AMERICAN FINANCIAL SERVICES ASSOSCIATION
LAW COMMITTEE

PAYMENT CARD COMMITTEE
REPORT ON RECENT DEVELOPMENTS
OCTOBER 21-23, 2019

I. CFPB Releases Report on Consumer Credit Card Market

The Consumer Financial Protection Bureau (Bureau) released its fourth biennial report on the state of the credit card market for the period 2017-2018. The Bureau noted that market conditions remain stable as a result of low unemployment, modest wage growth and high consumer confidence, consumer satisfaction remains high and debt service burdens are near the lowest level in more than a decade. Since 2015, consumers have more than doubled spending with credit cards with only modest balance growth. Academic scholarship examining the CARD Act's effects a decade after enactment indicates that the Act's effect on consumer welfare is mixed with some unintended results.

https://files.consumerfinance.gov/f/documents/201908_cfpb_card-act-report.pdf
https://www.dltlaw.com/Alerts/CFPB-RELEASES-2019-CARD-ACT-REPORT.pdf

II. *Madden*

A. FDIC/OCC File Amicus Brief

The Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency filed a joint *amicus* brief in Colorado federal district court in support of a bankruptcy court ruling on the valid-when-made doctrine. *Rent-Rite Super Kegs West Ltd v. World Business Lenders*, LLC, No. 1:19-cv-01552-REB (D. Col. filed Sept. 10, 2019). The case involved the Bank of Lake Mills as the originating bank. The agencies argued that the interest rate in a promissory note remains valid and enforceable despite the note's (multiple) assignment(s) because:

(1) Under the longstanding valid-when-made rule, an interest rate that was non-usurious when the loan was made remains non-usurious despite assignment;

(2) Under another well-settled rule, an assignee succeeds to all the assignor's rights in the contract, including the right to receive the interest rate agreed upon in the contract; and

(3) Section 1831d [or Section 85, respectively] itself gives banks the power to assign their home-state rates.

The agencies asserted that the interpretation of bank authority has serious implications for thousands of banks nationwide, directly "affecting their ability to maintain their *safety and soundness* through loan sales and securitizations, which could have unintended consequences for consumers, credit markets, and the U.S. financial system." (Emphasis added.) The agencies stated that the ability to sell loans (and transfer enforceable rights to the buyer) is "*necessary* for banks to be able to satisfy depositor withdrawals or repay large debts; to maintain adequate levels of capital and liquidity; to diversify their funding sources and interest-rate risks, and to have funds available for further lending to consumers." (Emphasis added.) The brief specifically addressed *Meade v. Avant of*

Colorado, LLC, 307 F. Supp. 3d 1134 (D. Colo. 2018), and *Madden v. Midland Funding*, LLC, 786 F.3d 246 (2d Cir. 2015), noting that *Meade* never actually reached the relevant issues presented and calling *Madden* "unfathomable".

B. Capital One Trusts Challenged

Cardholders have filed a class action against Capital One Funding and unrelated trusts and their bank trustees alleging that the rates of interest paid to the securitization trusts unlawfully exceed the 16% cap under New York's usury statute. *Cohen v. Capital One Funding, LLC*, 19-cv-03479 (E.D.N.Y. filed June 12, 2019). The national bank card issuer is not named as a party. The plaintiffs seek to recover excess interest payments and have requested an injunction to cap interest in the future. An answer was due August 19, but the defendants requested a pre-motion conference in anticipation of filing a motion to dismiss the complaint instead. The defendants cited *Madden* itself (citing *Krispin*), *Krispin* and *Gaither v. Farmers' & Mechs. Bank of Georgetown*, 26 U.S. 37 (1828) (for the VWM doctrine) in support of the proposed motion with a proposed briefing schedule. Plaintiffs submitted a response August 30, 2019. The August 19th and 30th letters provide a good summary of the positions on either side of *Madden*. A first amended complaint was filed on September 11, 2019.

C. Bills Remain Stalled in Congress so House Republicans Call on OCC to Provide a *Madden* Fix

In a September 19 letter to the OCC, House Republicans urged the OCC to take action to provide administrative solutions to *Madden*. The OCC and FDIC have previously remarked that they could take regulatory action if necessary. Senate Republicans issued a letter urging similar action on *Madden* to the FRB, the FDIC and the OCC in August.

https://www.dltlaw.com/Alerts/CONGRESSMEN-ENCOURAGE-OCC-TO-FIX-MADDEN.pdf
https://www.doddfrankupdate.com/DFU/ArticlesDFU/Republicans-push-for-faster-S-2155-adoption-76954.aspx

III. True Creditor Update

A. Colorado Litigation

The trial date in *Marlette* has been rescheduled for April 16, 2020; the trial date in *Avant* has been rescheduled for May 18, 2020, with a telephone conference on October 11, 2019.

B. Fourth Circuit Overturns Ruling Against Tribal Lender

On July 3, 2019, the United States Court of Appeals for the Fourth Circuit has dismissed a class action suit against Lake Superior Chippewa Indian Tribe, holding that the Tribe's lending entities were entitled to tribal sovereign immunity from state interest rate laws. *Williams v. Big Picture Loans, LLC*, 929 F.3d 170 (4th Cir. 2019). In its analysis, the Fourth Circuit adopted the five factors developed by the Tenth Circuit court in *Breakthrough Management Group, Inc. v. Chukchansi Gold Casino & Resort*, 629 F.3d 1173 (10th Cir. 2010). These five factors are: (i) the method of the entities' creation, (ii) their purpose, (iii) their structure, ownership and management, (iv) the tribe's intent to

share its sovereign immunity and (v) the financial relationship between the tribe and the entities. The Fourth Circuit concluded that all factors favored immunity for one lending entity and all but one for the other.

https://www.dltlaw.com/Alerts/FOURTH-CIRCUIT-OVERTURNS-RULING-AGAINST-TRIBAL-LENDER.pdf

C. NRO Boston Arbitration

Celtic Bank and Kabbage, Inc. won their arbitration proceeding against NRO Boston on all counts with regard to both Kabbage, Inc.'s *Kabbage*® merchant cash advance program and Celtic Bank's *Kabbage*® bank loan program, receiving a $3.3 million award, including attorneys' fees and costs, from the arbitrator, Hon. Charles B. Swartwood, III (Ret.), on July 14, 2019. Celtic Bank filed a motion to confirm the arbitration award, and a motion for pre-judgment attachment of NRO's assets, on September 9, 2019. The same day, NRO filed a petition to vacate the arbitration award, not in the same court where the suit was originally filed, but in a new action. Petition to Vacate an Arbitration Award, *NRO Boston v. Kabbage, Inc.*, No. 1;19-cv-11901-RGS (D. Mass. filed Sept. 9, 2019). NRO Boston asked the new court to set aside the arbitration award on grounds that the arbitrator (i) manifestly disregarded the law (*i.e.*, applied the "predominant economic interest" test incorrectly), (ii) exceeded his authority (finding that Kabbage, Inc. was not a party to Celtic Bank's bank loan agreement, but allowing claims to be arbitrated) and (iii) was evidently partial to Celtic Bank and Kabbage, Inc. because of a personal relationship with a NRO Boston creditor. Celtic Bank and Kabbage responded with motions to consolidate or reassign in both courts on September 25, 2019.

D. Kabbage, Inc. and Celtic Bank Sued Over Rates in New York

AF Trucking, Inc. v. Kabbage, Inc. and Celtic Bank Corporation, No. _____, (N.Y. Sup. Ct., Orange Cty, filed April 8, 2019) (settled).

E. Kabbage, Inc. Sued in NY

Kabbage, Inc. and its founders have been sued in New York federal district court, with plaintiffs claiming usury, RICO, UDAP and unlicensed lending claims, under various state and federal laws. *Bright Kids NYC, Inc. v. Kabbage, Inc*., No. 1:19-cv-09221-JMF (S.D.N.Y. filed Oct. 4, 2019). Plaintiffs (multiple businesses) claim that Kabbage entered into "an illegal 'rent-a-bank' scheme" with Celtic Bank. Plaintiffs claim that Kabbage originates, underwrites, securitizes and funds loans with rates as high as 95%, and then enters into sham transactions with Celtic Bank, which allegedly acts as the lender in name only. Plaintiffs claim that Celtic Bank retains no ownership or monetary interest in the receivables, and therefore, has no economic risk of loss due to a borrower's non-payment or subsequent default. Public comments by a Kabbage officer are cited to support plaintiffs' claims. Plaintiffs also cite *Madden* to claim that Kabbage cannot avail itself of federal preemption.

IV. Fintech

A. Bank Charter Developments

1. OnDeck plans to seek charter

https://www.lendacademy.com/ondeck-pursuing-bank-charter-loses-chase/

2. LendingClub has confirmed its plans to seek a national bank charter "soon" (past the exploratory phase and now in the business planning phase; "[O]ur vision would be to maintain our marketplace model and support it with a marketplace bank," said CEO Scott Sanborn.)

https://www.lendacademy.com/lendingclub-discusses-national-bank-charter-greensky-exploring-sale/

3. Court Dismisses CSBS Fintech Charter Challenge. On September 3, 2019, a D.C. federal district court dismissed without prejudice the Conference of State Bank Supervisor's second challenge to the Office of the Comptroller of the Currency's ("OCC") special purpose national bank charter for nondepository financial technology companies on the basis that the CSBS continued to lack standing and its claims remained unripe for adjudication. *Con. of St. Bank Supervisors v. Office of Comptroller of the Currency*, No. 18-2249 (D.D.C. Sept. 3, 2019). The court observed that not much has happened since the CSBS's first challenge was dismissed on the same basis in May 2018. No Fintech has applied for the special purpose Fintech charter and the OCC has not granted a charter. In May, a New York federal court allowed the New York Department of Financial Services' Fintech charter challenge to proceed. *Vullo v. Office of the Comptroller of the Currency*, No. 18-cv-0377 (S.D.N.Y. May 2, 2019). In a footnote, the D.C. federal court said it respectfully disagrees with the New York court's conclusion to the extent that its reasoning conflicts with the D.C. court's opinions.

https://www.dltlaw.com/Alerts/CSBSS-FINTECH-CHARTER-CHALLENGE-DISMISSED.pdf
https://www.dltlaw.com/Alerts/BUSINESS-OF-BANKING-REQUIRES-DEPOSIT-TAKING-COURT-ALLOWS-NY-DFS-CHALLENGE-TO-PROCEED.pdf

B. OCC to Hold October Office Hours for 1-on-1 Meetings with Innovation Pilot Program

https://www.occ.gov/topics/responsible-innovation/occ-innovation-general-brochure.PDF

C. Industrial Loan Companies

D. New York Fed Fintech Advisory Group

October 8 meeting scheduled.

https://www.newyorkfed.org/aboutthefed/ag_fintech.html

E. Visa Plans to Use "Deep Learning" AI to Fight Fraud

Visa, Inc. has announced plans to implement a cloud-based platform to test deep-learning algorithms to better detect unauthorized transactions. The new algorithms go farther than existing ones to detect more complex transactions by, for example, looking at all Visa-based transaction, not just past cardholder activity, to detect potential fraud with broader reach, greater accuracy and fewer false positives.

https://www.wsj.com/articles/visa-to-test-advanced-ai-to-prevent-fraud-11565205158?utm_campaign=morning%20scan%20plus-aug%208%202019&utm_medium=email&utm_source=newsletter&eid=%7Bmd5%28email%29

F. CFPB: Performance Metrics Provide Support for Use of Alternative Credit Data

The CFPB has issued an update on its first (and only) No-Action Letter recipient (fintech Upstart, Inc.). As a condition for receiving a No-Action Letter, Upstart agreed to a model risk management and compliance plan that required Upstart to (i) analyze and appropriately address risks to consumers, (ii) assess the real-world impact of alternative data and machine learning, and (iii) share information with the CFPB comparing outcomes from Upstart's underwriting and pricing model (tested model) against outcomes from a hypothetical model that uses traditional application and credit file variables and does not employ machine learning (traditional model). The traditional model was independently validated through fair lending testing to ensure that the model did not violate applicable antidiscrimination laws. Upstart was asked to answer several questions, including:

- Whether the tested model's use of alternative data and machine learning expands access to credit, including lower-priced credit, overall and for various applicant segments, compared to the traditional model; and
- Whether the tested model's underwriting or pricing outcomes result in greater disparities than the traditional model with respect to race, ethnicity, sex, or age, and if so, whether applicants in different protected class groups with similar model-predicted default risk actually default at the same rate.

The results of the analysis showed that the tested model approved 27% more applicants than the traditional model, and yielded 16% lower average APRs for approved loans, in Upstart's applicant pool. The expansion of credit generally held across all tested race, ethnicity, and sex segments:

- "Near prime" consumers with FICO scores from 620 to 660 were approved approximately twice as frequently.
- Applicants under 25 years of age were 32% more likely to be approved.
- Consumers with incomes under $50,000 were 13% more likely to be approved.

No fair lending disparities were identified.

https://www.consumerfinance.gov/about-us/blog/update-credit-access-and-no-action-letter/
https://www.wsj.com/articles/where-you-went-to-college-may-matter-on-your-loan-application-11565258402?mod=hp_lead_pos8

V. FRB Faster Payments Proposal

The Board of Governors of the Federal Reserve System has announced that the Federal Reserve Banks will develop a new real-time payment and settlement service to support faster payments. The new 24/7 service will be called the FedNow℠ Service and should be available in 2023 or 2024. The service will compete with the Clearing House's real-time payments system that was launched in November 2017.

https://www.federalreserve.gov/newsevents/pressreleases/other20190805a.htm
https://www.federalreserve.gov/newsevents/pressreleases/files/other20190805a1.pdf
https://www.federalreserve.gov/newsevents/pressreleases/files/other20190805a2.pdf

VI. Other

A. Chase Class Action Over Fees on Cryptocurreny Can Proceed

The proposed class action accusing Chase Bank of charging credit card customers surprise fees when it started billing cryptocurrency purchases as cash advances last year will go forward. *Tucker v. Chase Bank USA*, No. 18-Civ.-3155 (KPF), 2019 WL 3496642 (S.D.N.Y. Aug. 1, 2019).

B. Upgrade Issues New "Hybrid" Loan Card Product

Upgrade, the new company of Renaud Laplanche, the original founder and CEO of LendingClub, is issuing a new credit card through Cross River Bank with repayment terms that operate as an installment loan with equal monthly payments over terms of 12, 24 or 36 months. The product is designed for the borrower who needs to meet an unexpected emergency and claims to provide lower rates of interest and no fees. The card is said to replenish as it is paid off.

https://www.upgrade.com/upgrade-card/
https://www.americanbanker.com/news/lendingclub-founders-new-firm-launches-card-loan-hybrid-product
https://techcrunch.com/2019/10/10/upgrade-the-newest-company-by-renaud-laplanche-has-a-new-credit-card-that-it-swears-is-good-for-you/2019/10/10/upgrade-the-newest-company-by-renaud-laplanche-has-a-new-credit-card-that-it-swears-is-good-for-you/

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF NEW YORK

WILLIAM COHEN, SUE PAIVANAS and CHRISTY OGRODOSKI, individually and on behalf of all others similarly situated, **Plaintiffs,** **vs.** **CAPITAL ONE FUNDING, LLC; CAPITAL ONE MULTI-ASSET EXECUTION TRUST; and THE BANK OF NEW YORK MELLON, as Trustee of Capital One Master Trust; and** **Defendants.**	**JURY TRIAL DEMANDED** Case No. 1:19-cv-03479-KAM-RLM

FIRST AMENDED CLASS ACTION COMPLAINT

1. Plaintiffs William Cohen, Sue Paivanas, and Christy Ogrodoski, ("Plaintiffs"), individually and on behalf of all others similarly situated, bring this consumer class action against Capital One Funding, LLC; Capital One Master Trust by and through its trustee, The Bank of New York Mellon; and Capital One Multi-Asset Execution Trust, (together, "Defendants") to obtain statutory damages, compensatory damages, punitive damages, restitution, and declaratory and/or injunctive relief for themselves and the Class defined herein. Defendant The Bank of New York Mellon is named solely in its capacity as trustee for Capital One Master Trust.

2. Defendants charge, collect, and receive usurious rates of interest from New York consumers, including Plaintiffs, in excess of New York's usury cap. In so doing, Defendants have violated New York General Obligations Law § 5-501 and New York Banking Law § 14-a and

have been unjustly enriched as a result of their unlawful conduct. Plaintiffs make the following allegations upon information and belief, except as to his own respective actions, the investigation of their counsel, and the facts that are a matter of public record.

INTRODUCTION

3. New York has forbidden the practice of usury for over 200 years.

4. Since at least 1787, New York has prohibited lenders from charging excessive interest to debtors.[1] This ancient and bedrock principle remains a part of New York consumer financial law.

5. At all times relevant to this Complaint, New York has forbidden the collection of interest above 16% per annum. N.Y. Gen. Oblig. Law § 5-501; N.Y. Banking Law § 14-a. Persons and corporations are forbidden from "directly or indirectly, charg[ing], tak[ing] or receiv[ing]" interest above the usury limit. Interest includes not just items labeled as "interest," but also certain fees. *See* 3 N.Y.C.R.R. § 4.2(b).

6. The State of New York has such a strong interest in protecting consumers from unreasonable interest charges that receiving interest at some levels is a felony. New York Penal Law § 190.40 states that a "person is guilty of criminal usury in the second degree when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty-five per centum per annum or the equivalent rate for a longer or shorter period."

7. Here, Defendants receive principal and interest payments from Plaintiffs and Class members (as defined below) that are made pursuant to credit card loans. Defendants have charged,

[1] *See* L 1787, Ch. 13 (barring taking of interest above 7%).

taken, and received interest from Plaintiffs and Class members at rates in excess of 16%, in violation of New York's longstanding civil usury limit.

8. This class action suit seeks monetary damages, restitution, and injunctive relief to restore wrongfully obtained usurious interest payments and to prevent Defendants from charging, collecting, or receiving usurious interest in the future.

PARTIES

9. Plaintiff William Cohen ("Plaintiff Cohen" or "Cohen") is a consumer and a citizen of the State of New York, residing in Brooklyn, New York.

10. Plaintiff Cohen is a debtor on an unsecured credit card loan. His credit card loan is branded as the "CapitalOne Platinum MasterCard" ("Cohen Platinum MasterCard Loan").

11. Mr. Cohen is currently carrying a balance on the Cohen Platinum MasterCard Loan on which he pays an interest rate of at least 25.15%.

12. Plaintiff Cohen's payments on these loans go to an entity described only as "Capital One" with a mailing address in Carol Stream, IL.

13. On information and belief, Plaintiff Cohen's payments are owned by, and are paid to, Capital One Funding, LLC and/or Capital One Master Trust.

14. Plaintiff Sue Paivanas ("Plaintiff Paivanas" or "Paivanas") is a consumer and citizen of the State of New York, residing in Jamestown, NY.

15. Plaintiff Paivanas is a debtor on an unsecured credit card loan. Her credit card loan is branded as the "CapitalOne Platinum MasterCard" ("Paivanas Platinum MasterCard Loan").

16. Ms. Paivanas is currently carrying a balance on the Paivanas Platinum MasterCard Loan on which she pays an interest rate of 22.5%.

17. Plaintiff Paivanas' payments on these loans go to an entity described only as "Capital One" with a mailing address in Carol Stream, IL.

18. On information and belief, Plaintiff Paivanas' payments are owned by, and are paid to Capital One Funding, LLC and/or Capital One Master Trust.

19. Plaintiff Christy Ogrodoski ("Plaintiff Ogrodoski" or "Ogrodoski") is a consumer and a citizen of the State of New York, residing in Auburn, NY.

20. Plaintiff Ogrodoski is a debtor on multiple unsecured credit card loans. First, she is the debtor on a credit card loan branded as "CapitalOne Journey" ("Journey Loan"). Second, she is the debtor on a credit card loan branded as "CapitalOne Venture" ("Venture Loan"). Third, she is the debtor on a credit card loan branded as "CapitalOne Quicksilver: ("Quicksilver Loan").

21. Ms. Ogrodoski is currently carrying a balance on each of these loans. On the Journey Loan, Ms. Ogrodoski pays an interest rate of at least 26.24%. On the Venture Loan, Ms. Ogrodoski pays an interest rate of at least 24.24%. On the Quicksilver Loan, Ms. Ogrodoski pays an interest rate of at least 27.74%.

22. Plaintiff Ogrodoski's payments on these loans go to an entity described only as "Capital One" with a mailing address in Carol Stream, IL.

23. On information and belief, Plaintiff Ogrodoski's payments are owned by, and are paid to, Capital One Funding, LLC and/or Capital One Master Trust.

24. Defendant Capital One Funding, LLC ("Funding") is a Virginia Limited Liability Company.

25. Capital One Master Trust ("COMT") is a common law trust for which Defendant The Bank of New York Mellon is the Trustee.[2] Defendant Capital One Multi-Asset Execution

[2] The Bank of New York is now named The Bank of New York Mellon.

Trust ("COMET"), is a Delaware Statutory Trust, of which Deutsche Bank Trust Company Delaware is the Owner Trustee and Defendant Capital One Funding LLC is the beneficiary.[3]

26. Neither Funding, COMT, nor COMET is a bank.

JURISDICTION AND VENUE

27. This Court has jurisdiction over this action pursuant to the Class Action Fairness Act, 28 U.S.C. § 1332(d)(2) because the amount in controversy exceeds $5,000,000, exclusive of interest and costs, and more than two-thirds of the putative class reside in states other than the states in which Defendants are citizens. This Court also has supplemental jurisdiction over the state law claims pursuant to 28 U.S.C. § 1367. Declaratory relief is available under 28 U.S.C. §§ 2201 and 2202.

28. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1391, because Plaintiff Cohen resides in this District and suffered injury as a result of Defendants' acts in this District, many of the acts and transactions giving rise to this action occurred in this District, Defendants do substantial business throughout this District, Defendants have intentionally availed themselves of the laws and markets of this District, and Defendants are subject to personal jurisdiction in this District.

FACTUAL BACKGROUND

29. Defendants have violated New York law by charging and receiving payments from Plaintiffs and other New York consumers at interest rates exceeding the state usury limit.

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[3] *See* Second Amended and Restated Trust Agreement, January 13, 2006, *available at* http://media.corporate-ir.net/media_files/irol/70/70667/abs/COMET/COMET_AmendedRestatedTrust.pdf (Last visited: September 11, 2019).

30. Defendants acquire the usurious interest payments from Plaintiffs and the Class through a series of purchases involving a shell company as part of a process known as credit card securitization.

Credit Card Securitization Generally

31. Credit card securitization transactions begin with a financial institution (the securitization "sponsor") assembling a pool of receivables on credit card loans that it made or acquired. The sponsor then sells the receivables as part of a multi-step transaction that ultimately results in the sponsor exchanging the receivables for cash.

32. While the precise details vary among transactions, credit card securitizations generally follow a pattern similar to the following. First, the sponsor selects specific credit card accounts and sells the entire balance of the receivables arising from those accounts, as well as the right to purchase future receivables generated by those accounts to a wholly-owned, special-purpose subsidiary of the sponsor (the "depositor"), that has no other assets or liabilities.

33. This first sale is made to isolate the receivables from the sponsor's assets and liabilities, making them "bankruptcy remote," in the sense that they cannot be clawed back into the sponsor's bankruptcy or FDIC receivership estate. Absent bankruptcy remoteness, investors in the securitization could not invest based solely on the quality of the receivables and the risks specific to them. Instead, they would be exposed to the overall risks of the sponsor firm.

34. Second, the depositor sells these receivables (and the right to purchase future receivables) to a passive single-purpose entity ("SPE"), usually a trust. The SPE must be a stand-alone, legally-independent entity and *cannot be a subsidiary of the sponsor*, in order to ensure that it could not be consolidated in bankruptcy or FDIC receivership with the sponsor. The legal separation of the SPE from the sponsor and depositor is critical to ensure that investors in the

securitization are able to invest solely in the quality of the receivables and the risks specific to them, rather than the overall risks of the sponsor and depositor.

35. To raise the funds to pay the depositor for the initial receivables, the SPE issues certificated securities (essentially bonds) to the depositor. The depositor sells them to investors through underwriting affiliates. Because these securities issued by the SPE are collateralized by the receivables (assets) owned by the SPE, they are called "asset-backed securities" or "ABS." The depositor then uses the funds from the SPE's sale of ABS to investors in order to pay the sponsor for the initial receivables.[4]

36. The securitization transaction includes not just the sale of outstanding receivables on the designated credit card accounts, but also the right to purchase any new receivables generated by the designated accounts. As cardholders' subsequent purchase activities generate more receivables on the account, the new receivables are purchased (ultimately) by the SPE from the sponsor through the depositor. The SPE uses the principal payments collected from cardholders on the initial receivables to acquire the new receivables from the sponsor. The interest payments and fees collected from the cardholders are used to pay the SPE's operating expenses and the interest payments due on the ABS.

37. The SPE is designed to be a passive entity in order to enable ABS investors to invest solely in the risks of the receivables, not the general operating risks of a firm. The credit card receivables the SPE owns must be managed, however, as it is necessary for cardholders to be sent billing statements and for payments to be collected from them. Therefore, the SPE contracts with a servicing agent (the "servicer") to collect the payments from the cardholders on behalf of the

[4] Alternatively, the depositor may transfer the ABS to the sponsor, which will then sell them into the market through an underwriting affiliate or directly. Either way, the ultimate effect is the same: the sponsor has transformed a pool of credit card receivables into cash.

SPE for the benefit of the ABS holders. The servicer is often the issuer or an affiliate thereof, but need not be. Because the SPE owns the receivables, collections of the receivables from cardholders by the servicer are not made for the benefit of the financial institution that issued the credit cards in the first instance even if the servicer is the issuer.

38. The securitization transaction effectively separates the beneficial ownership of the receivables from the legal title to the receivables and from the management of the receivables: the SPE holds the legal title to the receivables;[5] the passive ABS investors (holders of the ABS) are the beneficial owners of the receivables; and the servicer manages the receivables as the agent of the SPE.

Defendants' Credit Card Securitization Process

39. Funding, COMT and COMET are engaged in collecting, taking and receiving payments from Plaintiffs and class members for debts incurred through credit card loans, generally originated by non-parties affiliated with Capital One Financial Corporation.

40. The diagram below, from a February 20, 2019 prospectus for notes issued by Defendant COMET, outlines the way credit card loan payments are obtained by Defendants. As shown in the diagram, non-party Capital One Bank (USA) National Association is the sponsor; Defendant Capital One Funding is the depositor, and COMT and COMET are SPE's that together issue ABS.[6]

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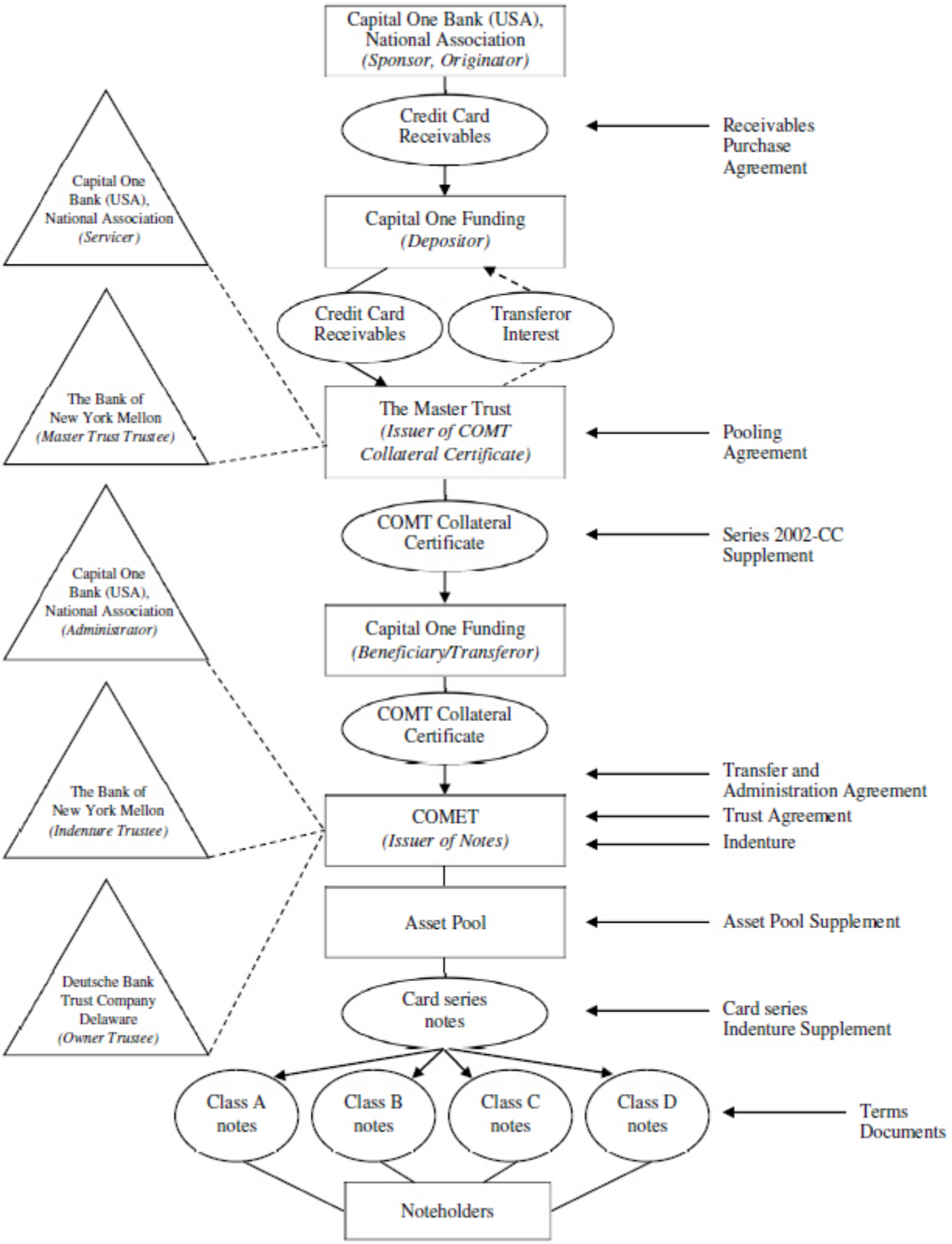
[5] If the SPE is a common law trust, as is the case here, then the trustee holds legal title to the receivables.

[6] https://www.sec.gov/Archives/edgar/data/922869/000119312519048060/d705467d424b5.htm (last visited: June 2, 2019).


Capital One Bank (USA), National Association (Sponsor, Originator)
Credit Card Receivables
Receivables Purchase Agreement
Capital One Bank (USA), National Association (Servicer)
Capital One Funding (Depositor)
Credit Card Receivables
Transferor Interest
The Bank of New York Mellon (Master Trust Trustee)
The Master Trust (Issuer of COMT Collateral Certificate)
Pooling Agreement
COMT Collateral Certificate
Series 2002-CC Supplement
Capital One Bank (USA), National Association (Administrator)
Capital One Funding (Beneficiary/Transferor)
COMT Collateral Certificate
Transfer and Administration Agreement
The Bank of New York Mellon (Indenture Trustee)
COMET (Issuer of Notes)
Trust Agreement
Indenture
Asset Pool
Asset Pool Supplement
Deutsche Bank Trust Company Delaware (Owner Trustee)
Card series notes
Card series Indenture Supplement
Class A notes
Class B notes
Class C notes
Class D notes
Terms Documents
Noteholders

41. The securitization process begins with consumers opening credit card loan accounts. In the case of accounts securitized by Defendants, most accounts are originated and marketed by affiliates or agents of non-party Capital One Financial Corporation.

42. After Plaintiffs and class members open credit card accounts, certain accounts are designated for securitization.

43. Funding is solely a shell company that has no employees and engages in no activity other than the purchase and re-sale of debts. Its only function is to purchase receivables and in turn, sell those receivables to COMT. For purposes of these transactions, the term "receivables" refers to all payments owed by credit card debtors such as Plaintiffs, including principal and interest payments, and payments for all fees, including late fees, over limit fees, and annual fees.

44. According to Defendants, the purchase of these receivables is a true and complete sale of the loan payments. As stated in a contract that governs Funding's role in securitization, the Receivables Purchase Agreement, Funding acquired all "right, title and interest, whether now owned or hereafter acquired, in, to and under [the credit card receivables]."[7] Receivables Purchase Agreement at Sections 2.01(a) and 2.01(d).

45. Funding and non-party Capital One Bank (USA) National Association further agreed that the loan payments "constitute an absolute sale, conveying good title, free and clear of any liens, claims, encumbrances or rights of others, from Capital One [Bank (USA) National Association] to Funding."[8] Receivables Purchase Agreement at Section 2.01(d).

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[7] August 1, 2002 Receivables Purchase Agreement available at http://media.corporate-ir.net/media_files/irol/70/70667/abs/comt/comt_capitalonebank_receivables.pdf (last visited: June 2, 2019) ("Receivables Purchase Agreement").
[8] *Id.*

46. Under the terms of the contract with non-party Capital One Bank (USA) National Association, Funding is legally bound to purchase and receive the consumers' payments on the designated accounts, even if the debt or fee payment obligation has not yet been incurred. Receivables Purchase Agreement at Section 2.01(a).

47. COMT is a common law trust with The Bank of New York Mellon as its Trustee, and exists solely to purchase receivables from Funding, and to facilitate the issuance of asset backed securities collateralized by the payments from class members and other debtors.

48. COMT purchases the right to the credit card payments of Plaintiffs, class members, and other cardholders from Funding. Defendants view this transaction as a true and complete sale.

49. The Amended and Restated Pooling and Servicing Agreement that governs Defendants' securitization activities stated that Funding "hereby transfers, assigns, sets over and other wise conveys to [The Bank of New York Mellon] Trustee all of its right, title and interest, whether now owned or hereafter acquired, in, to and under" the credit card receivables.[9] Pooling and Servicing Agreement at Section 2.01.

50. The Pooling and Servicing Agreement further contained the statement that Defendant The Bank of New York Mellon, as Trustee, "acknowledges its acceptance of all right, title and interest" to the credit card receivables. Pooling and Servicing Agreement at Section 2.02(a).

[9] Amended and Restated Pooling and Servicing Agreement, dated September 20, 1993 and amended January 13, 2006 available at http://media.corporate-ir.net/media_files/irol/70/70667/abs/comt/COMTAmendedandRestatedPoolingandServicingAgreement.pdf (last visited: June 2, 2019) ("Pooling and Servicing Agreement").

51. To be particularly explicit, Defendants further stated in the Pooling and Servicing Agreement that the transfer of credit card receivables "constitute a sale, and not a secured borrowing, for accounting purposes." Pooling and Servicing Agreement at Section 2.01.

52. Because Defendants' purchase of the debt payment obligations are true sales of all "right title and interest" in the receivables, in the event that the originating entity, in this case likely non-party Capital One Bank (USA) National Association, were placed in FDIC receivership, the payment obligations would not be the property of the receivership estate.

53. COMET is a Delaware Statutory Trust, with Funding as beneficiary, and Deutsche Bank Trust Company Delaware as Owner Trustee. By the terms of its Trust Agreement, COMET is to operate as a "Single Purpose Entity," with its sole purpose to engage in the purchase receivables and to issue debt against the payments from Class members and other debtors. Trust Agreement at Section 2.03.

54. To compensate Funding for the receivables, COMT issued a collateral certificate to Funding, which then conveyed it to COMET. As described in a recent filing with the Securities and Exchange Commission, the "collateral certificate issued by the Capital One Master Trust represents an undivided interest in the assets of the Capital One Master Trust."[10]

55. As described in the flow chart above, the collateral certificate conveys the payments of Plaintiffs, class members and other card holders from COMT to COMET.

56. Having an "undivided interest" in the receivables on Plaintiffs' and the Class members' loans, Defendant COMET sells securities to investors backed by these payment

[10] https://www.sec.gov/Archives/edgar/data/922869/000119312519048060/d705467d424b5.htm (Last visited: June 11, 2019)

obligations as ABS.[11] The proceeds of these ABS sales, pay for the purchase of receivables from Funding.

57. As with COMT, COMET is an entity that is "bankruptcy remote," ensuring that the title to class members' loan payments are not subject to recovery in the event that the originating entity were subject to bankruptcy or receivership proceedings. Moreover, COMET's Trust Agreement contains "nonpetition covenants," in which Deutsche Bank Trust Company Delaware and Capital One Funding agreed not to "acquiesce, petition, or otherwise invoke" bankruptcy or insolvency proceedings. Trust Agreement at Section 12.09.

58. Because COMT and COMET are special purpose entities with no employees, and the credit card receivables must be managed (*e.g.*, billing statements sent out to cardholders and payments collected from them), COMT contracts with a servicer to collect the payments from the cardholders on behalf COMT and COMET for the benefit of ABS holders.

59. Defendants pay the servicer a fee to collect on the payment obligations owned by the trusts. As part of this fee, all expenses related to servicing the receivables are reimbursed to the servicer and borne by the trusts. *See* Pooling and Servicing Agreement at Section 3.02.

60. Under the Receivables Purchase Agreement, non-party Capital One Bank (USA) National Association granted Defendant Funding a "license to use the name 'Capital One' and all related identifying trade or service marks, signs, symbols, logos, designs … and other intangibles in connection with the servicing of the Receivables purchased hereunder." Receivables Purchase Agreement at Section 3.03.

[11] The sale is done indirectly and the mechanics of the sale are not material to this complaint.

61. Because Defendants utilize the name, logos, and other indicia of Capital One Bank in billing and collections, the true owner of an account holder's receivables is concealed from the public, including Plaintiffs and the Class.

Securitization of Plaintiffs' Debt Payments

62. The list of specific accounts whose receivables have been sold is held by Defendants in secret and is ascertainable only from Defendants' nonpublic records. The Pooling and Servicing Agreement specifically directs the Trustee not to disclose the account numbers or other information indicating which accounts' payments are payable to Defendants. Pooling and Servicing Agreement at Section 2.02(b).

63. Public information demonstrates, however, that accounts whose payment obligations have been purchased by Defendants include those of class members paying interest at rates that exceed New York's usury limit.

64. According to a February 2019 prospectus for ABS from Defendant COMET, consumer credit card receivables owned by COMT have the following attributes: [12]

- 7.02% of the accounts in the securitization pool were from borrowers with a New York billing address (786,642 accounts);
- the average age of the accounts was approximately 168 months;
- the accounts had an average principal receivable balance of $2,818 and an average credit limit of $11,972
- 36.23% of the outstanding receivables had a balance between $1,500.01 and $5,000; and
- 29.86% of the outstanding receivables had a balance between $5,000.01 and $10,000.

[12] Prospectus available at https://www.sec.gov/Archives/edgar/data/922869/000119312519048060/d705467d424b5.htm (Last visited: June 11, 2019).

65. Plaintiffs' loans are consistent with these averages and are, upon information and belief, among the loans whose payments have been purchased by Defendant Capital One Funding and COMT.

66. Through this securitization scheme, Defendants have engaged in a standard practice and policy of charging, collecting, receiving, and attempting to collect interest from Plaintiffs and class members in excess of the permissible interest rate in New York.

Madden* and the *Attempted "Madden Fix"

67. In 2015, the Second Circuit considered a usury case brought by a cardholder against a debt collector that had acquired the cardholder's defaulted credit card loan. *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015). The plaintiff in *Madden*, a New York resident, alleged that the defendants violated the New York usury statute by charging and attempting to collect interest at a rate higher than that permitted by New York law. The defendant debt collector argued that the National Bank Act ("NBA") preempted the claim alleging violation of the New York state usury rate because the debt collector purchased the plaintiff's credit card loan from a national bank that was entitled to charge an interest rate allowed by the laws of the state, territory, or district where the bank is located.[13] *See Madden*, 786 F.3d at 250 (quoting 12 U.S.C. § 85).

68. The Second Circuit rejected the defendant's argument in *Madden* and held that entities other than national banks are only entitled to NBA-preemption under the limited circumstance where application of state law to the underlying action would significantly interfere with a national bank's ability to exercise its powers under the NBA. Specifically, the Second Circuit noted that "state usury laws would not prevent consumer debt sales by national banks to

[13] More specifically, the defendants argued that "as assignees of a national bank, they too are allowed under the [National Bank Act] to charge interest at the rate permitted by the state where the assignor national bank is located—here, Delaware." *Id.* at 250.

third parties. Although it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states (i.e., those with firm usury limits, like New York), such an effect would not 'significantly interfere' with the exercise of a national bank power." *Id.* at 251. The Supreme Court denied *certiorari*.

69. The Second Circuit's decision in *Madden* thus made clear that non-banks cannot charge usurious interest rates merely because they purchased or were assigned loans by national banks.

70. Following the *Madden* decision, the banking industry was indisputably on notice that national banks could not sell or assign their ability to charge otherwise usurious interest rates to non-national bank third parties.

71. In fact, the industry conceded this fact when urging the Supreme Court to grant *certiorari*. The Structured Finance Industry Group, an entity that lobbies on behalf of entities engaged in securitization, admitted in its *amicus* brief in favor of *certiorari* that *Madden* held that the National Bank Act does not "preempt the application of state usury law to sales of bank loans to non-banks[.]" Brief of the Structured Finance Industry Group, Inc., et al. as Amici Curiae in Support of Petitioners, *Midland Funding, LLC v. Madden*, No. 15-610 (December 10, 2015) at 3.

72. Industry *amici* urged that *Madden* be overturned, explicitly because "firms have removed loans made to borrowers in the Second Circuit from asset-backed securitizations due to usury concerns." Brief of the Clearing House Association, LLC, et al. as Amici Curiae Supporting Petitioners, *Midland Funding, LLC v. Madden*, No. 15-610 (December 10, 2015) at 23. Notwithstanding this industry understanding of the law, non-banks, including Defendants here, still collect and receive interest from New York consumers in violation of New York's usury limit.

73. Indeed, although Funding, COMT or COMET are not banks, they continued to purchase usurious credit card receivables from a national bank well after the *Madden* decision.

74. Rather than bring securitization practices into compliance with the clear statement of law, the lending industry chose to lobby Congress unsuccessfully to change the law.

75. The lending industry reported spending millions of dollars collectively on lobbying activity in 2017 and 2018, with specific references to two congressional bills informally known as "*Madden* Fix" legislation. Ultimately, neither the Financial CHOICE Act of 2017 (H.R. 10), nor the Protecting Consumers Access to Credit Act of 2017 (H.R. 3299, S. 1642) became law.

76. Despite failing to change the law, Defendants have still not changed their unlawful and usurious practices.[14]

CLASS ACTION ALLEGATIONS

77. Plaintiffs bring this action as a class action pursuant to Rule 23(b)(2) and (b)(3) of the Federal Rules of Civil Procedure on behalf of themselves and the following individuals:

> All individuals residing in New York that have paid interest to Defendants directly or indirectly pursuant to a credit card loan at a rate above 16% at any time since June 12, 2013.

(Collectively referred to herein as the "Class.")

78. Excluded from the Class are borrowers other than individuals, including but not limited to corporations, LLCs, non-profits and other organizations, and borrowers with credit card

[14] A February 2019 article by analysts with Standard & Poors / S&P Global that discussed the *Madden* decision and Colorado's efforts to enforce its usury laws against non-bank entities observed that some recent securitization transactions "excluded those loans made to Colorado residents above the state's usury limits … or with collateral pools that excluded all loans made to Colorado residents." *See* Chouhan *et al*., *Marketplace Lending and the True Lender Conundrum*, *available at* https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=2171229&SctArtId=467289&from=CM&nsl_code=LIME&sourceObjectId=10887397&sourceRevId=1&fee_ind=N&exp_date=20290222-18:32:49 (last visited: May 30, 2019). The clear implication is that lenders can readily exclude loans that violate state usury rates from their securitization pools if they choose to do so.

loan balances that exceed $250,000.00 or with credit card accounts deemed to be in default. Also excluded from the Class are Defendants, their subsidiaries, affiliates; officers, directors, legal representatives, and employees; all persons who make a timely election to be excluded from the Class; governmental entities; and any judge to whom this case is assigned and his/her immediate family. Plaintiffs reserve the right to revise the Class definition based on information learned through discovery.

79. Class certification is appropriate because Plaintiffs can prove the elements of their claims on a class-wide basis using the same evidence as would be used to prove those elements in individual actions alleging the same claim.

80. Numerosity—Fed. R. Civ. P. 23(a)(1). The Class is comprised of thousands of individuals who are or were New York credit card account holders, the joinder of which in one action would be impracticable. The exact number or identification of the Class members is presently unknown. The identity of the Class members is ascertainable and can be determined based on Defendants' records, records of originator entities, or similar entities and/or public records.

81. Predominance of Common Questions—Fed. R. Civ. P. 23(a)(2), 23(b)(3). The questions of law and fact common to the Class predominate over questions affecting only individual Class Members, and include, but are not limited to, the following:

(a) Whether the Class Members were charged interest at rates above 16%;

(b) Whether the Defendants received the Class Members payments, directly or indirectly;

(c) Whether, as a result of Defendants' conduct, Plaintiffs and the Class have suffered injury and, if so, the appropriate relief; and

(d) Whether Plaintiffs and the Class are entitled to damages and/or punitive damages or other relief.

82. Typicality—Fed. R. Civ. P. 23(a)(3). Plaintiffs' claims are typical of those of the Class in that Plaintiffs, like all Class members, incurred debt and paid interest at rates above the applicable limit. Plaintiffs have suffered damages in the form of additional interest costs, and such damages are consistent with those suffered by Class Members.

83. Adequacy—Fed. R. Civ. P. 23(a)(4); 23(g)(1). Plaintiffs are adequate representatives of the Class because they fit within the class definition and their interests do not conflict with the interests of the members of the Class they seek to represent. Plaintiffs are represented by experienced Class Counsel. Class Counsel have litigated numerous class actions, including many class actions involving the financial services industry, and Plaintiffs' counsel intend to prosecute this action vigorously for the benefit of the entire Class. Plaintiffs and Class Counsel can fairly and adequately protect the interests of all of the members of the Class.

84. Superiority—Fed. R. Civ. P. 23(b)(3). The class action is the best available method for the efficient adjudication of this litigation, because individual litigation of Class Members' claims would be impracticable and individual litigation would be unduly burdensome to the courts. Plaintiffs and the Class have suffered irreparable harm as a result of Defendants' conduct. Because of the size of the individual Class members' claims, no Class member could afford to seek legal redress for the wrongs identified in this Complaint. Without the class action vehicle, the Class would have no reasonable remedy and would continue to suffer losses, as Defendants continue to engage in the unlawful and unfair conduct that is the subject of this Complaint, and Defendants would be permitted to retain the proceeds of their violations of law. Further, individual litigation has the potential to result in inconsistent or contradictory judgments. A class action in this case presents fewer management problems and provides the benefits of single adjudication, economies of scale, and comprehensive supervision by a single court.

85. Plaintiffs and the Class do not anticipate any difficulty in the management of this litigation.

FIRST CAUSE OF ACTION
New York General Obligations Law § 5-501
(Asserted on Behalf of Plaintiffs and the Class)

86. Plaintiffs repeat, reallege, and incorporate by reference each of the foregoing and succeeding paragraphs of this Complaint as if fully set forth herein.

87. Defendants have violated and continue to violate N.Y. Gen. Obl. Law §5-501 and N.Y. Bank. Law §14-a by charging, collecting, and receiving interest from Plaintiffs and the Class at a rate in excess of the 16% usury limit.

88. Pursuant to N.Y. Gen. Obl. Law §§5-511 and 5-513, Plaintiffs and the Class are entitled to a declaration that Defendants cannot enforce the usurious contracts, and disgorgement of all sums paid in excess of the usury limit.

SECOND CAUSE OF ACTION
Unjust Enrichment
(Asserted on Behalf of Plaintiffs and the Class)

89. Plaintiffs repeat, reallege, and incorporate by reference each of the foregoing and succeeding paragraphs of this Complaint as if fully set forth herein.

90. As a result of Defendants' unlawful actions described above, Defendants have been and continue to be unjustly enriched at the expense of Plaintiffs and the Class as a result of their payment of excessive and improper interest rates.

91. Under the circumstances, it would be against equity and good conscience to permit Defendants to retain the ill-gotten benefits that it received from Plaintiffs and the Class.

92. Defendants should be required to disgorge the monies they have unjustly obtained to the detriment of Plaintiffs and the Class.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs, individually and on behalf of the Class, pray for judgment against Defendants granting the following relief:

a. An order certifying this case as a class action and appointing Plaintiffs' counsel to represent the Class and Plaintiffs as representatives of the Class;

b. All recoverable compensatory and other damages sustained by Plaintiffs and the Class;

c. Actual, treble, punitive, and/or statutory damages for injuries suffered by Plaintiffs and the Class in the maximum amount permitted by applicable law;

d. An order requiring Defendants to immediately cease their wrongful conduct as set forth above;

e. Payment of reasonable attorneys' fees and costs as may be allowable under applicable law; and

f. Such other relief as the Court may deem just and proper.

DEMAND FOR JURY TRIAL

Plaintiffs demand a trial by jury on all causes of action so triable.

Dated: September 11, 2019

Respectfully submitted,

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August 19, 2019

BY ECF

Honorable Kiyo A. Matsumoto
United States District Court
Eastern District of New York
225 Cadman Plaza East
Brooklyn, NY 11201

Re: *Cohen v. Capital One Funding, LLC et al.*
Case No.: 1:19-cv-03479- KAM-RLM

Dear Judge Matsumoto:

This firm represents Defendants Capital One Funding, LLC, Capital One Master Trust, and Capital One Multi-Asset Execution Trust (collectively, "Defendants") in connection with the above-referenced litigation. I am writing on behalf of Defendants to request a pre-motion conference regarding Defendants' anticipated Motion to Dismiss the Complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.

Plaintiffs William Cohen, Sue Paivanas and Christy Ogrodoski allege that they have been charged interest above the rates permissible under New York's usury statute, N.Y. Gen. Obl. Law § 5-501. Plaintiffs also have asserted a related common law claim for "unjust enrichment." Plaintiffs' state law claims, however, are preempted by the National Bank Act ("NBA"), 12 U.S.C. § 56; *Madden v. Midland Funding, LLC*, 786 F.3d 246, 250 (2d Cir. 2015).

In their Complaint, Plaintiffs assert that the decision of the Court of Appeals for the Second Circuit in *Madden* governs whether the NBA preempts their claims. Defendants agree. *Madden* demonstrates that Plaintiffs' claims are preempted.

In *Madden*, the Court cited a decision of the Court of Appeals for the Eighth Circuit for the proposition that the NBA preempts state usury laws when a national bank sells credit card receivables, but retains ownership of the underlying credit card accounts. *Madden*, 786 F.3d at 252 ("point of the *Krispin* holding was, however, that notwithstanding the bank's sale of its

receivables to May Stores, it retained substantial interests in the credit card accounts so that application of state law to those accounts would have conflicted with the bank's powers authorized by the NBA"), *citing Krispin v. May Department Stores*, 218 F.3d 919, 924 (8th Cir. 2000).

The facts of this case closely match those of *Krispin*. The Plaintiffs opened credit card accounts with Capital One Bank (USA), N.A. ("Capital One Bank") – a national bank. Capital One Bank sold the credit card receivables, but retained ownership of the underlying credit card accounts, including the ability to issue credit, process and services the accounts, and set such terms as interest rates and late fees. These facts are apparent from the Complaint and the documents incorporated by reference into the Complaint. *See, e.g.*, Complaint ¶¶ 31, 40 fn.6, 44 fn.7; Prospectus, p. 1, 21, 35-36, 94; Receivables Purchase Agreement, § 5.01(i). As the decisions in *Madden* and *Krispin* make clear, under the circumstances alleged here, the NBA preempts Plaintiffs' claims.

Additionally, Plaintiffs' claims violate the longstanding "valid when made rule." If the interest rate in the original loan was non-usurious, the loan cannot become usurious upon assignment – so, the assignee may lawfully continue to charge interest at the original rate. *Gaither v. Farmers' & Mechs. Bank of Georgetown*, 26 U.S. 37 (1828); *Galatti v. Alliance Funding Co.*, 228 A.D.2d 550 (2d Dep't 1996). Pursuant to the NBA, the terms of Plaintiffs' credit card account with Capital One Bank were non-usurious. Accordingly, the assignment of receivables derived from those accounts to securitization trusts cannot render those loans usurious.

Defendants have conferred with Plaintiffs' counsel and the parties propose the following briefing schedule for Defendants' motion to dismiss:

Memorandum in support of motion to dismiss served by September 13, 2019
Opposition to motion to dismiss served by October 4, 2019
Reply in support of motion to dismiss served by October 18, 2019

Accordingly, Defendants request that the Court grant them leave to file a motion to dismiss the Complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, and that the proposed briefing schedule be approved by the Court.

Respectfully,

/s/ Theodore R. Snyder

Theodore R. Snyder

cc: Christian Hudson, Esq.

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August 30, 2019

BY ECF

Honorable Kiyo A. Matsumoto
United States District Court
Eastern District of New York
225 Cadman Plaza East
Brooklyn, NY 11201

Re: *Cohen v. Capital One Funding, LLC, et al.*
Case No. 1:19-cv-03479-KAM

Dear Judge Matsumoto:

The undersigned counsel represent Plaintiffs in the above-referenced proceeding. I write on behalf of Plaintiffs in response to the August 19 letter from Murphy & McGonigle, P.C., seeking a pre-motion conference in connection with a planned Motion to Dismiss pursuant to Rule 12(b)(6) on behalf of Defendants Capital One Funding, LLC, Capital One Master Trust, and Capital One Multi-Asset Execution Trust. Plaintiffs believe the described motion is without merit.

The New York usury statute, N.Y. Gen. Obl. §5-501, states that "[n]o person or corporation shall, directly or indirectly, charge, take or receive" interest at a rate above the state's 16% per annum usury cap. *Compl.* at ¶ 5. Plaintiffs and class members are New York debtors on consumer loans that are being charged interest on receivables by Defendants (which are not national banks) above the New York usury limit. *Compl.* at ¶¶ 2, 7, 9-21. Plaintiffs allege that through the process known as securitization, Defendants acquired all "right, title and interest" to Plaintiffs' and class members' receivables. *Compl.* at ¶¶ 17-23, 29-66. It is Defendants, therefore, and not a national bank, who own the receivables and who charge interest on the receivables that they own. Accordingly, Plaintiffs allege that Defendants are unlawfully "charging, taking or receiving" interest in violation of New York law. *Compl.* at ¶ 2, 29, 66, 86-92.

Defendants assert that Plaintiffs' claims are "preempted by the National Bank Act." Letter Brief, ECF No. 19, at 1. None of the Defendants, however, are national banks. Defendants are corporate entities formed under state law, engaged in buying debt payments including those paid by Plaintiffs and class members. *Compl.* at ¶¶ 29-66. As such, Defendants are in the same posture as the debt buyers in *Madden v. Midland Funding, LLC*, 786 F.3d 246

(2d Cir. 2015). As here, the debt buyer in *Madden* argued that "as assignees of a national bank, they too are allowed under the NBA to charge interest at the rate permitted by the state where the assignor bank is located." *Id.* at 250.

The Court of Appeals rejected that sweeping assertion, holding that "[t]o apply NBA preemption to an action taken by a non-national bank entity, application of state law to that action must significantly interfere with a national bank's ability to exercise its power under the NBA." *Id.* The Second Circuit found that while application of New York's usury law to those debt buyers could "decrease the amount a national bank could charge for its consumer debt in certain states" such as New York, "such an effect would not 'significantly interfere' with the exercise of a national bank power." *Id.* at 251. The exact same possible effects are at stake here – and none would significantly interfere with the exercise of a national bank power.[1]

The Second Circuit distinguished *Krispin v. May Department Stores*, 218 F.3d 919 (8th Cir. 2000), citing to the facts of that unusual case in which a department store created a bank and assigned its credit card accounts to the bank, but purchased the receivables from the bank. 218 F.3d at 921-22. The *Madden* Court rejected following *Krispin* or *Munoz v. Pipestone Financial, LLC*, 513 F.Supp.2d 1076 (D.Minn. 2007), which relied on *Krispin*, reiterating that "the essential inquiry" is whether the application of state law would significantly interfere with the national bank's exercise of its powers. 786 F.3d at notes 2, 3. The notion that a national bank was the "originating entity" had "no significance." *Id.* at note 2.

As alleged in the Complaint, Defendants purchased "all right, title and interest" in the debt payments, transactions that "constitute an absolutely sale, conveying good title, free and clear of any liens, claims encumbrances or rights of others." *Compl.* at ¶¶44, 45, 49, 50. According to the Complaint, Plaintiff and class members' loan payments are the property of Defendants such that they are even beyond the reach of bankruptcy or receivership proceedings. *Compl.* at ¶¶ 52, 57.

The Complaint further alleges that servicing of the receivables – such as "billing statements sent out to cardholders and payments collected from them" – is performed on the Defendants' behalf contractually, for which the servicer is compensated by Defendants. *Compl.* at ¶¶58-59. To the extent a national bank performs these functions for receivables owned by Defendants, it does so as their agent, exercising only those powers that the principal is capable of delegating. These facts – which must be accepted as true for purposes of Defendants' proposed

[1] Moreover, the question of whether application of New York's usury statute to the Defendants here would significantly interfere with a national bank's power depends on findings of fact and is not appropriately addressed in connection with Defendants' proposed motion.

CUNEO GILBERT & LADUCA, LLP

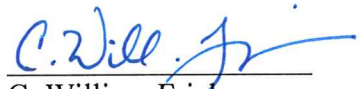
motion to dismiss – demonstrate that the status of the Defendant third party debt purchasers here is highly similar, if not identical, to the debt purchasers in *Madden.*

Finally, Defendants assert that Plaintiffs' claims "violate the longstanding 'valid when made rule.'" Plaintiffs would submit that this purported doctrine is neither longstanding nor a rule. Instead, it relies on misapplication of case law from 1828 – decades before the passage of the National Bank Act – that involved two separate interest charges on a single note. That line of cases only stands for the common sense proposition that in evaluating the rate of interest in a contract alleged to be usurious, the rate as set by the contract is the rate to be evaluated, and not the rate as modified by subsequent additional transactions.

In *Gaither v. Farmers' & Mechanics' Bank of Georgetown*, 26 U.S. (1 Pet.) 37 (1828), cited by Defendants' letter, a non-usurious note was pledged by the payee as collateral for an unrelated, usurious loan. 26 U.S. (1 Pet.) at 41. The Supreme Court observed that "[T]he rule cannot be doubted, that if the note free from usury, in its origin, no *subsequent usurious transactions* respecting it can affect it with the taint of usury." *Id.* at 43 (emphasis added). In short, the rule is that usury in transaction #2 does not impute usury to transaction #1. The rule has no bearing on Defendants' claim of right to ignore New York law.

As Defendants' letter states, counsel for Plaintiffs have conferred with Murphy & McGonigle, P.C., and agreed on the briefing schedule set forth in their letter.

Respectfully submitted,



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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

NRO BOSTON, LLC and ALICE INDELICATO, Plaintiffs, v. KABBAGE, INC. and CELTIC BANK CORPORATION Defendants.	Civil Action No. 1:19-cv-11901-RGS

ASSENTED TO MOTION FOR
CONSOLIDATION OR REASSIGNMENT OF RELATED CASES
BY CELTIC BANK AND KABBAGE

Pursuant to Fed. R. Civ. P. 42 and Local Rule 40.1(g)-(j), Celtic Bank and Kabbage respectfully request that this Court enter an order consolidating or reassigning this case with *NRO Boston, LLC, et al v. Kabbage, Inc., et al.*, 1:17-cv-11976 (D. Mass.). Both cases involve the same parties and competing efforts to confirm and vacate the same arbitration award, and they should be considered related to each other and assigned to a single judge to promote judicial efficiency.[1] NRO Boston and Alice Indelicato assent to this motion. In support of this motion, Celtic Bank and Kabbage state as follows:

1. This case arose out of a dispute between NRO Boston, LLC and its owner Alice Indelicato (together, "NRO"), on the one hand, and Celtic Bank Corporation ("Celtic Bank") and Kabbage, Inc. ("Kabbage"), on the other hand, over the enforceability of numerous Business

[1] Celtic Bank and Kabbage also have filed a substantively similar version of this motion to consolidate in *NRO Boston, LLC, et al v. Kabbage, Inc., et al.*, 1:17-cv-11976 (D. Mass.), because it is "the case first filed in this Court." L.R. 40.1(j).

Loan Agreements that NRO entered into with Celtic Bank. NRO initially filed a lawsuit in *NRO Boston, LLC, et al v. Kabbage, Inc., et al.*, 1:17-cv-11976 (D. Mass.), and that case was assigned to Judge O'Toole. However, the parties subsequently agreed to resolve this dispute in binding arbitration. 1:17-cv-11976, ECF No. 31.

2. On February 23, 2018, Judge O'Toole stayed all proceedings in *NRO Boston, LLC, et al v. Kabbage, Inc., et al.*, 1:17-cv-11976 (D. Mass.), pending the conclusion of that arbitration and directed the parties to file a joint status report within 30 days after the arbitrator's decision. ECF No. 32. On March 6, 2018, Judge O'Toole entered an order administratively closing that case, but directed the parties to "notify the Court if they wish to restore the case to the Court's active docket." ECF No. 33.

3. That arbitration has now concluded. On July 24, 2019, the Arbitrator, Hon. Charles B. Swartwood, III (Ret.), entered a Final Award rejecting NRO's efforts to have its loan agreements declared unenforceable. The Final Award also ordered NRO to pay Celtic Bank the amounts outstanding on its loans and to reimburse Celtic Bank for the reasonable attorneys' fees and costs it incurred defeating those claims. In total, NRO has been ordered to pay Celtic Bank $3,299.621.97.

4. Consistent with Judge O'Toole's 2018 orders in *NRO Boston, LLC, et al v. Kabbage, Inc., et al.*, 1:17-cv-11976 (D. Mass.), Celtic Bank filed a motion to confirm the arbitration award in that proceeding on September 9, 2019. *See* ECF No. 35. Celtic Bank also filed a motion for pre-judgment attachment of NRO's assets while its motion to confirm was pending. *See* ECF No. 38.

5. That same day, NRO filed a petition to vacate the arbitration award. But rather than file that request in the 1:17-cv-11976 docket, as Judge O'Toole's 2018 orders contemplate,

NRO initiated this action.

6. The issues raised in NRO's petition to vacate are identical to the issues presented by Celtic Bank's motion to confirm. In fact, the opposition that NRO filed to Celtic Bank's motion to confirm the arbitration award is nearly identical to the memorandum NRO filed in support of its motion to vacate.

7. Fed. R. Civ. P. 42(a)(2) permits a court to consolidate actions like these, which involve a common question of law or fact. In determining whether consolidation should occur, "[t]he threshold issue is whether two proceedings involve a common party *and* common issues of fact and law. Once this determination is made, the trial court has broad discretion in weighing the costs and benefits of consolidation to decide whether that procedure is appropriate. A motion for consolidation will usually be granted unless the party opposing it can show demonstrable prejudice." *Seguro de Servicio de Puerto Rico v. McAuto Sys. Group, Inc.*, 878 F.2d 5, 8 (1st Cir. 1989). In considering the costs and benefits of consolidation, the court should weigh "the convenience to the parties and judicial economy against the extent of any confusion, delay or prejudice that might result from consolidation." *Data General Corp. v. Grumman Sys. Support Corp.*, 834 F. Supp. 477, 487 (D. Mass. 1992).

8. First, the threshold requirement for consolidation under Rule 42(a) of the Federal Rules of Civil Procedure is met here. Both the instant case and the separate action that NRO initiated involve the same parties: NRO Boston and Ms. Indelicato, on one hand, and Celtic Bank and Kabbage, on the other. Both actions involve the same arbitration award, which Celtic Bank seeks to confirm, and which NRO seeks to vacate. The cases therefore share common factual and legal issues. *See Perry v. Equity Residential Mgmt., LLC*, 2014 WL 4198850, at *2 (D. Mass. Aug. 26, 2014) (granting consolidation where primary defendant was the same in both

actions, both actions involved allegations under the same statute, and involved the same unlawful fees); *Americus Mortg. Corp. v. Mark*, 2013 WL 3106018, at *12-13 (D. Mass. June 17, 2013) (granting consolidation where all parties in both cases were the same and both cases arose directly from efforts to collect on a final judgment).

9. Second, the balancing factors weigh in favor of consolidation here. Consolidation offers substantial benefits, and no drawbacks, since judicial economy and expediency is well served by assigning a single judge to rule on the parties' competing requests to enforce and vacate the arbitration award. *See Perry*, 2014 WL 4198850 at *2 (granting consolidation where "[t]he substantial overlap between the cases makes consolidation more economical and expedient"); *Americus Mortg. Corp.*, 2013 WL 3106018, at *12-13 (granting consolidation where it "avoids conducting duplicate hearings" and "sufficient prejudice to avoid consolidation is absent"). And, because the parties' competing motions seek contradictory relief on the same issue, consolidation will eliminate the risk of inconsistent rulings.

10. Consolidation or reassignment is also appropriate because these cases qualify as related cases under Local Rule 40.1. Local Rule 40.1 directs the clerk to "assign related cases to the same district judge without regard to the number of other cases in that category previously assigned to that judge." L.R. 40.1(g)(3). Cases are deemed "related" if "some or all of the parties are the same and if one or more of the following similarities exists also: the cases involve the same or similar claims or defenses; or the cases involve the same property, transaction, or event; . . .or the cases involve substantially the same questions of fact and law." L.R. 40.1(g)(1).

11. For the reasons outlined above, both actions involve the same parties, "the same or similar claims or defenses," "substantially the same questions of fact and law," and the "same property, transaction or event" having both directly arisen from the same arbitration award, and

therefore qualify as related under the Local Rules. When, as here, the clerk does not assign related cases to the same district judge, this can be corrected "by the joint decision of the district judge to whom it has been assigned and the district judge to whom it should be assigned. The judges may then transfer the case pursuant to subsection (i) of this rule, and shall notify the clerk of the reason for the transfer." L.R. 40.1(g)(5); *see also* L.R. 40.1(i)(1) ("In the interest of justice or to further the efficient performance of the business of the court, a district judge. . .may transfer the case to another district judge, if the other judge consents to the transfer.").

For the foregoing reasons, Celtic Bank and Kabbage respectfully request that this Court enter an order consolidating this case with, or reassigning this case to the judge presiding over, *NRO Boston, LLC, et al v. Kabbage, Inc., et al.*, 1:17-cv-11976-GAO (D. Mass.).

Dated: September 25, 2019

/s/ Michael Maya
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CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of September, I caused the foregoing document to be electronically filed with the Clerk of the Court using the CM/ECF system and to be sent electronically to the registered participants as identified on the Notice of Electronic Filing (NEF), pursuant to Local Rule 5.4(C).

/s/ Michael Maya
Michael Maya

LOCAL RULE 7.1 CERTIFICATION

I hereby certify that counsel for Defendants Celtic Bank and Kabbage met and conferred with counsel for Plaintiffs NRO Boston, LLC and Alice Indelicato to attempt in good faith to resolve or narrow the issues presented in this motion. Plaintiffs NRO Boston, LLC and Alice Indelicato assent to the relief requested by this motion.

/s/ Andrew Soukup
Andrew Soukup

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIGHT KIDS NYC, INC.; BRIGHT KIDS CHICAGO, INC.; BIGE DORUK; IB OLSEN, MIKE'S AUTO SERVICE, INC., MICHAEL L. PEDERSON, PIM SALONS, LLC D/B/A BEAUTIFUL BRANDS; MARCIA VAN CAMP; DBR CONSTRUCTION; JULIE COX; THE CEDARS OF LEBANON LLC; and THEODORE MONSOUR II, individually and on behalf of all those similarly situated, Plaintiffs, v. KABBAGE, INC., a Delaware corporation; ROBERT FROHWEIN, individually and, KATHRYN PETRALIA, individually, Defendants.	Docket No.: **JURY TRIAL DEMANDED**

CLASS ACTION COMPLAINT

Plaintiffs DBR Construction, Julie Cox, Bright Kids NYC, Inc., Bright Kids Chicago, Inc., Bige Duruk, Ib Olsen, Mike's Auto Service, Inc., Michael L. Pederson, Pim Salons, LLC d/b/a Beautiful Brands and Marcia Van Camp, The Cedars of Lebanon, LLC, Theodore Monsour, II (collectively "Plaintiffs") hereby bring this Class Action Complaint against Kabbage, Inc. ("Kabbage"), Robert Frohwein and Kathryn Petralia (collectively, "Defendants"). In support, Plaintiffs, individually and on behalf of all those similarly situated, hereby alleges, upon due investigation, and, where stated, due information and reasonable belief, as follows:

NATURE OF THE ACTION

1. As a matter of their strong public policy, more than a dozen states place limits on the amount of interest that can be charged on business loans.

2. Plaintiffs are small businesses and their individual owners who have been victimized by Defendants' unscrupulous scheme to evade these state imposed limits through their illegal "rent-a-bank" scheme.

3. Kabbage is an online digital technology company which provides funding directly to small businesses and consumers through an automated lending platform.

4. In order to obtain clients for its loans, Kabbage aggressively markets, underwrites and services short-term loans to small businesses in need of quick capital.

5. These loans often substantially exceed the statutory maximum legal interest rate in violation of state usury laws.

6. In an effort to hide—and ostensibly legalize—its illegal activities, Kabbage entered into an illegal "rent-a-bank" scheme with Celtic Bank, a foreign state chartered bank in Utah (a state with no maximum interest rate for commercial loans). *See* Ex. 1.

7. The enterprise's purpose is to evade the criminal usury laws of states throughout the country, including California, Colorado, Massachusetts and New York.

8. Under this "rent-a-bank" scheme, Kabbage originates, underwrites, securitizes and funds the loans, and then enters into sham transactions with Celtic Bank, which acts as the lender in name only. *See e.g., Kabbage Asset Securitization LLC, Series 2017-1, Additional Notes,* attached as Ex. 2.

9. Thus, in economic reality, Kabbage markets, underwrites, prices, approves, funds, and collects upon 100% of the loans. It also bears 100% risk of loss.

10. In contrast, Celtic Bank owns the receivables on paper *for just two-days*, bears zero risk of loss and literally does not lift a finger to service the loan.

11. From the inception of *every* loan that it originates, Kabbage is contractually obligated to purchase from Celtic Bank 100% of those receivables.

12. Celtic Bank retains no ownership or monetary interest in the receivables, and therefore, it has absolutely no economic risk of loss due to a borrower's non-payment or subsequent default. *See e.g., Kabbage Asset Securitization LLC, Series 2017-1, Additional Notes,* attached as Ex. 2.

13. Put another way, Celtic Bank rents its charter to Kabbage in exchange for a commission on loans originated and funded by Kabbage but nominally made under Celtic's name for the purpose of evading state usury laws. *See* Ex. 3, Hannon, J., *The True Lender Doctrine*: Function Over Form as a Reasonable Constraint on the Exportation of Interest Rates, Duke Law Journal, Vol. 67:1261, 1285 (2018) ("[R]ent-a-charter participants are likely to seize on factors identified by courts applying the true lender doctrine and subsequently attempt to structure the form of their relationships so as to avoid the appearance of sham transactions.").

14. Due to the volume and risk inherent in high-interest loans, Celtic Bank itself would never be able to make and to keep the loans on its balance sheet because they would create an unacceptable risk under FDIC regulations.

15. Kabbage, however, willingly approves and takes on these high-risk loans because it charges these small businesses usurious interest rates that are as high as 95% APR.

16. The result of these high interest rates can be devastating to struggling small businesses in desperate need of capital. For example, on a $100,000 loan, the most that can be charged per year under New York criminal law is $25,000. At a 95% APR, Kabbage would be charging a struggling small business $58,547. That is *double* the amount permitted in Colorado

and New York, nearly triple the amount permitted in Massachusetts, and more than *five times* the amount permitted in California.

17. In charging these unlawful interest rates, Kabbage itself has repeatedly admitted that the arrangement is a sham and that Kabbage is the true lender.

18. For example, during a joint webinar presented in partnership with the National Federation of Independent Business, Kabbage's co-founder and COO, Kathryn Petralia, acknowledged that Kabbage is the direct lender:

> Question: "Are you a direct lender?"
>
> Answer: "**The answer is yes**. We are not a marketplace lender. We do securitize the receivables that are generated, the loans that are generated, meaning **we have investors in those loans that we make**, but **Kabbage actually takes the risk of loss**. All of our loans are made in partnership with Celtic Bank, which is a Utah bank regulated by the FDIC."[1]

19. In another public interview, Petralia admitted:

> "We're a little bit different just, again, **because we're a direct lender**. So **we take balance sheet risk**, **we securitize the receivable**. So we don't have the exact same risk because we don't have retail investors. **For us, what happens is rates go up. We pay more. Our customers pay more**. That kind of sucks. But we don't have that same exact kind of platform risk, I think, that folks like Prosper may have."[2]

20. This type of "rent-a-bank" scheme is illegal and has been the subject of numerous enforcement actions by Attorneys General in different states.

21. In their letter to the FDIC on January 22, 2019, *ten state attorneys general* decried rent-a-bank schemes that seek to evade their state usury laws, including the state attorneys general for California, Colorado, Massachusetts and New York. *See* Ex. 5.

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[1] *See The Ins and Outs of Online Lending with Kabbage (Webinar Transcript),* Kabbage, https://www.kabbage.com/blog/ins-outs-online-lending-kabbage-co-founder-kathryn-petralia-webinar-transcript/ (last accessed Mar. 10, 2018) (emphasis added); Ex. 4.

[2] *See https://www.cbinsights.com/research/marketplace-lending-competition-brutal/* (emphasis added).

22. Through this unlawful scheme, Kabbage has systematically collected usurious interest from small businesses since March 2014 and continues to violate state usury laws today.

23. In addition to charging unlawful interest rates, the scheme is designed to trap small businesses in a never-ending cycle of debt.

24. The average Kabbage customer enters into an astonishing *twenty-two loans* with Kabbage over just a four-year period.[3]

25. When the small businesses that take on these usurious loans are unable to keep up with their debt repayments, Kabbage then sells the debt to TBF Financial, Inc. ("TBF"), a third-party debt collector, who takes over and acts as the collection arm for the criminal enterprise.

26. As occurred here, this classic "rent-a-bank" scheme typically results in litigation, as TBF sues the borrowers for defaulting on the usurious and predatory Kabbage loans.

27. Under the controlling law of this Circuit, however, neither Kabbage nor TBF are entitled to federal preemption. Thus, both are subject to applicable state usury laws. *See Madden v. Midland Funding, LLC*, 786 F.3d 246, 251-53 (2d Cir. 2015) ("Although national banks' agents and subsidiaries exercise national banks' powers and receive protection under the NBA when doing so, extending those protections to third parties would create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank.").

28. Defendants' rent-a-bank scheme here is precisely the type of sham arrangement the Second Circuit intended to prevent when it decided *Madden*.

29. Plaintiffs now bring this class action lawsuit to put an end to Defendants' unlawful scheme, and to remunerate the many thousands of similarly situated victims located in California, Colorado, Massachusetts and New York.

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[3] *See* *https://player.fm/series/cb-insights-a-conversation-with-2380182/a-conversation-with-kathryn-petralia-coo-co-founder-of-kabbage*.

THE PARTIES

30. Plaintiff Bright Kids NYC, Inc. is a New York corporation located in New York, New York.

31. Plaintiff Bright Kids Chicago, Inc. is an Illinois corporation located at in New York, New York.

32. Plaintiff Ib Olsen is a New York citizen and resident located in New York, New York.

33. Plaintiff Bige Doruk is a New York citizen and resident located in New York, New York.

34. Plaintiff Julie Cox is citizen and resident of California located in Apple Valley, California.

35. Plaintiff DBR Construction is a sole proprietorship of Julie Cox located and operated under the laws of California.

36. Plaintiff Mike's Auto Service, Inc. is a Massachusetts automotive repair business located in Somerville, Massachusetts.

37. Plaintiff Michael L. Pederson is a resident and citizen of Wakefield, Massachusetts.

38. Plaintiff Pim Salons, LLC d/b/a Beautiful Brands is a Massachusetts business located in Brighton, Massachusetts.

39. Plaintiff Marcia Van Camp is a resident and citizen of Westborough, Massachusetts.

40. Plaintiff The Cedars of Lebanon, LLC is Colorado company located Durango, Colorado.

41. Plaintiff Theodore Monsour, II, is an individual and resident and citizen of Colorado with a place of residence in Durango, Colorado.

42. Defendant Kabbage is a limited liability company duly organized and existing under the laws of the State of Georgia, with its principal place of business located at 25B Peachtree Street NE, Suite 1688, Atlanta, GA 30309.

43. Defendant Robert Frohwein is an individual resident and citizen of Georgia with a principal place of business at 925B Peachtree Street NE, Suite 1688, Atlanta, GA 30309.

44. Defendant Kathryn Petralia is an individual resident and citizen of Georgia principal place of business at 925B Peachtree Street NE, Suite 1688, Atlanta, GA 30309.

JURISDICTION

45. Each Defendant is subject to the personal jurisdiction of this Court because each Defendant regularly transacts business within the State of New York and has purposefully availed itself of the laws of New York for the specific transactions at issue.

46. The Court has subject matter jurisdiction pursuant to 28 U.S.C. § 1332(d)(2), because (i) at least one member of the Class is a citizen of a different state than Defendants, (ii) the amount in controversy exceeds $5,000,000 exclusive of interest and costs, and (iii) none of the exceptions under that subsection apply to this action.

47. The Court has subject-matter jurisdiction over this dispute pursuant to 28 U.S.C. § 1331 based on Plaintiffs' claims for violations of the Racketeer Influenced and Corruption Organizations Act, 18 U.S. C. §§ 1961–68.

48. The Court has subject-matter jurisdiction over Plaintiffs' state-law claims because they are so related to Plaintiffs' federal claims that they form part of the same case or controversy under Article III of the United States Constitution.

49. Venue is proper because each Defendants regularly conducts business within this judicial district.

FACTUAL BACKGROUND

Kabbage "Rents" a Utah Bank to Violate State Usury Laws

50. Defendants' rent-a-bank scheme began on or around March 20, 2014 when Kabbage entered into a "Program Management Agreement" ("PMA") with Celtic Bank.

51. Pursuant to the PMA, Celtic Bank agreed to "issue" business loans through the marketing efforts of Kabbage.

52. Kabbage and Celtic amended their PMA on June 30, 2015. One of the principle changes to the agreement was that the 5% participation interest that Celtic Bank was retaining in the loan receivables under the original agreement was eliminated.

53. Under the new agreement, Kabbage was obligated to purchase Celtic Bank's minor participation interest in all outstanding loans and it was required to purchase 100% of the loan receivables on all loans Kabbage originated going forward—*after just two days*.

54. Thus, as of June 30, 2015, 100% of the economic interest and risk for all loans that were "issued" in Celtic Bank's name was borne by Kabbage who was and is the true lender.

55. Defendants' rent-a-bank scheme was and is designed for one purpose: to allow third-party lenders like Kabbage to circumvent state usury laws.

56. Kabbage actually holds itself out as a direct lender notwithstanding its false claims that the loans are "issued" by Celtic Bank.

57. As pled above, during a joint webinar presented in partnership with the *National Federation of Independent Business*, Ms. Petralia explicitly acknowledged that Kabbage is the direct lender in transactions involving Celtic Bank.

58. As further evidence of the sham, each loan made to Plaintiffs was titled "Kabbage Business Loan Agreement," and Kabbage—*not* Celtic—bore the risk of loss on each.

59. Moreover, in the origination, execution, and financing of the loans, Plaintiffs at all times dealt exclusively with Kabbage.

60. In fact, from the inception of the loans, Plaintiffs were directed to make payments directly to Kabbage, and to provide all notices under the loans to Kabbage.

61. Plaintiffs had absolutely no dealings of any kind with Celtic Bank on any of these loan transactions.

The Criminal RICO Enterprise

62. Since at least March 2014 and continuing through the present, the members of the Enterprise have had ongoing relations with each other through common control/ownership, shared personnel and/or one or more contracts or agreements relating to and for the purpose of originating, underwriting, servicing and collecting upon unlawful debt issued by the Enterprise to small businesses throughout the United States, including Plaintiffs and the Class Members.

A. Each Member's Role in the Enterprise.

63. The Enterprise has organized itself into a cohesive group with specific and assigned responsibilities and a command structure to operate as a unit in order to accomplish the common goals and purposes of collecting upon unlawful debts including as follows:

a) Defendant Frohwein

64. Frohwein is the co-founder and Chief Executive Officer of Kabbage. Together with Defendant Petralia, Frohwein is responsible for the day-to-day operations of the Enterprise and has final say on all business decisions of the Enterprise including, without limitation, which usurious loans the Enterprise will fund, how such loans will be funded, which of Investors will

fund each loan and the ultimate payment terms, amount and period of each usurious loan, including the loans extended to Plaintiffs and the Class Members. Frohwein participated in, oversaw and ultimately approved the rent-a-bank scheme used to transact each of the loans extended to Plaintiffs and the Class Members.

65. In his capacity as one of the day-to-day leaders of the Enterprise, Frohwein, together with Petralia, is responsible for creating, approving and implementing the policies, practices and instrumentalities used by the Enterprise to accomplish its common goals and purposes including: (i) the rent-a-bank scheme at issue; (ii) the method and manner used by the Enterprise to attempt to avoid applicable usury laws; (iii) the method and manner of the Enterprise's collection of an unlawful debt; and (iv) the financing of the Enterprise. All such forms were used to make and collect upon the unlawful loans including, without limitation, the loans extended to Plaintiffs and the Class Members.

66. Frohwein has also taken actions and, directed other members of the Enterprise to take actions necessary to accomplish the overall goals and purposes of the Enterprise including directing the affairs of the Enterprise, funding the Enterprise, soliciting and recruiting members of the Enterprise, directing members of the Enterprise to collect upon the unlawful loans and executing legal documents in support of the Enterprise.

67. Frohwein has ultimately benefited from the Enterprise's funneling of the usurious loan proceeds to Kabbage, Celtic Bank, TBF, and Petralia.

b) Defendant Petralia

68. Petralia is the co-founder and Chief Financial Officer of Kabbage. Together with Frohwein, Petralia is responsible for the day-to-day operations of the Enterprise and has final say on all business decisions of the Enterprise including, without limitation, which usurious loans the

Enterprise will fund, how such loans will be funded, which of the Investors will fund each loan and the ultimate payment terms, amount and period of each usurious loan. Petralia participated in, oversaw and ultimately approved the rent-a-bank scheme used to transact each of the loans extended to Plaintiffs and the Class Members.

69. In her capacity as one of the day-to-day leaders of the Enterprise, Petralia, together with Frohwein, is responsible for creating, approving and implementing the instrumentalities used by the Enterprise to accomplish its common goals and purposes including: (i) the rent-a-bank scheme at issue; (ii) the method and manner used by the Enterprise to attempt to avoid applicable usury laws; (iii) the method and manner of the Enterprise's collection of an unlawful debt; and (iv) the financing of the Enterprise. All such forms were used to make and collect upon the unlawful loans including, without limitation, the loans extended to Plaintiffs and the Class Members.

70. Petralia has also taken actions and, directed other members of the Enterprise to take actions, necessary to accomplish the overall goals and purposes of the Enterprise including personally marketing the unlawful loans through numerous personal appearances at trade shows, radio shows, and media interviews.

71. Petralia has ultimately benefited from the Enterprise's funneling of the usurious loan proceeds to Kabbage, Celtic Bank, TBF, and Frohwein.

c) Defendant Kabbage

72. Kabbage is organized under the laws of Georgia and maintains officers, books, records, and bank accounts independent of Celtic Bank, and TBF.

73. Directly and through Frohwein, Petralia and its other agent employees, Kabbage has been an active participant and central person in the operation and management of the Enterprise and its affairs, and in the orchestration, perpetration, and execution of the Enterprise's collection

of unlawful debts. Kabbage has been and continues to be responsible for: (i) entering into contracts with brokers to solicit borrowers for the Enterprise's usurious loans and participation agreements with Investors to fund the usurious loans; (ii) pooling the funds of Investors in order to fund each usurious loan; (iii) underwriting the usurious loans and determining the ultimate rate of usurious interest to be charged under each loan; (iv) entering into the loans on behalf of the Enterprise; (v) servicing the usurious loans; and (vi) setting up and implementing the ACH withdrawals used by the Enterprise to collect upon the unlawful debt.

74. In this case, Kabbage: (i) solicited borrowers, including Plaintiffs and other Class Members; (ii) pooled funds from Investors to fund the loans; (iii) underwrote the loans; (iv) entered into the loans; and (v) collected upon the unlawful debt evidenced by the loans by effecting daily ACH withdrawals from the bank accounts of Plaintiffs and the Class Members.

75. Kabbage has ultimately benefited from the Enterprise's funneling of the usurious loan proceeds to Celtic Bank, TBF, Frohwein and Petralia.

d) Non-Party Celtic Bank

76. Celtic Bank is organized under the laws of Utah and maintains officers, books, records, and bank accounts independent of Kabbage, Celtic Bank and TBF.

77. Directly and through its other agent employees, Celtic Bank has been an active participant and central person in the operation and management of the Enterprise and its affairs, and in the orchestration, perpetration, issuance, execution and collection of the Enterprise's unlawful debts. Celtic Bank has been and continues to be responsible for: (i) acting as the front for the issuer of each of the loans; (ii) acting as the front for the funder of each of the loans; (iii) acting as the front for the underwriting of each of the loans; and (iv) acting as the front for collecting upon each of the loans.

78. In this case, Celtic Bank allowed the Enterprise to use its name as the party: (i) issuing the loans; (ii) funding the loans; (iii) underwriting the loans; and (iv) entering into the loans, including the loans to Plaintiffs and other Class Members.

79. Celtic Bank has ultimately benefited from the Enterprise's funneling of the usurious loan proceeds to Kabbage, TBF, Frohwein and Petralia.

e) Non-Party TBF

80. TBF is a debt collection company. It is organized under the laws of Illinois and maintains officers, books, records, and bank accounts independent of Kabbage and Celtic Bank.

81. Upon default of a borrower's obligations under the usurious loan agreements and in furtherance of the Enterprise's goal of collecting upon the unlawful debt, at the Defendants' direction, TBF collects upon the unlawful debts.

82. In furtherance of the Enterprise's goal of collecting upon the unlawful debt, TBF has filed numerous lawsuits to collect upon the unlawful debts of the Enterprise.

83. TBF has ultimately benefited from the Enterprise's funneling of the usurious loan proceeds to Kabbage, Celtic Bank, Frohwein and Petralia.

B. Interstate Commerce

84. Members of the Enterprise maintain offices in Georgia, Illinois and Utah and use personnel in these offices to originate, underwrite, fund, service and collect upon the usurious loans made by the Enterprise to entities in California, Colorado, Massachusetts, and New York, including Plaintiffs and the Class Members, and throughout the United States via extensive use of

interstate emails, mail, wire transfers and bank withdrawals processed through an automated clearing house.

85. In the present case, all communications between the members of the Enterprise, Plaintiffs and the Class Members were by interstate email and mail, wire transfers or ACH debits and other interstate wire communications. Specifically, the Enterprise used interstate emails to originate, underwrite, service and collect upon the loans, fund the advances under each of the loans and collect the payments via interstate electronic ACH debits.

86. In addition, at the direction of Kabbage, each of the loans was executed in states outside of Georgia, and original copies of the loans were transmitted from Georgia.

C. Conducting Affairs through a Pattern of Racketeering.

87. Defendants' conduct constitutes "fraud by wire" within the meaning of 18 U.S.C. 1343 which is "racketeering activity" as defined by 18 U.S.C. 1961(1). Its repeated and continuous use of such conduct to participate in the affairs of the Enterprise constitutions a pattern of racketeering activity in violation of 18 U.S.C. 1962(c).

D. Conducting Affairs Through the Collection of Unlawful Debt.

88. Defendants conducted the affairs of the Enterprise or participated in the affairs of the Enterprise, directly or indirectly, though the collection of this unlawful debt in violation of 18 U.S.C. 1962(c).

89. Specifically, Defendants obtained Plaintiffs' authorization to electronically withdraw payments on an unlawful debt from Plaintiffs' bank accounts.

90. Upon receipt of such authorization, Defendants did, in fact, make the daily withdrawals required by the loans.

91. When Plaintiffs could no longer make the daily payments required under the loans, Defendants made numerous interstate phone calls to collect upon the unlawful debt.

The Representative Class Action Plaintiffs

92. Plaintiffs are small businesses and their individual owners.

93. Plaintiffs Bright Kids NYC and Bige Doruk entered into at least twelve Business Loan Agreements with Defendants on December 31, 2014, January 19, 2015, February 16, 2015, April 7, 2015, May 3, 2015, May 18, 2015, July 27, 2015, August 21, 2015, September 21, 2015, October 30, 2015, November 30, 2015 and February 7, 2016.

94. The interest rates charged were in excess of 25%.

95. The interest rate for each of the loans was in excess of the maximum legal rate permitted under the laws of New York.

96. Plaintiffs Bright Kids Chicago and Ib Olsen entered into at least nine Business Loan Agreements with Defendants on May 28, 2014, February 16, 2015, April 6, 2015, May 4, 2015, June 2, 2015, June 27, 2015, August 21, 2015, November 2, 2015, and December 2, 2015.

97. The interest rates charged were in excess of 25%.

98. The interest rate for each of the loans was in excess of the maximum legal rate permitted under the laws of New York.

99. Plaintiffs DBR Constructions and Julie Cox entered into at least three Business Loan Agreements with Defendants on October 30, 2017, April 26, 2018, and August 16, 2018.

100. The interest rates charged were in excess of 10%.

101. The interest rate for each of the loans was in excess of the maximum legal rate permitted under the laws of California.

102. Plaintiffs Mike's Auto Service, Inc. and Michael L. Pederson entered into at least six Business Loan Agreements with Defendants on September 9, 2015, November 18, 2015, January 13, 2016, February 10, 2016, March 1, 2016, and March 28, 2016.

103. The interest rates charged were in excess of 20%.

104. The interest rate for each of the loans was in excess of the maximum legal rate permitted under the laws of Massachusetts.

105. Plaintiffs Beautiful Brands and Marcia Van Camp entered into at least nine Business Loan Agreements on October 27, 2016, October 25, 2017, January 25, 2018, March 25, 2018, April 29, 2018, July 6, 2018, July 25, 2018, August 10, 2018 and August 19, 2018.

106. The interest rates charged were in excess of 20%.

107. The interest rate for each of the loans was in excess of the maximum legal rate permitted under the laws of Massachusetts.

108. Plaintiffs The Cedars of Lebanon, LLC and Theodore Monsour, II entered into at least two Business Loan Agreements on April 16, 2018 and June 26, 2018.

109. The interest rates charged were in excess of 45%.

110. The interest rate for each of the loans was in excess of the maximum legal rate permitted under the laws of Colorado.

111. While those loans purported to be from Celtic, Kabbage in fact provided the marketing, origination, underwriting, approval, funding, and servicing for each of the loans.

112. The loans were applied for, executed and transacted in California, Colorado, Massachusetts and/or New York.

113. The agreements involve California, Colorado, Massachusetts and/or New York businesses and residents.

114. The loans were fully funded in California, Colorado, Massachusetts and/or New York.

115. The loan payments were electronically debited from a California, Colorado, Massachusetts and/or New York bank account.

116. In addition to these central contacts, the criminal activity and financial harm was directed and felt wholly within California, Colorado, Massachusetts and/or New York.

117. Furthermore, each of these loan transactions violated the strong public policy of California, Colorado, Massachusetts and/or New York.

118. The loans violated Stats. 1919, p. lxxxiii, § 2; and Stats. 1919, p. lxxxiii, § 3 and Article XV, § 1 of the California Constitution; C.R.S. 18-15-104(1); Colo. Rev. Stat. Ann. § 18-15-104; Mass. Gen. Law. c. 271, § 49; and N.Y. Penal Law § 190.40.

119. As New York courts have repeatedly explained:

> [U]sury laws are a declaration of this State's public policy. The First Department has characterized usury as a question of supervening public policy. *See Guerin v. New York Life Ins. Co.*, 271 AD 110, 62 N.Y.S.2d 805 (1st Dept 1946). The Court of Appeals has stated in *Schneider v Phelps* [41 NY2d 238, 243, 359 N.E.2d 1361, 391 N.Y.S.2d 568 (1977)], "[the] purpose of usury laws, from time immemorial, has been to protect desperately poor people from the consequences of their own desperation." Further, it has been reasoned from these cases that "the policy underlying our State's usury laws is in fact of a fundamental nature."

Clever Ideas, Inc. v 999 Rest. Corp., 2007 WL 3234747 (N.Y. Sup. Ct. Oct. 12, 2007); *see also Madden v. Midland Funding, LLC*, 2017 U.S. Dist. LEXIS 27109, *28-29 (S.D.N.Y. Feb. 27, 2017) ("A number of cases have applied New York law — despite the parties' choice of another forum's law — because New York's usury prohibition constitutes a fundamental public policy.) (citing *Am. Equities Grp.*, 2004 U.S. Dist. LEXIS 6970, 2004 WL 870260, at *8 ("New York has a strong public policy against interest rates which exceed 25%, which policy must be enforced."));

In re McCorhill Publ'g, Inc., 86 B.R. 783, 793 (Bankr. S.D.N.Y. 1988) (holding that enforcing New Jersey law would violate New York's "strong public policy against interest rates which exceed 25%, which policy must be enforced"); *Assih*, 893 N.Y.S.2d at 446 ("New York has a strong public policy against interest rates which are excessive and this is a policy the courts must enforce."); *N. Am. Bank, Ltd. v. Schulman*, 474 N.Y.S.2d 383, 387 (N.Y. Sup. Ct. 1984) ("[T]he policy underlying our state's usury laws is in fact of a fundamental nature."); *Guerin v. N.Y. Life Ins. Co.*, 62 N.Y.S.2d 805, 810 (1st Dep't 1946) ("Usury is a question of supervening public policy and relates to charges which are in themselves prohibited.").

CLASS ALLEGATIONS

120. Plaintiffs and the putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs.

121. Plaintiffs bring this action pursuant to Fed. R. Civ. P. 23(b)(2) and 23(b)(3).

122. Plaintiff Julie Cox d/b/a DBR Construction brings this action on behalf of itself and the following classes and subclasses of similarly situated persons:

> **California Merchant Class:** All persons residing in, headquartered in, or with a principal place of business in the State of California who, on or after October 4, 2015, entered into a Kabbage Business Loan Agreement and paid money pursuant to that Agreement.

123. Plaintiff Cox brings this action on behalf of herself and the following classes of similarly situated persons:

> **California Principal Class:** All citizens of the State of California who were designated as Principal on any Kabbage Business Loan Agreement pursuant to which money was paid on or after October 4, 2015.

124. Plaintiff The Cedars of Lebanon brings this action on its behalf and on behalf of the following class of similarly situated businesses:

> **Colorado Merchant Class:** All merchants residing in, headquartered in, or with a principal place of business in the State of Colorado that, on or after October 4, 2015,

entered into a Kabbage Business Loan Agreement and paid money pursuant to that Agreement.

Three-Year Colorado Merchant Subclass: All merchants residing in, headquartered in, or with a principal place of business in the State of Colorado that, on or after October 4, 2016, entered into a Kabbage Business Loan Agreement and paid money pursuant to that Agreement.

125. Plaintiff Theodore Monsour II brings this action on his behalf and on behalf of the following class of similarly situated persons:

Colorado Principal Class: All individual citizens of the State of New York who were designated as Principal on any Kabbage Business Loan Agreement pursuant to which money was paid on or after October 4, 2015.

Three-Year Colorado Principal Subclass: All individual citizens of the State of New York who were designated as Principal on any Kabbage Business Loan Agreement pursuant to which money was paid on or after October 4, 2016.

126. Plaintiffs Mike's Auto and Beautiful Brands bring this action on their behalf and on behalf of the following class of similarly situated businesses:

Massachusetts Merchant Class: All merchants residing in, headquartered in, or with a principal place of business in the Commonwealth of Massachusetts that, on or after October 4, 2015, entered into a Kabbage Business Loan Agreement and paid money pursuant to that Agreement.

127. Plaintiffs Michael Pedersen and Marcia Van Camp bring this action on their behalf and on behalf of the following class of similarly situated persons:

Massachusetts Principal Class: All individual citizens of the Commonwealth of Massachusetts who were designated as Principal on any Kabbage Business Loan Agreement pursuant to which money was paid on or after October 4, 2015.

128. Plaintiffs Bright Kids NYC and Bright Kids Chicago bring this action on their behalf and on behalf of the following class of similarly situated businesses:

New York Merchant Class: All merchants residing in, headquartered in, or with a principal place of business in the State of New York that, on or after October 4, 2013, entered into a Kabbage Business Loan Agreement and paid money pursuant to that Agreement.

> **Six-Year New York Merchant Subclass:** All merchants residing in, headquartered in, or with a principal place of business in the State of New York that, on or after October 4, 2013, entered into a Kabbage Business Loan Agreement and paid money pursuant to that Agreement.

129. Plaintiffs Bige Doruk and Ib Olsen bring this action on their behalf and on behalf of the following class of similarly situated persons:

> **New York Principal Class:** All individual citizens of the State of New York who were designated as Principal on any Kabbage Loan Agreement pursuant to which money was paid on or after October 4, 2015.
>
> **Six-Year New York Principal Subclass:** All individual citizens of the State of New York who were designated as Principal on any Kabbage Loan Agreement pursuant to which money was paid on or after October 4, 2013.

130. The California Merchant Class, the California Principal Class, the Colorado Merchant Class, the Colorado Principal Class, the Three-Year Colorado Merchant Class, the Three-Year Colorado Principal Class, the Massachusetts Merchant Class, the Massachusetts Principal Class, the New York Merchant Class, and the New York Principal Class, the Six-Year New York Merchant Class, and the Six-Year New York Principal Class are collectively referred herein as the "Class Members."

The following people are excluded from the classes: (1) any Judge or Magistrate presiding over this action and members of their families; (2) Defendants, Defendants' subsidiaries, parents, successors, predecessors, and any entity in which Defendants or their parents have a controlling interest along with their current and former employees, officers, and directors; (3) persons who properly execute and timely file a request for exclusion from the classes; (4) persons whose claims in this matter have been finally adjudicated on the merits or otherwise waived; (5) Plaintiffs' and Defendants' counsel; and (6) the legal representatives, successors, and assigns of any such excluded persons.

131. **Ascertainability:** Although Plaintiffs do not yet possess a list of potential class members, publicly available information and Defendants' business records will allow for the administratively feasible identification of all class members.

132. **Numerosity:** The exact number of members in the classes is not currently known to Plaintiffs, but individual joinder in this case is impracticable. On information and belief, each of the classes and subclasses is likely to number several hundred, if not several thousand, members.

133. **Commonality Questions and Community of Interest**: There are many questions of law and fact common to the claims of Plaintiffs and the proposed members of the classes, and those questions predominate over any questions that may only affect individual members. Common questions for the classes include but are not limited to the following:

a) Whether the loans at issue are usurious under applicable state law;

b) Whether the loans at issue are contrary to public policy;

c) Whether Defendants made deceptive, misleading, or false representations in connection with the loans;

d) Whether Plaintiffs and the classes and the subclasses may recover money paid to Defendants pursuant to any of the loans;

134. **Typicality:** Plaintiffs' claims are typical of the claims of the members of the classes and subclasses. Plaintiffs sustained damages as a result of Defendants' uniform wrongful conduct during transactions with Plaintiffs and the classes and subclasses.

135. **Adequate Representation**: Plaintiffs have and will continue to fairly and adequately represent and protect the interests of the classes and subclasses, and have retained counsel competent and experienced in complex litigation and class actions. Plaintiffs have no interests antagonistic to those of the classes, and Defendants have no defenses unique to Plaintiffs.

Plaintiffs and their counsel are committed to vigorously prosecuting this action on behalf of the members of the classes, and they have the resources necessary to do so. Neither Plaintiffs nor their counsel have any interest adverse to those of the other members of the classes or subclasses.

FIRST CAUSE OF ACTION

Usury

(On Behalf of All Plaintiffs and Class Members)

136. Plaintiffs and the putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs as if fully set forth herein.

137. Plaintiffs bring this cause of action individually and on behalf of the Putative Class Members against all Defendants.

138. Defendants have devised and engaged in a scheme to fund, issue, and collect usurious loans through a rent-a-bank scheme.

139. Plaintiffs have taken usurious loans from Defendants and the individual Plaintiffs were forced to personally guarantee these debts.

140. Defendants are not exempt from state usury laws, nor are the transactions that are the subject of this action exempt from state usury laws.

141. The interest charged by Defendants in connection with these transactions was in excess of the maximum interest rate permitted by Stats. 1919, p. lxxxiii, § 2; and Stats. 1919, p. lxxxiii, § 3 and Article XV, § 1 of the California Constitution; C.R.S. 18-15-104(1); Mass. Gen. Law. c. 271, § 49; Colo. Rev. Stat. Ann. § 5-12-107(2)(a); and N.Y. Penal Law § 190.40.

142. Plaintiffs have in fact paid Defendants interest in excess of the maximum interest rate permitted by Stats. 1919, p. lxxxiii, § 2; and Stats. 1919, p. lxxxiii, § 3 and Article XV, § 1 of the California Constitution; C.R.S. 18-15-104(1); Mass. Gen. Law. c. 271, § 49; Colo. Rev. Stat. Ann. § 5-12-107(2)(a); and N.Y. Penal Law § 190.40.

143. Defendants knowingly and willfully entered into the loans with usurious intent.

SECOND CAUSE OF ACTION

RICO, 18 U.S.C. § 1962(c)

(On Behalf of Plaintiffs and Class Members, except for the Six-Year New York Merchant Subclass, and the Six-Year New York Principal Subclass)

144. Plaintiffs and the putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs as if fully set forth herein.

145. Plaintiffs bring this cause of action individually and on behalf of the Putative Class Members against all Defendants.

146. At all relevant times, Defendants conducted and/or participated in the conduct of the Enterprise through a pattern of illegal activities to carry out the common purpose of the Enterprise, i.e. soliciting, funding, servicing and collecting upon usurious loans that charge interest at more than the enforceable rate under the laws of California, Colorado, Massachusetts, and New York and employing a "rent-a-bank" scheme with Celtic Bank and the other Defendants to evade the criminal usury laws of states throughout the country.

147. The Defendants' predicate acts of racketeering under 18 U.S.C. § 1961(1) include, but are not limited to, the violation of the state criminal usury laws of California, Colorado, Massachusetts, and New York. *See* 1919, p. lxxxiii, § 2; and Stats. 1919, p. lxxxiii, § 3 and Article XV, § 1 of the California Constitution; C.R.S. 18-15-104(1); Colo. Rev. Stat. Ann. § 18-15-104; Mass. Gen. Law. c. 271, § 49; and N.Y. Penal Law § 190.40.

148. Kabbage, Celtic Bank, TBF, Frohwein, and Petralia are "persons" within the meaning of 18 U.S.C. § 1961(3) and 18 U.S.C. § 1962(c) in that each is either an individual, corporation or limited liability company capable of holding a legal interest in property.

149. At all relevant times, Kabbage, Celtic Bank, TBF, Frohwein, and Petralia were, and are, persons that exist separate and distinct from the Enterprise.

150. Kabbage, Celtic Bank, TBF, Frohwein, and Petralia, constitute an association-in-fact enterprise (the "Enterprise") within the meaning of 18 U.S.C. §§ 1961(4) and 1962(c).

151. Kabbage, Celtic Bank, TBF, Frohwein, and Petralia are a group of persons that are associated-in-fact for the common purpose of carrying on an ongoing unlawful enterprise. Specifically, the Enterprise has a common goal of soliciting, funding, servicing and collecting upon usurious loans that charge interest at more than the enforceable rate under the laws of California, Colorado, Massachusetts, and New York and to hide its criminal activities, Kabbage entered into a criminal enterprise known as a "rent-a-bank" scheme with Celtic Bank and the other defendants.

152. The debt, including such debt evidenced by the Agreements, constitutes unlawful debt within the meaning of 18 U.S.C. § 1962(c) and (d) because (i) it violates applicable criminal usury statutes and (ii) the rates are more than the legal rate permitted under of the maximum interest rate permitted by Stats. 1919, p. lxxxiii, § 2; and Stats. 1919, p. lxxxiii, § 3 and Article XV, § 1 of the California Constitution; C.R.S. 18-15-104(1); Colo. Rev. Stat. Ann. § 18-15-104; Mass. Gen. Law. c. 271, § 49; and N.Y. Penal Law § 190.40.

153. The Enterprise has organized itself into a cohesive group with specific and assigned responsibilities and a command structure to operate as a unit in order to accomplish the common goals and purposes of collecting upon unlawful debts.

154. The Enterprise is engaged in interstate commerce and uses instrumentalities of interstate commerce in its daily business activities.

155. Defendants conducted the affairs of the Enterprise or participated in the affairs of the Enterprise, directly or indirectly, though a pattern of racketeering activity (wire fraud) in violation of 18 U.S.C. 1962(c).

156. Defendants' conduct constitutes "fraud by wire" within the meaning of 18 U.S.C. 1343 which is "racketeering activity" as defined by 18 U.S.C. 1961(1). Its repeated and continuous use of such conduct to participate in the affairs of the Enterprise constitutions a pattern of racketeering activity in violation of 18 U.S.C. 1962(c).

157. The interest rates charged by the loans were more than twice the criminal usury threshold of California and Massachusetts.

158. The loans constitute unlawful debt within the meaning of 18 U.S.C. 1962(c) because (1) they violate applicable criminal usury statutes, and (2) the rates are more than twice the legal rate.

159. Plaintiffs and the Class Members have and will continue to be injured in their business and property by reason of the Enterprise's violations of 18 U.S.C. § 1962(c), in an amount to be determined at trial.

160. The injuries to the Plaintiffs and the putative Class Members directly, proximately, and reasonably foreseeably resulting from or caused by these violations of 18 U.S.C. § 1962(d) include, but are not limited to, millions of dollars in improperly collected criminally usurious loan payments.

161. Plaintiffs and the Class Members have also suffered damages by incurring attorneys' fees and costs associated with exposing and prosecuting Defendants' criminal activities.

162. Pursuant to 18 U.S.C. § 1964(c), Plaintiffs and the Class Members are entitled to treble damages, plus costs and attorneys' fees from Defendants.

THIRD CAUSE OF ACTION

RICO Conspiracy, 18 U.S.C. § 1962(d)

(On Behalf of Plaintiffs and Class Members, except for the Six-Year New York Merchant Subclass, and the Six-Year New York Principal Subclass)

163. Plaintiffs and the putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs.

164. Plaintiffs bring this cause of action individually and on behalf of the Putative Class Members against all Defendants.

165. Defendants have unlawfully, knowingly, and willfully, combined, conspired, confederated, and agreed together to violate 18 U.S.C. § 1962(c) as describe above, in violation of 18 U.S.C. § 1962(d).

166. By and through each of the Defendants' business relationships with one another, their close coordination with one another in the affairs of the Enterprise, and frequent email communications among the Defendants concerning the underwriting, funding, servicing and collection of the unlawful loans, including the loans with Plaintiffs and the Class Members, each Defendant knew the nature of the Enterprise and each Defendant knew that the Enterprise extended beyond each Defendant's individual role. Moreover, through the same connections and coordination, each Defendant knew that the other Defendants were engaged in a conspiracy to collect upon unlawful debts in violation of 18 U.S.C. § 1962(c).

167. Each Defendant agreed to facilitate, conduct, and participate in the conduct, management, or operation of the Enterprise's affairs in order to collect upon unlawful debts, including the loans with Plaintiffs and the Class Members, in violation of 18 U.S.C. § 1962(c). In

particular, each Defendant was a knowing, willing, and active participant in the Enterprise and its affairs, and each of the Defendants shared a common purpose, namely, the orchestration, planning, preparation, and execution of the scheme to solicit, underwrite, fund and collect upon unlawful debts, including the loans.

168. As more fully described above, Defendants took actions in furtherance of the conspiracy, i.e. soliciting, funding, servicing and collecting upon usurious loans that charge interest at more than the enforceable rate under the laws of California, Colorado, Massachusetts, and New York and employing a "rent-a-bank" scheme with Celtic Bank and the other defendants to evade the criminal usury laws of states throughout the country.

169. The participation and agreement of each of Defendant was necessary to allow the commission of this scheme.

170. Plaintiffs and the Class Members have been and will continue to be injured in their business and property by reason of the Defendants' violations of 18 U.S.C. § 1962(d), in an amount to be determined at trial.

171. The injuries to the Plaintiffs and the Class Members directly, proximately, and reasonably foreseeably resulting from or cause these violations of 18 U.S.C. § 1962(d) include, but are not limited to, millions of dollars in improperly collected loan payments and the unlawful entry and enforcement of judgments.

172. Plaintiffs and the Class Members have also suffered damages by incurring attorneys' fees and costs associated with exposing and prosecuting Defendants' criminal activities.

173. Pursuant to 18 U.S.C. § 1964(c), Plaintiffs are entitled to treble damages, plus costs and attorneys' fees from the Defendants. The Court should also enter such equitable relief as it

deems just and proper to preclude the Defendants from continuing to solicit, fund and collect upon unlawful debt, including the loans issued to Plaintiffs and the Class Members

FOURTH CAUSE OF ACTION

California Business & Profession Code § 17500

(On Behalf of Plaintiffs DBR Construction, Julie Cox, the California Merchant Class, and the California Principal Class)

174. Plaintiffs and the Putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs.

175. Plaintiffs bring this cause of action individually and on behalf of the California Merchant and the California Principal Classes against all Defendants.

176. Defendants are businesses disseminating advertising in California through their website and other forms of social media.

177. False Advertising Law, Business and Professions Code, § 17500, et seq. ("FAL") prohibits false and misleading statements in advertising.

178. A violation of the FAL is a misdemeanor, punishable by fine or imprisonment.

179. Defendants, directly or indirectly as part of a larger criminal conspiracy, participated in advertising the Kabbage Business Loan Agreements in a false and misleading manner which included both material misrepresentations and omissions.

180. The misrepresentations and omissions included, among other things, stating that: (1) Celtic Bank was the lender; (2) the loans were not usurious; and (3) deceptively disclosing and/or failing to disclose the interest rate.

181. Kabbage also falsely designated the origin of the loans in its commercial advertising and promotion as being loans from Celtic Bank.

182. Defendants knew, or by the exercise of reasonable diligence should have known, that the above statements were untrue or misleading, and/or omitted to state the truth about the Kabbage Loan program.

183. Plaintiffs relied upon and were actually deceived by the misrepresentations that Kabbage made for itself and as a part of a larger criminal conspiracy with the other Defendants.

184. The misrepresentations also are likely to deceive other California small business owners.

185. The Defendants are directly and/or vicariously liable for the harm suffered by the Plaintiffs and other California business who were similarly deceived.

186. As a direct and proximate result of each of these loans, Julie Cox d/b/a DBR Construction and all members of the Classes suffered indivisible injury through loss of goodwill, lost profits, reputational harm and devaluation of its business.

187. As a direct and proximate result of each of these loans, Julie Cox d/b/a DBR Construction and all members of the California Merchant and the California Principal Classes suffered indivisible injury by having its other business loans being called in from legitimate banks, deterioration of its credit profile, and the inability to secure financing to obtain needed inventory and pay its vendors.

188. Alternatively, Julie Cox d/b/a DBR Construction and all members of the California Merchant and the California Principal Classes seek to disgorge the profits realized by Defendants from the illegal loan transactions.

FIFTH CAUSE OF ACTION

California Business & Profession Code §§ 17200, et seq.

(On Behalf of Plaintiffs DBR Construction and Julie Cox, the California Merchant Class, and the California Principal Class)

189. Plaintiffs and Putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs.

190. Plaintiffs DBR Construction and Julie Cox bring this cause of action individually and on behalf of the California Merchant Class and the California Principal Class against all Defendants.

191. California Business & Profession Code §§ 17200, et seq. ("UCL") prohibits "unfair competition" in the form of any unlawful, unfair, or fraudulent business act or practice.

192. Since at least March 2014, Defendants engaged in an unlawful business practices as prohibited by the UCL, and as further described in this Complaint:

193. Violating Cal. Const. Art. XV § 1 by charging interest rates in excess of 10% or 5% plus the applicable Federal Reserve rate;

194. Violating 18 U.S.C. § 1343 by furthering their scheme to defraud Plaintiffs by (i) making and receiving wire transfers, and (ii) using wires to transmit fraudulent communications;

195. Violating 18 U.S.C. § 1692(c) by conducting the Kabbage Enterprise through a pattern of racketeering and the collection of an unlawful debt; and

196. Violating Cal. Bus. & Prof. Code § 17500.

197. Additionally, Defendants engaged in unfair and fraudulent conduct by making false and misleading statements when advertising the Kabbage Business Loan Agreements.

198. Specifically, Kabbage as part of its commercial advertising and promotion misrepresented the nature, characteristics and qualities of its loans.

199. Kabbage's misrepresentations included, among other things, stating that: (1) Celtic Bank was the lender; (2) the loans were not usurious; and (3) deceptively disclosing and/or failing to disclose the interest rate.

200. Kabbage also falsely designated the origin of the loans in its commercial advertising and promotion as being a loan from Celtic Bank.

201. Each of these representations was literally false.

202. Kabbage and Celtic Bank knew that these representations were false at the time they were made.

203. Kabbage's misrepresentations were material and actually did influence Julie Cox d/b/a DBR Construction's decision to enter into the loan agreements.

204. The misrepresentations also are likely to influence the purchasing decisions of all members of the California Merchant and the California Principal Classes.

205. Defendants knew that Kabbage's misrepresentations have the tendency to deceive small businesses in need of financing and actually deceived Julie Cox d/b/a DBR Construction.

206. Defendants knew that Kabbage was placing, its false and misleading advertising in interstate commercial both through its website and other forms of social media.

207. Defendants, directly or indirectly, participated in the false advertisements for their collective benefit and as part of a larger criminal conspiracy to harm Plaintiffs and all members of the California Merchant and the California Principal Classes.

208. Defendants engaged in these actions to further their business activities, i.e., the issuing, and collection of debts.

209. In addition to their falsity and unlawfulness, Defendants' loans to Plaintiffs and the Classes charged unconscionably high interest rates. Defendants' loans were made with the

knowledge that many, if not most, of the borrowers would be unable to pay the excessive accrued interest, and would be forced to continually take out further loans until ultimately defaulting and triggering the recourse mechanisms available under the loan agreements.

210. Defendants' practices offend California's established public polices, and are immoral, unethical, oppressive, unscrupulous and substantially injurious to consumers.

211. Plaintiffs seek public injunctive relief to benefit the general public directly by bringing an end to Defendants' unlawful business practices which threaten future injury to the general public. Specifically, an injunction requiring Kabbage to immediately cease entering into usurious loans that charge interest at more than the enforceable rate under the laws of California would benefit the public at large because the public could then not be charged an unconscionable and unlawful APR by Defendants.

212. As a direct and proximate result of Defendants violations of the UCL, Plaintiffs and all members of the California Merchant and the California Principal Classes suffered, and continue to suffer, substantial injury to his business and/or property as they were forced to pay usurious amounts of interest and has lost, and will continue to lose, customers, profits, goodwill, and business value.

SIXTH CAUSE OF ACTION

California Financing Law Code §§ 22000, et seq.

(On Behalf of Plaintiffs DBR Construction and Julie Cox, the California Merchant Class, and the California Principal Class)

213. Plaintiffs and the Putative Class Members repeat and re-allege the allegations of each of the foregoing paragraphs.

214. Plaintiffs DBR Construction and Julie Cox bring this cause of action individually and on behalf of the California Merchant Class and the California Principal Class against all Defendants.

215. California Financial Code §§ 22000, et seq. ("Financing Code) prohibits any unlawful, unfair, or fraudulent representation in connection with the making or brokering of a loan.

216. Since at least March 2014, Defendants willfully and knowingly engaged in an unlawful practices that they knew were prohibited by the Financing Code, and as further described in this Complaint:

(a) Acting as a broker for a commercial loan without a license in violation of Fin. Code §§ 22001, 22004 , 22502, 22604, 22502, and 22780;

(b) Obtaining an arbitration provision through an unlicensed broker, which renders the arbitration provision void;

(c) Acting as a lender for a commercial loan without a license in violation of Fin. Code §§ 22001, 22009, 22502, 22604, 22502, and 22780; and

(d) Violating Cal. Bus. & Prof. Code § 17200 making numerous false and misleading representations described supra.

217. As a direct and proximate result of Defendants' violations of the Financing Law, Plaintiffs and all members of the California Merchant and the California Principal Classes suffered, and continue to suffer, substantial injury to his business and/or property as they were forced to pay usurious amounts of interest and has lost, and will continue to lose, customers, profits, goodwill, and business value.

SEVENTH CAUSE OF ACTION

Mass. Gen. Law ch. 93A §§ 2 and 11

(On Behalf of Plaintiffs Beautiful Brands, Mike's Auto, Marcia Van Camp, Michael Pedersen, the Massachusetts Merchant Class, and the Massachusetts Principal Class)

218. Plaintiffs repeat and re-allege the allegations of each of the foregoing paragraphs as if fully set forth herein.

219. Plaintiffs Beautiful Brands, Mike's Auto, Marcia Van Camp, and Michael Pedersen bring this cause of action individually and on behalf of the Massachusetts Merchant Class and the Massachusetts Principal Class against all Defendants.

220. Mass. Gen. Laws c. 93A, § 2(a) makes it unlawful to engage in any unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce in Massachusetts.

221. It is an unfair and deceptive practice under Mass. Gen. Laws c. 93A, § 2(a) for a seller of a product to use advertisements which are untrue, misleading, deceptive, or fraudulent. This includes advertisements which create an over-all misleading impression through the failure to disclose material information.

222. Defendants engaged, directly or indirectly, in the business of making loans greater than $6,000 to Massachusetts businesses.

223. In the course of making, servicing, or collecting on loans made to Plaintiffs, Defendants engaged in deceptive business practices in violation of G.L. c. 93A, § 2(a).

224. Defendants' unfair or deceptive acts or practices include, but are not limited to, the following:

a) Repeatedly or persistently making, servicing, or collecting, or attempting to collect, on loans issued to Plaintiffs without proper license or registration in violation of Massachusetts laws, including G.L. c. 93, § 24A and c. 140, §§ 96 through 114A;

b) Unconscionably making, servicing, or collecting, or attempting to collect, on loans issued to Plaintiffs without appropriate evaluation of Plaintiffs' ability to repay these loans;

c) Advertising the loans using false and misleading statements, including, among other things, stating that: (1) the loans were not usurious; (2) deceptively disclosing and/or failing to disclose the interest rate; and (3) falsely and/or deceptively disclosing the relationship between Kabbage and Celtic Bank.

d) Repeatedly or persistently charging and receiving illegal, usurious, and oppressive interest and fees;

e) Repeatedly misrepresenting to Plaintiffs, expressly and by implication, that the rates of interest being charged on the loans was legal; and

f) Repeatedly misrepresenting to Plaintiffs that Massachusetts law does not apply to the loans.

225. Defendants conspired with and acted in concert with each other to violate Mass. Gen. L. ch. 271, § 49 and also 940 CMR 6.00 et seq.

226. Defednants knew or should have known that by making, servicing, or collecting, or attempting to collect on these loans, it engaged in unfair or deceptive acts or practices, in violation of G.L. c. 93A, §§ 2 and 11.

227. Defendants knew or should have known that its advertisements about the loans were false, misleading or deceptive.

228. Defendants' violation of Mass. Gen. L. ch. 271, § 49 constitutes a per se violations of Mass. Gen. Law ch. 93A §§ 2 and 11.

229. Defendants also violated Mass Gen. Law ch. 93A §§ 2 and 11 by including unconscionable and unfair provisions in connection with the loan agreements, which were contracts of adhesion. Among these unconscionable and unfair provisions, Defendants required Plaintiffs to, among other things:

a) Waive the right to a jury trial;

b) Waive the right to participate in a class action;

c) Waive the right to seek legal redress in their home state;

d) Execute a Security Agreement giving Kabbage a UCC lien on all of its assets;

e) Execute a personal guarantee making the individual owner of the business personally liable for any default under the agreement; and

e) Waive claims for direct, consequential and punitive damages.

230. Defendants' conduct was willful, unfair and unlawful.

231. Defendants willfully and knowingly violated Mass Gen. Law ch. 93A.

232. Plaintiffs reasonably relied upon Defendants' representations and those representations induced Plaintiffs to enter into the loans.

233. As a direct and proximate result of each of these loans, Plaintiffs paid Kabbage interest in excess of the 20% maximum interest rate permitted by Massachusetts law.

EIGHTH CAUSE OF ACTION

N.Y. Gen. Bus. Law § 349

(On Behalf of Plaintiffs Bright Kids NYC, Bright Kids Chicago, Bige Doruk, Ib Olsen, the Six-Year New York Merchant Subclass, and the Six-Year New York Principal Subclass)

234. Plaintiffs repeat and re-allege the allegations of each of the foregoing paragraphs as if fully set forth herein.

235. Plaintiffs Bright Kids NYC, Bright Kids Chicago, Bige Doruk, Ib Olsen bring this cause of action individually and on behalf of the New York Merchant Class and the New York Principal Class against all Defendants.

236. The Kabbage Business Loans involve consumer-oriented transactions because they violate the strong public policy of New York and have an impact upon the public welfare.

237. Defendants conduct was unlawful and deceptive.

238. Defendants willfully and knowingly violated General Business Law § 349.

239. Plaintiffs suffered damages as a direct result of Defendants' unlawful and deceptive acts.

NINTH CAUSE OF ACTION

Col. Rev. Stat. § 6-1-105 and 6-113

(On Behalf of Plaintiffs The Cedars of Lebanon, Theodore Monsour, the Three-Year Colorado Merchant Subclass, and the Three-Year Colorado Principal Subclass Class)

240. Plaintiffs repeat and re-allege the allegations of each of the foregoing paragraphs as if fully set forth herein.

241. Plaintiffs The Cedars of Lebanon and Theodore Monsour bring this cause of action individually and on behalf of the Colorado Merchant Class and the Colorado Principal Class against all Defendants.

242. Defendants engaged in an unlawful and deceptive trade practice by, in the course of their business, vocation or occupation:

(a) Either knowingly or recklessly passing off goods, services, or property as those of another;

(b) Either knowingly or recklessly making a false representation as to the source, sponsorship, approval, or certification of goods, services, or property;

(c) Either knowingly or recklessly making a false representation as to affiliation, connection, or association with or certification by another; and

(d) Using deceptive representations or designations of geographic origin in connection with goods or services;

243. Defendants willfully and knowingly violated Col. Rev. Stat. § 6-1-105.

244. Plaintiffs suffered damages as a direct result of Defendants' unlawful and deceptive acts.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs and the Putative Class Members demand judgment in their favor against Defendants, jointly and severally, and seek an order:

a) Certifying the proposed Classes;

b) Appointing Plaintiffs as Class Representatives;

c) Appointing counsel for Plaintiffs as Class Counsel;

d) Permanently enjoining Defendants from engaging in the unlawful practices;

e) Awarding Plaintiffs compensatory, direct, and consequential damages, including prejudgment interest, in an amount to be determined a trial;

f) Awarding treble damages;

g) Requiring Defendants to pay Plaintiffs' attorneys' fees and costs; and

h) Granting such other and further relief as is just and proper.

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LendingClub's new pitch to institutional investors

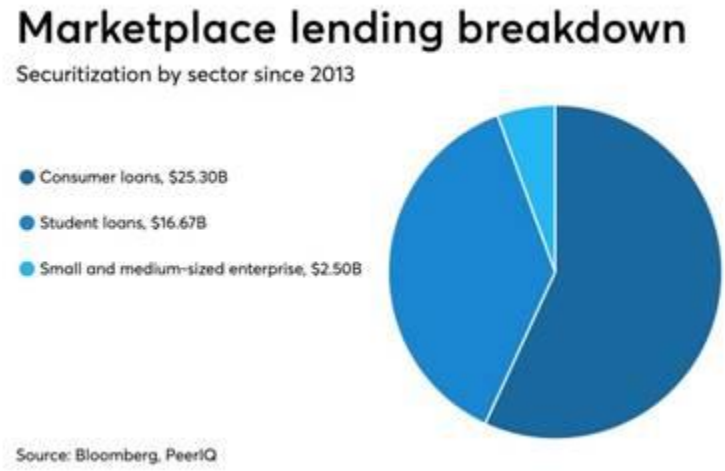
By Will Hernandez
October 10 2019, 3:17pm EDT

LendingClub introduced an institutional investor platform Thursday aimed at tapping the growing market of securitized marketplace loans.

Called LCX, the platform includes dynamic pricing and same-day settlement data of fully-funded loans. It comes on the heels of its Select Plus platform, which it launched in August to enable sophisticated investors to purchase loans made to borrowers that would have been previously rejected.

Anuj Nayar, LendingClub's financial health editor, said the changes to its online marketplace, including the launch of Select Plus, were a direct result of feedback from the institutions seeking to purchase securitized consumer loans.

"Our most sophisticated investors are coming back to us and saying, there are loans you wouldn't approve, but if you did approve them, we'd buy all of them," Nayar said.



LendingClub began creating new investment platforms for financial institutions in 2017 when it became clear consumer debt was becoming a mainstream asset class, Nayar said. That year marked the first time the company started to originate more than $1 billion in loans per month.

Unsecured personal loans are increasingly being packaged into an asset class for institutional investors, much in the same way that mortgages are bundled into mortgage-backed securities.

In the fourth quarter of 2018, there were eight marketplace lending securitizations, totaling $2.6 billion, according to PeerIQ.

In a company blog, LendingClub argues that institutional investors are drawn to such securitized marketplace loans primarily for their higher yields.

"This is a huge step forward in the evolution of unsecured consumer loans as an asset class," Valerie Kay, chief capital Officer of LendingClub, said in a press release.

Personal loan debt hit an all-time high in 2018 at $138 billion, according to the latest figures from TransUnion. Fintechs such as LendingClub and Social Finance have helped to lead that surge as they continue to siphon away customers for unsecured personal loans from traditional lenders.

A recent study from Experian found that digital lenders more than doubled their market share in the past four years.

Consumers have turned more to fintechs for personal loans mostly based on the digital methods used to apply for such loans. LendingClub sees some 44,000 consumers per day comes to its website seeking a personal loan, Nayar said.

“As the scale has been moving so quickly, we as a company have been very much thinking about how to make it easier for LendingClub to attract more and more investors,” he added.

LendingClub’s online marketplace brings in consumers that are seeking personal loans to mostly refinance credit card debt at a lower interest rate. Those borrowers are matched with investors that bear the risk of default.

Talk of a pending recession has not done much to make institutional investors skittish about purchasing personal loans, Nayar said.

He added that for LendingClub, “there’s always a concern to manage for an impending recession.”

“Our investors have already factored in future risks. They have to because they’re thinking about the repayment rate in the years 2021 and 2022. It’s built in,” Nayar said.

“We have thousands of borrowers coming to us that range from subprime to super prime and our job is to match them with investors that are looking for a price that matches their criteria.”

Sallie Mae seeks to fill CARD Act void with student credit cards

By Michael Moeser
October 10 2019, 4:20pm EDT

In a move to tap into an underserved market opportunity — but with the potential for political backlash — student lender and consumer banking provider Sallie Mae launched three different cash-back reward credit cards aimed at college students and young adults.

Sallie Mae's credit cards called Ignite, Accelerate and Evolve are designed to promote financial responsibility among younger adults, many of whom represent an untapped segment due to the fallout of the CARD Act of 2009.

The issue Sallie Mae could face is one that got major banks kicked off college campuses a decade ago: targeting young adults (under 21) with revolving credit lines. This segment has largely been forgotten by banks since the CARD Act virtually eliminated card marketing to students and very young adults.

“Provisions in the CARD Act are consistent with our philosophy of responsible lending," said Rick Castellano, vice president of corporate communications at Sallie Mae, in an emailed statement. "Our cards are specifically designed to promote financial responsibility and were co-created with students, parents, and recent graduates. We take many factors into consideration when making a credit decision, including the ability to repay, as outlined by the CARD Act."

Each of the cards has a unique value proposition that is designed based on market research to deliver the most appropriate financial resources and benefits to young adults both during and after college.

"Our Ignite card offers credit lines appropriate for the student population and has built in credit education," Castellano said. "Our priority is to help students build credit responsibly and reward them for it.”

Ignite offers a 1% cash-back reward and, after six months of on-time payments, and unlocks a 25% bonus on cash-back rewards for future purchases. The Sallie Mae Accelerate card features 1.25% cash-back rewards on all purchases and a 25% bonus cash-back when rewards are used to pay down any federal or private student loan. The third card is called Sallie Mae Evolve, which offers 1.25% cash-back rewards on all purchases plus a 25% bonus on rewards for the top two purchase categories in a given billing cycle.

Even though student debt stands at $1.5 trillion, according to the Federal Reserve of New York, there appears to be a potentially lucrative opportunity to help young adults build credit and use card-based rewards to help them pay off student loans.

Since the CARD Act requires anyone under 21 to have a cosigner such as a parent, or be able to prove an independent means of repaying any debt incurred, selling to college students and young adults has become much more difficult and costly. For these reasons most banks have completely eliminated marketing to younger adults. This essentially leaves Sallie Mae with an open field, and the only hurdle is to make sure it remains compliant with the CARD Act requirements.

“We also know from research studies like 'Majoring in Money' which we conducted with Ipsos, that nearly 6 in 10 college students have at least one credit card, and the biggest reason given for getting that first credit card is to build credit," Castellano said. "Our cards are designed to help them do that, responsibly."

Aside from any potential backlash and increased compliance requirements, Sallie Mae still needs to persuade Gen Z and younger millennials who normally eschew credit cards to ditch their debit cards. Based on a recent survey from the financial website Credible, millennials fear credit card debt more than the threat of war and dying.

Sallie Mae is also offering Ignite and Accelerate cardholders the chance to win $10,000 to pay down any of their student loans as part of a sweepstakes taking place each month for a year.