FinTech Regulation: How True Lender, Valid-When-Made, and the Fight About Usury Impact FinTech Business Models

*By Robert Savoie, Sarah Edwards, and Jaline Fenwick**

Introduction

The laws governing the financial technology ("FinTech") services companies have continued to develop. One prominent business model utilized by FinTech companies involves partnerships with traditional depository institutions, often state-chartered, FDIC-insured community banks.[1] In the context of this model, the non-depository FinTech companies and traditional depository institutions act together to offer consumer financial services and products. However, the regulatory response to these partnerships has varied over the years and the change in administration at the national level may have far reaching consequences for these programs.

During the past year, Congress passed a joint resolution repealing the Office of the Comptroller of the Currency's ("OCC") short-lived True Lender Rule pursuant to the Congressional Review Act ("CRA").[2] Subsequently, President Joe Biden signed the joint resolution passed by Congress.[3] The rule provided a bright-line test for examiners to determine the true lender in bank/nonbank partnerships.[4] The True Lender Rule was designed to provide protections regarding when and how a court could decide whether a loan is, or is not, actually made by the originating depository institution when that institution partners with a non-depository entity, such as a FinTech.[5] The repeal returns FinTech–bank partner programs to the prior uncertain environment with respect to how these business models will be regulated.

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1. Bd. of Governors of Fed. Reserve Sys., Community Bank Access to Innovation Through Partnerships iv (Sept. 2021), https://www.federalreserve.gov/publications/files/community-bank-access-to-innovation-through-partnerships-202109.pdf (stating that community banks are "increasingly partnering with third-party financial technology companies (fintechs) to access innovation").

2. S.J. Res. 15, 117th Cong. (2021).

3. *Id.*

4. National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68742 (Dec. 29, 2020) (to be codified at 12 C.F.R. § 7.1031).

5. *See id.* at 68742.

The Federal Deposit Insurance Corporation (the "FDIC") and the OCC established rules about an assignee's ability to assess the interest rates lawfully contracted for by depository institutions.[6] The regulations promulgated by these rules clarify that a loan that was "valid when made" will not be rendered usurious by a subsequent transfer.[7] The regulations are currently being challenged in the federal courts.[8] Many FinTech companies partner with depository institutions and subsequently sell or arrange for the sale of loans from the depository institutions to third-party investors, whether through private loan sales or securitizations. When FinTech programs are added to traditional loan sales, the challenges to these rules have potentially significant consequences to both FinTech business models and traditional depository institutions.[9]

The Rise and Fall of the OCC's True Lender Rule

The OCC's True Lender Rule[10]

On October 30, 2020, the OCC issued a final rule establishing a bright-line test to determine when a national bank or federal savings association makes a loan and is the true lender ("True Lender Rule").[11] The True Lender Rule took effect on December 29, 2020.[12] Under the rule's bright-line test, a covered bank makes a loan and is the true lender if, as of the date of origination, the bank is named as the lender in the loan agreement, or it funds the loan.[13] The rule also states that if, as of the date of origination, one bank is named as the lender in the loan agreement but another bank funds the loan, the bank that is named as the lender in the loan agreement is deemed to have made the loan.[14]

The True Lender Rule was created to provide the legal certainty necessary for covered banks to participate confidently in lending partnerships with third parties, such as FinTech companies.[15] Through such partnerships, banks are able to

6. 12 C.F.R. § 7.4001(e) (2021); *id.* § 160.110(d); *id.* § 331.4(e).

7. *See supra* note 6.

8. *See* Complaint, California v. Fed. Deposit Ins. Corp., No. 4:20-cv-05860 (N.D. Cal. Aug. 20, 2020); Complaint, California v. OCC, No. 4:20-cv-05200 (N.D. Cal. July 28, 2020).

9. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33530, 33532 (June 2, 2020).

10. The FDIC did not issue a True Lender Rule for state-chartered banks. *See* Leonard Chanin, Deputy to the FDIC Chairman (Dec. 2020), https://www.pli.edu/programs/consumer-financial-services-institute?t=ondemand&p=278961 (answering a question at a Practicing Law Institute presentation in December 2020) ("Our authority to determine true lender is not parallel to that of the OCC. That is, we do not have the same, if you will, preemptive authority that the OCC has. The OCC has the authority to determine when a loan is, quote, 'made.' We do not have that same authority under the FDIC Act. We have the authority to determine valid-when-made under the statute, but we simply don't have the ability to decide or to state that if a bank, for example, originates a loan, is on the paper, the note, that it is a true lender regardless of what state laws or other court decisions in other jurisdictions may state.").

11. National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68742, 68743 (Dec. 29, 2020) [hereinafter True Lender Rule].

12. *Id.* at 68742.

13. *Id.* at 68747 (formerly codified at 12 C.F.R. § 7.1031(b)).

14. *Id.* (formerly codified at 12 C.F.R. § 7.1031(c)).

15. *Id.* at 68742.

leverage technology developed by third parties and reach a broader customer base, "expand[ing] access to credit and provid[ing] an avenue for banks to remain competitive as the financial sector evolves."[16] The True Lender Rule was intended to facilitate these partnerships by defining which party makes a loan and, therefore, clarifying which laws apply to such loans.[17]

The True Lender Rule's bright-line test was also intended to eliminate doubt created by a "growing body of case law" that had "introduced divergent standards" for determining which entity makes a loan.[18] The OCC noted that "[t]his uncertainty may discourage banks from entering into lending partnerships, which, in turn, may limit competition, restrict access to affordable credit, and chill the innovation that can result from these relationships."[19] With the True Lender Rule, the OCC hoped that all parties would be able to "reliably determine the applicability of key laws, including the law governing the permissible interest that may be charged on the loan."[20]

In its rulemaking analysis, the OCC acknowledged concerns that the True Lender Rule would facilitate inappropriate "rent-a-charter" schemes that allow third parties to avoid state consumer protection laws and allow banks to disclaim compliance responsibility for their bank loans.[21] The OCC believes that the True Lender Rule does not preempt or interpret state law; it merely interprets existing federal banking law.[22] If the covered bank was determined to be the "true lender" of the loan under the True Lender Rule, then the bank would maintain compliance obligations with respect to the loans it makes.[23] Conversely, if the True Lender Rule determined that the nonbank partner was the true lender, then that lender would be subject to applicable state lending law and the OCC would continue to assess the covered bank's third-party risk management in connection with the partner relationship.[24]

Discord Over the True Lender Rule

In January 2021, a week after the True Lender Rule went into effect, the attorneys general of New York, California, Colorado, the District of Columbia,

16. *Id.*
17. *Id.* at 68744.
18. *Id.* at 68742. *Compare* CFPB v. CashCall, Inc., No. CV157522JFW, 2016 WL 4820635, at *6 (C.D. Cal. Aug. 31, 2016) (holding that in identifying the true or de facto lender, courts generally consider the totality of the circumstances and apply a "predominant economic interest," which examines which party or entity has the predominant economic interest in the transaction), *with* Beechum v. Navient Sols., Inc., No. EDCV 158239JGBKKx, 2016 WL 5340454, at *8 (C.D. Cal. Sept. 20, 2016) (holding that the court will look "only to the face of the transactions at issue").
19. True Lender Rule, *supra* note 11, at 68742.
20. *Id.*
21. *Id.* (stating "'[R]ent-a-charter' lending schemes [are] arrangements in which a bank receives a fee to 'rent' its charter and unique legal status to a third party. These schemes are designed to enable the third party to evade state and local laws, including some state consumer protection laws, and to allow the bank to disclaim any compliance responsibility for the loans.").
22. *Id.* at 68743.
23. *Id.* at 68743–44.
24. *Id.* at 68743.

Massachusetts, Minnesota, New Jersey, and North Carolina filed a federal lawsuit in New York alleging that the OCC's True Lender Rule is unlawful.[25] The state attorneys general argued that the rule facilitates predatory lending, preempts state usury laws, and enables "rent-a-bank" schemes.[26] The complaint further alleged that the OCC exceeded its statutory authority by adopting the rule.[27] Before the OCC could even file a response to their complaint, however, Congress had already begun the process to repeal the True Lender Rule through the CRA.[28] By June 30, 2021, the True Lender Rule was repealed through Congress's use of the CRA.[29] The decision to rescind the Rule rendered the state attorneys general lawsuit moot and they voluntarily dismissed the litigation against the OCC.[30]

The repeal of the True Lender Rule pursuant to the CRA prohibits the OCC from reissuing the True Lender Rule, or issuing a new rule that is substantially similar to the True Lender Rule, unless the new rule is specifically authorized by Congress.[31] Unless such congressional authority is granted and the OCC restarts the rulemaking process, all parties are returned to the *status quo ante* and the courts are free to determine which party "makes" a loan according to preexisting legal standards. Due to how often FinTech companies partner with depository institutions, the impact of the repeal of the True Lender Rule may be significant and is likely to prompt renewed true lender litigation against certain programs. These challenges present existential risks to the FinTech programs because if the FinTech, rather than the depository institution, is deemed the true lender, the interest assessed, or even the loans themselves, can be invalidated, and substantial civil money penalties can be imposed.

Valid-When-Made Doctrine Developments

Under the National Bank Act ("NBA"), a national bank is permitted to originate loans with interest rates allowed under that bank's home state's usury laws, even if the borrower resides in a state with lower permissible usury rates.[32] The Federal Deposit Insurance Act ("FDIA") grants state-chartered, FDIC-insured depository institutions the same privilege.[33] The FDIA was established by the Depository Institutions Deregulation and Monetary Control Act of 1980 to grant parity between national and state chartered depository institutions.[34] For many years, common

25. *See* Complaint, People v. OCC, No. 1:21-civ-00057-SHS (S.D.N.Y. Jan. 5, 2021).
26. *See id.* at 4.
27. *See id.* at 7.
28. S.J. Res. 15, 117th Cong. (2021); Answer to Complaint, People v. OCC, No. 1:21-cv-00057-SHS (S.D.N.Y. Apr. 14, 2021).
29. S.J. Res. 15, 117th Cong. (2021); Cong. Review Act, 5 U.S.C. §§ 801–808 (2018).
30. Stipulation of Voluntary Dismissal, People v. OCC, No. 1:21-cv-00057-SHS (S.D.N.Y. July 9, 2021).
31. 5 U.S.C. § 801(b)(2) (2018).
32. 12 U.S.C. § 85 (2018).
33. *Id.* § 1831d.
34. *See* Federal Interest Rate Authority, 85 Fed. Reg. 44146, 44148 (July 22, 2020) [hereinafter FDIC Rule].

law has generally established that an interest rate—that was valid under applicable law at the origination of the loan—remained lawful even after the originator sold or assigned the loan to another party.[35]

The Second Circuit issued a decision in 2015, however, challenging the ability of a loan purchaser to accrue and collect interest at the contract interest rate. In *Madden v. Midland Funding, LLC*,[36] the court held that a non-bank entity taking assignment of a loan originated by a national bank is not entitled to preemption under the NBA from state usury laws.[37] Prior to this decision, businesses purchasing loans originated by depository institutions were able to rely on the common law precedent establishing the Valid-When-Made Doctrine.[38] The *Madden* decision failed to acknowledge, much less analyze, this longstanding precedent. The decision materially impacted the ability of FinTech companies who partnered with depository institutions and relied on the Valid-When-Made Doctrine to ensure the loans would be enforceable by loan purchasers.[39] In response to the *Madden* decision, secondary markets saw a reduction in pricing for loans issued to borrowers in the Second Circuit due to concerns about whether the loans would be enforceable.[40] Due to the *Madden* decision and the controversy it created, the OCC and the FDIC separately initiated federal rulemaking procedures to confirm that a loan purchaser may collect and enforce the interest rates originally contracted for by the originating depository institution,[41] and subsequently adopted final rules ("OCC Rule" and "FDIC Rule").[42] Due to the fact that the OCC Rule was promulgated first, the following discussion will generally refer to the OCC Rule.

The OCC stated that the purpose of the final rule was to alleviate any confusion created by the *Madden* decision and existing legal precedent regarding

35. *See, e.g.*, Nichols v. Fearson, 32 U.S. (7 Pet.) 103, 109 (1833) ("a contract, which in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction"); *see also* Gaither v. Farmers & Merchs. Bank of Georgetown, 26 U.S. 37, 43 (1828) ("the 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'"); FDIC v. Lattimore Land Corp., 656 F.2d 139 (5th Cir. 1981) (bank, as the assignee of the original lender, could enforce a note that was not usurious when made by the original lender even if the bank itself was not permitted to make loans at those interest rates); FDIC v. Tito Castro Constr. Co., 548 F. Supp. 1224, 1226 (D.P.R. 1982) ("One of the cardinal rules in the doctrine of usury is that a contract which in its inception is unaffected by usury cannot be invalidated as usurious by subsequent events.").

36. 786 F.3d 246 (2d Cir. 2015).

37. *Id.* at 250.

38. *Fearson*, 32 U.S. at 109; *see also Lattimore Land Corp.*, 656 F.2d at 148–49 (observing that the "non-usurious character of a note should not change when the note changes hands" (citations omitted)).

39. *See* Robert Savoie, Madden v. Midland Funding: *A Sea Change in Secondary Lending Market* (Am. Bar Ass'n Consumer Fin. Servs. Comm. Newsl. Chicago, IL, Dec. 14, 2015), at 2, https://www.mcglinchey.com/wp-content/uploads/2020/06/ABA-CFSC-Newletter-Madden-v-Midland-December-2015-Savoie.pdf.

40. *See id.* at 3.

41. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64229, 64331 (Nov. 21, 2019); Federal Interest Rate Authority, 84 Fed. Reg. 66845, 66845–46 (Dec. 6, 2019).

42. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33530 (June 2, 2020) [hereinafter OCC Rule]; FDIC Rule, *supra* note 34, at 44148.

validity of interest rates of a loan at origination. The OCC sought to clarify that the interest rate remained lawful even after the originator sold or assigned the loan to another party.[43] The OCC also noted that the ability to transfer loans is an important element of how depository institutions manage liquidity, and it enhances the safety and soundness of the banking system.[44] In its analysis, the OCC pointed to U.S. Supreme Court precedent noting how important it is for banks to be able to transfer loans, particularly in the event of an emergency or a bank run, which can result in the loss of consumer confidence in the banking system should depositors be unable to access their savings because a depository institution is unable to sell loans in order to increase cash on hand.[45] Thus, the OCC concluded that the OCC Rule was in the interest of the banking system's safety and soundness, and necessary in order to clarify that bank-originated loans did not become usurious simply by virtue of their transfer to non-bank entities.[46] Although the OCC subsequently issued its True Lender Rule, as discussed above, the OCC clarified that the OCC Rule did not address whether the originating depository institution was the real party in interest, or the "true lender."[47]

The FDIC went further in the FDIC Rule, noting that it will not favor partnerships established with state-chartered depository institutions by non-depository entities for the sole purpose of evading a lower interest rate established under the law otherwise regulating the non-depository entity.[48] The FDIC's call out to bank partnerships for the sole purpose of evading a lower interest rate established under state law creates uncertainty regarding what it means to have the FDIC "not favor" a program. FinTech companies who partner with depository institutions may face litigation that blend a "true lender" allegation with claims that the sole purpose of the partnership is to evade state usury limits.

Valid-When-Made-Doctrine Litigation

Shortly after the issuance of the OCC Rule and the FDIC Rule, several state attorneys general filed lawsuits against each agency alleging that the rules exceeded the agencies' authority and are contrary to the statutory law. On July 29, 2020, the California, Illinois, and New York attorneys general filed a lawsuit in the Northern District of California challenging the OCC Rule.[49] The core allegation of the lawsuit was that the OCC Rule would reduce the ability of states to regulate the interest rates of consumer financial services products.[50] The lawsuit filed against the OCC also alleged that the rule violates the Administrative

43. OCC Rule, *supra* note 42, at 33530.
44. *Id.* at 33532.
45. *Id.* at 35532–33.
46. *Id.*
47. *Id.* at 33535.
48. FDIC Rule, *supra* note 34, at 44155.
49. *See* Complaint, California v. OCC, No. 4:20-cv-05200 (N.D. Cal. July 28, 2020).
50. *See id.* at 2.

Procedures Act ("APA") because the rule is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[51]

In August 2020, those attorneys general and others filed a substantially similar lawsuit in the Northern District of California challenging the FDIC Rule, with California acting as the lead plaintiff.[52] The complaint also asserted that the FDIC invented the Valid-When-Made Doctrine and that the doctrine did not exist previously in the law.[53] This position is wrong, and an inconsistent position for California to take as the lead plaintiff, given that California itself has a Valid-When-Made Doctrine and that the judicial precedent was cited by the FDIC in its FDIC Rule.[54] The California precedent shows California courts coming to the same conclusion as the FDIC and citing many of the same policy reasons that the OCC and FDIC cited in support of their rules when concluding that a non-bank purchaser could continue to accrue the interest lawfully contracted for by the originating bank at the time the loan was made.[55] Like in the lawsuit against the OCC, the states also pointed to the fact that the states impose maximum interest rate caps to prevent lenders from charging excessive rates on consumer loans, which are intended to protect consumers from excessive interest rates that make it difficult for consumers to repay loans.[56] The states argued that, in practice, the FDIC Rule "will facilitate evasion of state law by enabling 'rent-a-bank' schemes, in which banks that are not subject to interest-rate caps act as a mere pass-through for loans that, in substance, are issued by non-bank lenders."[57]

The stated goal of the litigation was to render loans sold to non-depository entities subject to the usury limits of each state, similar to the outcome of the *Madden* decision.[58] The FDIC Rule was promulgated to prevent this outcome, and the FDIC believed that if loans sold to non-depository entities are subject to the usury limits of each state, it would jeopardize the safety and soundness of depository institutions, reduce credit availability, and reduce the value of bank balance sheets without actually changing the consumer products those banks could offer to borrowers.[59] In response to the complaints filed in both actions, the OCC and the FDIC simply filed their answers.[60] The parties did not engage in any discovery and, in both cases, have moved for summary

51. *See id.* at 60.
52. *See* Complaint, California v. Fed. Deposit Ins. Corp., No. 4:20-cv-05860 (N.D. Cal. Aug. 20, 2020) [hereinafter FDIC Complaint].
53. *See id.* at 2–6, 70–72.
54. *See* FDIC Rule, *supra* note 34, at 44155 (citing Savoie, *supra* note 39).
55. *Id.* (citing Strike v. Trans-W. Disc. Corp., 92 Cal. App. 3d 735, 745 (Ct. App. 1979) (noting that "a contract, not usurious in its inception, does not become usurious by subsequent events")).
56. *See* FDIC Complaint, *supra* note 52, at 2–6.
57. *See id.* at 5.
58. FDIC Rule, *supra* note 34, at 44151.
59. *Id.*
60. *See* Answer to Complaint, California v. Fed. Deposit Ins. Corp., No. 4:20-cv-05860-JSW (N.D. Cal. Aug. 20, 2020); Answer to Complaint, California v. OCC, No. 4:20-cv-05200-JSW (N.D. Cal. July 28, 2020).

judgment.[61] As of this writing, the two challenges remain pending while the rules remain in effect.

A successful challenge to the Valid-When-Made Doctrine would have a substantial impact on FinTech companies who operate through partnerships with depository institutions and either purchase the loans or facilitate the sale of the loans to third-party investors. If the third-party investors or the FinTech companies themselves could not rely upon the lawfully contracted interest rate, the ability to continue operating would be put in substantial jeopardy due to the potential risks facing third-party loan purchasers in terms of recovering their contemplated investment. When considering the broader impact to the depository institutions themselves, a successful challenge would substantially impact secondary market interest in the underlying loans in a manner that would make continued operation difficult for the reasons noted by the FDIC in promulgating the rule. As a result, both FinTech companies and traditional depository institutions will be watching the challenges closely and evaluating their programs with respect to the risks these challenges present.

61. *See* Plaintiffs' Motion for Summary Judgment, California v. Fed. Deposit Ins. Corp., No. 4:20-cv-05860-JSW (N.D. Cal. Apr. 22, 2021); Plaintiffs' Motion for Summary Judgment, California v. OCC, No. 4:20-cv-05200-JSW (N.D. Cal. Dec. 10, 2020).