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Valid-When-Made and True Lender Doctrines: Usury Issues With Partnerships Between Bank and Non-Bank Lenders

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A Push/Pull Between Federal & State Regimes

- The tension between federal and state regimes to regulate lending is not new.
- In the late 1990s and early 2000s, consumer advocates objected to such partnerships used to provide payday loans to consumers in states that had banned or restricted payday loans. Both the OCC and the FDIC took actions to stop its banks from partnering with payday lenders.
- The root of the tension has its origins in competing concepts:
  - States regulate rates of interest in each state. Dodd-Frank expressly incorporated this concept into statutory law: (o) NO AUTHORITY TO IMPOSE USURY LIMIT.—No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.
  - Banking law permits both state- and federally-chartered banks to charge the rates of interest available in its home state and export those rates to other states, a power upheld by the U.S. Supreme Court. Some states (Utah, Delaware) do not limit rates of interest, which is why banks locate there.

What is Interest?

- Interest is the monetary charge for the privilege of borrowing money. Interest expense or revenue is often expressed as a dollar amount, while the interest rate used to calculate interest is typically expressed as a yearly or other periodic rate or an annual percentage rate (APR). Interest is the amount of money a lender or financial institution receives for lending out money.
- Every state in the United States of America has some framework (and usually multiple frameworks) that applies to the interest that can accrue on a loan of money by a creditor.
- Many creditors that offer credit on a nationwide basis have to comply with each state's rules around interest.

Interest Rate Exportation

- Both state & federal depository institutions can export interest rates & interest fees from their home states & any states where they have a branch that performs certain activities.
- This authority allows banks to "trump" usury restrictions imposed by other states.
- The U.S. Supreme Court has upheld bank power to export interest rates & interest fees.
- Unlike other entities, depository institutions can offer the same interest on a loan product across all states.*

Interest Rate Exportation

- Federal thrifts and national banks are not subject to state licensing, state consumer credit and usury laws (other than that of their home state), or state high-cost or predatory lending laws. In *Lako v. Portfolio Recovery Associates*, the U.S. District Court for the Western District of Wisconsin recently affirmed that an entity that bought a charged off account from a national bank did not have to comply with Wisconsin law regarding right to cure because national banks are not subject to those requirements.
- State banks may also export interest rates and interest fees from their home states to borrowers located in other states. All other state requirements apply, although sometimes they are ignored/overlooked. **Remember that the ability of a state bank to export rates does not equal an ability to ignore other state laws.**
- State non-bank licensed lenders are subject to all state consumer credit statutes and are regulated by a host of different state regulators. Partnering with a bank can eliminate the need for as much state law compliance (it does not eliminate it).
- Most banks (not all) in the Bank Partnership space are in states that allow the bank to contract for any rate of interest (like California and Utah).
- **Rate exportation is rooted in federal law and is longstanding and not likely to change. We will not be discussing the ultimate goal of consumer advocates: a national rate cap.**

Rate Exportation – National Banks

National Bank Act of 1964 – enacted to help finance the cost of war.

"Any association may . . . charge on any loan, . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this Title. When no rate is fixed by the laws of the State … the bank may take . . . a rate not exceeding seven per centum . . . ."

Two key features:

✦ National Banks get a federal rate if none under state law, supplementing state law.

✦National Banks get <u>best</u> state bank rate, preempting any limits on who can use that rate.

Rate Exportation – National Banks

- *Farmers' & Mechanics' National Bank v. Dearing* (1875). The Supreme Court stated that the constitutionality of the NBA rested "on the same principle as the act creating the second bank of the United States."
- That principle was upheld under the necessary and proper clause of Article I, section 8 of the Constitution in *McCulloch v. Maryland* (1819) and *Osborn v. Bank of the United States* (1824).
- The validity of the NBA has been unchallenged since 1875.

Rate Exportation – National Banks

- In 1946, John C. Biggins, of Flatbush National Bank of Brooklyn, NY, created a system called "Charg-It," a bank-issued card that let people in a two-square-block radius charge purchases to the bank. The area was limited by necessity —merchants had to leave sales slips with the bank — but allowed use of the card at multiple businesses. This first credit card was not intended for use across the states.
- About 100 years after the National Bank Act was passed, national banks began issuing credit cards to individuals in other states that could be used across the states. Looking at the plain language of Section 85, these national banks concluded that they were entitled to charge interest at the rate allowed by the laws of the states where they were located, even if the borrowers were "located" in different states. The BankAmericard was introduced by Bank of America in 1958 as the first general purpose credit card (the BankAmericard was later rebranded as VISA). This was also the first credit card with revolving credit that could be paid down incrementally instead of paying the balance at the end of each month.
- Some lower courts concluded that, plain language aside, this was not what Congress had intended, and that national banks couldn't rely on Section 85 when making loans in other states.

Rate Exportation – National Banks

✦The issue of rate exportation eventually made its way to the U.S. Supreme Court.

✦Marquette National Bank, a national bank located in Nebraska, issued BankAmericards to consumers located in other states, including Minnesota, to the competitive disadvantage of a Minnesota bank, who sued.

✦In 1978, the U.S. Supreme Court held that Section 85 of the National Bank Act of 1864 "plainly provides that a national bank may charge interest 'on any loan' at the rate allowed by the laws of the State in which the bank is 'located'." *Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299, 308, 99 S.Ct. 540, 545 (1978).

Suddenly, having a federal charter is a huge competitive advantage in a national economy and any national or regional banking market.

Rate Exportation – State-Chartered Banks

- Prime Rate reaches 21%, Mortgage rates are 13%
- At the time, many states (e.g., Arkansas) had constitutional usury limits in the 6% to 8% range

Congress steps in and passes the *Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA or DIDMCA)*

Section 521 of DIDMCA provides that "[a state-chartered bank may]. . . . notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, ... charge on any loan . . . . , interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . . is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater." 12 USC section 1831d(a).

DIDMCA created a uniform national playing field for pricing limits for all credit products offered by state-chartered banks, overriding state balkanization of financial service pricing, because it had resulted in extremely reduced credit access.

Federal Rate Preemption for Federally-Related Mortgage Loans

DIDMCA Section 501 also eliminated usury caps for certain mortgage transactions for all lenders

"(1) The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance which is—

(A) secured by a first lien on residential real property, by a first lien on all stock allocated to a dwelling unit in a residential cooperative housing corporation, or by a first lien on a residential manufactured home;

(B) made after March 31, 1980; and

(C) described in section 527(b) of the National Housing Act ." (defines "federally related mortgage loan" in same manner as RESPA – not limited to bank lenders)

The bank partnerships we discuss in this presentation do not generally involve mortgage loans and thus we do not discuss this further.

Rate Exportation – National Banks

- *Marquette* addressed the interest rate national banks could charge, but did not address any interest fees. Further, the National Bank Act did not address interest fees. The Office of the Comptroller of the Currency accordingly promulgated regulations that describe what interest fees national banks could charge.
- The regulation reflected OCC interpretive opinions on the types of fees and charges that are included and not included in the meaning of the term "interest." The rule provided non-exclusive lists of specific fees that are "interest" (for example, numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees) and that ordinarily are not "interest" (for example, appraisal fees, premiums and commissions on insurance guaranteeing repayment, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports).
- In 1996, the U.S. Supreme Court found that the OCC's definition of "interest" is entitled to *Chevron* deference, stating, "(i)t is our practice to defer to the reasonable judgments of agencies with regard to the meaning of ambiguous terms in statutes that they are charged with administering." *Smiley v. Citibank (South Dakota) N.A.* , 517 U.S. 735, 739, 116 S.Ct. 1730, 1733 (1996).

Rate Exportation – Dodd Frank

Dodd Frank expressly provides that the Consumer Financial Protection Bureau has no authority to impose a usury limit.

- **(o)NO AUTHORITY TO IMPOSE USURY LIMIT** No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.

It is unlikely that Congress would pass a rate cap, although it is very likely that this will continue to be a political issue.

What does "Bank Partnership" mean?

- A bank partnership is an arrangement through which a state or federal depository institution contracts with a vendor to provide services to assist the bank to originate loans.
- Banks work with vendors across bank functions to assist the bank perform its lawful activities, and both the OCC and the FDIC have issued guidance on how its banks should monitor the risks posed by the use of these vendors.
- The most "controversial" partner of a bank is one that assists the bank to originate a loan and then participates in the economics of the loan.

Bank Partnerships 1.0

- After origination of the loan by the bank, the bank typically sold the originated loan to the partner.
- In the late 1990s, banks partnered with entities that support the provision of payday loans to consumers.
- The OCC warned its members against this practice in 2000 and a series of enforcement actions effectively ended the partnerships by 2003; the FDIC cracked down after that.
- In this version of the bank partnership, the bank had little compliance oversight and took no risk (hence the adoption of the term "rent a bank" or "rent a charter.")

Bank Partnerships 2.0

- The OCC and the FDIC did not ban bank partnerships outright; rather, they prohibited their member banks from participating in certain arrangements involving "payday lenders."
- Other forms of bank partnerships emerged in the recession, including some of the larger marketplace lending platforms.
- OCC and FDIC have issued guidance on such partnerships and more generally on managing the risk posed by third-party service providers.
- This version of the bank partnership model includes greater oversight and controls consistent with regulator guidance.

Bank Partnerships 3.0

- In the 2.0 version of the bank partnership, the bank still sold the whole loan it originated to the partner.
- The model shifted again with the *Madden v. Midland Funding* decision out of the U.S. Court of Appeals for the Second Circuit.
- *Madden* is a valid-when-made case with true lender implications.
- *Madden* shifted many programs to bank retention of a portion of a loan's payment stream and/or title to the loan.

Bank Partnerships 3.0

- Unlike the programs of the late 1990s/early 2000s, bank partnerships today operate seamlessly in an online environment.
- Both the FDIC and the OCC have issued extensive guidance regarding how its member banks can partner with third-party vendors to deliver financial products to customers.
- The subprime consumer has had her options expanded by the advent of mobile technology, with any bank able to solicit her for business through a mobile device.
- In 2019, 96% of people in the USA owned a cellphone of some kind, with 81% of those people owning a smart phone. As of 2019, nearly ¾ of U.S. adults owned desktop or laptop computers, ½ owned tablet computers and ½ owned e-reader devices.
- Banks are great at lending, but fintechs are better at technology. Given that the OCC and the FDIC both have issued extensive guidance to its member banks that it can rely on vendors to perform functions for the banks, it makes sense for banks to partner with these vendors to deliver products to customers.
- Such partnerships also bring customers into the banking system, giving them access to credit they would otherwise not have.

What does "True Lender" mean?

- As we have noted, states have a patchwork of laws that apply to different types of credit products and different types of creditors. The power of rate exportation permitted to banks is significant; there is an advantage to being a bank.
- There have been some arrangements where courts concluded that the bank was not the true lender. When the bank is not the true lender, one must consider what allows the actual or "true" lender to charge the rates and fees charged on the credit product.
- Generally, the entity that is the "true lender" in these scenarios is not a bank, and does not have the ability to export rates or interest fees. These entities would need other authority to charge certain interest rates or interest fees, such as state licenses.
- If a court recharacterized the bank loan as a loan made by an entity other than a bank, the loan could be void or voidable if the nonbank entity did not have sufficient licenses or registration to permit the rate to it.
- All bank partnerships must be structured to ensure that the bank is the true lender, not the vendor that assists it.
- **There is no federal statute or regulation that provides how a bank partnership must be structured**. Congress repealed a regulation promulgated by the OCC at the end of the Trump administration that would have established a bright line (the "true lender" rule). So, we are left with a myriad of cases and other guidance that discuss what factors are relevant in this analysis.

What does "True Lender" mean?

Case law over the years has led to the identification of certain characteristics that should exist in a bank partnership for the Bank to be the "true lender." Some factors include:

- Company promotes, markets, administers and services consumer loans.
- The Bank pays the Company a separate fee for servicing activities that the Company undertakes on behalf of the Bank.
- The Bank is named as the lender in the loan documents and provides the funds for each loan.
- The Bank establishes the underwriting criteria and approves it.
- The Bank approves changes to the underwriting criteria.
- The Company maintains a Collateral Account at the Bank or elsewhere where it funds the money needed to buy the obligations from the Bank.
- The Bank is responsible for ensuring that the loan documents are legally enforceable under applicable law.
- The Bank retains the loans.
- The Company preliminarily approves loans subject to the Bank's underwriting criteria. Nothing in the agreement obligates the Bank to extend credit to an applicant if the applicant does not meet the Bank's Credit Policy or the Bank determines that doing so would constitute an unsafe or unsound banking practice.
- There is a time period (usually three days) between when the loan is funded and when Company purchases it.

OCC True Lender Rulemaking

- The Office of the Comptroller of the Currency finalized its rule that determines when a national bank or federal savings association is the "true lender" on a loan made in the context of a partnership between a bank and a third party.
- The OCC's final rule specifies that a bank makes a loan and is the true lender if, as of the date of origination, it (1) is named as the lender in the loan agreement or (2) funds the loan. The rule also specifies that if, as of the date of origination, one bank is named as the lender in the loan agreement for a loan and another bank funds that loan, the bank that is named as the lender in the loan agreement makes the loan.
- The rule also clarifies that as the true lender of a loan, the bank retains the compliance obligations associated with the origination of that loan, thus negating concern regarding harmful rent-a-charter arrangements.
- The OCC final rule adopts the "form" test employed by numerous courts that have considered "true lender" issues.
- The rule was to take effect December 29, 2020.

OCC True Lender Rulemaking

Almost immediately, members of Congress indicated that they would seek to overturn the OCC Rule. Additionally, after the OCC Rule became final, 25 state Attorneys General sent a letter to Congressional leaders expressing their strong objection to the rule.

In this letter, the AGs urged Congress to use its powers under the Congressional Review Act ("CRA"), 5 U.S.C. §§ 801 *et seq.,* to review and revoke the true lender rule.

The AGs contended that the rule enables national banks and federal savings associations to enter into "rent-a-bank" arrangements that allow nonbanks to avoid state usury laws. The Attorneys General argued that the rule would ultimately breed "predatory consumer-lending partnerships."

OCC True Lender Rulemaking

The states of New York, California, Colorado, Massachusetts, Minnesota, New Jersey and North Carolina, as well as the District of Columbia, sued the OCC over this rule on January 5, 2021, asserting that the OCC had no authority to promulgate the rule and that the proper test to determine the "true lender" is the "predominant economic interest" test.

The FDIC did not issue a similar rule because it stated that it does not have the ability to do so.

OCC True Lender Rulemaking

In March 2021, a group of Senators introduced a resolution under the CRA to repeal the OCC Rule. Under the CRA, before a rule, including the OCC Rule, can take effect, the federal agency promulgating the rule (here, the OCC) must submit to each House of the Congress and to the Government Accountability Office a copy of the rule, a concise statement relating to the rule, including an assessment as to whether it constitutes a "major" rule, and the proposed effective date.

The OCC also was required to submit a report to the GAO that is made available to each House of Congress. For purposes of the CRA, the Office of Information and Regulatory Affairs ("OIRA") of the Office of Management and Budget ("OMB") determines whether a final rule is a "major rule." OIRA determined that the OCC Rule was not a major rule.

OCC True Lender Rulemaking

Under the CRA, a rule shall not take effect (or continue), if Congress enacts a joint resolution of disapproval. "Joint resolution" means only a joint resolution introduced in the period beginning on the date on which the report provided by the OCC to the GAO was received by Congress and ending 60 days thereafter.

On May 11, 2021, the U.S. Senate voted 52-47 to repeal the OCC Rule. The Senate's approved resolution was presented to the House of Representatives, which affirmed it on June 24, 2021. President Biden signed the resolution on June 30, 2021, effectively repealing the OCC Rule.

Because the resolution to repeal the OCC Rule was successful, not only the OCC Rule, but no rule that is "substantially similar," can subsequently be enacted.

"Valid When Made"

- Valid when made (also sometimes valid-when-made) is a legal doctrine that holds that the terms of a loan, if legally valid at the time of its creation, remain valid after the loan is sold or assigned to a third-party.
- The doctrine has often been applied to loans made by national banks and then transferred to secondary lenders. Under the doctrine, debt buyers may purchase loans from national banks and collect interest on them at the same rate as the original lender, even if the debt buyer could not have originated the loan on the same terms as the national bank.
- Prior to the 2015 decision in *Madden v. Midland Funding*, 786 F.3d 246 (2d Cir. 2015), virtually all bank partnerships involved the sale of a whole loan after a holding period by the bank (remember Bank Partnerships 2.0). *Madden* threw this arrangement into a tailspin as it stood for the idea that a loan is no longer "valid when made" when transferred to a party that did not hold the same powers to originate as the originating creditor.
- Programs structured around *Madden* in a few ways, including by structuring these programs as a sale of a participation interest to the non-bank party, with the bank retaining title to the loans.
- Markets understand *Madden* now, and *Madden* has not been adopted by any other court as of today.
- *Madden* was significant in part because the U.S. Court of Appeals includes, along with Connecticut and Vermont, New York, one of the largest markets in the United States.

"Valid When Made" Rulemaking

- OCC and FDIC adopted rules intended to combat the negative effects of *Madden*.
- Under the rules and the "valid when made" doctrine, the interest rate on a bank-made loan remains valid and enforceable even after the bank sells or transfers it to a party that could not have originated the loan on the same terms as the bank.

"Valid When Made" Rulemaking

- Numerous states sued both the OCC and the FDIC to reverse the regulators' "valid when made" rules.
- In February 2022, the U.S. District Court for the Northern District of California rejected two challenges by a consortium of state Attorneys General to the "valid when made" regulations issued in 2020 by the OCC and the FDIC. *California et al. v. FDIC*, 2022 WL 377404 (N.D. Ca. February 8, 2022); *California et al. v. OCC et al.*, Case No. 20-cv-05200-JSW (N.D. Ca. February 8, 2022).

Significant Case Law Impacting Bank Partnerships

There are dozens of cases that practitioners review to inform their views on how to structure a bank partnership arrangement so that it will withstand a "true lender" attack.

These cases use different tests to examine whether a bank partnership has been structured such that the bank is the "true lender" in the origination of the loan.

Roughly, those tests fall into two camps.

- *Form Test*: In this line of cases, the court examines who is named as the lender in the loan agreement, the marketing materials, and related public-facing materials. When courts apply this test, the bank is almost always found to be the true lender (because most partnerships do not get these things wrong). A recent example of the application of this test is ***Sims v. Opportunity Financial, LLC***, 2021 U.S. Dist. LEXIS 71360 (N.D. Cal. April 13, 2021).
- *Substance Test*: In this line of cases, the court examines the substance of the transaction, going underneath the "form" of the agreement to probe other factors, such as which party takes the most economic risk, adopts the underwriting criteria, and other substantive factors. See e.g. *People ex rel. Spitzer v. Cty. Bank of Rehoboth Beach, Del.*, 846 N.Y.S.2d 436, 439 (N.Y. App. Div. 2007).

Significant Case Law Impacting Bank Partnerships

Sims v. Opportunity Financial

- Consumer-borrower asserted that the marketing partner and not the bank was the true lender. Sims asserted that OppLoans violated California law by charging an excessive and unconscionable rate of interest. The U.S. District Court for the Northern District of California held that this California law does not apply to any person doing business under any law of any state relating to banks.
  - When considering claims for violation of the usury law, a court may "look only to the face of a transaction when assessing whether it falls under a statutory exemption from the usury prohibition and not look to the intent of the parties." *Beechum v. Navient Sols., Inc.,* 2016 WL 5340454, at *7 (C.D. Cal. Sept. 20, 2016). As Judge Bernal pointed out in *Beechum*, this rule of construction derives from two California Court of Appeal decisions, *WRI Opportunity Loans II, LLC v. Cooper*, 154 Cal. App. 4th 525, 536 (2007) and *Jones v. Wells Fargo Bank*, 112 Cal. App. 4th 1527, 1538 (2003).
  - "There is no question that FinWise is the lender on the loan agreement. That agreement includes a 'Lender Box' and preamble. Both provisions detail "FinWise" as lender. Id. FinWise is an out-of-state chartered bank. Accordingly, California Financial Code § 22050(a) exempts the loan agreement from any condition set forth in California Financial Code §§ 22000-22780. The purportedly violated California Financial Code sections identified by plaintiff fall within that range. Thus, they may not support his § 17200 claim for unlawful conduct."

Significant Case Law Impacting Bank Partnerships

Sanh v. Opportunity Financial, LLC

- In January 2021, the U.S. District Court for the Western District of Washington issued two rulings in *Sanh v. Opportunity Financial, LLC*. The rulings granted motions to dismiss by Opportunity Financial, LLC, and RISE Credit Service of Texas, LLC. The plaintiff alleged that Opportunity and RISE violated the Washington Consumer Protection Act when they solicited her for loans from FinWise Bank, a federally chartered bank, at interest rates above Washington's usury limit. The plaintiff asserted two claims under the CPA: first, that the defendants violated the CPA *per se* by violating state usury law, and second, that their failure to disclose interest rates properly was an unfair or deceptive act or practice under the CPA.
- With respect to the usury claim, the defendants argued that because FinWise was a federally insured, state-chartered bank, the Depository Institutions Deregulation and Monetary Control Act allowed FinWise to export rate authority from its home state, effectively preempting Washington's usury laws. The plaintiff argued that preemption was not available because the defendants, rather than FinWise, were the true lenders. The court noted that the plaintiff had not alleged facts to support her claim that the defendants were the true lenders. Rather, the plaintiff alleged that the defendants were lead generators and received compensation per successful loan referral. As a result, the plaintiff did not allege facts to support her claim that the defendants violated Washington's usury law, and her *per se* CPA claim failed.
- With respect to the claim of unfairness or deception, the plaintiff argued that any advertisement for a loan that did not disclose an interest rate, or that disclosed too high an interest rate, was deceptive. The court disagreed. As the court explained, a loan advertisement that does not disclose an interest rate is not misleading because a reasonable consumer will not assume a certain interest rate. Additionally, the plaintiff did not explain how a loan advertisement specifying a certain interest rate, such as 160%, was deceptive. As a result, the plaintiff's CPA claim for unfairness or deception also failed.

Significant Case Law Impacting Bank Partnerships

Robinson v. National Collegiate Student Loan Trust 2006-2

- Two student loan borrowers filed a class action against 13 statutory trusts alleging violations of Pennsylvania law in connection with the interest rates charged on the student loans held in the trusts.
- PNC Bank, a national bank, originated the loans and subsequently sold the loans to the statutory trusts.
- The plaintiffs alleged that the loans were not "valid when made" because the interest rate exceeded the rate permitted under Pennsylvania law. The court noted that the bank could charge more than that rate due to a wildcard (parity) statute. The court thus found the loans were valid when made.
- The plaintiffs further alleged that the trusts were the "true lender," not the bank. The court pointed to the Loan Purchase Agreement that reflected that PNC did have an economic interest in the loans, that PNC was required to fund and fully disburse the loans, that PNC could hold the loans for longer than the seasoning period, and that PNC has to repurchase the loans upon breach of representations and warranties. PNC "therefore placed its own money at risk at various times throughout the loan transaction…(e)ven assuming that the true lender doctrine were applicable, in light of the (Loan) Purchase Agreement and the Credit Agreement, Plaintiffs have failed to plausible alleged that PNC was not the true lender."

Significant Case Law Impacting Bank Partnerships

District of Columbia v. Elevate Credit Inc.

- The District of Columbia sued Elevate Credit in D.C. court for violations of the District's UDAP law. The District alleged that Elevate was the "true lender" of loans it markets and sells to District residents that contain interest rates of up to 149% for one of its products and 251% for another of its products—well in excess of the 24% and 6% caps in the District's usury statutes—and that Elevate misrepresents material characteristics of these loans when marketing them to consumers, all in violation of District law.
- Elevate removed the case to this Court, asserting that federal jurisdiction exists because the District's claims: (1) are completely preempted by federal banking law; and (2) implicate significant federal issues and invoke serious federal interests.
- The U.S. District Court for the District of Columbia held that even if Section 27 of the FDIA completely preempts state law usury claims against state-chartered banks, it does not completely preempt the District's claims against Elevate, a non-bank entity. Accordingly, Section 27 does not provide a basis for removal of this action to federal court.
- There was a similar case brought by the District against OppFi.

Significant Case Law Impacting Bank Partnerships

Salazar v. Atlanticus Services Corporation

✦ In January 2021, the Maryland Commissioner of Financial Regulation charged an FDIC-insured, out-of-state, state-chartered bank and its non-bank service providers in connection with the bank's consumer lending platform. Among other allegations, the Commissioner asserted that the bank must obtain a state lending license to originate loans to Maryland residents. The charge further asserts that the service providers each needed a credit services business license to assist the bank with its loan origination and a collection agency license to service the loans on behalf of the bank. The defendants removed the case to the U.S. District Court for the District of Maryland.

✦ Mid-America Bank & Trust Company engaged Fortiva Financial, LLC to assist it in originating loans with an APR of 36% and less to Maryland consumers, including in-store retail credit financing and store-branded credit card accounts. The bank retained ownership of accounts after origination. The Commissioner claimed that the bank violated Maryland law by failing to hold any licenses to make loans under the following three consumer credit statutes: (1) the Maryland Consumer Loan Law, the state's small loan act; (2) the Credit Grantor Closed End Credit Provisions; and (3) the Credit Grantor Revolving Credit Provisions. The Commissioner also claimed that Fortiva and Atlanticus Service Corporation, the bank's service providers, violated Maryland law by failing to: (1) hold a license under the Maryland Credit Services Businesses Act to assist Maryland consumers in obtaining extensions of credit; and (2) hold a collection agency license under the Maryland Collection Agency Licensing Act to collect on the accounts on behalf of the bank.

✦ The Commissioner claimed that because the bank allegedly made the loans to Maryland residents without the required consumer lending licenses, the loans were unenforceable and the bank and its assignees could not collect principal and any other amounts related to the loans. The Commissioner brought these claims even though the Maryland Consumer Loan Law expressly provides that the "Commissioner may not license any bank, trust company, savings bank, credit union, or savings and loan association." In its notice of removal, the defendants argued that the Maryland licensing statutes interfered with the bank's rate exportation authority under Section 27 of the Federal Deposit Insurance Act and that the Commissioner's claims were, therefore, completely preempted.

Significant Case Law Impacting Bank Partnerships

Salazar v. Atlanticus Services Corporation

- On April 28, 2022, the U.S. District Court for the District of Maryland granted a plaintiff's motion to remand a case to the Maryland Office of the Commissioner of Financial Regulation because the defendants did not properly remove the case from the OCFR pursuant to the federal removal statute, 28 U.S.C. § 1441(a).
- The federal district court agreed with the plaintiff and remanded the case. Section 1441(a) provides that a defendant may remove to federal court "any civil action brought in a State court of which the district courts of the United States have original jurisdiction." The district court considered whether the OCFR, as a state administrative agency, is a "State court" under Section 1441(a). The district court noted that it must remand a case if the defendant cannot show that the agency functions as a court *and* federal interests predominate over state interests.
- Relying on its prior decision addressing this issue, the federal district court found that the OCFR does not function like a state court because the agency does not possess judicial power. The district court reasoned that "the OCFR possesses some 'court-like' attributes. ... For example, the OCFR may conduct hearings, and issue subpoenas, cease and desist orders and fines. ... But, as plaintiff persuasively argues, many other attributes of the OCFR make clear that this agency does not possess judicial power. For example, it is undisputed that the OCFR cannot enforce its own subpoenas or orders, and that the agency must apply to a Maryland circuit court to enforce its subpoenas and orders. ... The OCFR also cannot impose injunctions or other equitable remedies without filing a complaint in a Maryland circuit court. ... In addition, decisions of the OCFR are appealable to a Maryland circuit court, and the circuit court may hear additional evidence and either reverse, affirm, or modify a decision by the OCFR. ... Given this, the facts about how the OCFR functions make clear that this agency does not function as a State court."
- In addition, the defendants did not show that there is a federal interest that outweighs Maryland's interest in the case, given Maryland's "substantial interest in regulating lending within its jurisdiction and in providing a forum for enforcement of the [Maryland Consumer Loan Laws] and related rules."

"Predominant Economic Interest" ("PEI")

- This concept derives from a Georgia statute limiting payday lending. The statute restricted in-state payday stores from acting as agents for out-of-state banks where the agency agreement grants the in-state agent "the predominate economic interest" in the bank's payday loan, which the parties agree means that the payday stores hold more than 50% of the revenues from the loan. Georgia outlawed this one type of agency agreement to prevent in-state payday stores from circumventing Georgia's usury laws. This "test" – which prior to January 2021 was found in similar statutes in Nevada and New Hampshire – has been cited in *Bankwest v. Baker,* 411 F.3d 1289 (11th Cir. (Ga.) 2005), at 1293 without tying it to a statute.
- Illinois consumer advocates snuck a predominant economic interest test into its 36% all-in interest rate cap in January 2021. That law provides that banks, savings banks, savings and loan associations, and credit unions chartered under the laws of the United States are also exempt from the rate limitations. However, the rate cap applies to the person who holds, acquires, or maintains, directly or indirectly, the predominant economic interest in the loan. The bill also applies to any person or entity who markets, brokers, arranges, or facilitates the loan and holds the right, requirement, or first right of refusal to purchase loans, receivables, or interests in the loans, and to any person or entity where the totality of the circumstances indicate that the person or entity is the lender and the transaction is structured to evade the requirements of the law.
- Maine and New Mexico have since adopted a similar bill, with Hawaii likely to try again to pass a PEI law in the next session.

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✦**The PEI concept will be fleshed out in the *Opportunity Financial LLC. v. Hewlett*, Case No. 228TCV08163 (Cal. Sup. Ct. 2022), currently being litigated in California.**

✦ In March 2022, Opportunity Financial LLC ("OppFi"), which partners with a Utah-chartered FDIC insured bank, sued the California Department of Financial Protection and Innovation ("DFPI") for the regulator's apparent decision to enforce California's licensed lender law against OppFi.

✦ AB 539, effective January 1, 2020, amended the California Financing Law ("CFL") to include an interest rate cap of 36% for covered loans between $2,500 and $10,000 made by "finance lenders" subject to the CFL.

✦ According to the complaint, the DFPI concluded that OppFi's bank-related activities, where it acts as a marketing partner for the loans that the bank originates under Utah law, were subject to the CFL and violated AB 539 because, according to the Commissioner, OppFi is the "true lender" on bank loans, and the interest rate on those loans exceeds the interest rate cap in AB 539. *

✦ The DFPI also allegedly concluded (1) that OppFi had violated California Financial Code section 22303 because the interest rate on the bank loans in amounts under $2,500 exceeded the interest rate cap set forth in the CFL; and (2) that OppFi's purported interest rate violations constitute unfair and deceptive practices under the California Consumer Financial Protection Law ("CCFPL"). OppFi seeks a declaratory judgment that AB 539 does not apply to loans originated by the bank, among other things.

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The DFPI countersued OppFi, alleging that OppFi, not the bank, is the true lender of bank loans based on the "substance of the transaction" and the "totality of the circumstances," with the primary factor being "which entity—bank or non-bank—has the predominant economic interest in the transaction." The DFPI alleges that OppFi holds the predominant economic interest in the loans because:

- OppFi purchases between 95 to 98 percent of the receivable for each loan;
- On average, OppFi purchases the receivables from the Bank within three days after the Bank funds the loan and before any initial loan payments are made to the Bank;
- OppFi insulates the Bank from "essentially" any credit risk "by creating a guaranteed secondary market" for the loans which OppFi accomplishes by purchasing the loans using its wholly owned subsidiaries created solely to purchase receivables from bank partners such as the bank;
- OppFi's Loan Receivables Sale Agreement with the bank provides that the bank is only obligated to fund loans if OppFi's purchasing subsidiary maintains a minimum amount of security, consisting of a cash collateral account, an alternative collateral account, and letters of credit for the bank's benefit;
- OppFi pays the bank a guaranteed monthly "Bank Program Fee" based on a percentage of the principal amount of loans originated by the bank, "not only further mitigating any actual credit risk for [the bank] but literally providing the bank partner loan-volume based rent for its charter;" and
- OppFi paid the Bank for startup costs of the partnership and is responsible for paying the Bank's expenses related to the partnership.

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✦ The DFPI's cross-complaint also alleges that in addition to holding the predominant economic interest, OppFi "performs all of the functions of a traditional lender," is responsible for all marketing in association with the loans, determines the underwriting criteria for the loans with minimal input from the bank, and undertakes the servicing obligations of the loans. OppFi filed a demurrer, asking the court to rule as a matter of law that the bank is the lender of the loans at issue.

✦ The DFPI claims that the loans are subject to the CFL and that OppFi is violating the CFL by making loans more than the CFL rate cap. As remedies for the alleged CFL violations, the DFPI seeks (1) an injunction permanently barring OppFi from collecting on the loans, (2) a declaration that the loans are void, (3) an order requiring OppFi to make restitution to all borrowers on the loans, (4) an order requiring the removal of any negative credit reporting relating to the loans, and (5) OppFi's payment of "penalties of $2,500 for each and every violation of the CFL, in an amount of at least $100 million."

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- Although OppFi holds a CFL license, the cross-complaint also alleges that OppFi's conduct is nevertheless subject to the California Consumer Financial Protection Law ("CCFPL"). The CCFPL provides that it does not apply to a CFL licensee "to the extent that person or employee is acting under the authority" of a CFL license. According to the DFPI, "OppFi has affirmatively disclaimed that it is conducting any of its activities under its CFL license [and] [t]therefore, to the extent OppFi is not offering [the loans] under the authority of its CFL license, OppFi's conduct is subject to the CCFPL." The cross-complaint alleges that OppFi has violated the CCFPL by conduct that includes offering and collecting on loans at rates that exceed the rate permitted under the CFL.
- The relief that the DFPI seeks for OppFi's alleged CCFPL violations includes (1) disgorgement of payments and interest and other charges received by OppFi from California borrowers on loans, and (2) an injunction permanently barring OppFi from (a) "making use of automated payments and remotely created checks that rely on consumer banking data, payment systems and networks and online banking systems to receive payments on unlawful [loans]," and (b) "promoting and recommending unlawful [loans] as a way to 'build credit history' and purporting to provide services to assist a consumer with debt management or debt settlement by recommending its [loans] as a means of consolidating debt."

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- OppFi filed a motion of demurrer to the DFPI's cross-complaint.
- In September, the Superior Court of California overruled OppFi's demurrer filed in response to DFPI's cross-complaint. The move means that the cross-complaint by DFPI will proceed.
- The court reasoned that the issue is the identity of the lender, which cannot be resolved on demurrer.
- The court cited a list of California cases highlighting that the essence of finding the true lender of the loan lies in the *substance* of the transaction. Therefore, the court concluded that a judgment as a matter of law is inappropriate at this early stage for deciding the identity of the true lender.

This decision does not mean that the court will not subsequently rule that the bank is the true lender.

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- OppFi then filed its own cross-complaint against the DFPI.
- The OppFi cross-complaint claims that the DFPI's reliance on the "true lender" doctrine to subject OppFi to interest rate limitations under the CFL constitutes adoption and enforcement of an "underground regulation", which is impermissible under California's Administrative Procedure Act (APA).
- "Because DFPI did not submit its 'true lender doctrine' to the APA's rule making process, it is invalid as an 'underground regulation' and cannot be enforced."
- OppFi seeks a "peremptory writ of mandate setting aside and rendering invalid use of the true lender doctrine" because the DFPI failed to comply with the rulemaking requirements of the APA; and should declare "that DFPI's adoption of the true lender doctrine . . . violated the rulemaking requirements of the APA and is therefore invalid."

Implications for Bank Partnerships Going Forward

- Consumer advocates continue to falsely equate higher interest rates with predatory lending at the same time the federal banking agencies strengthened the ability of its member banks to engage in bank partnerships. These two ideas are colliding in 2022 and will continue to collide so long as access to credit (and its cost) is viewed through a partisan issue.
- Both "true lender" and *Madden* provide fodder for litigation by class action attorneys and partisan railing by politicians.
- It is likely a fair statement to say that all parties in the bank partnership ecosystem would like clear rules so those rules can be followed and there is no debate. Unfortunately, that is not the reality.
- NCLC has a "high-cost rent-a-bank loan watch list" web page that features a spreadsheet with specific lenders and how they operate (allegedly) in each state.

Implications for Bank Partnerships Going Forward

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