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True Lender and Rate Exportation: Reviewing the Major 2023 Legislation

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In recent years, several state legislatures have enacted consumer credit laws designed to regulate FinTech companies operating through partnerships with depository institutions, or more generally to limit the interest rates charged by those depository institutions. 2023 was no exception, and this growing trend should be watched closely by state-chartered depository institutions and financial services companies.

Section 521 of the Depository Institutions Deregulation and Monetary Control Act ("DIDMCA"), authorizes FDIC-insured state-chartered banks to use both the most favored lender authority and federal exportation authority enjoyed by national banks under 12 U.S.C. 85 by preempting state law. DIDMCA Section 521 allows states to "opt out" of the federal preemption; if a state does not opt out by statute, constitutional amendment, or referendum, then the state law interest rate limitations are preempted by federal law. Iowa and Puerto Rico have already opted out, with Colorado joining them in July 2024 and opt-out legislation recently introduced in the District of Columbia. Meanwhile, many other states are increasing their scrutiny and adopting laws to impose regulations on bank–FinTech partnerships, rather than upon all state-chartered depository institutions.

On June 5, 2023, Colorado House Bill 23-1229 was signed, clarifying that consumer loans made in Colorado are excluded from the provisions of DIDMCA Section 521. HB 23-1229 amends the Colorado Uniform Consumer Credit Code to change the terms and finance charges that a lender may impose in consumer credit transactions. This amendment requires that out-of-state banks follow Colorado's interest rate and fee restrictions when lending to Colorado residents in Colorado.

The Colorado opt-out will impact state-chartered banks issuing loans to Colorado residents, including those that have programs with FinTech companies. The opt-out arises in a long context of enforcement, notably the Avant-Marlette settlement that set forth the expectations for FinTech-bank programs. In that case, Colorado's Consumer Credit Administrator directly challenged the out-of-state loans made by an out-of-state bank, in partnership with multiple FinTech companies. The state argued that the federal interest rate preemption could not be applied because the bank was not the true lender of the loans and the partner company could not stand in the bank's shoes for loans sold by the originating bank. The case was settled in an agreement that put into place certain operational requirements for the programs, but it did not apply Colorado's usury limits to the originating bank given that, at the time, Colorado had not opted out of Section 521.

State legislatures have also sought to enact laws regulating partnerships between depository institutions and FinTech companies. On June 29, 2023, Connecticut enacted legislation to join states that have previously adopted such laws, including Maine, New Mexico, and Illinois. The laws codify a predominant economic interest test, and create other tests seeking to determine when the FinTech—not the originating depository institution—should be viewed as the "true lender," in which case the depository institution's federal rate preemption should be disregarded. The laws also impose varying interest rate limits and rate calculation methodologies.

Similar legislation in Minnesota, Minn. S.F. 2744, was enacted on May 24, 2023, and became effective January 1, 2024. The law caps the annual percentage rate ("APR") on consumer small loans and consumer short-term loans at a 50 percent all-in APR. Consumer small loan is defined as a consumer-purpose unsecured loan for an amount equal to or less than $350 that must be repaid in a single installment. A consumer short-term loan is a loan that has a principal amount, or an advance, on a credit limit of $1,300 or less, and requires a minimum payment of more than 25 percent of the principal balance or credit advance within sixty days. Minn. S.F. 2744 provides that, if the all-in APR exceeds 36 percent, the lender must perform an ability-to-pay analysis, reviewing evidence of the borrower's net income, major financial obligations, and living expenses. Like statutes in other states, it also implements the predominant economic interest test and other tests for the true lender.

The tests utilized in these laws vary by state, but they often provide that a nonbank entity should be viewed as the lender if any of the following are true:

1. the person holds, acquires, or maintains, directly or indirectly, the predominant economic interest in the consumer credit product at issue;
2. the person markets, brokers, arranges, or facilitates the consumer credit product and holds the right, requirement, or right of first refusal to purchase the consumer credit products; or
3. the totality of the circumstances indicate that such person is the lender and the transaction is structured to evade the applicable state law requirements.

The laws typically establish several factors to consider for the totality of the circumstances test. They may vary from state to state but typically include a review of:

1. Indemnifying, insuring, or protecting an exempt person for any costs or risks related to the consumer credit product;
2. predominantly designing, controlling, or operating the lending program; or
3. purporting to act as an agent, service provider, or in another capacity for an exempt person (typically any depository institution) in the state while acting directly as a lender in another state.

To date, there has been little public enforcement activity regarding these laws, making it hard for commentators to assess their impact on partnerships between banks and non-banks. State legislative trends indicate that more states will continue to consider legislation regulating such programs or opting out of DIDMCA, leading to a more fragmented landscape in the United States compared to the consistency seen in other countries. DIDMCA opt-outs raise interesting questions regarding how a DIDMCA opt-out will actually impact banks located out of state, and whether it will actually reach such loans. Similarly, the interplay of federal rate exportation authority with laws seeking to curtail that exportation absent DIDMCA opt-out raise interesting enforceability questions that may lead to future litigation should the trend continue.

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