER AGREEMENT, ZERO 1 (Mar. 19, 2020), <https://zero.app/zerocard->

State-Chartered Partner	Fintech Firm Partner	Credit Product APR
Cross River Bank <sup>NM</sup> (NJ)	Affirm	0–30% <sup>287</sup>
	Best Egg	5.99–29.99% <sup>288</sup>
	FreedomPlus	7.99–29.99% <sup>289</sup>
	Rocket Loans	7.161–29.99% <sup>290</sup>
	Upstart	8.94–35.99% <sup>291</sup>
FinWise Bank <sup>NM</sup> (UT)	Rise (Elevate Credit)	60–299% <sup>292</sup>
	Opportunity Loans	59–160% <sup>293</sup>
Capital Community Bank <sup>NM</sup> (UT)	Today Card (Elevate Credit)	32.25% <sup>294</sup>

As Table 3 shows, some of these partnerships result in very high-cost lending—including Elevate Credit’s partnership described in Part III. Take, for example, the partnership between the online lender, Opportunity Financial, and FinWise Bank. Opportunity Financial, a so-called “leading socially responsible online lender and one of the fastest-growing organizations in the FinTech space today,”<sup>295</sup> offers \$500 to \$4000 loans up to 160 percent APR in California and Arizona.<sup>296</sup> As an illustration, one consumer advocacy group found that a \$3,000 Opportunity Financial loan for 12 months would require a total repayment of \$6,175.20.<sup>297</sup> Such a rate would be illegal under the laws of both Arizona.<sup>298</sup> However, OppLoans partners with Utah-chartered

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agreement [<https://perma.cc/3AZA-8WMZ>].

287. *Here’s What Customers Will Pay*, AFFIRM, <https://www.affirm.com/business/apr-calculator> [<https://perma.cc/WF3N-R2KZ>].

288. *What is a Debt Consolidation Loan?*, BEST EGG, <https://www.bestegg.com/personal-loans/debt-consolidation-loan> [<https://perma.cc/UG6C-36HL>].

289. *How FreedomPlus Works*, FREEDOMPLUS, <https://www.freedomplus.com/how-it-works> [<https://perma.cc/JKC7-5H8S>].

290. ROCKET LOANS, <https://www.rocketloans.com> [<https://perma.cc/5BE8-9FRV>].

291. UPSTART, <https://www.upstart.com> [<https://perma.cc/Q87B-7WHL>].

292. Elevate Annual Report on Form 10-K, *supra* note 130, at 15 (“Rise – Line of Credit”).

293. *Rates, Terms and Licenses*, OPPLOANS, <https://www.opploans.com/rates-and-terms> [<https://perma.cc/2C8A-YETF>] (range calculated based on each state’s APR in the “Currently Offering Installment Loans” list).

294. TODAY CARD, <https://www.todaycard.com/apply/findmyoffer> [<https://perma.cc/TQM7-U9XZ>] (select “Pricing & Terms”).

295. *OppLoans Affiliate Program*, PARTNERCENTRIC, <https://partnercentric.com/client/opploans> [<https://perma.cc/AR5J-9XES>].

296. *Rates, Terms and Licenses*, *supra* note 293.

297. *Arizona Licensure Information: Loan Details in Arizona*, OPPLOANS, <https://www.opploans.com/rates-and-terms/arizona> [<https://perma.cc/4ML6-9AHX>] (giving examples for Arizona); *see also* Letter from Kelly Griffith, Exec. Dir., Ctr. for Econ. Integrity, to Robert E. Feldman, Exec. Sec’y, FDIC, at 2 (Jan. 22, 2019) [hereinafter Letter from Kelly Griffith], <https://www.fdic.gov/regulations/laws/federal/2018/2018-small-dollar-lending-3064-zao4-c-012.pdf> [<https://perma.cc/UqJM-95QH>] (describing the installment loans that Opportunity Financial offers in Arizona).

298. *See* Letter from Kelly Griffith, *supra* note 297, at 1–2.

FinWise Bank to originate the loans, with OppLoans acting as servicer, and with both donning the mantle of “fintech.”<sup>299</sup>

Fintechs purposefully select bank partners chartered by these states. Utah has a stated interest rate limit of ten percent per annum,<sup>300</sup> but by agreement parties can specify *any* rate that they desire. Thus, a fintech credit firm partnering with a state-chartered financial institution in Utah can use a combination of parity laws and FDIC interest rate exportation to make extremely high-cost, predatory loans on a nationwide basis to borrowers in states where such loans would otherwise be illegal.

Kentucky, where Republic Bank & Trust is located, also has a generous usury statute. The general rule is that interest cannot exceed eight percent per year, but if the loan is for more than \$15,000, then the parties can agree to *any* rate of interest.<sup>301</sup> Additionally, if a bank is making a loan of less than \$15,000, then it can charge “interest at any rate allowed national banking associations by the laws of the United States of America.”<sup>302</sup> Since a national bank operating in Utah, for example, could charge a limitless amount of interest under the National Bank Act and *Marquette*, then a state bank in Kentucky can similarly charge a limitless amount of interest under this only seemingly restrictive provision.

Also, the public face of these bank partners when it comes to their predatory fintech activities is deliberately opaque. For instance, FinWise bills itself as “the financial tech bank with a community heart” and declares that its aim is to help “friends and neighbors” without the hassles “you expect from a big bank.”<sup>303</sup> On its website, the bank describes its deposit account offerings and mentions that it engages in *consumer lending*, but only under the heading of “Small Dollar Lending Education.”<sup>304</sup> This sends the viewer to a page containing links to news stories about financial literacy and the virtues of banks getting into the small dollar lending business, alongside quotes about the struggles of being unbanked or underbanked.<sup>305</sup> Nowhere on the page is there a discernable link to Elevate, OppLoans, or any kind of loan application from its nonbank fintech partners. For all its fintech pride, FinWise does not offer these high-cost loans directly to its own customers.<sup>306</sup>

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299. *Id.*

300. UTAH CODE ANN. § 15-1-1 (LexisNexis 2019) (setting the state interest rate at ten percent at least through the 2019 2d Special Session).

301. KY. REV. STAT. ANN. § 360.010 (West 2019) (setting the interest rate rules at least through 2021 legislation).

302. *Id.* § 286.3-214.

303. FINWISE BANK, <https://www.finwisebank.com> [<https://perma.cc/5HPF-W28X>].

304. *Id.*

305. *Small Dollar Lending Education*, FINWISE BANK, <https://www.finwisebank.com/lending/smalldollarlendingeducation> [<https://perma.cc/7LDD-B2HB>].

306. *Id.* For a discussion of bank reputation risk, see Julie Andersen Hill, *Regulating Bank Reputation Risk*, 54 GA. L. REV. 523 (2020).

First Electronic Bank furnishes another example of predatory fintech lending. This bank states that it “offers revolving private-label bank card and closed-end financing programs through its strategic partners.”<sup>307</sup> The frontpage of the bank’s website features the logos (without links) of its fintech partners, including the high-cost lender Personify Financial.<sup>308</sup> If one clicks on the website header tab “Products and Services,” the resulting page provides a mere three sentence description of the bank’s history, including that “First Electronic Bank offers customized strategic partnership programs, specifically tailored to fit the needs of your customers and is able to originate and fund loans in all 50 states.”<sup>309</sup> Brazenly, the bank markets that its charter (and accompanying regulatory powers) are available for rent. Yet, nowhere on First Electronic Bank’s website is there any kind of link to Personify or a way to submit a loan application. Republic Bank is even more deceptive about its predatory fintech operations. The bank has no information about its nonbank fintechs partners anywhere on its site.<sup>310</sup> A simple search of the bank’s website for the words “Elastic”<sup>311</sup> and “Elevate”<sup>312</sup> produce no relevant results whatsoever.

In sum, the entire fintech-bank model operates to avoid laws aimed at protecting consumers. Through savvy branding, however, the industry has been able to superficially differentiate itself from typical fringe lending and instead identify with the much lauded fintech movement. Whether through licensing or usury, these arrangements are meant to allow harmful and predatory forms of credit to maneuver through the bank and the nonbank regulatory apparatus in order to avoid being adequately captured by either. All the while, these partner banks operate in the shadows, largely keeping their predatory fintech activities hidden from view.

## V. POLICY IMPLICATIONS AND RECOMMENDATIONS

These predatory fintech partnerships are becoming increasingly prevalent, even as some states have tried to crack down on high-cost and predatory lending. Take for example the State of California, which passed a usury law in 2019 that imposed a maximum rate of 36 percent on loans of up

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307. *About Us*, FIRST ELEC. BANK, <https://www.firstelectronic.com/about-us> [<https://perma.cc/WBZ4-V568>].

308. *Who We Are*, FIRST ELEC. BANK, <https://web.archive.org/web/20181108131142/https://www.firstelectronic.com>.

309. *Products and Services*, FIRST ELEC. BANK, <https://web.archive.org/web/20150214014959/http://www.firstelectronic.com/products-and-services>.

310. REPUBLIC BANK, <https://www.republicbank.com> (last visited Mar. 29, 2021).

311. *Search Results: Elastic*, REPUBLIC BANK, <https://www.republicbank.com/home/site/search?q=elastic> (last visited Mar. 29, 2021).

312. *Search Results: Elevate*, REPUBLIC BANK, <https://www.republicbank.com/home/site/search?q=elevate> (last visited Mar. 29, 2021).

to \$10,000.<sup>313</sup> Predatory fintech lenders, however, are already seeking ways to use bank partnerships to avoid this limitation. Enova International, a publicly traded tech/consumer finance company, provides a good example. Enova directly offers high-cost loans in a handful of states under its CashNetUSA brand with APRs ranging from 325 percent for a line of credit loan in Missouri to 547.50 percent for a ten-day payday loan in Minnesota.<sup>314</sup> In other states, Enova has a partnership with Republic Bank for making online loans of up to 99.99 percent through its “NetCredit” program.<sup>315</sup> Recent public reports note that Enova is now seeking out bank partners in order to make high-cost loans in California.<sup>316</sup>

This raises two important policy implications, for which this Article makes two recommendations. First, the short-term issue is that these bank-fintech partnerships allow predatory lending to proliferate in ways designed to skirt state law without meaningful oversight from banking regulators. The following proposes a way for the FDIC—the regulator most suited to tamping down on these practices in the immediacy—to curtail these schemes.

Second, the long-term problem is that consumer finance is changing, and the current legal structures are suboptimal for dealing with the growth of nonbank firms. Our current dual system, whereby the licensing of nonbank companies is left to the states, while bank chartering is split between state and federal, all while consumer protection is parceled out to the CFPB and others by a series of byzantine definitions, needs a redesign. It’s time to rethink how consumer finance is regulated in the United States.

#### A. *POLICING BANK-FINTECH PARTNERSHIPS*

All the banks that partner with nonbank firms to make high-cost loans are currently regulated by the FDIC. In fact, as noted above, it is through their participation in the FDIC’s insurance program that these banks can engage in interest rate exportation. This makes the FDIC the most appropriate agency to handle predatory fintech lending. The CFPB also has various authority over these firms as noted in Section IV.A.3, but there is one significant legal limitation that makes the consumer bureau ill-suited to the task—the problem of predatory fintech is, at its heart, a problem of usury. Congress specifically prohibited the CFPB from ever enacting a “usury

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313. Assemb. B. 539, 2019 Leg., Reg. Sess. (Cal. 2019), [https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB539](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB539) [<https://perma.cc/3QPG-CMT4>].

314. *Missouri Line of Credit*, CASHNETUSA, <https://www.cashnetusa.com/rates-and-terms.html> (last visited Mar. 29, 2021) (select “Missouri” in the “You can apply in” dropdown menu); *Minnesota Payday Loan*, CASHNETUSA, <https://www.cashnetusa.com/rates-and-terms.html> (last visited Mar. 29, 2021) (select “Minnesota” in the “You can apply in” dropdown menu).

315. *Rates and Terms: Oklahoma*, NETCREDIT, <https://www.netcredit.com/rates-and-terms/oklahoma> [<https://perma.cc/RBCN-KNVX>].

316. See Cal. Assemb. B. 539.

limit.”<sup>317</sup> This admonition by Congress has made the bureau shy away from attempts at regulating the cost of credit. Whether the CFPB can do indirectly what it cannot do directly has yet to be tested. In the interest of certainty, I therefore point to the FDIC as the best possible agency to develop a solution.

To be sure, the FDIC cannot create a usury limitation on its own—it would need Congress to act.<sup>318</sup> Yet, the FDIC has broad authority to set the rules for safe and sound practices by the banks it supervises, as well as the ability to go after UDAAP violations.<sup>319</sup> Additionally, the FDIC is not directly hamstrung by the same absolute prohibition on affecting a “usury limit” as is the CFPB. As detailed below, the FDIC should act in three ways—*disclosure*, *consumer protection*, and *safety and soundness*.

### 1. Disclosure

First, the FDIC should state that it is a deceptive act or practice<sup>320</sup> for an FDIC-insured bank to partner with a nonbank company for purposes of originating credit, unless the bank conspicuously offers the credit product on its own website and through its other marketing channels. As noted above, several bank partners attempt to keep their predatory fintech offerings secret—leaving the nonbank to be the face of the high-cost credit while the bank merely provides the regulatory cover.

While the Dodd–Frank Act provides no definition of deception, the FDIC could look to the CFPB’s examination manual for guidance.<sup>321</sup> It provides that “[a] representation, omission, act, or practice is deceptive [if it] . . . is likely to mislead . . . consumer[s], if [t]he consumer[s]’ interpretation [thereof] is reasonable under the circumstances[,] and [if] [t]he misleading

317. 12 U.S.C. § 5517(o) (2018) (“No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.” (citation omitted)).

318. *Id.* § 1831d(a); *see also id.* § 1463(g) (regarding preemption of state usury laws).

319. For the power to set safety and soundness rules for banks, *see id.* § 1818(b)(1). For UDAAP authority, *see id.* § 5536; and *id.* § 5516(d).

320. *Id.* § 5536 (providing UDAAP authority). In this case, the FDIC has the exclusive authority to enforce the UDAAP provisions of the Dodd–Frank Act because the banks that partner with fintechs each have assets of less than \$10 billion. *See id.* § 5516(d) (bank call report total asset data from Q1 2020 on file with Author); *see also* Bd. of Governors of the Fed. Rsvr. Sys. et al., Opinion Letter on Interagency Guidance Regarding Unfair or Deceptive Credit Practices (Aug. 22, 2014), <https://www.fdic.gov/news/financial-institution-letters/2014/fil14044a.pdf> [<https://perma.cc/94GK-XXVY>] (stating that the banking regulators, including the FDIC, “may determine that statutory violations exist even in the absence of a specific regulation governing the conduct”).

321. *See generally* CFPB, CFPB SUPERVISION AND EXAMINATION MANUAL (2020), [https://files.consumerfinance.gov/f/documents/cfpb\\_supervision-and-examination-manual.pdf](https://files.consumerfinance.gov/f/documents/cfpb_supervision-and-examination-manual.pdf) [<https://perma.cc/K6E4-H7CN>]. Indeed, prior to the Dodd–Frank Act, the FDIC adopted a similar interpretation of deception. *See Financial Institution Letters: Unfair or Deceptive Acts or Practices by State-Chartered Banks*, FED. DEPOSIT INS. CORP. (Mar. 11, 2004) [hereinafter *Financial Institution Letters*], <https://www.fdic.gov/news/financial-institution-letters/2004/fil2604a.html> [<https://perma.cc/P3CR-LE3S>].

representation, omission, act, or practice is material” in nature.<sup>322</sup> For the last prong, the bureau advises that materiality is met if the “act[] or practice . . . is likely to affect a consumer’s choice of, or conduct regarding, the product or service.”<sup>323</sup>

The FDIC should advise its regulated banks that it is deceptive to the bank’s depositary customers and the public to hide a lending relationship with a third party when the credit products furnished are materially more expensive than those offered directly by the bank. When banks hide lending relationships with third parties, the bank wishes to avoid reputational harm that might be derived from a public disclosure of its high-cost partnership. This omission is a form of deception. The reason relates to the fact that corporate values can serve as a driving force for consumer decision-making.<sup>324</sup> For example, a consumer seeking a deposit relationship with a bank may, in whole or in part, desire to select a bank that is aligned with that individual’s preferences—political or otherwise—when it comes to the provision of credit. It is deceptive for the bank to purposefully hide these relationships, particularly given the data around the harms of high-cost lending.

## 2. Consumer Protection

Second, the FDIC needs to do a better job of enforcing the rules it claims to impose on banks that partner with third-party service providers. In doing so, I argue that the agency needs to take a stronger stance in how it uses its UDAAP authority. As noted in Section IV.A.3, the FDIC advises its banks that in order to partner with third-party companies, they must have a risk management program in place to manage these outside relationships. As recently as February 2020, the FDIC issued an information brochure titled “Conducting Business With Banks[:] A Guide for Fintechs and Third Parties” reiterating the need for effective and tailored risk management programs.<sup>325</sup>

Among other things, the FDIC requires that banks ensure that their third-party fintech firms “can demonstrate compliance with applicable laws and regulations.”<sup>326</sup> As described previously, one such applicable law is the prohibition against committing UDAAP violations.<sup>327</sup> High-cost, predatory

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322. CFPB, *supra* note 321, at 7.

323. *Id.*

324. See N. Craig Smith, *Consumers as Drivers of Corporate Social Responsibility*, in THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 281, 297–98 (Andrew Crane et al. eds., 2007); Isabelle Maignan, *Consumers’ Perceptions of Corporate Social Responsibilities: A Cross-Cultural Comparison*, 30 J. BUS. ETHICS 57, 69–70 (2001); Adam Lindgreen, Valérie Swaen & Wesley J. Johnston, *Corporate Social Responsibility: An Empirical Investigation of U.S. Organizations*, 85 J. BUS. ETHICS 303, 305–06 (2009).

325. FED. DEPOSIT INS. CORP., CONDUCTING BUSINESS WITH BANKS: A GUIDE FOR FINTECHS AND THIRD PARTIES 2 (2020), <https://www.fdic.gov/fditech/guide.pdf> [<https://perma.cc/4Q9QJ45Y>].

326. *Id.*

327. *Financial Institution Letters*, *supra* note 321.

lending that is designed to create roll overs or cause defaults constitutes *unfair* acts and practices under the three-part UDAAP framework. These types of loans cause substantial injury to consumers by putting them in situations where constant, additional high-cost borrowing is the only way to avoid a default.<sup>328</sup> Additionally, consumers who find themselves at the payday/high-cost loan window typically have no other good choices, and thus suffer from a “absence of meaningful choice”<sup>329</sup> when it comes to borrowing. Lastly, the injury caused by this kind of triple digit borrowing produces no net benefit that would otherwise outweigh the cost of the harm it generates.

The FDIC can also articulate a reason for why triple-digit lending is *deceptive*. As noted in Part III, these fintech lenders purport to furnish affordable credit to middle income Americans. They, like Elevate, state that their sophisticated algorithms and use of alternative data make their models highly predictive. When a borrower is approved for one of these loans, what is implied is that the borrower can afford to repay what is owed. Yet, research tells us that high-cost lending of the type these predatory schemes generate are not affordable.<sup>330</sup> This is the very notion behind roll-over in fringe finance. This is *deception*. It is a representation that misleads the consumer in a material way—taking out a loan that he or she cannot afford—and done through savvy marketing that would lead to a reasonable belief in the efficacy of the fintech lender’s underwriting program.

And lastly, the FDIC could also state that this kind of high-cost lending is *abusive*.<sup>331</sup> Unlike deception and fairness, which existed under the Federal Trade Act and was only later copied into the Dodd–Frank Act, the ability to police *abusive* acts and practices is new.<sup>332</sup> Although unfairness and deception alone provide sufficient grounds, there is also an abusive nature to triple digit lending that purports to be affordable. An act can be abusive if it meets any one of four statutory situations.<sup>333</sup> Applying selectively here, I argue that predatory fintech lending unreasonably takes advantage of a consumer’s lack of understanding when it comes to financial transactions and the risks that

328. The Consumer Financial Protection Act requires three things to be present in order for an act or practice to be unfair. See 12 U.S.C. § 5531(c)(1) (2018). The arguments above track the three requirements—“substantial injury to consumers[,] which is not reasonably avoidable[,] . . . and . . . [that] is not outweighed by [a] countervailing benefit[] to consumers or . . . competition.” *Id.*; see *Financial Institution Letters*, *supra* note 321.

329. LEVITIN, CONSUMER FINANCE, *supra* note 18, at 187 (citing *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965)); see also Trade Regulation Rule; Credit Practices, 49 Fed. Reg. 7740, 7746 (proposed Mar. 1, 1984) (codified at 16 C.F.R. pt. 444) (discussing the same concept).

330. See *supra* Section II.A.1.

331. 12 U.S.C. § 5516(d)(1).

332. BUREAU OF CONSUMER FIN. PROT., STATEMENT OF POLICY REGARDING PROHIBITION ON ABUSIVE ACTS OR PRACTICES 3 (2020), [https://files.consumerfinance.gov/f/documents/cfbp\\_abusiveness-enforcement-policy\\_statement.pdf](https://files.consumerfinance.gov/f/documents/cfbp_abusiveness-enforcement-policy_statement.pdf) [<https://perma.cc/9FGT-GQ48>].

333. 12 U.S.C. § 5531(d).

high-cost credit causes for the economically vulnerable. Cognitive bias prevents these consumers—facing financial hardship, particularly COVID-related—from protecting their interest in selecting financial products. And lastly, aggressive marketing whereby the fintech purports to have the borrowers' best interest at heart and attests to the superiority of its underwriting suggests that the fintech is taking unreasonable advantage of the individual's reliance on the lender to act in the consumer's best interest. The CFPB actually used very similar theories of abusiveness to support its proposed (and now largely abandoned) payday lending rule of a few years ago.<sup>334</sup> Any one of these would be sufficient under the broad definition of *abusive* for the FDIC to act.

### 3. Safety and Soundness

Even broader than its UDAAP authority, the FDIC is empowered by Congress to issue cease and desist orders to any bank over which it has primary authority if said bank is engaged “in an unsafe or unsound practice . . . or is violating or has violated . . . a law, rule, or regulation.”<sup>335</sup> Also, if during a bank's examination the FDIC gives “a less-than-satisfactory rating for asset quality, management, earnings, or liquidity” then the bank may be deemed to be engaged in unsafe and unsound banking practices.<sup>336</sup>

Although the statute itself does not provide much guidance, a widely-accepted interpretation<sup>337</sup> of the phrase from a 1966 congressional memorandum states: “an ‘unsafe and unsound practice’ embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.”<sup>338</sup>

I argue that this broad authority allows the FDIC to curtail predatory fintech relationships. Prudent banking operation should not allow for such high-cost lending. This is particularly true against the backdrop of both the

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334. See Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,864, 47,933–34 (July 22, 2016) (to be codified at 12 C.F.R. pt. 1041) (“Payday borrowers tend to overestimate their likelihood of repaying without reborrowing and underestimate the likelihood that they will end up in an extended loan sequence. . . . [C]onsumers in extreme financial distress tend to focus on their immediate liquidity needs rather than potential future costs in a way that makes them particularly susceptible to lender marketing . . .”).

335. 12 U.S.C. § 1818(b)(1).

336. *Id.* § 1818(b)(8).

337. See, e.g., Patrick Adams, OCC AA-EC-11-50, at 4–5 (2014), <https://www.occ.gov/static/enforcement-actions/ea2014-126.pdf> [<https://perma.cc/9ZZW-BVUT>] (adopting the Horne definition); Gulf Fed. Sav. & Loan Ass'n of Jefferson Par. v. Fed. Home Loan Bank Bd., 651 F.2d 259, 264 (5th Cir. 1981), *abrogated on other grounds by* First Gibraltar Bank, FSB v. Morales, 19 F.3d 1032, 1050–51 (5th Cir. 1994); Frontier State Bank Okla. City v. FDIC, 702 F.3d 588, 604 (10th Cir. 2012); Seidman v. Off. of Thrift Supervision, 37 F.3d 911, 932 (3d Cir. 1994); Hoffman v. FDIC, 912 F.2d 1172, 1174 (9th Cir. 1990).

338. 112 CONG. REC. 26,474 (1966).

empirical data on the disastrous financial effects of fringe credit on households and the fact that the federal banking agencies disapproved of similar partnerships in the early 2000s. The reputational harm to the bank as an institution that rents—often in the shadows—its special, chartered-status to high-cost online lenders should be more than enough to sound the alarm on unsafe and unsound banking practices. Additionally, the potential UDAAP violations outlined above, either by the bank itself or by virtue of the activities of its third-party service providers, furnish grounds for a finding of unsafe and unsound practices. Lending that is unfair, abusive, or deceptive is not prudent and presents an abnormal risk and damage to the bank.

Lastly, the FDIC should not be timid in using its broad safety and soundness powers in this manner. As described previously, not only is there solid statutory ground for doing so, courts are also generally deferential to such findings by banking regulators.<sup>339</sup> As both the Tenth and Eleventh circuits have observed: “Congress requires us to defer the opinions of bank regulators as long as their opinions are within a ‘zone of reasonableness.’”<sup>340</sup> Additionally, the use of the concept of unsafe and unsound business practices as a tool to protect consumers in financial distress was recently wielded by the State of New York in a similar fashion. In late March 2020, the Governor of New York signed an executive order that made it an unsafe and unsound business practice for any financial institutions under the authority of the New York State Department of Financial Services to fail to furnish a 90-day loan forbearance for those businesses and families negatively impacted by COVID-19.<sup>341</sup>

In sum, the FDIC has the tools to curtail these high-cost, predatory lending arrangements. Right now, it is turning a blind eye.

### B. *REFORMING CONSUMER FINANCE FOR THE DIGITAL AGE*

Short-term efforts by the FDIC, however, are not enough. They will solve the immediate problem of these state-chartered banks, their fintech partners, and their predatory online lending programs, but these efforts do not address the larger issues at hand. These involve both the growing role played by state-licensed nonbank firms in American consumer finance and the division of

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339. See, e.g., *Fed. Sav. & Loan Ins. Corp. v. Bass*, 576 F. Supp. 848, 852 (N.D. Ill. 1983); *Dodge v. Comptroller of Currency*, 744 F.3d 148, 156 (D.C. Cir. 2014) (siding with OCC’s view of instances of misconduct); *Candelaria v. FDIC*, No. 97-9515, 1998 WL 43167, at \*6 (10th Cir. Feb. 3, 1998).

340. *Frontier State Bank Okla. City*, 702 F.3d at 597 (citing *Sunshine State Bank v. FDIC*, 783 F.2d 1580, 1581–84 (11th Cir. 1986) (per curiam)).

341. State of New York, Exec. Order No. 202.9, Continuing Temporary Suspension and Modification of Laws Relating to the Disaster Emergency 1 (Mar. 21, 2020), [https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO\\_202.9.pdf](https://www.governor.ny.gov/sites/governor.ny.gov/files/atoms/files/EO_202.9.pdf) [<https://perma.cc/BS7P-VZUW>].

authority over these firms, both when they act alone and when they partner with regulated banks.

### 1. Modern Dual Banking Wars

As of this writing, a battle for dominance over nonbank lending is playing out in real time. Federal banking regulators have adopted an agenda that seeks to shield banks and their fintech partners from state consumer protection regulations. These battles reveal the weaknesses in how the law currently deals with the provision of credit when the originator does not neatly fit into our entity-based regulatory system.<sup>342</sup>

This battle has mainly played out through usury and licensing. In the usury context, state officials and consumer advocates argue that even if the partner bank makes the loan in the first instance, once the loan is sold by the bank to a nonbank entity, then all of the attendant regulatory advantages that the loan enjoys are lost.<sup>343</sup> Fintechs and their bank partners, however, assert that there exists a “valid-when-made doctrine” that prevents this from occurring.<sup>344</sup> This doctrine operates under the theory that if a state bank originates a loan that does not violate a state’s usury statute, then the loan can never be said to run afoul of usury, regardless of whether the bank holds the loan or if it is sold to another party.

The valid-when-made doctrine, however, came into question when the Second Circuit decided the case of *Madden v. Midland Funding, LLC* in 2015.<sup>345</sup> The court in that case was asked to answer the question as to whether credit card debt that was sold by Bank of America to a third-party debt collector could be collected at an interest rate of 27 percent.<sup>346</sup> Such a rate would have been perfectly legal if the collection was done by Bank of America, since it is a national bank that has rate exportation authority under the National Bank Act.<sup>347</sup> However, the plaintiff argued that it violated New York

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342. Jeremy C. Kress, Patricia A. McCoy & Daniel Schwarcz, *Regulating Entities and Activities: Complementary Approaches to Nonbank Systemic Risk*, 92 S. CAL. L. REV. 1455, 1487–88 (2019) (describing both activities-based and entities-based approaches to financial regulation).

343. Adam J. Levitin, ‘Madden Fix’ Bills Are a Recipe for Predatory Lending, AM. BANKER (Aug. 28, 2017, 10:24 AM), <https://www.americanbanker.com/opinion/madden-fix-bills-are-a-recipe-for-predatory-lending> [<https://perma.cc/AK3W-7C6G>].

344. *Gaither v. Farmers & Mechs. Bank of Georgetown*, 26 U.S. (1 Pet.) 37, 44–45 (1828); *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 106–07 (1833); see John Hannon, *The True Lender Doctrine: Function over Form as a Reasonable Constraint on the Exportation of Interest Rates*, 67 DUKE L.J. 1261, 1278–79, 1285 (2018). For a full discussion of the history of the valid-when-made principle, see Motion for Leave to File Amicus Curiae Brief of Professor Adam J. Levitin in Support of Appellant, *Rent-Rite Super Kegs West, Ltd. v. World Bus. Lenders, LLC*, No. 1:19-cv-01552-REB (D. Colo. Sept. 19, 2019), <https://www.creditslips.org/files/levitin-amicus-brief-rent-rite-super-kegs-west-ltd-v-world-business-lenders-llc.pdf> [<https://perma.cc/8SQY-FNZZ>].

345. *Madden v. Midland Funding, LLC*, 786 F.3d 246, 255 (2d Cir. 2015), cert. denied, 136 S. Ct. 2505 (2016).

346. *Id.* at 248.

347. *Id.* at 247–49.

state usury law for the nonbank debt collector (now the owner of the credit card debt) to enforce the debt at such a rate of interest.<sup>348</sup> The Second Circuit held that the debt collector/buyer had not “acted on behalf of a national bank,” but instead on its own behalf.<sup>349</sup> Perhaps most significant, the circuit court cautioned that granting “[National Bank Act] preemption to third-party debt collectors . . . would create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank.”<sup>350</sup> When the debt collector/buyer appealed, the Supreme Court denied cert.<sup>351</sup> It is precisely because of *Madden* that, I argue, Elevate (described in the Case Study in Section III.B) is only purchasing “participations” in the loans that are originated by its bank partners and by having the bank partner retain a 5-10 percent interest in the loans. By nominally and only superficially keeping title to the loans in the name of the banks, the fintech and the bank partners hope to avoid the issue of *Madden* and maintain FDIC rate exportation benefits.

The valid-when-made *Madden* litigation has resulted in attempted interventions by federal regulators—interventions that, I offer, undermine the ability of states to fulfill their consumer protection responsibilities. These interventions also provide evidence of this new dual banking war. In November 2019, both OCC and the FDIC issued proposed rules to overturn *Madden*.<sup>352</sup> The FDIC’s version is particularly important since fintechs, as noted in Section IV.A, favor insured state-chartered banks as partners. The FDIC stated that “[a] bank’s power to make loans implicitly carries with it the power to assign loans” and “a State bank’s statutory authority to make loans at [the maximum rate permitted to any State-chartered or licensed lending institution in the State where the bank is located] necessarily includes the power to assign loans at the same rate.”<sup>353</sup> Both the OCC’s<sup>354</sup> and the FDIC’s<sup>355</sup> rules became final at the end of May and June 2020 respectively, with litigation over both already underway.<sup>356</sup>

348. *Id.* at 248.

349. *Id.* at 251.

350. *Id.* at 251–52.

351. *Midland Funding, LLC v. Madden*, 136 S. Ct. 2505 (2016) (mem.).

352. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64,229 (proposed Nov. 21, 2019) (to be codified at 12 C.F.R. pts. 7, 160); Federal Interest Rate Authority, 84 Fed. Reg. 66,845 (proposed Dec. 6, 2019) (to be codified at 12 C.F.R. pt. 331).

353. Federal Interest Rate Authority, 84 Fed. Reg. at 66,845.

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

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

356. *Comment Opposing the FDIC’s Proposed Rule That Would Allow Predatory Non-bank Lenders to Route Their Loans Through Banks*, CTR. FOR RESPONSIBLE LENDING (Feb. 5, 2020), <https://www.responsiblelending.org/research-publication/comment-opposing-fdics-proposed-rule-would-allow-predatory-non-bank-lenders> [<https://perma.cc/H88M-CPN4>]; see NAT’L CONSUMER L. CTR., FDIC/OCC PROPOSAL WOULD ENCOURAGE RENT-A-BANK PREDATORY LENDING 1 (2019),

Yet another recent salvo from federal banking regulators aimed at reducing the power of states over nonbanks relates to the so-called *true lender doctrine*.<sup>357</sup> The doctrine has its roots in a statute passed by the Georgia legislature in 2011 aimed at addressing partnerships between traditional brick and mortar payday lending businesses and their partnerships with out-of-state banks.<sup>358</sup> The Georgia law provided that, looking at “the entire circumstances of the transaction,” if “the purported agent holds, acquires, or maintains a predominant economic interest in the revenues generated by the loan” then that agent is treated legally as the maker of that loan.<sup>359</sup> Since its passage, courts in states such as New York, Maryland, and West Virginia have adopted the concept in dealing with similar situations.<sup>360</sup>

A successful true lender claim results in the court ignoring the bank’s involvement in the loan origination and, instead, treating the nonbank as the lender (i.e., the true party in interest)—and thus subject to all of a particular state’s laws that an out-of-state bank might otherwise avoid, such as usury and licensing requirements.<sup>361</sup> For example, in 2017, Colorado brought an action against the fintech credit firms Avant and Marlette Funding in relation to their high-cost Colorado lending programs in partnership with WebBank<sup>362</sup> and Cross River Bank,<sup>363</sup> respectively. Colorado argued that the fintech companies had the “predominant economic interest” in the loans that the banks originated because the fintech company paid all of the bank’s expenses related to the lending program, including marketing costs, and the fintech company decided who would receive loans.<sup>364</sup> In June 2020, the district court

[https://www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/ib-fdic-rent-a-bank-proposal-dec-2019.pdf](https://www.nclc.org/images/pdf/high_cost_small_loans/ib-fdic-rent-a-bank-proposal-dec-2019.pdf) [https://perma.cc/gUFF-PS7G]; Jeremy T. Rosenblum, *Seven States and D.C. File Lawsuit Challenging FDIC “Madden Fix” Rule*, CONSUMER FIN. MONITOR (Aug. 25, 2020), <https://www.consumerfinancemonitor.com/2020/08/25/seven-states-and-d-c-file-lawsuit-challenging-fdic-madden-fix-rule> [https://perma.cc/NKN2-KC8P]; Jeremy T. Rosenblum & James Kim, *Three-State Attack on the OCC’s “Madden Fix” Rule*, CONSUMER FIN. MONITOR (Aug. 3, 2020), <https://www.consumerfinancemonitor.com/2020/08/03/three-state-attack-on-the-occs-madden-fix-rule> [https://perma.cc/3K7M-Z4Z4].

357. See 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, 487 (2019).

358. Hannon, *supra* note 344, at 1280; see GA. CODE ANN. § 16-17-2(b)(4) (West 2018).

359. GA. CODE ANN. § 16-17-2(b)(4).

360. See Hannon, *supra* note 344, at 1280–84; *People ex rel. Spitzer v. Cnty. Bank of Rehoboth Beach*, 846 N.Y.S.2d 436, 438 (App. Div. 2007); *CashCall, Inc. v. Md. Comm’r of Fin. Regul.*, 139 A.3d 990, 1005 (Md. 2016).

361. *CFPB v. CashCall, Inc.*, No. CV 15-7522-JFW (RAOx), 2016 WL 4820635, at \*5–6 (C.D. Cal. Aug. 31, 2016).

362. Amended Complaint at 5, *Meade v. Avant of Colo., LLC*, No. 1:17-cv-00620-WJM-STV (D. Colo. Mar. 9, 2017), <https://www.courtlistener.com/recap/gov.uscourts.cod.169530/gov.uscourts.cod.169530.6.o.pdf> [https://perma.cc/BMR5-LFSV].

363. Amended Complaint at 4, *Meade v. Marlette Funding LLC*, No. 1:17-cv-00575-MJW (D. Colo. Mar. 3, 2017), <https://www.courtlistener.com/recap/gov.uscourts.cod.169378.5.o.pdf> [https://perma.cc/7GVT-VKZ2].

364. *Id.* at 5.

ruled in favor of Colorado.<sup>365</sup> Similar suits have been brought by other states, including a 2017 action in West Virginia<sup>366</sup> and in June 2020 by the attorney general of Washington D.C. against Elevate for its bank-partnered high-cost lending.<sup>367</sup> Yet, like the response to *Madden*, the Acting Comptroller of the Currency during the waning months of the Trump Administration issued a regulation attempting to overturn the true lender case law by stating that if “[a bank] is named as the lender in the loan agreement” or otherwise “funds the loan,” then the bank shall be definitively regarded as the originator of the loan for all legal purposes—with no other factual analysis possible.<sup>368</sup> As of this writing, it remains to be seen whether the FDIC will follow the OCC’s lead.<sup>369</sup>

## 2. The Politics of Fintech

The dual banking wars of the past had consequences—often harmful to both consumers and the economy. This was particularly true when it came to the overreaching preemption efforts of the OCC in trying to shield national banks from state consumer protection laws, while at the same time failing to impose equivalent rules on banks.<sup>370</sup> There is no reason to allow the same kinds of harms to happen again in these renewed conflicts over the regulation of banking and finance.

To be sure, it would be unfair to say that the current conflict is being pushed by federal banking regulators alone. The financial services industry and fintech advocates are powerful driving forces. At the core of the industry’s argument is that state consumer finance laws, broadly, are too variant and restrictive when applied to a credit marketplace that has become national in scope and innovative in practice.<sup>371</sup> If states prevail in their efforts to curtail

365. *Fulford v. Marlette Funding, LLC*, No. 2017CV30376 (Colo. Dist. Ct. June 9, 2020), <https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2020/06/2020.06.09-CO-v.-Marlette.pdf> [<https://perma.cc/RB6D-VTKN>].

366. Catherine M. Brennan & Latif Zaman, *True Lender Developments: Litigation and State Regulatory Actions*, 74 *BUS. LAW.* 545, 547 (2019).

367. Press Release, Off. of Att’y Gen. for D.C., AG Racine Sues Predatory Online Lender for Illegal High-Interest Loans to District Consumers (June 5, 2020), <https://oag.dc.gov/release/ag-racine-sues-predatory-online-lender-illegal> [<https://perma.cc/P8EK-N6WY>].

368. 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).

369. Fintech legal advocates “continue to hope for a substantially similar ‘true lender’ rule from the FDIC.” See Jeremy T. Rosenblum & Mindy Harris, *OCC Issues Final “True Lender” Rule*, *CONSUMER FIN. MONITOR* (Oct. 29, 2020), <https://www.consumerfinancemonitor.com/2020/10/29/occ-issues-final-true-lender-rule> [<https://perma.cc/EXS9-3PLG>].

370. See LEVITIN, *CONSUMER FINANCE*, *supra* note 18, at 163–64.

371. See, e.g., A *U.S. Regulatory Patchwork Quilt: Cryptocurrency and Money Transmitter Licensing*, DECHERT LLP (Apr. 11, 2019), <https://www.dechert.com/knowledge/onpoint/2019/4/a-u-s-regulatory-patchwork-quilt-cryptocurrency-and-money-tran.html> [<https://perma.cc/L8X4-U796>] (illustrating that state consumer finance laws are too restrictive when applied to a national credit marketplace in the context of cryptocurrency).

these “innovative” fintech partnerships,<sup>372</sup> industry argues that such victories will “chill the market for bonds tied to consumer loans” and the “fallout could ultimately extend to the [larger capital] market.”<sup>373</sup> Fintech industry leaders and their banking allies describe important state consumer finance laws as an inefficient “patchwork” that is harmful to credit availability.<sup>374</sup>

Unlike the original duality that existed at the beginning of the American banking system, this new duality is between the ability of the states and the federal government to regulate, either directly or indirectly, the provision of *nonbank* consumer financial products and services. The true lender doctrine and the decision in *Madden* (and the regulatory responses that followed both) are all examples of the new dual banking system conflict. Although some aspects of this struggle are not new,<sup>375</sup> the marriage between the political and market influence that fintechs wield and the political and regulatory powers enjoyed by banks, adds a new dimension to the dual banking system conflict.<sup>376</sup>

This is not to say that every aspect of the system is undesirable. Business law scholars have noted the downsides of state dominance in the corporate law context—a certain level of “race to the bottom.”<sup>377</sup> But within the sphere of finance as applied to technology, there are aspects of the fintech marketplace that militate against a system whereby states compete for business by creating the most lenient regulatory environment. While it was historically possible for a nonbank firm to move to another state and thereby avoid an unfriendly regulatory environment in a given locale, the offering of consumer financial products and services over the internet and the ability of states to impose limitations on those activities when they are offered to residents of a particular state extends the regulatory arms in ways that have the potential to produce a race to the top. As some scholars of the history of American

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372. *How FinTech Partnerships with Banks Shape the Future of Finance*, FINTECHTRIS (June 20, 2019), <https://www.fintechtris.com/blog/2019/6/20/how-fintech-partnerships-with-banks-shape-the-future-of-finance> [<https://perma.cc/F5ZJ-48Y3>]; Rodrigo Suarez, *Bank-Fintech Partnerships Are a Necessity, Not a Fad*, BANK AUTOMATION NEWS (Oct. 17, 2019), <https://bankinnovation.net/allposts/innovation/startups/bank-fintech-partnerships-are-a-necessity-not-a-fad> [<https://perma.cc/BZ9W-QZM2>].

373. Claire Boston, *Usury Lawsuits Put Future of a \$563 Billion Bond Market at Risk*, BLOOMBERG: QUINT (Sept. 18, 2019, 5:22 AM), <https://www.bloombergquint.com/markets/usury-lawsuits-put-future-of-a-563-billion-bond-market-at-risk> [<https://perma.cc/U565-DNCB>].

374. *Id.*

375. See LEVITIN, CONSUMER FINANCE, *supra* note 18, at 133–36.

376. See, e.g., *WebBank v. Meade*, No. 17-CV-00786-PAB-MLC, 2018 WL 1399914, at \*5 (D. Colo. Mar. 19, 2018) (dismissing WebBank’s claim, suggesting a disregard for whatever defense could be raised in connection with the bank’s partnership with Avant); see also *Cross River Bank v. Meade*, No. 17-CV-00832-PAB-KMT, 2018 WL 1427204, at \*4 (D. Colo. Mar. 22, 2018) (dismissing Cross River Bank’s claims under the same rationale), *appeal dismissed sub nom.* *Cross River Bank v. Zavislan*, No. 18-1171, 2018 WL 5292045, at \*1 (10th Cir. Aug. 17, 2018).

377. See, e.g., William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 666 (1974); Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REGUL. 209, 225 (2006).

banking and financial regulation have observed: “[s]uccessful state experiments with banking regulation have taught valuable lessons and have built public confidence in innovative policies.”<sup>378</sup>

Relatedly, the dual banking system—through the ability of states to set different policy priorities—is consistent with the American political system’s pluralistic values, whereby public debate among interest groups is ultimately beneficial to the public at large (even if not always to the bottom line of financial institutions).<sup>379</sup> As Anne Fleming explains in her important work on the distinctive history of the regulation of small dollar lending: “states . . . learned from one another as they drafted and updated their lending rules” and, as a result, “states made much progress.”<sup>380</sup> Indeed, state experimentation in the banking and finance sector has created several positive changes, such as the payment of interest on consumer demand deposit accounts, deposit insurance, and other consumer financial benefits that today we take for granted.<sup>381</sup>

Additionally, federalism allows for competing policy interests to be balanced in times of rapidly changing political winds. For example, in January 2017, then-newly elected President Trump issued an executive order declaring “that ‘for every one new regulation issued, at least two prior regulations [must] be identified for elimination.’”<sup>382</sup> Shortly thereafter, he also promised business leaders that “he would cut all federal regulation by 75 percent.”<sup>383</sup> The next month, he issued another executive order that specifically focused on financial deregulation.<sup>384</sup> In the face of these changes in the ideological direction of the federal government, state financial services regulators and attorneys general have bolstered their own regulatory and enforcement actions to protect consumers.<sup>385</sup> They are filling the gaps and

378. Felsenfeld & Bilali, *supra* note 168, at 51 (chronicling the historical arguments advanced in favor of federalism in banking regulation).

379. Edwards J. Symons Jr., *The United States Banking System*, 19 *BROOK. J. INT’L L.* 1, 3, 22–23 (1993).

380. FLEMING, *supra* note 190, at 8.

381. *See generally* Consumers Sav. Bank v. Comm’r of Banks, 282 N.E.2d 416 (Mass. 1972) (ruling that banks are permitted to allow depositors to transfer funds from accounts without appearing in-person); *see also* Felsenfeld & Bilali, *supra* note 168, at 50 (listing positive innovations developed by state banks).

382. ODINET, FORECLOSED, *supra* note 77, at 156; Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Feb. 3, 2017), <https://www.govinfo.gov/content/pkg/FR-2017-02-03/pdf/2017-02451.pdf> [<https://perma.cc/RRT4-3ZDG>].

383. ODINET, FORECLOSED, *supra* note 77, at 156; Brena Swanson, *[Video] Trump Wants to Cut All Regulation by 75%*, HOUSINGWIRE (Jan. 23, 2017, 3:51 PM), <http://www.housingwire.com/articles/39014-video-trump-wants-to-cut-all-regulation-by-75> [<https://perma.cc/G2W5-K7YC>].

384. ODINET, FORECLOSED, *supra* note 77, at 156; Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 8, 2017), <https://www.govinfo.gov/content/pkg/FR-2017-02-08/pdf/2017-02762.pdf> [<https://perma.cc/76V4-3MZZ>].

385. *See generally* Amy Widman & Prentiss Cox, *State Attorneys General’s Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 *CARDOZO L. REV.* 53 (2011)

proving themselves a counterweight to an otherwise deregulatory agenda at the federal level.<sup>386</sup>

The maintenance of financial federalism also helps states protect their residents in ways that may strongly reflect local preferences even when markets become national in scope. To illustrate this point, consider usury. In a 2008 ballot initiative, Arizona voters affirmatively chose to keep the state's 36 percent interest rate cap on small dollar loans.<sup>387</sup> Ohio voters defeated a similar small dollar loan industry-led ballot initiative to raise that state's 28 percent limit.<sup>388</sup> California's recent usury cap law is yet another example.<sup>389</sup> The fintech-bank partnership model, however, undermines these deliberative, state-level policy choices.

To be clear: It may very well be true that, from a business perspective, the duality makes business compliance difficult. Fintech credit firms that lend or materially assist in lending programs across state lines must potentially obtain and maintain licenses in each state where they do business. However, this is part of choosing to do business in the consumer finance marketplace—it is part of learning to live in the dual banking system as it is currently constituted. While that system can certainly be improved, it does not serve the public interest to allow high-cost lenders and unscrupulous banks to manipulate the system, exploit loopholes, and fly under the radar.

### 3. A New Consumer Credit Commission

This Article will be published shortly after the 2020 presidential election. In this new presidential term, there should be a comprehensive reorientation of how consumer financial products and services are regulated, chiefly

(explaining concurrent public enforcement between state and federal prosecutors relative to federal consumer protection laws).

386. See ETHAN LUTZ, MIKE LITT & ED MIERZWINSKI, U.S. PIRG EDUC. FUND, POSITIONED TO PROTECT: HOW STATE AND LOCAL AUTHORITIES CAN FILL THE CFPB VOID 1–2 (2018), [https://uspirg.org/sites/pirg/files/reports/positionedtoprotect\\_Word\\_finalwcover.pdf](https://uspirg.org/sites/pirg/files/reports/positionedtoprotect_Word_finalwcover.pdf) [<https://perma.cc/DQ9N-BZ3Q>]; *States Step up Where CFPB Steps Back*, PYMNTS.COM (Apr. 20, 2018), <https://www.pymnts.com/news/cfpb/2018/states-attorney-general-cfpb-regulation-protection> [<https://perma.cc/RG4M-HDAU>]; James Gutierrez, *States Must Step Forward as CFPB Retreats on Predatory Lending*, HILL (Feb. 4, 2019, 11:00 AM), <https://thehill.com/blogs/congressblog/politics/428330-states-must-step-forward-as-cfpb-retreats-on-predatory-lending> [<https://perma.cc/LV6H-PC47>]; Allison Schoenthal, *Insight: A Shift in Regulation From the CFPB to the States*, BLOOMBERG L. (Aug. 28, 2018, 8:33 AM), <https://news.bloomberglaw.com/banking-law/insight-a-shift-in-regulation-from-the-cfpb-to-the-states> [<https://perma.cc/A4EW-Q5QC>].

387. Letter from Kelly Griffith, *supra* note 297, at 2; see Tyler Evilsizer, *Lenders Couldn't Buy Laws*, FOLLOWTHEMONEY.ORG (Aug. 18, 2009), <https://www.followthemoney.org/research/institute-reports/lenders-couldnt-buy-laws> [<https://perma.cc/RWF4-P6JJ>].

388. Evilsizer, *supra* note 387.

389. See Assemb. B. 539, 2019 Leg., Reg. Sess. (Cal. 2019), [https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB539](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB539) [<https://perma.cc/3QPG-CMT4>]; Taryn Luna, *High Interest Rate Loans Could Soon Be Capped in California Under Plan Approved by Lawmakers*, L.A. TIMES (Sept. 13, 2019, 8:00 PM), <https://www.latimes.com/california/story/2019-09-13/high-interest-rate-loans-cap-california-legislature> [<https://perma.cc/SMA4-WZGC>].

through a more targeted embrace of how federal financial regulators and state financial regulators can coordinate efforts and how inefficient overlap can be improved or corrected. What is needed is a *cooperative federalism* approach in nonbank regulation—one that rejects the premise that federalism is to blame for a lag in innovation and that sees the push and pull of state and federal interests as a positive force that moves regulation forward.

To be sure, the notion of a cooperative federalism approach is broad. I do not mean here to set forth all the various policy changes or new initiatives that would come out of such an endeavor. Over the past decade, scholars of consumer financial regulation and banking law have advanced numerous policy proposals for how to bring financial markets and household financial health into the digital age. COVID-19 and the financial damage it has caused for countless families in the United States make this national dialogue more urgent than ever.

My proposal is that a bipartisan national commission on consumer finance should be convened by President Biden and Congress. Such a body was commissioned by Congress once before in the late 1960s to study and make recommendations on the need for further regulation of consumer finance markets.<sup>390</sup> The work that came out of that effort produced, in part, a golden age of consumer financial protection legislation and created a much more significant understanding of how people in the United States managed their finances.<sup>391</sup>

Much has changed in the consumer credit market since the commission of the 1960s. New forms of financial engineering, the use of artificial intelligence in underwriting, novel securitization structures, and new forms of partnerships between regulated banks and nonbank entities are to name but a few. Importantly, the commission should be comprised of a balance of state and federal financial regulators, consumer advocates, and industry representatives, and should be chaired by an individual—appointed and with the strong support of the President—who will work to see that the commission's recommendations translate into congressional or administrative action.

Specific policies that might come out of the commission's deliberations include the creation of a national usury interest rate cap or a principles-based cap derived from a nation-wide, mandatory ability to repay analysis for all lenders. It could also result in a passporting system—an idea already bandied about by CSBS—that would allow licenses granted under the laws of one state to be recognized in other states. Or, perhaps it will result in the offering of a

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390. NAT'L COMM'N ON CONSUMER FIN., *CONSUMER CREDIT IN THE UNITED STATES* 1–4 (1972).

391. Ronald L. Hersbergen, *Consumer Protection*, 43 *LA. L. REV.* 343, 346 (1982); Andrea Michele Farley, *The Spousal Defense—A Ploy to Escape Payment or Simple Application of the Equal Credit Opportunity Act?*, 49 *VAND. L. REV.* 1287, 1291 (1996); Note, *Credit Scoring and the ECOA: Applying the Effects Test*, 88 *YALE L.J.* 1450, 1486 (1979).

well-regulated, limited, and consumer-oriented nation-wide license or charter for some fintech companies.

The underlying goal of this national effort would be to bring together regulatory, industry, and, importantly, consumer stakeholders to engage in a concerted effort to address the changing and increasingly digital landscape of consumer finance—comprised of both banks and nonbanks. It must directly address how best to share power and responsibility for both protecting American households individually and the larger economy more broadly as the country fights the pandemic and attempts to repair the broken economy.<sup>392</sup>

## VI. CONCLUSION

The United States has a long and often repeated history of underestimating the risks and harms that can arise from the financial sector. This lack of foresight often heralds large-scale deregulatory efforts that are followed by large-scale negative consequences. In current times, the hypnotic effect of fintech is energizing deregulatory efforts in the banking sector and blurring the lines of authority between the states and federal government—to potentially harmful or even disastrous effects.

The COVID-19 pandemic is revealing the financial precarity of many American families. This means that for many households, borrowing is the only way to survive. Predatory lenders always strike hardest when economic pressures are high. Indeed, reports abound of high-cost online lenders targeting households via social media as they sheltered-at-home to fight the spread of the coronavirus.<sup>393</sup> Online lenders with their bank partners, operating under the protective fintech mantle, are making high-cost credit both easier to spread and harder to police. As lawmakers and President Biden consider our national recovery from this pandemic, we must not only address predatory fintech in the short term, but also envision what consumer finance should look like in the future.

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392. The CFPB recently launched a task force to study federal consumer financial laws and whether they are in need of updating. However, none of the individuals chosen to serve on the taskforce are dedicated solely to representing the interests of consumers. See Press Release, CFPB, CFPB Announces Membership of Taskforce on Federal Consumer Financial Law (Jan. 9, 2020), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-membership-taskforce-federal-consumer-financial-law> [<https://perma.cc/CDC5-NUNK>]; Press Release, CFPB, CFPB Announces Additional Member of Taskforce on Federal Consumer Financial Law (Jan. 17, 2020), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-additional-member-to-taskforce> [<https://perma.cc/723U-CY4V>].

393. Coulter Jones, Jean Eaglesham & AnnaMaria Andriotis, *How Payday Loan Lenders Target Consumer Hurt by Coronavirus*, WALL ST. J. (June 3, 2020, 8:23 AM), <https://www.wsj.com/articles/how-payday-lenders-target-consumers-hurt-by-coronavirus-11591176601> [<https://perma.cc/4C67-TQA9>].