WHAT'S OLD IS NEW AGAIN: *THE FUTURE OF BANK PARTNERSHIP PROGRAMS FROM SMALL DOLLAR INSTALLMENT LOANS TO MORTGAGES TO EVERYTHING*

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I. INTRODUCTION

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Bank partnerships allow banks to offer loans to consumers and businesses by leveraging the resources of non-bank entities. The relationships between banks and their non-bank entity partners have existed for many years. In the Internet age, banks have come to partner with financial technology companies which offer technology-based solutions to banks that extend credit and other products to consumers. The model has been challenged in many ways since it first developed and continues to be challenged.

What follows are a few examples; unconscionability is the basis of the recent *De La Torre v. CashCall*[1] decision in California, which, although decided against a licensed lender,[2] may impact banks' interest rate authority in California. In two pending enforcement actions against non-bank partners in Colorado, the Administrator of Colorado Uniform Consumer Credit

1. De La Torre v. Cashcall, Inc., 422 P.3d 1004 (Cal. 2018)
2. *Id*. at 1022.

Code has alleged that the non-bank partners are illegally charging interest that exceeds Colorado law.[3]

The New York Department of Financial Institutions released a report on online lending that has set out the regulator's overall negative view of bank partnerships as a model.[4] In an effort to curtail what is essentially a business relationship between the bank and a service provider, the Iowa regulator has begun to assert that the state's opt-out from federal preemption under the Depository Institutions Deregulation and Monetary Control Act is a bar to loans with rates exceeding the state's usury limit—even when the loans are offered by a bank in the context of a bank partnership.

These issues are merely a sample of the developing legal landscape for bank partnerships—they are not nearly an exhaustive review of the challenges and responses to bank partnerships that are currently ongoing. Bank partnerships are an active area of industry, regulation, and the law, and they require close attention.

II. Unconscionability in California

In *De La Torre v. CashCall*, the California Supreme Court held that the interest rate on a consumer loan of $2,500 or more may render the loan unconscionable under the California Financing Law (CFL), even though the CFL does not set an interest cap for those loans.[5] The court issued the opinion in response to a certified question from the United States Court of Appeals for the Ninth Circuit because the issue—whether a loan originated under a statute that allows the parties to contract for any rate of interest could be unconscionable based on the interest rate—had not yet been addressed by the court.[6]

The case opens the door for consumer claims that loans are unconscionable based on the interest rates, but the door is heavy. The court reiterated that an unconscionability claim is a fact-intensive question based on the circumstances of the individual loan transaction. California law requires both procedural and substantive unconscionability to justify relief.[7] The court also acknowledged that unsecured loans made to high-risk borrowers often justify high rates.[8] Moreover, the remedies available are limited to restitution and injunctive relief. They do not include attorneys' fees or damages. The court observed that the "relative paucity of remedies . . . should serve to limit pure attorney-driven lawsuits (since no attorney fees may be

3. Meade v. Avant of Colorado, LLC, 307 F. Supp. 3d 1134 (D. Colo. 2018); Meade v. Marlette Funding, LLC, No. 17-cv-00575-PAB-MJW, 2018 WL 1417706 (D. Colo. March 21, 2018).
4. Press Release, N.Y. Dep't of Fin. Serv., DFS Issues Online Lending Report (July 11, 2018), *available at* https://www.dfs.ny.gov/about/press/pr1807111.htm.
5. *CashCall*, 422 P.3d at 1022.
6. *Id*. at. 1007.
7. *Id*. at 1014–15.
8. *Id*. at 1007.

recovered) as well as blackmail settlements (since no money recovery beyond restitution is possible)."[9]

Even without addressing bank partnerships specifically, *CashCall* echoes in the bank partnership space because of how it will affect rate exportation. In short, rate exportation is the authority under which a national or state-chartered bank located in one state may charge the interest rate permitted by its home state to a resident of another state, even though the bank's home state rate exceeds the rate permitted in the consumer's state. *CashCall* interacts with rate exportation because interest rates imposed by a bank exporting California's interest rate authority do appear to be limited by unconscionability concerns. *CashCall* relies on the unconscionability standard codified in California's Civil Code, which is incorporated into the CFL.[10] Although the CFL does not apply to banks, the California Civil Code does.[11] And under the Office of the Comptroller of the Currency's regulations, banks' exportation authority is limited by state law relating to "that class of loans that are material to the determination of the permitted interest."[12] Accordingly, even when banks export interest from outside the CFL, they still will be limited by the Civil Code's unconscionability standard.

CashCall decided a new question of law in California, and for that reason it is exciting. Although the aspects of the case that impact rate exportation are important, the case is unlikely to drastically alter banks' lending operations, whether they are lending to California consumers or under California law.

III. True Lender Challenges in Colorado

In January 2017, the Colorado Uniform Consumer Credit Code Administrator (U3C Administrator) filed lawsuits against online lenders Marlette Funding, LLC and Avant of Colorado, LLC to shut down the companies' bank partnerships with New Jersey-based Cross River Bank and Utah-based WebBank, respectively.[13] The U3C administrator has asserted that the banks are not actively engaged in the lending program and do not receive the benefits or take the risks of a true lender, i.e. a "true lender" challenge.[14] If a true lender challenge is successful, a non-bank partner may face penalties for failing to be licensed as a lender, or as the U3C administrator has alleged in its enforcement actions against Marlette and Avant, the loans may be usurious.

9. *Id*. at 1021.
10. *Id*. at 1011.
11. *Id*.; *see also* Cal. Civ. Code § 1670.5 (2018).
12. 12 C.F.R. § 7.4001(b) (2018).
13. Meade v. Avant of Colorado, LLC, 307 F. Supp. 3d 1134 (D. Colo. 2018); Meade v. Marlette Funding, LLC, No. 17-cv-00575-PAB-MJW, 2018 WL 1417706 (D. Colo. March 21, 2018).
14. *Avant*, 307 F. Supp. 3d at 1138; *Marlette*, 2018 WL 1417706, at *1.

Marlette and Avant removed the U3C Administrator's cases to federal court, but both were remanded to state court in March 2018.[15] In both cases, judges on the U.S. District Court for the District of Colorado rejected the companies' jurisdictional argument that the case should be heard in federal court based on the banks' federal rate authority.[16] The courts explained that although preemption may be a defense to the U3C Administrator's allegations, the defense alone is not a basis for the cases to be heard in federal court.[17] Accordingly, both the Marlette and Avant cases have been returned to state court, where the companies will likely make the substantive preemption arguments: That banks are the true lenders and the banks' federal rate authority preempts Colorado's usury limit.

The banks will not be able to make the arguments on their own behalf as Cross River Bank's and WebBank's federal lawsuits on that issue were both dismissed in March 2018.[18] In those lawsuits the banks sought a declaratory judgment that the banks' rate authority preempts Colorado state law.[19] Both cases were dismissed based on the theory of *Younger* abstention.[20] *Younger* abstention dictates that a federal district court must not interfere with an ongoing state court proceeding by granting equitable relief when relief may be sought before the state court.[21] The courts reasoned that because the U3C Administrator's enforcement actions are pending in state court, the federal courts could not grant equitable relief (in the form of a declaratory judgment) in the cases.[22]

IV. New York Department of Financial Services Online Lending Report

In July, New York's Department of Financial Services (N.Y. DFS) released its report on online lending with recommendations to regulate online lending in the state, including: (1) equal application of consumer protection laws; (2) application of the state's usury limits to all lending in New York; and (3) licensing and supervision for all online lenders.[23] N.Y. DFS sees bank partnerships as a regulatory concern. N.Y. DFS explained that it disagrees with the position that in bank partnerships, because the bank is the

15. *Avant*, 307 F. Supp. 3d at 1153; *Marlette*, 2018 WL 1417706, at *10.
16. *Avant*, 307 F. Supp. 3d at 1145; *Marlette*, 2018 WL 1417706, at *9–10.
17. *Avant*, 307 F. Supp. 3d at 1141–43; *Marlette*, 2018 WL 1417706 at *8–9.
18. Cross River Bank v. Meade, No. 17-cv-00832-PAB-KMT, 2018 WL 1427204 (D. Colo. March 22, 2019); WebBank v. Meade, No. 17-cv-00786-PAB-MLC, 2018 WL 1399914 (D. Colo. March 19, 2018).
19. *Cross River*, 2018 WL 1427204, at *1; *WebBank*, 2018 WL 1399914, at *1.
20. *Cross River Bank*, 2018 WL 1427204, at *2; *WebBank*, 2018 WL 1399914, at *2.
21. *Cross River Bank*, 2018 WL 1427204, at *2; *WebBank*, 2018 WL 1399914, at *2.
22. *Cross River Bank*, 2018 WL 1427204, at *2; *WebBank*, 2018 WL 1399914, at *2.
23. N.Y. Dep't of Fin. Serv., Online Lending Report (July 11, 2018), https://www.dfs.ny.gov/reportpub/online_lending_survey_rpt_07112018.pdf [https://perma.cc/3WTZ-9CN4].

true lender and the non-bank entity is not lending, the non-bank entity is not subject to New York's licensing requirements.[24] Rather, the N.Y. DFS believes, in many cases, the online lender is the true lender. Although this appears to be a criticism of specific bank partnerships, and not the bank partnership model in general, N.Y. DFS's Report casts bank partnerships generally as problematic.[25]

N.Y. DFS is particularly concerned with the interest rates on financial products offered to New York consumers—and non-bank entities' authority to charge those rates. On that issue, N.Y. DFS cited with approval *Madden v. Midland*,[26] in which the Second Circuit Court of Appeals held that non-national bank entities that purchase loans originated by national banks cannot rely on the National Bank Act to protect them from state-law usury claims, effectively disposing of the valid-when-made theory on which loan assignees have relied for years.[27] The holding in *Madden* suggests that a non-bank that purchases loans originated by a bank cannot continue to impose the rates for which the bank contracted without holding its own independent rate authority. The report also states that N.Y. DFS opposes the pending federal bill, the "Modernizing Credit Opportunities Act (H.R. 44391)," which seeks to overrule *Madden*, stating that if enacted, the bill "could result in 'rent-a-bank charter' arrangements between banks and online lenders that are designed to circumvent state licensing and usury laws."[28] Former N.Y. DFS head Maria T. Vullo recently announced that she will propose administrative action to expand licensing to cover fintech companies that partner with banks, a move, that if it occurs, will absolutely lead to litigation against the department.

V. State Bank Preemption Under DIDMCA

The Iowa regulator continues to assert that the state's opt-out provision under Section 525 of the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) prevents certain bank partnerships in Iowa. The DIDMCA opt-out provision means that federally insured state-chartered banks cannot export their home state interest rate with respect to loans made in Iowa. However, the effect of the opt-out provision is narrower than to completely prevent bank partnerships from existing in Iowa.

Section 521 of DIDMCA preempts state usury laws that apply to federally insured state-chartered banks in two ways.[29]

- Section 521 gives a federally insured state-chartered bank the right to charge federally prescribed rates on loans, including the interest rate permitted by the institution's home state.

24. *Id.* at 28–29.
25. *Id.*
26. Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015).
27. *Id.* 250–52; 12 U.S.C. § 85 (2012).
28. Online Lending Report, *supra* note 23 at 29 n.39.
29. 12 U.S.C. § 1831d(a).

- Section 521 provides that a federally insured state-chartered bank may "export" its home state's interest rate, no matter where the borrower is located.[30]

The authority under Section 521 is nearly identical to the rate authority given to National Banks under Section 85 of the National Bank Act. Indeed, the FDIC has affirmed that it construes Section 521 to give state banks the authority to export their home state interest rates in the same manner as national banks export rates under Section 85.[31]

Section 525 of DIDMCA allows states to opt-out of federal preemption under Section 521 as to loans "made in such state."[32] In 2018, only Iowa and Puerto Rico opted-out under Section 525. However, the opt-out does not simply end the inquiry into a federally insured state-chartered bank's rate authority in Iowa and Puerto Rico. Rather, under Section 525, the opt-out authority belongs to the state where the loan "is made."[33] In other words, the fact that Iowa and Puerto Rico have opted out under Section 525 should not affect a loan made to an Iowa or Puerto Rico consumer, so long as the loan is not "made in" Iowa or Puerto Rico.[34]

The FDIC has explained in an interpretive letter that the determination of where a loan is "made" is a fact-based inquiry into the circumstances surrounding the extension of credit.[35] Some relevant factors include: (1) where finance charges are assessed; (2) where payment is remitted; (3) where the credit decision is made; and (4) choice of law provisions in the contract. In sum, where a loan is made is a factual conclusion based on the terms of the contract and all the facts present—not simply where the consumer lives.[36] Thus, the interpretation of the DIDMCA opt-out provision to prevent bank partnerships from offering any loans to Iowa consumers is simply too broad. The opt-out bars only loans made in Iowa—not all loans made to any Iowa consumer.

30. *Id.*
31. General Counsel's Opinion No. 10; Interest Charges Under Section 27 of the Federal Deposit Insurance Act, 63 Fed. Reg. 19258 (April 17, 1998).
32. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221; § 525, 94 Stat. 132, 167 (formerly codified at 12 U.S.C. § 1730g).
33. FDIC Interp. Ltr. 88-45 (June 29, 1988), 1988 WL 583093 (F.D.I.C.).
34. *Id.*
35. *Id.*
36. *Id.*; *see also* Marquette National Bank v. First of Omaha Service Corp., 439 U.S. 299 (1978) (cited by the FDIC and looking at certain factors in connection with an interstate credit card program).

VI. Conclusion

The bank partnership model is long-established and an effective means of delivering financial services to consumers. We expect that, as it has withstood challenges for years already, it will continue to withstand pressure from states, regulators, and plaintiffs, particularly as financial technology proliferates in consumer financial services.

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