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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES, CENTRAL DIVISION

OPPORTUNITY FINANCIAL LLC, Plaintiff, v. CLOTHILDE HEWLETT, in her official capacity as Commissioner of the Department of Financial Protection and Innovation for the State of California, Defendant.	Case No: 22-ST-CV-08163 Assigned for All Purposes to: Hon. Timothy P. Dillon, Dept. 73 **BRIEF OF *AMICI CURIAE* CENTER FOR RESPONSIBLE LENDING ET AL. IN OPPOSITION TO DEMURRER FILED BY PLAINTIFF/CROSS-DEFENDANT OPPORTUNITY FINANCIAL LLC**
CLOTHILDE HEWLETT, in her official capacity as Commissioner of the Department of Financial Protection and Innovation for the State of California, Cross-Plaintiff, v. OPPORTUNITY FINANCIAL LLC, and DOES 1-100 Cross-Defendants.	**Demurrer Hearing:** Date: July 20, 2022 Time: 8:30 a.m. Dept: 73 Action Filed: March 7, 2022

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Pursuant to this Court's inherent discretion to entertain amicus filings, *see In re Veterans' Indus.* (1970) 8 Cal.App.3d 902, 924, Center for Responsible Lending, California Reinvestment Coalition, Consumer Federation of California, National Consumer Law Center, Public Law Center, and UC Berkeley Center for Consumer Law & Economic Justice, as *amici curiae*, through their counsel and their accompanying Application for Leave to File Brief of *Amici Curiae*, hereby submit this brief in support of Defendant/Cross-Plaintiff Department of Financial Protection and Innovation ("DFPI").[1]

INTRODUCTION

The question in this case is whether California law allows courts to consider the substance of a loan transaction, including all relevant facts, in order to prevent evasions of the state's usury laws, or whether courts must instead simply accept the bald assertion in the loan documents about the identity of the lender even in the face of evidence to the contrary. California law is clear that courts may look beyond the form of the transaction to the substance, and nothing in California law supports the theory put forward by Plaintiff/Cross-Defendant Opportunity Financial LLC ("OppFi") that courts must unquestioningly accept that the entity named on a loan document is the lender, however fictitious and designed to evade California's consumer protection statutes the arrangement may be.

Since the American Revolution, states have limited interest rates to protect consumers from predatory lending. Evasions of usury laws are as old as the laws themselves and are infinitely varied. "Sensitive to the ingenuity and creativity of those entrepreneurs willing to engage in legal brinkmanship to maximize profits, courts have carefully scrutinized the form of seemingly innocuous commercial transactions to determine whether the substance amounts to a usurious arrangement." *Ghirardo v. Antonioli* (1994) 8 Cal.4th 791, 802 (quoting *DCM Partners v. Smith* (1991) 228 Cal.App.3d 729, 733).

This case concerns a growing form of evasion: "rent-a-bank" lending. Two decades ago,

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[1] No person or entity other than *amici curiae* or their counsel directly or indirectly, authored this brief in whole or in part or made a monetary contribution to the preparation or submission of this brief.

payday lenders first started using banks as a front to evade state usury laws, attempting to take advantage of exemptions that banks receive in state laws or through federal preemption. *See* Michael Calhoun, *Bank regulator's True Lender Rule undercuts bank regulatory protections and shelters predatory lending*, Brookings Inst. (June 21, 2021).[2] While courts and regulators eventually halted schemes involving store-front payday lenders, recent years have witnessed the growth of rent-a-bank schemes involving on-line installment loans. *Id*. Today, high-cost, non-bank lenders like OppFi are again trying to hide behind banks to evade usury laws that forbid rates that can reach an annual percentage rate ("APR") of 225%. These lenders have even openly boasted on public calls to investors that they can evade newly enacted laws aimed at their predatory installment loans by moving to rent-a-bank models. *See infra* at 10-11. Indeed, OppFi itself once offered loans directly in California but later shifted fully to the "bank partnership model" after California adopted stronger interest rate protections via the passage of Assembly Bill 539, the Fair Access to Credit Act, enacted to address the very predatory lending conducted by lenders like OppFi. *See infra* at 10.

In a variety of contexts, courts have repeatedly recognized that the bank's name on the paperwork may not reflect the "true lender"; and if the true lender is not a bank, then state usury laws apply. *See infra* at 11-12. The true lender doctrine is simply an application of the broadly accepted substance-over-form anti-evasion doctrine. The Federal Deposit Insurance Corporation ("FDIC") has also acknowledged the true lender doctrine, and Congress recently repealed a regulation that would have overturned the doctrine. *See infra* at 12 (citing Federal Interest Rate Authority, 85 Fed. Reg. 44146, 44155 (July 22, 2020); S.J. Res. 13, 117th Cong. (2021)).

In the face of this well-established jurisprudence, OppFi relies on two unpublished federal district court decisions that misinterpret California law. Contrary to those federal court decisions, under California law courts are not powerless to look beyond the face of a transaction to prevent evasions of usury statutes, no matter what form the evasion takes. To be sure, a party's *subjective intent* to evade a usury statute may not be relevant if the transaction is

[2] https://brook.gs/3nGgIpp

unequivocally exempt from the usury limit. But courts in California are not precluded from engaging in a *factual determination* about the identity of the true lender and the applicability of the usury statute. Here, DFPI's cross-complaint establishes liability through concrete factual allegations about OppFi's predominant economic interest in the loan program and effective control over every substantive aspect of its rent-a-bank lending program. It is these concrete facts about OppFi's overarching and pervasive control that make it the true lender.

Considering all the facts to determine the true lender would not lead to the parade of horribles asserted – without supporting evidence – in the *amicus* brief filed by the banks that partner with OppFi in its rent-a-bank scheme. *See* FinWise Br. at 8-11. True lender does not threaten state banks' ability to securitize loans. Current federal regulations permit state banks to securitize loans that were actually and validly made by those banks, and those regulations will govern regardless of the outcome of this litigation. *See infra* at 14-15 (citing 12 C.F.R. §§ 7.4001(e), 331.4(e)).

Accordingly, OppFi's demurrer should be overruled.

ARGUMENT

I. Rent-a-bank schemes are part of a long and disreputable tradition of attempts to evade usury statutes.

Usury laws are among the simplest and most effective protections against predatory lending. *See* National Consumer Law Center ("NCLC"), *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default* (July 2016).[3] They are also among the most well established and widespread. The original 13 states all had usury laws. James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 Ariz. St. L.J. 61, 85 (1981).[4] Today, at least 45 states and the District of Columbia cap interest rates on consumer credit, depending on the size and type of the loan. Among those that cap rates, the median annual rate, including fees, is 32% for a $2,000, two-year installment loan, *see* NCLC, *Predatory Installment*

[3] https://bit.ly/39xF12Q

[4] https://bit.ly/3Ihwi4l

Lending in the States 2022 (June 2022)[5], and 25% for a $10,000, five-year installment loan, NCLC, *A Larger and Longer Debt Trap? Analysis of States' APR Caps for a $10,000 5-year Installment Loan* (Oct. 2018).[6]

But these usury protections are threatened by the "ingenuity and creativity of those entrepreneurs" seeking to "maximize profits." *Ghirardo*, 8 Cal. 4th at 802. The latest contrivance is a form of rent-a-bank lending, which tries to take advantage of the fact that, due to a combination of federal preemption and states not wanting to put state-chartered banks at a disadvantage compared to federally chartered banks, most banks are not subject to interest rate caps on loans to consumers. *See generally* NCLC, Consumer Credit Regulation § 3.5.4 (3d ed. 2020), *updated at* www.nclc.org/library. Under California law, for example, if the actual lender is an out-of-state bank, the loan is exempt from the state's constitutional usury limits. *See* Cal. Const. art. XV, § 1. Amici do not dispute that a true bank loan by FinWise bank is exempt; the question is whether, for the loans at issue in this case, FinWise or OppFi is the true lender.

In a rent-a-bank scheme, the bank is designated the lender but has only a minor role; the lending program is run almost entirely by a non-bank institution that typically bears most of the risk, takes most of the profits, and effectively designs, runs and controls the program. The non-bank typically designs and markets the loan, sets pricing and underwriting criteria (nominally approved by the bank), owns the branding and intellectual property for the loan program, takes and processes applications, controls which banks to partner with, and then sends the loan to a bank to nominally approve and fund the loan. The bank then immediately sells the loan (or the bulk of the receivables or participation interests) back to the non-bank lender (or a related entity), which charges interest, collects payments, bears the primary risk of nonpayment, and typically receives the vast majority of the revenues. In many cases, the non-bank covers most of the bank's costs, has a right to buy the loans or receivables, and protects the bank from the risk of loss through indemnity agreements, required deposits, or other arrangements. Despite the fact

[5] https://bit.ly/3anqJEP

[6] http://bit.ly/instloan18

that the bank's role is only a minor part of the lending program, the non-bank claims that the loans are bank loans immune from state rate caps. *See* NCLC, *Testimony of Lauren Saunders before the U.S. House Financial Services Committee on Rent-a-Bank Schemes and New Debt Traps* (Feb. 2020)[7]; CRL, *Testimony of Lisa F. Stifler before the Senate Committee on Banking, Housing, and Urban Affairs on The Reemergence of Rent-a-Bank* (Apr. 2021).[8]

DFPI has alleged OppFi's participation in a classic rent-a-bank scheme in this case. *See* Cross-Compl. ¶¶ 19-27.

Rent-a-bank schemes first appeared 20 years ago, developed by payday lenders making short-term loans up to 400% APR. States and federal bank regulators eventually shut down those evasive stratagems. *See* NCLC, Consumer Credit Regulation § 3.5.4. Now, however, similar schemes are making a comeback, primarily for longer-term loans. Today, a growing list of high-cost, non-bank lenders are using a few obscure, rogue banks to enable installment loans and lines of credit at 99% to 225% APR in states that forbid interest rates at those levels. *See* NCLC, *High-Cost Rent-a-Bank Loan Watch List* (Jan. 2022).[9] Although these new lenders may market themselves as sophisticated new "fintech" companies, the gist of the evasion – laundering high-cost loans through a bank to evade state usury laws – remains the same. *See DC v. Elevate Credit, Inc.* (D.D.C. 2021) 2021 WL 2982143 at *9 (discussing "many similarities between the rent-a-bank scheme" of a modern, high-cost fintech lender and other earlier arrangements where the non-bank was found to be the true lender).

Most banks do not abuse their exemption from state usury laws. But the business model of some less scrupulous banks, like FinWise, revolves almost entirely around rent-a-bank partnerships with predatory lenders: *over 96%* of FinWise's loan origination volume comes from its "strategic partnerships" program with fintech companies like OppFi. *See* Seeking Alpha, *FinWise Bancorp: A Risky Fintech-Heavy Partnership Model With Huge Potential Upside* (Jan.

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[7] http://bit.ly/debt-trap-schemes

[8] https://bit.ly/3IjIIZu

[9] https://bit.ly/2JCGf2c

6, 2022).[10] Thus, FinWise's business model is based on "selling" its bank charter and exemption from others states' usury laws to allow OppFi and other lenders to make loans that would otherwise be unlawful in the states where they are made. In this way, laundering a non-bank's loan into a "bank loan" undermines the reasoned policy choices of the vast majority of states that have decided to protect their residents from predatory loans.

Indeed, rent-a-bank schemes have proliferated in California since the enactment of California's recent rate cap law – the law OppFi is alleged to have violated in this case. Cross-Compl. ¶40 & n.8. Shortly after the legislature passed AB 539 in 2019, and before Governor Newsom even signed the bill into law, executives at three companies – Enova, Elevate Credit, and CURO – told investors during quarterly earnings calls that they were exploring the use of bank "partners" to circumvent the new law and continue to make the kinds of predatory debt-trap loans that the California legislature specifically sought to stop. *See* Congress.gov, *Testimony of Assemblymember Monique Limón before the U.S. House Financial Services Committee on Rent-a-Bank Schemes and New Debt Traps* (Feb. 2020).[11]

Many rent-a-bank lenders, like OppFi, use bank "partnerships" in only some states, typically where their loan products exceed state interest rate limits; in states that do not limit high-cost loans, they lend directly in their own name. Through 2019, OppFi lent directly to Californians through its license with DFP. *See* Cross-Compl. ¶15. After California tightened its interest rate caps in 2019, OppFi switched exclusively to rent-a-bank lending in the state. *Id*. Even today, OppFi lends through a rent-a-bank scheme in California and a handful of other states but continues to lend directly in four states. NCLC, *High-Cost Rent-a-Bank Loan Watch List*.[12] Other lenders structure their business similarly. *See* NCLC, *Payday Lenders Plan to Evade California's New Interest Rate Cap Law Through Rent-A-Bank Schemes* (Oct. 2019) (quoting Elevate Credit, Inc. (ELVT), Q2 2019 Results - Earnings Call Transcript, Seeking Alpha (July

[10] https://bit.ly/3IhliUH

[11] https://bit.ly/3nGObzV

[12] https://bit.ly/2JCGf2c

29, 2019) ("we expect to be able to continue to serve California consumers via bank sponsors that are not subject to the same proposed state level rate limitations.")).[13]

II. Courts routinely apply substance over form to unmask rent-a-bank schemes, and California law supports that inquiry.

California courts, like courts in virtually every state, "have carefully scrutinized the form of seemingly innocuous commercial transactions to determine whether the substance amounts to a usurious arrangement." *Ghirardo*, 8 Cal.4th at 802 (quoting *DCM Partners*, 228 Cal.App.3d at 733); *see also Glaire v. La Lanne-Paris Health Spa, Inc.* (1974) 12 Cal.3d 915, 927 ("As we have often noted, substance not form must dictate the treatment that a transaction is to be accorded under the usury law, and the question of substance is predominantly a factual inquiry."); NCLC, Consumer Credit Regulation § 3.9 (citing over 100 cases in 49 states including 17 in California).

As rent-a-bank schemes emerged, courts applied the traditional substance-over-form approach to assess whether a bank or non-bank was the true lender. *See, e.g.*, *CashCall, Inc. v. Morrisey* (W. Va. 2014) WL 2404300, *14 (citing *Crim v. Post*, 41 W. Va. 397, 23 S.E. 613 (1895)); *BankWest v. Oxendine* (Ga. Ct. App. 2004) 598 S.E.2d 343, 348 (quoting *Pope v. Marshall* (Ga. 1887) 4 S.E. 116). Many courts have recognized the doctrine or have recognized other ways to look beyond the name on the loan agreement to the facts when assessing who the lender is. *See, e.g.*, *Community State Bank v. Strong* (11th Cir. 2011) 651 F.3d 1241, 1259-60 (finding federal jurisdiction over potential racketeering claim because federal law does not preempt usury laws if the bank is not the true lender); *In re Community Bank* (3d Cir. 2005) 418 F.3d 277, 297 ("despite the provision in the loan agreement that loans were made through a national or state-chartered bank . . . , the loans were, in fact, made and serviced by Shumway, a non-depository institution"); *Easter v. American West Fin'l* (9th Cir. 2004) 381 F.3d 948, 957-59 (applying Washington law); *Inetianbor v. CashCall, Inc.* (S.D. Fla. 2015) 2015 WL 11438192 ("because Inetianbor has raised a genuine issue of material fact as to Western Sky's status as the

[13] http://bit.ly/rent-a-bank-ib

actual lender, enforcement of the choice-of-law provision in the Loan Agreement would be unjust and unreasonable on a motion to dismiss"); *Ubaldi v. SLM Corp.* (N.D. Cal. 2012) 852 F.Supp.2d 1190, 1202-03 (denying motion to dismiss in case alleging that Sallie Mae, not a national bank, was the true lender).

The FDIC, which regulates FinWise, has also recognized the true lender doctrine. *See* 85 Fed. Reg. at 44155 (noting that the rule regulating the terms by which banks can sell loans that they validly and actually made "cannot be reasonably interpreted to foreclose true lender claims. The rule … is premised upon a State bank having made the loan.").

Congress and the President have also recently supported true lender claims. When the Office of the Comptroller of the Currency ("OCC") in the previous Administration adopted a rule that would have overturned the true lender doctrine as to national banks, Congress and the current President overturned the OCC's rule on a bipartisan basis. *See* National Banks and Savings Ass'ns as Lenders, 85 Fed. Reg. 44223, 44224 n.8 (July 22, 2020); S.J. Res. 13, 117th Cong. (2021). President Biden, when signing the resolution into law, noted that repealing the rule would "protect borrowers against predatory lenders" that operated "so called 'rent-a-bank' schemes" to "prey on veterans, seniors, and other unsuspecting borrowers." White House, Remarks by President Biden Signing Three Congressional Review Act Bills into Law: S.J. Res. 13; S.J. Res. 14; and S.J. Res. 15 (June 30, 2021 17:37).[14]

California law is fully consistent with this authority recognizing the substance-over-form doctrine and its application to determine the identity of the true lender. OppFi relies only upon two federal district court cases. *See Sims v. Opportunity Fin, LLC* (N.D. Cal. 2021) 2021 WL 1391565 and *Beechum v. Navient Sols., Inc.* (C.D. Cal. 2016) 2016 WL 5340454). Decisions of federal courts, of course, "are not binding on" California courts. *Rubin v. Ross* (2021) 65 Cal.App.5th 153, 163. Nor are OppFi's cases even persuasive authority regarding the application of substance-over-form to prevent usury evasions, because both fundamentally misread the California Court of Appeal cases that *do* bind this Court.

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[14] https://bit.ly/3utIGZk

The California cases cited by *Sims* and *Beechum* support an outcome quite different from that reached by the federal trial courts. First and foremost, neither *WRI v. Cooper* (2007) 154 Cal.App.4th 525 nor *Jones v. Wells Fargo Bank* (2006) 112 Cal.App.4th 1527 involved the question of who the lender was; in neither case was there any dispute about the lender's identity. *See WRI*, 154 Cal.App.4th at 530 (no question that WRIO was lender); *Jones*, 112 Cal.App.4th at 1535 (no dispute that Wells Fargo was the lender). Thus, neither case addresses the question at issue in this case: is the bank that is exempt from the usury statutes in fact the lender?

Further, none of the reasoning in *WRI* or *Jones* casts doubt on the power of California courts to determine*, as a factual matter*, which entity is the actual lender. Both *WRI* and *Jones* discuss the extent to which a lender's *subjective intent* is relevant to a usury claim. In *WRI*, the court held that the loan at issue was not exempt from the usury statutes because it did not meet the statutory definition of a "shared appreciation loan." 154 Cal.App.4th at 539. In so holding, *WRI* explained that when the *substance* of the transaction at issue fits within an exception to the usury statutes, "courts will not look beyond those requirements to determine whether the underlying transaction . . . betrays an intent to evade the usury law." *Id*. at 536. Similarly, in *Jones*, a bank was alleged to have made usurious loans but was held exempt from the interest rate cap because it was a bank acting in its fiduciary capacity. 112 Cal.App.4th at 1535. *Jones* explained that because the loan agreements "fit within a legally authorized exception to the general usury law, their interest provisions do not exceed the statutory maximum. Defendants' intent is irrelevant." *Id*. at 1538.

In sum, *WRI* and *Sims* foreclose an inquiry into the *subjective* intent of a lender only when the objective circumstances of the transaction plainly put the transaction within or outside a usury statute. All that *WRI* and *Jones* hold is that, where the substance of a transaction clearly satisfies an exemption to the usury statutes, it is immaterial whether the lender intentionally structured the transaction to satisfy that exemption and thereby avoid usury limits. Neither decision precludes a court from considering the *objective* facts of a transaction to determine whether the transaction does in fact satisfy an exemption to the usury statutes.

In fact, the courts in *WRI* and *Jones* performed just the sort of factual inquiry into the substance over form required in true lender cases. In *WRI*, the court reaffirmed that courts "look[] beyond the face of the agreement to assess whether" the usury exception is satisfied, 154 Cal.App.4th at 535, but the court did not look beyond the plain language of the agreement only "[b]ecause neither party submitted extrinsic evidence bearing on the meaning of the loan documents." *Id*. at 532; *see also id*. at 537. In *Jones*, the court stated that, in determining whether a transaction is subject to usury law, "a court must look beyond the surface of the transaction to its substance," 112 Cal.App.4th at 1538, but the "pleadings and stipulated facts establish" an exception to the usury statutes, *id.* at 1535. That is precisely the inquiry in true lender cases like this one: looking beyond the face of the loan to determine whether, taking the facts as a whole, the exempt entity is in fact the lender. *Sims* and *Beechum* misread *WRI* and *Jones* by reading those cases to foreclose that factual inquiry.

III. The assertions about market disruption by *amici curiae* FinWise Bank and Capital Community Bank are unfounded.

Amici curiae FinWise Bank and Capital Community Bank ("FinWise") offer scattershot asserted "policy implications" of the true lender doctrine, which boil down to the claim that true lender constrains lenders in selling their loans in the secondary market. *See* FinWise Br. at 8-11. That claim is baseless. It makes no sense to assert, as FinWise does, that there will be serious effects on the "mortgage market" (FinWise Br. at 9), because, banks' assignees are already exempt from state usury laws in the secondary market in home mortgage loans. State usury laws are specifically preempted for federally insured mortgages (i.e., most mortgages), regardless of what entity holds them. 12 U.S.C. §§ 1735f-7, 1735f-7a.

In any case, the true lender rule does not govern the ability of banks to sell valid bank loans; its focus is on the *identity* of the lender. It is a different rule, the "valid-when-made" doctrine, now codified in federal regulation, that addresses what rate applies after banks sell their loans and makes them subject to any usury exceptions those banks may enjoy. *See California v. Fed. Deposit Ins. Corp.* (N.D. Cal. 2022) 2022 WL 377403, at *2-*3. Current FDIC and OCC regulations provide that "[w]hether interest on a loan is permissible . . . is determined as of the date the loan was made. Interest on a loan that is permissible . . . shall not be affected by . . . the sale, assignment, or other transfer of the loan, in whole or in part." 12 C.F.R. § 331.4(e) (FDIC); *see also* 12 C.F.R. § 7.4001(e) (same for OCC). Those regulations currently apply to all state and national banks, making FinWise's assertions about the threat of the true lender doctrine to bank securitization a red herring. Indeed, the FDIC has specifically noted that its "valid-when-made" rule "cannot be reasonably interpreted to foreclose true lender claims." 85 Fed. Reg. at 4415. Securitization of loans actually and validly issued by banks is entirely distinct from rent-a-bank schemes where the bank is a front for a non-bank true lender running the loan program. Enforcement of true lender claims will not undermine state banks' ability to securitize loans that those banks actually and validly made.

What such enforcement *will* do is to protect the public from sham arrangements that, if permitted, will frustrate the express and duly enacted will of 40 million Californians.

CONCLUSION

This Court should not accept OppFi's unsupported and dangerous theory that California law requires courts to blindly accept companies' assertions and to look only at the nominal form of a transaction, rather than evaluating the substance of the transaction based on all the facts to determine the identity of the actual lender in a consumer transaction.

OppFi's demurrer should be overruled.

Dated: July 8, 2022

Respectfully submitted,

CENTER FOR RESPONSIBLE LENDING
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