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February 26, 2024

The Hon. Zack Stephenson
Chair, House Commerce Finance & Policy
Committee
449 State Office Building
St. Paul, MN 55155

The Hon. Tim O'Driscoll
Ranking Member, House Commerce Finance
& Policy Committee
237 State Office Building
St. Paul, MN 55155

Re: House File 3680

Dear Chairman Stephenson and Ranking Member O'Driscoll:

Pursuant to my duty under section 8.32 of the Minnesota Statutes to recommend statutory changes to protect consumers, I write in strong support of HF 3680. This important legislation is necessary to protect consumers from harmful online lending and ensure a level playing field for businesses that offer loans in Minnesota.

I. Background: Minnesota Usury Law, DIDMCA, and Predatory Online Lending

The threat of predatory lending is nothing new. Since territorial times, the legislature has maintained “usury” laws to prevent lenders from charging excessive interest on consumers during times of need. These statutes are one of the most longstanding and basic forms of consumer protection in American law—deeply rooted in policy, religious, and moral imperatives that exploiting and profiting from those with limited means is unfair and harmful to consumers and society at large. Minnesota law thus sets rate ceilings that allow lenders to reasonably profit without taking unfair advantage of vulnerable consumers. Such laws includes Minn. Stat. ch. 334, which sets a general rate limit for written contracts; Minn. Stat. § 47.59, which sets higher limits for certain “financial institutions” supervised by Minnesota or federal regulators; and Minn. Stat. §§ 47.60 and 47.601, which place special limits for “payday” and other short-term loans that pose higher risk for abuse. The rate ceiling under the short-term and small-dollar loan laws is 36%.

While businesses that operate in Minnesota must generally follow these rules, some lenders have exploited a complicated loophole to make loans online at egregious rates. These schemes stem from a federal law passed in 1980 called the Depository Institutions Deregulation and Monetary Control Act (DIDMCA). Section 521 of DIDMCA allows federally insured banks located out of state to lend at the higher of the rate allowed by the state in which the bank is located or 1% over the Fed’s discount rate. Section 521 was meant to allow such banks to extend credit to their customers at a time when borrowing costs were extremely high (the Fed’s rates were at that time were approaching 20%) and online lending did not yet exist. But this provision also was read to supersede or “preempt” a consumer’s state usury laws when the loan is made by an out-of-state bank, allowing the bank to lend according to the usury laws of its home state.

While DIDMCA may not have posed serious problems after it was passed, Minnesota and other states have witnessed a large influx of predatory lending recently by lenders ostensibly taking advantage of section 521 in making loans online. A number of factors have led to this phenomenon, including the ease of internet marketing and electronic funds transfers, increasing securitization of consumer loans, and actions of several states to increase if not eliminate usury limits to attract lending businesses that may be looking to exploit the loophole. These dynamics have also created a particular concern in non-bank lenders devising “rent a bank” schemes, whereby a non-bank entity operating online enters a contractual arrangement with a bank to make loans using the bank’s higher allowed interest rate. The online, non-bank entity oftentimes underwrites, services, markets, and purchases the loan or its revenue stream, while the bank does little except fund the loan and put its name on loan documents.

Rent-a-bank schemes have become all too common, harming Minnesota consumers and undermining Minnesota laws (as well as businesses complying with those laws). Indeed, my Office has received hundreds of complaints in recent years from consumers all across the State that were led to take out rent-a-bank loans without understanding that they carry triple-digit interest rates—rates that are several times higher than that allowed under Minnesota law. Consumers taking these loans out are forced to pay back amounts several times their original balance, causing severe financial harm at a time when they are most vulnerable.

II. The Solution: DIDMCA Opt-Out

Luckily, when it passed DIDMCA, Congress created a way for states to avoid preemption of their usury rates and protect state residents under these circumstances. Specifically, section 525 of DIDMCA gave states the ability to “opt out” of the preemption provisions by simply stating via legislation that it “does not want [section 521] to apply with respect to loans made in such State.”

While various states have opted out of section 521 over the years, Iowa and Puerto Rico are the only states or territories currently opted out and have been opted out for several decades. In doing so, they have protected consumers without disadvantaging or disrupting banking activity and access to credit. And just last year, Colorado responded to the same rent-a-bank problem facing that state by passing legislation to opt out of DICMA’s preemption provisions.

The legislature should enact the opt-out language in HF 3680 and take back its lawmaking authority to protect consumers. By opting out of DIDMCA preemption, the legislature will be able to decide what usury ceilings should apply for different loans. And online companies that partner with banks without rate ceilings will no longer be able to exploit the DIDMCA loophole and circumvent Minnesota law. Indeed, none of the consumer harms described above would have occurred if HF 3680 were in place when the loan was made. Opting out of DIDMCA preemption will also make our laws consistent with Minnesota’s approach to mortgage loans, in which it is one of fourteen states that opted out of DIDMCA preemption for mortgage loans since the early 1980s. *See* Minn. Stat. § 47.203.

Opting out of DIDMCA preemption also allows the legislature to exercise its sovereign authority to decide proper usury caps. If the legislature believes that rates should be lower or higher, it can respond to constituents and make that policy choice. For example, to the extent there is concern that legitimate credit cards carrying higher rates than other types of credit could be

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affected under Minnesota's usury law, HF 3680 allows card issuers to continue to use home state rates. I support this carve-out because the harms described above are exclusive to unsecured, closed-end loans rather than credit-card debt issued by regulated banks and credit unions. While credit cards may pose certain risks and abusive practices, they do not involve the same level of abuse that my Office has seen with payday and other small loans described above.

I strongly encourage your committee to support this important bill. If you have any questions or would like additional information, my team and I would be happy to help in any way that we can.

Sincerely,

A handwritten signature in blue ink that reads "Keith Ellison". The signature is written in a cursive, flowing style.

KEITH ELLISON
Attorney General