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Bank Partnership Showdown in Colorado

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In the wake of the Colorado Uniform Consumer Credit Code Administrator's attacks on FinTech companies engaged in lending partnerships with banks, the banks have sued the Colorado regulator, setting up a direct showdown over the bank partnership model in Colorado.

In January 2017, the Colorado UCCC Administrator filed lawsuits against Marlette Funding and Avant. Marlette and Avant partner with New-Jersey based Cross River Bank and Utah-based WebBank, respectively, to offer consumer loans through an online lending platform. The banks originate consumer loans nationwide on a uniform basis, relying on their authority under Section 27 of the Federal Deposit Insurance Act to charge the same interest rate in all states.

Citing *Madden v. Midland Funding, LLC*, the UCCC Administrator alleged in her lawsuit that state banks cannot assign their Section 27 interest rate preemption authority to their non-bank partners when the partners purchase the loans. Because of this, the loans - which were originated in excess of the rates permitted under Colorado law - suddenly violate the UCCC's limitations on interest rates and fees when the partners purchase them. In *Madden*, the U.S. Court of Appeals for the Second Circuit held that a non-bank lender that purchased charged-off debt from a bank could not rely on the bank's federal preemption authority to charge the same interest rate as the bank. Essentially, under *Madden*, the bank's rate exportation authority did not transfer to the non-bank purchaser after the loan was charged off in default, making the loans usurious. The *Madden* decision undercuts the valid-when-made doctrine, a bedrock principal upon which the banking and financial services industry have relied that holds that a contract that is not usurious when it is made retains its validity for the life of the contract, no matter who holds it.

The UCCC Administrator also claimed that the non-bank partners were the true lenders of the loans, applying the so-called predominant economic interest test recited in *CashCall, Inc. v. Morrisey*, a state case out of West Virginia. Specifically, the Colorado regulator identified the following factors to prove that the non-bank partners had the predominant economic interest in the transactions and were therefore the true lender:

- The non-bank partners paid the bank's costs associated with the initiation of the lending program, as well as the marketing costs for the program.

- The non-bank partners decided which applicants would receive loans, applying lending criteria agreed to by Marlette/Avant and the bank.
- The banks bore little or no risk of financial loss in the event the borrower defaulted on the loan, and its share of the profit was very low.

In response to the Colorado regulator's lawsuits against their partners, Cross River Bank and WebBank filed separate lawsuits seeking a declaratory judgment and injunctive relief. The banks argue that although the UCCC Administrator filed the enforcement actions against the non-banks, these actions unlawfully restrict the banks' lending business and cause irreparable financial loss. Specifically, the banks argue that the enforcement actions interfere with their authority under Section 27 of the FDIA to operate a nationwide lending program with uniform interest rates, and that the application of *Madden* unlawfully restricts their ability to sell loans to third parties.

The banks further contend that the true lender argument is an attempt to circumvent federal preemption of the banks' FDIA authority that is explicitly granted to them by Congress and assert that they are the true lender based on, among other things, the following:

- The banks retain many of the loans they originate, and sometimes they choose to sell loans to various partners.
- The banks use non-bank partners as technology service providers to help market and originate loans to geographically diverse consumers.
- The banks bear continuing regulatory accountability over the loans under FDIC and state banking regulations.
- The banks have continuing oversight and monitoring of legal compliance, even after a loan is sold.

In short, WebBank and Cross River appear ready to fight to preserve their ability to rely on the expertise of their partners in setting up a nationwide lending program and to freely transfer the loans they originate in order to reduce risk and promote liquidity. After months of uncertainty around these programs and how banks might best defend their federal authority, this is an encouraging development.

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