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## Payday Lending in North Carolina: Now You See It, Now You Don't

### I. INTRODUCTION

“With a family to feed and no money for groceries, Navy Yeoman 2nd Class Damon LaForce recently” visited one of the many payday lending businesses located around the country.<sup>1</sup> “LaForce wrote the lender a postdated check for \$300. Five minutes later, the sailor walked out with \$255 cash in his pocket.”<sup>2</sup> LaForce, a few weeks after his initial loan from the payday lender, then took out another loan to pay off the first advance.<sup>3</sup> In total, LaForce paid \$150 in fees and interest for a \$255 advance.<sup>4</sup> Payday lenders “can be both a blessing and a curse” for people who cannot, or choose not to, obtain credit from mainstream lenders.<sup>5</sup> The payday lending industry has recently experienced incredible growth—growing from \$10 billion in volume in 2000 to \$25 billion in volume in 2003.<sup>6</sup> Payday lending was once said to be “the fastest growing segment of the fringe banking economy.”<sup>7</sup> Now, however, significant federal and state regulation may have suppressed the rapid growth of the payday lending industry.<sup>8</sup> According to the

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1. Thomas Watkins, *Payday Lending Under Attack*, ROCKY MOUNTAIN NEWS, Sept. 1, 2006, available at [http://www.rockymountainnews.com/drmn/other\\_business/article/0,2777,DRMN\\_23916\\_4960668,00.html](http://www.rockymountainnews.com/drmn/other_business/article/0,2777,DRMN_23916_4960668,00.html).

2. *Id.*

3. *Id.*

4. *Id.*

5. Michael A. Stegman, *The Public Policy Challenges of Payday Lending*, 66 POPULAR GOV'T 16 (2001) [hereinafter Stegman, *The Public Policy Challenges of Payday Lending*] available at [http://www.kenan-flagler.unc.edu/assets/documents/CC\\_paydayLending.pdf](http://www.kenan-flagler.unc.edu/assets/documents/CC_paydayLending.pdf).

6. KEITH ERNST ET AL., CTR. FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 2 (2004), available at <http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf>.

7. Press Release, Office of N.Y. State Attorney Gen., New York Sues to Stop Illegal Payday Lending Scheme (Sept. 24, 2003), available at [http://www.oag.state.ny.us/press/2003/sep/sep24a\\_03.html](http://www.oag.state.ny.us/press/2003/sep/sep24a_03.html).

8. See Letter from the Fed. Deposit Ins. Corp. (FDIC) (Feb. 25, 2005), available at <http://www.fdic.gov/news/news/financial/2005/fil1405a.html> (noting FDIC requirement that banks ensure that payday loans are not made to customers who

Center for Responsible Lending, payday lending costs consumers an estimated \$3.4 billion each year.<sup>9</sup> In 1999 alone, “payday lending in North Carolina completed more than 2.9 million transactions totaling approximately \$535 million in loans . . . .”<sup>10</sup>

On December 22, 2005, Commissioner of Banks, Joseph A. Smith, Jr., put an end to “rent-a-charter”<sup>11</sup> payday lending in North Carolina by holding that the practice violated the North Carolina Consumer Finance Act.<sup>12</sup> The North Carolina State Banking Commission subsequently affirmed this decision.<sup>13</sup> Part II of this Note provides an overview of payday lending and examines how out-of-state banks exported interest rates to North Carolina under the rent-a-charter or agency framework.<sup>14</sup> The history of payday lending in North Carolina is examined in the third section.<sup>15</sup> Part IV reviews the North Carolina Commissioner of Banks’ decision to end the rent-a-charter or agency method of payday lending in North Carolina.<sup>16</sup> Part V looks at the similarities between the North Carolina Commissioner of Banks’ decision and the Georgia case *BankWest v. Baker*.<sup>17</sup> Ultimately, the Note concludes with the theory that the Commissioner appears to be expanding the *BankWest* argument in a way that it could be used in states without

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have had payday loans outstanding from any lender for a total of three months out of the previous twelve months). Payday lending has also been limited in certain states like Georgia. See also *BankWest, Inc. v. Baker*, 324 F. Supp. 2d 1333 (N.D. Ga. 2004).

9. ERNST ET AL., *supra* note 6, at 2.

10. Stegman, *The Public Policy Challenges of Payday Lending*, *supra* note 5, at 17.

11. See *infra* notes 44-58 and accompanying text. The “rent-a-charter” method of payday lending allows in-state payday lending companies to make loans under the charters of out-of-state banks. *Id.* As such, payday lenders are able to take advantage of high usury ceilings and make loans at rates exponentially higher than allowed by in-state usury and consumer protection laws. *Id.*

12. In re Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 53-54 (Comm’r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf); N.C. Gen. Stat. § 53-164 (2005).

13. In re Appeal of Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 1 (Comm’r of Banks, May. 24, 2006) (final agency decision), available at [http://www.nccob.org/NR/rdonlyres/F3A69A8A-CE9A-4E3C-8A8D-05068774962D/0/44\\_AppealofAdvanceAmerica.pdf](http://www.nccob.org/NR/rdonlyres/F3A69A8A-CE9A-4E3C-8A8D-05068774962D/0/44_AppealofAdvanceAmerica.pdf).

14. See *infra* notes 18-74 and accompanying text.

15. See *infra* notes 75-116 and accompanying text.

16. See *infra* notes 117-60 and accompanying text.

17. See *infra* notes 161-94 and accompanying text.

the Georgia statute and may have far-reaching effects in shutting down the rent-a-charter business by payday lending shops.

## II. AN OVERVIEW OF PAYDAY LENDING AND THE EXPORTING OF INTEREST RATES

### A. *The Basics of Payday Lending*

“Payday loans . . . are small, short-term, unsecured loans that borrowers promise to repay out of their next paycheck or regular income payments.”<sup>18</sup> To obtain a loan, borrowers typically post-date a check for the amount of cash they need plus the fee charged by the lender.<sup>19</sup> The payday lender then gives the borrower the principal of the loan in cash minus the loan fee.<sup>20</sup> Because the loan matures on the borrower’s next payday, they are referred to as “payday loans.”<sup>21</sup> The annual percentage rate (APR) is very high on payday loans because of the short time until maturity.<sup>22</sup>

Due to the short term of the loan, payday loans are typically extremely expensive for borrowers.<sup>23</sup> Payday loans rarely quote interest rates; rather lenders frequently charge a predetermined fee.<sup>24</sup> Once this fee is converted to an annual percentage rate, a consumer could potentially be paying as much as 6,205% for using a payday loan.<sup>25</sup> For example, a borrower may write a check to a payday lender in the amount of \$117.<sup>26</sup> The borrower would then take \$100 in cash and leave \$17 with the

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18. FDIC, GUIDELINES FOR PAYDAY LENDING, <http://www.fdic.gov/regulations/safety/payday/> (last visited Sept. 17, 2006).

19. ERNST ET AL., *supra* note 6, at 2.

20. *Id.*

21. *BankWest v. Baker*, 324 F. Supp. 2d 1333, 1339 (N.D. Ga. 2004).

22. FDIC, *supra* note 18.

23. *In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 53-54 (Comm’r of Banks, Dec. 22, 2005) (order), *available at* [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf). Often the APR on payday loans tops 400%. *Id.*

24. CONSUMER CREDIT DIV., IND. DEP’T OF FIN. INST., PAYDAY LOANS = COSTLY CASH, *available at* [http://www.in.gov/dfi/education/payday\\_loans.htm](http://www.in.gov/dfi/education/payday_loans.htm) (last visited Jan. 6, 2007).

25. *Id.*

26. *In re Advance Am.*, No. 05:008:CF, at 7.

lender as the fee for the loan.<sup>27</sup> If the term for this loan was two weeks, the typical term for a payday loan, the annual percentage rate would amount to an astounding 443.21%.<sup>28</sup>

Payday loans also have a reputation for creating a relentless debt cycle that many consumers are unable to break.<sup>29</sup> Some commentators suggest that ninety cents of every dollar made by the payday lending industry comes from consumers caught in the payday lending debt cycle.<sup>30</sup> With such high interest rates many borrowers take out several additional payday loans in order to pay off their initial loan.<sup>31</sup> The Center for Responsible Lending suggests that, on average, the typical borrower takes out 8.1 payday loans each year.<sup>32</sup> For instance:

[One woman] . . . took out her first loan when faced with a family emergency and was still paying to roll the loan over every payday three years later. At first, this 36-year-old woman viewed her payday loan as a safe and easy way to obtain “free money.” For the next three years, she paid the interest but was unable to repay the balance in a cycle that she could not end. Over the life of the \$300 loan, she paid a total of \$4,130 (\$17.65 per \$100 x 3 x 78 renewals). She still owes the principal.<sup>33</sup>

Statistics show that “91% of payday loans are made to borrowers who receive five or more loans per year.”<sup>34</sup> As such, the woman in the previous example does not appear to be unique. However, recent guidelines imposed by the FDIC require institutions to set a “cooling off” period between payday loans,

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27. *Id.*

28. *Id.*

29. Nat'l Endowment for Fin. Educ., *The Debt Cycle: Using Payday Loans to Make Ends Meet* (2002), <http://www.nefe.org/pages/whitepaperpaydayloans.html>.

30. Karen L. Werner, *Payday Lenders Collect \$4.2 Billion in 'Excessive' Fees, Center Says in Report*, 87 BANKING REP. 855 (Dec. 12, 2006).

31. *Id.*

32. ERNST ET AL., *supra* note 6, at 10.

33. Nat'l Endowment for Fin. Educ., *supra* note 29.

34. ERNST ET AL., *supra* note 6, at 7.

and to set a maximum number of payday loans a customer can take out each calendar year.<sup>35</sup>

Many opponents of the payday lending industry claim that payday lenders intentionally target distinct segments of the population.<sup>36</sup> The payday lending industry has been charged with targeting minorities, low-income earners, military personnel, and the elderly.<sup>37</sup> One study “found that lower-income counties were more likely to have a higher density of payday lending stores than higher-income counties.”<sup>38</sup> A recent report from the Department of Defense estimates that 225,000 military service members have used payday loans.<sup>39</sup> That amounts to 17% of the entire United States military.<sup>40</sup> Navy personnel with debt more than 30% of their income are prohibited from deploying overseas because their financial troubles may make them vulnerable to bribery.<sup>41</sup> President Bush recently signed into law the John Warner National Defense Authorization Act for Fiscal Year 2007 (Act).<sup>42</sup> The Act caps the annual percentage rate (APR) that may be charged to a member of the military at 36%.<sup>43</sup> The state of Missouri just recently forced dozens of nursing homes to quit running payday lending operations.<sup>44</sup> Ultimately, Jean Ann Fox, Director of Consumer Protection for the Consumer Federation of America

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35. FDIC, *supra* note 18.

36. Tom Feltner & Marva Williams, *New Terms for Payday Loans: High Cost Lenders Change Loan Terms to Evade Illinois Consumer Protections*, 25 WOODSTOCK INST. 1, 5 (2004), available at [http://woodstockinst.org/document/alert\\_25.pdf](http://woodstockinst.org/document/alert_25.pdf).

37. Press Release, Office of N.Y. State Attorney Gen., *supra* note 7.

38. Feltner & Williams, *supra* note 36, at 4.

39. DEP'T OF DEF., REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 13 (2006), [http://www.defenselink.mil/pubs/pdfs/Report\\_to\\_Congress\\_final.pdf](http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf).

40. *Id.*

41. Watkins, *supra* note 1.

42. John Warner Nat'l Def. Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2083 (to be codified at 10 U.S.C. § 987).

43. *Id.* A member of the military is defined as a member on active duty or active guard or reserve duty. *Id.* The banking industry fears that this law may encourage other activists to seek lending limits for other groups. See Stacy Kaper, *Lobbyist Face Hard Task on Military APR Provision*, AM. BANKER., Oct. 20, 2006.

44. RTOonline.com, *Missouri Governor Blunt Bans Employer Payday Loan Programs in Nursing Homes*, [http://www.rtoonline.com/Content/Article/Sep\\_06/PaydayLoansNursingHomesMissouri091306.asp](http://www.rtoonline.com/Content/Article/Sep_06/PaydayLoansNursingHomesMissouri091306.asp) (last visited Jan. 12, 2007).

concludes that “[p]ayday loan customers are those unable to exert enough market pressure to protect *themselves*.”<sup>45</sup>

*B. The “Rent-a-Charter” Method of Payday Lending*

National payday lending companies typically use in-state agents to carry out their business in states where lending laws are particularly stringent.<sup>46</sup> “In states with no enabling legislation for payday lending, some payday [lending] stores operate as agents for banks . . . located in states without restrictive usury limits. Under this arrangement, the bank is said to be ‘renting its charter’ and ‘exporting its usury ceiling.’”<sup>47</sup> Federal law allows banks to charge interest rates permitted in their home state to all consumers regardless of where they reside around the country.<sup>48</sup> Payday lending services typically partner with banks located in Delaware and South Dakota because these states place no cap on interest rates.<sup>49</sup> The rent-a-charter or agency method effectively allows lenders to avoid state caps on interest rates by conducting business under more profitable usury laws of other states.<sup>50</sup>

Interest rates in North Carolina are capped at 36% for licensed lenders<sup>51</sup> and 16% for unlicensed lenders.<sup>52</sup> However, by using the rent-a-charter method, payday lenders located in North Carolina charge interest rates much higher than the 36% and 16% allowed by North Carolina usury and consumer protection laws.<sup>53</sup>

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45. Nat’l Endowment for Fin. Educ., *supra* note 29.

46. *See, e.g.*, In re Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 9 (Comm’r of Banks, Dec. 22, 2005) (order), *available at* [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031D DB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031D DB4/0/43_AANCFINALORDER122205.pdf).

47. MARK FLANNERY & KATHERINE SAMOLYK, FED. RESERVE BANK OF CHICAGO, PAYDAY LENDING: DO THE COSTS JUSTIFY THE PRICE? 4 (2005), [http://www.chicagofed.org/cedric/files/2005\\_conf\\_paper\\_session1\\_flannery.pdf](http://www.chicagofed.org/cedric/files/2005_conf_paper_session1_flannery.pdf).

48. 12 U.S.C. § 85 (2000) (national banks); 12 U.S.C. § 1831d (2000) (state banks). “The National Bank Act and the Federal Deposit Insurance Act allow banks to charge any customer the interest rates allowed in their home state.” FLANNERY & SAMOLYK, *supra* note 47, at 3.

49. FLANNERY & SAMOLYK, *supra* note 47, at 3.

50. *See* Rob Blackwell, *Congress Cheers, Jeers FDIC on Payday Lending*, AM. BANKER, Mar. 21, 2003.

51. N.C. Gen. Stat. § 53-173 (2005).

52. § 24-1.1.

53. *See* Press Release, Senator Charles E. Schumer, Schumer Warns Capital

For example Advance America Cash Advance Centers of North Carolina, Inc. (AANC), a North Carolina payday lender, charged interest rates ranging from 443.21% to 521.43%.<sup>54</sup> Furthermore, the out-of-state bank generally has no other connection to the in-state payday lender other than renting out its charter.<sup>55</sup> In a typical rent-a-charter agreement, the payday lender agrees to maintain and staff its stores, conduct marketing and advertising for the cash centers, accept and process applications, disburse loan proceeds, and collect the loans.<sup>56</sup> Within a few days, the bank generally sells up to 95% of the participation of the loan back to the payday lender.<sup>57</sup> Essentially, the bank is charging the payday lender a 5% fee for lending under the bank's charter.<sup>58</sup> For example, AANC contracted with Peoples National Bank of Paris, Texas to use its charter in exchange for 10.08% of the gross revenue while AANC retained the remaining 89.92% of the profits.<sup>59</sup> Congress has suggested that the rent-a-charter loophole "undermine[s] traditional state authority to regulate small loans, expose[s] consumers to abusive lending practices, and create[s] a competitive disadvantage for other local lenders."<sup>60</sup>

C. *Payday Lending in the United States—The Trend Toward Regulation*

The payday lending industry experienced rapid initial growth.<sup>61</sup> From an industry that "was virtually nonexistent a

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Region Military Families to Beware of Payday Loan Scams that Prey on Soldiers & Rip them off with 900% Interest (Aug. 3, 2004), [http://www.senate.gov/~schumer/SchumerWebsite/pressroom/press\\_releases/2004/PR02797.paydayalbany080304.html](http://www.senate.gov/~schumer/SchumerWebsite/pressroom/press_releases/2004/PR02797.paydayalbany080304.html).

54. *In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 7, 12 (Comm'r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf).

55. *See, e.g., id.* at 14.

56. *See, e.g., id.*

57. Press Release, Senator Charles E. Schumer, *supra* note 53.

58. *Id.*

59. *In re Advance Am.*, No. 05:008:CF, at 12.

60. Letter from U.S. House of Rep. Comm. on Fin. Serv., to Donald E. Powell, Chairman, Fed. Deposit Ins. Corp. (Mar. 18, 2003), available at [http://www.house.gov/apps/list/press/ba31\\_democrats/paydaylending.pdf](http://www.house.gov/apps/list/press/ba31_democrats/paydaylending.pdf).

61. ERNST ET AL., *supra* note 6, at 2.



decade ago,”<sup>62</sup> the payday lending industry, by 2000, grew into a national network that cashed more than 180 million checks a year with a face value of \$55 billion.<sup>63</sup> The payday loan industry was estimated to be involved in “65 million transactions to [eight] to [ten] million households generating \$2.4 billion in fee revenue.”<sup>64</sup> Some scholars estimated that there were approximately 10,000 check cashing outlets located in the United States.<sup>65</sup> Some states were said to have more payday lending stores than they had Burger King and McDonald’s restaurants combined.<sup>66</sup>

The high-risk nature and the substantial growth of the payday lending industry has led to more state and federal restrictions.<sup>67</sup> “Payday lending raises many consumer protection issues and attracts a great deal of attention from consumer advocates and other regulatory organizations . . . .”<sup>68</sup> For example, in March of 2005, the FDIC issued extensive guidelines for banks that engage in the payday lending business.<sup>69</sup> These guidelines allow the FDIC to examine payday lenders and their relationship with in-state agents,<sup>70</sup> and, as noted earlier, the restrictions limit the number of payday loans a consumer can obtain in a calendar year.<sup>71</sup> Furthermore, the state of Georgia has a statute that “restricts in-state payday stores from acting as agents for out-of-state banks in one, limited circumstance: where the agency agreement grants the *in-state agent* ‘the predominate economic interest’ in the bank’s payday loan, which . . . means that the

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62. *Id.*

63. Michael A. Stegman, *Banking the Unbanked: Untapped Market Opportunities for North Carolina’s Financial Institutions*, 5. N.C. BANKING INST. 23, 28 (2001) [hereinafter Stegman, *Banking the Unbanked*].

64. JEAN ANN FOX, CONSUMER FED’N OF AM., RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 6 (2001), <http://www.consumerfed.org/pdfs/paydayreport.pdf>.

65. Stegman, *Banking the Unbanked*, *supra* note 63, at 29.

66. Michael Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. QUARTERLY 8, 9 (2003), available at [http://www.kenan-flagler.unc.edu/assets/documents/CC\\_Payday\\_lending.pdf#search=%22Payday%20AND%20Lender%20And%20Burger%20And%20King%22](http://www.kenan-flagler.unc.edu/assets/documents/CC_Payday_lending.pdf#search=%22Payday%20AND%20Lender%20And%20Burger%20And%20King%22).

67. *See* FDIC, *supra* note 18.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

payday stores hold more than 50% of the revenues from the loan.<sup>72</sup> Also, as noted earlier, President Bush recently signed into law a bill that limits the interest rates that can be charged to active and reserve military personnel.<sup>73</sup> The state and federal reaction to this booming industry suggests a trend towards more regulation.<sup>74</sup>

### III. THE HISTORY OF PAYDAY LENDING IN NORTH CAROLINA

Prior to October 1, 1997, North Carolina law did not expressly permit the making of payday loans.<sup>75</sup> During this period, all short-term loans were subject to the North Carolina Finance Act and North Carolina's usury laws.<sup>76</sup> On October 1, 1997, the North Carolina General Assembly passed the North Carolina Check Cashing Act (NCCCA).<sup>77</sup> This Act permitted payday loans in North Carolina but required that they be no more than \$300 including fees, contain a maturity date not more than thirty-one days after the loan was issued, and required that the total fees not exceed 15% of the face value of the check.<sup>78</sup> Furthermore, the NCCCA required that all payday lenders be licensed by the state of North Carolina as check cashers.<sup>79</sup> The NCCCA contained a "sunset date" of July 31, 2001.<sup>80</sup> The North Carolina General assembly extended this date until August 31, 2001; however, the NCCCA was allowed to expire on August 31, 2001.<sup>81</sup> During this

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72. *BankWest, Inc. v. Baker*, 411 F.3d 1289, 1293 (11th Cir. 2005).

73. John Warner Nat'l Def. Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2083 (to be codified at 10 U.S.C. § 987).

74. Elizabeth Willoughby, Note, *BankWest, Inc. v. Baker: Is it Mayday for Payday Lenders in Rent-A-Charter Arrangements?*, 9 NC BANKING INST. 269, 287 (2005).

75. *In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 6 (Comm'r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf).

76. *Id.* at 6. Licensed lenders are allowed to charge interest rates no higher than thirty-six percent. N.C. Gen. Stat. § 53-276 (2005). Unlicensed lenders are allowed to charge interest rates no higher than sixteen percent. § 24-1.1.

77. N.C. Gen. Stat. § 53-276 (2005).

78. § 53-281(b-d) (1999) (repealed).

79. *Id.*

80. *In re Advance Am.*, No. 05:008:CF, at 7.

81. *Id.*

four-year “experiment”<sup>82</sup> with payday lending, payday lenders operated under the “standard business model.”<sup>83</sup> Under the standard business model, payday lenders were properly licensed, used their own funds to loan money, and acted in accord with the regulations set forth in the North Carolina Check Cashing Act.<sup>84</sup>

The expiration, on August 31, 2001, of the NCCCA did not put an end to the payday lending industry in North Carolina.<sup>85</sup> While some payday lenders did cease operations, others kept their doors open by using other designs.<sup>86</sup> Some entities, for example, employed leasing and Internet service schemes.<sup>87</sup> One “[f]ormer payday lender operated an Internet service ‘rebate’ scheme where customers received an instant cash ‘rebate’ that had to be repaid through a long-term Internet contract.”<sup>88</sup> The courts looked at this transaction and determined it was essentially a guise for a payday lending business and held that it violated North Carolina usury laws, the North Carolina Consumer Finance Act, and was an unfair and deceptive trade practice.<sup>89</sup> Another payday lender attempted to operate a payday lending operation under the pretext of a leasing company.<sup>90</sup> The company would buy property from a consumer and then lease it back to him or her in exchange for a small loan.<sup>91</sup> A North Carolina judge put an end to this practice in

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82. Press Release, Roy Copper, N.C. Att’y Gen., Payday Lending on the Way out in NC, at 4 (Mar. 1, 2006), <http://www.ncdoj.com/DocumentStreamerClient?directory=PressReleases/&file=paydaylenders3.06.pdf#search=%22Payday%20lending%20North%20Carolina%22>.

83. *In re Advance Am.*, No. 05:008:CF, at 7.

84. *Id.*

85. Press Release, Roy Cooper, *supra* note 82, at 4.

86. *Id.*

87. *Id.*

88. *Id.*

89. *State ex rel. Cooper v. NCCS Loans, Inc.* 624 S.E.2d 371, 374 (N.C. Ct. App. 2005). The court determined that the Internet service transactions were essentially the same as the payday loan transaction. *Id.* at 375. At first the customer was required to show proof of employment and proof of a checking account. *Id.* Then the customer was given a cash advance that he was required to payoff in the future. *Id.* The court noted that all the advertisements for the Internet service provider emphasized instant cash and were listed under loans in the Yellow Pages. *Id.* at 376. A survey of customers indicated that they signed the Internet service contract solely for the instant cash. *Id.* Further, no evidence was offered that *any* person had ever patronized the store to obtain Internet service. *Id.*

90. Press Release, Roy Cooper, *supra* note 82, at 4.

91. Democratic Leadership Council, New Dem of the Week: Roy Cooper (May

November of 2003.<sup>92</sup> Other companies used the rent-a-charter or agency method to continue operations.<sup>93</sup> These lenders partnered with national banks in order to avoid state usury and consumer protection laws.<sup>94</sup> For example, Dollar Financial Group, a payday lender, entered into an agreement with Eagle National Bank (ENB) of Upper Darby, Pennsylvania.<sup>95</sup> ENB was one of the most notorious national banks offering its charter for rent.<sup>96</sup> ENB was so deeply involved in payday lending that almost half its profits were a result of the payday lending industry.<sup>97</sup> From 1995 until 2001, ENB's payday lending volume increased by an enormous \$397 million.<sup>98</sup>

Concerned that national banks were renting out their charters, the Office of the Comptroller of the Currency (OCC) wrote an advisory letter "warning any national bank engaged in payday lending to do so in a 'safe and sound manner.'"<sup>99</sup> Because ENB continued to operate its payday lending operation, the OCC issued an enforcement action against the bank requiring it to sever its relationship with payday lenders.<sup>100</sup> In North Carolina,

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12, 2003), [http://www.ppionline.org/ndol/ndol\\_ci.cfm?kaid=104&subid=116&ontentid=251580](http://www.ppionline.org/ndol/ndol_ci.cfm?kaid=104&subid=116&ontentid=251580). "James Crawford was buying consumers' property and then leasing it back to them in exchange for loans of \$50 to \$300. In a typical transaction for a \$300, 13-month loan, a borrower would have to make bi-weekly payments of \$54, plus \$9 in taxes. That adds up to a total payment of \$1,764 -- equal to an annual percentage rate of 480% -- on top of which, borrowers would have to pay an additional \$300 at the end of their lease term to buy back their property." *Id.*

92. *Id.*

93. In re Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 9 (Comm'r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf).

94. 12 U.S.C. § 85 (2000); *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978). The court, interpreting 12 U.S.C. § 85, held that a national bank located in Nebraska could charge interest at the rates allowed under Nebraska law on credit-card loans made to customers who resided in Minnesota, even though such rates would be usurious under Minnesota law. *Id.*

95. Scott Shaaf, Note, *Update on Payday Lending: State and National Regulators are Getting Aggressive*, Independent Study 7 (Mar. 18, 2002) (on file with N.C. Banking Inst.).

96. *Id.*

97. Nicole Duran, *OCC Orders Bank to Exit Payday Biz*, AM. BANKER, Jan. 4, 2002.

98. Press Release, Comptroller of the Currency, Fact Sheet: Eagle National Bank Consent Order 2 (Jan. 3, 2002), <http://www.occ.treas.gov/ftp/release/2002-01a.doc>.

99. Shaaf, *supra* note 95, at 7.

100. Duran, *supra* note 97, at 1.

Advance America, Cash Advance Centers of North Carolina, Inc. (AANC) was partnered with People's National Bank of Paris, Texas.<sup>101</sup> In early 2002, the OCC announced that it was filing charges against People's National Bank “[for engaging] in unsafe and unsound practices in connection with its payday lending program.”<sup>102</sup> Ultimately, AANC and People's National Bank agreed to end their payday lending relationship and to pay \$175,000 in civil money penalties.<sup>103</sup>

After the OCC began aggressively regulating relationships between national banks and payday lenders, many such lenders entered into agreements with banks chartered under state law.<sup>104</sup> For example, immediately after AANC terminated its relationship with People's National Bank, it entered into an agreement with Republic Bank and Trust Company, which is a state bank chartered under the laws of Kentucky.<sup>105</sup> While AANC was under contract with Republic Bank and Trust, the FDIC introduced revised guidance procedures for payday lenders.<sup>106</sup> The new guidance procedures limited “the number of payday advances that could be made to a customer in a year while allowing other alternative long-term credit products, generally installment loans.”<sup>107</sup>

These changes caused AANC to terminate its relationship with Republic Bank and Trust, and enter into an agreement with First Fidelity Bank (FFB), a bank chartered under the laws of South Dakota.<sup>108</sup> FFB was authorized under South Dakota law to make high interest installment loans.<sup>109</sup> “Republic was not

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101. In re Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 6 (Comm'r of Banks, Dec. 22, 2005) (order), *available at* [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf).

102. *Id.* at 12.

103. *Id.*

104. *Id.* at 13.

105. *Id.*

106. *Id.* at 16.

107. In re Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 20 (Comm'r of Banks, Dec. 22, 2005) (order), *available at* [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf).

108. *Id.* at 19.

109. *Id.* at 21.

authorized under Kentucky law to make high interest rate installment loans comparable to the FFB installment loans at the rates charged by FFB under South Dakota law,” thus, AANC replaced Republic Bank and Trust with FFB.<sup>110</sup> AANC and other payday lenders maintained these relationships until the North Carolina Commissioner of Banks ended the rent-a-charter or agency payday-lending model in North Carolina.<sup>111</sup>

The pervasiveness of payday lending in North Carolina mirrored that of the United States as a whole.<sup>112</sup> Some estimates suggested that there were more than 1200 payday-lending outlets located in North Carolina, which made up approximately ten percent of all payday lending outlets in the United States.<sup>113</sup> “In 1999, payday lenders in North Carolina originated more than 2.9 million transactions totaling more than \$535 million, generating in excess of \$80 million dollars in fees . . . and this excludes licensed pawnbrokers in North Carolina who provide their own unique brand of consumer credit.”<sup>114</sup> Put another way, there was one payday lender in North Carolina for every two traditional banks, and, in some counties, payday lenders outnumbered traditional banks.<sup>115</sup> The North Carolina Association of Check Cashers said that customers in North Carolina visited payday lenders 654,000 times each month for a total of 7,859,000 times each year.<sup>116</sup>

#### IV. RENT-A-CHARTER PAYDAY LENDING COMES TO AN END IN NORTH CAROLINA

On December 22, 2005, the North Carolina Commissioner of Banks ended rent-a-charter or agency payday lending in North Carolina.<sup>117</sup> The issue in *In re Advance America, Cash Advance*

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110. *Id.*

111. *Id.* at 23.

112. Stegman, *The Public Policy Challenges of Payday Lending*, *supra* note 5, at 18.

113. *Id.* at 17.

114. *Id.*

115. *Id.*

116. Shaaf, *supra* note 95, at 2.

117. *In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 53-54 (Comm’r of Banks, Dec. 22, 2005) (order), available at <http://www.nccob.org/NR/>

*Centers of North Carolina, Inc.*, was whether payday lenders who used the rent-a-charter or agency method of doing business violated the North Carolina Consumer Finance Act (CFA).<sup>118</sup> One such questionable lender was Defendant AANC.<sup>119</sup> AANC is a wholly owned subsidiary of Advance America, Cash Advance Centers, Inc., a Delaware corporation that is the largest payday lending company in the United States.<sup>120</sup> AANC had operated as many as 118 payday lending stores in North Carolina.<sup>121</sup> From October 31, 1997 until August 31, 2001, when payday lending was statutorily authorized in North Carolina, AANC operated under the standard business model.<sup>122</sup> After the sunset of the North Carolina Check Cashing Act, AANC continued to operate under the rent-a-charter or agency model.<sup>123</sup>

A. *Issue 1: Is AANC Subject to the CFA?*

In order for a company to be subject to the CFA, it must be determined that it is (i) a person (ii) that is engaged in the business of lending, (iii) which lending is in amounts of \$10,000 or less.<sup>124</sup> The Commissioner found, and there was no dispute, that AANC was a corporation and thus was a “person” within the meaning of the CFA.<sup>125</sup> The Commissioner then had to determine whether AANC was “engaged in the business of lending.”<sup>126</sup>

There was significant dispute as to whether AANC was “engaged in the business of lending” under the CFA.<sup>127</sup> The North Carolina Attorney General contended that the statute should be interpreted broadly, and under such an interpretation, AANC

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118. *Id.*; N.C. Gen. Stat. § 53-164 (2005).

119. *In re Advance Am.*, No. 05:008:CF, at 2.

120. *Id.*

121. *Id.*

122. *Id.*

123. *See id.*

124. N.C. Gen. Stat. § 53-166 (2005).

125. *In re Advance Am.*, No. 05:008:CF, at 32.

126. *Id.*

127. *See id.*

would be “engaged in the business of lending.”<sup>128</sup> AANC contended that the CFA did not apply to AANC under the rent-a-charter or agency model and should be interpreted strictly.<sup>129</sup> The Commissioner, after reviewing the plain language of the CFA, the intent of the General Assembly, and the legislative history, determined that the scope of the CFA was “to be interpreted and applied broadly.”<sup>130</sup> After an extensive review of the record, the Commissioner held that AANC was “engaged in the business of lending” in North Carolina because the sole purpose of AANC’s centers in North Carolina was for the origination, servicing and processing of loans.<sup>131</sup> The Commissioner determined that AANC’s small loans and advances fell within the CFA because the borrower received cash or its equivalent in amounts less than \$10,000.<sup>132</sup>

*B. Issue 2: Has AANC Violated the CFA?*

AANC violated the CFA if it received compensation in amounts greater than allowed by North Carolina usury law, Chapter 24.<sup>133</sup> Under Chapter 24, unless AANC is a licensed consumer finance lender, the maximum rate allowed on loans of \$25,000 or less is 16% per annum.<sup>134</sup> If AANC was a licensed lender, then the maximum rate on loans less than \$30,000 is 36% for the first \$600 and 15% on amounts greater than \$600. After an extensive review of AANC’s agency relationship with its three out-of-state partners, the Commissioner determined that AANC’s compensation for payday loans was much greater than allowed by Chapter 24 of the CFA.<sup>135</sup> AANC typically received compensation at an annual percentage rate of approximately 450%.<sup>136</sup>

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128. *Id.*

129. *Id.*

130. *Id.* at 33.

131. *In re Advance Am.*, No. 05:008:CF, at 37.

132. *Id.* at 38.

133. N.C. Gen. Stat. § 53-166(a) (2005).

134. § 24-1.1.

135. *In re Advance Am.*, No. 05:008:CF, at 39. AANC’s relationship with Peoples National Bank yielded interest rates of 443.21%. *Id.* at 9. AANC’s relationship with Republic Bank and Trust company yielded interest rates of 456.26%. *Id.* at 14.



C. *Issue 3: Is AANC Exempt from the CFA?*

Lastly, the Commissioner was required to determine whether AANC was exempt from the CFA by the terms of the statute or because enforcement of the CFA against AANC was preempted by federal law.<sup>137</sup> AANC argued that because G.S. § 53-190b<sup>138</sup> refers to agents of out-of-state lenders but does not state that such agents are liable under the CFA, such agents are therefore exempt from the statute.<sup>139</sup> After reading the relevant portions of the CFA, the Commissioner determined that “subsection (b) of N.C. Gen. Stat §190 is a long-arm statute intended to extend the State’s jurisdiction to out-of-state lenders when they operate in North Carolina, either directly or through agents.”<sup>140</sup>

AANC also contended that federal law and the U.S. Constitution preempted enforcement of the CFA against AANC.<sup>141</sup> This argument rested on the concept that a state cannot enforce a law that conflicts with the purpose of a federal law.<sup>142</sup> AANC based its claim for preemption on Section 27 of the Federal Deposit Insurance Act (FDIA).<sup>143</sup> “AANC argue[d] that

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AANC’s relationship with First Fidelity Bank yielded interest rates of 521.43%. *Id.* at 21.

136. *Id.* at 14.

137. *In re Advance Am.*, No. 05:008:CF, at 42.

138. N.C. Gen. Stat. § 53-190(b) (2005). “If any lender or agent of a lender who makes loan contracts outside this state in the amount or of the value of ten thousand dollars (\$10,000) or less, comes into this State to solicit or otherwise conduct activities in regard to such loan contracts, then such lender shall be subject to the requirements of this article.” *Id.*

139. *In re Advance Am.*, No. 05:008:CF, at 41.

140. *Id.* at 42.

141. *Id.*

142. *Id.*

143. *In re Advance Am.*, No. 05:008:CF, at 43.

In order to prevent discrimination against State-chartered insured depository institutions . . . with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank . . . would be permitted to charge in the absence of this subsection, such State bank . . . may, notwithstanding any State constitution or statute which is hereby preempted for the purpose of this section, take, receive, reserve, and charge on any loan or discount made, or upon any other note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 percentum in excess of the discount rate on ninety-day commercial paper in

enforcement of the CFA against it would frustrate the interstate operations of the banks provided for by the FDIA.”<sup>144</sup> However, the Commissioner noted that:

State law is not lightly set aside, especially in areas typically regulated by state law, like banking and consumer protection, unless Congress has shown a clear intent to preempt the state law, either by express language, by clear implication, or by a federal agency acting within the authority given to it by Congress.<sup>145</sup>

Furthermore, the Commissioner found that the express language of Section 27 of the FDIA refers to the protection of banks, and neither of the state-chartered banks AANC partnered with to carry out business in North Carolina were parties to the lawsuit.<sup>146</sup>

AANC further argued that “it should gain the benefit of federal preemption under Section 27 [of the FDIA] because the banks were the true lenders of [a]dvance and [i]nstallment [l]oans and AANC was only their agent, providing ministerial services in connection with such advances and loans.”<sup>147</sup> However, the Commissioner reasoned that the relationships between AANC and its partner banks do not fit the characterization as merely an agency.<sup>148</sup> “AANC and [its parent company] were the controlling parties in all such relationships, [they] took the predominant share of benefits of such relationships, and [they] changed partners virtually at will to insure the maximum return to the [p]arent [company].”<sup>149</sup> Ultimately, the Commissioner held that AANC

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effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State . . . where the bank is located . . . .

12 U.S.C. 1831(d) (2000) (Section 27).

144. *Id.* at 42.

145. *Id.* at 43.

146. *Id.*

147. *Id.* at 44.

148. *Id.*

149. *In re Advance Am.*, No. 05:008:CF, at 44.

“failed to show that it is a person operating under the authority of a federal banking law, or that any principles of federal preemption control the application of the CFA to [AANC’s] operations in North Carolina.”<sup>150</sup>

AANC also made an estoppel claim.<sup>151</sup> Essentially, AANC contended that because the Commissioner of Banks and the Attorney General did not take legal action against AANC immediately after the NCCCA expired, those two offices were estopped from enforcing the law.<sup>152</sup> However, the Commissioner held that because the offices did not receive any benefit from AANC, they are not required to bear the burden of failing to enforce the law.<sup>153</sup> Furthermore, the State cannot be estopped from exercising a clear governmental function—enforcing the law.<sup>154</sup>

#### D. Conclusion

After a review of all the evidence, the Commissioner determined that AANC was subject to the North Carolina CFA.<sup>155</sup> Furthermore, AANC had consistently violated the CFA by offering loans at rates radically higher than allowed by North Carolina law.<sup>156</sup> The Commissioner also dismissed the claims that AANC was exempt from the CFA based on federal preemption principles and estoppel claims.<sup>157</sup> As such, AANC was ordered to immediately cease and desist further payday operations in North Carolina.<sup>158</sup> Any violation of the Commissioner’s order could result in civil penalties.<sup>159</sup> The Commissioner’s ruling has effectively ended rent-a-charter payday lending in North Carolina.<sup>160</sup>

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150. *Id.* at 46.

151. *Id.* at 48.

152. *Id.*

153. *Id.* at 49.

154. *Id.* at 52.

155. *In re Advance Am.*, No. 05:008:CF, at 53.

156. *Id.* at 53.

157. *Id.* at 54.

158. *Id.*

159. *Id.*

160. *Id.* at 53-54.

V. THE COMMISSIONER'S OPINION: EXPANDING THE *BANKWEST V. BAKER* ARGUMENT?

A. *BankWest v. Baker*

In *BankWest*, the primary issue considered by the court was whether a Georgia payday lending statute was preempted by the FDIA.<sup>161</sup> The Georgia Act “restricts in-state payday stores from acting as agents for out-of-state banks in one, limited circumstance: where the agency agreement grants the in-state agent ‘the predominant economic interest’ in the bank’s payday loan, which . . . means that the payday stores hold more than 50% of the revenues from the loan.”<sup>162</sup> The state of Georgia enacted this law to prevent in-state payday stores from circumventing Georgia’s usury laws.<sup>163</sup>

The plaintiffs in the case were two state banks chartered under the laws of Delaware and South Dakota.<sup>164</sup> Plaintiff banks filed a lawsuit for a preliminary injunction enjoining application of the new Georgia payday lending law.<sup>165</sup> Plaintiff banks had agents in the state of Georgia who operated the payday-lending stores.<sup>166</sup> “The agents set up retail locations in Georgia at which borrowers could apply for payday loans, and the agents’ duties were to market and service the loans as well as to collect payment and report to the banks providing the funds for the loan.”<sup>167</sup> Plaintiff banks retained certain responsibilities such as setting “the terms of the loan, including the loan amounts, fees and charges, interest rates, repayment terms, credit limits, and credit standards.”<sup>168</sup>

Ultimately, the trial court concluded, and the appellate court affirmed, that the Georgia payday lending statute was not preempted by any federal legislation.<sup>169</sup> Specifically, the trial court

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161. *BankWest, Inc. v. Baker*, 411 F.3d 1289, 1301 (11th Cir. 2005).

162. Ga. Code Ann. § 16-17-2(b)(4) (2006).

163. *BankWest*, 411 F.3d at 1293.

164. *Id.*

165. *Id.* at 1299.

166. *Id.* at 1295.

167. Willoughby, *supra* note 74, at 280.

168. *Id.*

169. *BankWest, Inc. v. Baker*, 411 F.3d 1289, 1302 (11th Cir. 2005).

held that there was “nothing in the federal banking laws or the cases applying them that gives banks and their purported agents the sole and exclusive right to define the nature of their relationship and their transaction . . . for the sole purpose of avoiding the application of state usury laws.”<sup>170</sup> The Georgia payday lending statute allows out-of-state banks to export their state’s interest rates; however, it prohibits out-of-state banks from using an agent who receives a predominant economic interest in the loan.<sup>171</sup> Out-of-state banks could potentially restructure their agency relationships to comply with the Georgia statute and continue providing payday loans in Georgia at rates greater than allowed by Georgia usury law.<sup>172</sup>

*B. The North Carolina Commissioner of Banks’ Decision – Taking BankWest One Step Further?*

Some scholars have suggested that the decision in *BankWest* is “likely to have an important impact on payday lending in states across the country, as state lawmakers will likely follow Georgia’s lead in implementing statutes to effectively outlaw such rent-a-charter practices within their borders.”<sup>173</sup> The Commissioner’s decision to end the rent-a-charter method of payday lending appears to be a manifestation of this predicted trend. The Commissioner appears to be expanding the *BankWest* argument in a way that it could be used in states without the Georgia statute and may have far-reaching effects in shutting down the rent-a-charter business model used by payday lending shops.

While not explicitly setting a “predominant economic interest” standard, like the one used in *BankWest*, the Commissioner used very similar language in describing the interest of AANC versus the interest of the banks for which AANC was acting as the purported agent.<sup>174</sup> The Commissioner stated,

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170. *BankWest, Inc. v. Baker*, 324 F. Supp. 2d 1351 (N.D. Ga. 2004).

171. Ga. Code Ann. § 16-17-1(c) (2004).

172. *BankWest*, 324 F. Supp. 2d at 1352.

173. Willoughby, *supra* note 74, at 286.

174. *In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 28 (Comm’r of Banks, Dec. 22, 2005) (order), available at <http://www.nccob.org/NR/>

“AANC continued its cash advance lending business in North Carolina after the State’s payday lending law expired by ‘outsourcing’ the funding and underwriting of its operations [to Peoples National Bank] for a fee of just over 10% of the gross revenue.”<sup>175</sup> Furthermore, the Commissioner asserted that “[f]or [AANC’s] services under the agreement [with Republic Bank and Trust], AANC received 67% of the revenue. . . .”<sup>176</sup> As noted earlier, the Commissioner felt that “AANC and [its parent company] were the controlling parties in all such relationships, [they] took the predominant share of benefits of such relationships, and [they] changed partners virtually at will to insure the maximum return to the [p]arent [company].”<sup>177</sup>

The Commissioner’s opinion appears to go one step further than the opinion in *BankWest* in constructing a framework for ending the rent-a-charter method of payday lending.<sup>178</sup> The strength of the Commissioner’s opinion is that it does not rely on a specific North Carolina payday lending statute to eliminate the rent-a-charter method of payday lending, rather the Commissioner looks to the North Carolina CFA.<sup>179</sup> The CFA was not enacted to deal specifically with payday lenders; instead, it is a broad statute dealing with all aspects of consumer finance.<sup>180</sup> The Commissioner’s argument that the CFA forecloses an agent of an out-of-state bank from importing interest rates into North Carolina in excess of the state’s usury laws seems to be on solid ground.<sup>181</sup>

In a recent FDIC rulemaking proceeding, the FDIC examined the issue of state law preemption under Sections 24(j)

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175. *Id.* at 12.

176. *Id.* at 14.

177. *Id.* at 44.

178. *Id.* at 53-54.

179. *Id.* at 46.

180. N.C. Gen. Stat. § 53-164 (2005).

181. In re Advance Am., Cash Advance Centers of N.C., Inc., No. 05:008:CF, 46 (Comm’r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORD ER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORD ER122205.pdf).

and 27 of the FDIA.<sup>182</sup> Based on this proceeding, the FDIC issued a Notice of Proposed Rulemaking limited to implementation of FDIA Section 24(j) and Section 27.<sup>183</sup> The Commissioner found, “[t]he proposed rule with regard to Section 27 applies to banks and, by reference to OCC interpretations, to operating subsidiaries of banks. It does not refer at all to agents or other affiliated parties of banks.”<sup>184</sup> Ultimately the Commissioner concluded, “[that] the FDIC . . . when presented with the opportunity to officially interpret the preemptive effect of federal law generally, and Section 27 in particular, has not extended such preemption to third party providers such as AANC.”<sup>185</sup>

By not specifically setting a “predominant economic interest” standard, the Commissioner’s decision may make it difficult, if not impossible, for out-of-state banks to restructure their agency relationships in such a way as to continue lending in North Carolina in excess of North Carolina usury law.<sup>186</sup> In *BankWest*, the state statute left open the possibility that out-of-state banks could restructure their relationships with in-state agents so as to continue lending in Georgia at interest rates above what is allowed by state usury laws.<sup>187</sup> Even so, the new payday lending structure in Georgia is much less attractive to in-state agents because the agents must keep less than 50% of the profit.<sup>188</sup> The Commissioner, by relying on the North Carolina CFA, takes a more hard-line stand against payday lending.<sup>189</sup> By finding that agents of out-of-state banks are subject to the North Carolina CFA, there is no way in which in-state agents can restructure their

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182. *Id.* at 45.

183. *Id.*

184. *Id.* at 46.

185. *Id.* at 45.

186. *Id.* at 12, 14, 22. The Commissioner never states a specific “predominant economic interest” standard like the standard used in Georgia. Ga. Code. Ann. § 16-17-2(b)(4) (2006). However, the Commissioner notes the economic interest AANC retains in all its relationships with out-of-state banks. *In re Advance Am.*, No. 05:008:CF, at 12, 14, 22.

187. *BankWest, Inc. v. Baker*, 324 F. Supp. 2d 1352 (N.D. Ga. 2004).

188. Willoughby, *supra* note 74, at 285.

189. *In re Advance Am.*, No. 05:008:CF, at 53. The Commissioner does not rely on a specific North Carolina payday lending statute. *Id.* Rather, the Commissioner finds that agents of out-of-state payday lenders must abide by the North Carolina Consumer Finance Act. *Id.*

relationships with out-of-state banks to avoid North Carolina usury limits.<sup>190</sup>

Many states already limit payday lending practices by banks within their borders.<sup>191</sup> The Commissioner's decision creates a framework by which other states can reach out-of-state banks and end the rent-a-charter method of payday lending without having to engage in the onerous legislative process.<sup>192</sup> Other states could follow North Carolina's lead and end the rent-a-charter method of payday lending by holding that agents of out-of-state banks are subject to state consumer finance laws.<sup>193</sup> Similar interpretations by other states will effectively shut down the rent-a-charter method of payday lending and will result in a more economically healthy society.<sup>194</sup>

## VI. CONCLUSION

The payday lending industry in the United States was once a massive business.<sup>195</sup> However, the high-risk nature of the short term credit industry and the potential for abuse has led to more restrictions on payday lending.<sup>196</sup> The payday lending industry has seen a storm of both federal and state regulations.<sup>197</sup> On December 22, 2005, the North Carolina Commissioner of Banks effectively ended payday lending in North Carolina.<sup>198</sup> The

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190. N.C. Gen. Stat. § 53-190 (2005). "If any lender or agent of a lender who makes loan contracts outside this State in the amount or of the value of ten thousand dollars (\$10,000) or less, comes into this State to solicit or otherwise conduct activities in regard to such loan contracts, then such lender shall be subject to the requirements of this Article." *Id.*

191. Erik Eckholm, *Seductively Easy, 'Payday Loans' Often Snowball*, N.Y. TIMES, Dec. 23, 2006, at A1. Payday lending is banned in 11 states. *Id.*

192. *See In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 32-53 (Comm'r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf). Other states could prevent the rent-a-charter method of payday lending by requiring in-state agents of out-of-states banks to comply with state consumer finance laws. *Id.* This method would be less burdensome than proposing and enacting a payday lending specific statute. *Id.*

193. *See id.* at 32-38.

194. NAT'L ENDOWMENT FOR FIN. EDUC., *supra* note 29.

195. *See supra* notes 61-66 and accompanying text.

196. *See supra* notes 67-74 and accompanying text.

197. *See supra* notes 67-74 and accompanying text.

198. *In re Advance Am., Cash Advance Centers of N.C., Inc.*, No. 05:008:CF, 53-



Commissioner's opinion can be viewed as yet another wave in the changing tide of payday lending regulation.<sup>199</sup> Ultimately, the Commissioner's opinion provides a framework by which other states may limit the rent-a-charter method of payday lending within their borders without having to engage in the arduous legislative process.<sup>200</sup>

Following the state of Georgia's lead, the Commissioner expanded the *BankWest v. Baker* argument and ended payday lending in North Carolina by holding that in-state agents of out-of-state banks are subject to North Carolina consumer finance laws.<sup>201</sup> The novelty of the Commissioner's argument is that it does not require a specific anti-payday lending statute in order to end payday lending.<sup>202</sup> Rather, states simply need to hold that payday lenders are subject to general consumer finance laws.<sup>203</sup> Furthermore, states that choose to rely on their own consumer finance laws to end the rent-a-charter method of payday lending are unlikely to be preempted by federal law because in-state payday lenders are not merely agents of out-of state banks.<sup>204</sup> Rather, in-state payday lenders conduct all of the business and reap 90% or more of the profits from the payday lending operation.<sup>205</sup>

Payday lending continues to survive unregulated in 39 states.<sup>206</sup> If these states follow North Carolina's lead and interpret their consumer finance laws to reach in-state agents, in-state payday lenders will be forced to end their relationships with out-of-state banks.<sup>207</sup> Without the ability to import interest rates in

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54 (Comm'r of Banks, Dec. 22, 2005) (order), available at [http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43\\_AANCFINALLORDER122205.pdf](http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALLORDER122205.pdf).

199. See *supra* notes 67-74 and accompanying text.

200. See *In re Advance Am.*, No. 05:008:CF, at 29-52.

201. *Id.* at 53-54.

202. *In re Advance Am.*, No. 05:008:CF, at 29-52. In *BankWest*, the state of Georgia relied on Ga. Code Ann. §§ 16-17-1 – 16-17-10 (2004), a specific payday lending statute, in order to limit payday lending in Georgia. *BankWest v. Baker*, 411 F.3d 1289, 1296 (2005).

203. *Id.* at 53-54.

204. See *supra* notes 137-154 and accompanying text.

205. *In re Advance Am.*, No. 05:008:CF, at 12.

206. Erik Eckholm, *supra* note 191, at A1.

207. See *In re Advance Am.*, No. 05:008:CF, at 53-54.

excess of state usury laws, payday lending becomes significantly less profitable.<sup>208</sup> With less profit, many payday lenders are “likely to find it economically infeasible to continue operating.”<sup>209</sup>

Evidenced by the size of the payday lending industry, there was significant demand for short-term credit to manage the monetary problems of people with few assets.<sup>210</sup> The Commissioner’s ruling, ending payday lending in North Carolina, has removed a source of short-term credit for cash-strapped consumers.<sup>211</sup> Traditional banks can fill the short-term credit void by offering credit to consumers in a socially responsible fashion.<sup>212</sup> Thus, the Commissioner’s decision to end the rent-a-charter method of payday lending will have positive consequences for individual consumers<sup>213</sup> and traditional banks.<sup>214</sup> Furthermore, ending payday lending and bringing check cashers into the financial mainstream has important implications for “long-term family self-sufficiency” and the financial well-being of our society as a whole.<sup>215</sup>

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208. See Willoughby, *supra* note 74, at 287.

209. *Id.*

210. See Stegman, *The Public Policy Challenges of Payday Lending*, *supra* note 5, at 19.

211. See Erick Bergquist, *NC Order Puts Payday Firm in Limbo*, AM. BANKER, Dec. 27, 2005.

212. See Stegman, *The Public Policy Challenges of Payday Lending*, *supra* note 5, at 21.

213. NAT’L ENDOWMENT FOR FIN. EDUC., *supra* note 29. Payday loans have a reputation for creating a relentless debt cycle that many consumers are unable to break. *Id.*

214. See Stegman, *The Public Policy Challenges of Payday Lending*, *supra* note 5, at 21. “The prolific growth and profitability of [payday lending] reflect the fact that mainstream financial institutions have failed to meet the demand for short-term credit by working people who already have banking relationships. Moral obligations aside, banks, . . . and credit unions have a real market opportunity to ‘reach out to these consumers and provide responsible services for their legitimate needs.’” *Id.* “FDIC-insured institutions could receive Community Reinvestment Act credit for offering [short-term credit] products.” Joe Adler, *In Brief: FDIC Offers Guidelines on Short-Term Loans*, AM. BANKER, Dec. 5, 2006.

215. Stegman, *Banking the Unbanked*, *supra* note 63, at 23.

